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Defined Contribution Plan Education Session
Retirement Income Options

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DC Plan Design Focus Now Shifting to Distribution Phase

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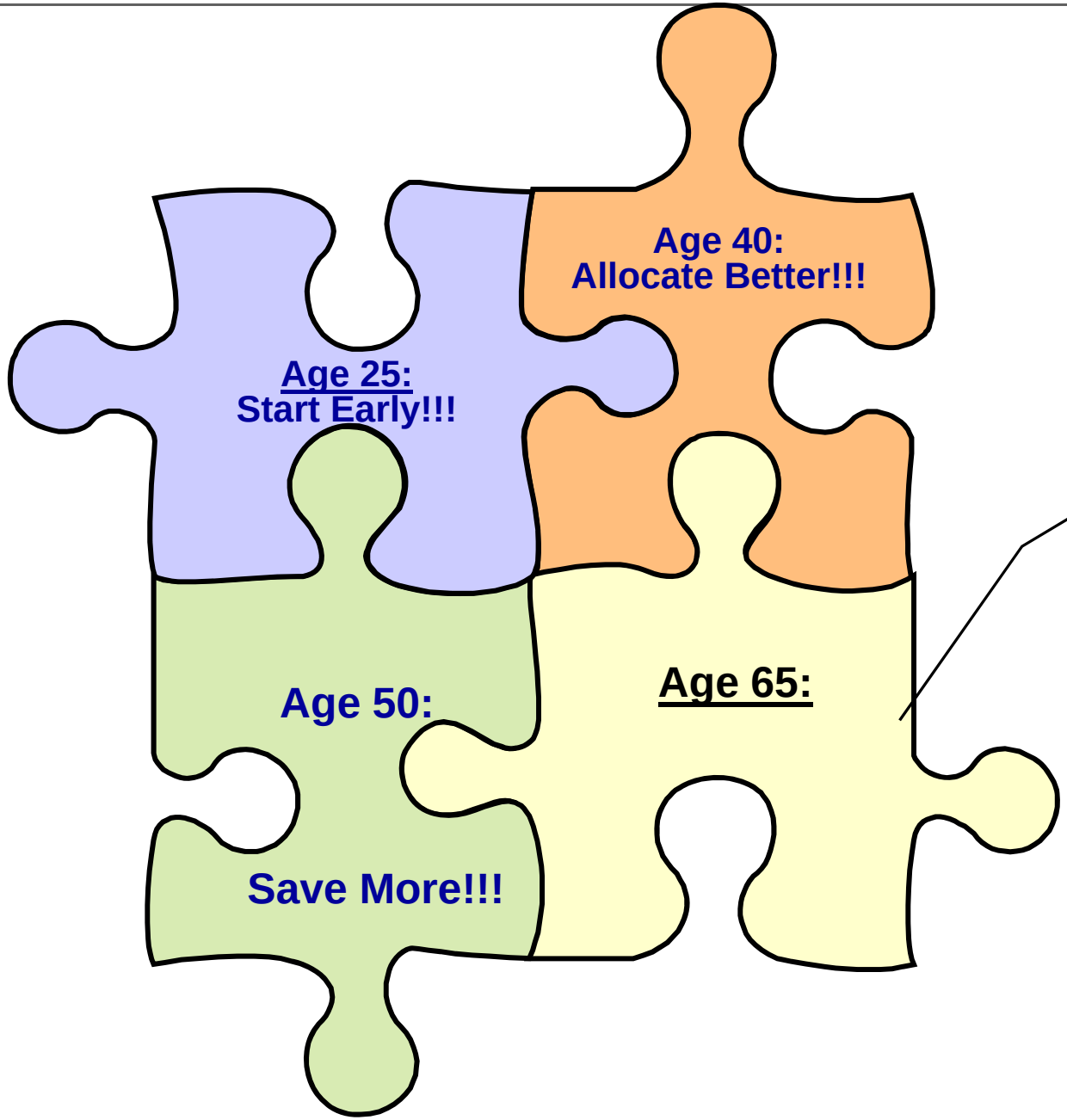

Now What???

Most 401(k) efforts traditionally have focused on getting people to join the plan, save more and allocate assets better

As the first generation of participants who significantly rely on DC plans for retirement income is approaching retirement, the focus is shifting *to translating the account balance into post-retirement income*

Confidence in Post-Retirement Assets is Falling

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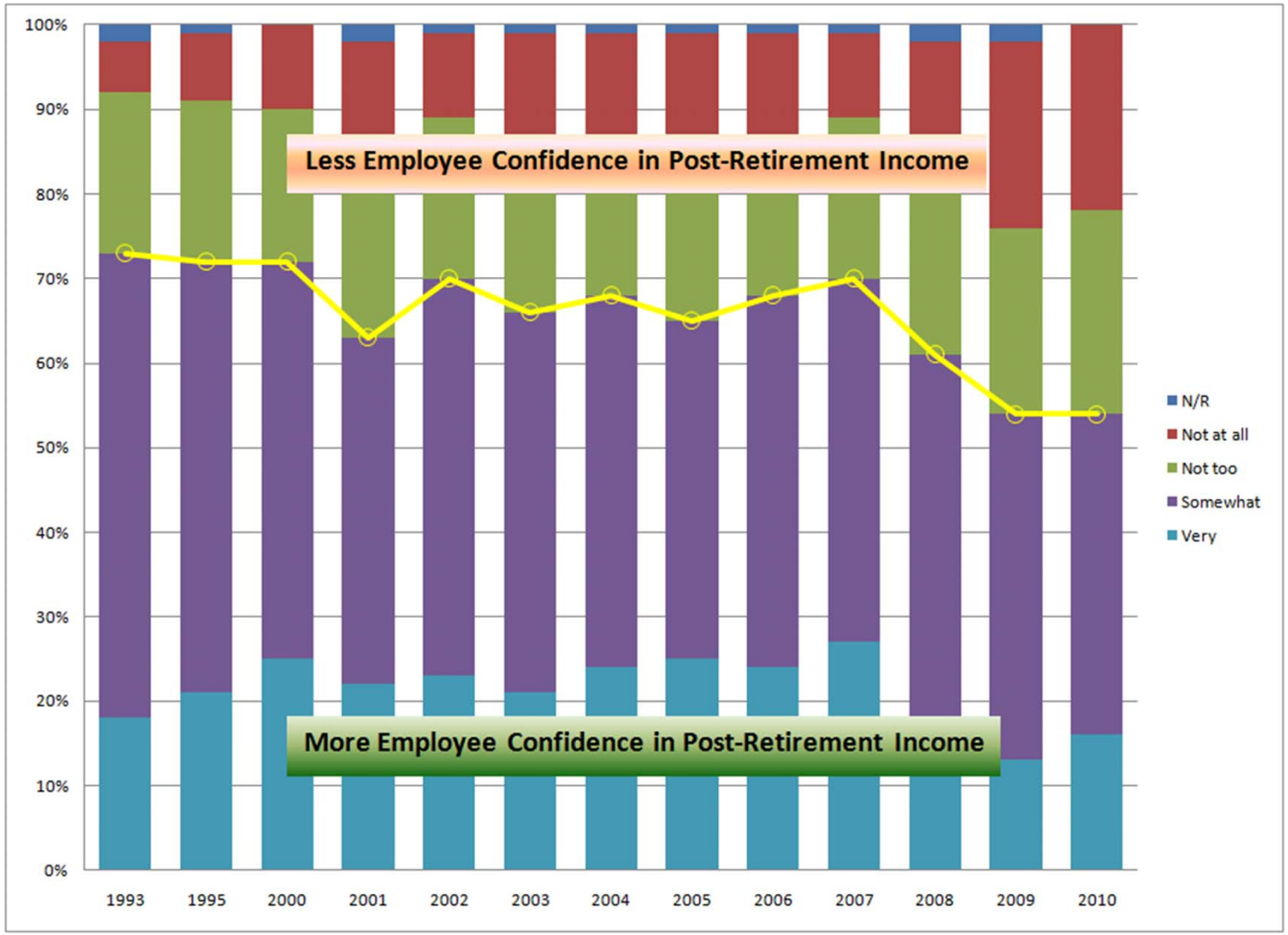
- EBRI Retirement Confidence Surveys show that workers' confidence in the ability of their post-retirement assets to meet their income needs has fallen in recent years



Evolution of Retirement Income Market

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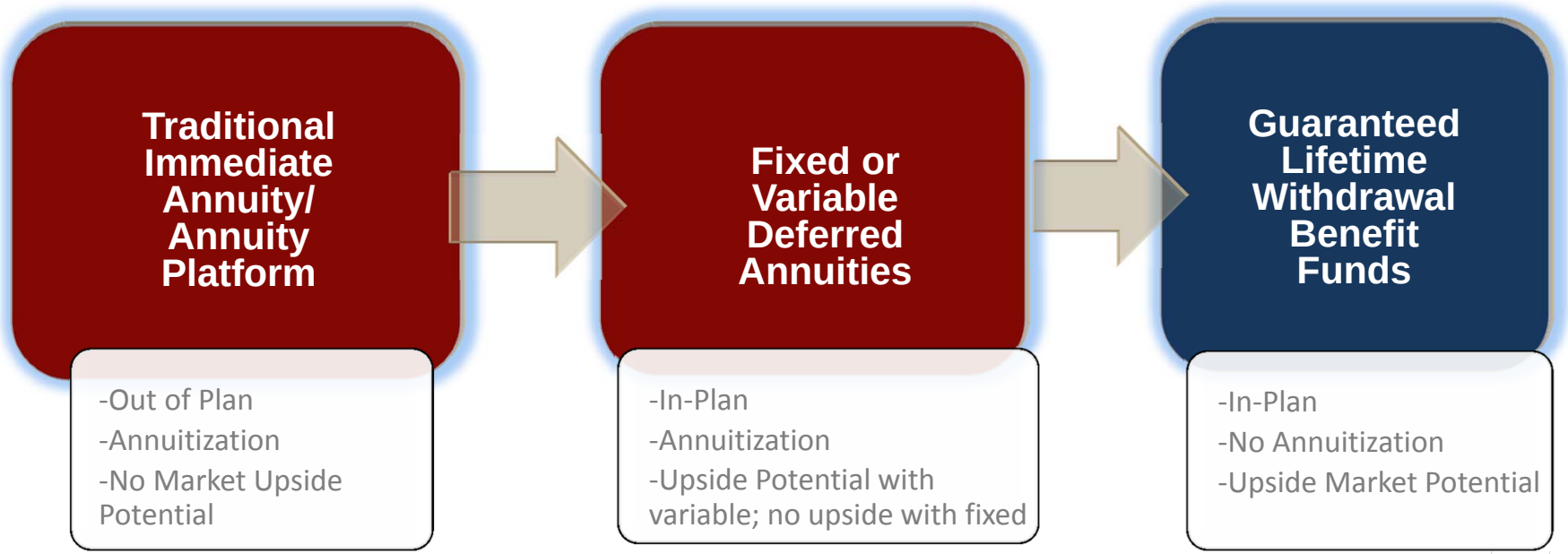
- To date, the traditional retirement income offering to plan participants (when offered) has been a traditional fixed annuity
  - In reality, few retirees actually utilize these options when offered
    - People fear dying sooner rather than later, therefore risk exists of not realizing value from annuity
    - Participants do not like giving up control of assets
- Guaranteed Lifetime Withdrawal Benefit fund options are a newer product offering in the marketplace, providing a solution to enable participants to obtain retirement income without giving up control of assets



Overview of Guaranteed Lifetime Withdrawal Benefit Funds

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- A Guaranteed Lifetime Withdrawal Benefit option is designed to provide plan participants with an option for obtaining a steady stream of income in retirement without the traditional objections to regular annuities
  - An annuity from an insurance company requires participants to turn over their account balances in exchange for guaranteed payments for life; GLWB funds do not have this requirement
- Generally speaking, the composition of these types of funds is effectively an insurance rider (the guarantee) that is built onto an underlying investment vehicle like a target date fund or a balanced fund
  - Provides participants the ability to withdraw a minimum amount throughout their retirement lifetime regardless of the performance of the investment
- Insurance companies were the first movers into the marketplace, but investment management firms have now started offering products to the market
  - Prudential's IncomeFlex, the first product in market, started in 2006
- While these type of products provide important benefits to participants, the high cost of the protection (~1% for the rider guarantee) reduces their efficacy

Guarantee Lifetime Withdrawal Benefit Funds How They Work: Accumulation Phase

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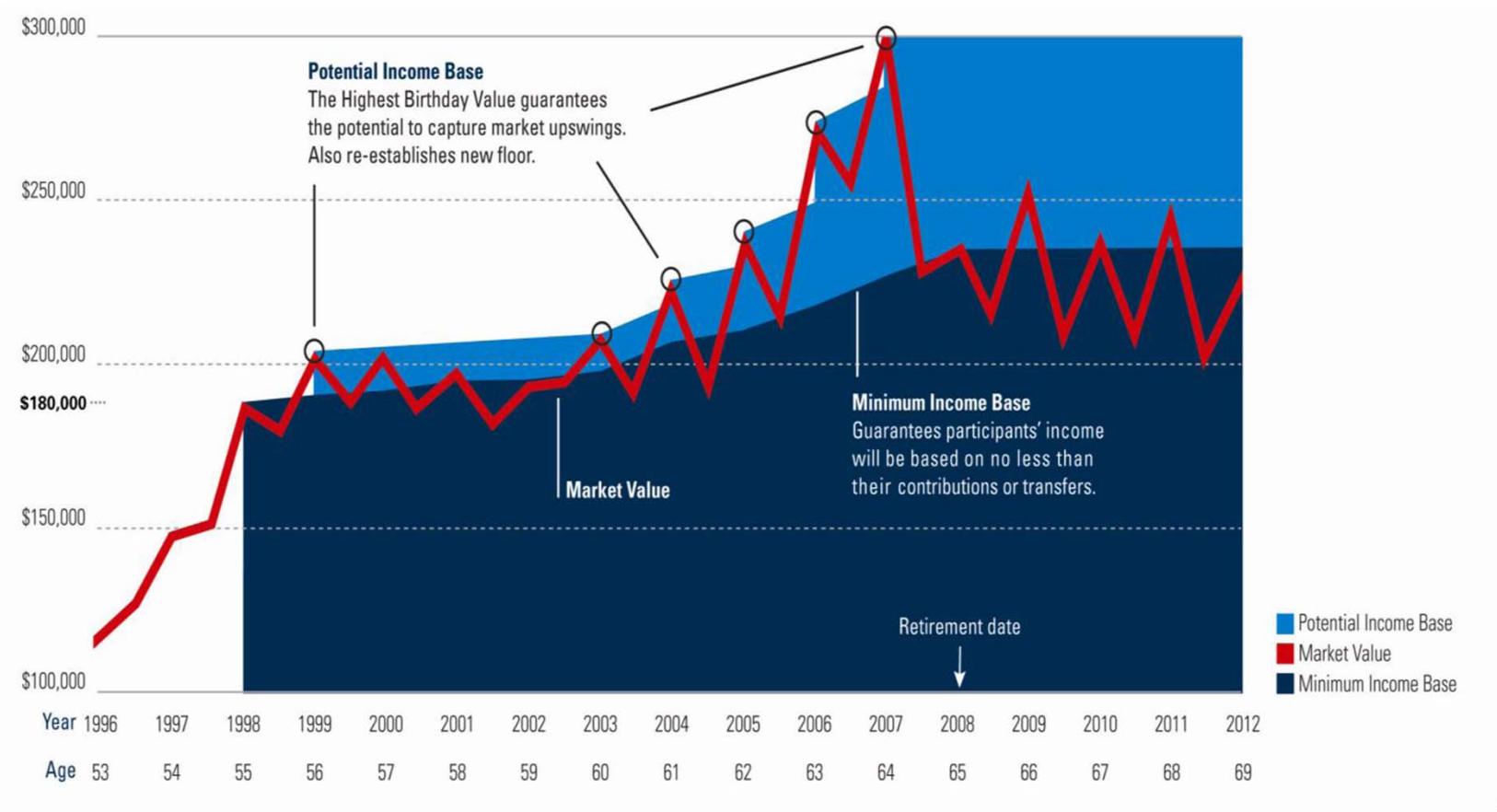
- In the accumulation phase of the product, typically starting 10 years before normal retirement age of 65, participants can invest in a diversified portfolio with income guarantees
  - Underlying asset portfolio is typically a Target Date Fund or risk based balanced portfolio
- On an annual basis, a new high-watermark is established which guarantees a new asset base floor



Guarantee Lifetime Withdrawal Benefit Funds How They Work: Distribution Phase

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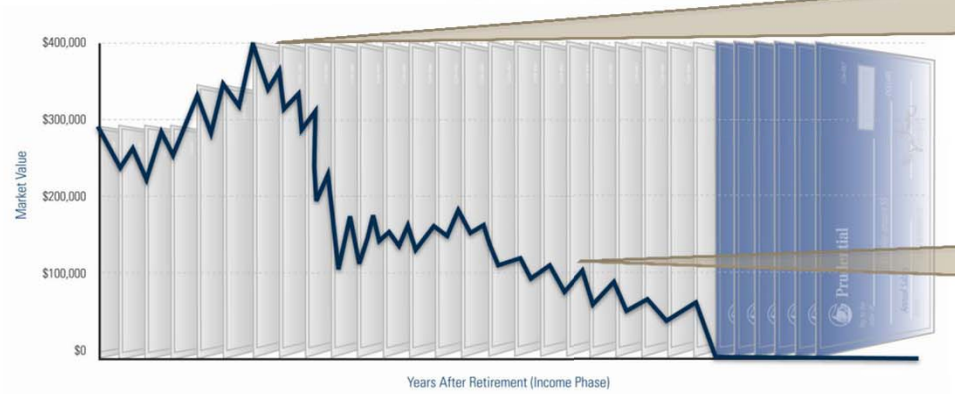
- In the distribution phase of the product, the annual withdrawal amount is set based on the age of the participant when the distribution phase begins
- Withdrawal amounts based on high water-mark account balance- will not decrease
- Additional withdrawals can be made for emergency purposes (will reset future withdrawal amount)
- Residual value of account belongs to heirs

Withdrawal is set at a % of horizon date market value of the account, determined by age of withdrawal. Can adjust for spousal benefit.

Guaranteed Withdrawal is set based on high watermark unless additional withdrawals are made.



Individual account balance is maintained and can be withdrawn at any time. Residual goes to heirs.

Guarantee Lifetime Withdrawal Benefit Funds: Pros and Cons

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Pros:

- Participants' balance stays invested and does not require annuitization
- Withdrawal amounts based on high water-mark account balance- will not decrease
- Additional withdrawals can be made for emergency purposes (will reset future withdrawal amount)
- Residual value of account belongs to heirs
- May be eligible as a QDIA
- Provides guaranteed level income for life (as do annuities)

Guarantee Lifetime Withdrawal Benefit Funds: Pros and Cons

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Cons:

- Fee for guarantee is high - currently ~90-100 basis points per year
  - This fee is on top of the investment management fee for the underlying investment product
- Complex instruments; Risk of oversimplifying their explanation to participants to increase usefulness
- Counterparty risk exists for the insurance company providing the guarantee
  - Some versions of annuity products offered by investment managers utilize multiple insurance companies as wrappers
    - Theory that multiple wrap providers diversify counter-party risk in reality may not turn out to be true as observed in the recent stable value fund turmoil
    - Insurance companies' fate tend to be highly correlated with each other
- Although the underlying asset account is portable, the guarantees are not portable
  - Were Montana to change recordkeepers, a GLWB Fund would need to remain an option for as long as members were invested in it
- Given Montana's limit on the number of investment options, GLWB funds would take away a slot from other options
- If the annual payout does not have a COLA, the income stream may not be sufficient late in retirement

Providers of GLWB Funds

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- The marketplace of GLWB funds is still at its early stages, and therefore the number of offerings in the market is at this point low
- Providers of these funds initially were insurance companies, but recently investment management firms have begun rolling out products to market

- Example Insurance Companies offering GLWB funds include:
  - Prudential
  - Great West Life

- Example Investment Managers offering GLWB funds include:
  - Vanguard
  - Alliance Bernstein

Conclusions

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- The introduction of Guaranteed Lifetime Withdrawal Benefit options is an important step in the evolution of defined contribution plans, offering participants a new means for obtaining a secure source of retirement income without downsides of annuitization

- While these type of products provide important benefits to participants, the high cost of the protection (~1% for the rider guarantee) reduces their efficacy

- While plan sponsors are starting to increase their examination and consideration of these types of products, we have not seen widespread adoption

- As the market for these products continue to evolve, we look for more economical solutions to improve the viability of these products