

Annuities in DC Plans: The Pros and Cons of the New Generation Products

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Agenda

- ▶ Why Annuities?
- ▶ The Old Guard
- ▶ The Current Landscape
- ▶ Product Comparison: Pros, Cons, and Pitfalls



Why Annuities?

- ▶ After experiencing a few decades in 401(k) plans, many participants are seeking a way to shift longevity risk and investment risk back to product providers.
- ▶ Plan sponsors are realizing that 401(k) plans won't provide the income and certainty participants are seeking in retirement.
 - ▶ At one time, providing participants efficient access to the investable markets and tax-deferred accumulation was enough.
 - ▶ Now to have the 401(k) plan valued as a competitive benefit, a retirement income option seems more and more necessary.

Is there a way to get protection while still maintaining access to the markets?



The Old Guard

- ▶ Traditional annuities are an insurance contract, generally considered to be a relatively safe, low-yielding investment
 - ▶ Provides payments to the holder at specified intervals, usually after retirement
 - ▶ Tax-deferred accumulation
 - ▶ Fixed – guarantee a certain payment amount
 - ▶ Variable – do not guarantee a payment amount, but have potential for greater returns
- ▶ Available through retail or group-affiliated channels



Benefits & Issues - Participant

Benefits

- ▶ Eliminates mortality risk
- ▶ Limits or eliminates investment risk

Issues

- ▶ Perceived high upfront cost
- ▶ Sequencing risk
- ▶ Loss of upside
- ▶ Trap-door decision (little or no liquidity)
- ▶ Perceived or actual high fees
- ▶ Issuer credit risk



Benefits & Issues – Plan Sponsor / Fiduciary

Benefits

- ▶ More secure employees → higher satisfaction
- ▶ DB-like benefit without the funding risk

Issues

- ▶ Recordkeeping & administration integration
- ▶ Fiduciary issues selecting the issuer
- ▶ Complexity
- ▶ Communications to employees



The Current Landscape

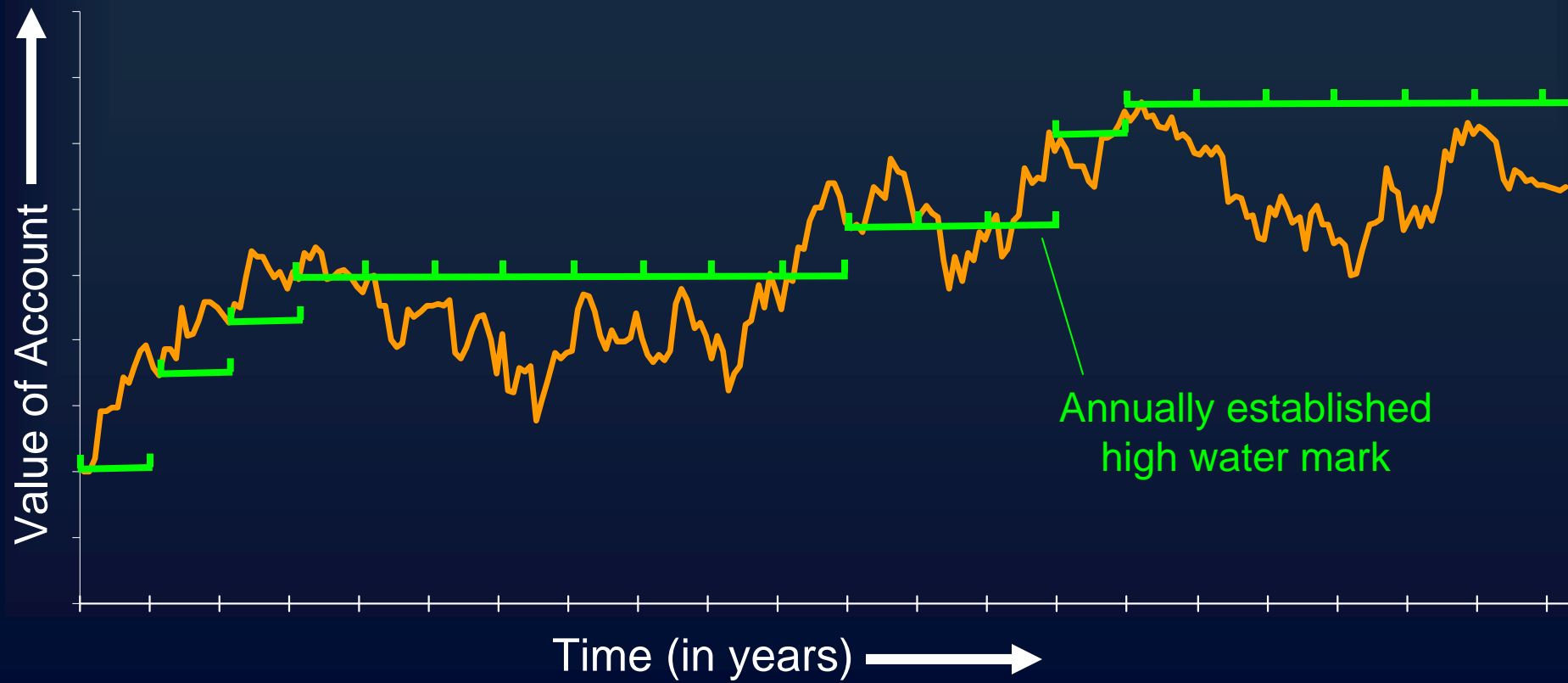
- ▶ Enhanced group variable annuities
 - ▶ Improvements to pricing, liquidity, and investment upside
- ▶ Annuity purchase platforms
 - ▶ Competitive pricing at group rates
- ▶ Guaranteed Minimum Withdrawal Benefit contracts (GMWB)
 - ▶ Variable annuity wrap contract
 - ▶ High water mark feature
- ▶ Pooled Products
 - ▶ Diversify default risk by using multiple issuers

The new breed of products seek to provide DB-like benefits in a DC plan.



High Water Mark Guarantee

Illustration of High Water Mark Guarantee



Most products assess the high water mark annually, on the participant's birthday.



General Product Comparison

	Traditional Fixed Annuity	Enhanced Annuities	GMWB	Guaranteed Pools
Delivery	Out-of-Plan; Retail	DC Platform	DC Platform	DC Platform
Pricing	Individual Basis	Individual Basis	Plan-level Negotiation	Plan-level Negotiation
Deposits	Lump Sum	Ongoing Payroll Deduction	Ongoing Payroll Deduction	Ongoing Payroll Deduction
Asset Control	None	Some - if Variable product	Yes	Yes
Withdrawals	None	Some	Generally unrestricted – reduces guarantee	Generally unrestricted – reduces guarantee
Termination	None	Limited	Yes – at market value	Yes – at market value



General Product Comparison

	Traditional Fixed Annuity	Enhanced Annuities	GMWB	Guaranteed Pools
Guarantee	Lifetime Income	Lifetime Income	Lifetime Income; High Water Mark	Lifetime Income; High Water Mark
Solvency Risk	Undiversified	May be secured by assets	Secured by plan assets	Secured by plan assets and diversified



Delivery

- ▶ Who manages the product-level recordkeeping and calculations?
- ▶ How is data fed to the recordkeeping platform provider?
 - ▶ How long does it typically take to fully integrate with a platform?
- ▶ Is there product portability? (i.e., accommodated by various recordkeepers)
 - ▶ Is the provider independent or affiliated with a recordkeeper, asset manager, or both?
- ▶ What would a participant statement look like?
 - ▶ How will they see account value and retirement income displayed?
- ▶ What type of participant communication and education is available?
 - ▶ Will participants have access to personalized illustrations?



Pricing

- ▶ What are the fees?
 - ▶ Plan-level and Participant-level
 - ▶ Commissions
- ▶ Are fees broken down into component parts?
 - ▶ Portfolio Management
 - ▶ Insurance/Guarantee Fee
 - ▶ Recordkeeping Cost
- ▶ Are participants getting institutional pricing?
- ▶ Can the fees change after issue?
 - ▶ Circumstances
 - ▶ Limits
 - ▶ Non-retroactive



Deposits

- ▶ Is there any recordkeeping lag?
- ▶ Can participants deposit out of payroll as with other DC plan contributions?
- ▶ Does income accumulate with each contribution or transfer-in?
 - ▶ How is this shown on the website and participant statements?



Asset Control

- ▶ Are the underlying funds proprietary to the product or specific to the plan?
- ▶ Does the product use balanced funds or target date funds?
- ▶ Is the underlying portfolio actively-managed or indexed?
- ▶ Is there potential for retirement income to increase if there is positive investment performance?



Withdrawals

- ▶ Is the product benefit-responsive for withdrawals during accumulation phase?
- ▶ Can the income stream be modified after payout begins?
- ▶ Does the participant have access to the remaining account balance even in payout phase?
- ▶ Does remaining account balance / payments go to beneficiaries?



Termination

- ▶ Can the participant unwind the product?
 - ▶ Under what circumstances?
 - ▶ At what cost?
 - ▶ Are accrued benefits lost?
- ▶ Can the fiduciaries unwind the product?
 - ▶ Under what circumstances?
 - ▶ At what cost?
 - ▶ Are accrued benefits lost?
- ▶ Are the benefits portable?



Guarantees

- ▶ What is the long-term viability of the guarantee?
- ▶ High water mark feature in accumulation phase only or also in payout phase?
- ▶ Is there income guaranteed for life?
- ▶ Are there annuity form options (e.g., single life, joint life, etc.)
- ▶ Can the product accommodate early retirement?
- ▶ What name do participants see in conjunction with the guarantee?



Solvency

- ▶ How safe is the issuer?
 - ▶ Credit ratings
 - ▶ Business mix
 - ▶ Depth and breadth of portfolio
- ▶ How long has the issuer been providing guarantees in general?
- ▶ How long has the issuer been providing retirement income guarantees?
- ▶ How is the guarantee structured (e.g., separate account)?
 - ▶ Is the product insulated from other creditors of the company as well as any other business risk?



Remember...

GMWB products represent a significant step forward in the evolution of retirement programs, and the landscape is still evolving.

Marketers are paid to be optimists.

Plan fiduciaries have a duty to think about what can go wrong with a product before a new option is added to a plan.



Thanks for your time!

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How to Conduct an Effective Investment Manager Meeting

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Agenda

- ▶ Setting Up the Meeting
- ▶ Digging Through the Deck
- ▶ Running the Meeting
- ▶ Following Up



Setting Up the Meeting - Logistics

▶ Time Frame

- ▶ Make sure time is adequate for the discussion
 - Generally 1 hour is sufficient for standard review
 - More time might be necessary if a specific problem needs to be addressed

▶ Materials

- ▶ Request detailed fund report
 - More info than the fund fact sheet
 - Additional detail should reveal topics for discussion
- ▶ Review materials in advance of the call
 - Questions surfaced will create agenda for the meeting



Setting Up the Meeting - Logistics

▶ Attendance

▶ Make sure the right people are on the call

- Portfolio Manager
 - Actually makes the decisions for the portfolio
 - Will have the most knowledge about the strategy and tactics
 - Usually have limited time
- Product Specialist
 - Serve as a bridge between portfolio manager and clients
 - Have in-depth knowledge of a number of products
 - May not have the same level of detailed knowledge as PM
- Marketer (e.g., Wholesaler, Account Manager, etc.)
 - Generate and cultivate leads
 - Will have the broadest knowledge on the offerings of the firm
 - Knowledge of specific strategies will typically be very high level



Setting Up the Meeting - Etiquette

▶ Decorum

- ▶ Even if there are performance or other problems with the fund, keep the meeting professional
- ▶ Respect the time of the attendees

▶ In-person Attendance

- ▶ Don't strand IM representatives
 - Provide them with internet and phone access if they arrive early



Setting Up the Meeting - Expectations

- ▶ Set Expectations for the Call in Advance
 - ▶ Identify issues or problems
 - Be blunt
 - ▶ Outline what you expect to get from the call
 - Who you want to speak with
 - What you want them to cover



Digging Through the Deck - People

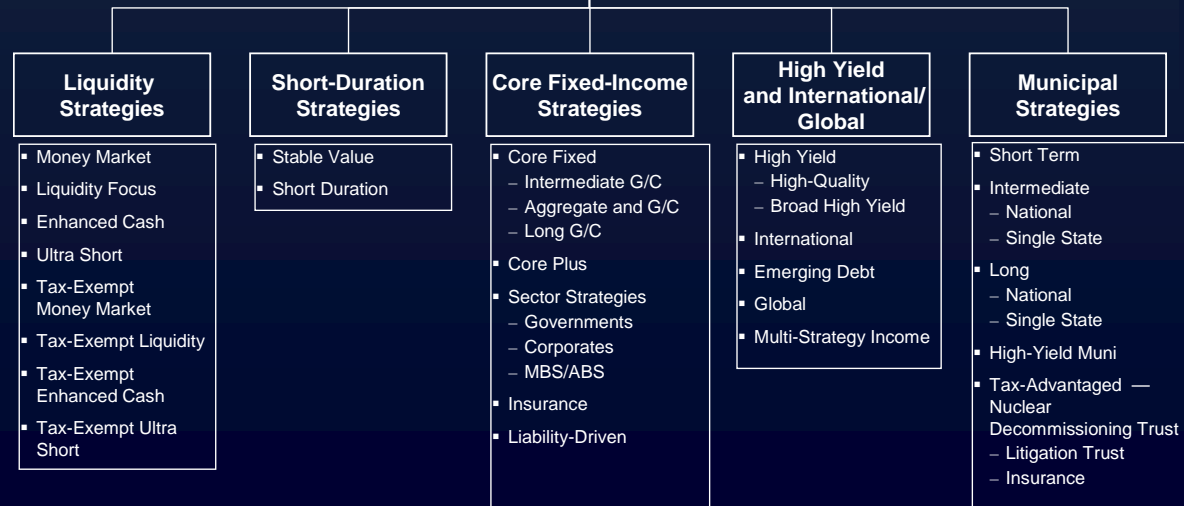
- ▶ Depth and stability of the team
 - ▶ Composition of the team
 - Experience
 - Expertise
 - ▶ Tenure on specific strategy and in industry
 - ▶ Additional resources available to PM
 - ▶ Any upcoming changes?
- ▶ Relationship between managers & analysts
 - ▶ How are they compensated?
 - ▶ How do information and recommendations flow?
- ▶ Clarity of the decision-making process
 - ▶ Who makes the decisions?
 - ▶ Does the PM have veto power?
 - ▶ Get a walk-through of the process



Typical Exhibits – Organizational Chart, Bios

Team	Materials and Energy	Health Care	Industrials	Consumer	Technology	Financials
Small-Cap Growth	Bugs Bunny, CFA Elmer Fudd, CFA	Underdog, CFA	George Jetson, CFA	Fred Flintstone, CFA	Barney Rubble, CFA	Donald Duck, CFA
Mid-Cap Growth	Scooby Doo, CFA Mighty Mouse Magilla Gorilla	Scooby Doo, CFA Tennessee Tuxedo, CFA	Mighty Mouse	Charlie Brown, CFA	Daisy Duck	Magilla Gorilla
Large-Cap Growth	Minnie Mouse, CFA Daffy Duck	Mickey Mouse, CFA	Curious George, CFA Peppermint Patty, CFA	Woody Woodpecker Felix the Cat	Minnie Mouse, CFA Sally Brown, CPA	Daffy Duck
Multicap Growth	Mickey Mouse, CFA					
Growth Sectors –Health care –Technology		Yosemite Sam, CFA Pepe LePew, CFA Foghorn Leghorn			Foghorn Leghorn, CFA Porky Pig, CFA Speedy Gonzales, CFA	

Fixed Income



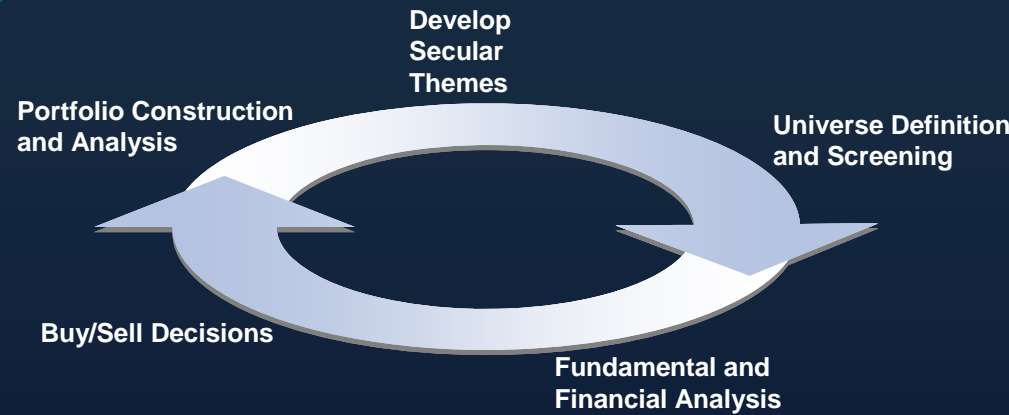
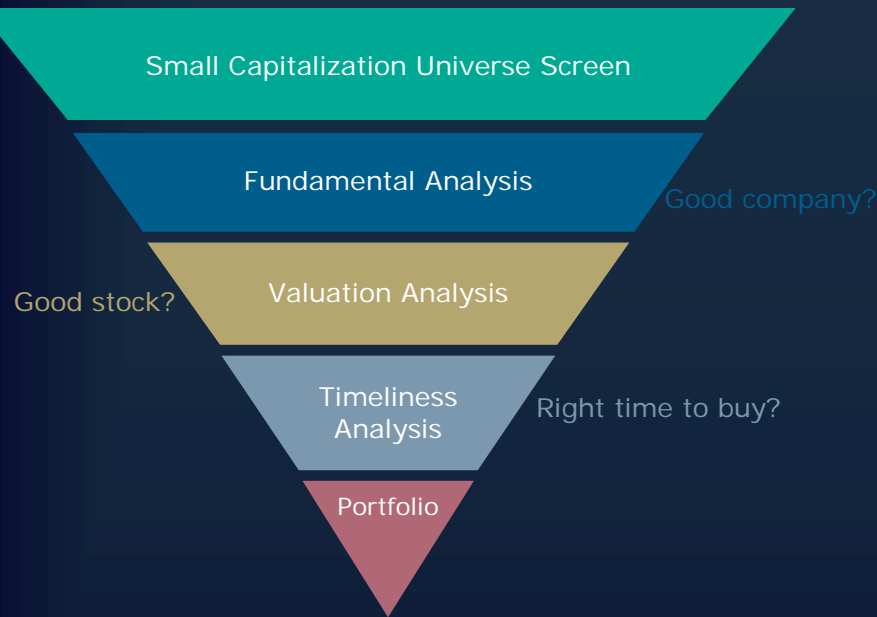


Digging Through the Deck - Process

- ▶ Sound Theoretical Basis
 - ▶ Does it make sense?
- ▶ Sustainability
 - ▶ Can the process be repeated?
 - ▶ Will it work through various market cycles?
- ▶ Risk Exposure
 - ▶ How are risks identified and measured?
- ▶ Controls
 - ▶ Are there checks and balances?
 - ▶ Self-imposed or external review?
- ▶ Discipline
 - ▶ How is the process implemented?
 - ▶ When / how often does the PM deviate from it?



Typical Exhibits – Process Charts, Risk Controls





Digging Through the Deck - Portfolio

▶ Consistency with Stated Process

- ▶ Do the holdings reflect the strategy?
 - Style drift
 - Deviation from benchmark

▶ Stability over time

- ▶ How has the portfolio changed?
 - Style drift?

▶ Risk exposures

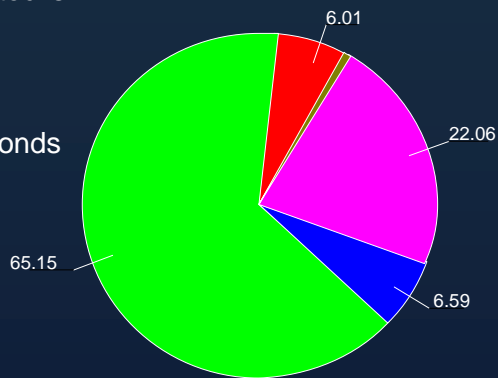
- ▶ What are the stated controls?
- ▶ How concentrated is the portfolio?
- ▶ Are there (or have there been) unintentional positions taken?
- ▶ How is it monitored and controlled?



Typical Exhibits – Holdings, Fund Composition

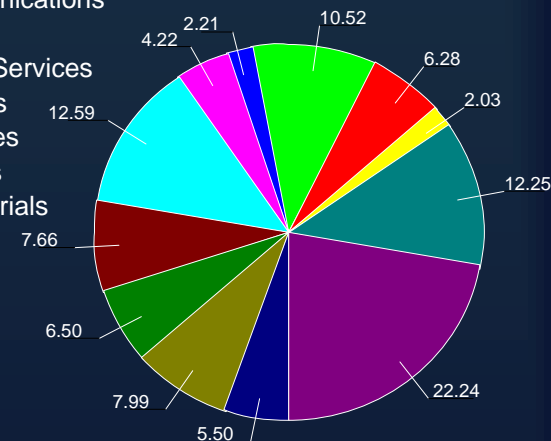
Portfolio Composition

- % Cash
- % US Stocks
- % Bonds
- % Non-US Stocks
- % Pref
- % Conv
- % Other
- % Non-US Bonds



Sector Distribution

- % Software
- % Hardware
- % Media
- % Telecommunications
- % Healthcare
- % Consumer Services
- % Biz Services
- % Fin'l Services
- % Con. Goods
- % Indus. Materials
- % Energy
- % Utilities



Top Ten Holdings

Suncor	2.7%
Oracle	2.2%
Microsoft	2.0%
Cisco Systems	1.8%
Merck	1.8%
JPMorgan Chase	1.8%
Roche	1.7%
McDonald's	1.6%
Eli Lilly	1.4%
Google	<u>1.4%</u>
	18.4%

Holdings as of 3/31/2009



Typical Exhibits – Portfolio Statistics

Portfolio Characteristics	Fund	Russell 2000 Index
P/E	19.72	20.02
P/E FY1	13.69	13.46
Historic 3 yr EPS Growth (%)	19.15	15.42
Est 3-5 yr EPS Growth (%)	14.28	15.13
Price/Book	2.26	2.23
Dividend Yield (%)	1.28	1.58
Number of Companies	161	1,960
Weighted Avg Market Cap (\$M)	\$2,250	\$1,044

Returns-Based Characteristics (3 Years)	Fund	Russell 2000 Index
Beta	0.91	1.00
Tracking Error (%)	2.87	N/A
Turnover (% annualized)	83*	N/A



Digging Through the Deck - Price

- ▶ Competitiveness
 - ▶ Compared to other funds in category
- ▶ Expense Control
 - ▶ Trading
 - ▶ Administrative



Typical Exhibits

Actual Fees %

12b-1:	0.00
Management:	0.20

Net Expense Ratio:

Annual Report:	0.14
Prospectus:	0.14

Expense Waivers (sample language):

“The Advisor has contractually agreed to bear a portion of the Fund’s expenses so that the Fund’s ordinary operating expenses (excluding any distribution and service fees, brokerage commissions, interest, taxes and extraordinary expenses, but including custodian charges relating to overdrafts, if any), after giving effect to any balance credits from the Fund’s custodian, do not exceed 0.14% annually through June 30, 2009.”

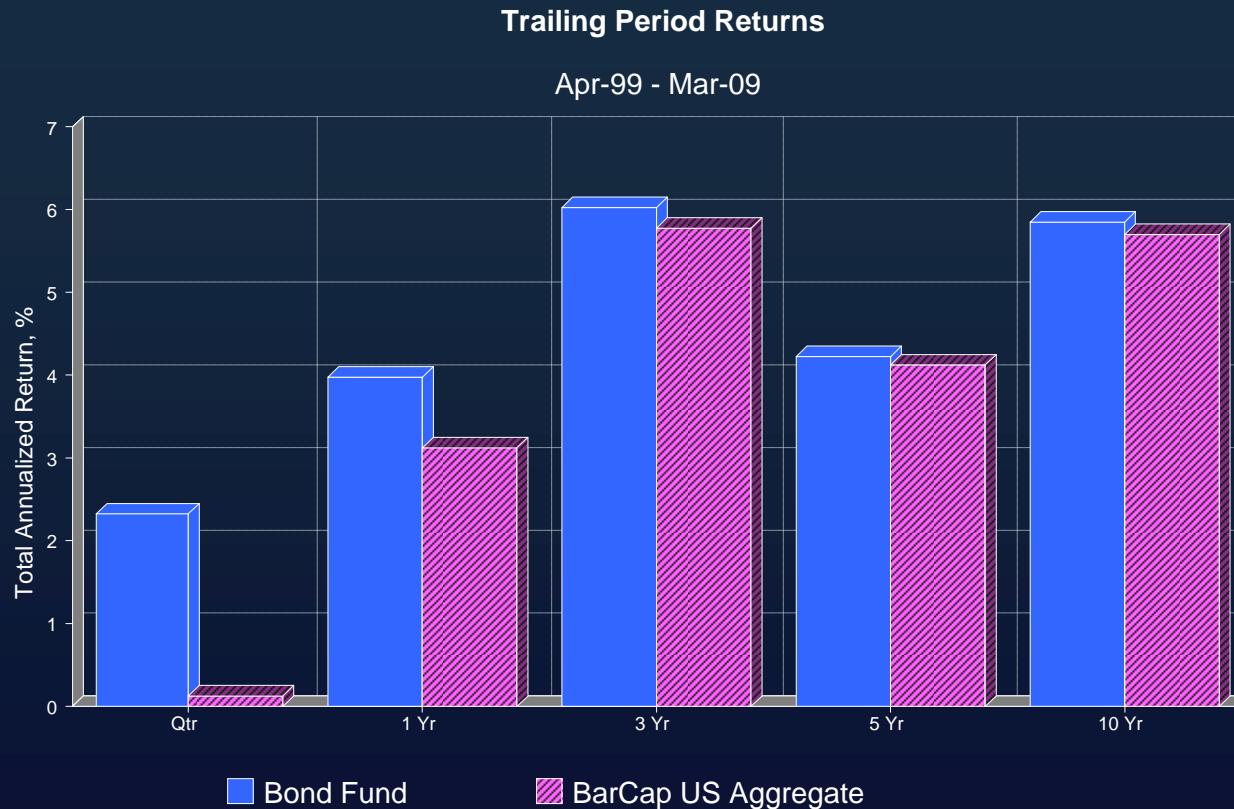


Digging Through the Deck - Performance

- ▶ Competitiveness
 - ▶ Compared to benchmark
 - ▶ Compared to peers
- ▶ Consistency with Stated Process
 - ▶ Generally tracking benchmark – up and down?



Typical Exhibits – Performance vs. Benchmark





Typical Exhibits – Performance Attribution

Economic Sector	Portfolio		Russell Midcap[®] Value		Net Management Effect*		
	% Avg. Weight	% Return	% Avg. Weight	% Return	Alloc Effect	Select Effect	Total Effect
Autos And Transportation	6.54	16.25	3.66	18.92	0.08	-0.27	-0.20
Consumer Discretionary	26.67	12.08	11.15	18.68	0.23	-1.37	-1.14
Consumer Staples	4.11	51.38	6.72	26.52	-0.20	0.77	0.57
Financial Services	28.35	10.65	33.60	12.05	0.33	-0.83	-0.50
Health Care	0.36	-3.24	2.92	7.60	0.37	-0.17	0.21
Integrated Oils	--	--	1.27	34.04	-0.17	--	-0.17
Materials And Processing	4.46	22.64	8.13	23.81	-0.23	0.18	-0.05
Other	0.00	-9.96	1.90	15.96	0.03	-0.00	0.03
Other Energy	15.44	3.06	3.92	21.74	0.88	-2.86	-1.97
Producer Durables	1.65	11.05	4.52	1.16	0.42	0.31	0.72
Technology	7.76	27.68	6.31	-0.29	0.17	2.42	2.59
Utilities	0.24	8.85	15.91	32.60	-2.10	0.04	-2.06
Cash	4.44	5.11	--	--	-0.46	--	-0.46
Total	100.00	14.72	100.00	17.14	-0.65	-1.77	-2.42



Running the Meeting

- ▶ Review Meeting Expectations
 - ▶ Highlight issues or questions that need to be addressed
 - ▶ Confirm time allocated for discussion
- ▶ Pitfalls to Avoid
 - ▶ Too much time spent on organizational overview
 - If possible, ask to dive right in to fund discussion.
 - ▶ Portfolio manager focuses on specific holdings
 - Ask a question that moves the focus back to a portfolio-level discussion.
 - ▶ Purposeless meetings
 - Make sure you have the right people on the call for the topics you want addressed
 - ▶ Marketing spin (e.g., “We’re good stock-pickers”)
 - Maintain healthy skepticism about everything you are told; try to get examples or supporting data



Following Up

- ▶ Review the list of follow-up items before ending the meeting.
- ▶ Schedule additional time, if necessary.
- ▶ Note timing for next review.



Thanks for your time!

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