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- CFP
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Qualified Default Investment Alternatives: Lessons Learned

Moderator: Richard Davies – AllianceBernstein

Panelists: Craig Stone – Utah Retirement Systems
 Scott Donaldson – Vanguard
 James Lauder – Global Index Advisors

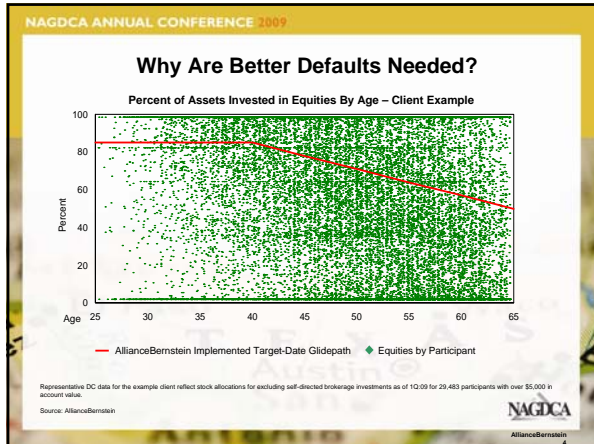
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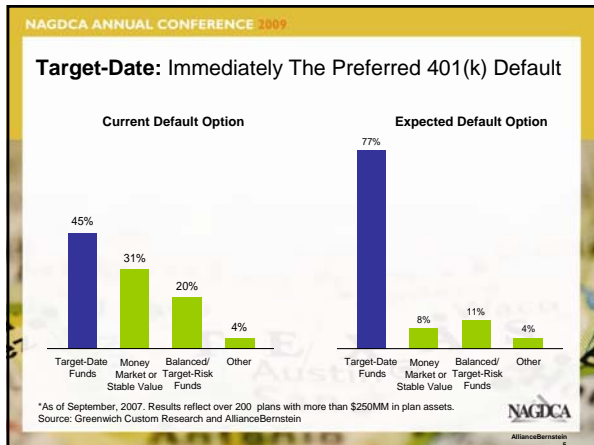
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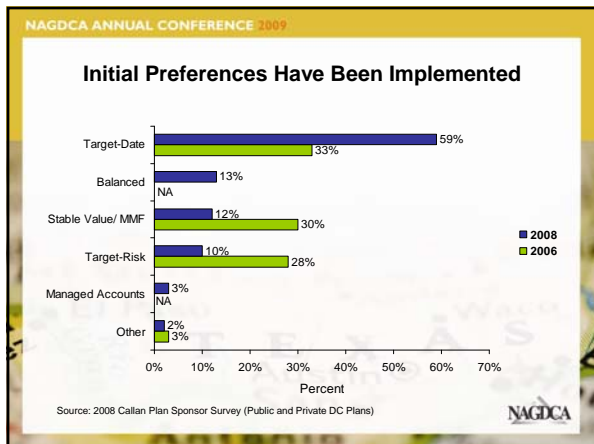
Key DC Provisions of the 2006 Pension Protection Act

- **Endorsement of Asset Allocation Funds (Default Safe Harbor):**
 Provides fiduciary safe harbor for Qualified Default Investment Alternatives (QDIAs), subsequently defined by Dept of Labor as target-date funds, target-risk funds and investment management services that mix plan options “based on the participant’s age, target-retirement date...or life expectancy.”
- **Incentives to Automate (Non-Discrimination Testing Safe Harbor):**
 Plans offering auto-enrollment/escalation programs that meet certain standards are exempt from otherwise required tests and constraints
- **Eases Simplification of Investment Menu (Reallocation Protection):**
 Clarifies protection when assets are automatically mapped to new or remaining investment options without participant direction

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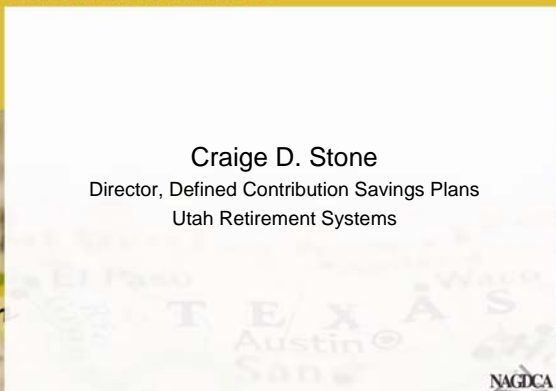






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Craige D. Stone
Director, Defined Contribution Savings Plans
Utah Retirement Systems

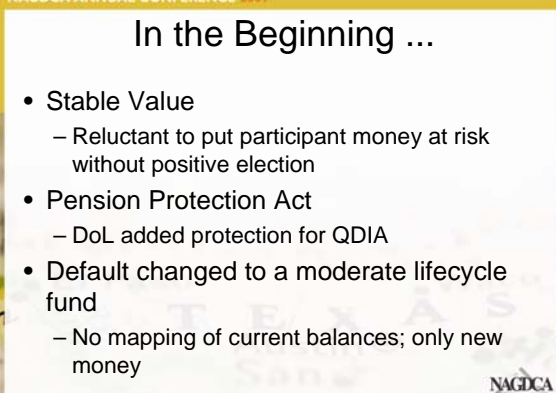


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In the Beginning ...

- Stable Value
 - Reluctant to put participant money at risk without positive election
- Pension Protection Act
 - DoL added protection for QDIA
- Default changed to a moderate lifecycle fund
 - No mapping of current balances; only new money

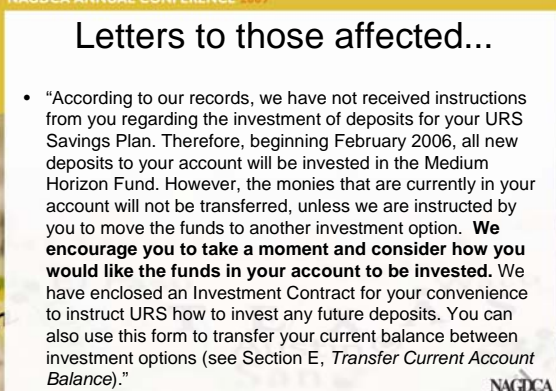


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Letters to those affected...

- "According to our records, we have not received instructions from you regarding the investment of deposits for your URS Savings Plan. Therefore, beginning February 2006, all new deposits to your account will be invested in the Medium Horizon Fund. However, the monies that are currently in your account will not be transferred, unless we are instructed by you to move the funds to another investment option. **We encourage you to take a moment and consider how you would like the funds in your account to be invested.** We have enclosed an Investment Contract for your convenience to instruct URS how to invest any future deposits. You can also use this form to transfer your current balance between investment options (see Section E, *Transfer Current Account Balance*)."



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Additional Communication

- Newsletters
- Bulletins
- Web site
- Forms
- Statements

Medium Horizon Fund
Moderate Strategy (**Default)

The Medium Horizon Fund is a moderate risk portfolio that is generally balanced between stocks and bonds. This Fund is designed for investors with a time horizon of approximately 5-10 years.

Year	1999	2000	2001	2002
Return	20.7%	-5.4%	-0.5%	-6.8%

INVESTMENT of FUTURE DEPOSITS
All new deposits into your account will be allocated as follows:

100.00%	Medium Horizon
100.00%	Account Total

No Future Allocations are on file for your account, therefore your deposits are automatically invested in the Medium Horizon Fund. You may change where your future deposits are invested via the IRS web site, the phone system (800), or by submitting an Investment Contract.

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Transition to Target Date Funds?

- Move from risk based asset allocation to age based
 - Personal risk tolerance?
- Average (mean) demographic vs. median demographic
- Consider Pension & Social Security
 - Can participants assume more risk/higher return?
 - Or should they enjoy less risk/lower return?
 - How to know participant bias?

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Transition to Target Date Funds?

- Political Risk
 - Losing principle vs. missed earnings
 - Negative media
- Mapping
 - Keep or map from risk based & balanced funds
 - Winners & losers due to timing
- Regulatory environment
 - DoL & SEC
 - Will regulators dictate risk/return model?

Transition to Target Date Funds?

- Industry
 - No agreed-upon, conventional standards:
i.e. equity exposure for retirees
- Participants
 - Educating: What is a "target date?"
 - Risk
 - Inflation
 - Market
 - Longevity
 - How many fund options?



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Scott J. Donaldson CFA, CFP®
Senior Investment Analyst
Vanguard Investment Strategy Group



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Fiduciary responsibilities and ERISA 404(c)

ERISA Section 404(c)

Limits liability for losses resulting from participant direction of investments.

Limitations


Protection has not applied when participants failed to act:

- Mapping during conversion/other replacement of funds
- Investment in default funds such as in autoenrollment

PPA added new opportunities for 404(c) protection

Mapping to "like funds"

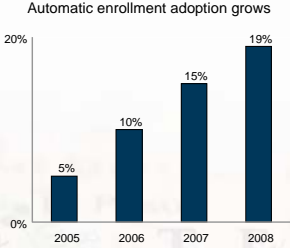
Directing participants into a QDIA



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PPA boosts automatic savings features

Automatic enrollment adoption grows




Year	Adoption Rate
2005	5%
2006	10%
2007	15%
2008	19%

Automatic enrollment designs

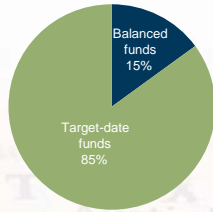
- 19% of plans offer automatic enrollment.
- 60% enroll at 3%.
 - 25% choose higher rates.
- 77% have automatic deferral increases.
 - 75% choose 1% increase.

Source: How America Saves 2009, Vanguard, 2009.



Default fund designation

Half of Vanguard plan sponsors have designated a qualified default investment alternative.



Source: How America Saves 2009, Vanguard, 2009.



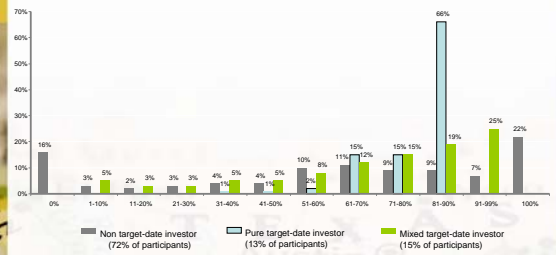
Why target date funds?

- The responsibility for retirement income is shifting to the employee.
 - Uncertain future for social security.
 - Decline in corporate and public pension funds.
- The investing process is extremely difficult for most people.
 - Few implement appropriate asset allocation strategies.
 - Few practice maintenance, due diligence, and rebalancing.
 - All are subject to behavioral mistakes.
- Target date funds outsource these crucial components in a low-cost, packaged, and professionally managed solution.



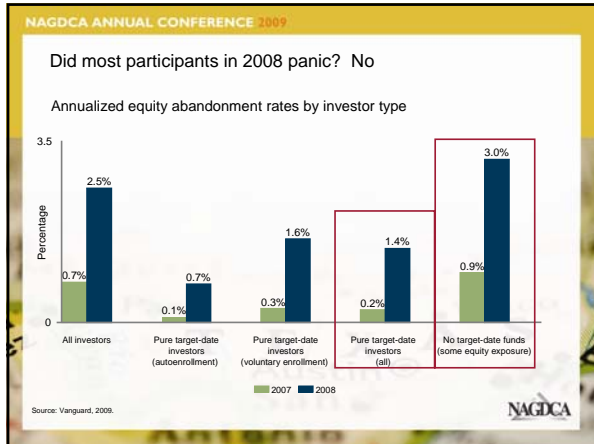
Participants maintain a wide variation in equity holdings

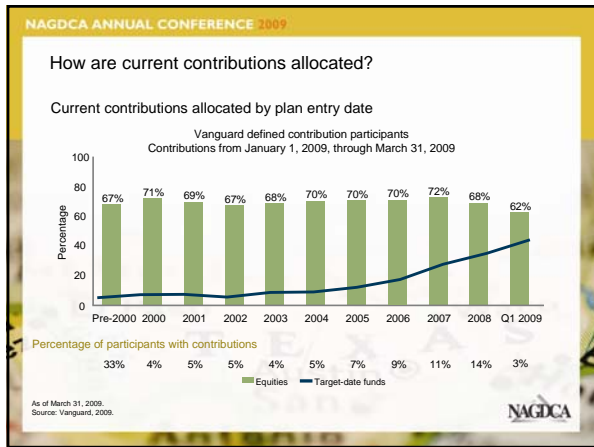
Vanguard defined contribution participants



Source: Vanguard, 2009.







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What is reenrollment?

- A plan strategy that resets participant investments directs current holdings into a qualified default investment alternative (QDIA).
 - Typically applies to future contributions also.
- Designed to improve plan asset allocation.
- Sanctioned by the Pension Protection Act of 2006 (PPA).
- Provides dual benefits of:
 - Improved portfolio diversification for participants.
 - Fiduciary protection for plan sponsors.
- Requires an opt-out provision in order to qualify for fiduciary protection.

Multiple funds

➔

QDIA

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Possible reenrollment situations

Reenrollment could be:

- Implemented during a plan conversion
- Used for current clients making substantial changes to the plan's investment menu.
- Useful for a sponsor concerned that plan participants are not adequately diversified.

Reenrollment could target:

- Specific employee segments with serious portfolio construction errors such as an overconcentration in company stock, 100% cash, etc.
- The entire participant population.

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Benefits for participant portfolios

- Participant inertia persists in periods of market volatility.
- At enrollment, participants react to current market conditions.
- Autoenrollment continues to rise.

The best time to set participant portfolios is at enrollment

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Choosing the right target date fund for your plan

Four key considerations

- Key 1** Asset allocation glide path
What's your committee's philosophy about risk and age?
Is your glide path clear, readily explained?
- Key 2** Active or passive
Consider costs, risks, and fiduciary responsibilities.
- Key 3** Packaged versus custom solutions
A sensible starting place—not the "optimal" portfolio—is the goal.
- Key 4** Impact on participant portfolios
Sponsor and participant behavior will both drive outcomes.

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QDIA Options

- Target Date Funds/LifeCycle Funds
- Relative Risk Funds/LifeStyle Funds
 - Balanced Funds
- Managed Accounts
- Grandfathered Stable Value

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Pros and Cons of QDIA Options

	Pros	Cons
Target Date Funds	<ul style="list-style-type: none"> • "Set it and Forget it" all in one solution • Requires little/no participant involvement • Supposed to reduce risk as participants near retirement 	<ul style="list-style-type: none"> • Assumes one glide path is appropriate for all participants • May have different opinion of "reducing risk" than fiduciary • Can be difficult to evaluate/compare
Relative Risk Funds	<ul style="list-style-type: none"> • Provides participants an investment tailored to their personal risk tolerance 	<ul style="list-style-type: none"> • Requires participant decision to select appropriate fund • Requires periodic reassessment of risk tolerance
Balanced Fund	<ul style="list-style-type: none"> • Most simple solution • Requires no participant involvement 	<ul style="list-style-type: none"> • Possibly too conservative for young workers • Very likely too aggressive for older workers and retirees
Managed Accounts	<ul style="list-style-type: none"> • Most individualized QDIA alternative 	<ul style="list-style-type: none"> • Requires the most participant input • No track record • May lack transparency and repeatability • Lacks portability
Stable Value	<ul style="list-style-type: none"> • Provides some protection of invested principal • Fairly consistent, but modest, investment returns 	<ul style="list-style-type: none"> • Unlikely to help younger workers reach a state of retirement readiness • Not applicable to ongoing contributions

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What Makes the Ideal QDIA for Your Plan?

(Or at least one that won't surprise you next year)

- QDIA Provider's philosophy on managing risk is closely aligned with that of the Plan Sponsor
- Provides full spectrum of risk/return options for participants and appropriate tools for participant decision making
- Able to set, and deliver on, a set of reasonable expectations and participant based outcomes
- Methodology is objective, transparent, systematic and repeatable
- Consistent and competitive results versus expectations
 - Risk adjusted basis/absolute basis


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Major Considerations in Evaluating QDIAs

- Risk Management - Breadth of participant options, or risk posture over time in the case of Target Date Funds
- Asset Allocation – Portfolio Manager, Black Box (TAA), Modern Portfolio Theory, Asset Allocation versus Managing Risk
- Diversification – Breadth of Asset Classes Included, Depth of Exposure to Asset Classes, Disciplined Rebalancing
- Active/Passive/Both – Performance Attribution in Multi Asset Class Portfolios, Style Discipline, Capacity Constraints, Costs
- Quality of Components – Plain and simple: Would they stand up to your Investment Policy Statement on their own? Performance, Manager Tenure, etc.
- Expense Ratios

Philosophy of Target Date Funds

Implementation of that Philosophy




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Expectations Versus Reality

Insights from a December 2008 NAGDCA Webcast Poll

When asked what level of loss was permissible over a twelve-month period for a participant two years away from retirement:

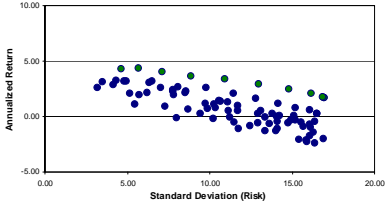

- 62.5% of Plan Sponsors said less than a 10% loss
- 37.5% of Plan Sponsors said a loss of 10-20% was permissible
- Not a single plan sponsor felt that a loss of more than 20% was permissible for a participant this close to retirement.

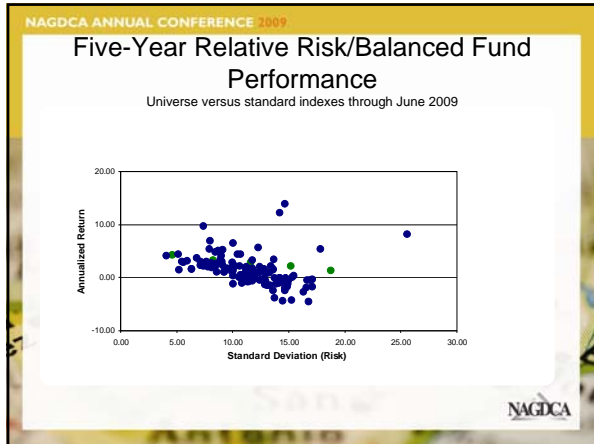


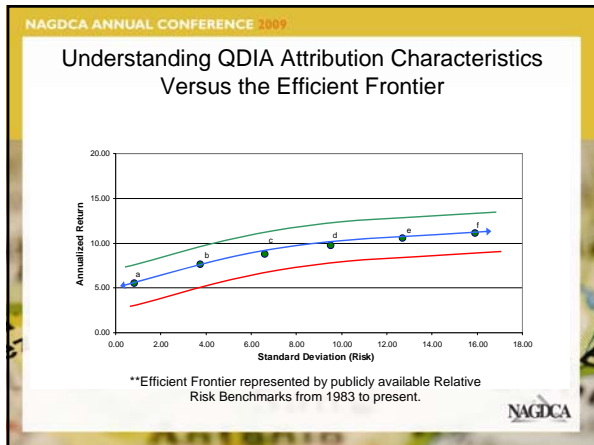
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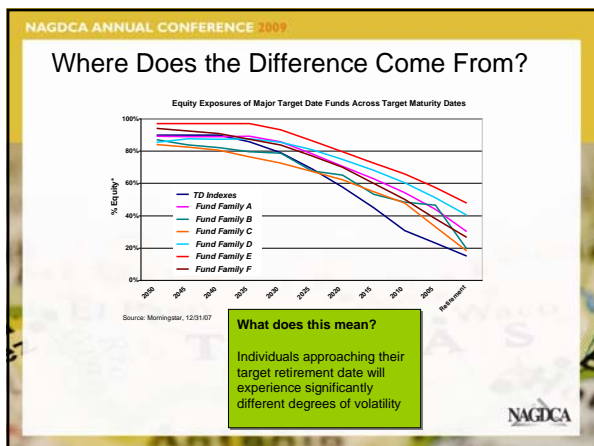
Five-Year Target Date Fund Performance

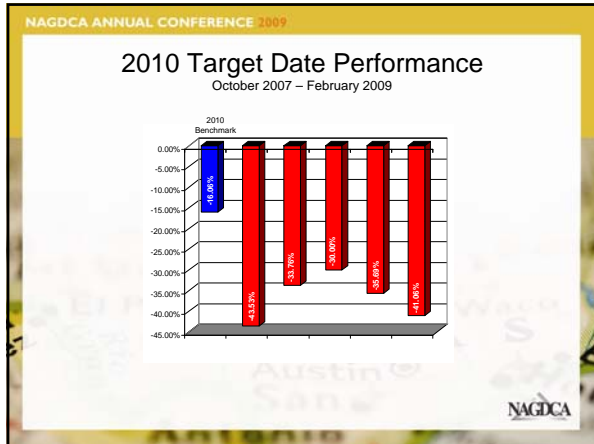
Universe versus standard indexes through June 2009

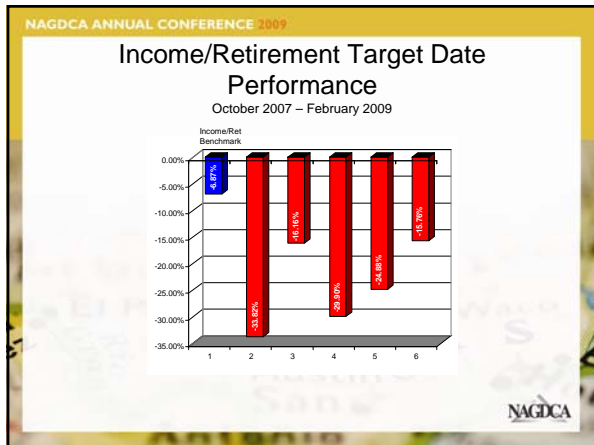













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Evaluating the Implementation of the Philosophy

Objectivity, Transparency, and Repeatability

Asset Allocation

- Portfolio Manager
- Black Box (TAA)
- Modern Portfolio Theory
- Managing Allocations versus Managing Participant Risk

Asset Class Diversification

- Breadth of Asset Classes Included - Sensible?
- Depth of Exposure to Asset Classes
- Disciplined Rebalancing

Active/Passive

- Performance Attribution in Multi Asset Class Portfolios
- Style Discipline
- Capacity Constraints
- Costs

Quality of the Component Funds/Underlying Investments

- Plain and simple: Would they stand up to your Investment Policy Statement on their own? Performance, Manager Tenure, etc.

Delivered at a reasonable cost to participants.

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Education and Communication

- Even the best QDIA is no substitute for a prudent, well planned, savings program on the part of the participant.
- Even in the case of Target Date Funds, the need to educate and communicate does not go away.
- The nature of the education and communication changes from creating expert investors to creating informed results-focused savers.



QDIAs: Ongoing Monitoring

Relative to expectations and participant experience – not peer group

- Are returns, absolute and risk adjusted, generally meeting with expectations based on original shared philosophy on managing risk?
 - If not, where is that “tracking error” from expectations coming from?
 - Asset Allocation: Deliberate and/or Non-Deliberate
 - Securities Selection
- General performance of underlying components/funds
 - Meet investment policy guidelines individually
 - Style purity
 - Style/security overlap
 - Management consistency: existing funds or new additions
 - Capacity concerns: Emerging Markets, Small Cap



Q&A