

HEALTH WEALTH CAREER

CONNECTICUT RETIREMENT SECURITY BOARD GUARANTEE AND INVESTMENT OPTION DISCUSSION GUIDE

September 2nd, 2015

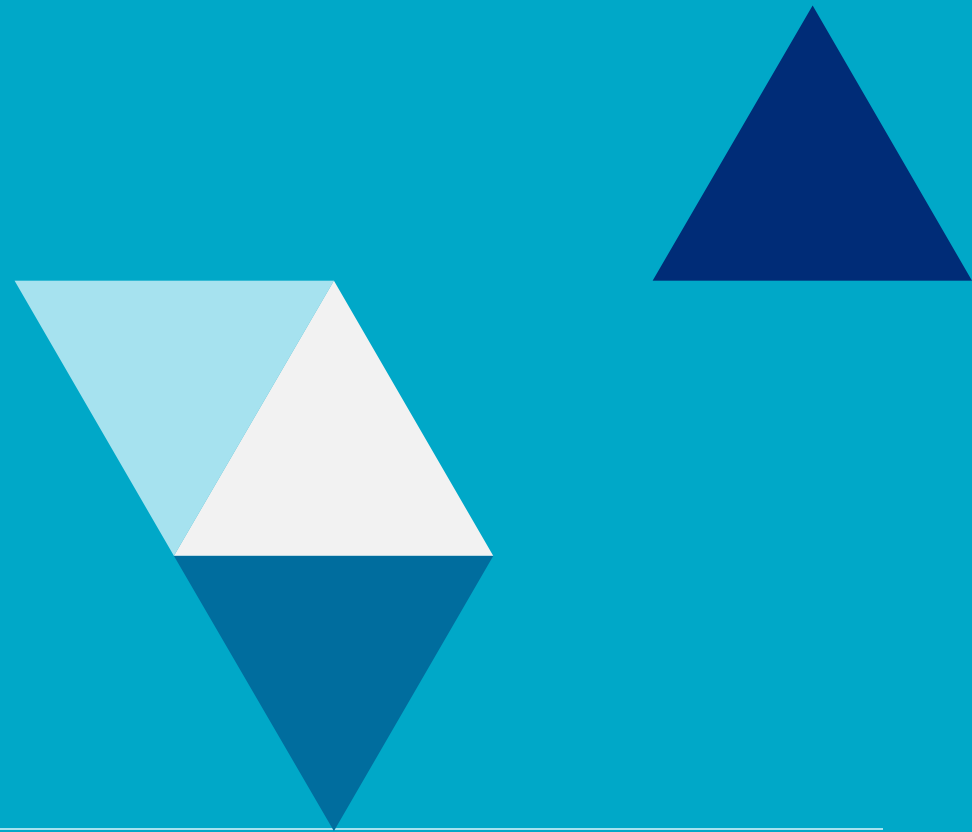
Rashid Hassan
Liana Magner

Hartford, Connecticut

AGENDA & TOPICS

- Guarantees
- Investment options

GUARANTEES



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?

~~State
sponsored
guarantee~~

Insurance
company
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



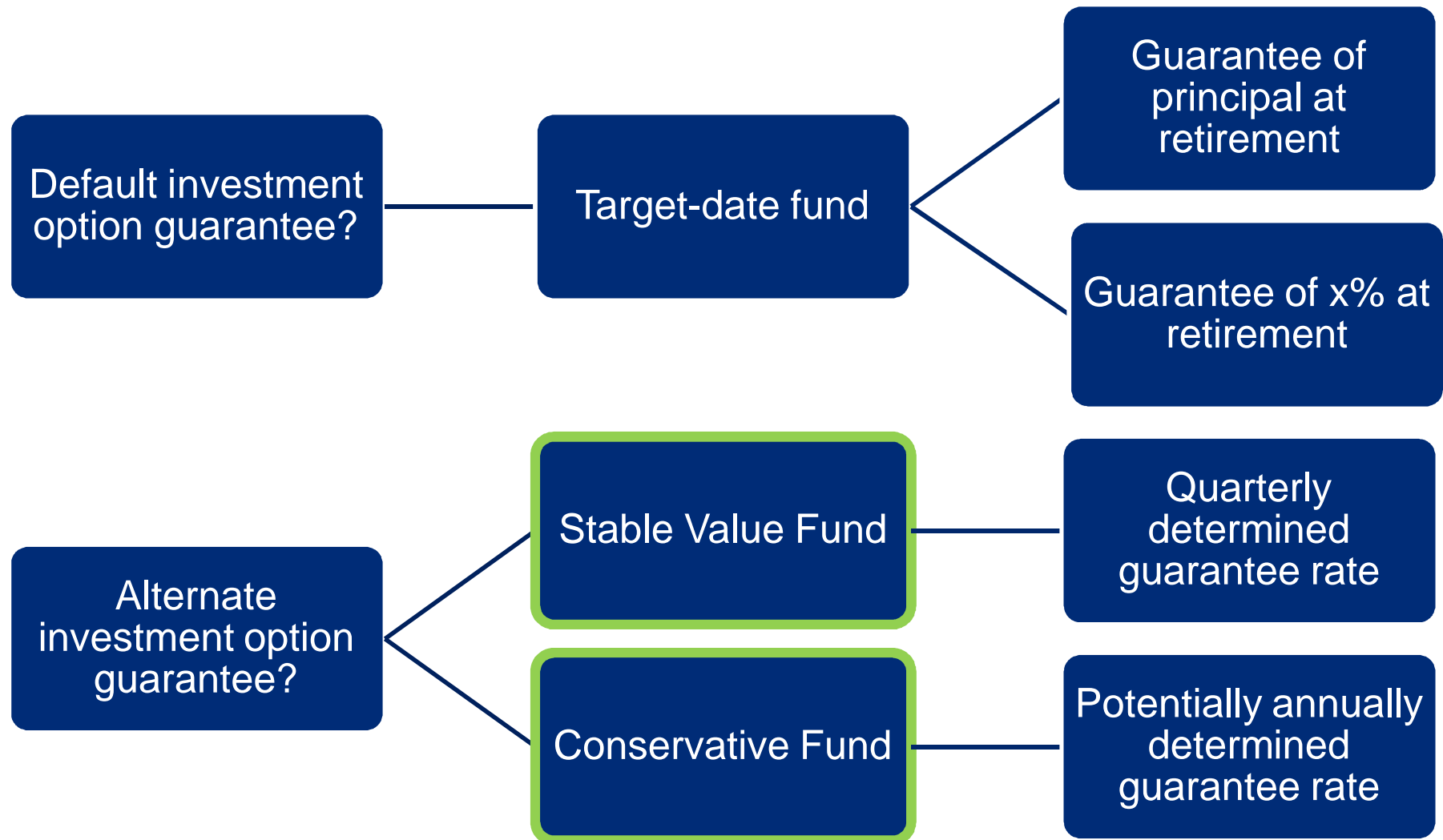
- Costs
- Operational complexity
- Impact on retirement readiness
- Participant communication
- Portability



- Policy objective
- Benefits



IF A GUARANTEE IS OFFERED, IN WHAT MANNER SHOULD IT BE AVAILABLE?



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| Only at retirement | No, must buy an annuity | No | 1.00%* | Simple | Participants lose the guarantee if assets are withdrawn | Yes | No |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.

DECISIONS

- Statutory Conforming Plan: What guarantee do you want to consider offering?
- Recommended Plan: Do you want to offer a guarantee at all? If so, in what format?

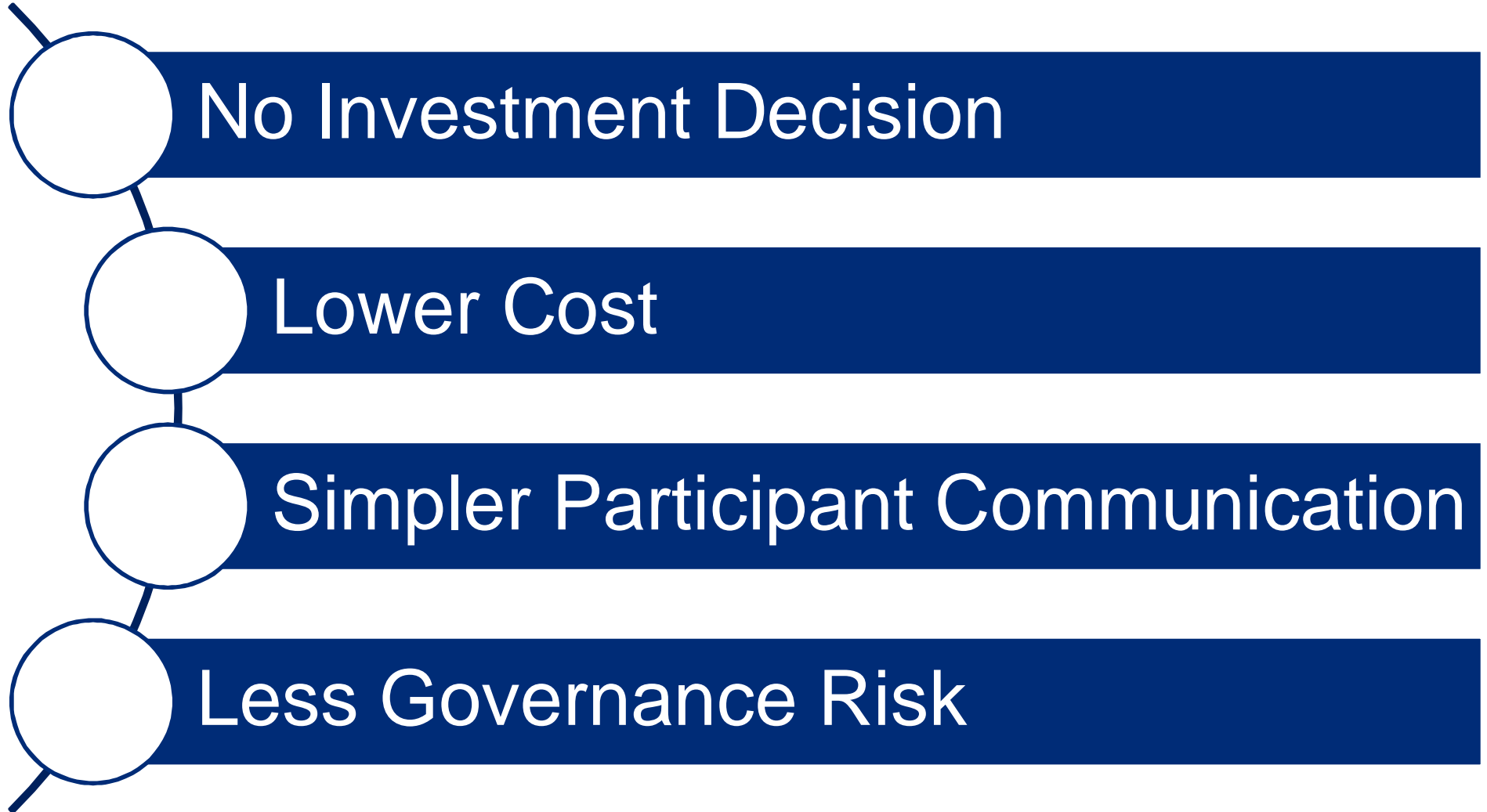
INVESTMENT OPTIONS



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.

SUGGESTED STRUCTURES FOR MULTIPLE INVESTMENT OPTION APPROACH

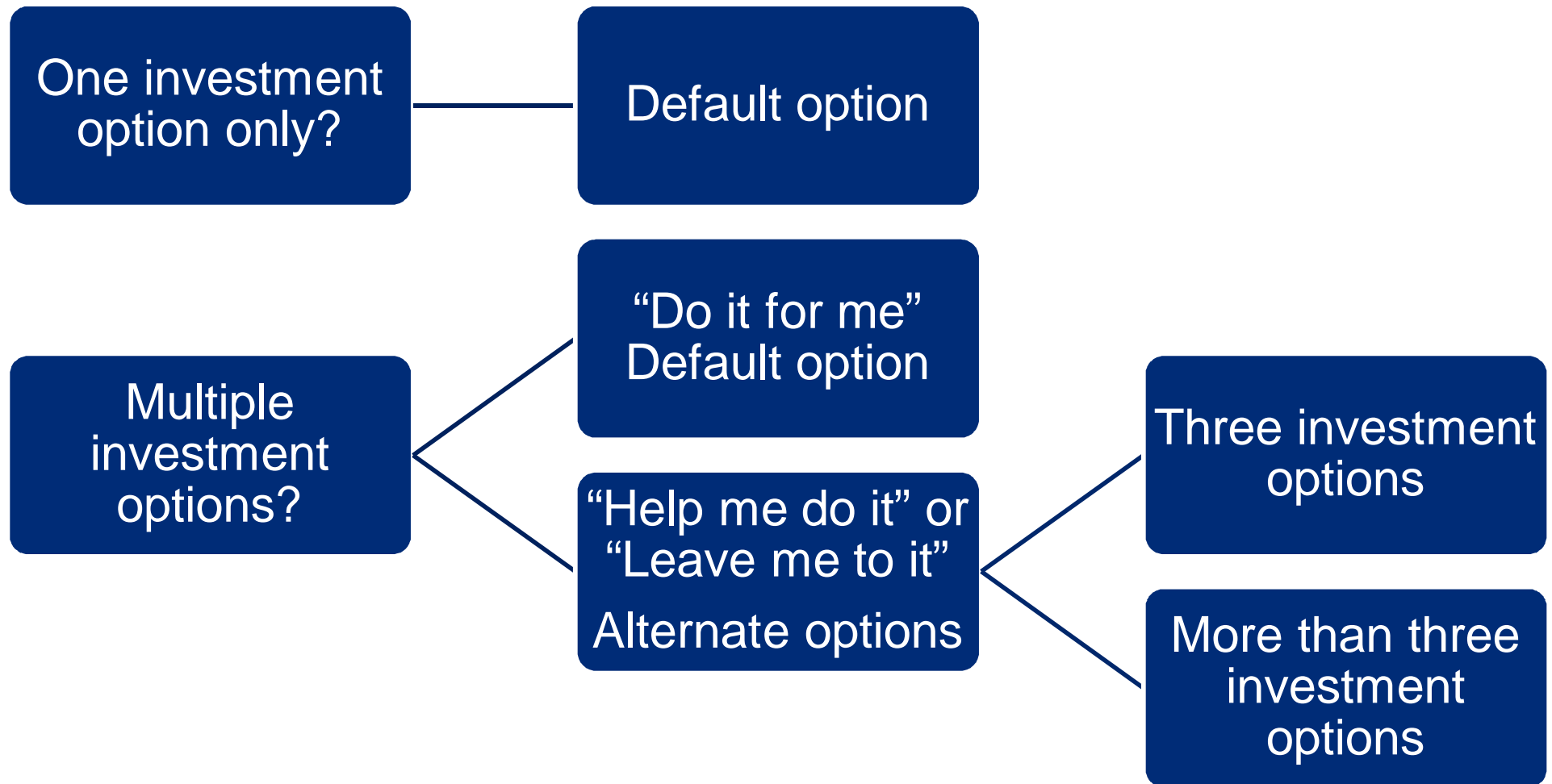
EXAMPLE 1: RECOMMENDED INVESTMENT DESIGN

| “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 |

APPROACHES TO CONSIDER



IMPORTANT NOTICES

References to Mercer shall be construed to include Mercer LLC and/or its associated companies.

© 2015 Mercer LLC. All rights reserved.

This contains confidential and proprietary information of Mercer and is intended for the exclusive use of the parties to whom it was provided by Mercer. Its content may not be modified, sold or otherwise provided, in whole or in part, to any other person or entity, without Mercer's prior written permission.

The findings, ratings and/or opinions expressed herein are the intellectual property of Mercer and are subject to change without notice. They are not intended to convey any guarantees as to the future performance of the investment products, asset classes or capital markets discussed. Past performance does not guarantee future results. Mercer's ratings do not constitute individualized investment advice.

Information contained herein has been obtained from a range of third party sources. While the information is believed to be reliable, Mercer has not sought to verify it independently. As such, Mercer makes no representations or warranties as to the accuracy of the information presented and takes no responsibility or liability (including for indirect, consequential or incidental damages), for any error, omission or inaccuracy in the data supplied by any third party.

This does not constitute an offer or a solicitation of an offer to buy or sell securities, commodities and/or any other financial instruments or products or constitute a solicitation on behalf of any of the investment managers, their affiliates, products or strategies that Mercer may evaluate or recommend.

For the most recent approved ratings of an investment strategy, and a fuller explanation of their meanings, contact your Mercer representative.

For Mercer's conflict of interest disclosures, contact your Mercer representative or see www.mercer.com/conflictsofinterest.

Mercer universes: Mercer's universes are intended to provide collective samples of strategies that best allow for robust peer group comparisons over a chosen timeframe. Mercer does not assert that the peer groups are wholly representative of and applicable to all strategies available to investors.

**MAKE
TOMORROW
TODAY**

