

NAGDCA ANNUAL CONFERENCE 2009

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**DEFINED BENEFIT & DEFINED
 CONTRIBUTION INTERRELATIONSHIP**

Moderator:
Alex Roitz
Advised Assets Group

Presented by:
Cathie Eitelberg
The Segal Company
Kurt Weber
State of New Mexico

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Cathie Eitelberg
 Senior Vice-President
 National Public Sector Market Director
 The Segal Company

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TOPICS

- 1 Retirement Security: How the Pieces Fit Together
- 2 Evolution of Defined Benefit Plans
- 3 Plan Design Innovations
- 4 It's All About Timing
- 5 Sustainability Through Reform

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How The Pieces Fit Together

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Evolution Timeline: Revolution to Evolution

Year	Event	Funding	Benefit Design	Key Facts
1774	Continental Army	Funded by the sale of "lottery"	Disability benefit: percentage of sales proceeds by rank	Congress appropriates assets to pay down civil war debt
1774	Continental Army	Pay Go	Disability benefit: percentage of pay by rank	Forerunner of current plan
1857	NYC Fire	Pay Go	Lump sum disability benefit	Evolves into a retirement plan
1911	MA Teachers	Funded	Cash Balance	Evolves into a Defined Benefit Plan
1934	9 States Establish Plans	Pay Go	Defined contribution	Slow Growth
1935	Social Security Enacted	Pay Go	Prohibited state and local government participation	Public plans designed outside of Social Security
1945	Expansion of Plans	Pay Go	Defined Benefit/ Defined Contribution	Conversion to Defined Benefit Plan Began
1950	Social Security Extended	Pay Go	Defined Benefit	Coverage given to 75% of Statistical Workers
1970	85 Statewide Plans Exist	Pay-Go Funding Begins	Defined Benefit	Restricted to fixed income investments "Legal Last"
1974	ERISA Enacted	Public Plans Exempted	Regulated by State Unemployment Statutes	Expanded regulation through taxcode
1990	High Levels of Funding	High Levels of Funding	Defined Benefit	Expanded investments to stocks. High market return
2008	Average 87% for large plans	Average 87% for large plans	Defined Benefit (88%) Hybrid Plans	Recovery from market downturn

LEGEND
Funding
Benefit Design
Key Facts

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Evolution: Public Retirement Plans

- First Public Plans
 - Continental Congress Military Plans
 - NYC Fire and Police
 - Massachusetts Teachers
- U.S. cities began offering plans for teachers, firemen, and police officers in the mid-nineteenth century
- Plans become more common with the introduction of civil service reforms—i.e. the conversion of public employment from patronage to merit
- By 1916 Massachusetts, Illinois, New Jersey, and Pennsylvania established plans

Early plans provided Individual Disability and Widows and Orphans Plans.

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Evolution: Public Retirement Plans

- By 1934, only nine states had established retirement plans for their general state employees
- Following World War II establishment of plans exploded—today there are 85 statewide and over 3000 local government plans
- States and localities excluded from Social Security until 1953, in 1986 required to cover new hires in Medicare and 1991 mandated participation in Social Security for employees not covered under employer plan
- Over 92% of Public Sector full-time employees (15 million) are covered by final average pay defined benefit plans, which also provides disability, survivor benefits and inflation protection—and many retiree health care

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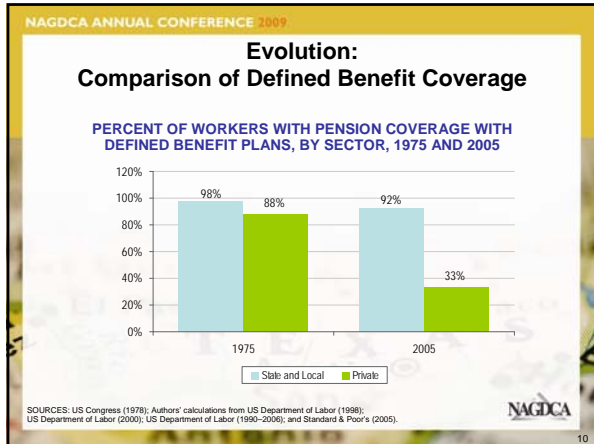
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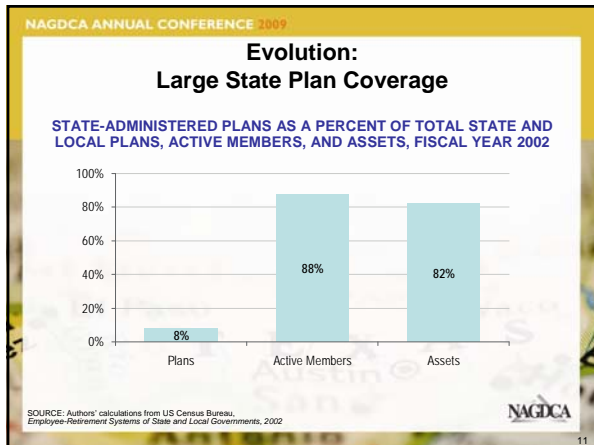
Evolution: Public Retirement Plans

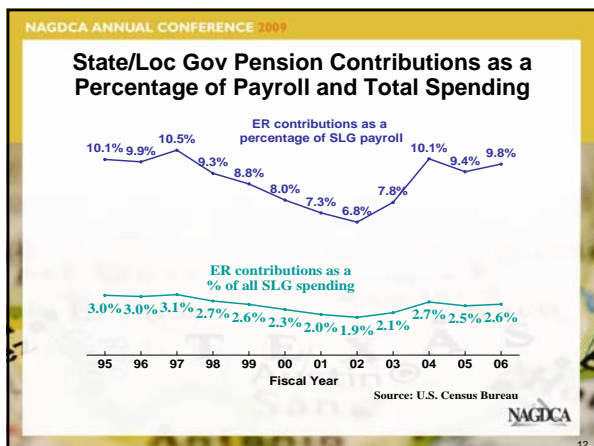
- 88% of the state full-time workers are covered by 8% of plans
- Two states, Michigan (1999) and Alaska (2006), sponsor only a defined contribution plan for state workers
- Defined contribution plans are common in higher education (universities 403 (b) plan) and as supplemental K-12 plans
- All states and most local governments offer a supplemental voluntary defined contribution plan (457 and/or 401(k) plans)
- Many governments have “hybrid” plans

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Evolution: Funding and Regulation

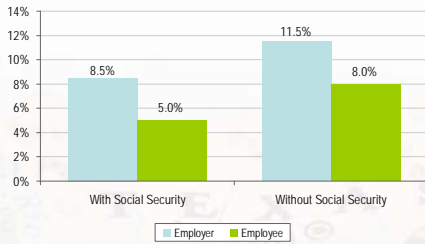
- Funding was primarily pay-go until the 1970s when advance funding methods started to be adopted
- Public Plans cover 15 million participants and currently hold \$2.5 trillion in assets that are invested in a wide range of assets
- Public Defined Benefit Plans are generally jointly funded by employers and employees
- Public Plans are not regulated under ERISA/state laws and statues contain the exclusive benefit rule and prudent investor rule found in the Federal Law
- Most common funding method is Entry Age Normal
- Governmental Accounting Standards Board sets reporting and disclosure rules

Public Sector Plans hold \$2.5 trillion of assets.



Shared Funding

STATE AND LOCAL EMPLOYER AND EMPLOYEE MEDIAN CONTRIBUTION RATES, 2006



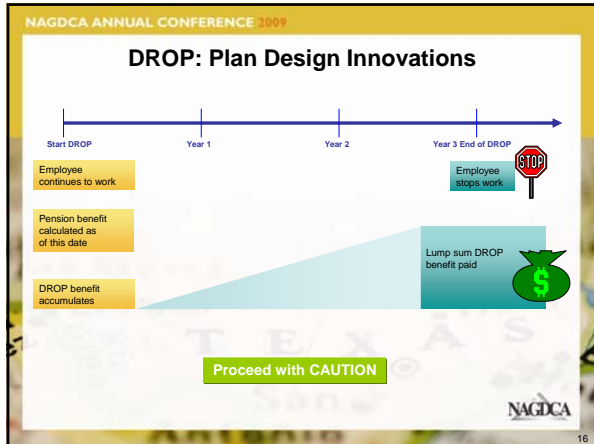
SOURCE: Brainard (2007)



Plan Design Innovations

- Crossovers Plans
- Hybrid Plans
- DROP Plans
- Future Design Direction
 - Benefit Design Changes
 - Funding Volatility Management Measures
- “Defined Benefitization” of Defined Contribution Plans
 - Automatic enrollment
 - Automatic increase
 - Annuitization





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What Do We Know...It's All About Timing

- Trust Fund Balances
- Benefit Payout Cashflow Scenarios
- Business Cycle Recovery
- And....

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Sustainability Through Reform

- Larger Role for DC Plans
- Total Rewards Concept
- Stabilization of DB Benefit
- Continued Shift to Individual Responsibility
 - But different then Private Sector
- Retiree Health Care Component

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Sustainability Through Reform



- Funding of Benefit Increases
- Building Reserve Funds
- Mandate Contribution of Annual Requirement
- Rethink Benefit Design
- GASB Review

The "New" Normal

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Kurt D. Weber
Deputy Executive Director
New Mexico Public Employees Retirement Association

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DEFINED BENEFIT/DEFINED CONTRIBUTION INTERRELATIONSHIPS

- New Mexico State 457 Plan History/Statistics
- Common Board Oversight
- Cost Savings
- Plan Fees
- Communications
- DB Service Credit Purchases
- Other Related Challenges

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NEW MEXICO STATE 457 PLAN HISTORY/STATISTICS

- In the 70's when Deferred Compensation plans were started they were primarily offered and administered by Insurance Companies using insurance based products.
- The products within the plan generally consisted of Whole Life Insurance and Annuities (i.e. bond and stock mutual funds wrapped within an annuity contract).
- Most plan designs were "bundled" – multiple services were performed by one provider. Plan Administration, participant recordkeeping, selection and "sales" of Investment products were performed by one provider. Most "sales" staff were paid on commission – some investment products (i.e. whole life insurance and investment products of the provider) paid higher commissions.

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NEW MEXICO STATE 457 PLAN HISTORY/STATISTICS

- In 1997, PERA "unbundled" the services within the Plan and converted to more flexible, less costly direct mutual fund investment products.
- A separate Investment Advisor was hired to assist PERA in selecting and monitoring Plan investment options.
- Plan administration counselors focus on providing education about benefits and investments. Their compensation became salary based - not commission.
- Mutual funds were "unwrapped" out of the annuities – a cost saving of 125+ basis points or +1.25% per year. Costs were significantly lowered and are clearly identified to participants on their quarterly statements.

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NEW MEXICO STATE 457 PLAN HISTORY/STATISTICS

- Loan program was implemented on 10/22/04.
- Self-directed brokerage account option was implemented on 2/14/05 for participants who want to be very involved in customizing their portfolios. This option was expanded in January 2009 to allow a wider range of investments other than just mutual funds.
- 5 LifeCycle Portfolios were implemented on 2/25/05 utilizing funds from the existing core investment options; 1 additional portfolio was added on 5/10/07.

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NEW MEXICO STATE 457 PLAN HISTORY/STATISTICS

- As of March 31, 2009
 - Plan assets - \$269 million
 - Quarterly contributions – average \$9.0 million/quarter
 - Quarterly distributions – average \$862 thousand/quarter
 - Plan participants – 15,604 (7% increase since 3/31/08)

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COMMON BOARD OVERSIGHT

- Advantages
 - Familiar with Investment Products
 - Participants high comfort level
 - Access to employers and other contacts
- Disadvantages
 - Treating investments same as DB
 - Time/priority devoted to 457 Plan

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COST SAVINGS

- One full-time staff manager expenses charges to participant fees
- Board, Senior Management and general internal legal review expenses not allocated to participants

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Plan Fees

- Third Party Administrator - \$14.75 per quarter
- Investment Consultant - \$1.26 per quarter
- PERA Administrative - \$1.22 per quarter

- All fees and refunds are fully disclosed to the participants
- Institutional level share classes are utilized where possible to reduce fund fees
- 12b-1 fees and administrative refunds from product providers are credited back to the participants
- Additional fees are charged to participants who enroll in the Morningstar Clearfuture Advice option, Charles Schwab Brokerage option, or the Loan program

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COMMUNICATIONS

- Advantages
 - Access to/partnering with DB
 - Employer group meetings
 - Pre-retirement meetings
 - Access to DB member database
- Disadvantages
 - Negative DB press can carry over to 457

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DB SERVICE CREDIT PURCHASES

- DB Service Credit Purchases
 - One year "air-time"
 - Military time
 - Withdrawn service credit

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OTHER RELATED CHALLENGES

- Other Related Challenges
 - Retiree Healthcare – the four-legged sturdy table
 - Many design features/communication geared toward DC only
Plans: i.e. auto enrollment, investments

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Contacts

- New Mexico Public Employees Retirement Association
33 Plaza La Prensa
Santa Fe, New Mexico 87507
 - Kurt Weber
Deputy Executive Director
(505) 476-9304
kurt.weber@state.nm.us
 - JoAnn Garcia
Deferred Compensation Plan Manager
(505) 476-9395
joann.garcia@state.nm.us

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Q&A

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