Russell Investments

SECOND EDITION

A DEFINED CONTRIBUTION RETIREMENT PLAN HANDBOOK

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Preface to second edition

Since the first edition of this handbook was published in May 2014, the defined contribution industry landscape has continued to evolve:

- Defined contribution (DC) plan governance is coming under greater scrutiny than ever before
- Many plan sponsors are seeking more innovative, customized qualified default investment alternatives (QDIAs) beyond traditional target date funds
- Often plan menus are becoming more consolidated and less focused on offering lots of brand name funds
- The industry is taking a more holistic approach to participants' financial wellness in the context of retirement readiness
- Fiduciary roles, as defined by the Department of Labor, are in a state of flux, so much so that we intentionally omitted any discussion of them from this edition because regulations were still pending at the time of publication. However, the trend to higher fiduciary standards for providers of retirement services is not in doubt.

This second edition updates the existing material, adds some new topics and includes additional references.

Introduction

Defined Contribution (DC) arrangements are today the primary retirement savings vehicle for America's private sector workers, but it's a role that they stumbled into. The most common form of DC arrangement, the 401(k) plan, originates in a clause in the tax code that was not specifically intended to apply to retirement savings at all (it covered all forms of deferred income). But as corporations began to move away from Defined Benefit arrangements in the 1980s, DC – almost by accident – became the new retirement superpower.

This role was belatedly recognized in 2006, with the passage of the Pension Protection Act giving the clearest signal yet that legislators understood the central role now being played by DC. And if the regulatory spotlight was not welcomed by plan sponsors, even less welcome was the attention of class-action lawyers and a growing number of lawsuits alleging various types of breach of fiduciary duty.

The challenges of running a DC plan have only grown since then as attention has focused on the features needed for the new role: raising participation rates, ensuring adequate contributions, improving investment decisions, turning a 'saving' mentality into a 'retirement income' mentality, managing fees, and reducing leakage. Participants often lack the information, expertise or energy to look after their own best interests. But litigation risk and an increasingly complex administrative backdrop can draw the attention of plan sponsors away from what is needed to build the best possible plan.

This handbook has been written to help guide plan sponsors who want to understand the best practices for the design and management of a competitive DC plan in this complex and challenging environment.

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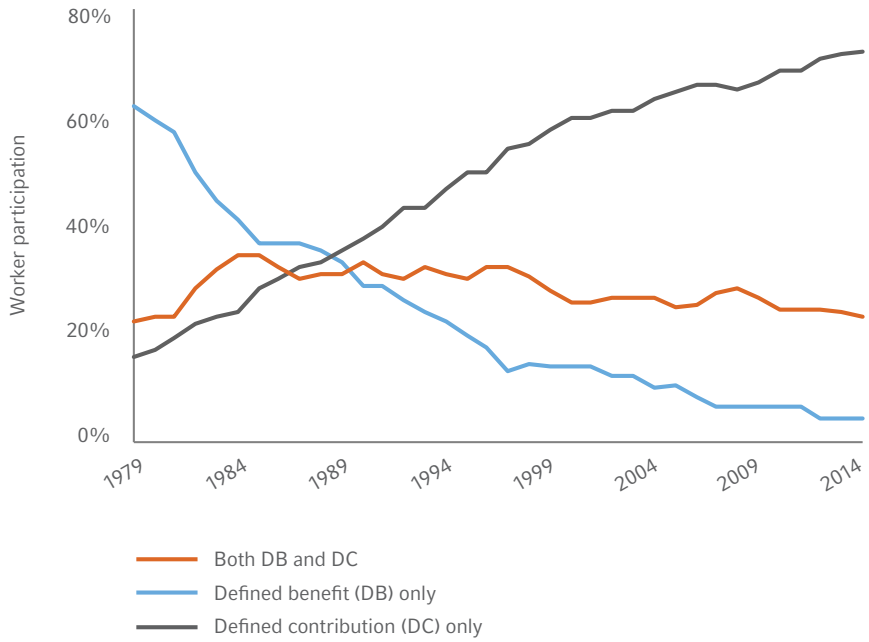
OVERVIEW

Defined contribution is now the primary retirement planning vehicle

Over time, most employers who offer retirement plans have moved from a defined benefit model to a defined contribution model. Today a defined contribution plan is the main source of retirement savings for many individuals. Plan sponsors have many reasons to care about their participants' success in achieving their retirement income goals, and intuitively, employees who spend less time worrying about their finances tend to be more productive.

PRIVATE-SECTOR U.S. WORKERS PARTICIPATING IN EMPLOYMENT-BASED RETIREMENT PLANS: 1979–2014



Source: U.S. Department of Labor Form 5500 Summaries 1979-1998, Pension Benefit Guaranty Corporation, Current Population Survey 1999-2013, EBRI estimates 1999-2014.

WHAT TYPE OF DC PLAN ARE YOU OFFERING?

	401(k)	PROFIT SHARING	403(b)	457(b)
Governed by	ERISA	ERISA	Non-ERISA	Non-ERISA
Typically used by	Corporations	Corporations	Non-profit entities: schools, hospitals, endowments	Governmental entities
Unique investment types	Mutual funds, commingled funds and separate accounts	Mutual funds, commingled funds and separate accounts	Mutual funds and annuities	Primarily mutual funds
Employer contributions	May provide a match or a profit sharing contribution	Percentage of salary based on profitability of company	May provide a match or an employer contribution	May provide a match

Source: Russell Investments.

Savings are the biggest drivers of participant success

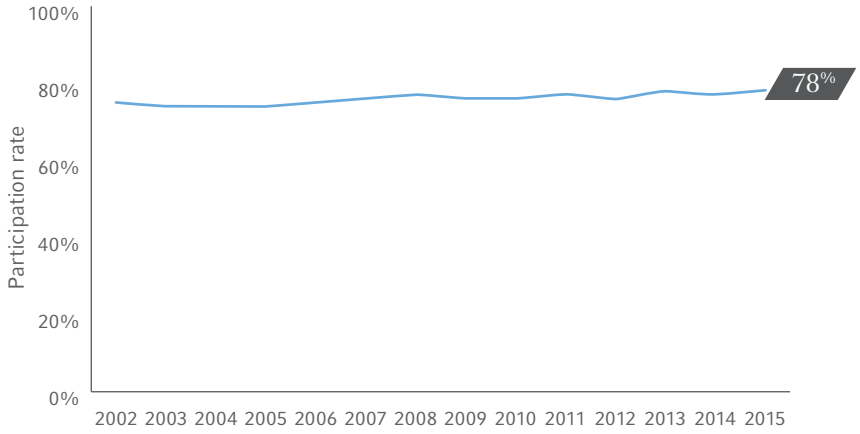
- Full-career employees need to save 11 times their final salary in order to have an 85% chance of funding retirement without running out of money.
- To reach this goal in a classic 60% S&P 500® Index / 40% Bloomberg Barclays U.S. Aggregate Bond Index portfolio, the average savings rate needs to be 12% annually over a 40-year career.
- Only 1 out of 5 employees are projected to have retirement savings that exceed the amount needed at age 65.

Effective August 24, 2016, the Barclays fixed income benchmark indices, including the Barclays Aggregate family of indices, were renamed the Bloomberg Barclays family of indices.

Source: *The Real Deal: 2015 Retirement Income Adequacy at Large Companies* report, Aon plc. Available online at aon.com.

Too few workers are enrolled in their employers' DC plans

AVERAGE EMPLOYEE PARTICIPATION RATE OVER TIME



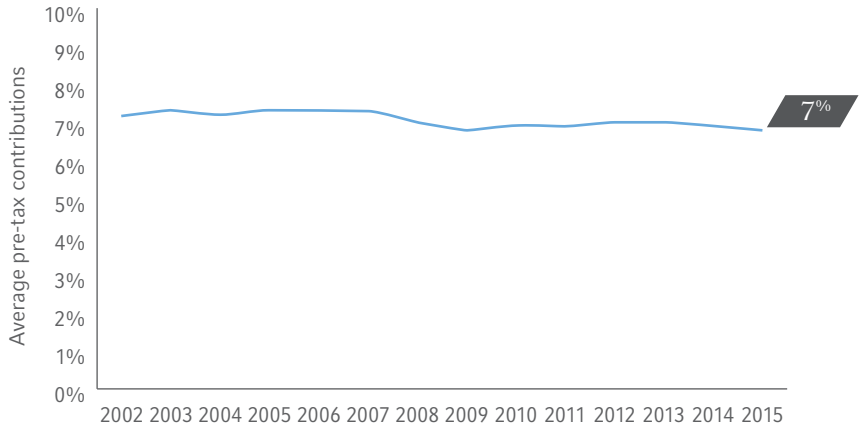
Source: *How America Saves 2016: A report on Vanguard 2015 defined contribution plan data*, Vanguard. Available online at vanguard.com.

Defined contribution plans have evolved over the years; many give participants online access to individual account data and provide investment education, more robust investment menus and wider arrays of tools. But these enhancements have not led to increased participation rates, which have remained around 75% for a number of years.

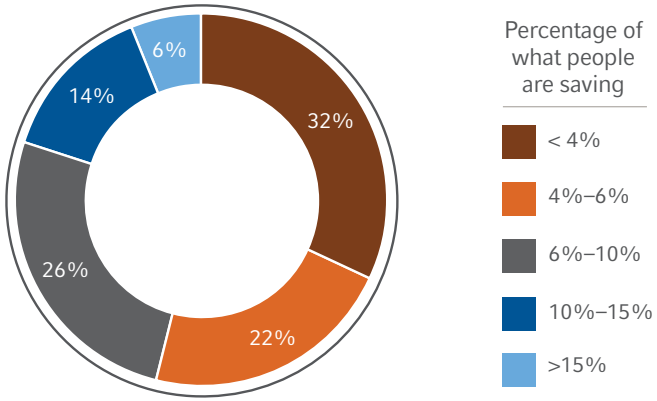
In your role as a plan sponsor, it is important to think of ways to encourage participation in order to help your employees achieve successful retirement outcomes.

Those who are enrolled aren't saving enough

PRE-TAX CONTRIBUTION RATE



DISTRIBUTION OF 2015 PRE-TAX CONTRIBUTIONS

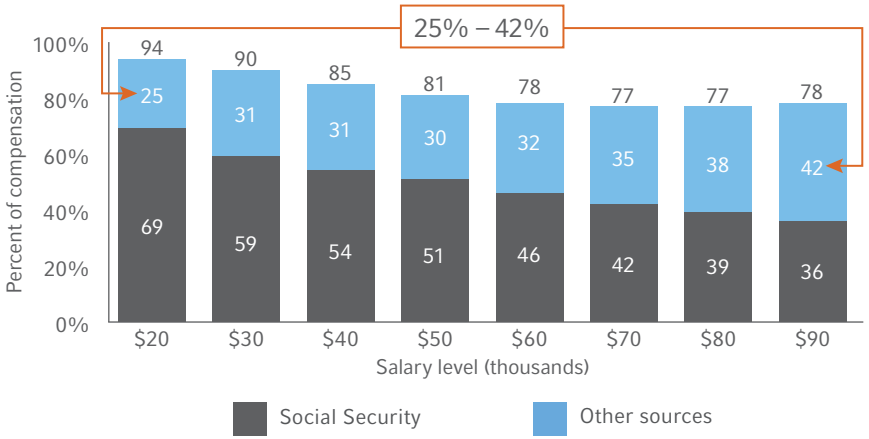


Additionally, many participants who have taken the step of enrolling in a 401(k) plan are not making large enough contributions to reach a successful retirement outcome.

Source: *How America Saves 2016: A report on Vanguard 2015 defined contribution plan data*, Vanguard. Available online at vanguard.com.

Evaluating goals: What percentage of their income will your employees need to replace?

PARTICIPANTS SHOULD PLAN TO REPLACE AT LEAST 25%–42% OF THEIR PRE-RETIREMENT INCOME FROM SOURCES OTHER THAN SOCIAL SECURITY[1]



Participants must save adequately to replace their income in retirement. Research shows that to maintain their current lifestyle, participants should save enough to replace 80% of their pre-retirement income.[2] Social Security and pension plans will account for a portion of post-retirement income, but for most participants, their defined contribution plan savings will represent a large portion of income in retirement.

[1] Based on a salary of less than $90,000.
[2] Aon Consulting's *Replacement Ratio Study: A Measurement Tool for Retirement Planning* (2008), page 4, available online at aon.com.

How much should participants save?

There are different ways to save for retirement, but as DC plans become the preeminent investment vehicle, the question of how much to save comes up often. There are many rules of thumb, but it may be more useful for participants to quantitatively define a savings rate. The Target Replacement Income (TRI) generated from the DC plan can follow a simple formula, as described below.

THE TRI METHOD CAN BE USED AS A RULE OF THUMB BY EMPLOYEES SAVING OVER THEIR 40-YEAR CAREERS.

TRI30 Method

TRI (Target Replacement Income goal)

x 30%

= Annual savings rate[3]

TRI includes your company contributions.

[3] For a 90% probability of meeting the income replacement rate.

Examples of the TRI30 Method

Replacement income goal (A)		Savings rate (B)
25%	Then your savings rate should be: 25% x 30% = 7.5% (rounded up to 8)	8%
42%	Then your savings rate should be: 42% x 30% = 12.6% (rounded up to 13)	13%

Use the **TRI30** Method below.

Replacement income goal (A)		Savings rate (B)
%	A x 30% = B	%

How does your plan compare?

As a plan sponsor, you should ask yourself: Do I want my plan to be just good enough or average, or do I want an excellent plan? "Excellence" can differ by plan. As a sponsor, you should strive to do better than average.

We encourage you to complete this chart to see how your plan compares to the national average and to an "excellent" plan.

	"AVERAGE" PLAN	"EXCELLENT" PLAN[7]	YOUR PLAN
Participation rate	~75%–80%[4]	95%+	_____ %
Average contribution rate	9%–12%[5]	12%–15% (Employer + employee)	_____ %
Percentage of participants in professionally managed allocation (typically default)	53%[6]	80%+	_____ %
Number of investment options (a target date fund counts as one fund)	12–20 options[5]	6–10 options	_____ options

See page 14 for a list of some key plan design attributes to consider.

[4] How America Saves 2016: A report on Vanguard 2015 defined contribution plan data, Vanguard. Available online at vanguard.com.

[5] PSCA's 58th Annual Survey of Profit Sharing and 401(k) plans, 2016.

[6] TDF adoption in 2016. Vanguard. Available online at vanguard.com.

[7] An "excellent" plan is based on our experience, what we believe most plans will need to strive for in order to better the chance that their participants will achieve a secure retirement.

See *Seven attributes of an excellent defined contribution plan.*

Automatic features can help participants achieve better outcomes

- Auto-enrollment
- Auto-escalation of contributions
- Robust investment defaults
- Re-enrollment and mapping to default investments

Passage of the Pension Protection Act of 2006 (PPA) gave employers additional ways to increase plan participation and savings rates and encourage appropriate investment allocations.

POTENTIAL SOLUTIONS TO THREE COMMON PROBLEMS

1 Low participation › Auto-enrollment
- At employment
- Annually for all
- Start at 6%, not 3%
- Participant opt-out will likely be limited

2 Low savings › Auto-escalation
- Safe harbor to 10%
- You can go higher
- Start at 2% per year, not 1%
- Stretch match formula to support higher savings

3 Poor allocations › Plan re-enrollment
- Plan menu change
- Or recordkeeper change
- Or create an event
- Provide notice
- Negative consent to map assets and future contributions

EXCELLENT PLAN

95%+ participation | 12%–15% savings | 80%+ into default (with match)

GLOSSARY OF TERMS

Auto-enrollment: Automatically enrolling new hires into a QDIA within the DC plan, at a fixed contribution rate.
Auto-escalation: Increasing participant contribution rates at regular intervals, by a predetermined amount.
QDIA re-enrollment: Redirecting existing account balances and future participant contributions from existing investment allocations to a QDIA, unless participants opt out or make another election before assets are moved. Provided that the plan sponsor has satisfied the safe harbor requirements, it will be provided with relief under ERISA Section 404(c) for investment outcomes related to the QDIA.

Source: The Defined Contribution Institutional Investment Association (DCIIA) (2016), *Building a Common Language to Promote Adoption of Auto Features in DC Plans*.

Seven attributes to consider as you strive for DC plan excellence

1 **ADOPT A RETIREMENT INCOME MIND-SET**
First, help to change participants' attitudes toward saving. Use account statements and other communications to encourage them to think in terms of replacement income in retirement.

2 **DESIGN THE INVESTMENT MENU THOUGHTFULLY**
Make it simple. Streamline your "core" menu with a limited number of broad multi-manager, multi-style investment options.

3 **PROVIDE BEST-OF-BREED INVESTMENTS**
Provide the best available investment option for each asset category.

4 **RECOGNIZE DIVERSE PARTICIPANT NEEDS**
Be a guide to help participants determine which plan options best fit their needs and have the potential to lead to successful outcomes.

5 **PROVIDE EFFECTIVE EMPLOYEE EDUCATION**
Focus on financial education.

6 **FOSTER HIGHER PARTICIPATION RATES**
Decide whether auto-enrollment is right for your plan.

7 **ENCOURAGE HIGHER CONTRIBUTION RATES**
Utilize tools like auto-escalation and targeted communications to increase participants' savings rates.

See *Seven attributes of an excellent defined contribution plan*.

Re-enrollment: What needs to happen

- A new plan investment menu is announced.
- Participants are educated about the potential benefits of target date funds.
- Members are asked to select or reselect investments during the notice period.
- If no selection is made, current investments and future contributions are mapped to target date funds.

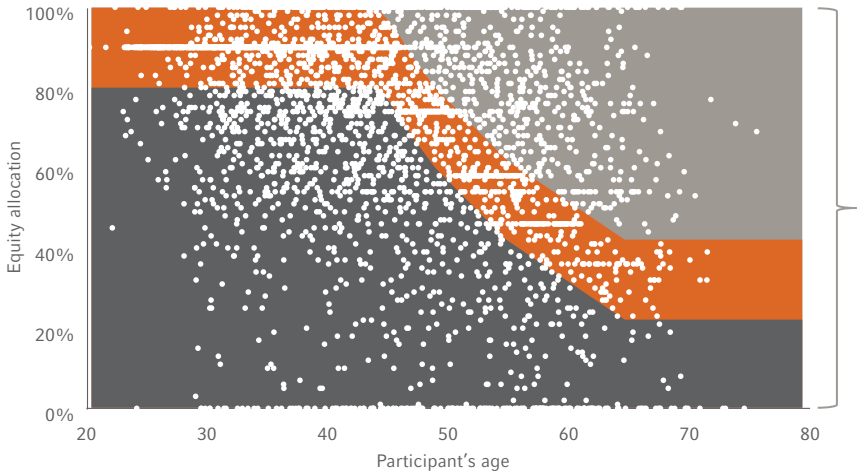
! *PPA gives safe harbor protection to plan fiduciaries using this re-election process; given proper notice, participants who fail to act may have their assets mapped into QDIAs.*

See *DC plan re-enrollment: A fiduciary imperative? (updated)*.

Participants are often allocated inappropriately

Before

APPROXIMATELY 50% ARE ±10% IN THE "APPROPRIATE AGE-BASED ALLOCATION"



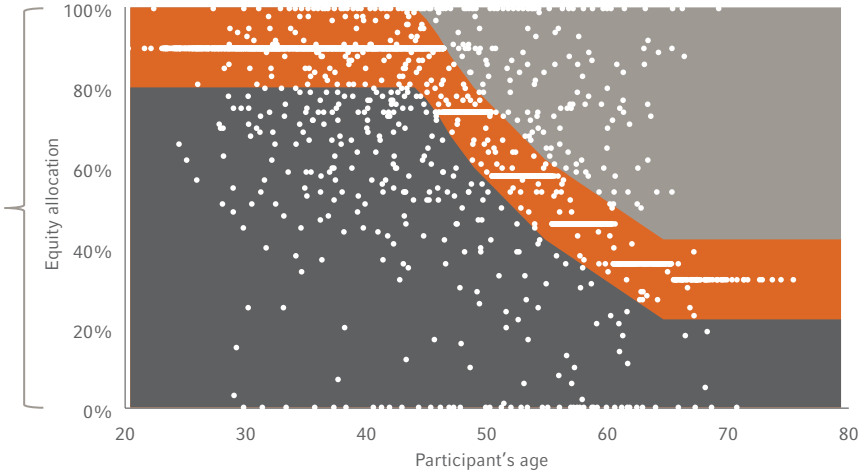
- Too conservative early in career? Risk of insufficient asset growth and failure to reach goals.
- Too aggressive close to or even in retirement? No time to recover from potential market losses.
- Appropriate age-based allocation (~50% of participants, +/-10%).

+/- 10 percentage points of equity roll-down schedule.
This case study is provided for illustrative purposes.

Re-enrollment can get participants back on track

After

APPROXIMATELY 90% ARE ±10% IN THE "APPROPRIATE AGE-BASED ALLOCATION"



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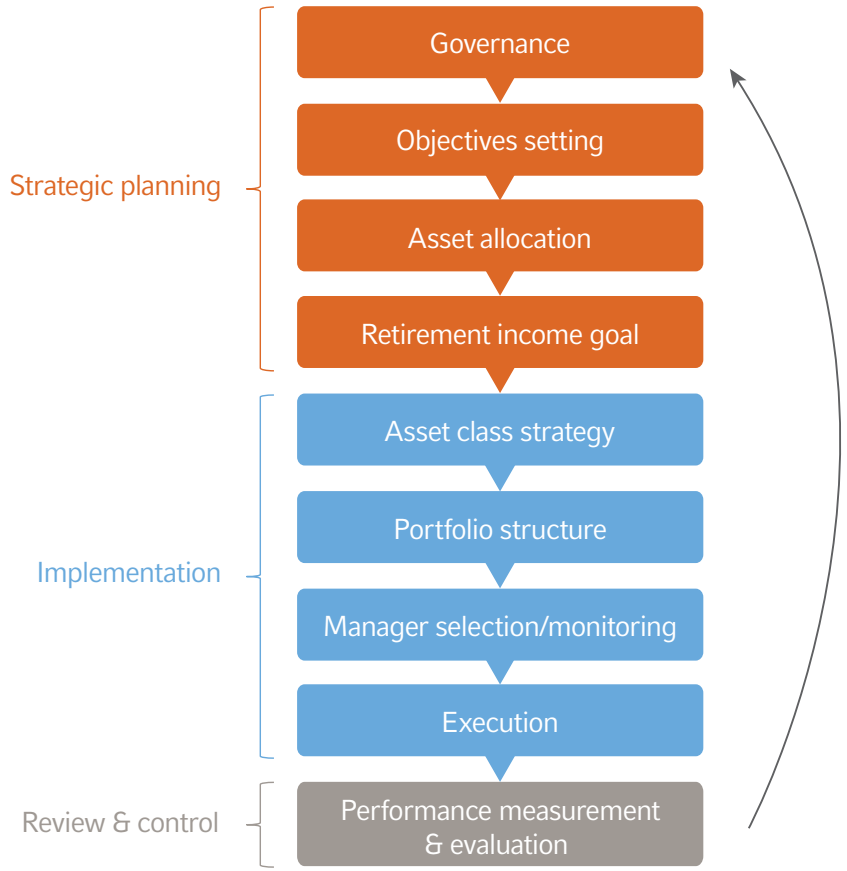
This case study is provided for illustrative purposes.

GOVERNANCE

Plan the work: Our fiduciary ladder



A strong governance model is an important component of any defined contribution plan. Whether you use a model similar to the one above or have one of your own, it is important to have one in place so that you can effectively manage your plan. Keep in mind that governance is a continual process that starts with setting objectives for the plan. Our fiduciary ladder is a starting point for thinking about how an investment committee should allocate its time and resources.

The investment policy statement

Many plans have governing principles summarized by the investment policy.

- The investment policy statement (IPS) exists to give clear guidelines and standards by which investment fiduciaries can make decisions
- It gives staff a set of principles for monitoring and executing investment operations
- A coherent policy statement sets the standards by which investment managers and other service providers will be held accountable

ESSENTIAL ELEMENTS OF AN IPS:

1. Description of the plan and definition of the plan's stated objectives
2. Definition of the parties responsible for carrying out specific tasks
3. Objectives and constraints for investment alternatives
4. Process for selection, monitoring and replacement of investment alternatives
5. Other provisions as necessary such as treatment of company stock and proxy voting, if applicable

ACTION ITEMS FOR STAFF AND COMMITTEES

- *Identify and remove any overly prescriptive language*
- *Reaffirm comfort with existing language and/or add flexibility*
- *Establish a process of regular review of plan documents*
- *Review documentation with your ERISA counsel*
- *Follow the IPS and do what you say you are going to do*

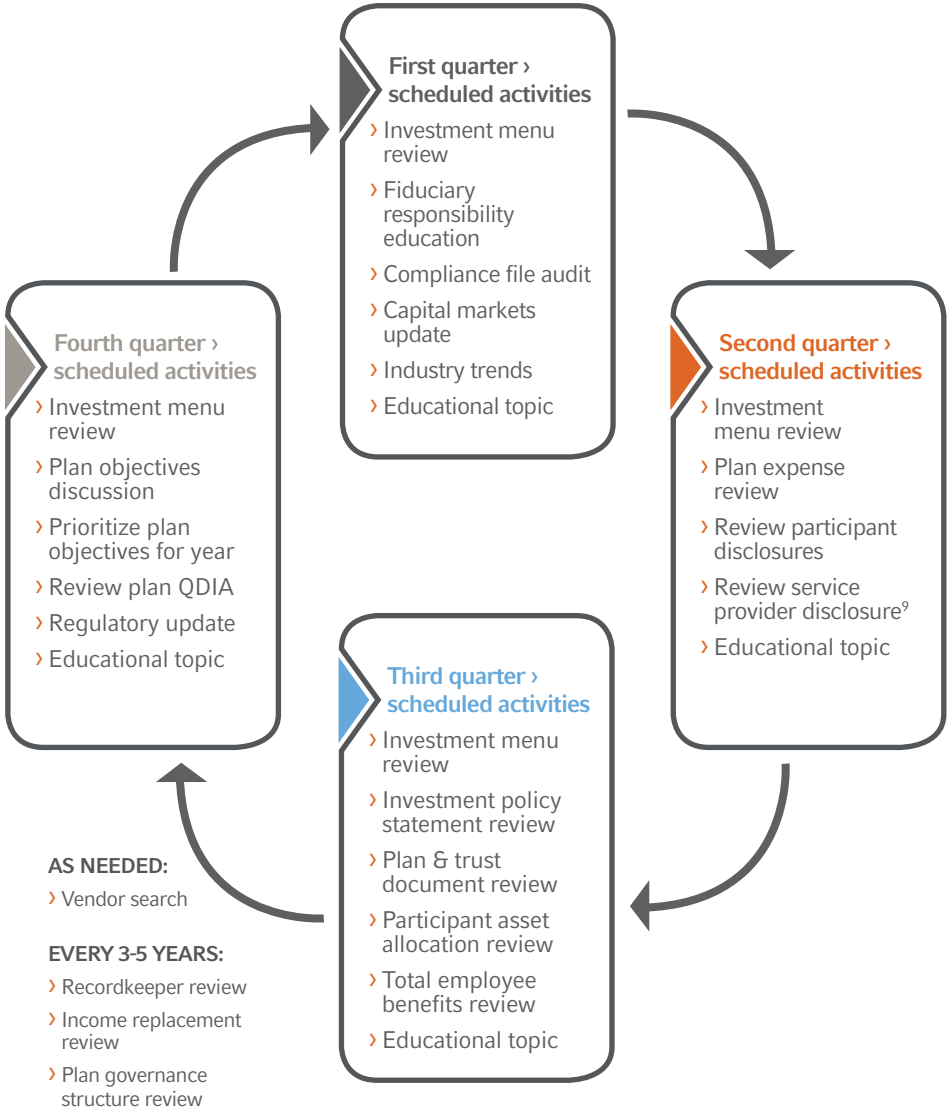
Understand your governance structure

We invite you to think about who serves in what role for your plan. You can start by filling in the percentage of time your investment committee and staff spend planning, implementing and reviewing. Then ask yourself, "Who is responsible for governing the plan, who is responsible for implementation, and who is responsible for reviewing to make sure things go smoothly?" Now think about how much time these individuals spend to carry out their duties. Remember, good governance requires that plans seek out experts as needed.

WHAT % OF TIME IS SPENT IN EACH AREA?			
	PLANNING (A)	IMPLEMENTATION (B)	REVIEW (C)
Named fiduciary	_____ %	_____ %	_____ %
Investment committee	_____ %	_____ %	_____ %
Investment staff	_____ %	_____ %	_____ %
Consultant/ outsourced	_____ %	_____ %	_____ %
A+B+C = 100%			
Examples	› IPS[8] development › Strategic asset allocation › Income replacement	› Asset class strategy › Manager implementation › Rebalancing	› Provider review › Risk management

[8] Investment policy statement (IPS).

DC plan governance: Sample committee roadmap



[9] Plan sponsor is responsible for initial review of new or updated disclosures within 90 days.

Overview of the roles and responsibilities in structuring a DC plan

EMPLOYER
CEO & CFO / board of directors responsible for overall retirement benefit strategy and related corporate expense.

EXECUTIVES	RETIREMENT COMMITTEE	PLAN STAFF
SETTLOR ROLE	**NAMED FIDUCIARY ROLE**	**STAFF ROLE**
› Establish/ terminate plan › Employer match › Profit sharing › Vesting requirements	› Employee(s) or committee names in the plan documents › Charged with selecting, monitoring and evaluating plan service providers › Responsible for plan investments › Responsible for administration and operation of the plan	› Investment strategy work › Recommendations preparation › Investment due diligence › Disclosure preparation › Service provider liaison

WHAT ARE THE RESPONSIBILITIES OF EACH FUNCTION?

STRATEGY	IMPLEMENTATION	ADMINISTRATION
› QDIA objective setting › Investment menu options › Income replacement targets	› Manager selection and due diligence › Investment guideline negotiation › Fee negotiation › Target date fund/ white label fund assembly[10]	› Recordkeeper selection and review › Trust/custodian selection and review › Disclosure and reporting compliance › Disputes/withdrawals

There are the various roles and duties that staff, investment committees and providers can carry out; think about who at your company is performing these tasks. In some cases, an independent advisor or fiduciary can give your plan a more robust approach to plan management by providing custom asset class funds or custom target date funds, or by performing administrative duties or other roles where an expert may be required.

[10] See page 57 for information on white label options.

What types of functions can be delegated?

STRATEGIC INVESTMENT ADVISOR

"3(21) Advisor"

- Advises on plan investments
- Scope varies to fit plan needs
- E.g., plan consultant

INVESTMENT MANAGER

"3(38) Fiduciary"

- Delegates authority for decisions on plan investments

For example:

- Target date series
- Stand-alone menu
- All investments
- Asset allocation, e.g., custom target date funds, managed accounts

INDEPENDENT PLAN ADMINISTRATOR

"3(16) Independent Fiduciary"

- Traditionally hired to assume certain reporting and disclosure responsibilities (Form 5500, etc.)
- Can perform service provider selection, oversight and other administrative duties as agreed

As defined contribution plans have grown, some plan sponsors have found that their fiduciary responsibilities have increased beyond in-house capabilities. These sponsors have explored the potential benefits of hiring specialist fiduciaries to help them in governance of their plans.

In the past, many DC plan fiduciaries have attempted to go it alone. Today there are other approaches available for getting the job done, such as calling on experts for consulting support or outsourcing certain fiduciary tasks to a third-party specialist.

Selecting a DC plan outsourcer

Outsourcing for a DC plan can take many forms, from limited scope duties such as investment manager selection and monitoring to full plan management and administration. If you've decided that outsourcing certain fiduciary duties to a third party is the right decision for your plan, you must now select a provider. There are generally **three** types of firms providing outsourcing services. How do you choose among them?

CONSULTANTS

Consulting firms have made the foray into outsourcing, requiring a build-out of the infrastructure and expertise to offer new services and products.

Questions for consultants:

- Track record in the outsourcing business
- Willingness to provide fiduciary services beyond advice
- Strength in and experience with investment implementation
- True focus on investment outsourcing
- Dynamic, real-time management of client portfolios

INVESTMENT MANAGERS

Investment managers have experience making investment decisions and providing investment-related services, but their focus is not necessarily on an entire portfolio.

Questions for investment managers:

- Broad asset management experience
- A strong manager research capability
- Willingness to offer a customized approach
- Ability to manage risk across asset classes
- Measurement of goals that matter to me

MULTI-MANAGERS

Multi-managers seek to provide small-to-medium sized plans with greater diversification and access to money managers typically available only to large plans. Multi-managers generally focus on managing overall exposures within the entire portfolio rather than narrow security selection within specific asset classes.

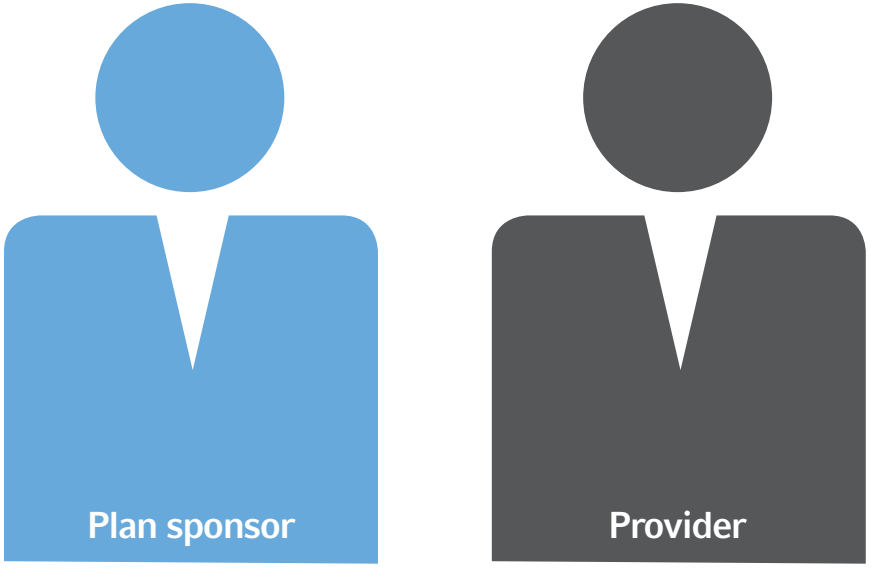
Questions for multi-managers:

- Willingness to provide fiduciary services beyond manager selection oversight
- Able to provide broad set of investment options
- Moving from single to multi-manager may require more transition
- Strength and experience in consulting

See DC outsourcing: A compendium of white papers on fiduciary solutions. "*Selecting a DC plan outsourcer*".

Maintain control of what is important to you

Delegate the rest.



Maintains control of strategic decisions relating to your unique employee population

(decisions concerning asset classes, active/passive styles, QDIA type, etc.)

Delegated investment manager selection, monitoring and replacement

ERISA Section 404(c)

If your plan allows participants to control their investment decisions, be sure you are in compliance with ERISA Section 404(c).

As a plan sponsor, you are responsible for selecting and monitoring plan investment choices on an ongoing basis. However, you may reduce your fiduciary responsibility for participants' personal investment decisions while remaining in compliance with Section 404(c), as follows:

- Offer at least three diversified investment choices with materially different risk/return characteristics.
- Ensure that all investments are "prudent" — i.e., appropriate for retirement investment.
- Allow participants to direct their own investments.
- Let participants transfer their allocations among the investment options at least quarterly.
- Upon request, give participants access to additional in-depth information on the investment options.

DC plan fees: three general categories

It isn't always easy to understand your plan fees.

All of the providers in your defined contribution plan have specific sets of fees associated with their services. As the plan fiduciary, you are responsible for understanding those fees and ensuring that they are reasonable. Increasingly, we see plans moving away from revenue-sharing arrangements and billing administrative and investment-related expenses separately.

1 Investment-based fees are:

- Associated with the management and operation of plan investment options
- Determined on a sliding scale for non-registered funds, flat-fee basis for mutual funds
- Generally expressed as a percentage of assets or basis points

2 Plan administration fees are:

- Fees for administering the plan
- Typically presented on a per-participant basis. Total plan administrative costs should be distributed evenly across participant base
- Fixed rate. Plan costs are based on the number of plan participants (however, many administrative costs are charged through revenue sharing, which will vary by assets)

3 Transaction-based fees are:

- Those for a particular service, transaction or event, such as a brokerage window transaction, loan or qualified domestic relations order (QDRO)
- Typically assessed at the participant level
- Based on participant usage

Investment-based fees

Investment-based fees have three components — typically assessed as a percentage of assets:

1. **INVESTMENT MANAGEMENT FEES**
   Fees paid to the investment's portfolio managers.
2. **DISTRIBUTION OR REVENUE SHARING FEES**
   May be used to compensate a financial advisor or plan recordkeeper, which would offset recordkeeping and administrative expenses.
3. **OTHER FEES**
   Includes custody, legal, transfer agent, recordkeeping and operating expenses.

! *Fees can be allocated a number of different ways. However, many recordkeepers bundle administration fees and use revenue sharing agreements to offset recordkeeping costs. We recommend separating investment-related fees and administration fees to improve transparency and negotiating ability. See page 33 for pros and cons of using revenue sharing to pay plan expenses.*

Understanding investment-related fees

- Plan sponsors should seek out providers that charge reasonable compensation. However, that does not always mean the lowest-fee investment product should be chosen in any one investment category or across the plan.
- A prudent process should allow the plan sponsor to determine the *value* received for the fee.
- However, when evaluating similar investments, plan sponsors should determine whether they have the ability to lower fees for an *otherwise identical* investment.

A FEE ANALYSIS SHOULD TAKE INTO ACCOUNT:

- Mandate size or negotiating power with the manager
- An appropriate benchmark universe, noting any asset allocation differences between the product under analysis and the universe
- Other available investment vehicles (e.g., separate accounts, collective trust funds)
- Additional operational fees not related to investments

TIP: Plans should consider the fee benefits of non-mutual fund vehicles such as collective trusts.

Note: Fee benchmarking should examine the full range of fees in the universe, not just the median fee.

Investigate current revenue sharing arrangement

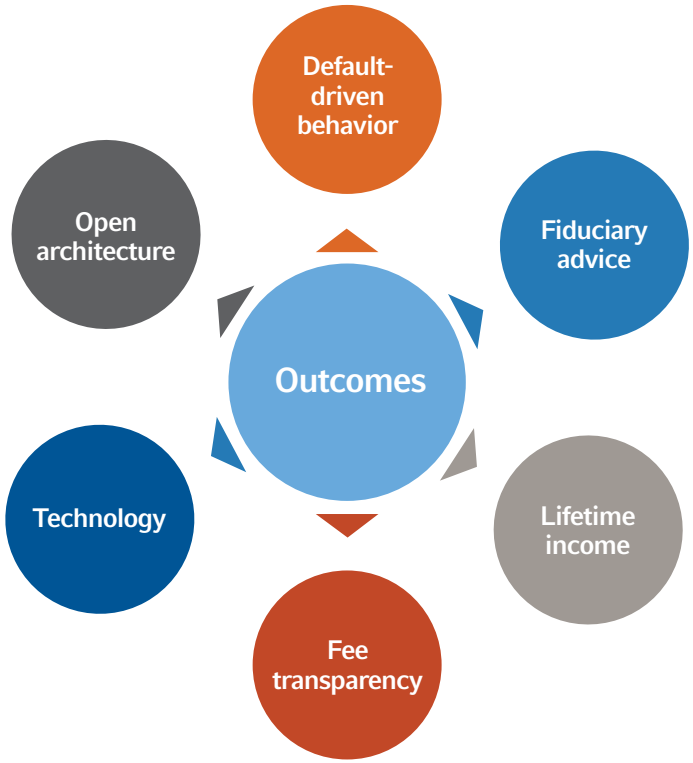
Pros and cons of using revenue sharing to pay plan expenses

Pros	Cons
Maintains existing structure for participants	Less transparent
Certain investment strategies may be available only in mutual funds with revenue sharing	Asset-based fee (recordkeeper costs are account-based)
	Inequitable: Some participants pay more for like recordkeeping services than others
	Recordkeeping fees increase when total plan assets increase

Market and regulatory trends are focused on outcomes

We are observing many market and regulatory trends focused on solutions that may result in better outcomes for participants.

The lesson for sponsors is to think about solutions and processes that aren't necessarily focused on specific features, but rather, are aligned with the outcomes you are seeking for your plan and participants.

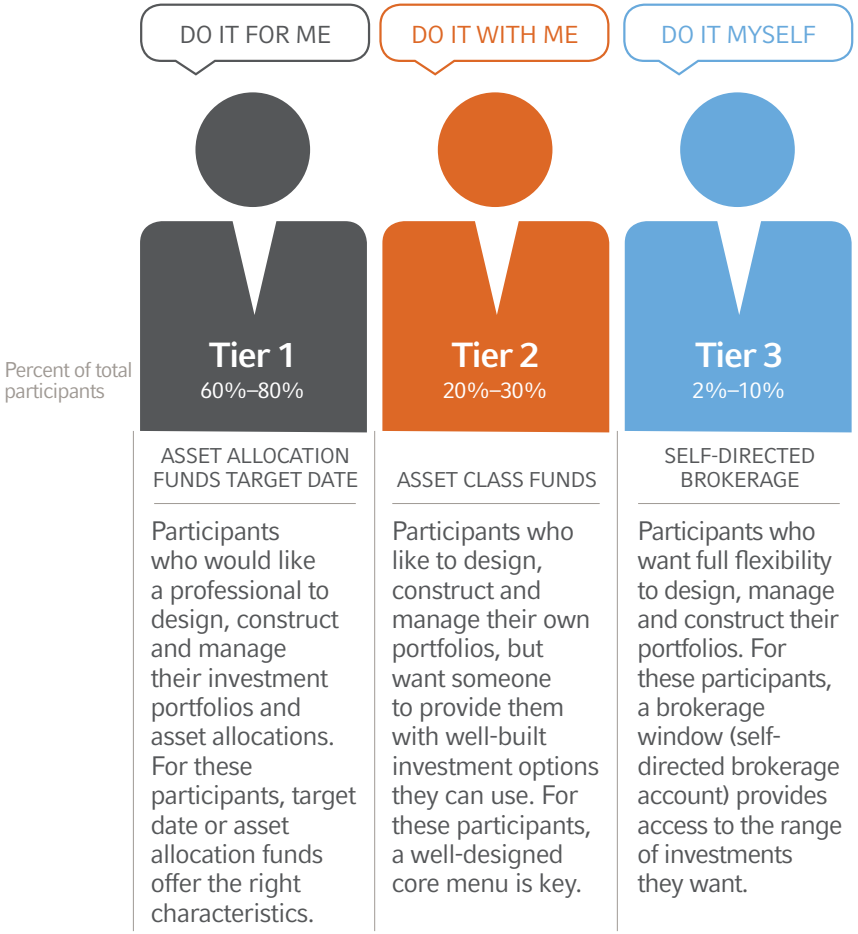


SECTION II — THE DC INVESTMENT MENU

OVERVIEW

Participation in your plan

When it comes to investing, DC plan participants tend to fall into three groups.



Qualified default investment alternatives (QDIAs)

The Department of Labor (DOL) has approved the following options as having safe harbor status:

TARGET DATE FUND
A product with a mix of investments that takes into account the individual's age or retirement date (life-cycle or target date fund).

MANAGED ACCOUNT
A product that allocates a plan participant's contributions among existing plan options to provide an asset mix that takes into account the individual's age or retirement date.

BALANCED FUND
A product with a mix of investments that takes into account the characteristics of the group of employees as a whole, rather than those of each individual participant.

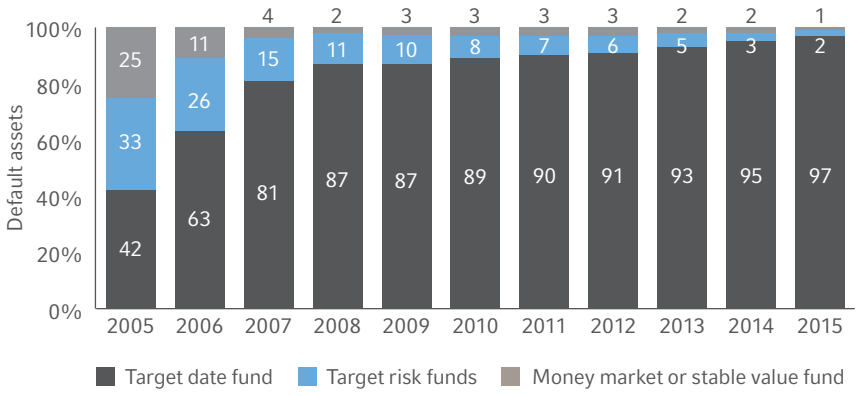
A CAPITAL PRESERVATION PRODUCT
Allowed only for the first 120 days of participation for sponsors wishing to simplify administration if workers opt out of participation before incurring an additional tax.[11]

In many plans, the QDIA is offered to Tier 1 ("Do it for me") participants and as the default investment for any participants who are auto-enrolled or who otherwise fail to make an investment election.

[11] From "Regulation Relating to Qualified Default Investment Alternatives in Participant-Directed Individual Account Plans," a DOL fact sheet available at http://www.dol.gov/ebsa/newsroom/fsQDIA.html.

The default choice has changed rapidly

Since passage of the PPA, which provides a safe harbor for target date funds as QDIAs, the use of target date funds has increased dramatically. Additionally, target date funds are popular for "Do it for me" participants who want to leave the management and monitoring of their portfolios to a professional investment manager.

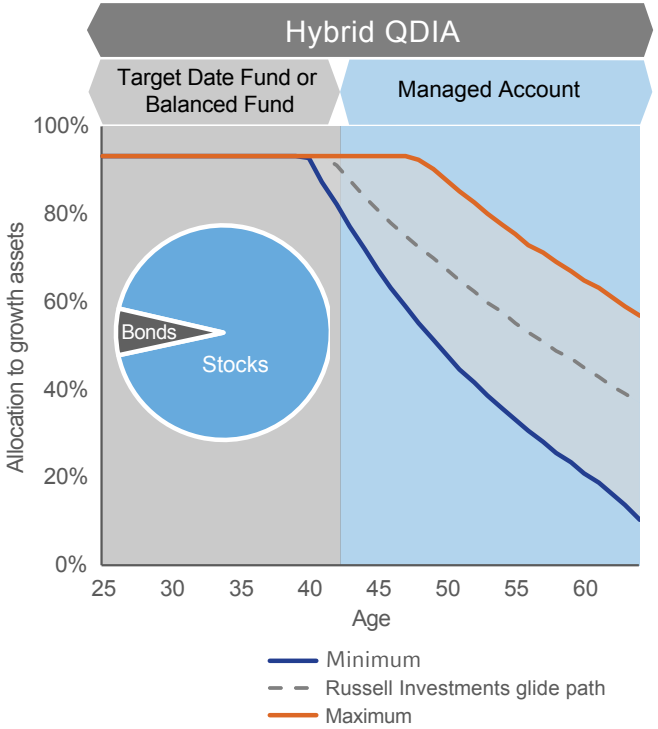


Source: *How America Saves 2016: A report on Vanguard 2015 defined contribution plan data*, Vanguard. Available online at vanguard.com.

The forefront of QDIA solutions: Hybrid QDIAs

A hybrid QDIA combines an asset allocation QDIA solution, such as a target date fund or balanced fund, with the features of a managed account.

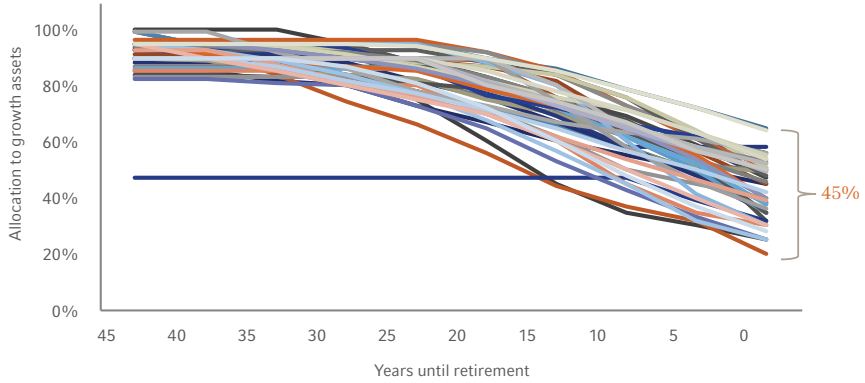
Participants may be defaulted into different types of QDIAs depending on their age and financial circumstances. Participants who are defaulted into a target date/balanced fund have the opportunity to transition into a managed account when their financial situations become increasingly complex.



Source: Russell Investments. For illustrative purposes only.

TIER 1: TARGET DATE FUNDS AND MANAGED ACCOUNTS

Not all target date funds are the same



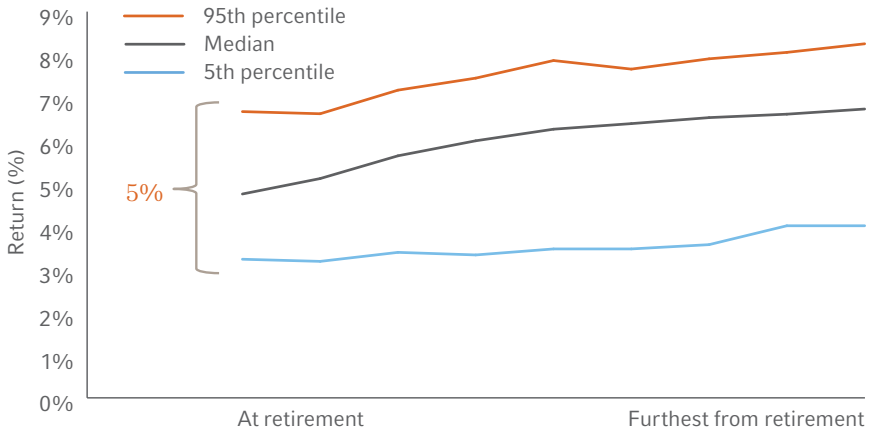
The chart above shows that not all target date funds are the same. The percentage of growth assets vs. capital preservation assets changes markedly over the life of the fund, in what is known as "the glide path."

To illustrate that at the point of retirement there is a 45% range in growth assets among all target date fund providers, select a series of target date funds that best aligns your set of beliefs and your workforce.

Source: Morningstar, Russell Investments analysis, as of 6/30/16.

As a result, target date fund returns have varied widely

DISTRIBUTION OF MORNINGSTAR TARGET DATE UNIVERSE RETURNS



Source: Morningstar Direct and Russell Investments analysis. Reflects the one-year return of the Morningstar Universe as of 6/30/16. Results not adjusted for survivorship bias.

Differences in the asset allocations of target date funds can lead to very different outcomes for participants. It is important to fully understand how your funds are built.

You need to evaluate:

- Asset classes
- Underlying funds
- Methodology
- Strategic asset allocations
- Tactical asset allocations

Understanding the methodology behind target date funds is important; there are many different approaches

Funds can be designed for ❯
- Maximum accumulation
- Downside protection
- Income replacement in retirement

Glide paths can ❯
- Continue to de-risk, post-retirement
- Remain flat, post-retirement

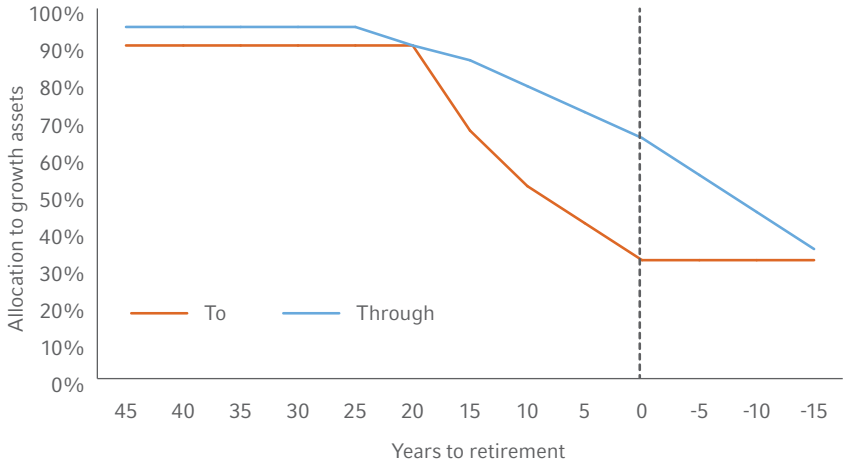
It is important to ❯

1. Understand the differences between glide paths.
2. Know your plan participant demographics and behaviors and how they compare to glide path assumptions.
3. Determine the levels of risk that make sense for your participants at each life stage.
4. Review underlying asset classes and underlying manager performance.
5. Choose the glide path that best fits your plan participants' needs.

"To, or through?" is not the right question

The right question: "How much equity exposure do you want your plan participants to have at the point of retirement?"

"TO" AND "THROUGH" GLIDE PATHS



For illustrative purposes only. Not meant to represent any actual investment.

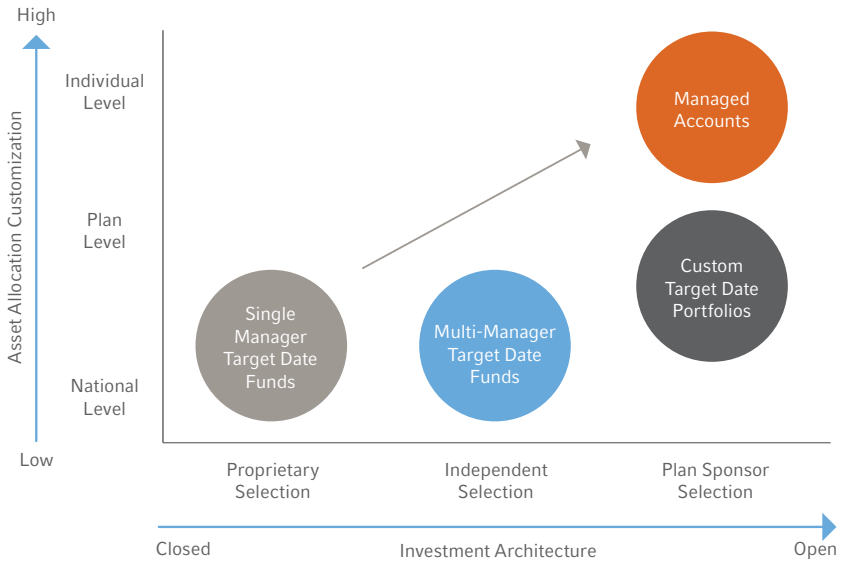
It is important to understand that the shape of your target date funds glide path can impact your participants' retirement outcomes.

The DOL provides a framework for selecting and monitoring target date funds

EXPLORE	**Inquire** about whether a custom or non-proprietary solution would be a better fit.
PROCESS	**Establish** a process for comparing and selecting funds. Document it.
RESEARCH	**Understand** the investments and how they change over time.
CALCULATE	**Review** the fees and expenses.
COMMUNICATE	**Develop** effective employee communications.
MANAGE AND MONITOR	**Evaluate** the target date fund and recommendations you received.

In February 2013, the Department of Labor released "Target Date Retirement Funds—Tips for ERISA Plan Fiduciaries" for plan sponsors to use when selecting and monitoring target date investments. Chief among the suggestions from the DOL was that fiduciaries need to understand how target date funds work, and to establish a process for evaluating their fit for a specific plan. Recognizing that the target date fund universe is as varied as the American workforce, regulators made the point that non-proprietary and custom solutions may be viable options for some plans and should be explored.

Managed accounts can provide individualized customization relative to industry QDIA solutions



There has been an evolution within the QDIA space over time. Trends and plan sponsor philosophies have shifted from single manager off-the-shelf offerings (typically offered by their recordkeepers), to more customized, open architecture approaches. Managed accounts can offer participants individual asset allocation customization while leveraging the preferred products/options selected by the plan sponsor for the plan menu.

Managed accounts: Custom asset allocation at the participant level

BENEFITS	✓ Yes × No	TARGET DATE FUNDS	MANAGED ACCOUNTS
No participant input required		✓	✓
Provides widely diversified portfolios		✓	✓
Considers biggest risk factor: age		✓	✓
Reasonable cost		✓	✓
Meets QDIA requirements		✓	✓
Customized asset allocation based on participant data		×	✓
Adapts to a participant's actual market experience		×	✓
Targeted plan sponsor reporting		×	✓
Participant access to advice tool		×	✓

Managed accounts: Considerations for selecting provider

1 **THE INVESTMENT METHODOLOGY IS SOUND**

2 **THE METHODOLOGY MATCHES THE PLAN PHILOSOPHY**
Examples of different philosophies are: Target retirement income and variety of different mean/variance portfolios at different risk level.

3 **IT WAS BUILT AS A QDIA, NOT OPT-IN (IF SELECTING AS QDIA)**
If built as opt-in, it is less effective as a QDIA because methodology assumes participant input.

4 **THE PROVIDER IS WILLING TO TAKE FIDUCIARY RESPONSIBILITY FOR THE ASSET ALLOCATION**

5 **THE PROVIDER ALLOWS FULL OPEN ARCHITECTURE**
In order to leverage plan menu and active/passive preferences, must be full open architecture not only within passive.

6 **THERE IS A HIGH DEGREE OF CUSTOMIZATION**
There are varying levels of customization, with some providers offering only a few risk-based portfolios.

7 **THE INTERACTIVE TOOLS ARE ROBUST AND INTUITIVE**
Interactive tools help participants make better decisions and align to replacement income objectives.

8 **THE REPORTING AND COMMUNICATIONS ARE COMPREHENSIVE**
Reporting and communications can help you understand your participant base better. It can help with targeted campaigns to assist participants who are behind.

Managed accounts: Implementation considerations

There are three ways to implement managed accounts:

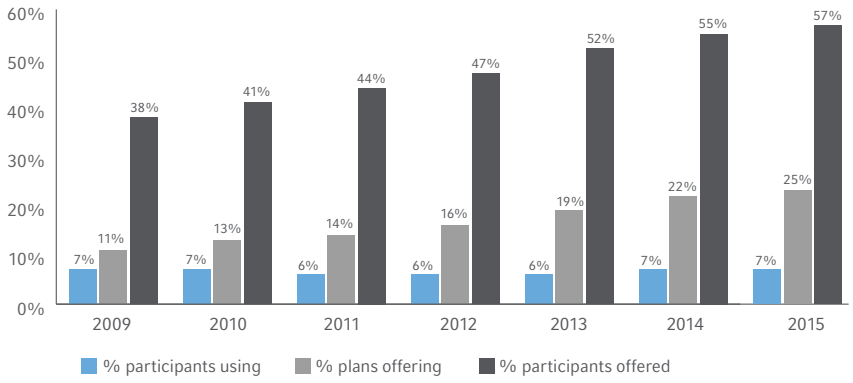
1. Allow participants to opt in to the managed accounts service
2. Re-enroll into managed accounts as default
3. Default participants without re-enrollment.

BENEFIT	OPT-IN — NOT QDIA	QDIA WITH RE-ENROLLMENT	QDIA WITHOUT RE-ENROLLMENT
Consistency of asset allocation offerings	Only if QDIA is same provider	✓	✓
Consistency of underlying investments	Unlikely unless custom QDIA	✓	✓
Clean transition	N/A – no transition	✓	May be difficult
Pricing advantage from scale	✕	✓	✕
No participant input or effort	✕	✓	✓
High adoption	✕	✓	Over time
Fees	Higher	Lower	Higher

✓ Yes
✕ No

Undergoing a re-enrollment into managed accounts and using the managed accounts as a default is the most appropriate, cleanest and most beneficial way to implement.

Managed accounts offerings in DC plans

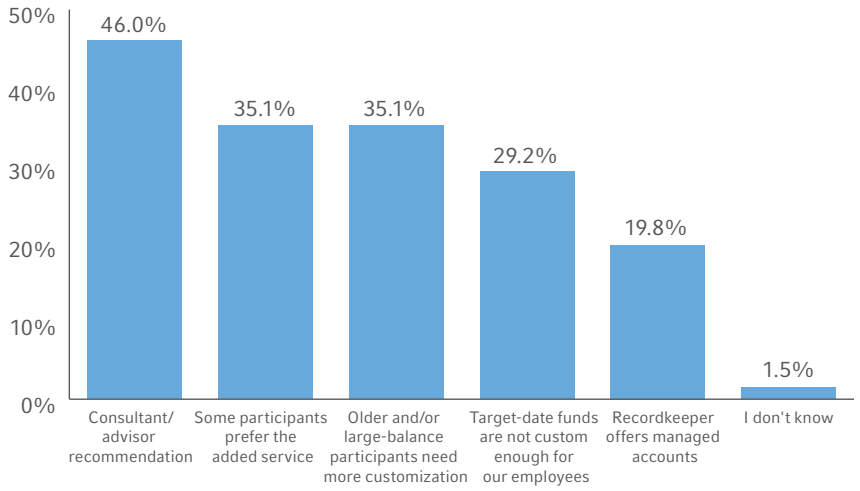


Source: Vanguard: How America Saves 2016.

Managed accounts are offered by 25% of plans, which covers 57% of participants. However, utilization is still low--only 7% of participants are using them and just 4.5% of plans use them as a QDIA[12].

[12] How America Saves 2016: A report on Vanguard 2015 defined contribution plan data, Vanguard. Available online at vanguard.com.

Plan sponsors' reasons for offering managed accounts



As you think about your QDIA, consider if customization at the individual level is best for your plan. Also consider if older participants need more guidance and customization.

Source: Cerulli Retirement Markets 2015.

TIER 2: ASSET CLASS MENU

Tier 2 participants are different because...

- They want to monitor their asset allocation
- They want a predesigned menu to build a portfolio
- They want manager oversight, support and advice

These present unique challenges to menu construction.

Every plan will be different, but we have found that participants appreciate a well-constructed core menu that represents a diversity of risk and potential return choices, while keeping the investment options easy to understand. We recommend that plan sponsors streamline their investment menus, but then think about multi-manager solutions as well, where high-caliber specialists can work alongside each other to obtain optimal exposures. Consider using passive management sleeves to adjust the fee and tracking error of these funds according to your plan's preferences.

Designing your Tier 2 or core plan menu

We recommend a three-pronged approach to the Tier 2 investment menu.

20%–30% OF PARTICIPANTS SELF-IDENTIFY AS "DO IT WITH ME" INVESTORS

1 Streamline the menu

- Narrow choices to 6–10 core options
- Include distinct options that span the risk/return spectrum
- Use broad, multi-style core mandates
  - Lump U.S. equity together
- Bundle for diversification
  - Ex: Put real assets such as commodities, real estate and infrastructure into one offering

2 Implement multi-manager portfolios

- Construct options with managers who specialize in different styles
- Eliminate single manager risk
- Outsource the multi-manager selection process, if inclined
- Blend passive and active management where appropriate

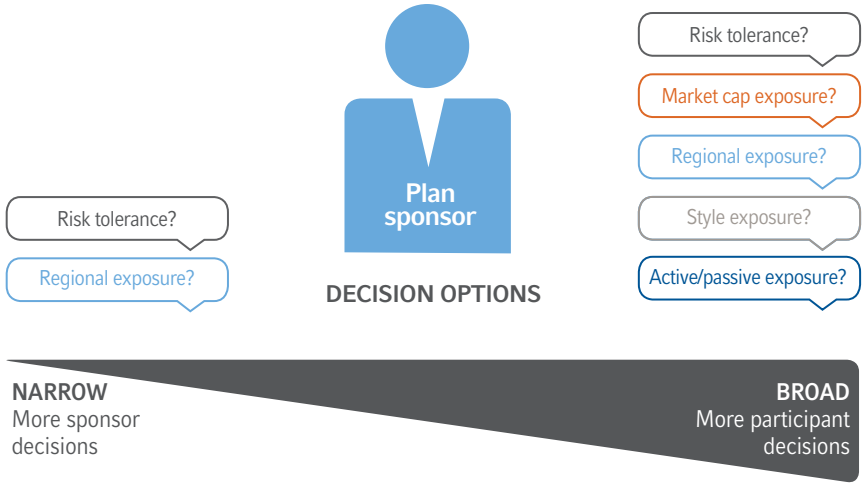
3 White label the options

- Give investments descriptive names that help participants use them appropriately
  - I.e., asset class name
- Allows for easier manager changes
  - Often reduces the amount of communication and administration that comes with change

See *Core: What is it good for?* and *Q&A: Redesigning your plan's core menu.*

What level of decision-making is right for your participants?

As a plan sponsor, you can decide what decisions to leave to your participants as you build your Tier 2 or core menu.



FOR EXAMPLE

- If you want to leave participants with very limited decision-making, you could structure the menu around risk tolerance and offer only two funds: a "growth" fund and a "capital preservation" fund.
- Or you could go in the opposite direction and offer a full array of options for styles, exposures, market caps and risk tolerances.
- Or find a balance somewhere in between.

Your menu can be complex...

COMPLEX MENU

- LARGE CAP GROWTH
- LARGE CAP CORE
- LARGE CAP VALUE
- MID CAP GROWTH
- MID CAP CORE
- MID CAP VALUE
- SMALL CAP GROWTH
- SMALL CAP CORE
- SMALL CAP VALUE
- NON-U.S. EQUITY
- EMERGING MARKETS
- INFRASTRUCTURE
- COMMODITIES
- REAL ESTATE
- TIPS
- CORPORATE BONDS
- TREASURIES
- STABLE VALUE OR MONEY MARKET

...or simplified

SIMPLIFIED MENU

- U.S. LARGE CAP EQUITY
- U.S. SMALL/MID CAP EQUITY
- ALL COUNTRY INTERNATIONAL EQUITY
- REAL ASSETS
- FIXED INCOME
- STABLE VALUE OR MONEY MARKET

It is important to understand your participants and to build a menu that best aligns with their needs.

Communicate simplified investment strategies

WHAT'S INSIDE

- U.S. MID CAP VALUE
- U.S. MID CAP GROWTH
- U.S. SMALL/MID CAP CORE
- U.S. SMALL CAP VALUE
- U.S. SMALL CAP GROWTH

WHAT THE PARTICIPANT SEES

- U.S. SMALL/MID CAP EQUITY

Offering multi-asset, multi-manager options facilitates participant communications, and most plan participants appreciate having complex decisions — such as how to combine managers, styles and active/passive options — made for them. It makes it easier for them to construct and manage their portfolios.

Easy-to-understand names help dispel confusion

MENU OF BRAND-NAME FUNDS

- FAMOUS FUND A
- FAMOUS FUND B
- FAMOUS FUND C
- FAMOUS FUND D
- FAMOUS FUND E
- FAMOUS FUND F

LOGICAL NAMES ADD CLARITY

- U.S. LARGE CAP EQUITY
- U.S. SMALL/MID CAP EQUITY
- ALL COUNTRY INTERNATIONAL EQUITY
- REAL ASSETS
- FIXED INCOME
- STABLE VALUE OR MONEY MARKET

Historically, many DC plans have offered single manager options in the core menu and used the brand name of the fund. These fund names do not always give participants clarity on how to use the funds in their portfolios. Fund names that clearly describe the asset class(es) they hold can help your participants construct better portfolios.

What is a "stable value" fund?

- A portfolio of fixed income securities that are "wrapped" or guaranteed by an insurance company or a group of insurance companies to pay participants a $1 net asset value
- A portfolio of bond investments with a short-term time horizon and high liquidity
- The return from a stable value fund is a function of:
  1. The yield on the underlying portfolio and
  2. The crediting rate — an accounting mechanism that allows portfolio gains and losses to be amortized over time

There's no one right answer to offering a capital preservation option, but it is important to understand the trade-offs and risks for whichever option you choose.

STABLE VALUE VS. MONEY MARKET FUNDS

STABLE VALUE	MONEY MARKET
Seeks capital protection	Capital preservation
Smoothed returns/wraps designed to provide lower volatility	Relatively lower risk, albeit with yield uncertainty
Higher gross expected yields vs. money market funds due to ability to invest in longer-term securities	Lower expected long-term return
Crediting rate lags in rising and falling rate environments	Market-responsive
Higher, increasing costs	Lower fees
Increasing scrutiny/regulation	Strict regulation
Complicated structure and oversight	Simple option
Less liquid/stable value providers can impact decisions	Liquid

Other options include:

- Short-duration bond funds
- Targeted income funds
- Age-appropriate asset allocation solutions

Trade-off between types of money market funds

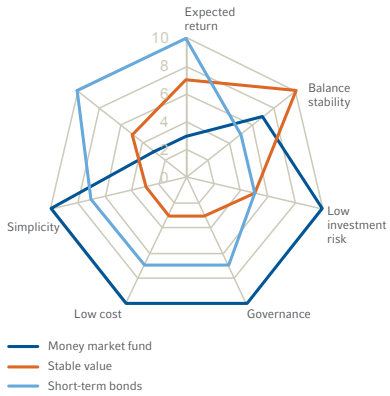
The new Money Market Reform regulations, effective in October 2016, changed the way money market funds operate. Plan sponsors must weigh the trade-offs between higher yield and the floating NAV, plus restrictions on redemptions.

ASSET CLASS/ OBJECTIVE	TREASURY-ONLY	GOVERNMENT	PRIME (INSTITUTIONAL)	PRIME (RETAIL)
Principal protection	Highest	Middle	Lowest	Lowest
Yield	Lowest	Middle	Highest	Highest
Steady $1 NAV	Yes	Yes	No	Yes
Redemption gates/ liquidity fees	No	No	Yes	Yes

Source: Russell Investments.

Considerations for choosing a capital preservation option

Stable value fund returns have historically been higher than returns on money market funds. Money market funds are shorter in duration, meaning they capture less of a term premium. Stable value, because of the crediting rate mechanism, has been able to smooth returns over time. By comparison, short-duration bonds have shown higher returns than both money market and stable value due to having more credit exposure, slightly longer duration, and fees that don't include wrap fees.



	MONEY MARKET FUND	STABLE VALUE	SHORT-TERM BONDS
Expected return	3	7	10
Balance stability	7	10	5
Potentially lower investment risk	10	5	5
Governance ease	10	3	7
Lower cost	10	3	7
Simplicity	10	3	7
Control	3	5	10

Source: Russell Investments. Data as of 12/31/2016. The scale is 1 = lowest, 10 = highest.

Past performance is no guarantee of future results. All investments carry some level of risk, including the potential loss of principal invested. They do not typically grow at an even rate of return and may experience negative growth. As with any type of portfolio structuring, attempting to reduce risk and increase return could, at certain times, unintentionally reduce returns.

Keep in mind that the graph above depicts a period of generally declining interest rates. During a period of rising interest rates, money market yields will react more quickly than some alternatives. Plan sponsors should consider these potential trade-offs when evaluating capital preservation alternatives.

See *Guidelines for investing in stable value post-2008.*

TIER 3: BROKERAGE WINDOW

Self-directed broker accounts (SDBAs)

Also known as the brokerage window.

Benefits

- Allow employees to customize their portfolios
- Allow plan sponsor to simplify and institutionalize the core fund lineup
- May increase participation rates

Costs

- Fiduciary oversight
- Administrative costs — both plan sponsor and participant
- Outcomes — increased chance of participants' making investment "errors"

Other considerations

- What limits should the committee put on what is offered through the brokerage window?
- Are the fees for participating in the brokerage window reasonable?

Things to keep in mind when you offer company stock as an option

Legal considerations for company stock:

- ✓ ERISA demands exclusive loyalty to plan participants. Relatively lower risk, albeit with yield uncertainty
- ✓ Potential conflicts involving plan participants.
  - Voting on behalf of company stock held by retirement plan
  - Management's desire to conserve cash vs. participant diversification
  - Federal "insider trading" laws vs. duty to disclose to participants
- ✓ PPA includes provisions to permit selling of company stock.
- ✓ Company stock is an undiversified investment. Regulations require that participants are able to diversify into other investments.
- ✓ The committee has a duty to monitor company stock like any other investment option, and to take action if necessary.

See *Revisiting company stock in defined contribution plans*.

What's this I hear about "stock-drop" lawsuits?

What's the risk?

- ✓ More than 200 cases have been brought, resulting in excess of $2 billion in settlements.[13]
- ✓ Typical claims against plan fiduciary:
  - Fiduciary maintained stock fund after it was prudent to do so
  - Fiduciary failed to provide full and accurate information to participants
  - Fiduciary violated duty of exclusive loyalty to participants
- ✓ Governance: clearly define fiduciary roles and responsibilities to avoid protracted litigation.

See *Revisiting company stock in defined contribution plans.*

[13] As of 2010. Source: Ross, N. and P. Kolluri (2011), *An Introduction to ERISA Lawsuits Over 401(k) Plan Company Stock Funds.* McDermott Will & Emery by CNA Financial Corporation. Available at: https://www.cnapro.com/pdf/ERISALawsuitsover401kPlanCompanyStockFunds.pdf.

Company stock best practices

Some actions fiduciaries are taking:

- Hiring outside fiduciaries to provide services.
- Removing "insiders" from the investment committee.
- Rewriting plan documents to better address the role of company stock in plans.
- Increasing plan participant education and communication; adding third-party advice providers to help participants diversify.
- Consider matching in cash vs. stock when feasible.

! *If you have not removed company stock from the menu, there are several levers for mitigating fiduciary risk available to you (see above).*

OTHER PLAN MENU CONSIDERATIONS

Decide whether your plan should offer active, passive or a mix of both

Passive is not the safe fiduciary option.

ERISA's "standard of care" emphasizes…

- …the need to make careful, informed decisions…
- …in the best interests of participants…
- …while keeping expenses reasonable.

Implication: Do not automatically dismiss attractive active management opportunities.

See *Passive management and the false premise of fiduciary relief.*

Active/passive: How to find the right mix

For each asset class, ask yourself:

"What is my objective?"

"What are the active management opportunities in this asset class?"

"What is my fee budget?"

INVESTMENT CONSIDERATIONS

- Readily replicable index unavailable?
- Passive index inconsistent with objectives?
- Passive index inefficiently constructed?
- Investment environment favors active?
- Skilled managers can be identified?

PLAN-SPECIFIC FACTORS

- Scale (affects access and fees)
- Fee budgets
- Benchmark sensitivity
- Core menu design

Going passive is an active decision

Defined contribution fiduciary responsibility and oversight are not eliminated when selecting passive funds in a DC plan's investment options.

There has been an increase in interest among defined contribution (DC) plan sponsors for passive investment options that seems to be, in part, based on the false premise that fiduciary oversight requirements are nearly eliminated. Plan sponsor fiduciary responsibility may not be reduced to the extent plan sponsors believe when selecting passive funds to include in their DC lineup.

THE FOLLOWING OBLIGATIONS STILL EXIST WHEN SELECTING AND MONITORING PASSIVELY MANAGED INVESTMENT VEHICLES:

GENERAL OBLIGATIONS

- Review the index provider's organization
- Review the index provider's methodology
- Review the passive fund manager's implementation capability
- Review the manager's ability to replicate the index and the costs to do so
- Review the fees charged by the passive fund provider
- Determine whether active management opportunities may be more prudent
- Review the glide path[14]
- Review the asset allocation[14]

[14] Additional considerations for target date funds.
See *Passive management and the false premise of fiduciary relief.*

Best practices in participant communication

In our experience with thousands of DC plan participants, we have found that:

- **Direct, focused content that reflects an employer's culture is typically most effective.**[15] Concise, easy-to-understand messaging is more likely to filter through all the "noise" typical participants encounter daily.
- **Relevant, personalized plan communications with easy-to-implement tactics (i.e., opt in/out) are more likely to produce better results**. These include increased enrollments, higher savings rates and better investing habits.[16]
- **Repetition is key:** Effective campaigns include multiple touchpoints that emphasize and reinforce the message.[16]
- **Group meetings where participants can ask questions and interact with plan experts are more impactful**. Such forums engage participants and increase their understanding of plan offerings.[17]
- **What's more, sponsor collaboration generally leads to better campaign outcomes.** Targeted emails from plan sponsors may foster better understanding of how plan benefits can help participants reach their retirement goals.[18]

[15] *PlanSponsor magazine PSNC 2016: Best Practices in Participant Communication. June 2016.*
[16] Society of Actuaries, *"The Next Evolution in Defined Contribution Retirement Plan Design: A Guide for DC Plan Sponsors to Implement Retirement Income Programs". September 2013.*
[17] PlanSponsor magazine, *"PSNC 2016: Best Practices in Participant Communication". June 2016.*
[18] FiduciaryFirst blog, *"Your Employees & Retirement: Best Practices in Employee Communication". September 2016.*

Traditional pre-tax 401(k) or Roth 401(k)

Participants may contribute up to $18,000 in 2017.[19]

IRS allows associates who are age 50 or older by year end to contribute an additional $6,000[19] (above the $18,000 limit) on a pre-tax and/or Roth 401(k) basis.

PRE-TAX 401(K)

- Contributions deducted on a pre-tax basis
- Taxes deferred until withdrawal after age 59½
- Principal and earnings taxed as ordinary income at withdrawal
- Withdrawals prior to age 59½ result in 10% tax penalty

ROTH 401(K)

- Contributions deducted on a post-tax basis
- Principal and earnings tax-free at withdrawal after age 59½
- Earnings withdrawn prior to age 59½ result in 10% IRS tax penalty

Did you know? You can withdraw Roth IRA contributions at any time without penalty.

[19] Contribution limits available at www.irs.gov.

To Roth or not to Roth

	ASSOCIATE A	ASSOCIATE B	ASSOCIATE C
	PRE-TAX 401(k)	ROTH 401(k)	NONE
SAVINGS PLAN			
Salary	$50,000	$50,000	$50,000
- Pre-tax contribution	-$5,000	-$0	-$0
= Taxable income	$45,000	$50,000	$50,000
- Federal income tax[20]	-$7,028	-$8,278	-$8,278
- After-tax contribution	-$0	-$5,000	-$0
= After-tax income	$37,972	$36,722	$41,722
RETIREMENT SAVINGS			
Participant contribution	$5,000	$5,000	$0
+ Employer match	+$2,500	+$2,500	+$0
= Total	$7,500	$7,500	$0

In the example above, Associate A is invested in a pre-tax, or traditional, 401(k); Associate B is in a Roth option; Associate C has no option of tax deferral or exemption. If tax rates don't change, there is no impact on earnings, but after-tax income is lower for Associate B. The benefit to the Roth option, however, is that earnings grow federally tax-free, whereas Associate A's earnings are taxed upon withdrawal, presumably at a higher rate. Plans should consider whether offering a Roth option helps their participants save for retirement more effectively than not offering one.

[20] 2016 Federal Tax Table for a single individual.

Example is shown for illustrative purposes only. Actual federal income tax results will vary depending on income and filing status. State and local taxes may apply as well.

SECTION III — THE NEXT FRONTIER

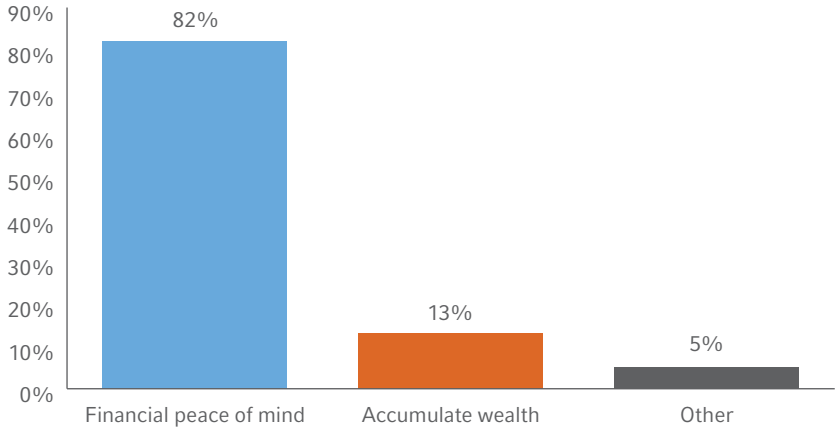
RETIREMENT INCOME

LEAKAGE

RETIREMENT INCOME

Participants want financial security

WHAT IS YOUR TOP FINANCIAL GOAL IN RETIREMENT?



Financial peace of mind is six times more important than accumulating wealth.

80% of employed people age 55 and older want education and advice on saving and investing for retirement at their workplace.

Source: SunAmerica (2011). Retirement Re-set Study.

How to think about income solutions

IN-PLAN

- Retain assets, retirees and beneficiaries post-retirement
- Due diligence in selection and ongoing monitoring of product provider
- Plan's rules on Qualified Domestic Relations Orders (QDROs) may need to change
- Potential operational issues with mergers & acquisitions/ plan termination

OUT OF PLAN

- Participants' responsibility to select appropriate product
- Reduces plan design changes
- Eliminates/reduces operational expenses and complexity

Motivations and objectives of "early adopters" of in-plan lifetime income

Why add in-plan lifetime income?

1. Replace the closed or frozen defined benefit (DB) plan.
   - Continue to offer employees a retirement income benefit
   - Transfer the financial burden to a third party
2. Communicate a new benefit to attract and retain talent.
   - Downside lifetime income protection pre-retirement
   - Flexibility of income options, including spousal benefit
   - Reward loyalty
3. Retain participant assets in the plan post-retirement.
   - Lower institutional fees
   - Greater flexibility in underlying asset classes

Regulatory support for in-plan guarantees is increasing

OCT. 2008 **SAFE HARBOR FOR SELECTING AN ANNUITY PROVIDER:** DOL issued regulations that provide a safe harbor for fiduciaries selecting an annuity provider for benefit distributions from an ERISA plan.

FEB. 2010 **EDUCATION ON LIFETIME INCOME:** DOL and Treasury jointly issued an RFI on the barriers to offering lifetime income options in DC plans and on how to educate participants about considering a lifetime income option.

FEB. 2012 **ANNUITIES GUIDANCE:** Treasury provided guidance on annuities within DC plans to help participants obtain longevity protection.

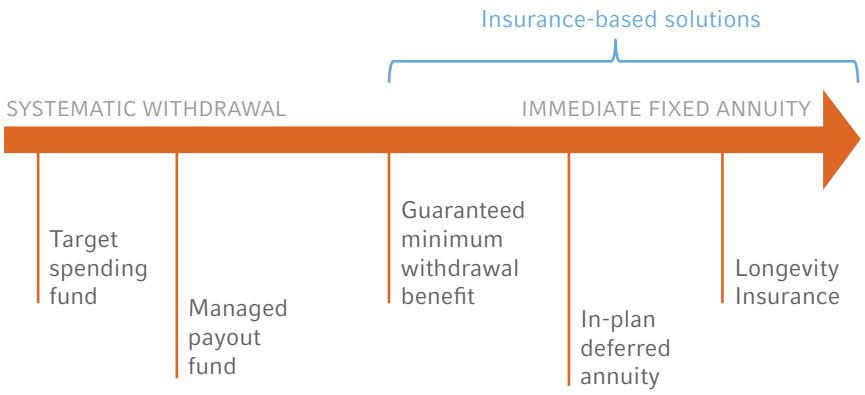
OCT. 2014 **TREASURY ISSUES NOTICE TO CLARIFY CERTAIN ISSUES RELATED TO QLACS:** Inclusion of annuities in target date fund series does not violate non-discrimination requirements.

OCT. 2014 **DOL ISSUES GUIDANCE AROUND TDFS AND ANNUITIES:** TDFs may include annuities and still be considered QDIA.

AUG. 2016 **THE U.S. GOVERNMENT ACCOUNTABILITY OFFICE (GAO) RELEASES REPORT: DOL COULD TAKE STEPS TO IMPROVE RETIREMENT INCOME OPTIONS FOR PLAN SPONSORS:** GAO makes seven recommendations to the DOL on how to increase adoption of lifetime income options in 401(k) plans.

SEPT. 2016 **THE RETIREMENT ENHANCEMENT AND SAVINGS ACT OF 2016 PASSED:** Includes provision for fixing DC annuity fiduciary safe harbor.

What is available today and how do you choose?



- High control of assets
- No guarantee of income

VERSUS

- Low/no control of assets
- Guarantee of income by insurance company

This is just a sampling of the types of solutions that now exist in the marketplace.

Source: Russell Investments. For illustrative purposes only.

Create an evaluation framework

BENEFITS	GUARANTEED LIFETIME INCOME	RETIREMENT LIQUIDITY/ BEQUESTS	COSTS	PROVIDERS HIGHER CUMULATIVE RETIREMENT INCOME IN
Lump sum withdrawal	✕	✓	Low — consider taxes	Good markets if invested
Systematic withdrawal	✕	✓	Low	Good markets
Pay down strategy	✕	✓	Varies — typically low	Good markets
COLA annuity	✓	✕	High	Average and poor markets
Guaranteed lifetime withdrawal benefit (GLWB)	✓	✓	High	Good markets
Longevity insurance	✓	Partial liquidity	Low	Average and poor markets

✓ Yes
✕ No

If you are considering adding annuities to your plan, consider the nuances of each product offering, the insurers, and the restrictions they might place on plan investments or participant balances.

Guaranteed Lifetime Income subject to claims' paying ability of the insurer.
Source: Russell Investments. For illustrative purposes only.

LEAKAGE

What is plan "leakage"?

Leakage from retirement plans is defined as any type of pre-retirement withdrawal that permanently removes money from retirement accounts. Such withdrawals typically occur in four ways:

1. Financial hardship withdrawals
2. Withdrawals after age 59 ½
3. Cash-outs
4. Loans

Should I be concerned about "leakage" from my company's retirement plan?

Each organization tends to have its own philosophy about the importance of stemming plan leakage and retaining participants in an employer-sponsored plan after termination.

It may be helpful to have a discussion about plan leakage with your committee. Here are some questions to get you started:

- ✓ Does our organization want to keep participants in our plan after termination of employment?
- ✓ If yes, do we have programs/plan design features in place to encourage retention of assets?
- ✓ Does our plan document discourage retention of plan assets post-termination (i.e., forced cash-outs, not allowing partial withdrawals)?
- ✓ How may our loan features be contributing to plan leakage?
- ✓ Are we educating our employees about their options for their retirement plan balance after termination?
- ✓ Are there ways we could simplify the roll-in process for employees?

! *Leakage is generally a concern because it disproportionately affects lower balance workers who are least prepared for retirement and seemingly small leakages of 1.5%[21] are estimated to reduce a worker's wealth at retirement by 25%.[22]*

[21] DCIIA. "Plan leakage: A study on the psychology behind leakage of retirement plan assets". February 2016.
[22] Center for Retirement Research at Boston College. "The Impact of Leakages on 401(k)/IRA Assets". February 2015.

Closing thoughts

While reading this guide, you may have thought, "Wow, I have a lot to look after!" And you will have been right. Plan sponsors striving to offer a "best-in-class" plan know what success looks like, and they have a path for getting there.

The nature of the 401(k) system is voluntary, which means many factors can influence the retirement outcome. A lot depends on participants' taking the right actions at the right times. However, that doesn't mean plan sponsors can't act as useful guides, and occasionally "nudge" folks in the right direction.

We push our clients to develop excellent plans. "Excellence" goes beyond just picking investments and meeting with managers quarterly. It means following a disciplined process, creating frameworks for understanding, and ultimately prioritizing the workload. Oftentimes that might mean giving up control of certain functions you enjoy doing, such as selecting and interviewing managers, to a qualified third party, or hiring an additional staff person to take care of service provider communications.

When it comes to investments, be sure that the investment committee and your plan participants have the right tools to make effective decisions. Don't confuse investment performance with participant success, and remain skeptical, even when a service or an investment solution has worked well in the past.

And finally, keep an open mind and look to the future. At times, changes to the plan in isolation might seem to have marginal impact. However, if you take many small steps in the right direction, the extra care and diligence can help improve your participants' lives in retirement.

Kevin Knowles | Mark Teborek | Holly Verdeyen

Further reading

The titles below, representing Russell Investments research on DC issues, are available at Russellinvestments.com/dcresearch.

Murray, S., (2016, November). *"Adaptive investing – better data makes better solutions."* Russell Investments.

Knowles, K., Teborek, M., (2016, March). *"8 observations on custom target date funds."* Russell Investments.

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Cohen, J., (2015, May). *"DC retirement income solutions."* Russell Investments.

Greves, J., Cohen, J., Knowles, K., (2015, February). *"Russell Investments' beliefs in building institutional quality target date solutions."* Russell Investments.

Further reading (continued)

Barry, M., (2014, December). *"The outsourcing contract."* Russell Investments.

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Fan, Y., Greves, J., Murray, S., (2014, September). *"Review of Russell Investments' target date fund methodology."* Russell Investments.

Barry, M., (2014, July). *"What to outsource?."* Russell Investments.

Cohen, J., (2014, June). *"ARA: Aiming for the bull's-eye (Updated)."* Russell Investments.

Cohen, J., (2014, June). *"New research findings evolve our target date series methodology."* Russell Investments.

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Knowles, K., Greves, J., (2014, May). *"A fresh look at the five key findings that impact Russell's target date fund glide path design."* Russell Investments.

Cohen, J., (2013, June). *"Core: What is it good for?"* Russell Investments.

Cohen, J., (2012, November). *"Seven attributes of an excellent DC plan (Updated)."* Russell Investments.

Gardner, D., (2012, May). *"Active or passive management in defined contribution plans? It doesn't have to be either/or."* Russell Investments.

Teborek, M., Cohen, J., (2012, April). *"Real assets for the defined contribution menu."* Russell Investments.

Fan, Y., (2011, November). *"Russell Investments' adaptive investing methodology."* Russell Investments.

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