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Trends in Defined Contribution Plans: A View from Callan’s 2016 DC Trends Survey

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Key Functions of a DC Plan Fiduciary

In managing DC plan investments, fiduciaries should consider eight key areas:

1. Evaluating and Update the Investment Structure
2. Evaluating and Monitoring the Target Date Fund Glide path
3. Applying and Periodically Reviewing the Investment Policy Statement
4. Reviewing and Monitoring Investment Manager Performance
5. Monitoring and Benchmarking Plan Fees
6. Overseeing Required Employee Communications
7. Reviewing Overall Plan Utilization
8. Reviewing Defined Contribution Trends and Overall Plan Effectiveness
Callan conducted the DC Trends Survey online in September and October of 2015. The survey incorporates responses from 144 plan sponsors.

Most companies either offer no DB plan or the DB plan was frozen.

### What is the primary DC plan that you offer?

<table>
<thead>
<tr>
<th>Plan Type</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other</td>
<td>0.7%</td>
</tr>
<tr>
<td>Profit Sharing</td>
<td>2.1%</td>
</tr>
<tr>
<td>401(a)</td>
<td>6.9%</td>
</tr>
<tr>
<td>457</td>
<td>7.8%</td>
</tr>
<tr>
<td>403(b)</td>
<td>11.1%</td>
</tr>
<tr>
<td>401(k)</td>
<td>71.5%</td>
</tr>
</tbody>
</table>

### What is the size of the primary DC plan?

- >$1 billion: 43.0%
- $501 mm to $1 bn: 10.6%
- $201 to $500 mm: 18.3%
- $101 to $200 mm: 10.6%
- $51 to $100 mm: 7.0%
- $20 to $50 mm: 4.9%
- <$20 million: 5.6%
Fiduciary Positioning

Rank each of the following actions in terms of their importance in improving the fiduciary position of your DC plan within the past 12 months:

- Updated or reviewed investment policy statement: 12.8
- Reviewed plan fees: 12.3
- Changed investment menu: 12.1
- Conducted formal fiduciary training: 11.9
- Reviewed 404(c) compliance: 11.9
- Replaced fund manager(s): 11.5
Plan Influences

Rank which of the following events have most influenced the management of your organization’s DC plan

1. Department of Labor’s 2011–2012 fee disclosure requirements 5.1
2. 2006 Pension Protection Act 5.1
3. 2008–2009 market collapse 4.3
4. 2013 EBSA’s Tips for ERISA fiduciaries in monitoring and evaluating target date funds 4.2
5. 2006 Schlichler, Bogard, and Denton fee lawsuits 3.6
6. Supreme Court’s 2014 decision invalidating presumption of prudence as a stock-drop lawsuit defense 2.8
7. U.S. Treasury initiatives to facilitate use of lifetime income solutions in DC plans 2.6
Investment Menu
Evaluating and Updating the Investment Structure

Fewer than half of plan sponsors use a tiered investment structure (e.g., tier one: asset allocation, tier two: core options, and tier three: specialty options) within their fund lineup.

What best describes your plan’s investment menu approach?

- 68.4%: Mix of active and passive funds
- 18.8%: Active/Passive mirror
- 4.3%: All active funds
- 3.4%: All passive funds
- 5.1%: Don’t know
### Investment Vehicles

Evaluating and Updating the Investment Structure

#### Does your plan offer the following investment types within the fund lineup?*

<table>
<thead>
<tr>
<th>Investment Type</th>
<th>2015</th>
<th>2014</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mutual funds</td>
<td>82.3%</td>
<td>88.2%</td>
<td>85.2%</td>
</tr>
<tr>
<td>Collective trusts</td>
<td>70.8%</td>
<td>60.0%</td>
<td>51.9%</td>
</tr>
<tr>
<td>Separate accounts</td>
<td>40.7%</td>
<td>42.7%</td>
<td>50.6%</td>
</tr>
<tr>
<td>Brokerage</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
</tr>
</tbody>
</table>

*Multiple responses were allowed.
Investment Structure Changes
Evaluating and Updating the Investment Structure

How did/will the plan’s investment menu change?

- Increased # of funds: 2.6%, 4.3%
- Decreased # of funds: 13.2%, 6.5%
- # of funds remained the same: 84.2%, 89.1%

- Increased proportion of active funds: 15.0%, 4.3%
- Increased proportion of passive funds: 11.3%, 6.4%
- Mix of active and passive remained same: 73.8%, 89.4%
Evaluating and Monitoring the Qualified Default Investment Alternative (QDIA)

Fiduciaries are prudent in using the DOL’s “Target Date Retirement Funds: Tips for ERISA Plan Fiduciaries” as a guide. The Tips recommend:

- Establishing a process for comparing and selecting TDFs that considers how well the TDF’s characteristics align with eligible employees’ ages and likely retirement as well as other characteristics of the participant population.
- Establishing a process for the periodic review of selected TDFs a minimum examining whether there have been any significant changes.
- Understanding the fund’s investments—the allocation in different asset classes (stocks, bonds, cash), individual investments, and how these will change over time.
- Reviewing the fund’s fees and investment expenses.
- Inquiring about whether a custom or non-proprietary target date fund would be a better fit for your plan.
- Developing effective employee communications.
- Documenting the process.
Target Date Funds

Most DC plans offer a target date fund as their default investment for non-participant directed monies.

Source: Callan DC Index. Note that the 2015 data point is as of September 30, 2015.
TDF Glidepath Allocations Run the Gamut

Source: Callan TDVantage
Meeting the DOL’s Challenge and Balancing TDF Risks

Decision Variables: Evaluating the Efficacy of a Glide Path

Wealth Accumulation (Shortfall Risk)
- Expected long-term replacement ratio
- Probability of meeting replacement ratio target
- Exposure to growth assets

Downside Risk (Short-Term Volatility)
- Worst-case annual return (2 standard deviation event)
- Dollar-weighted risk
- Multi-year drawdown
- Roll-down rate
- Exposure to downside protection assets

Post-Retirement (Inflation Risk and Longevity Risk)
- Probability of outliving assets
- Asset-life expectancy
- Dollar-weighted risk
- Multi-year drawdown
- Breadth and level of inflation sensitive asset exposure
98% of DC plans have a **qualified default investment alternative** as the default investment fund.

If you offer either a target date or target risk fund, which approach do you use?

- **Other**: 9.0%
- **Don't know**: 0.9%
- **Custom target strategies**: 16.2%
- **Collective Trust that isn't recordkeeper's**: 26.1%
- **Mutual Fund that isn't recordkeeper's**: 23.4%
- **Mutual fund or collective trust of recordkeeper**: 21.6%
Target Date Fund Landscape
Evaluating and Monitoring the TDF Glidepath

What investment approach does your target date fund use?

- Mix of Index and Active Management: 23.0%
- Actively Managed: 34.5%
- Indexed: 42.5%

Changes to the Target Date Fund
Evaluating and Monitoring the TDF Glidepath

If action was/is expected to be taken with your target date fund, please describe*

67% took no action with respect to their target date fund

- Evaluate suitability of glide path: 67.7% in 2015, 75.7% in 2016
- Change share class of target date fund: 22.6% in 2015, 16.2% in 2016
- Replace target date fund/manager: 16.1% in 2015, 8.1% in 2016
- Move to a target date collective trust: 16.1% in 2015, 2.7% in 2016
- Eliminate target date fund: 6.5% in 2015, 2.7% in 2016
- Change communication approach to target date fund: 3.2% in 2015, 0.0% in 2016

*Multiple responses were allowed.
Company Stock

Monitoring Funds

Just under 40% of plans offer company stock.

This is down from nearly half of plans offering company stock in 2009.

How do you limit potential liability with respect to company stock?*

<table>
<thead>
<tr>
<th>Method</th>
<th>2015</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Communicate to improve diversification out of company stock</td>
<td>54.5%</td>
<td>73.3%</td>
</tr>
<tr>
<td>Regularly review company stock in investment committee meetings</td>
<td>27.3%</td>
<td>50.0%</td>
</tr>
<tr>
<td>Offer tools to improve diversification out of company stock</td>
<td>36.4%</td>
<td>46.7%</td>
</tr>
<tr>
<td>Cap contributions to company stock</td>
<td>30.0%</td>
<td>9.1%</td>
</tr>
<tr>
<td>Hard-wire company stock into the plan document (e.g., require that it is offered as an investment option)</td>
<td>30.0%</td>
<td>40.9%</td>
</tr>
<tr>
<td>Outsource oversight of company stock</td>
<td>23.3%</td>
<td>27.3%</td>
</tr>
<tr>
<td>No insiders are on the oversight committee</td>
<td>16.7%</td>
<td>9.1%</td>
</tr>
<tr>
<td>Provide clear guidelines for evaluation and monitoring in the investment policy statement</td>
<td>13.3%</td>
<td>9.1%</td>
</tr>
<tr>
<td>Company stock is frozen</td>
<td>6.7%</td>
<td>4.5%</td>
</tr>
</tbody>
</table>

*Multiple responses were allowed.
IPS Dos and Don’ts

Applying and Reviewing the IPS

**Do**

- Stay on point.
- Be clear.
- Develop specific criteria for evaluating results.
- Document decisions.
- Follow the IPS process.

**Don’t**

- Get too detailed.
- Overcommit.
- Focus on the short term.
- Set it and forget it.
Updating the Investment Policy Statement

Applying and Reviewing the IPS

When did you last review and/or update the investment policy statement?

90% of DC plans maintained an IPS in 2015.

More than 3 years ago 2.4%
Within the past 3 years 12.6%
63% Updated IPS in past 12 months
Within the past 12 months 84.3%
Don't know 0.8%
Fee Payment Policy

Applying and Reviewing the IPS

Do you have a written, plan-fee payment policy?

- **Yes, as part of the investment policy statement**: 26.3%
- **Yes, as a separate document**: 18.2%
- **No, but plan to in the next 12 months**: 42.3%
- **No**: 2.2%
- **Don't know**: 0.7%
- **Other**: 10.2%
Reviewing and Monitoring Investment Manager Performance

Tibble v Edison: Has the bar been raised?

Background: On May 18, 2015, the U.S. Supreme Court reversed the 9th Circuit Court of Appeals’ ruling that the 401(k) fee lawsuit of Tibble v Edison International was time-barred due—citing the need to monitor investments on an ongoing basis.

Details:

• At issue: is there a continuing violation for every day a fund remains in the plan if the initial decision to add the funds to the plan was in violation?
• Court found that fiduciaries not only have a duty to prudently select funds, but to prudently revisit fund selection on an ongoing basis.
• But. . . Life is too short to monitor funds at the same level as initial selection.
• Still. . . The Court provided no checklist for monitoring and didn’t come to a conclusion on how to monitor.
• The Supreme Court remanded the case back to the 9th Circuit to determine if a prudent review process had been in place.

Lawsuits have proliferated since then. . .
2015 in Review: 401(k) Fee Lawsuit Timeline

Countdown to a Tough Fee Environment

- **January**: Dennard v AEGON—Float Case against Fidelity Dismissed
- **February**: Abbott v Lockheed Martin—Settled for $62 m
- **March**: Overall v. Ascension Health
- **April**: Secretary of Labor v City National
- **May**: Supreme court reverses 9th Circuit Court decision On Tibble v Edison
- **June**: Spano v Boeing—Settled for $57 m
- **July**: Sulyama v Putnam
- **August**: Brotherson et al v Prudential
- **September**: Mary Bell et al v Anthem
- **October**: Wood et al v Prudential
- **November**: Ellis et al v Fidelity
- **December**: Urakchin et al v Allianz

**Key Events**
- Filed
- Settled
- Lost
- Dismissed
- In Appeals

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Callan
Knowledge. Experience. Integrity.

2016 DC Trends
Manager Selection Criteria

Monitoring Managers

What are your key attributes in the evaluation and selection of investment funds?

<table>
<thead>
<tr>
<th>Attribute</th>
<th>Weighted Average Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment Performance</td>
<td>9.6</td>
</tr>
<tr>
<td>Fills style or strategy gap</td>
<td>9.3</td>
</tr>
<tr>
<td>Cost and fees</td>
<td>8.9</td>
</tr>
<tr>
<td>Investment management team stability</td>
<td>8.7</td>
</tr>
<tr>
<td>Style consistency</td>
<td>7.9</td>
</tr>
<tr>
<td>Quality of service to plan sponsors</td>
<td>5.7</td>
</tr>
<tr>
<td>Leverage existing pension fund managers</td>
<td>4.9</td>
</tr>
<tr>
<td>Participant communication and educational support</td>
<td>4.4</td>
</tr>
<tr>
<td>Ease of integration with recordkeeping system</td>
<td>4.3</td>
</tr>
<tr>
<td>Brand name/market image</td>
<td>3.7</td>
</tr>
<tr>
<td>Participation request</td>
<td>2.5</td>
</tr>
</tbody>
</table>

Weighted Average Score (11=Most important)
Monitoring and Benchmarking Plan Fees

Investment Management Fees

● Certain funds/asset classes are more “commodity like” (e.g., S&P 500 Index fund), and a reasonable fee can be more clearly identified.

● For other investments, it may be more feasible to establish a reasonable range of fees and to note that other criteria—like performance—are relevant in fund evaluation.

● If a fund offers a lower-fee share class than the one used, it is important to document why the plan does not take advantage of it (e.g., insufficient assets).

Administration Fees

● It is important that plan sponsors understand:
  – What fees are being paid
  – What services are covered
  – Whether fees paid are reasonable given service levels
  – Who pays for plan administration
  – How it is paid (revenue sharing, out of pocket asset based, dollar fee)

Under ERISA, sponsors must ensure that plan fees are reasonable and avoid conflicts of interest. Further, with the issuance of ERISA section 408(b)(2) regulations in 2012, the Department of Labor raised the bar for plan sponsors by requiring them to obtain certain fee information from service providers.
Fee Calculation and Benchmarking

Monitoring and Benchmarking Plan Fees

When was the last time you calculated fees for your DC plan?

- 85.5% - More than 36 months ago
- 4.5% - Past 12 months
- 3.6% - Past 24 months
- 1.8% - Past 36 months
- 4.5% - Never
- 6.7% - Don’t know

In calculating fees, did you benchmark the level of fees?

- 76.0% - Yes
- 17.3% - No
- 6.7% - Don’t know
Fee Benchmarking Outcomes

Monitoring and Benchmarking Plan Fees

What was the outcome of your fee calculation and/or benchmarking?*

- Kept fee levels the same: 2015 - 43.9%, 2014 - 49.5%
- Reduced plan fees: 2015 - 32.7%, 2014 - 36.1%
- Changed the way fees are paid*: 2015 - 21.4%, 2014 - 17.5%
- Initiated a recordkeeper search: 2015 - 9.2%, 2014 - 4.1%
- Rebated excess revenue sharing back to participants: 2015 - 8.2%, 2014 - 7.2%

*Multiple responses were allowed.
Fee Payment

Monitoring and Benchmarking Plan Fees

How are the plan’s administrative fees paid?

- 52.3%: at least partially paid by participant
- 26.6%
- 20.2%
- 0.9%

How do participants pay?

- 5.9%: Other/Don’t know
- 29.4%
- 22.4%
- 22.4%
- 20.0%

- Solely as a percentage fee that is assessed across some or all funds outside of the investment management fees
- Solely through an explicit per participant dollar fee
- Through a combination of revenue sharing and an explicit per-participant charge
- Solely through revenue sharing or some kind of administrative allocation back from the investment fund
# Changes to Fee Approaches

## Monitoring and Benchmarking Plan Fees

**What steps around fees are you most likely to engage in next year (2016)?**

<table>
<thead>
<tr>
<th>Action</th>
<th>Very likely</th>
<th>Somewhat likely</th>
<th>Somewhat unlikely</th>
<th>Very unlikely</th>
</tr>
</thead>
<tbody>
<tr>
<td>Conduct a fee study</td>
<td>32.0%</td>
<td>20.0%</td>
<td>25.3%</td>
<td>22.7%</td>
</tr>
<tr>
<td>Rebate participant fees/revenue sharing</td>
<td>29.4%</td>
<td>23.5%</td>
<td>10.3%</td>
<td>36.8%</td>
</tr>
<tr>
<td>Renegotiate recordkeeper fees</td>
<td>23.1%</td>
<td>10.3%</td>
<td>25.6%</td>
<td>41.0%</td>
</tr>
<tr>
<td>Switch certain funds to lower-fee share classes</td>
<td>20.8%</td>
<td>40.3%</td>
<td>12.5%</td>
<td>26.4%</td>
</tr>
<tr>
<td>Reduce or eliminate the use of revenue sharing to pay for plan expenses</td>
<td>18.5%</td>
<td>15.4%</td>
<td>10.8%</td>
<td>55.4%</td>
</tr>
<tr>
<td>Change the way fees are paid</td>
<td>12.7%</td>
<td>12.7%</td>
<td>23.9%</td>
<td>50.7%</td>
</tr>
<tr>
<td>Conduct a recordkeeper search</td>
<td>12.0%</td>
<td>8.0%</td>
<td>10.7%</td>
<td>69.3%</td>
</tr>
</tbody>
</table>
Automatic Enrollment

Plan Utilization

Does your DC plan offer automatic enrollment?

- 2015: 61.0%
- 2014: 61.7%
- 2013: 58.3%
- 2012: 52.1%
- 2011: 47.6%
- 2010: 51.3%

17.7% who automatically enroll also include existing employees. The rest only automatically enroll new hires.

What is/will be the automatic enrollment default contribution rate for your plan?

- 2015: Average 4.0%, Median 3.0%
- In 2016: Average 4.2%, Median 4.0%
Automatic Contribution Escalation

Plan Utilization

46% of plans have automatic contribution escalation.

Four-fifths of plans that have automatic enrollment also offer automatic contribution escalation.
Structure of Auto Features

Plan Utilization

What is the cap on contributions under automatic escalation?

- **Average**: 19.2%
- **Median**: 10.0%

For automatic escalation, why did you select the cap that you did?*

- Maximize likelihood participants will reach retirement income goals: 40.6%
- Likely to be most palatable to participants/limit opt outs: 37.5%
- Prevalent within industry/plan type: 18.8%
- Recommended by third party: 18.8%
- Other: 15.6%
- Adhere to safe-harbor: 12.5%

*Multiple responses were allowed.
Re-Enrollment into the Qualified Default Investment Alternative

Plan Utilization

Have you ever engaged in an asset re-enrollment of the plan?

- Don't know: 1.8%
- No, but plan to in next 12 months: 73.5%
- No, and not planning to: 4.4%
- Yes: 20.4%

What is the motivation for the re-enrollment?*

- Changes to the fund lineup: 70.4%
- New recordkeeper: 29.6%
- Poor existing investment elections by participants: 22.2%
- Plan merger or other significant event necessitates it: 18.5%
- Other: 3.7%

*Multiple responses were allowed.
Overseeing Required Employee Communications

● Many public plans follow ERISA participant disclosure guidelines.

● At a high level, these guidelines require providing the following information about the plan’s fund menu choices, permitting a straightforward comparison:
  – Identifying information – investment type or category
  – Performance data
  – Benchmarking data
  – Fee and expense information

● However, many plans go beyond offering just communication and disclosures, and also offer investment advice to plan participants.
Investment Advice

Employee Communication

Do you offer investment guidance/advisory services?

- 2015: 88.3%
- 2014: 79.1%
- 2013: 69.9%
- 2012: 71.3%

What type of guidance or advice do you offer?*

<table>
<thead>
<tr>
<th>Service</th>
<th>2015</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Online advice (e.g., Financial Engines, Morningstar)</td>
<td>35.7%</td>
<td>9.2%</td>
</tr>
<tr>
<td>On-site seminars</td>
<td>46.9%</td>
<td>58.2%</td>
</tr>
<tr>
<td>Guidance</td>
<td>43.9%</td>
<td>41.3%</td>
</tr>
<tr>
<td>One-on-one advisory services</td>
<td>35.7%</td>
<td>27.6%</td>
</tr>
<tr>
<td>Managed accounts (e.g., Financial Engines, Morningstar)</td>
<td>35.7%</td>
<td>36.2%</td>
</tr>
<tr>
<td>Full financial planning (e.g., Ayco, E&amp;Y)</td>
<td>9.2%</td>
<td>10.3%</td>
</tr>
<tr>
<td>Financial Wellness services (e.g., HelloWallet)</td>
<td>n/a</td>
<td>9.2%</td>
</tr>
</tbody>
</table>
Reviewing Overall Plan Utilization and Effectiveness

- A regular evaluation of plan usage can help officials understand what adjustments to plan design, delivery, and communication might be required to achieve better outcomes.

- Such a review might include:
  - Participant asset allocation decisions
  - Transfer activity
  - Participation levels
  - Participant deferral levels
  - Loans and withdrawals

- The plan’s recordkeeper can typically supply required data on participant behavior.

- Increasingly, plan officials are also evaluating overall plan effectiveness, using measures such as a retirement income adequacy analysis. This involves projecting expected income levels that the plan is likely to generate for participants in retirement, given contribution levels, available investments, time horizon, etc.
## Measuring Plan Success

**Plan Effectiveness**

How do you measure the success of your plan?

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Importance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contribution/savings rate</td>
<td>4.4</td>
</tr>
<tr>
<td>Participation rate/plan usage</td>
<td>4.4</td>
</tr>
<tr>
<td>Cost effectiveness</td>
<td>4.0</td>
</tr>
<tr>
<td>Employee satisfaction</td>
<td>3.9</td>
</tr>
<tr>
<td>Investment performance</td>
<td>3.9</td>
</tr>
<tr>
<td>Investment diversification</td>
<td>3.8</td>
</tr>
<tr>
<td>Benchmark against other plans</td>
<td>3.6</td>
</tr>
<tr>
<td>Retirement income adequacy</td>
<td>3.6</td>
</tr>
<tr>
<td>Ability to attract/retain employees</td>
<td>3.5</td>
</tr>
</tbody>
</table>
Conclusions

● The stakes have never been higher when it comes to managing DC plans.

● Plan sponsors are focused on getting their IPS in order and reviewing plan fees.

● Plan participation and savings rates are also areas of focus, with plan sponsors increasingly honing their use of auto features.

● Growth in target date funds have made them a key area of focus.

● Along with DC lawsuits, other game changers have been increased requirements, legislation, and regulation around DC plans.