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Municipal Employees' Retirement System

RETIREMENT MYTHBUSTERS

Can Retirement Plan Adequacy and Affordability Co-Exist?

Tara Tyler, MERS of Michigan

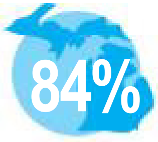
Agenda

- Who is MERS of Michigan?
- Plan Design Strategies and Considerations
- Managing Unfunded Accrued Liability
- Maximizing Flexibility and Adequacy
- Understanding the Fiduciary Role
- A Sustainable Approach to Retiree Health Care
- Retirement Plan Myth Busting

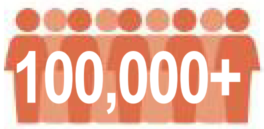
Who is MERS of Michigan?

MERS is an independent, professional retirement services company that was **created to administer** the retirement plans for Michigan municipalities on a **not-for-profit basis**

BY THE NUMBERS



of Michigan's pension plans participate with MERS



participants

in combined total assets

Myth #1

I'm not a fiduciary because my library only offers a voluntary 457 program.

Myth #2

The bigger our investment menu, the better.

Employees want lots of options.

Myth #3

When it comes to choosing an affordable plan, a small difference in participant expenses doesn't really matter.

Myth #4

Other post-employment benefits (OPEB) plans are defined benefit-style plans with unpredictable costs.

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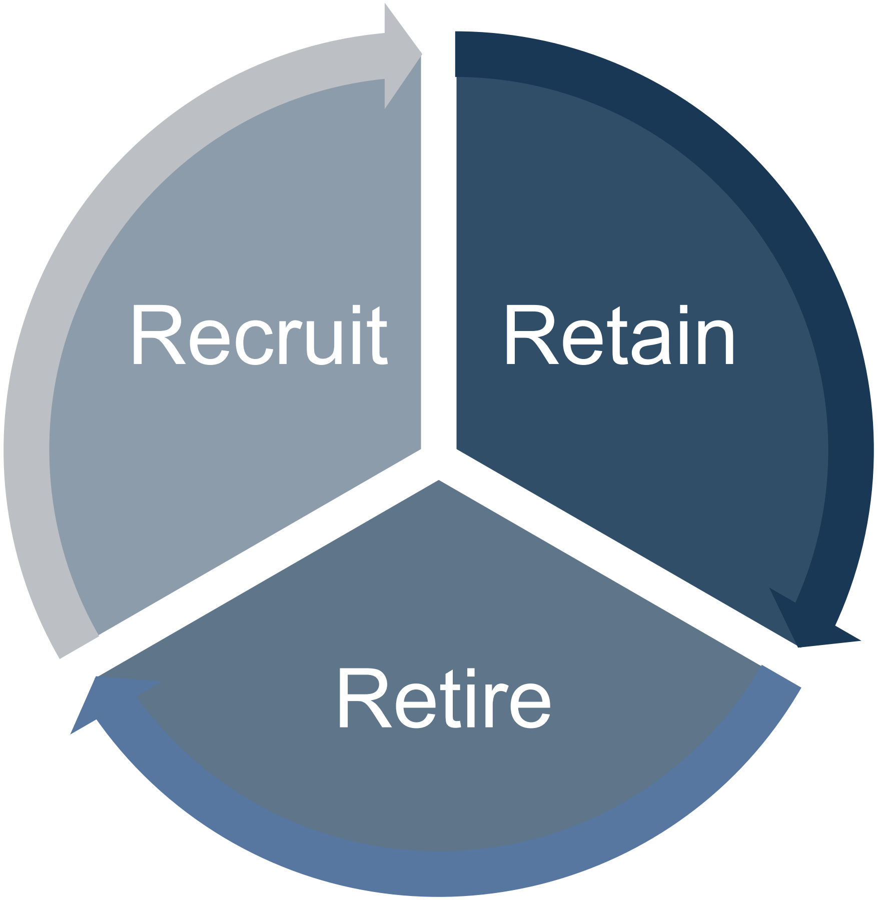
Plan Design Strategies and Considerations

Retirement Plan Adequacy

An adequate retirement plan can strengthen your workforce



Retirement Plan Considerations

Plan Type	• Is the plan intended solely for retirement income or for health care costs as well? • Is the purpose to supplement a pension or to be the primary retirement plan?
Participation	• Is the plan mandatory or voluntary? • Would automatic enrollment enhance the plan?
Contribution Structure	• Are employee contributions voluntary and flexible or fixed? • What is the employer contribution budget? • Do the employer contributions incentivize increased participation and/or contributions from the employee? • Would automatic escalation enhance the plan?
Vesting Schedule	• Vesting schedules help retain employees • Unvested dollars can return to employer and offset future contribution costs
Loans	• Will participants be allowed to take out loans?

Retirement Plan Trends

Increased life expectancy means retirees need larger retirement savings

Trend of employers no longer offering traditional pensions

Trend of employers no longer offering retiree health insurance

Public Sector Retirement Options

Defined Benefit	Hybrid	Defined Contribution
• Lifetime benefit that does not fluctuate with investment gains or losses • Contributions fluctuate • Funded by the employer, employee and investment earnings	• Combines the best of both plans • Benefit and contributions vary • Funded by the employer, employee and investment earnings	• Benefit based on account balance • Fixed contributions • Funded by the employer, employee and investment earnings

457 Program

- Supplemental savings account that can be added to any retirement plan
- Voluntary and flexible employee contributions
- Pre-tax and Roth options

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Managing Unfunded Accrued Liability

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Reducing Unfunded Accrued Liability

There are two ways a library can close its unfunded accrued liability (UAL) gap:

Increase assets to close the funding gap

- Funding strategies

Reduce or eliminate liability moving forward

- Plan design strategies

Plan Design Strategies to Manage UAL

Strategy	Description	Trend 2013	2014	2015	2016	2017	2018	Impact
Lower Benefit to New Hires	New hires receive a lower tier of Defined Benefit provisions	53	43	52	34	47	16	Existing employees are not affected Reduces the liability for new hires
Bridged Benefits for Existing Employees	Benefits are offered in parts to existing employees Multiplier is lower going forward	19	29	16	45	27	26	Leaves earned benefits unchanged Reduces the liability for new hires and existing employees
Hybrid for New Hires	New hires receive a Hybrid Plan	31	43	21	15	12	10	Existing employees are not affected Reduces liability for new hires
Defined Contribution for New Hires	New hires receive a Defined Contribution Plan	45	30	37	39	73	42	Existing employees are not affected Eliminates liability for new hires
Defined Benefit Plan Freeze	Plan is frozen and all employees move to a new plan	n/a	n/a	n/a	8	2	2	Existing employees do not accrue additional service credit and FAC is frozen

Divisions that have adopted these strategies as of 8/31/2018.

Funding Strategies to Manage UAL

Strategy	Description	Trend 2013	2014	2015	2016	2017	2018	Impact
Cost Sharing for Existing Employees[1]	Employees contribute to help fund the overall cost of the plan	280	143	97	136	169	112	Reduces the employer cost, but does not affect total cost or the plan's unfunded liability
Voluntary Contributions[2]	Additional payments made into plan toward unfunded liability	211	210	277	320	421	379	Reduces existing liability Extra dollars are invested and recognize market returns
Bonding[3]	Municipalities may bond for all or a portion of their unfunded accrued liabilities—pension or OPEB	n/a	4	1	2	2	3	Proceeds of the bond are deposited and potentially will fully fund the UAL No guarantee that future unfunded liabilities may not occur

[1]Divisions that have adopted this strategy as of 8/31/2018.

[2]Municipalities that have adopted this strategy as of 7/31/2018.

[3]Municipalities that have adopted this strategy as of 8/31/2018.

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Maximizing Flexibility and Adequacy

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What is an Adequate Savings Rate?

- Rather than a one-size-fits-all answer, it's important to look at how much income a person is likely to need in retirement
- **80% income replacement rate** is the industry standard
- The contribution rate needed to achieve that income replacement rate varies from person to person and depends on several factors:
  - Current age
  - Expected age at retirement
  - Life expectancy
  - Health
  - Cost of health insurance
  - Investment risk tolerance
  - Social Security
  - Other income sources
  - Lifestyle in retirement
  - Debt
- Providing the ability to choose a savings rate enables employees to make the best individual choice for their circumstances

Flexible Retirement Savings

- The IRS prevents an employee from changing their contribution rate in a 401(a) Defined Contribution Plan after initial election
- Pairing a 401(a) Defined Contribution Plan with a 457(b) Supplemental Savings Program provides 401(k)-like flexibility
- An example of this plan design is the **MERS Defined Contribution *PLUS*** – two programs essentially function as a single plan

How Does it Work?

Offering an employer match to incentivize employee saving

- Employers establish the contribution structure for the Defined Contribution Plan
  - Any employer contributions are deposited into the employee's Defined Contribution account
  - Employee contributions may or may not be required
- Employers can encourage even greater employee participation by offering a match on any voluntary contributions the employee makes
  - Voluntary employee contributions are deposited into the employee's 457 account
  - Employer's matching contributions are deposited into the employee's Defined Contribution account

Simplified Reporting and Administration

Blending two plans into one seamless design

- Joint reporting of contributions saves employers time
- Combined statements and online account access make it convenient for participants to monitor investment performance
- Using a single investment menu simplifies the decision making process
  - Less administration for employers
  - Choosing investment options and making allocations is easier for participants

Benefits of Combining Plans

Employer	Employee
• Minimum level of participation in the Defined Contribution Plan can be required • A vesting schedule can be applied to all employer contributions • Loans can be restricted from the Defined Contribution account, while still allowed from the 457 account • Having both programs administered by a single vendor lowers plan expenses	• Employees can contribute up to the annual IRS maximum in each plan (Up to $55,000 in Defined Contribution and $18,500 in 457)* • Voluntary contributions can start, stop or be changed at any time • Matching contributions from employer are not taxed as income when received

**IRS limits for 2018*

Plan Feature Comparison

Plan Type	401(a)	457(b)	Combined
Primary Purpose	Qualified Retirement Plan	Supplemental Savings Program	Qualified Plan with Supplemental Savings Program
Enrollment	Mandatory	Voluntary	Mandatory
Employee Contribution Flexibility	Choice only at Enrollment	Complete Flexibility	Complete Flexibility Above Required Contributions
Required Contributions	Yes	No	Yes
Automatic Enrollment (optional)	n/a	Yes	Yes
Automatic Contribution Escalation (optional)	No	Yes	Yes
Roth Option Available	No	Yes	Yes
Allows Employer Contribution	Yes	Yes (included as employee earnings)	Yes
Allows Vesting	Yes	Varies	Yes

Incentivizing Employee Savings

- Offering an employer match encourages employees to save more to avoid “leaving money on the table”
- A tiered matching schedule may encourage employees to increase their deferral rates further

	Required Contributions			
Employee Contributions - Deposited into DC Account	3%			
Employer Contributions - Deposited into DC Account	3%			
	Voluntary Contributions			
Employee Voluntary Contributions - Deposited to 457 Account	0%	1%	2%	3%
Employer Matching Contributions - Deposited into DC Account	0%	0.5%	1.5%	3%
Total Retirement Contributions	**6%**	**7.5%**	**9.5%**	**12%**

Influence Decision Making

Learning from an experiment with movie goers and popcorn prices

When presented with a simple choice, most patrons chose the less expensive popcorn.

But introducing a decoy was a game changer!

People perceived so much value in the extra popcorn for only 50¢, they were willing to spend a little more to get a better deal.

Applying What We Learned from Popcorn

Can we make saving more for retirement a deal too good to pass up?

As it turns out, people are influenced more by the ***fear of loss of savings*** than by actual savings!

Employee Contribution	Employer Contribution	Total
3%	50% match (contributes 1.5%)	4.5%
6%	75% match (contributes 4.5%)	10.5%
7%	**100% match** (contributes 7%)	**14%**

Influence saving rates by providing an easy comparative win.

And extra butter.

Participant Education is Key

Preparing participants for a successful retirement

- Regardless of the plan design, ensuring that participants understand how their benefit works is crucial
- Higher financial literacy among employees is associated with higher voluntary participation rates or lower quit-rates in automatic enrollment plans
- Financial literacy has a larger effect on saving than a sizable increase in income
- Knowledge of a plan's specific features—such as the employer matching threshold—is also associated with increased saving

Source: Center for Retirement Research at Boston College

Understanding the Fiduciary Role

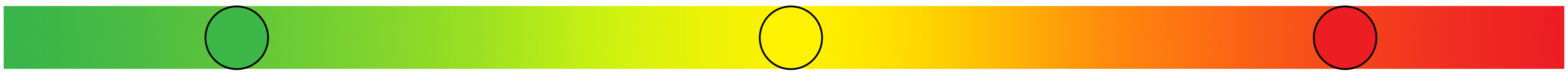
Fiduciary Oversight

- A fiduciary is anyone who has discretionary authority over:
  - Plan assets
  - The administration of the plan
  - The management of the plan
- Fiduciaries are subject to standards of conduct and must act on behalf of participants
- Responsibilities:
  - Adherence to Plan Document
  - Investment oversight
  - Ensure reasonable expenses

MERS provides employers with peace of mind because the ***MERS Retirement Board takes on the sole fiduciary responsibility of their plan*.**

Degrees of Fiduciary Responsibility

When it comes to the fiduciary responsibility for your retirement plan, not all plan providers assume the role of sole fiduciary



Plan Provider

In some instances, the plan provider takes fiduciary responsibility, establishes the plan document, determines the investment options available and monitors performance.

MERS provides employers with this level of confidence.

Co-Fiduciary Responsibility

Many plan providers act as co-fiduciaries. The provider offers investment information and makes recommendations. The employer is responsible for selecting and monitoring the performance of the funds.

The plan provider and employer share fiduciary responsibility for the plan.

Employer

Most plan providers act only as a record keeper and leave decisions regarding the plan document, investment options and performance monitoring to the employer.

The employer has unlimited choices under this scenario, but risks being held liable for fiduciary violations.

Investment Menu Design and Overnight

Responsibilities of the plan fiduciary

- Establish clear goals and objectives for the plan investment options with well-defined measures for success
- Maintain a disciplined process for hiring, evaluating and terminating investment managers for the plan
- Choose an appropriate investment default fund
- Document all of the above in a formal Investment Policy Statement

Is a Bigger Investment Menu Better?

Psychologists have concluded that an overload of options can paralyze people or push them into decisions that are against their own best interest.

When Less is Actually More

A study on shopping behavior experimented with jam displays. One table held 24 varieties of gourmet jam; the other held only 6 varieties. The large display attracted more interest, but people were 1/10th as likely to buy from the large display as from the small display.

The same principle of "less is more" was found to apply to participation rates in retirement programs. A large number of fund choices actually *discourages participation* amongst even well informed participants.[1, 2]

[1] *Mottola, Gary and Utkus, Stephen. "Can There Be Too Much Choice In a Retirement Savings Plan?" The Vanguard Center for Retirement Research, June 2003*

[2] *Schwartz, Barry. "More Isn't Always Better." Harvard Business Review, 01 June 2006. Web. 24 Feb. 2016*

Monitoring Participant Expenses

Responsibilities of the plan fiduciary

- Understand all costs paid by the participants, including:
  - Direct investment and administrative charges
  - Third-party and/or indirect fees
  - Reimbursements
- Assess whether plan fees are reasonable
- Ensure that all plan fees charged to participants are clearly disclosed

Why Fund Costs Matter

How much impact can a 1% difference have on retirement income?

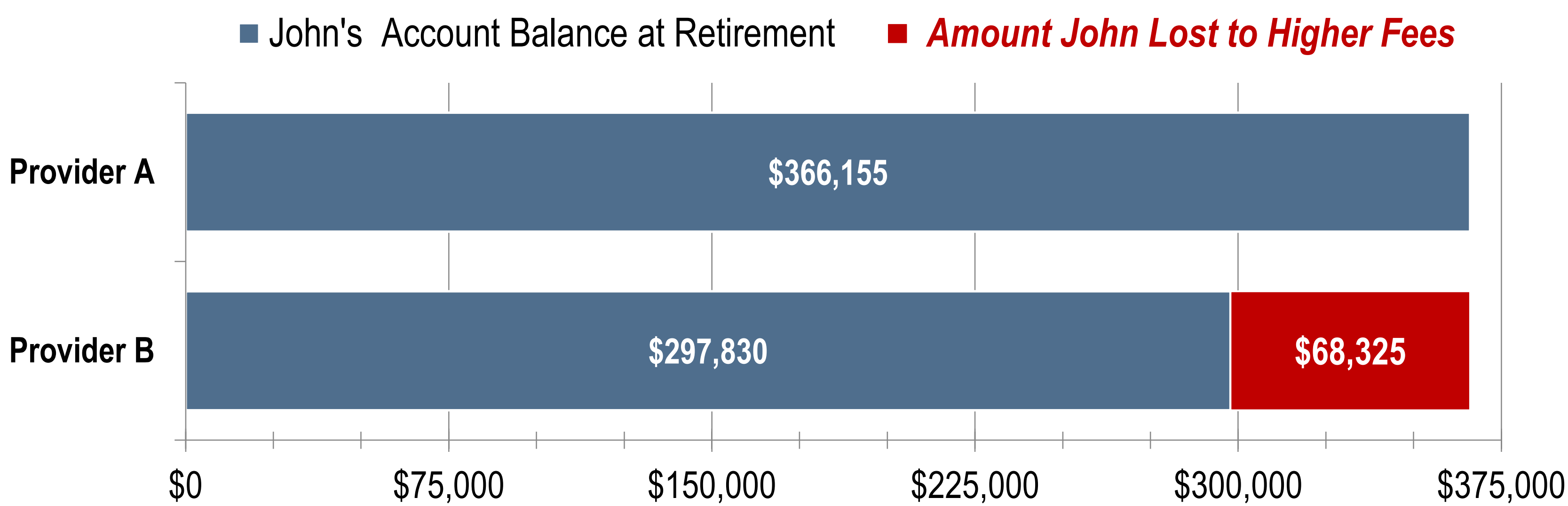
Meet John

- John is 30 years old
- He currently makes $48,000/year, and anticipates a 2% annual salary increase
- John makes bi-weekly contributions of 5% of his salary into his retirement account
- His account currently has a $5,000 balance
- He expects a 7% investment return *before factoring in investment expenses*
- John plans to retire at age 62
  - He plans to receive equal monthly payments over 28 years (until age 90)
  - He anticipates a lower investment return of 5% during his retirement *before factoring in investment expenses*

Comparing Providers *Balance at Retirement*

A comparison report can help an employer gauge the impact of higher costs during the ***accumulation phase*** of an average employee.

A 1% difference in fund expenses would provide John with
23% more at retirement!

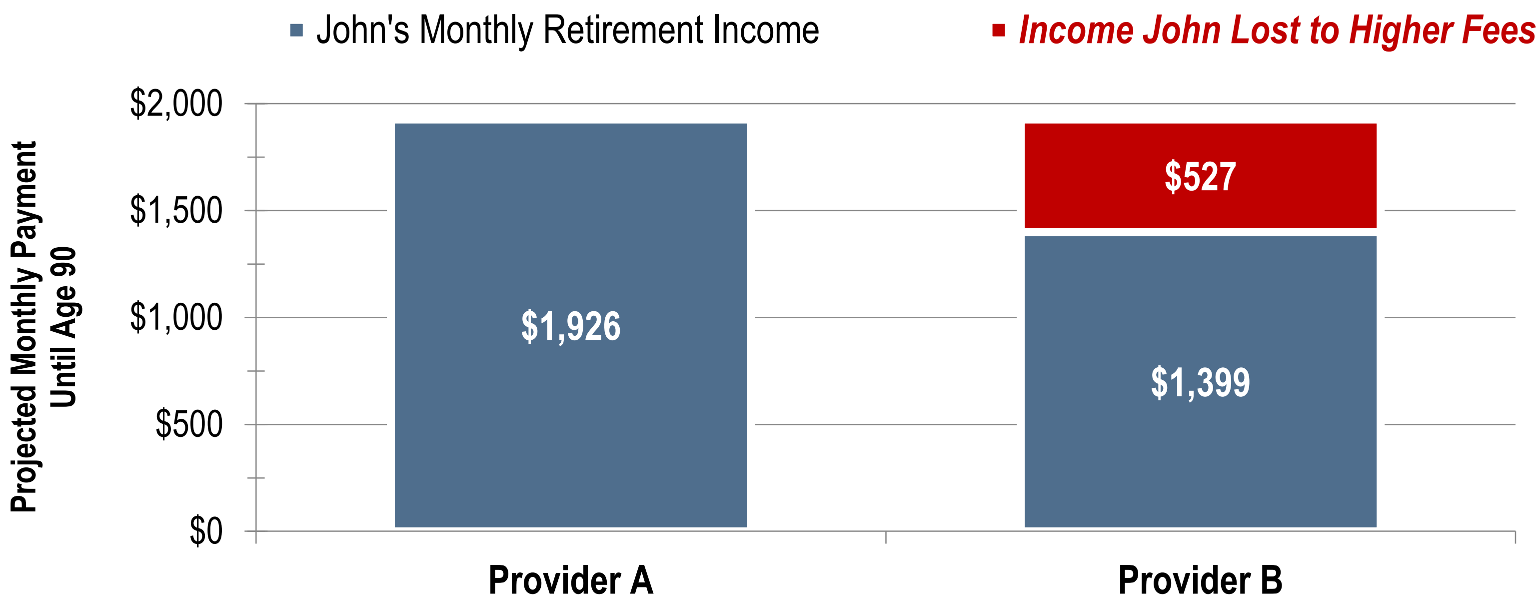


Weighted Average Expense Ratios: Provider A – 0.43% and Provider B – 1.43%.

Comparing Providers *Monthly Income in Retirement*

The comparison report can also help an employer gauge the impact of higher costs during the ***distribution phase*** of an average retiree.

A 1% difference in fund expenses would provide John with
<u>38% more in monthly income during retirement!</u>



Weighted Average Expense Ratios: Provider A – 0.43% and Provider B– 1.43%.

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A Sustainable Approach to Retiree Health Care

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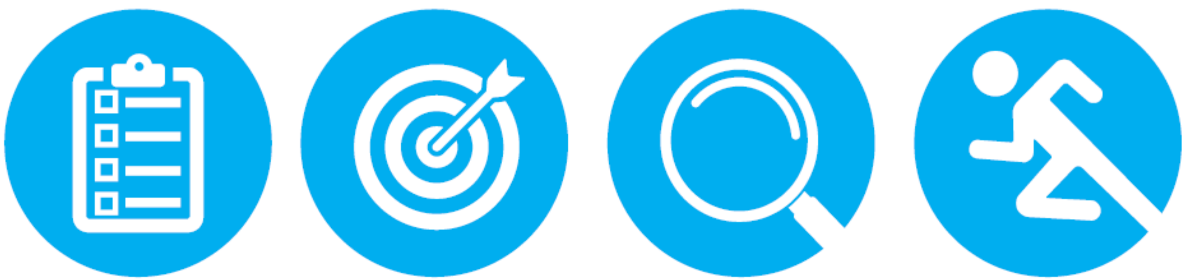
OPEB Liability Under Increased Scrutiny

GASB Statements 74 & 75 affect the accounting and financial reporting of liability for Other Post-Employment Benefits (OPEB)

- **Liability must appear on the employer's balance sheet**
- Unfunded plans must use a municipal bond rate to discount non-covered payments

Requirements of Recent Legislation

- Protecting Local Government Retirement and Benefits Act (PA 202) affects local units of government with defined benefit retirement and retiree health care plans
- Requires prefunding normal cost of retiree health care premiums for new hires
- Addresses existing unfunded liability through four stages:



Statewide OPEB Funding Levels

How do Michigan's local units of government stack up?

514

SYSTEMS

$13.7 billion in liabilities
$4.4 billion in assets
$9.3 billion in unfunded liabilities

214

0% FUNDED

42% of systems have not prefunded and operated on a pay-as-you-go basis

380

<40% FUNDED

74% of systems did not meet the funding threshold of PA 202

Source: PA 202 reporting data as of 9/14/2018

Why a Private Health Care Exchange?

A private exchange changes the way employers provide retiree health care benefits, without diminishing their commitment to retirees

Increased buying power enables retirees to access plans that provide **equal or better coverage** at a lower cost than typical group plans

Proven strategy helps employers reduce OPEB liability while maintaining their commitment to provide quality benefits

Reduced administrative cost and challenges for employers as compared to supporting a group plan

Private Exchange Overview

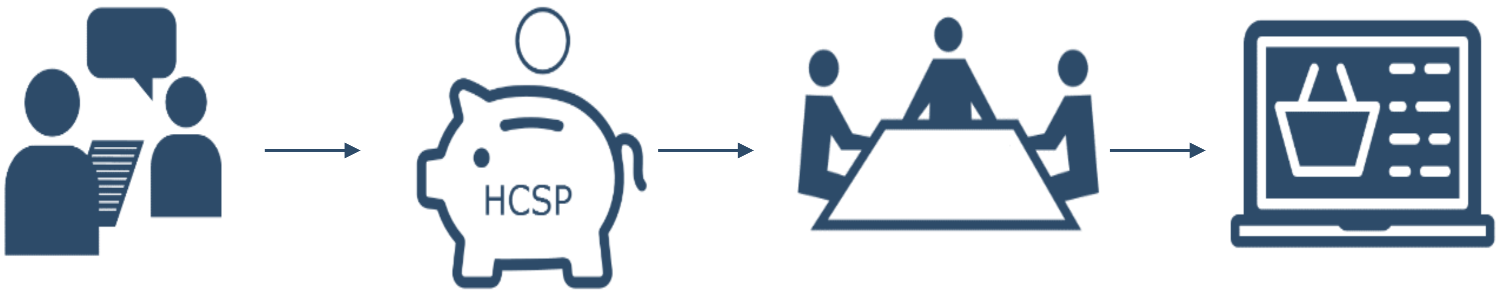
AN EXCHANGE IS A MARKETPLACE OF INSURANCE PRODUCTS

Private health care exchanges couple insurance products with support and tools to help people shop, compare and enroll in plans that best meet their needs

Private Medicare exchanges are dedicated to helping seniors access all types of Medicare plans: Medicare Supplement (or MediGap), Medicare Advantage and Medicare prescription drug plans

Medicare exchanges have been around for decades and have helped millions of Medicare beneficiaries find and enroll in the best coverage for them

How Employer Groups Use the Exchange



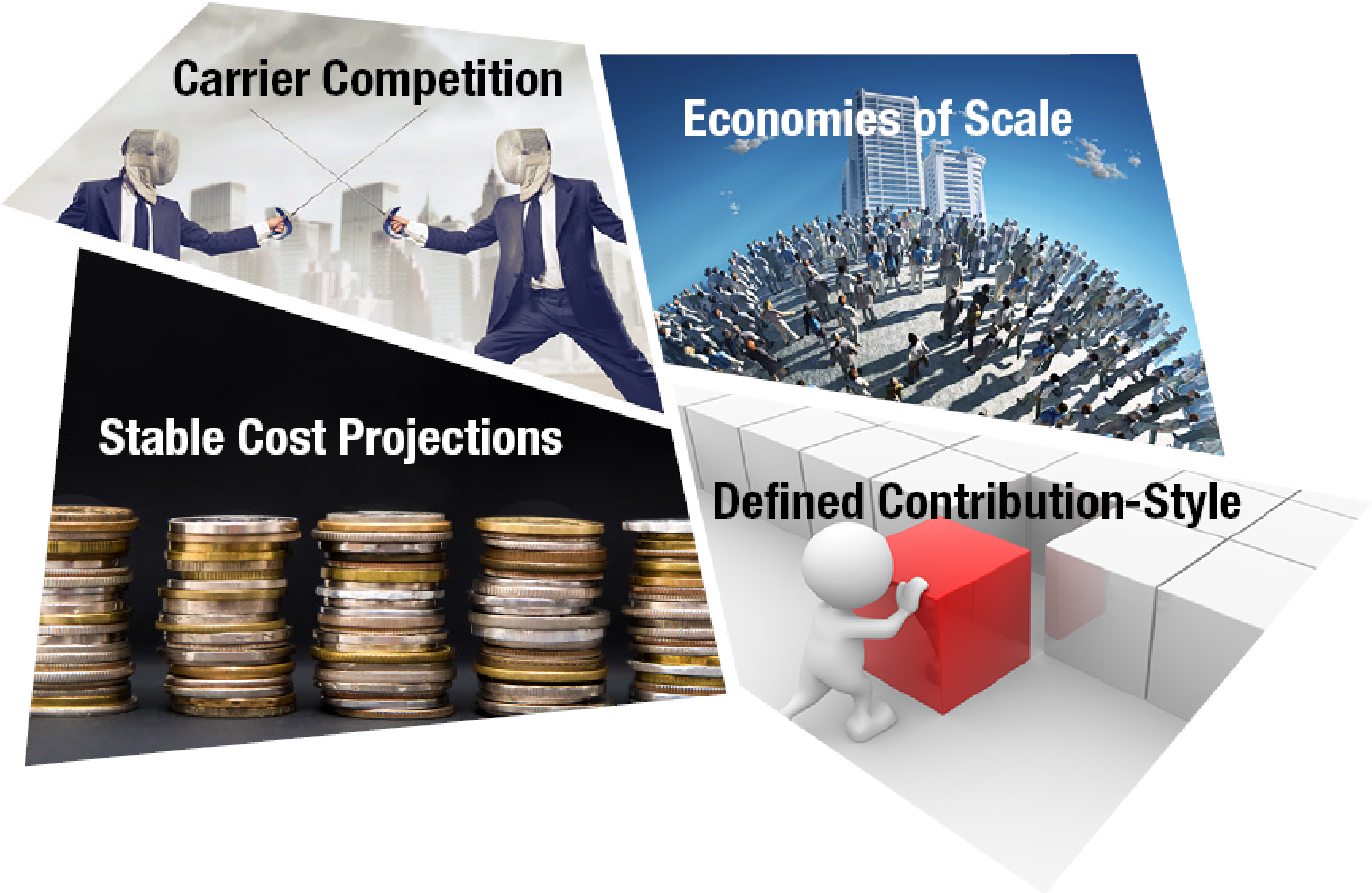
Consultants compare employer's existing group plan to options available on exchange and help determine an appropriate stipend

Stipend is deposited into each retiree's health care savings program account

Benefits counselors work with each retiree to help them select the plan that best meets their needs

Retirees use funds from their health care savings account to purchase an individual plan through the private exchange

Cost Advantages



Win-Win Results

Employer

- Can offer affordable, quality benefits
- Reduces annual costs and long-term OPEB liabilities
- Develops long-term retiree health care program
- Reduces or eliminates plan administration costs

Retiree

- Can select a plan that meets individual health care needs
- Tax-free deposits go directly into a health care savings program account
- Remaining account balance can be used for other qualified health care expenses

Jackson District Library
Discover • Learn • Succeed

Municipality Profile

- 160 employees total
- 10 retirees
- 27 eligible active employees
- $8 Million in OPEB liability

Featured MERS Programs

- Retiree Health Funding Vehicle
- Health Care Savings Program

Situation

The Jackson District Library had a **projected OPEB liability of $8 million** for health insurance benefits promised to retirees.

Strategy

The Library was already using the **MERS Retiree Health Funding Vehicle** to pre-fund their benefits, but they wanted to find a more cost-effective way to provide health insurance.

The Library worked with a health care consultant to develop a plan for their Medicare-eligible retirees. The Library paired the **MERS Health Care Savings Program** with access to a **private retiree health insurance exchange.** The consultant helped evaluate the coverage options available, project the associated cost, and determine the stipend necessary to fund the benefit.

Results

The Library's **cost to provide retiree health care was reduced by nearly 65%, shrinking their future OPEB liability to $1.5 million.**

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Retirement Plan Myth Busting

Myth #1

I'm not a fiduciary because my library only offers a voluntary 457 program.

If you select the investment options available to participants under your plan, ***you have fiduciary responsibility for the plan.***

Myth #2

The bigger our investment menu, the better. Employees want lots of options.

Most people find large investment menus intimidating.

Providing a streamlined investment menu with carefully selected options can empower your employees to make the right decision for their investment goals.

Myth #3

When it comes to choosing an affordable plan, a small difference in participant expenses doesn't matter.

Seemingly small expenses can really add up.

A 1% difference in fund costs can mean a 38% difference in retirement income.

Myth #4

Other post-employment benefits (OPEB) plans are defined benefit-style plans with unpredictable costs.

Public sector employers are taking a modern approach to providing retiree health care.

Pairing a defined contribution-style plan with a private health care exchange can help you reduce unfunded accrued liability.

Contacting MERS of Michigan

MUNICIPAL EMPLOYEES' RETIREMENT SYSTEM

1134 Municipal Way
Lansing, MI 48917

800.767.MERS (6377)

www.mersofmich.com