

Evolution³

The Evolution of Indexes, Products, and Applications in the “New Normal” of DB

Presented by

James P. Lauder & Dorann J. Cafaro

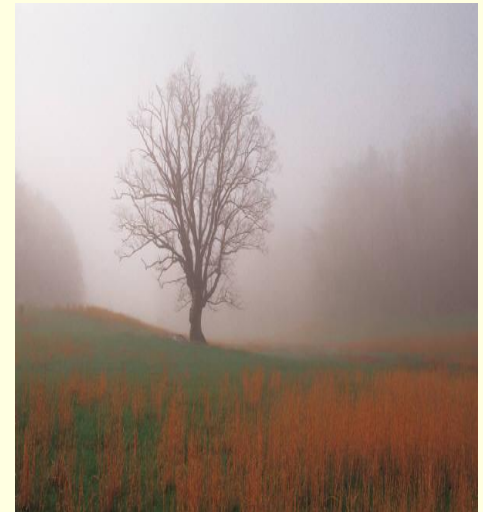
March 22, 2011

What We Will Cover

- **DC challenges/changes and the evolution of DC products**
- **Target Date Indexes: an outcome oriented benchmark**
- **Think differently: Do best practices flow both ways?**
- **A DC solution for a DB problem**
- **Solutions that Work**
- **Q & A**

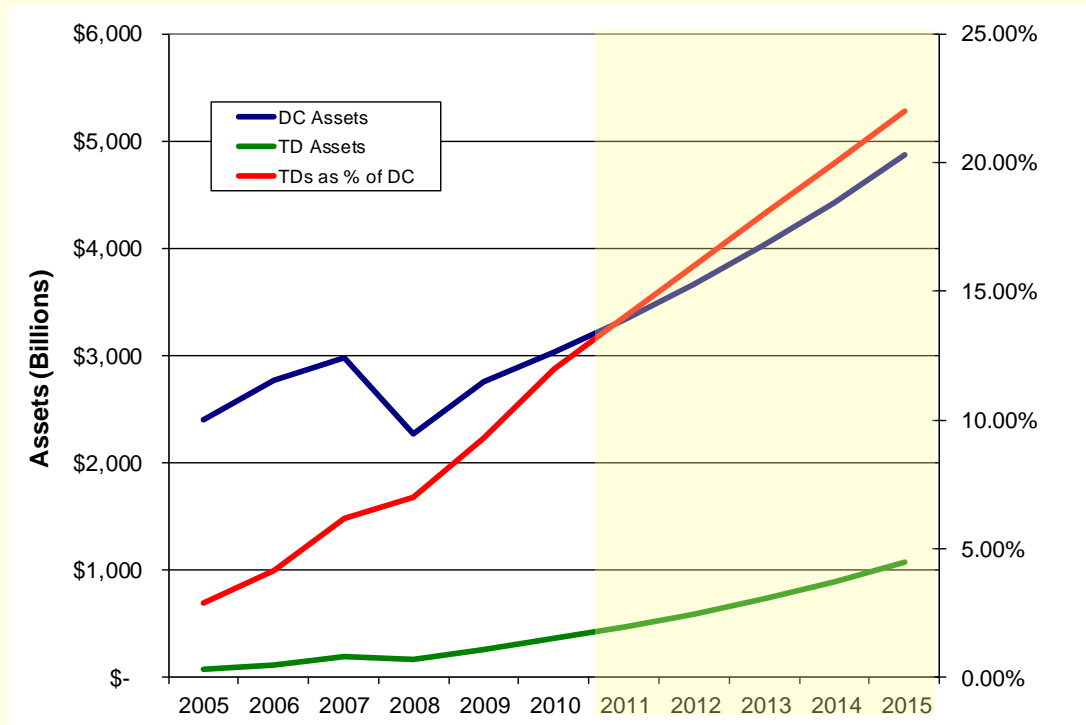
Evolution of Target Date Funds and Target Date Indexes

- Shortcomings of participant education and better understanding of behavioral norms lead to the first “Target Date” funds being launched in 1994, by Wells Fargo and BGI.
- Balanced Funds and “Relative Risk” (Lifestyle Funds) dominated flows for Asset Allocation products. Very few TDF providers.
- Dow Jones Target Date Indexes launched in 2005 followed by product offerings from SSgA and Wells Fargo in 2005 and 2006.
- Pension Protection Act of 2006 passed in response to growing significance of defined contribution plans and need to balance fiduciary protection/increased participation and savings rates.
- DOL guidance on Qualified Default Investment Alternatives.
- Proliferation of TDFs and misguided attempts to differentiate.
- Market (and TDFs) tested by global recession October 2007 – March 2009.



The Demand for “New” Solutions

DC and Target Date Asset Five Year Projections



- TDF market has grown 3.7X in four years
- TD assets (mutual funds) now represent 10% of total DC assets but capture 19% of DC flows
- At a 10% growth rate, the 401k market could reach \$4.8T in five years
- If TDFs conservatively pick up another 2% share of the market per year, they will have over \$1T in assets by the end of 2015

Source: Morningstar and The Investment Company Institute. Projections by Global Index Advisors

Two Significant Types of Retirement Savings Risk

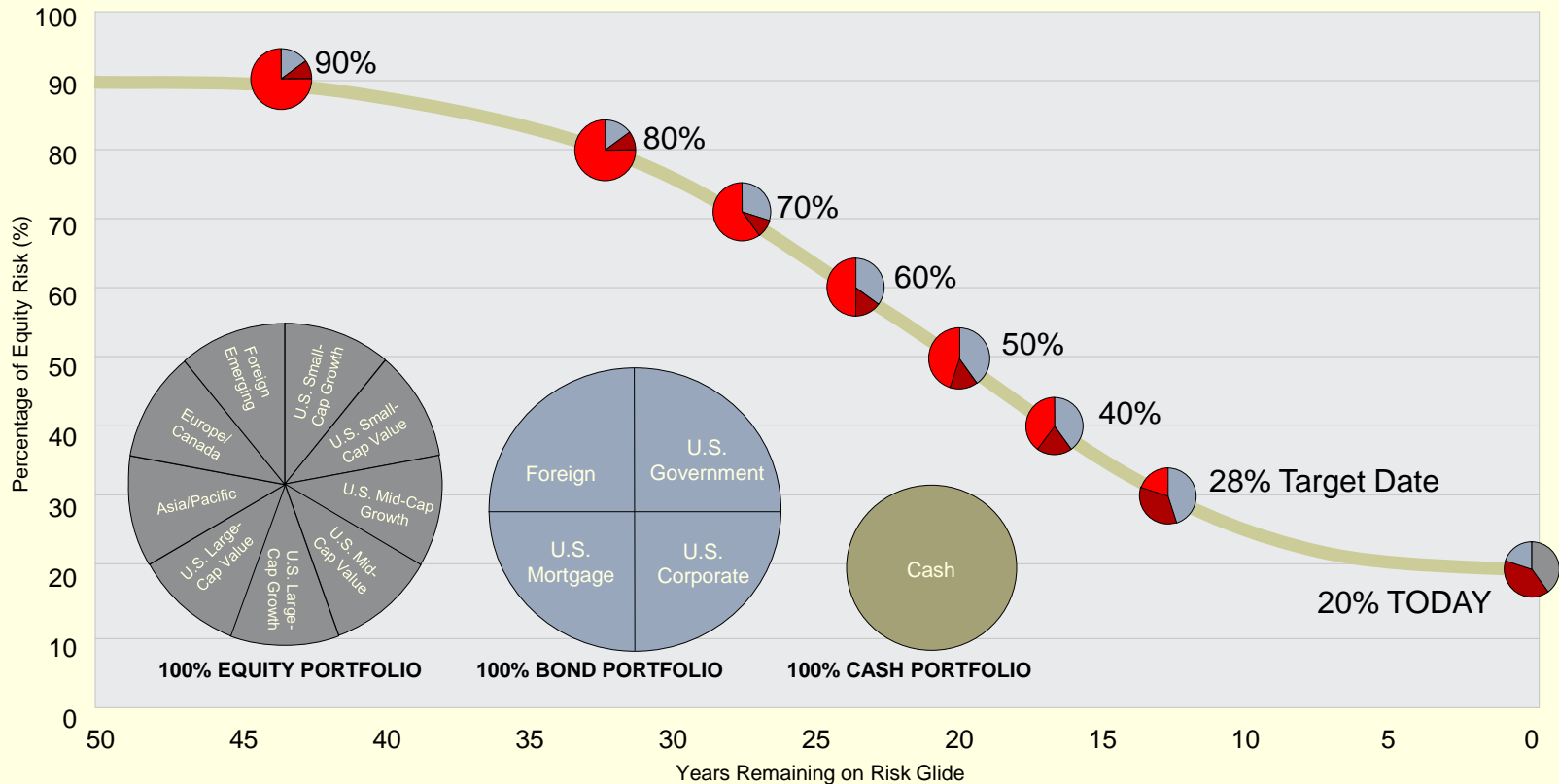
Market/Volatility Risk –

- The risk of significant market losses decreasing retirement assets. This risk increases significantly in the years immediately prior to retirement (Pre-Retirement Savers) and once the investor begins withdrawing assets from the portfolio.
- Market risk and participant loss aversion are also the primary drivers of irrational participant behavior.
- Unpredictable.
- Impact on individual investors is path dependent.
- Market/Volatility risk can be mitigated through product design.
- Can not be eliminated through changing investor behavior.

Longevity/Shortfall Risk –

- The risk of not having a large enough nest egg upon reaching retirement to satisfy long term needs.
- This is a predictable risk and is most influenced by participant saving behavior.
- Impossible to eliminate this risk through product design.
- Can be reduced significantly through automatic enrollment and automatic contribution increases.

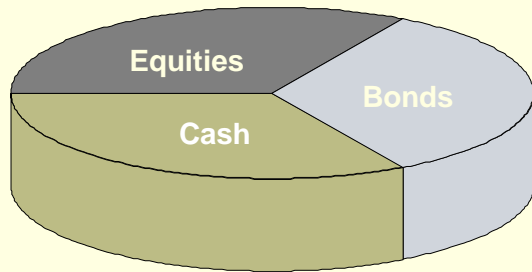
First Line of Defense: Glide Path



	100% EQUITY PORTFOLIO	100% BOND PORTFOLIO	100% CASH PORTFOLIO
Average Return	12.07%	8.62%	4.81%
Highest 12-Month Return	66.78%	32.76%	10.50%
Lowest 12-Month Return	-46.67%	-3.31%	0.11%

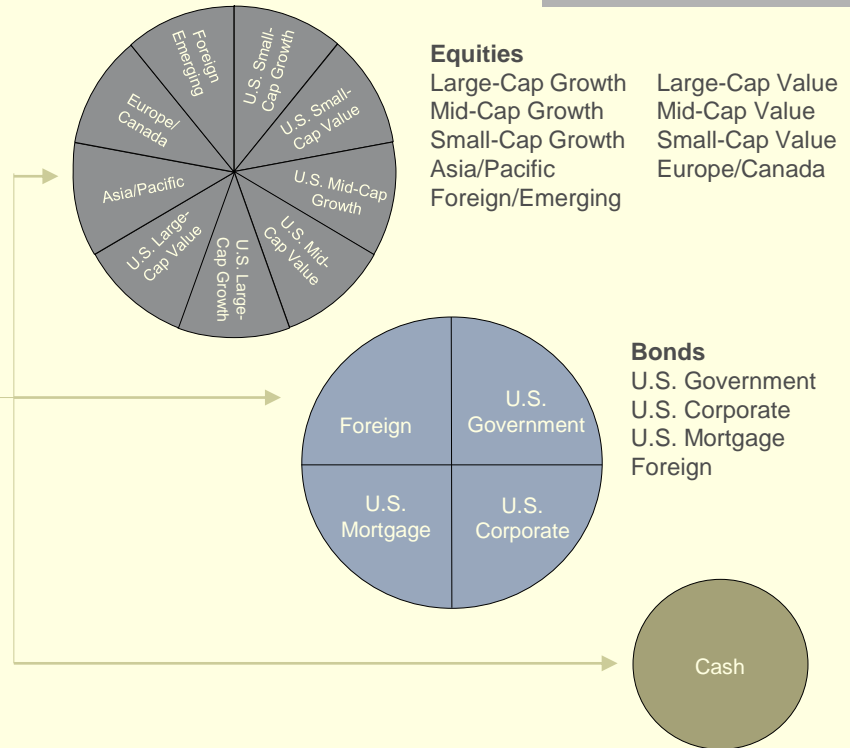
Breadth & Depth of Diversification

Each Index consists of a diversified mix of equities, bonds, and cash.



This diversified structure remains intact at all levels of risk.

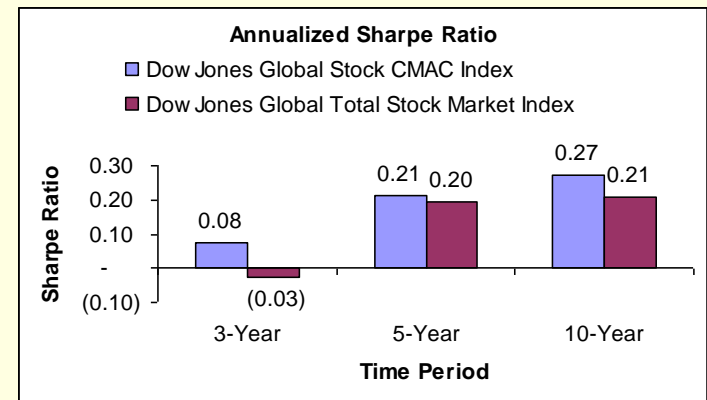
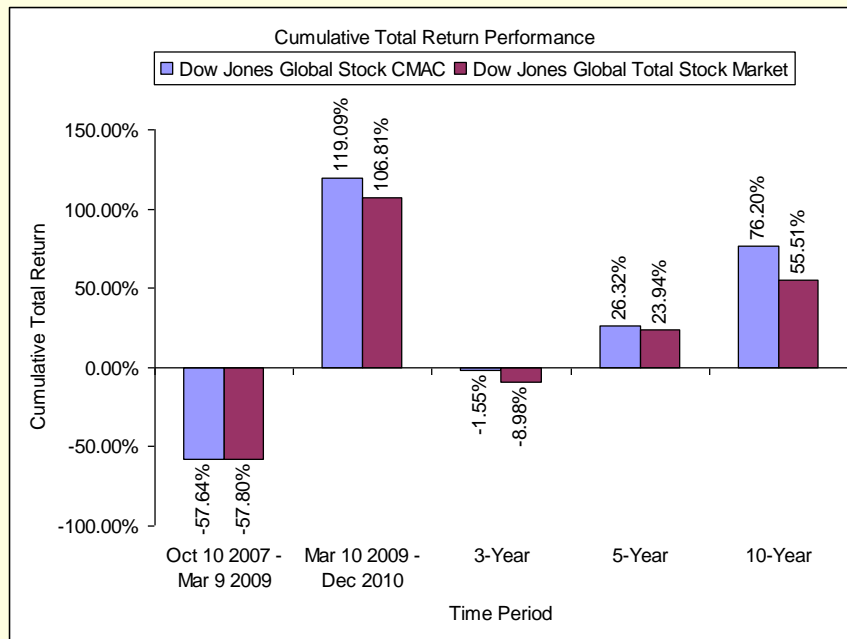
- Risk is managed by adjusting allocations among the three major asset classes, not by including or excluding asset classes or sub-asset classes.



Index Notes

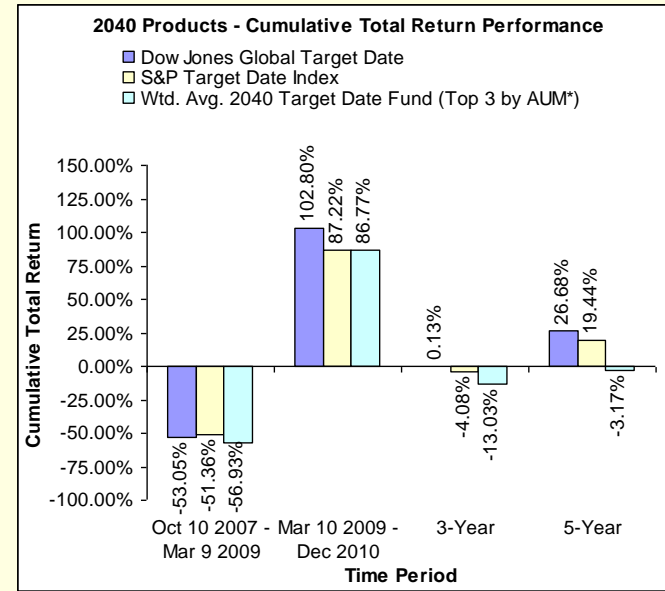
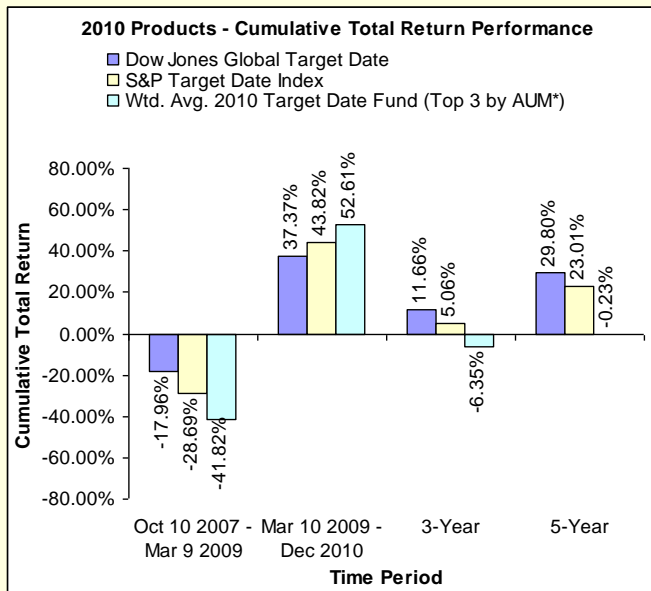
- All international holdings are unhedged to currency exposures; foreign bond holdings are composed solely of sovereign debt securities.
- Bond components are linked to corresponding Barclays Capital indices.
- Underlying index components (large-cap growth, large-cap value, etc.) are cap-weighted, float-adjusted indices.

Benefits of Disciplined Diversification



Source: Dow Jones Indexes white paper

Combined with Risk Management



Source: Dow Jones Indexes white paper

Index/Product Summary

- **Index focuses on desired participant outcome not product category behavior. This ensures alignment of interests between participants and managers.**
- **Controls/Manages downside volatility within acceptable ranges.**
- **Provides Breadth and Depth of diversification to participants at all times.**
- **Delivers on a fiducially sound philosophy with unequalled objectivity, transparency, and repeatability.**



Time to Think Differently?

Where's the Retirement Income?

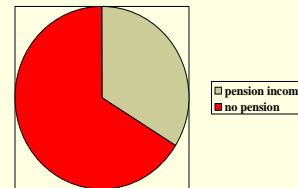
Retirement Benefits is about providing retirement income:

- 34% of retirees received pension income from private sector retirement plans up from 21% in 1975 ^(SEI)
- Majority of employees who had a DB plan prefer them over DC plans or hybrid plans
- Fact that young employees who do not plan to stay with employer better to have DC plans but those that plan to remain with employer better served by DB ^(EBRI)
- 58% total retirement income comprised of Social Security in 2009

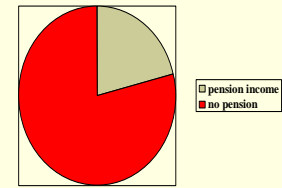
How much income is from ss?



Who receives pension income?

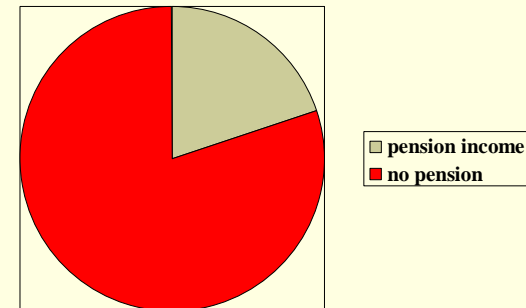


Retirees Today



Retirees In 1975

Today 20% of retiree income is from pension plan ^(EBRI)



DB Emotional Challenge



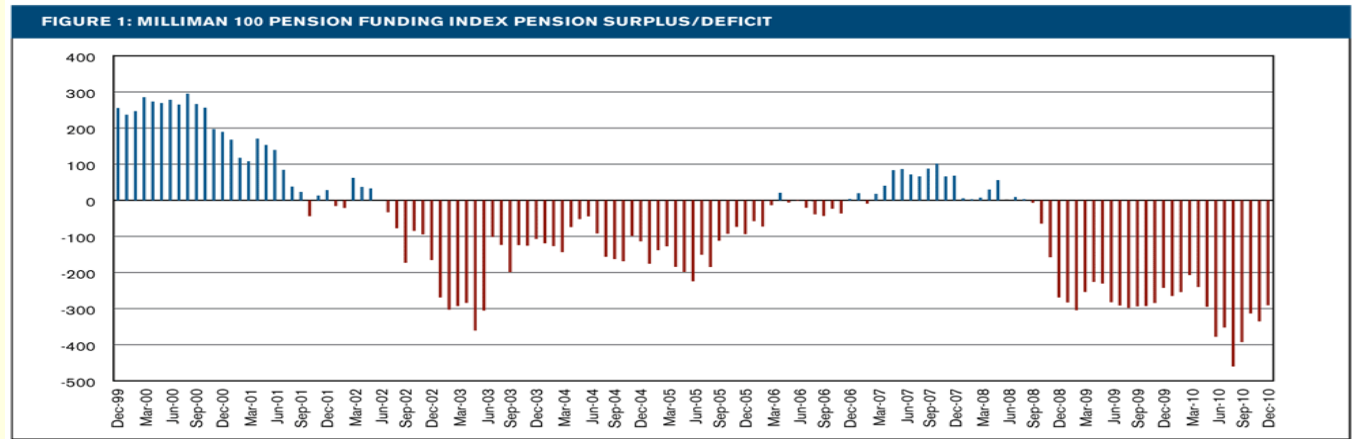
Source: Standard & Poor's, First Call, Compustat, FactSet, J.P. Morgan Asset Management.
 Dividend yield is calculated as the annualized dividend rate divided by price, as provided by Compustat. Forward Price to Earnings Ratio is a bottom-up calculation based on the most recent S&P 500 index price, divided by consensus estimates for earnings in the next twelve months (NTM), and is provided by FactSet Market Aggregates. Returns are cumulative and based on S&P 500 Index price movement only, and do not include the reinvestment of dividends. Past performance is not indicative of future results.

1990 Surplus

2000 increased equities

2003 increased risk

2009 moved to passive

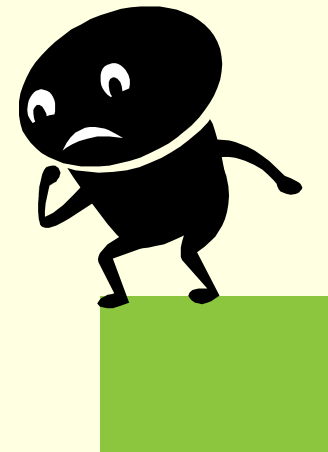


DB Risk

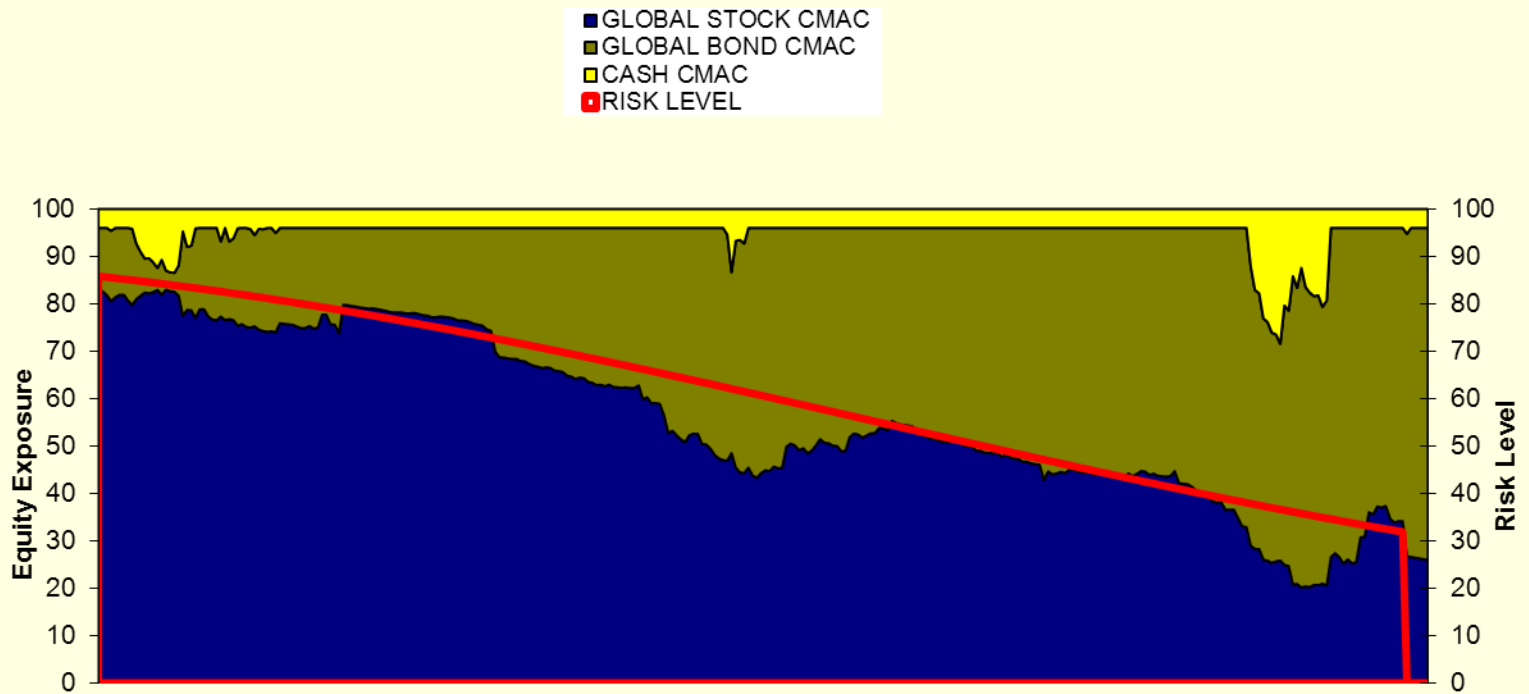
- Pension costs uncertainty driven by combination of assets & liabilities
 - **Investment risk** – professional investment management
 - **Interest rate risk** – can match liabilities with rates
 - **Longevity & mortality risk** – DB offers Mortality pooling, less income to those who live a short time in retirement – keeps money in the plan
 - **Divergence** of asset growth relative to plan liabilities- volatility can be smoothed

DB Risk Management

- Risk Management Concepts
 - **Transfer** – sell to 3rd party, annuitize
 - **Sharing** – plan design driven
 - **Mitigation** – LDI (no free lunch) or other alternative investment strategies or buy-in annuities
- JP Morgan De-risking Paper July 2010
 - Using high allocation to intermediate fixed will **raise contribution & pension expenses**
 - Using long duration allocation may be positive at first but then **raises pension expenses** by decreasing exposure to equities
 - Using synthetic overlay can cause **liquidity issues** & may be impractical for small plans
 - Using dynamic allocation, increasing fixed as funding ratios improve leads to **increased contributions**



Thinking Differently



New Solution

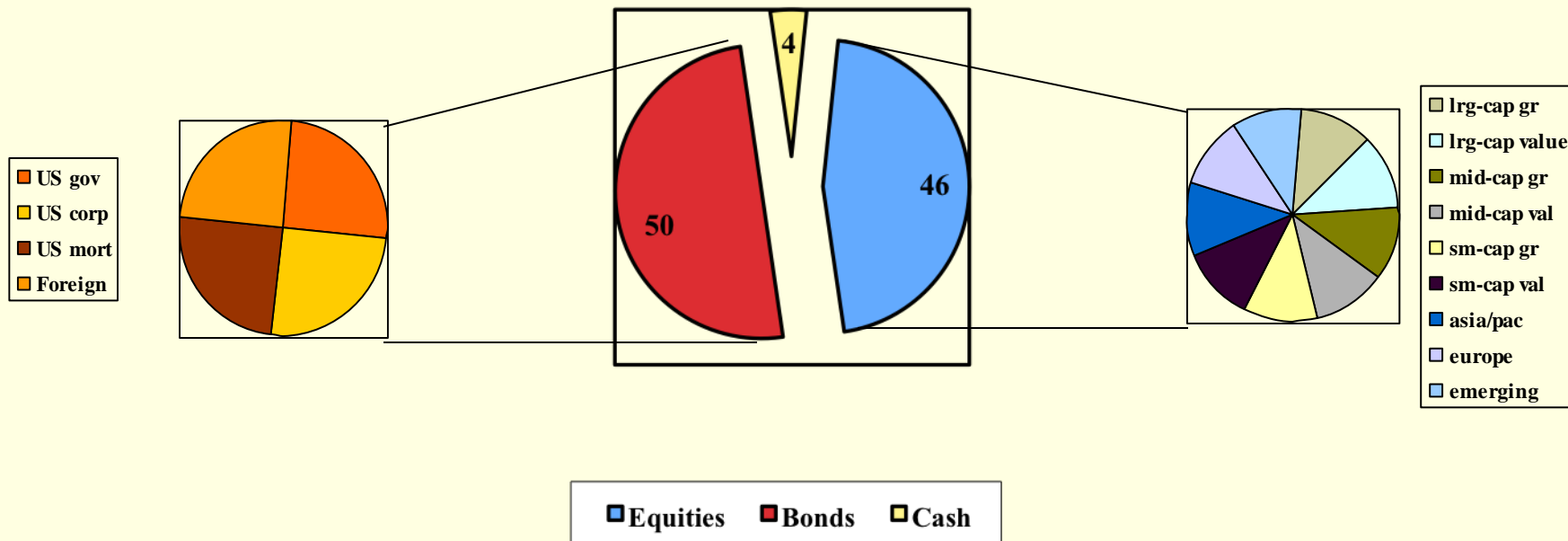
- Mapping Liability
 - With glide path
 - Forward looking risk management segmented by liability
 - Use most efficient frontier
 - Use lowest investment expenses
 - Reduce consulting costs
 - Reduce burden on committee
 - Use a proven performance success

Dow Jones Liability Sample Model

Liability Model

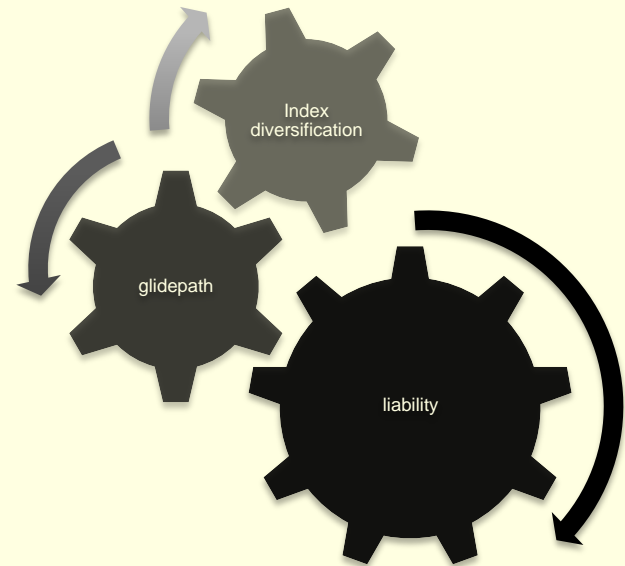
- 20% plan liability in next year
- 43% plan liability in 18 yrs
- 4% plan liability in 35 yrs

Portfolio Over-View



Talk to Us About A New Solution

- Solution that works
- Maps liability more accurately
- A DC-izing your DB plan



Presenter Bio

- **James P. Lauder**
- Jim is Chief Executive Officer of Global Index Advisors, Inc., and portfolio manager for both the Wells Fargo Advantage Dow Jones Target Date Funds and the SSgA Dow Jones Target Date Collective Trust Funds. Jim led the design of the Dow Jones Target Date Indexes in 2002 and has worked with their strategic partners to grow the DJ Target Date franchise to over \$12 billion in assets under management since their launch in 2005. He was recently profiled in *Barron's* and is quoted on retirement and investment topics in *The Wall Street Journal*, *Pensions & Investments*, *Institutional Investor*, & *Bloomberg*. Jim has also had articles on portfolio construction and multi-asset class portfolio benchmarking published in *The Journal of Indexing* and has testified in front of the DOL and SEC on Target Date and retirement related issues.
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- He has served in a variety of senior management and consultative positions in the financial services industry, holds a Masters of Business Administration from the Goizeuta Business School at Emory University and received his BS degree in Finance from The University of South Alabama. He has served in positions at AmSouth Bank, KPMG Consulting, SunTrust Banks, and as President and Founder of Lauder Consulting Group – a bank strategy consulting firm.

Presenter Bio

Our firm and its partners have received considerable recognition including the following:



Awarded National Retirement *Advisor of the Year* by PLANSPONSOR® magazine, the industry's leading national journal



Named time and again among the **100 most influential people** by 401k Wire® online.



Affiliate and among the founders of National Retirement Partners® (NRP), a leading national network of independent retirement experts



Founding Member of the Institutional Retirement Income Research Council (IRIRC), whose overall mission is to support and facilitate the culture shift of retirement plans



Testified in front of the US Department of Labor's Advisory Council.



Winner of NBJEZ™ Magazine's Forty Under 40 Award, honoring the 40 most dynamic and professionally committed business leaders under the age of 40 throughout NJ.

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Dorann J. Cafaro, PRP®, AIF®

Dorann is a national consultant on retirement plans. She was founding partner of Cafaro Greenleaf LLC, with roots going back as far as 1981. She also is among the founders for National Retirement Partners, a leading national network of independent retirement experts. Dorann has been widely nationally recognized throughout the retirement industry. She was named Retirement Advisor of the Year by PLANSPONSOR magazine, was named by 401k Wire as one of the top 50 most influential people in the 401k retirement industry, is a frequent and keynote speaker on the retirement industry at national conferences and seminars, has provided retirement education and consulting services for Fortune 500 companies, and has testified in front of the USDOL.

Dorann has been a Regional Director of Retirement Services for Prudential Investments, a Corporate V.P. and National Director of Retirement Planning for PaineWebber/UBS, and a Senior Vice President of Marketing for a leading money management firm. She holds a B.S. from Marquette University in mathematics, and is Series 7, 8, 63, 65 and Health and Life licensed. With over 30 years in the financial industry, Dorann is recognized for her unique and unbiased consulting advice, and genuine care for the financial well-being of the retirement plan sponsor and participants.