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IT TAKES VISION

Revitalizing Your Benefits Strategy – Rethinking Your Retirement Plan

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Total Rewards

Thinking bigger

Total rewards – the toolbox

- Salary and incentives
- Medical, dental and vision
- Life insurance
- Disability
- Sick leave
- Time off
- Retirement
- Retiree medical
- Perquisites
- Career development
- Work environment
- Recognition
- Social responsibility
- Organization’s reputation

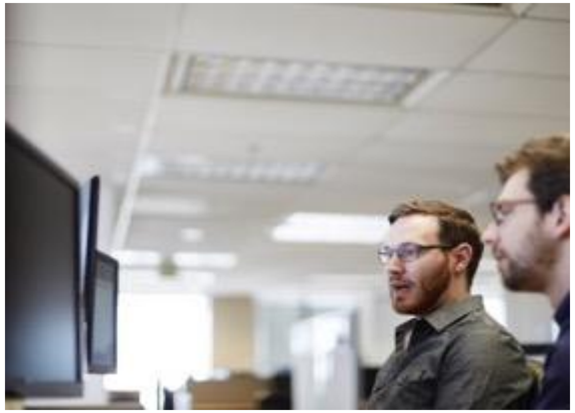
Will you stand out?

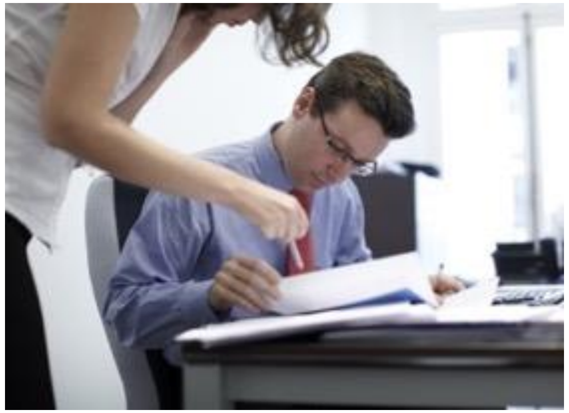
Will you have
the more competitive
wage and benefits package?

Total rewards

- What’s your brand?
- Actions speak louder than words
- Are yours aligned?
- Have changes been made holistically? Or in silos?

Total rewards – external pressures





Pay (low salary increase environment)

Healthcare (rising costs, ACA)

Retirement (volatile market, lower expectations)

Changing job market

Total rewards – changing workforce

- Generational differences in buying preferences and expectations
- Financial stress is high across generations
  - Baby boomers – sufficient retirement saving
  - Millennials – already saddled with record-high debt from student loans
- Workers are turning to employers for help

Total rewards – a changing tide?

Trouble with workforce management:

- Older workers are delaying retirement due to inadequate savings
- Difficulty retaining younger workers who are not being promoted
- Challenges with attracting, hiring and retaining top talent
- Retirement plans are often not differentiators

“Most people are going to arrive at retirement and not have adequate money. This is serious. None of us are good at doing our own retirement savings.”

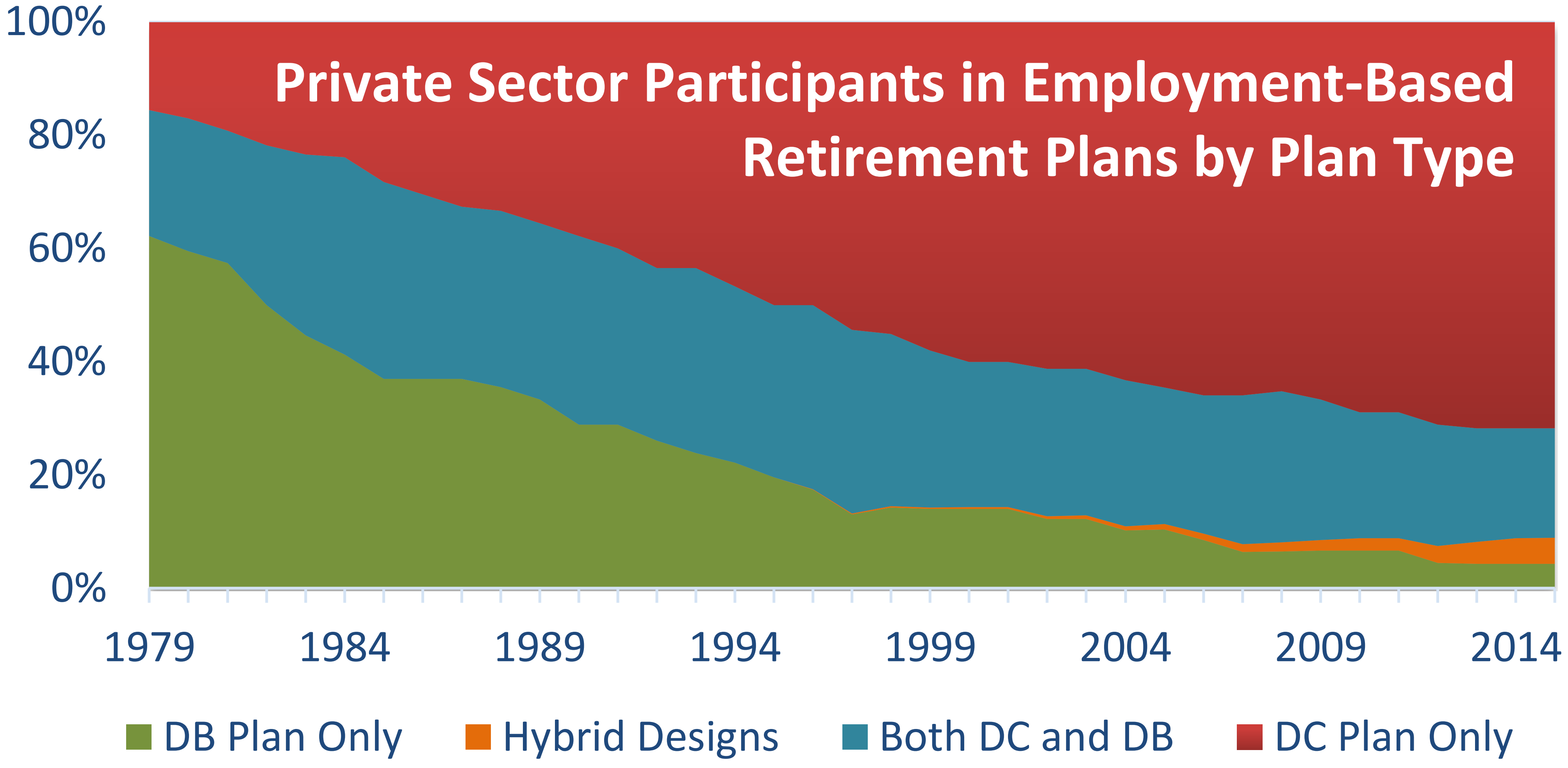
– Alicia Munnell, Ph.D., Director of the Center for Retirement Research; Peter F. Drucker Professor of Management Sciences at Boston College’s Carroll School of Management


RECORD LIFE EXPECTANCY
RETIREMENT SAVINGS
caglecartoons.com

Retirement Plan Trends

Risks and rethinking

Plan design prevalence



Is the tide changing?

There is a movement toward DB plans again

- DB-izing DC plans – DC sponsors trying to make DC plans work better
  - Automatic enrollment and automatic escalation features
  - Default investment can be target date fund
  - Adding annuity options
- DB plans are thawing

Thawing a Frozen DB Plan

A case study

Thawing the frozen DB plan!

Why? The 401(k) Plan:

- Did not provide meaningful benefits
- Was negatively perceived by newer employees
- Didn’t stand out as innovative; typical and standard
- Failed to attract and retain talented employees

Retirement Plans

Solving the structural problems

What if “DB or DC” is a false choice?

Rethinking your retirement plans

What would we want if we could start from scratch? A plan that:

- Stays fully funded in all market conditions
- Has predictable contributions
- Produces balance sheet stability
- Provides benefits with lifelong income and inflation protection
- Improves ability to attract and retain top talent
- Facilitates an orderly exit from the workforce

What if “DB or DC” is a false choice?

Rethinking your retirement plans

What about a plan that offers:

- Stable, predictable contributions for the employers, like a DC plan
- Lifelong retirement income for participants, like a DB plan, plus inflation protection

Evolution of a new plan design

- Variable Annuity Plan (basic VAP) legal since 1953
- It is not an insurance product
- Plan stays funded in all market environments
- Not popular due to routine benefit declines, even for retirees
- 2014 regulations issued allowing for creation of Milliman Sustainable Income Plan™ (SIP)

Basic VAP Overview

- Participant earns a benefit for each year of service
- Employer funds the benefit earned
- Accruals go up AND down based on the Fund's actual return on assets for actives AND retirees
- Plan stays funded in all market conditions
- Keeps assets and liabilities in balance by adjusting liabilities
- Basic VAPs are fully exposed to market volatility

Emerging hybrid plan designs

- A lot of activity now is around fixing the problem of 1953 design—benefits going up and down
- But keeping everything that makes is work
- There are a number of ideas out there, we don't have time for them all
- We will focus on the one we are most excited about—the SIP

Basic VAP—How it works

- Career average or flat dollar accumulation
- **Hurdle rate**, usually set between 4% and 5%
- Liabilities calculated at hurdle rate
- Contributions must be at least as large as normal cost, plus expenses
- Earned benefits fluctuate annually based on investment return

Return **=** Hurdle Rate: **accrued benefits do not change**

Return **>** Hurdle Rate: **accrued benefits increase by excess**

Return **<** Hurdle Rate: **accrued benefits decrease by shortfall**

Basic VAP—Example

- Suppose a retiree's benefit is $1,000/month
- The plan has a 4% **hurdle rate** and gets a -1% return
- The new monthly benefit amount under the basic VAP is $952

$$\$1{,}000 * (1-0.01) \,/\, (1+0.04) = \mathbf{\$952}$$

- The next year, the plan's return is 16%
- The monthly benefit amount changes to $1,062

$$\$952 * (1+0.16) \,/\, (1+0.04) = \mathbf{\$1{,}062}$$

SIP—Overview

- Improves on basic VAP by storing excess returns for use when needed
- Has a **cap**, which limits benefit increases in years with particularly high returns
- **Stabilization reserve**: built in years when the **cap** is reached, is used to **shore-up** benefits when returns are less than the **hurdle rate**
- **High-water-mark**: highest benefit level ever paid, and is paid as long as there are sufficient **stabilization reserves**

SIP—Downside volatility management

- Suppose a retiree's benefit is $1,000/month in a plan with a 4% **hurdle rate**
- The plan gets a -1% return
- The new **underlying benefit** is **$952**, which is fully funded

$1,000 * (1-0.01) / (1+0.04) = **$952**

- The retiree receives the $952 **underlying benefit** plus a $48 shore-up from the **stabilization reserve**, so the **high-water-mark** benefit of $1,000 is preserved

SIP—Harvesting the upside

- The next year, the adjustment is applied to the **underlying benefit** of $952
- The Plan's return is 16%, which would result in a basic VAP increase of 11.5%, to $1,062

(1+0.16) / (1+0.04) – 1 = **11.5%**

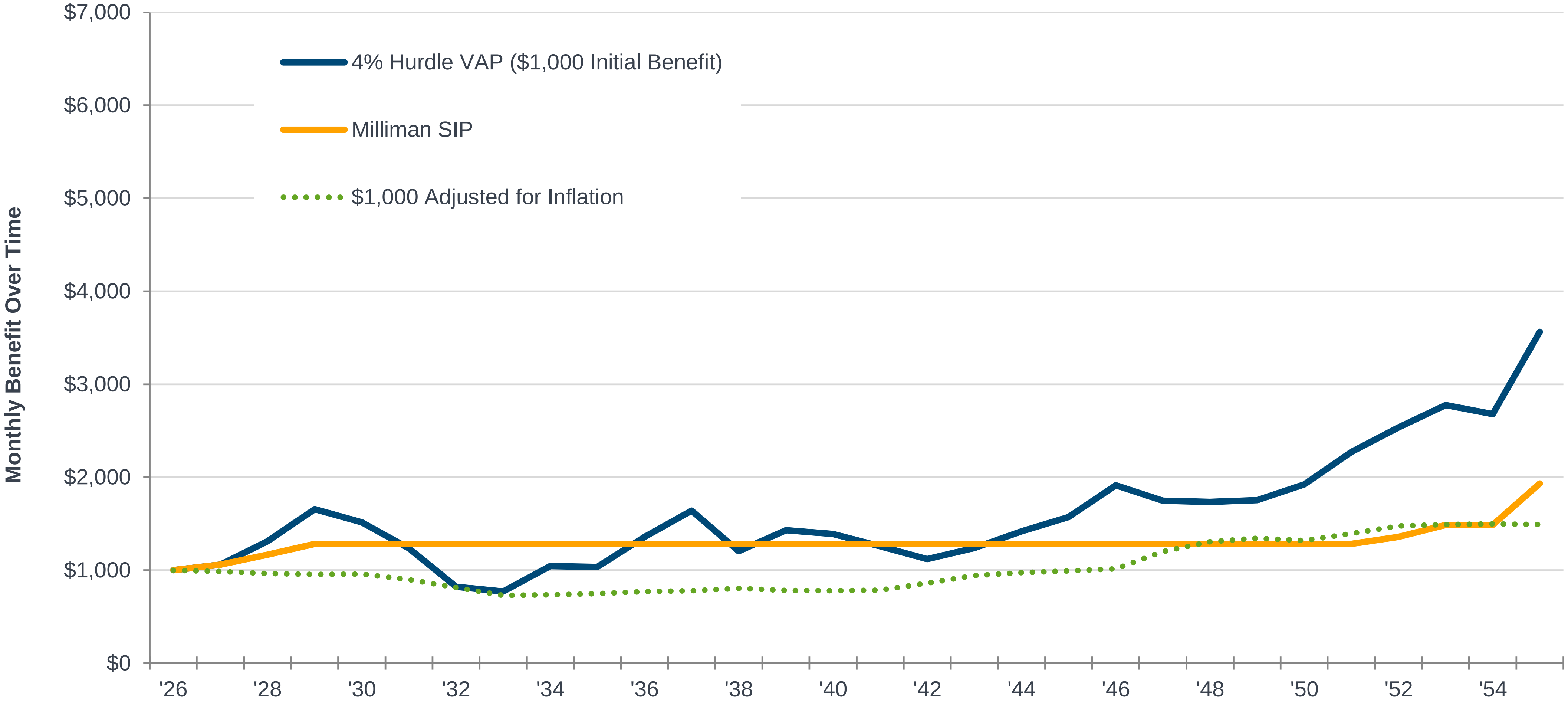
- But, the SIP has a **cap**, so benefit increases are limited to 10%
- The monthly benefit amount changes to **$1,047**

$952 * 1.10 = **$1,047**

- The excess above 10% builds the **stabilization reserve** to **shore-up** benefits for future downturns
- New **high water mark** of $1,047 to be protected

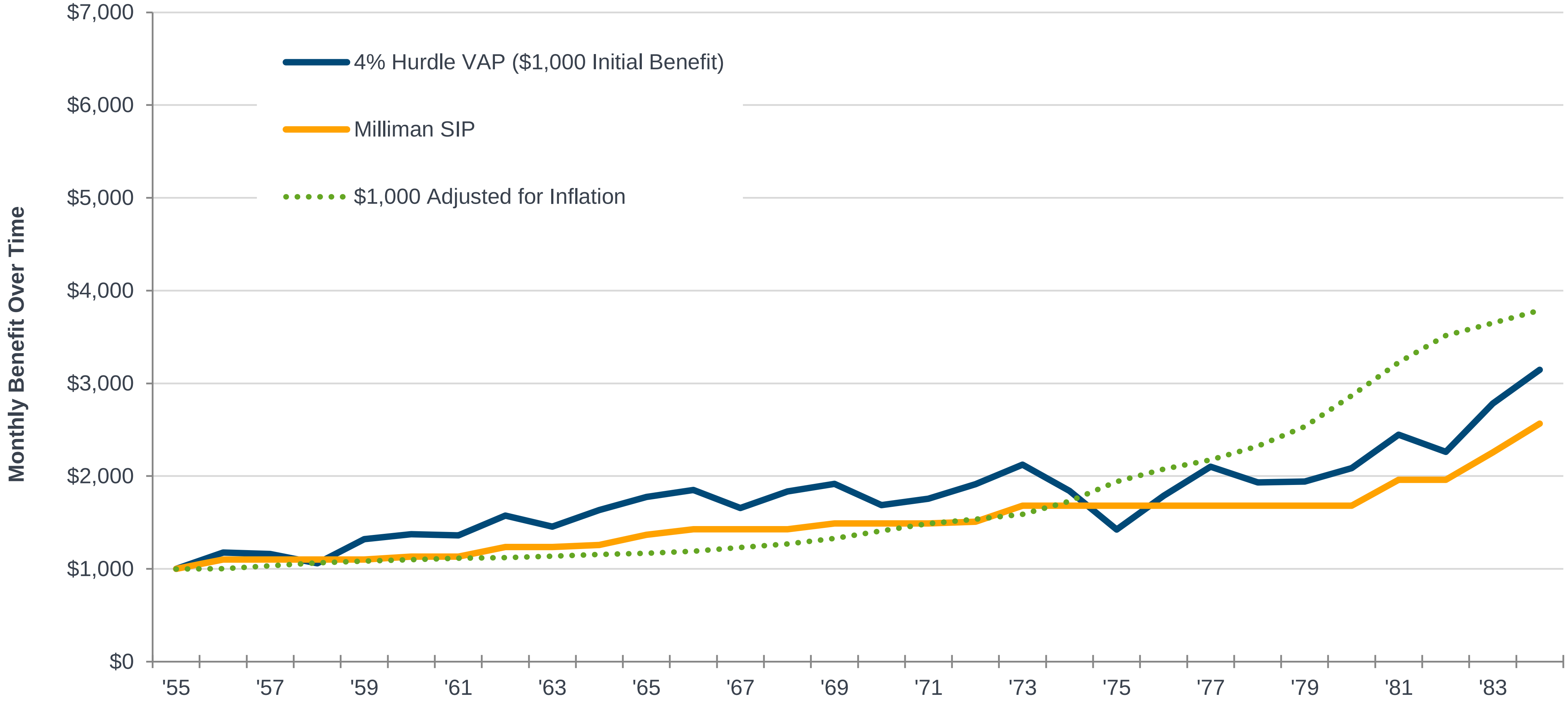
The Depression, WWII and the Baby Boom

1926 to 1955 — Cap increases at 10%, limit funded status to 150%, 4% hurdle; 70% Stocks / 30% bonds; 115% funded in 1926



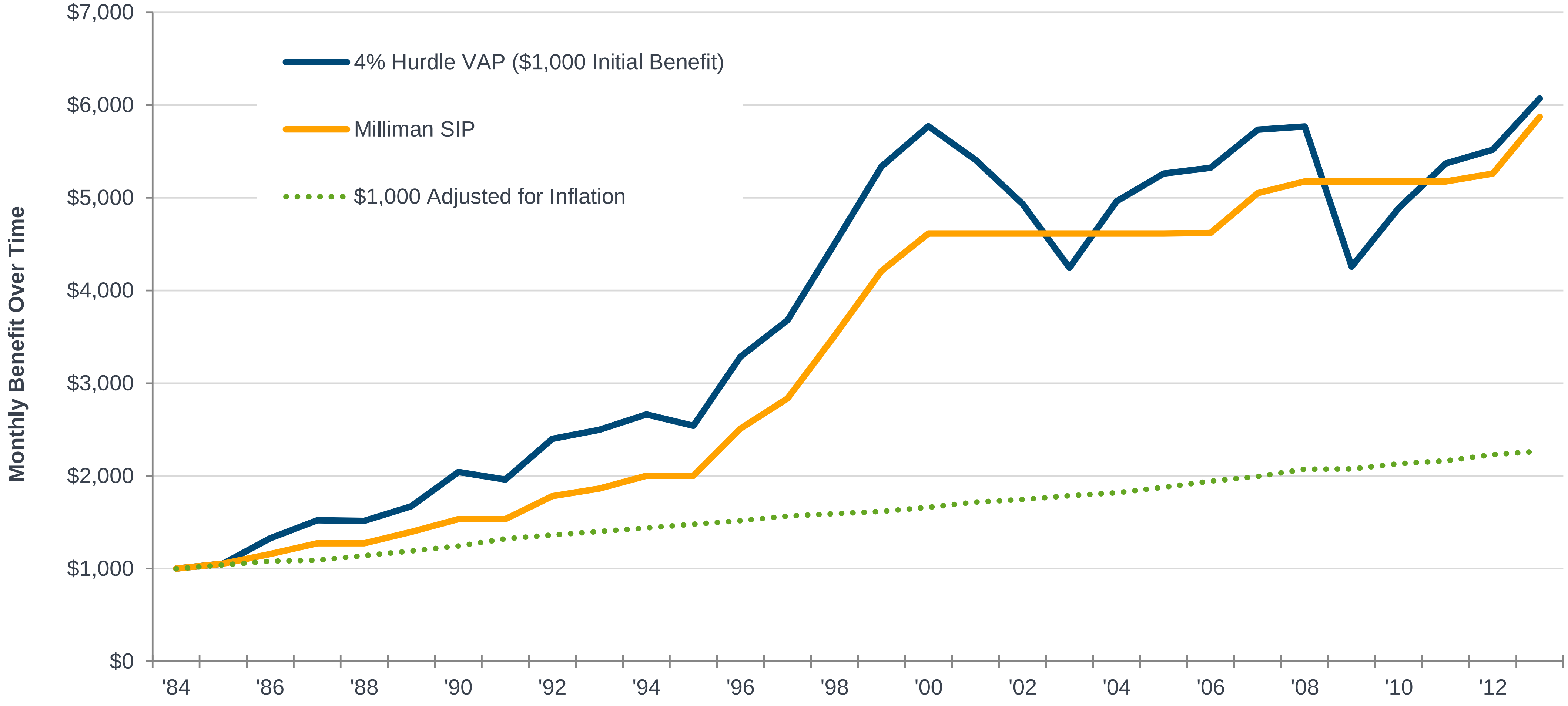
Elvis, the Oil Embargo and Mount St. Helens

1955 to 1984 — Cap increases at 10%, limit funded status to 150%, 4% hurdle; 70% stocks / 30% bonds; 115% funded in 1955



Berlin Wall falls, Y2K, great bull then volatility

1984 to 2013 — Cap increases at 10%, limit funded status to 150%, 4% hurdle; 70% Stocks / 30% bonds; 115% funded in 1984

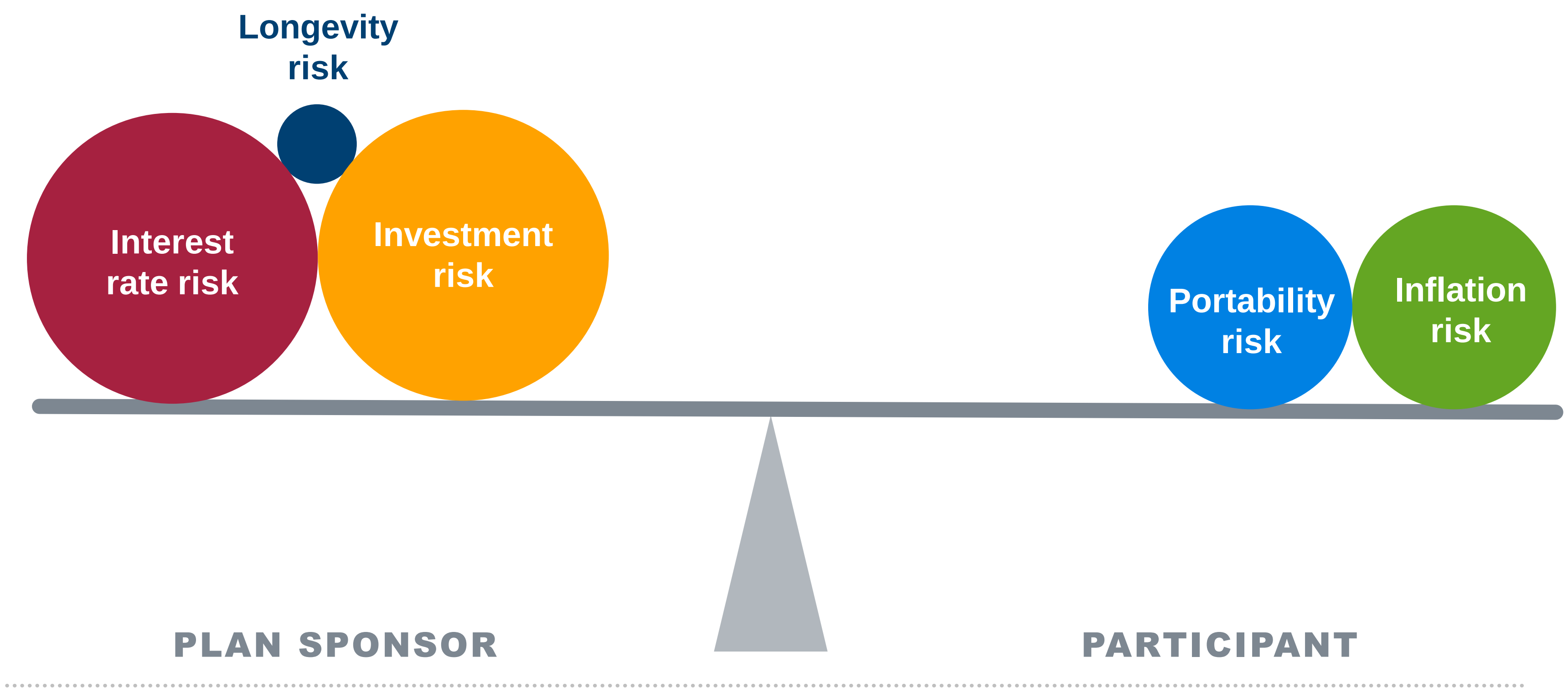


Historical performance

- Benefits lag in bull markets
- Downside protection in bear markets
- Generally keeps pace with inflation
- Maintains investment discipline to maximize return (70/30 equity/fixed income in example)

Traditional Defined Benefit Plan

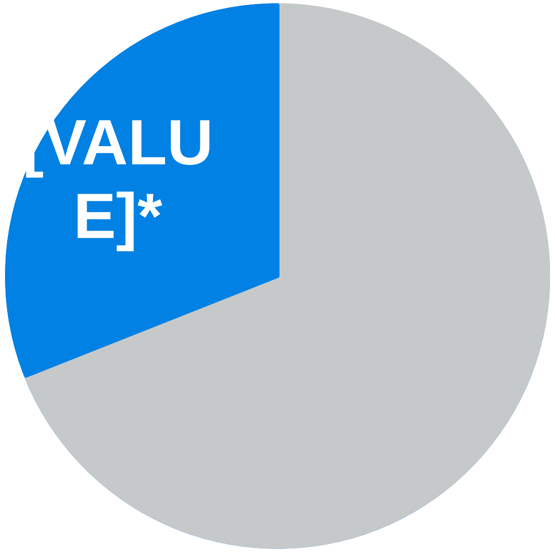
Plan Sponsor bears **most** of the risks



DB plan sponsors' risk aversion

Private sector American workers with a **DB plan**

2011

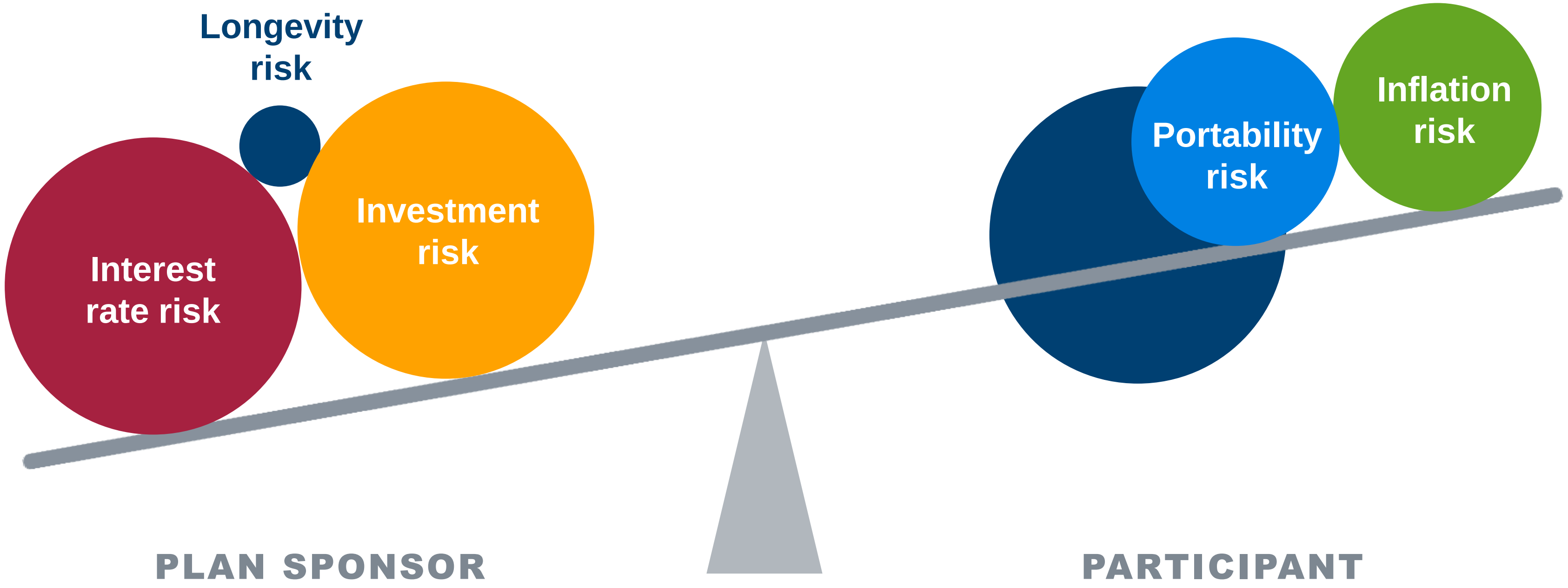


*Among Americans with a retirement plan working in the private sector. *Employee Benefit Research Institute (EBRI)*

Defined Contribution Plan

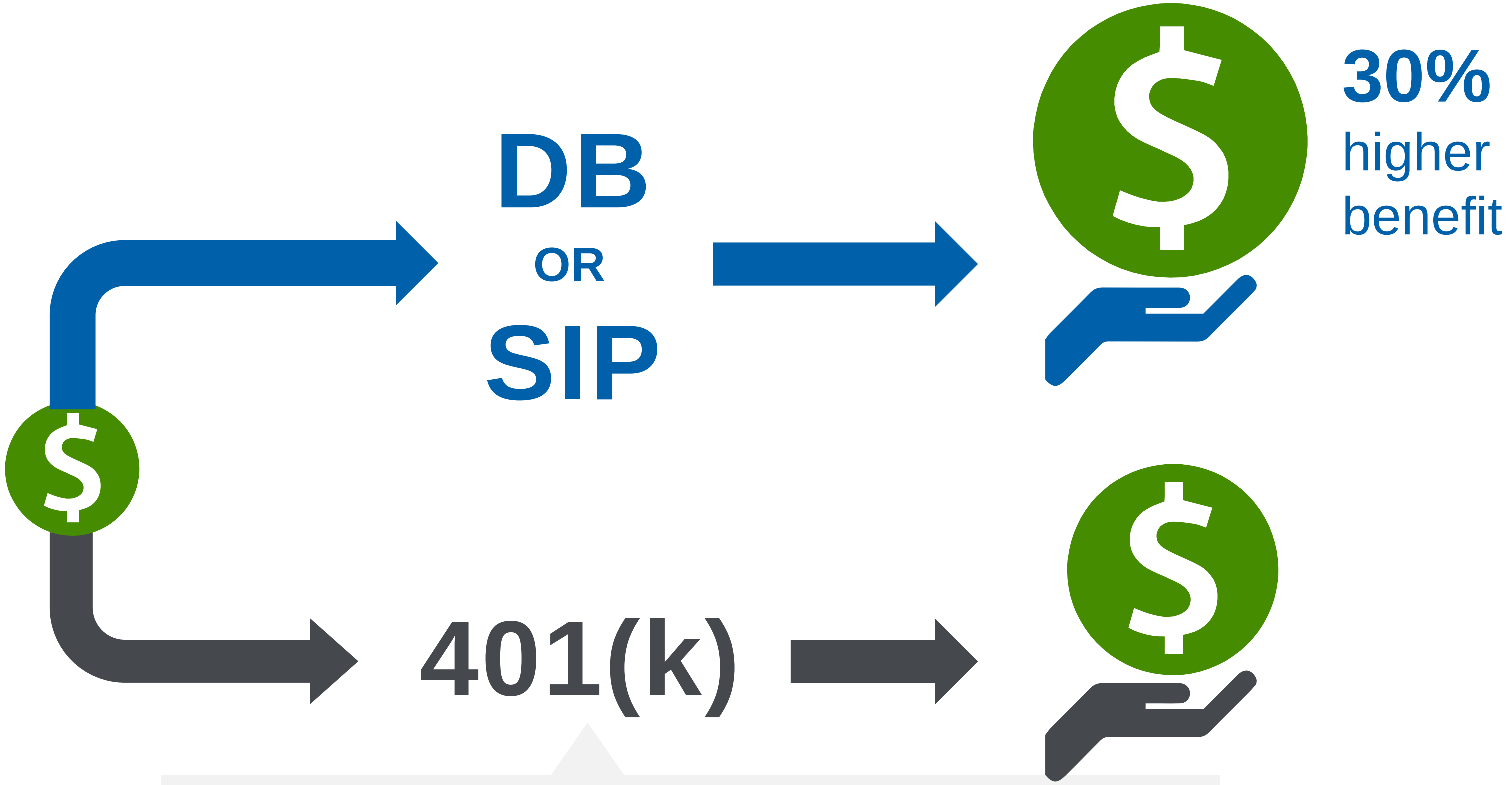
Plan Sponsor bears **none** of the risks

Participants bear **all** of the risks



Portability risk minimized

Get more for your money

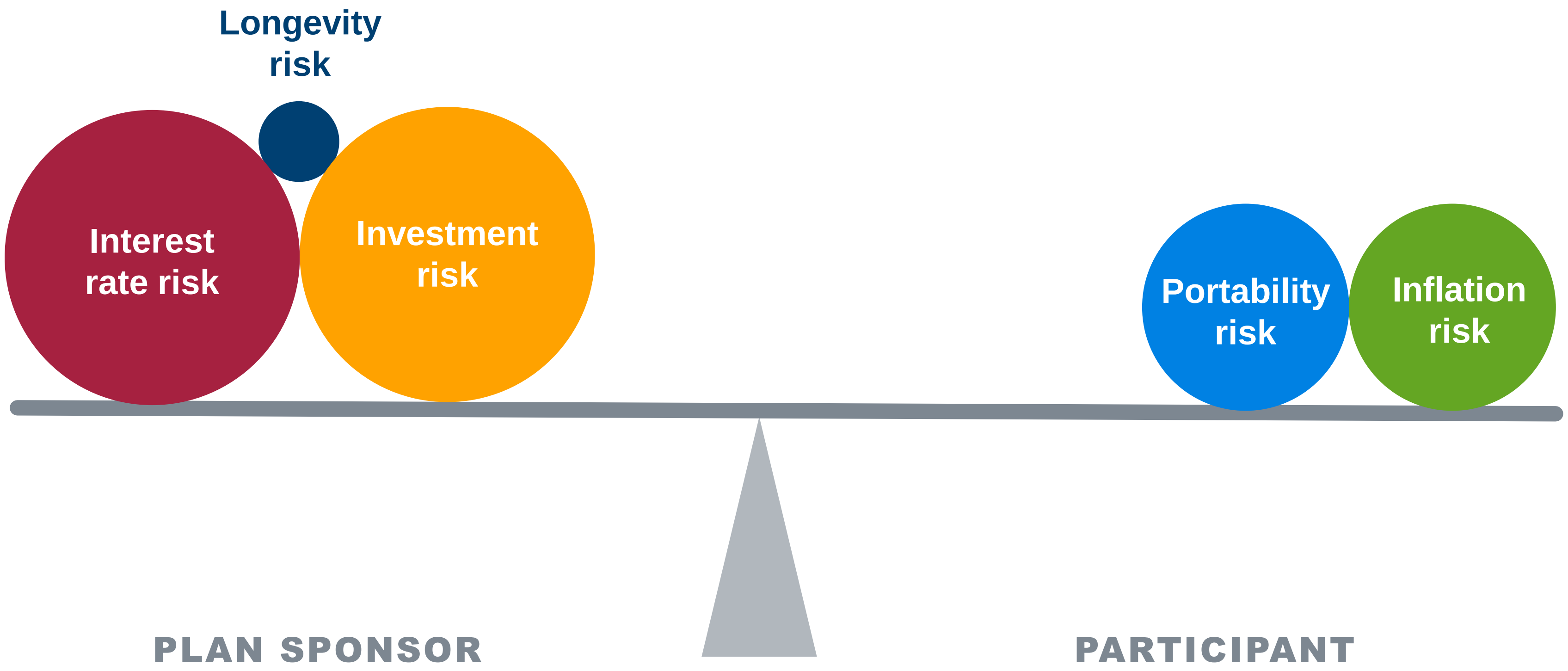


Value of 401(k) benefits is eroded by:

- Higher fees in retirement
- Lack of longevity pooling
- Lack of professional management

Sustainable Income Plan

Risks are shared in a rational way

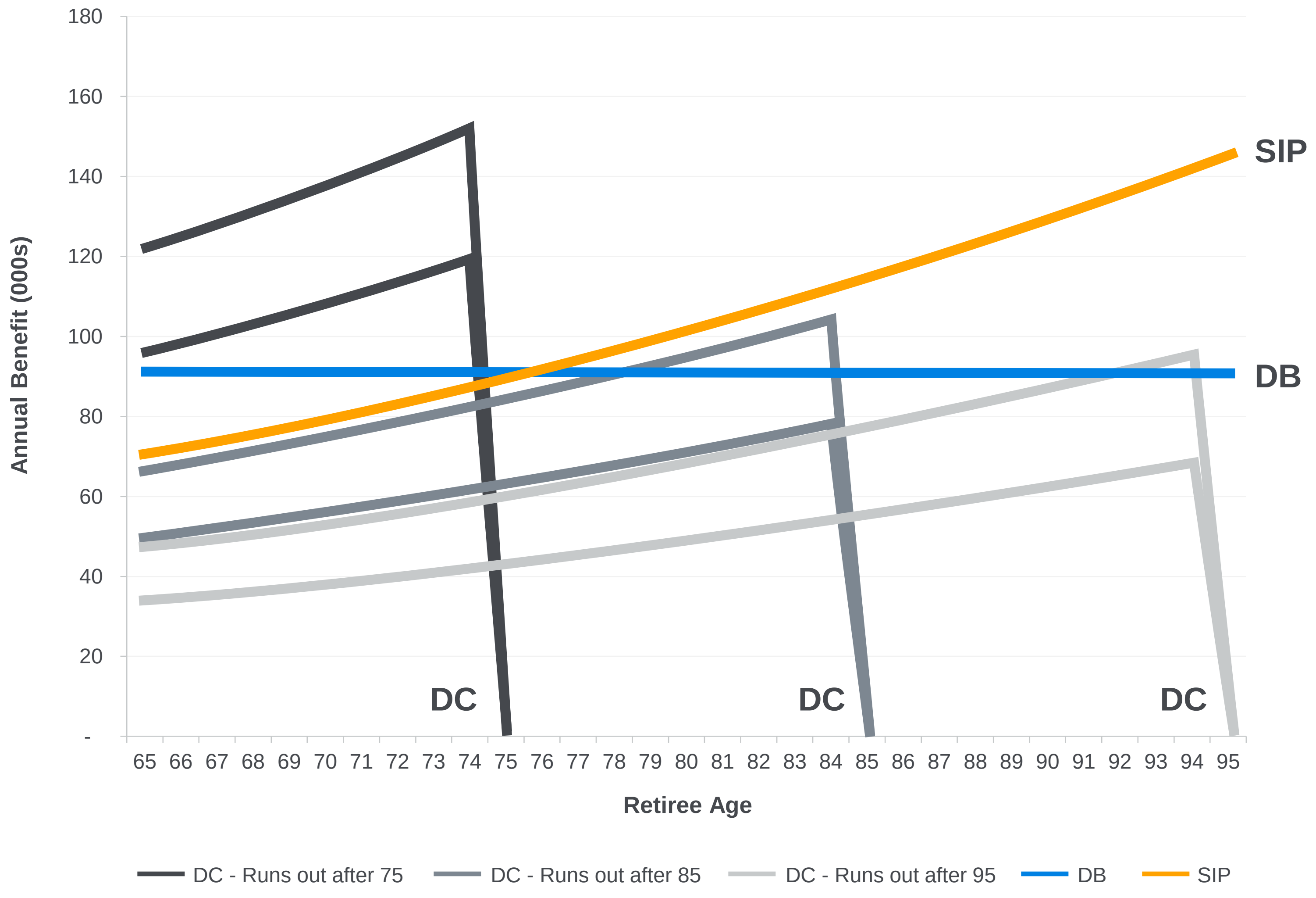


Portability risk minimized

Inflation risk minimized

Interest rate risk minimized

Benefits side by side: DC vs DB vs SIP



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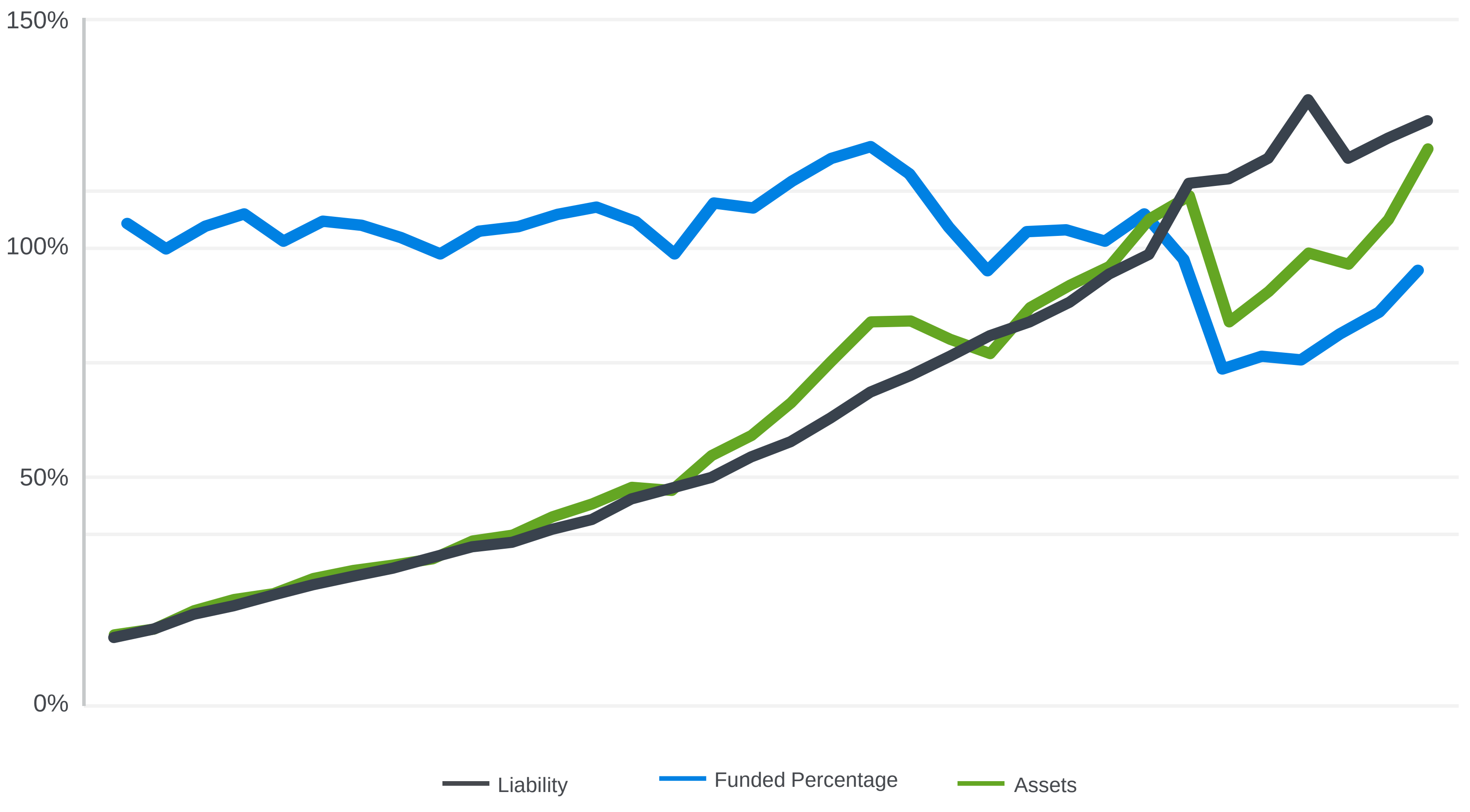
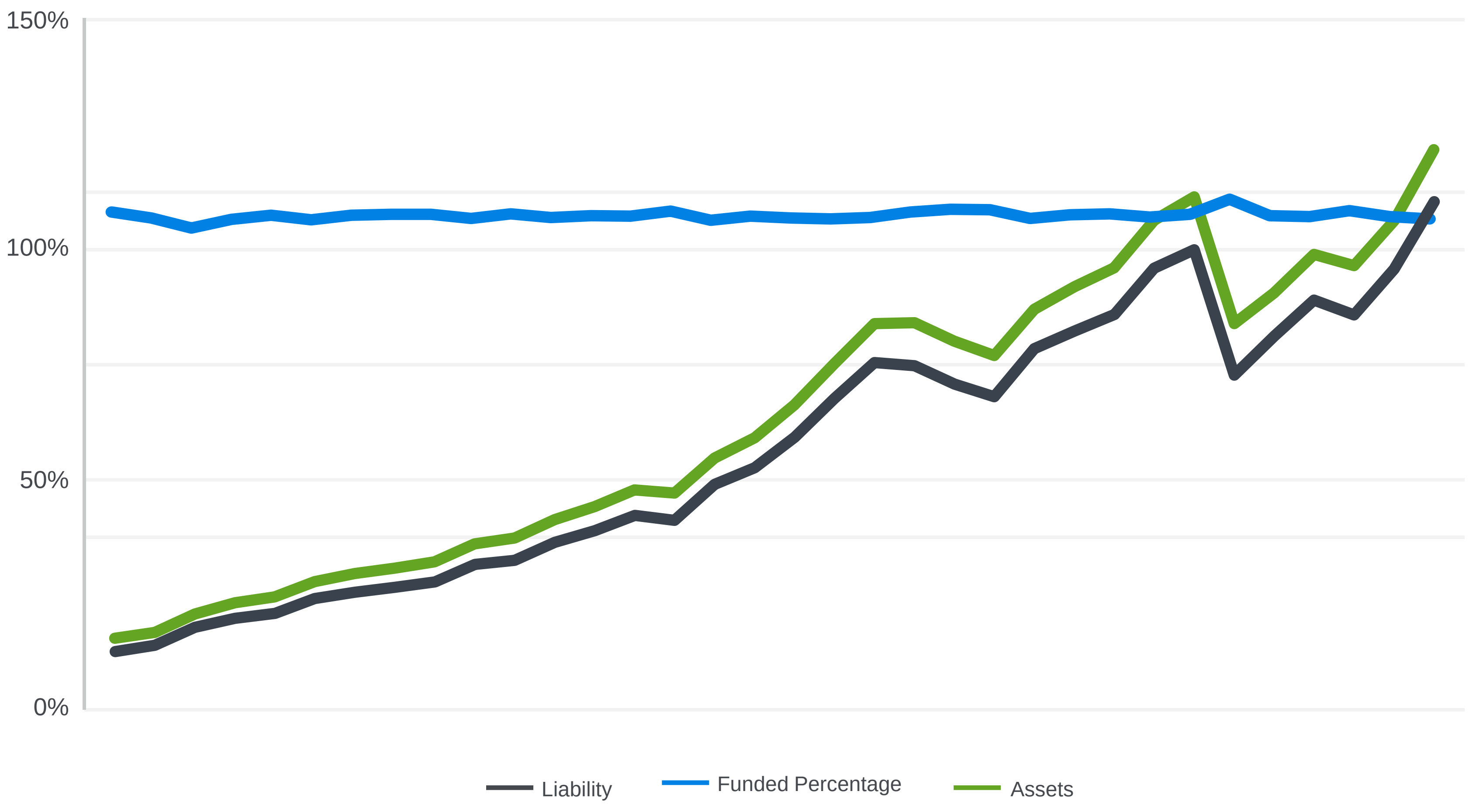
Traditional DB plan - funding



SIP – funding



SIP – the best of both worlds

For **employers**

- Stable contribution requirements
- Stable balance sheet
- Plan stays fully funded
- Maximum benefit per $1 of contribution

For **participants**

- Lifelong benefits
- Inflation protection
- Maximum benefit per $1 of contribution

The future of secure retirement

- Standout retirement solution
  - SIP for employer contributions
  - DC for personal savings
- And for highly compensated participants
  - Can provide comparatively larger benefits
  - Tax-qualified limits are separate for DC and SIP

How will you stand out?

- What role will your retirement plan play in your total rewards program?
- Does your retirement plan set you apart from your peer group of employers?
- What is the value of your retirement plan to employees?
- Is your retirement plan enhancing your total rewards program?
- Do employees understand and utilize your retirement plan?

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Thank you