

# RISK-MANAGED DEFINED CONTRIBUTION PLAN DESIGN

Prepared by TIAA-CREF for

THE STATE ADMINISTRATION AND VETERANS' AFFAIRS INTERIM  
COMMITTEE OF THE STATE OF MONTANA

April 2, 2010



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FOR THE GREATER GOOD®**

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TIAA-CREF is pleased to provide this summary of a risk-managed defined contribution pension plan that the State Administration and Veterans' Affairs Interim Committee of the State of Montana (SAVA) may consider as part of its efforts related to House Bill No. 659. We understand that under the bill, SAVA is currently:

- Reviewing trends and best practices in public retirement plan design and funding, and
- Examining options for changes to each of the 10 retirement systems administered by the Public Employees Retirement Board.

Within this mandate, SAVA is exploring options to redesign the system and develop legislation to implement the redesign. HB 659 has established the parameters for the Committee's activities. In particular, any redesign proposal the Committee generates relating to the Teachers Retirement System (TRS) must:

- Ensure that members will have a guaranteed benefit in retirement
- Provide that employers and employees share the risk of actuarial gains and losses and allow contributions to be adjusted to meet that requirement
- Be sustainable and funded on an actuarially-sound basis
- Provide benefits designed to attract qualified and competent employees
- Comply with the Internal Revenue Code governing tax-qualified public pension plans
- Keep the Teachers' Retirement Board as the system's administrator and the Board of Investments as the investor of the plan's assets
- Provide a foundation for financial security

This document demonstrates how a well-designed risk-managed defined contribution plan can efficiently meet the retirement benefit needs of the State and its employees whether as a part of a combination defined benefit/defined contribution plan or in a defined contribution-only design.

## THE LEADING PROVIDER OF PRIMARY RISK-MANAGED DEFINED CONTRIBUTION PLANS TO THE PUBLIC AND NON-PROFIT SECTORS

TIAA-CREF offers products and services designed to consistently meet the long-term goals of its clients and their employees with the best possible terms. Formed in 1918 by the Carnegie Foundation, TIAA-CREF has:

- More than 90 years of experience in helping plan sponsors in the government, academic, medical, cultural and research fields provide their employees with adequate and secure income in retirement
- \$414 billion in total retirement assets under management<sup>1</sup>
- More than three million participants in more than 23,000 plans at more than 15,000 public and private not-for-profit clients
- 500,000 participants who received *lifetime* annuity income in 2009

**TIAA-CREF is the largest provider of retirement plans to the public and non-profit sectors. It is the only organization that serves defined contribution Optional Retirement Programs in 46 states and the District of Columbia, including an ORP for the State of Montana University System.**

**We believe no other company has the combination of experience, products and services needed to help meet the unique objectives of primary defined contribution plans.**

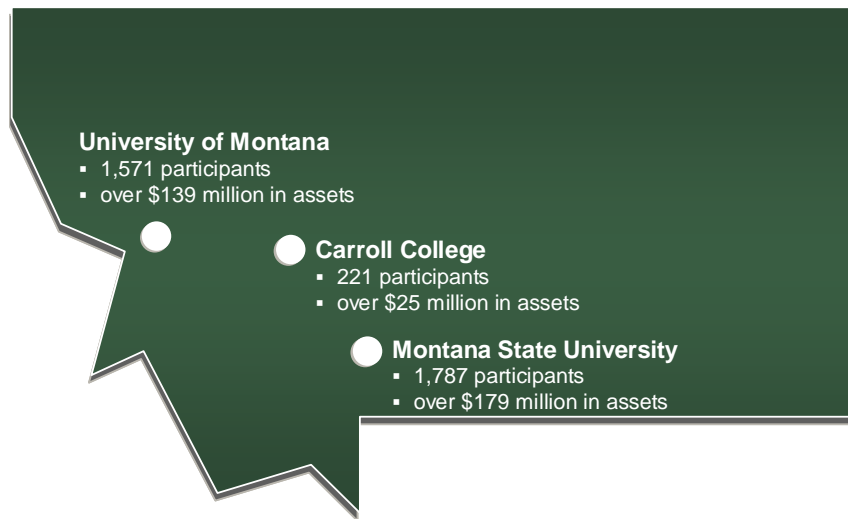
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<sup>1</sup> \$414.6 billion in total assets under management as of December 31, 2009.

TIAA-CREF's insurance company affiliate, TIAA, is one of only three U.S. life insurance companies that holds the highest possible rating from each of the four leading insurance company rating agencies: A.M. Best Co., Fitch, Moody's Investors Service and Standard & Poor's.<sup>2</sup>

## TIAA-CREF IN THE STATE OF MONTANA

TIAA-CREF manages more than \$737 million in assets for 10,343 Montana residents and administers plans for 53 nonprofit educational, research and health care institutions in the state, including:



## ABOUT RISK-MANAGED DEFINED CONTRIBUTION PENSION PLANS

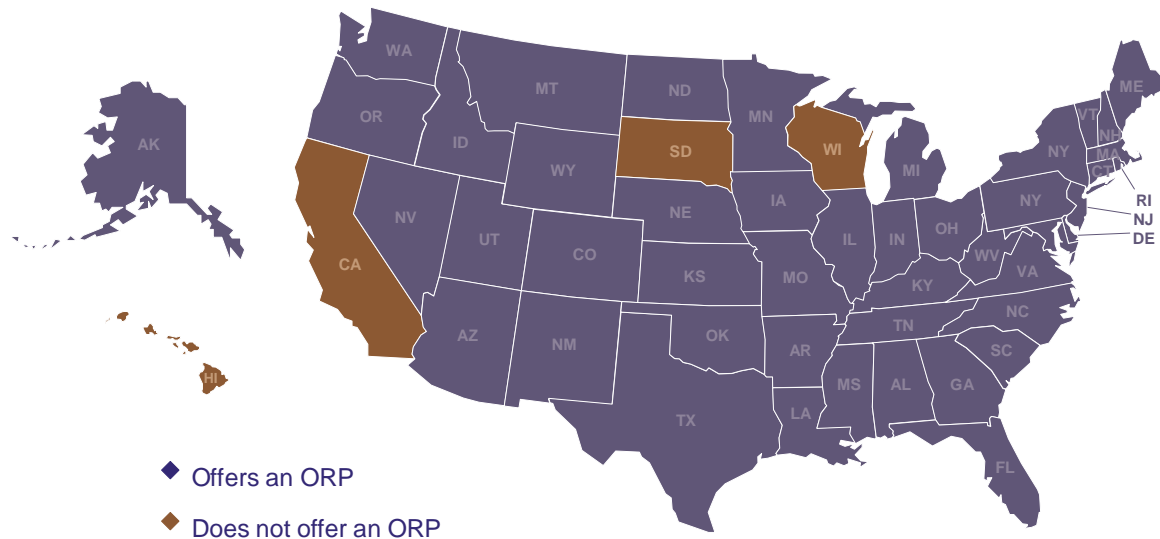
Unlike the standard 401(k) style defined contribution plan or 457(b) deferred compensation plan, a risk-managed defined contribution pension plan is designed to:

- Provide adequate and secure income throughout retirement as a primary objective. This supports critical workforce management goals such as attracting and retaining quality employees and facilitating an orderly transition into retirement.
- Provide full-career employees with a target retirement replacement income from all sources that is sufficient to maintain the employee's standard of living during retirement.
- Create a high degree of certainty that participants will achieve an adequate and secure income throughout retirement by taking into account the following risks:
  - Funding shortfall risk – total employer and employee funding should be adequate to achieve the desired income replacement objectives.
  - Longevity risk – the benefit provided should mitigate the risk the retiree will outlive his or her retirement assets.
  - Investment risk – the investment structure must be established to adequately address both normal market volatility and that attributable to more major economic downturns, such as occurred in 2008-2009.
  - Inflation risk – the risk that the standard of living provided by the plan is eroded by increases in the cost of living.

<sup>2</sup> Aaa by Moody's (as of 10/09); AAA by Fitch Ratings (as of 6/09); AAA by Standard & Poor's (as of 12/09); and A++ by A.M. Best Company (as of 12/09). These ratings are for TIAA as an insurance company and do not apply to variable annuities, mutual funds or any other product or service not fully backed by the claims-paying ability of TIAA. Ratings are subject to change. There is no guarantee that current ratings will be maintained.

The risk-managed defined contribution pension plan is not new or revolutionary – it has become the standard for public higher education employees in 46 states and the District of Columbia.

## STATES WITH OPTIONAL RETIREMENT PLANS (ORPs)



## ADVANTAGES OF A RISK-MANAGED DEFINED CONTRIBUTION PLAN

### FOR PLAN SPONSORS:

By delivering adequate and secure retirement income benefits, a risk-managed defined contribution pension plan will allow plan sponsors to:

- Provide an attractive tool to meet workforce management needs
- Help reduce the funding risk for the current defined benefit plan by creating a stable and fixed employer contribution for participants in the new defined contribution plan
- Improve the predictability of the total retirement budget to the extent that participation in the new plan increases over time
- Help reduce new defined benefit pension liabilities for participants in the new offering while continuing to leverage the total compensation base of the existing and new tiers to support the long-term funding obligations of the overall defined benefit plans

### FOR PARTICIPANTS:

The risk-managed defined contribution pension plan can also effectively meet the retirement security objectives of plan participants. It focuses not on wealth accumulation but on delivering adequate and secure retirement income for the life of the participant. This is accomplished through design features that:

- Promote an adequate level of retirement savings
- Manage investment volatility
- Protect against inflation and outliving the participant's retirement assets
- Help ensure the accrual of meaningful benefits for a mobile workforce

## SUMMARY OF THE PLAN'S MAJOR RISK MANAGEMENT FEATURES

The primary objective of the risk-managed defined contribution plan is to deliver an adequate and secure retirement income for the life of a participant. TIAA-CREF believes that to accomplish this, the design of the plan must differ from that of corporate 401(k) or governmental 457(b) plans, as these tax-deferred savings vehicles were not designed or intended to deliver lifetime income security during retirement. Following are the major elements of a risk-managed defined contribution plan.

Plan Design Feature	Risk Management Best Practices	Risk Benefit
Eligibility and Participation	<ul style="list-style-type: none"> <li>• Mandatory enrollment and participation</li> <li>• No age restrictions</li> <li>• No more than a one-year waiting period</li> </ul>	Reduces the risk of non-participation
Vesting of Employer Contributions	Shorter vesting periods, e.g., 100% after one year	Reduces the risk of forfeiture
Total Contributions (Employer and Employee)	At least 12% of pay if covered by Social Security	Reduces the risk of underfunding
Investments	<ul style="list-style-type: none"> <li>• Mandatory or default into lifecycle/target date or qualified managed account (QMA)</li> <li>• Limited array of participant directed investments covering the major asset classes</li> <li>• Individual investment advice for participant-directed investments</li> <li>• Broad-based employee investment education and financial planning</li> </ul>	Connects participants to efficient asset allocations, thereby lowering the risk of poor investment decisions by participants
Distributions	<ul style="list-style-type: none"> <li>• Limited or no hardship or loan features</li> <li>• Distributions are limited to the plan's retirement age (except small benefit accumulations)</li> <li>• Some level of mandatory guaranteed life income annuity</li> <li>• Limited lump-sum distributions</li> <li>• Provide inflation protected options and features</li> </ul>	<ul style="list-style-type: none"> <li>• Reduces the risk of "retirement asset leakage" before retirement</li> <li>• Reduces the risk of the participant outliving his or her accrued DC benefits</li> <li>• Helps maintain the participant's standard of living during retirement</li> </ul>

## CONSISTENCY WITH HB 659 PRINCIPLES

A well designed risk-managed defined contribution pension plan is consistent with the benefit and administrative objectives established by HB 659 for the Teachers Retirement System:

HB 659 Principle	Yes	Risk-Managed DC Plan Feature
Ensure that members will have a guaranteed benefit in retirement	<input checked="" type="checkbox"/>	The risk managed defined contribution plan can provide guaranteed retirement income for life. <sup>3</sup>
Provide that employers and employees share the risk of actuarial gains and losses and allow for adjustment of contributions to meet that requirement	<input checked="" type="checkbox"/>	<ul style="list-style-type: none"> <li>• No actuarial funding risk for employers</li> <li>• Guaranteed benefit risks borne by the insurer, not the employee</li> <li>• Participant-borne risks are managed by the plan design</li> </ul>
Be sustainable and funded on an actuarially sound basis	<input checked="" type="checkbox"/>	Contribution requirements for the employer remain stable. The financial stability of the benefit guarantee is dependent upon the insurer.
Provide benefits designed to attract qualified and competent employees	<input checked="" type="checkbox"/>	A risk-managed defined contribution plan can meet the human resource objectives established by the plan sponsor.
Comply with the Internal Revenue Code governing tax-qualified public pension plans	<input checked="" type="checkbox"/>	The risk-managed defined contribution plan uses features fully compliant with applicable federal tax laws.
Keep the Teachers' Retirement Board as the administrator of the system and the Board of Investments as the investor of the plan's assets	<input checked="" type="checkbox"/>	The guarantee feature, however, would have to be provided by a qualified insurance company. The Board could remain as plan administrator. Investments could still be managed by the Board of Investments. This would allow the plan to take advantage of existing low cost investment structures and specialized asset classes managed by Board of Investments.
Provide a foundation for financial security	<input checked="" type="checkbox"/>	The primary purpose of a risk-managed defined contribution plan is to provide secure retirement income for life.

## SUMMARY

TIAA-CREF is dedicated to helping its governmental and other nonprofit community plan sponsors and their employees build for the best retirement possible and live successfully once they reach it. We have successfully provided sustainable adequate and secure lifetime retirement income benefits throughout our history of more than 90 years.

We would be pleased to discuss with the SAVA Committee our approach to designing and delivering risk-managed defined contribution pension plans. We have recently provided similar consultations to numerous public sector entities including the states of Pennsylvania, Louisiana, Missouri, Michigan and Utah.

Should you have questions related to this summary or to TIAA-CREF's products and services, please contact **Richard Hiller at 303 607-2200 or rhiller@tiaa-cref.org, or Roderick B. Crane at 303-607-2896 or rcrane@tiaa-cref.org.**

<sup>3</sup> Subject to the claims paying ability of the insurance company.





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