

HEALTH WEALTH CAREER

CONNECTICUT RETIREMENT SECURITY BOARD DISCUSSION GUIDE

August 5th, 2015

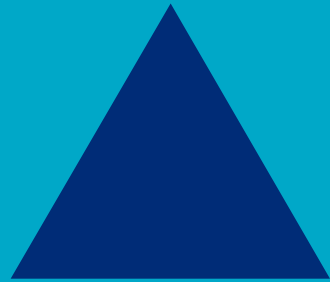
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AGENDA & TOPICS

1. Discussion goals
2. Primary topics
 - Governance
 - Contribution Process
 - Identify Employers & Employees
 - Guarantees
 - Investment options

DISCUSSION GOALS



THE CRSB'S GOALS ARE TO:

- Provide feedback to the State Legislature on the feasibility of the proposed auto-enroll IRA program's goals and design features, and
- Recommend methods best suited to accomplish the program's goals and design features

IN FULFILLING THESE GOALS, THE CRSB HAS THREE OPTIONS FOR EACH PROGRAM ELEMENT

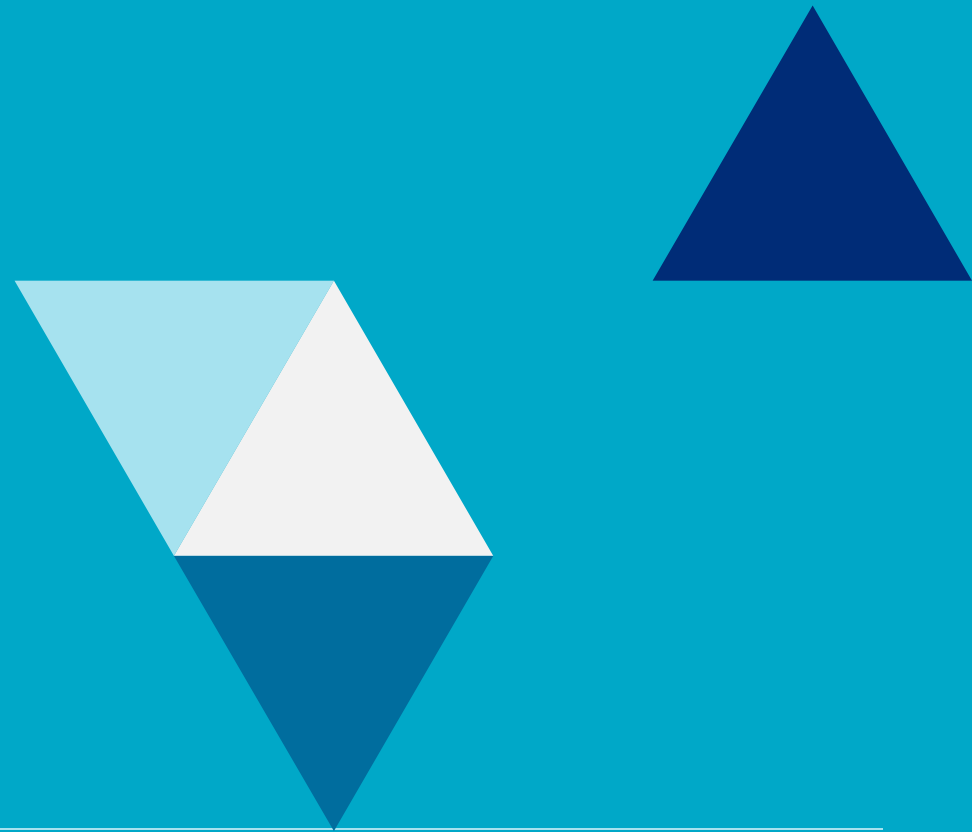


Provide detailed feedback to Legislature

Allow the Legislature to decide the details

Recommend the decisions be made by
the group(s) responsible for
implementation

PRIMARY TOPICS



GOVERNANCE FRAMEWORK

RELEVANT GOAL & DESIGN FEATURE

Sec. 185 (4)

“The promotion of transparency and accountability in the management of the retirement funds through oversight, regular reporting to plan participants and ethics review of plan fiduciaries;”

Sec. 185 (21)

“Ensuring that any assets held for the plan shall be used for the purpose of distributing individual retirement savings balances to the plan participants and paying the operational, administrative and investment costs associated with the plan;”

ESTABLISHING GOVERNANCE FRAMEWORK

	Governing Bodies	Managing Bodies	Operating Bodies
Role	<ul style="list-style-type: none"> Establish the organizational structure Make “big picture” strategic decisions. Oversee program implementation. Oversee broader program performance against goals and risks. 	<ul style="list-style-type: none"> Oversee the implementation of administration and operational decisions. Oversee and manage the operations. Are accountable to the governing bodies 	<ul style="list-style-type: none"> Make day-to-day decisions (e.g. administration, employer servicing, participant servicing, investment management, custody). Implement strategy under guidance of managing bodies.
Responsibility	<ul style="list-style-type: none"> Establish vision, strategy, goals and policies. Design decision-making. Determine deferral rates & auto-escalation rates. Delegate day-to-day responsibilities to managing and operating bodies and hold them accountable for performance. Monitor structure and performance of the program. Understand fiduciary responsibilities; minimize agency costs. 	<ul style="list-style-type: none"> Act as advisors to governing bodies. Devise strategies for achieving objectives and implementing policies. Design administration and operational processes, as well as controls to ensure program integrity. Implement and monitor program administration and operations. Manage and monitor operating bodies. Accountable for program performance. 	<ul style="list-style-type: none"> Manage program operations. Monitor risk. Manage information systems. Provide reporting. Interface with participants and employers.

GOVERNANCE ELEMENTS

THE GOVERNING BODY

Key Elements	Recommendation
Governing Body	<ul style="list-style-type: none"> Legal structure follows the program's legal structure, e.g. a trust would have a trustee board. The governing body be independent from other State-managed programs.
Governing Body for implementation vs. ongoing oversight	<ul style="list-style-type: none"> A functional approach to organizing the Governing Body for implementation, moving to a more stakeholder focused or representative approach for ongoing program management.
Appointing members to the Governing Body and terms for appointments	<ul style="list-style-type: none"> Protocols for appointment left to the Legislature to define; however, recommend parameters around the appointments, e.g. 3-year appointment and/or staggered terms.
Composition	<ul style="list-style-type: none"> CRSB consider whether to make recommendations.
Standard of care	<ul style="list-style-type: none"> Consistent with law guiding the legal structure and market best practices, if law is less than a fiduciary-level
Mandates & duties	<ul style="list-style-type: none"> CRSB consider whether to make specific recommendations along the lines of slide 5.
Delegation of duties	<ul style="list-style-type: none"> CRSB provide guidance to the Legislature that the Governing Body can delegate along the lines of slide 5.
Discretion in interpreting legislation	<ul style="list-style-type: none"> Leave this decision to the Legislature, but highlight that the legislation should make specific provisions to guide the Governing Body.
Reporting requirements to Legislature	<ul style="list-style-type: none"> Leave this decision to the Legislature with a recommendation of a minimum, e.g. annual reporting.

GOVERNANCE ELEMENTS

THE MANAGING BODY

Key Elements	Recommendations
Entity responsible	<ul style="list-style-type: none"> The CRSB provide a specific recommendation on which State agency or department has responsibility.
Standard of care	<ul style="list-style-type: none"> Consistent with law guiding the legal structure and market best practices, if law is less than a fiduciary-level
Mandates & duties	<ul style="list-style-type: none"> CRSB consider whether to make specific recommendations along the lines of slide 5.
Delegation of duties	<ul style="list-style-type: none"> CRSB provide guidance to the Legislature that the Managing Body can delegate along the lines of slide 5.
Discretion in deciding implementation issues, e.g., vendors and ongoing operations	<ul style="list-style-type: none"> CRSB should consider whether to provide recommendations.
Reporting requirements to Governing Body	<ul style="list-style-type: none"> The Governing Body determine the reporting requirements and parameters within legislatively determined core requirements. CRSB provide guidance to the Legislature regarding the approach.

GOVERNANCE ELEMENTS

CONSIDERATIONS FOR OPERATING BODIES

1. Whether to outsource
2. Set procurement standards
3. Recommend procurement goals, e.g. reasonable costs for services or within a specific cost limit, e.g. 0.75%
4. Identify particular areas that should be addressed in legislation versus during implementation

CONTRIBUTION PROCESS

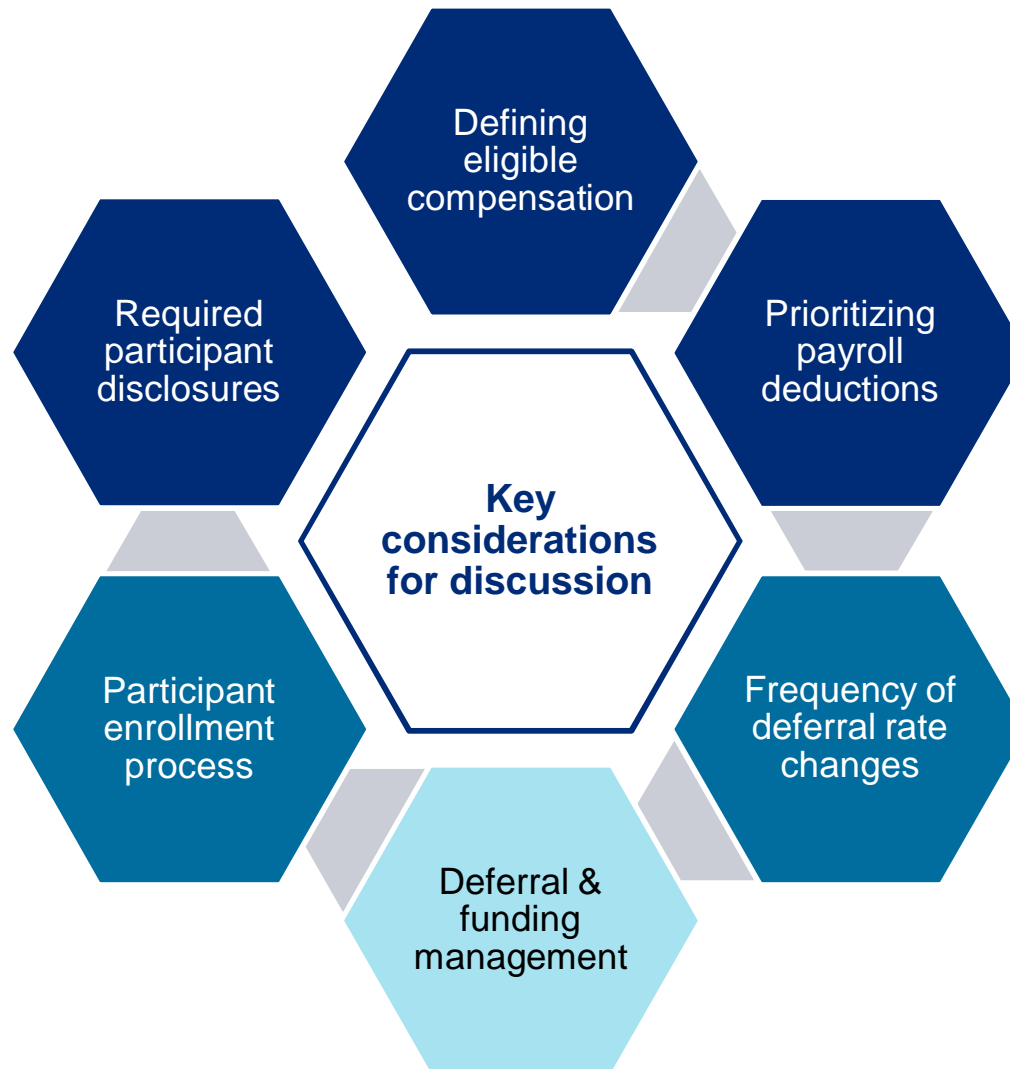
RELEVANT GOAL & DESIGN FEATURE

Sec. 185 (15)

“A process by which a qualified employer shall credit the plan participant's contributions to his or her individual retirement account through payroll deposit;”

CONTRIBUTION PROCESS

CREDITING PARTICIPANT ACCOUNTS



Adopt existing federal or market standards

Governing and/or managing body establish

CRSB provide a recommendation

IDENTIFYING EMPLOYERS & EMPLOYEES RELEVANT GOAL & DESIGN FEATURE

Sec. 185 (14)

“A process to determine the eligibility of an employer, employee or any other individual to participate in the plan and to ensure mandatory participation by any qualified employer that does not offer an employer-sponsored retirement plan to its employees;”

CURRENT LEGISLATION DEFINED A QUALIFIED EMPLOYER AS FOLLOWS:

"Qualified employer" means any person, corporation, limited liability company, firm, partnership, voluntary association, joint stock association or other entity that employs five or more persons in the state. "Qualified employer" does not include:

- (A) The federal government, (B) the state or any political subdivision thereof, or (C) any municipality, unit of a municipality or municipal housing authority."

KEY REQUIREMENTS

The legislation must provide criteria for employers, the Governing Body or Enforcement Body to use in deciding an employer's and / or employee's status. The key elements of the criteria are:

1. Determining whether the 5 employee cut-off is the right threshold,
2. Defining an employee for the purposes of determining headcount,
3. Defining an employer,
4. Clarifying what a “qualified employer savings plan” is for the statute purposes,
5. Identifying the employees to be auto-enrolled.

ONLY 28% OF EMPLOYERS WITH FEWER THAN 10 EMPLOYEES OFFER A RETIREMENT PLAN

Firm size (number of employees)	Offer any retirement plan (%)			Participation in any retirement plan (%)			Take up of any retirement plan (%)		
	2006	2009	2012	2006	2009	2012	2006	2009	2012
All	72	75	75	58	63	61	80	83	82
100 or more	84	87	87	68	73	71	81	84	82
Fewer than 100	50	50	52	39	40	42	79	79	80
Fewer than 10	34	33	28	28	27	23	83	82	82
10–24	46	46	51	36	35	42	77	78	82
25–49	60	59	63	46	47	51	77	81	80
50–99	70	67	73	54	52	57	78	78	78
10 or more	77	81	80	62	67	65	80	83	82
Number of observations	23,753	20,499	14,464	23,753	20,499	14,464	15,631	15,525	10,873

Source: National data from the Office of Retirement and Disability Policy using data from the Survey of Income and Program Participation (SIPP) for 3 years: 2006, 2009, and 2012.

EMPLOYERS WITH < 5 EMPLOYEES EMPLOY ABOUT 100K PEOPLE, BUT MANY ARE SOLE PROPRIETORS

State of Connecticut employment by firm size (From 2004 to 2013)

Number of Employees	Counted by Worksites				Employees			
	Number		% of Total		Number		% of Total	
	Min	Max	Min	Max	Min	Max	Min	Max
0 - 4	62,847	67,017	59.5	61.8	102,396	106,173	7.2	7.6
5 - 9	17,616	18,451	16.3	17.2	116,787	122,278	8.3	8.6
10 - 19	11,401	12,228	10.5	11.2	153,514	164,954	11.1	11.6
20 - 49	7,679	8,315	7.1	7.5	232,324	251,228	16.8	17.7
50 - 99	2,582	2,898	2.4	2.7	176,576	198,776	12.9	13.7
100 - 249	1,575	1,728	1.5	1.6	236,328	261,072	17.3	17.9
250 - 499	326	363	0.3	0.3	108,259	123,696	7.8	8.6
500 - 999	99	115	0.1	0.1	64,027	73,619	4.7	5.2
1,000 & over	67	75	0.1	0.1	164,117	174,792	11.6	12.5
	105,670	110,238	100.0	100.0	1,368,303	1,461,194	100.0	100.0

Source: Mercer estimates based on Quarterly Census of Employment and Wages by Connecticut Department of Labor. This excludes government workers.

CRSB CAN COMMENT ON TWO ASPECTS OF DEFINING EMPLOYEES: HEADCOUNT & COVERAGE

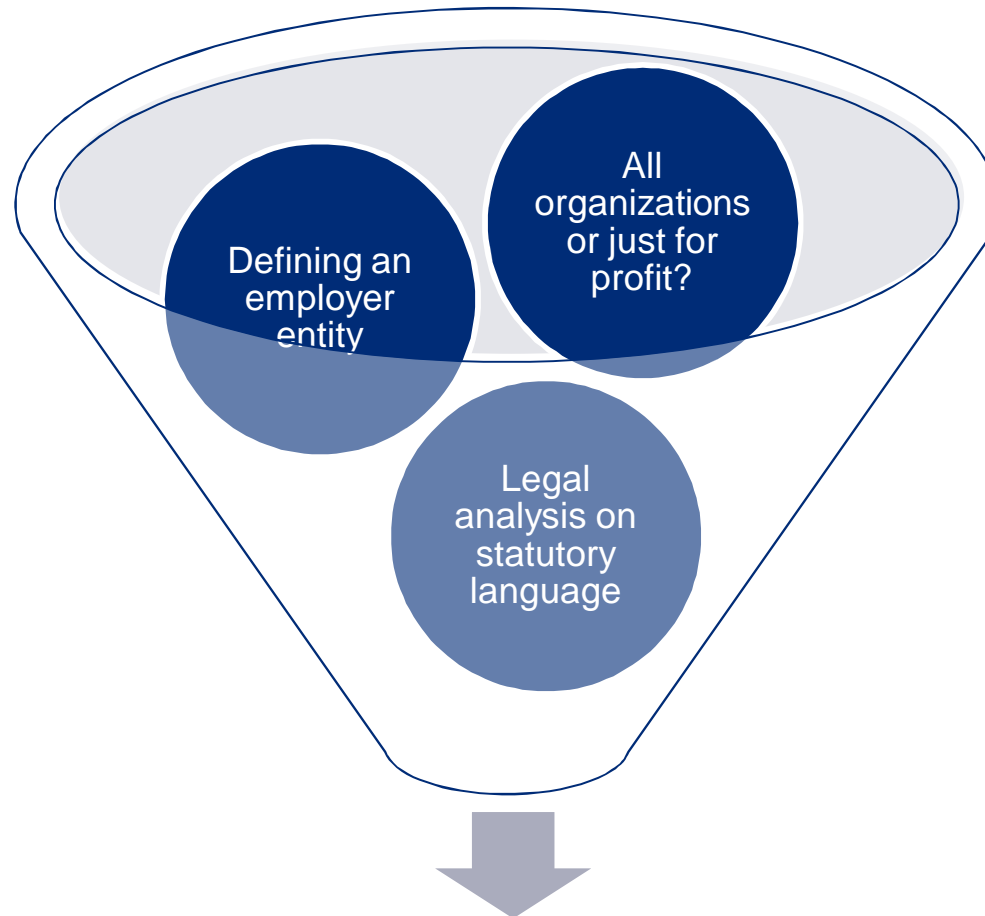
Headcount

- Not possible to differentiate between full, part-time seasonal workers on payroll submissions– true in every state not just CT. What threshold should be used to mandate an employer auto-enroll?
- Turnover complicates counting heads over a period of time. Date for determining headcount under other State statutes is 1 October.

Coverage

- Which employees should be auto-enrolled?
- Should coverage extend beyond the mandated coverage, i.e. can employer offer broader auto-enrollment

CRSB SHOULD CONSIDER WHAT INPUT TO GIVE ON DEFINING ELIGIBLE EMPLOYERS



Importance depends on employee headcount threshold
Employer entity definition may impact enforcement decisions

CRSB SHOULD ALSO CONSIDER ON WHICH EMPLOYER EXEMPTIONS TO COMMENT

- Existing retirement plan
 - Recommend including the following :
 - Payroll deduction IRA
 - Simplified Employee Pension (SEP)
 - Simple IRA
 - Profit sharing, with 401(k) feature
 - 403(b) (employer and/or employee contributions)
 - Defined benefit plan (open to new participants and providing accruals)
 - Money purchase pension plan (open to new participants and providing accruals)
- Employer status
 - Firms In bankruptcy?
 - Firms in business less than specified period, e.g. 2 years?

NEW SMALL BUSINESSES EXPERIENCE HIGH FAILURE RATES, WHICH CAN LEAD TO OPERATIONAL ISSUES

Turnover of private sector establishments in State of Connecticut

Year	# of opening establishments ¹	# of closing establishments ¹	Net Change
2014 (YTD to 9/30/2014)	9,058	8,497	+561
2013	12,126	12,052	+74
2012	12,174	11,814	+360
2011	11,957	11,587	+370
2010	13,460	12,829	+631
2009	10,557	13,480	-2,923
2008	11,473	12,694	-1,221
2007	12,147	12,247	-100

¹ Note: These figures contain all firm sizes; Census data from 2010 show that 87 percent of establishment births and deaths were in firms with fewer than 500 employees.

	Small businesses* opened	Survival rates of small businesses*	
2013	6,762	82.1%	One year through 2014
2010	5,197	74.4%	Two years through 2012
2007	7,275	45.4%	Five years through 2012
2002	6,952	34.2%	Ten years through 2012

*A small business is defined as one with fewer than 500 employees.

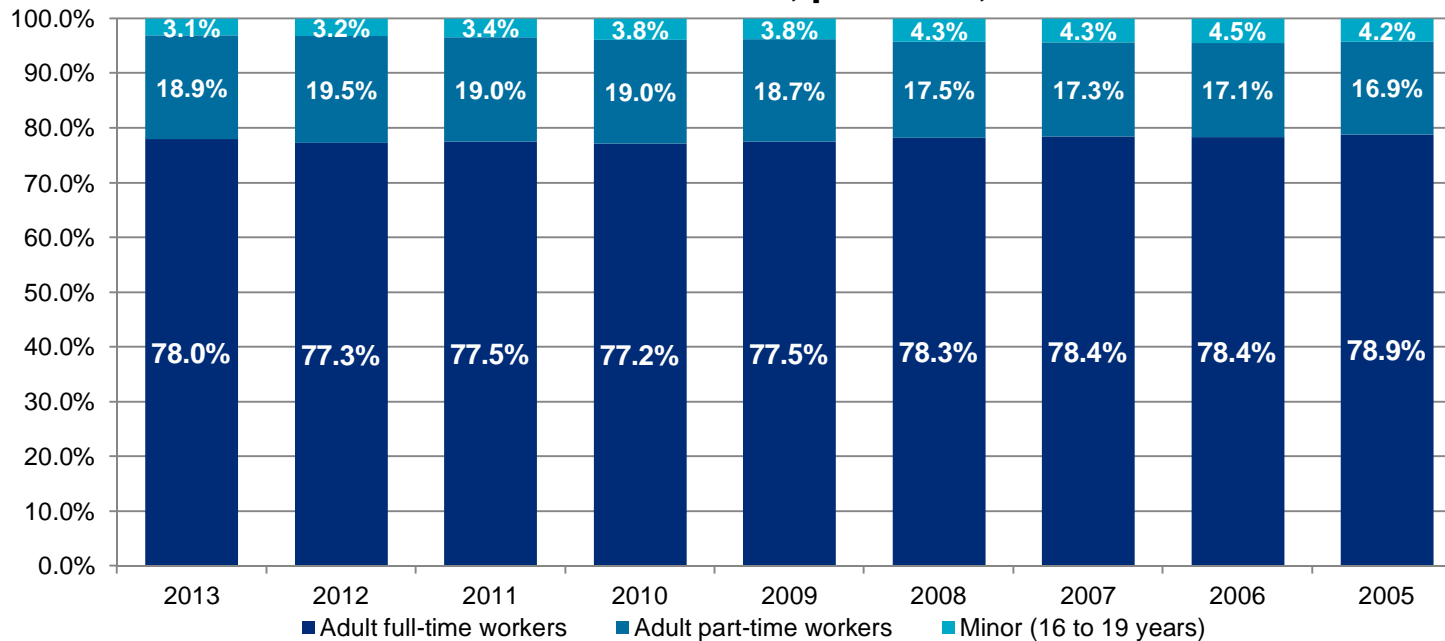
Source: Business Employment Dynamics , U.S. Department of Labor, Bureau of Labor Statistics

AUTO-ENROLLING EMPLOYEES

1. Which employees must be auto-enrolled?
2. Should there be a grace period for enrollment?
3. Cross-state employees should follow salary and wages, which is standard across the US for taxes and other benefits
4. Time period for allowing an employee to opt-out.
5. Time period for enrolling new employees.

INCLUDING MINORS INCREASES COVERAGE BY 53,000 BUT COULD HAVE A LARGE COST IMPACT

State of Connecticut's full-time, part-time, and minor workers



Thousands	2013	2012	2011	2010	2009	2008	2007	2006	2005
Total full-time workers	1,342	1,339	1,366	1,342	1,360	1,405	1,419	1,407	1,376
Adult	1,334	1,331	1,354	1,327	1,346	1,389	1,403	1,390	1,359
Minor (16 to 19 years)	8	8	12	15	14	16	16	17	17
Total part-time workers	368	383	380	377	377	370	370	367	347
Adult	323	336	332	326	325	310	309	304	291
Minor (16 to 19 years)	45	47	48	51	52	60	61	63	56
Total employed	1,710	1,722	1,746	1,719	1,737	1,775	1,789	1,774	1,723

Source:
Connecticut Bureau
of Labor Statistics,
Geographic Profile
Survey

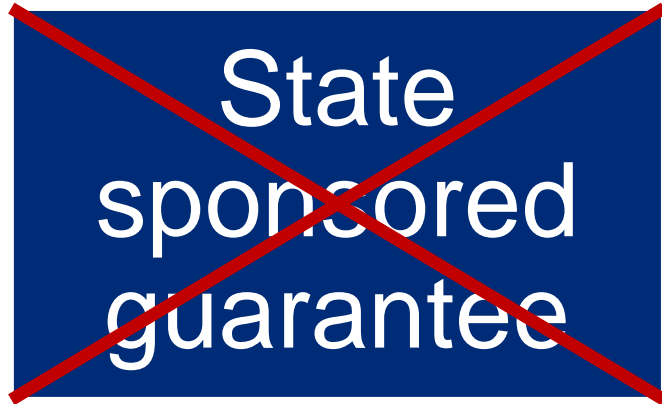
GUARANTEES

RELEVANT GOAL & DESIGN FEATURE

Sec. 185 (9)

“An annually predetermined guaranteed rate of return and the procurement of insurance, as necessary, to guarantee the stated rate of return;”

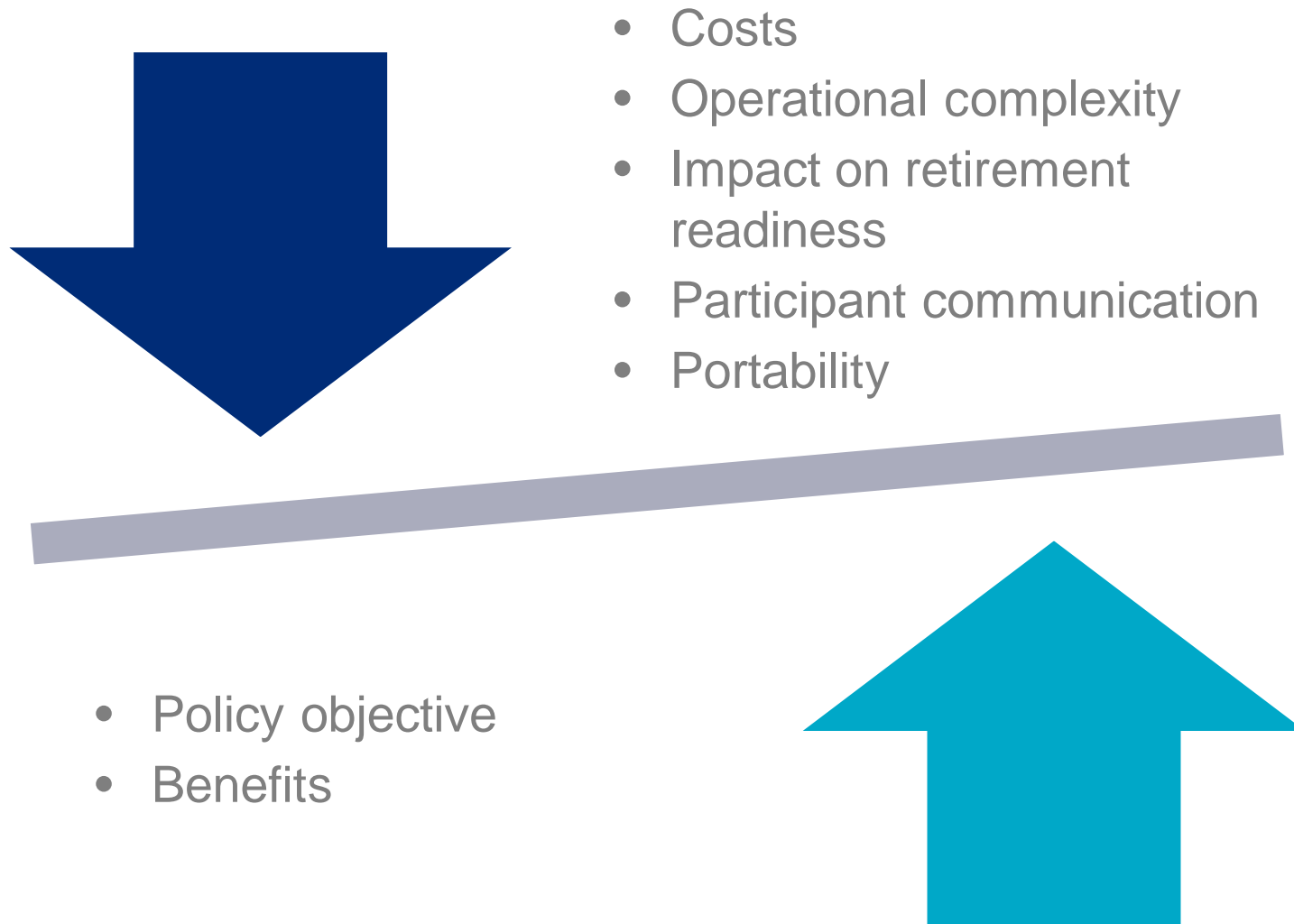
WHO CAN INSURE THE GUARANTEE?



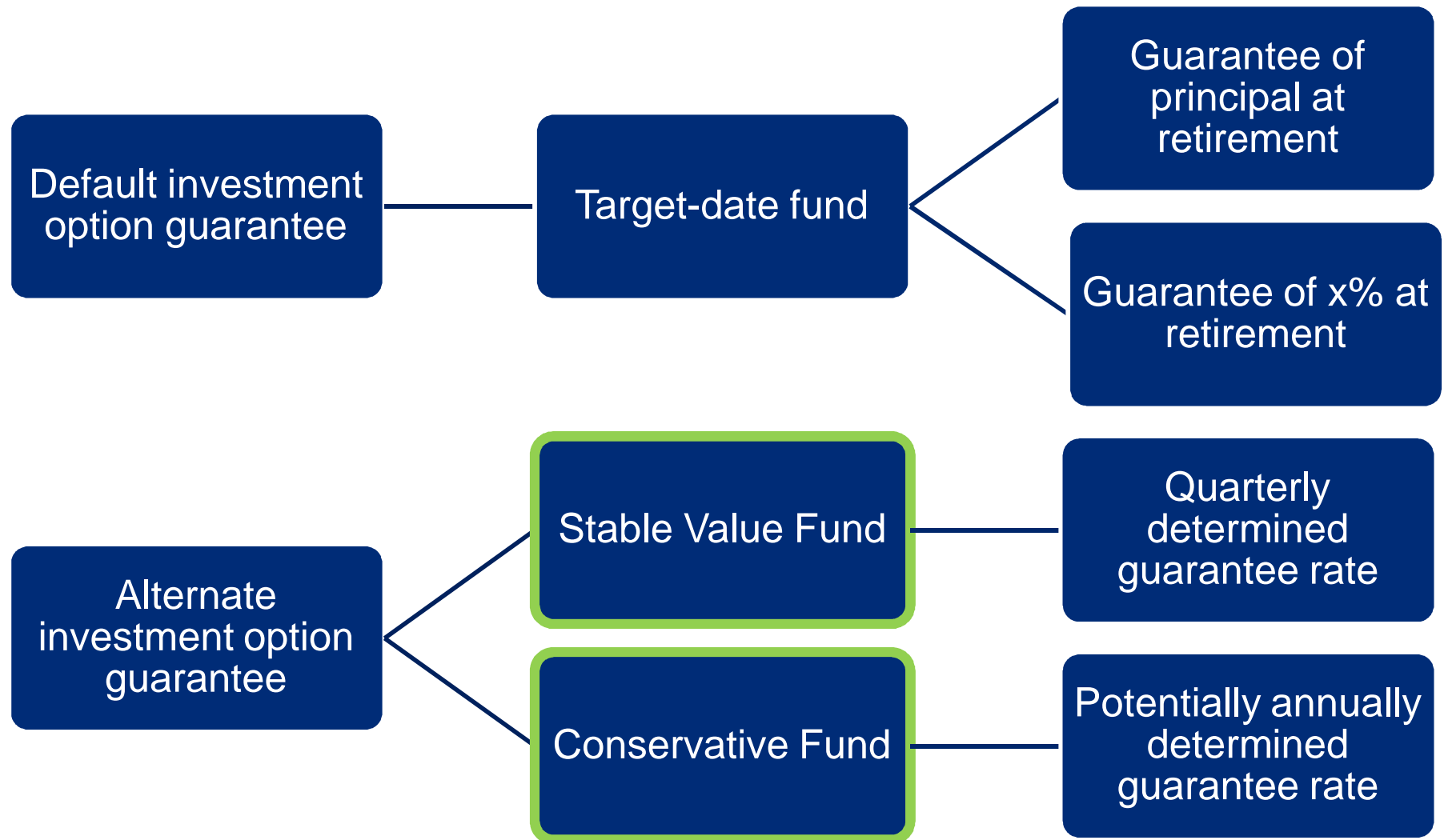
Sec. 185 (23)

“Ensuring that any contract entered into by or any obligation of the plan shall not constitute a debt or obligation of the state and the state shall have no obligation to any designated beneficiary or any other person on account of the plan and all amounts obligated to be paid pursuant to the plan shall be limited to amounts available for such obligation;”

KEY CONSIDERATIONS IN OFFERING A GUARANTEE



INSURANCE OPTIONS



KEY CONSIDERATIONS IN OFFERING A GUARANTEE

	Benefits			Cost	Participant Communication	Portability	Operational Complexity	Retirement Readiness
	Principal Protection	Retirement Income	Longevity Risk	Insurance Fees	Difficulty level of explaining	Withdrawal limit	Additional Operational Complexity	Improves Income Replacement Ratio in Retirement
Target Date Fund (TDF) with principal guarantee	Only at retirement	No, must buy an annuity	No	1.00%*	Simple	Participants lose the guarantee if assets are withdrawn	Yes	No
TDF with x% return guarantee				2.00%**				
Stable Value Fund	Yes	No, must buy an annuity	No	0.50%†	Difficult	Yes	Yes	No
Conservative Fund	Yes	No, must buy an annuity	No	TBD	Potentially difficult	Most likely	Yes	No

* Indicative pricing gathered from two insurers. **Assumes 1% return guarantee. †Based on Mercer's stable value fund survey for qualified DC plans.

GUARANTEE COSTS* REDUCE THE INCOME REPLACEMENT RATIO

EXPECTED INCOME REPLACEMENT RATIO (INCLUDING SOCIAL SECURITY BENEFITS) AT 6% CONTRIBUTIONS, IF INVESTED IN A TARGET DATE FUND WITH NO GUARANTEES

	Age 25	Age 40	Age 55
Low Income	104.0%	71.3%	58.4%
Mid Income	99.5%	62.5%	49.8%
High Income	94.4%	54.6%	36.3%

THE EXPECTED DECLINE IN INCOME REPLACEMENT RATIO IF ASSETS ARE INVESTED IN A GUARANTEED OPTION LISTED BELOW VS. INVESTING IN A TARGET DATE FUND WITH NO GUARANTEE

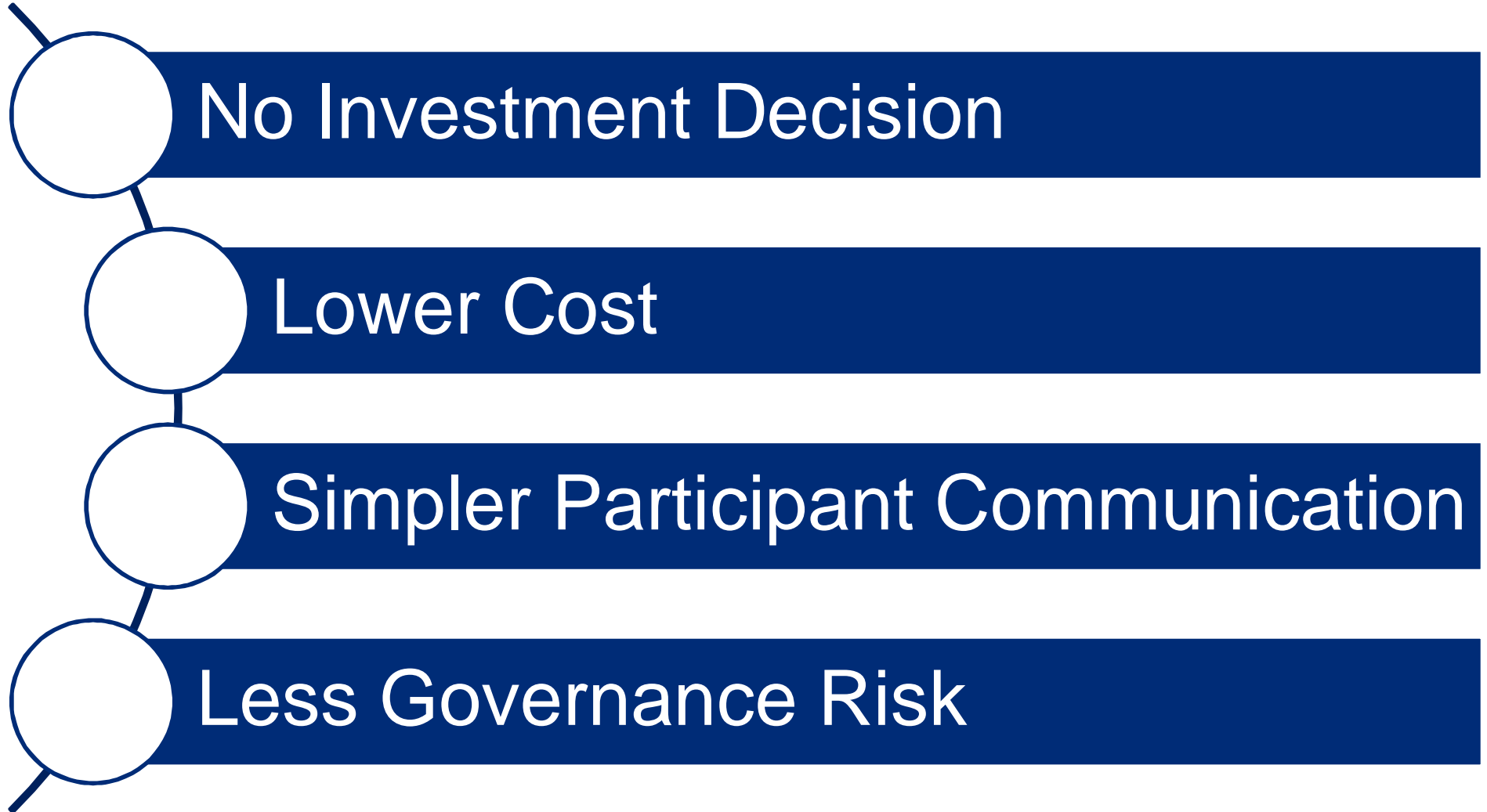
Across all income levels	Age 25	Age 40	Age 55
Target Date Fund with Principal Guarantee	10.7%	2.8%	0.3%
Target Date Fund with 1% Return Guarantee	18.0%	5.0%	0.6%
Stable Value Fund	20.4%	5.4%	0.6%
Conservative Fund	30.4%	9.2%	1.1%

* Cost includes both higher fees and lower expected return. Please see Mercer's Guarantee memo for assumptions used to calculate income replacement ratios.

RECOMMENDATIONS ON INVESTMENT OPTION DESIGN

- The Connecticut Retirement Security legislation does not explicitly require that the CRSB make recommendations on investment option design; however, the statutes have goals of:
 - providing access to a quality retirement program,
 - reducing the need for public assistance, and
 - requiring minimal participant financial sophistication.
- The CRSB may want to recommend an investment design or approach to the Legislature in two potential areas:
 - whether the Retirement Security Program should offer investment choice and
 - the investment option(s) to be offered.

THE BENEFITS OF ONE INVESTMENT OPTION



ONE SIZE DOES NOT FIT ALL

“Do it for me” Investor

- Rarely reviews portfolio
- No engagement in investment allocation decisions
- Lacking in investment knowledge, interest and/or time to proactively managed investments
- Wants professional assistance managing investment exposure over time

“Help me do it” Investor

- Reviews overall investment allocation occasionally
- Wants control over major shifts in allocation
- Limited engagement on implementation, rebalancing and other shorter-term issues

“Leave me to it” Investor

- Frequently reviews portfolio
- Utilizes full range of investment options
- Wants to control all key investment allocation decisions

BUT CHOICE HAS CONSEQUENCES

DC Investment Options	
Χαπιταλ Πρεσερπατιον	Ηιγη Ψιελδ Φυνδ
Διπερσιφιεδ Φιξεδ Ινχομε	Διπερσιφιεδ Ινφλατιον
Διπερσιφιεδ Ινφλατιον	ΤΠΣ
Λαργε Χαπ ραλυε	Χομμοδιτιεσ
Λαργε Χαπ Γρωωτη	
Σμαλλ/Μιδ Χαπ ραλυε	
Σμαλλ/Μιδ Χαπ Γρωωτη	
Ωορλδ εξ–ΥΣ Εθυιτψ	
Ταργετ Δατε Φυνδσ	
Λαργε Χαπ Ινδεξ	
Σμαλλ Χαπ Ινδεξ	
Ιντερνατιοναλ Χαπ Ινδεξ	
Τεχνηολογψ Φυνδ	

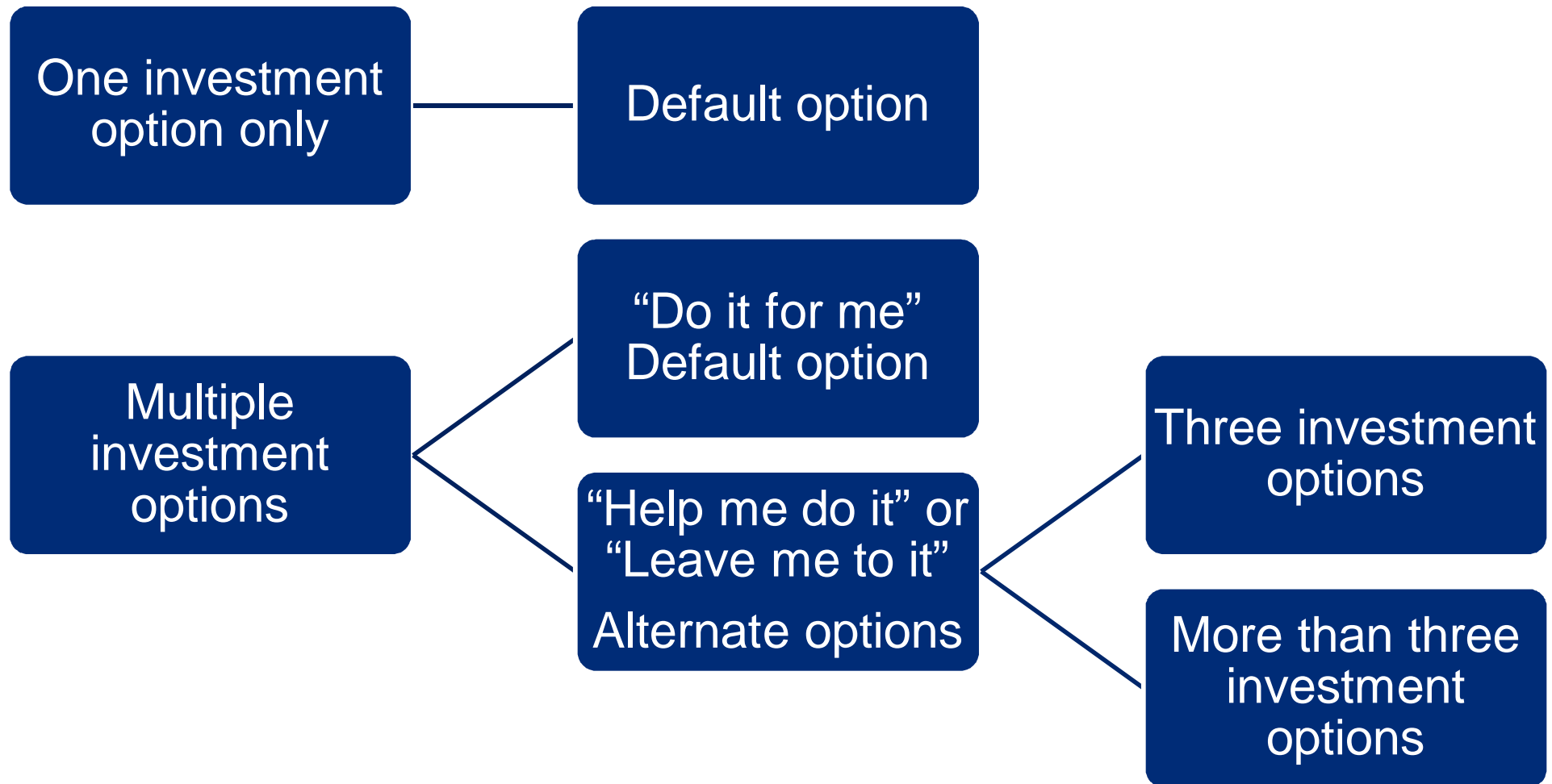
How the average DC plan participant sees her retirement plan investment options



LOOKING TO ERISA FOR GUIDANCE

- ERISA section 404(c) requires qualified plans to offer a broad range of investment options to give participants a reasonable opportunity to:
 - Materially affect the potential return on investment and the degree of risk taken.
 - Choose from a range of investment alternatives
 - Diversify the investment of his or her account so as to minimize the risk of large losses
- Most qualified defined contribution (DC) plans have interpreted 404(c) to mean that a diversified fund from the following asset classes should be offered:
 - equity,
 - fixed income, and
 - capital preservation.

APPROACHES TO CONSIDER



SUGGESTED STRUCTURES FOR MULTIPLE INVESTMENT OPTION APPROACH

EXAMPLE 1: RECOMMENDED INVESTMENT DESIGN

“Do it for me”	“Help me do it”
	Capital Preservation
	Diversified Fixed Income
Target Date Funds 5-year increments	
	Global All Cap Equity

EXAMPLE 2: ALTERNATE INVESTMENT DESIGN (WITH INFLATION PROTECTION FUND)

“Do it for me”	“Help me do it”
	Capital Preservation
	Diversified Fixed Income
Target Date Funds 5-year increments	Diversified Inflation
	Global All Cap Equity

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**MAKE
TOMORROW
TODAY**

