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Memorandum

Date: May 14, 2010

To: Rachel Weiss, Staff
Montana State and Veterans' Affairs Interim Committee

From: Roderick B. Crane, JD
Director, Government Market

Re: Risk Managed Defined Contribution Pension Options for Consultant Analysis

TIAA-CREF appreciates the opportunity to share our pension expertise with the SAVA Interim Committee regarding the potential advantages of our Risk Managed Defined Contribution Pension Plan design for public employees in the State of Montana. As a follow-up to that presentation, this memorandum provides a more detailed description of two ways the Risk Managed Defined Contribution Pension Plan approach may be used to meet the objectives of the Committee:

- Option 1 - a DC-only approach
- Option 2 - a combination DB/DC approach

The tables that follow outline the major elements of each option and how each incorporates the risk management principles discussed with the Committee during our presentation in April. The significant advantages of using the Risk-Managed design elements include:

- No new unfunded liabilities for the DC components of the retirement program
- A high probability of delivering adequate and secure retirement income for life for plan participants.
- Continued delivery of important ancillary disability and survivor benefits.
- Cost effective approaches that continue to utilize expertise of the BOI.

If the Committee is interested, we would be pleased to discuss how such a plan could be included in the analysis along with the other options being prepared by your advisor, Buck Consulting.

We appreciate the opportunity to provide this information and to address and further questions the Committee may have.

Plan Design Element	<p align="center">Montana SAVA Interim Committee</p> <p align="center"><u>Option 1 – DC Only</u></p> <p align="center">TIAA-CREF</p> <p align="center">Risk Managed DC Pension Plan Feature</p>														
Eligibility	<p>Same as current plans</p> <p>Best practice: Low age and service requirements</p>														
Participation entry date	<p>Same as current plans</p> <p>Best practice: Immediate, no longer than 1-year service requirement</p>														
Vesting	<p>Recommend no more than 5 years</p> <p>Best practice: 3 years or less</p>														
Total Employer and Employee Contributions	<p>Minimum 12% of covered compensation</p> <p>Higher contributions for public safety personnel and those not participating in Social Security, if any.</p> <p>Consider age and/or service based contribution structure; for example:</p> <table border="1" data-bbox="464 768 1839 1044"> <thead> <tr> <th colspan="2" data-bbox="464 768 1297 849">Contribution Amounts Based on Salary and Age</th></tr> <tr> <th data-bbox="464 816 877 849">Age of Employee</th><th data-bbox="1297 816 1839 849">% of Salary Contributed</th></tr> </thead> <tbody> <tr> <td data-bbox="464 849 877 881">Up to 24</td><td data-bbox="1297 849 1839 881">6.0%</td></tr> <tr> <td data-bbox="464 881 877 914">25 to 29</td><td data-bbox="1297 881 1839 914">7.0%</td></tr> <tr> <td data-bbox="464 914 877 946">30 to 44</td><td data-bbox="1297 914 1839 946">10.0%</td></tr> <tr> <td data-bbox="464 946 877 979">45 to 54</td><td data-bbox="1297 946 1839 979">13.0%</td></tr> <tr> <td data-bbox="464 979 877 1011">55 and up</td><td data-bbox="1297 979 1839 1011">15.0%</td></tr> </tbody> </table> <p>Employer/Employee share of total contribution amounts would be determined based on employer affordability</p>	Contribution Amounts Based on Salary and Age		Age of Employee	% of Salary Contributed	Up to 24	6.0%	25 to 29	7.0%	30 to 44	10.0%	45 to 54	13.0%	55 and up	15.0%
Contribution Amounts Based on Salary and Age															
Age of Employee	% of Salary Contributed														
Up to 24	6.0%														
25 to 29	7.0%														
30 to 44	10.0%														
45 to 54	13.0%														
55 and up	15.0%														
Investments	<p>Sponsor directed/mandatory or default into age/risk appropriate target date/target risk fund with custom designed allocation strategies to achieve desired outcome probability and volatility objectives.</p> <p>Alternatives: Core DC menu created and participants mandated to use either sophisticated or simplified QMA/asset allocation advice service. Cost range: 1-20 bps depending on complexity of the QMA/advice service selected.</p> <p>Core funds under all alternatives selected and managed by BOI</p>														
Hardship Distributions	None														
Loans	None														

Plan Design Element		Montana SAVA Interim Committee <u>Option 1 – DC Only</u> TIAA-CREF Risk Managed DC Pension Plan Feature															
Retirement Distribution Eligibility		Stated Normal and/or early retirement age only – Not upon separation unless small account value exception is applicable															
Permitted Forms of Retirement Distributions		<ul style="list-style-type: none"> - Some level of mandatory guaranteed lifetime income (e.g., 50%); may vary by exception process (e.g., proof of other financial support) and Social Security eligibility - Periodic life expectancy payments - Very limited or no lump sums 															
Pre-retirement survivor benefits		Separately provided through group term life insurance. Associated costs depends on benefit level. Decision needs to be made regarding source of funding – employer vs. employee or shared.															
Post-retirement survivor benefits		Joint and Survivor features															
Disability benefits		Options to consider: <ul style="list-style-type: none"> - Provided through existing DB disability fund - Provided through separate Long-Term Disability Insurance Decision needs to be made regarding source of funding – employer vs. employee or shared.															
Administrative costs		Depends on eligible population – e.g., all new hires, optional for new hires, optional for current DB participants. Estimated to range from 30-50 bps with the potential for lower depending on the plan structure and whether associated with existing 457 plans to achieve greater cost efficiencies															
Investment costs		Depends on underlying fund manager selection by BOI estimated at 10-20 bps Fund of funds administration/recordkeeping fees Estimated at approximately 5-10 bps.															
Consistency with Retirement Program Goals Suggested Rating (1-10 Low to High Value)										Consistency with Retirement Plan Risk Factors Suggested Rating (1-10 Low to High Risk)							
Employee Retention	Death and disability	Professional investment management	Adequate income replacement	Lifetime income security	Maintain adequate income	HR management tool	Employee attraction	Attract entry level employees	Reward Career Employees	Cost/tax mismatch	Low bang for the buck	Increase to other costs	Contribution rate volatility	High administrative costs	Hit to bond ratings	High contr. vs. competing employers	High contr. Vs. public sector
6	6	10	6	6	6	6	5	6	7	3	4	6	1	4	1	1	1

Plan Design Element	Montana SAVA Interim Committee Option 2 – Hybrid DB/ Risk Managed DC Pension TIAA-CREF Hybrid DB/Risk Managed DC Pension Plan Feature	
Eligibility	Same as current plans Best practice: Low age and service requirements	
Participation entry date	Same as current plans Best practice: Immediate, no longer than 1-year service requirement	
Vesting	Recommend no more than 5 years Best practice: 3 years or less	
DB Accrual Formula	Depends on multiple factors including ability of plan sponsor to continue to take on funding rate risk. Assume for illustration purposes a 1.0% multiplier.	
Total Employer and Employee DC Contributions	Minimum 4-6% of covered compensation Higher contributions for public safety personnel and those not participating in Social Security, if any. Consider age and/or service based contribution structure; for example:	
	Contribution Amounts Based on Salary and Age	
	Age of Employee	% of Salary Contributed
	Up to 24	2.0%
	25 to 29	3.0%
	30 to 44	6.0%
	45 to 54	7.0%
	55 and up	8.0%
	Employer/Employee share of total contribution amounts would be determined based on employer affordability	
	Investments	DB: Sponsor managed investments DC: Sponsor directed/mandatory or default into age/risk appropriate target date/target risk fund with custom designed allocation strategies to achieve desired outcome probability and volatility objectives.
Alternatives: Core DC menu created and participants mandated to use either sophisticated or simplified QMA/asset allocation advice service. Cost range: 1-20 bps depending on complexity of the QMA/advice service selected.		
Core funds under all alternatives selected and managed by BOI		

Plan Design Element	<p align="center">Montana SAVA Interim Committee <u>Option 2 – Hybrid DB/ Risk Managed DC Pension</u> TIAA-CREF Hybrid DB/Risk Managed DC Pension Plan Feature</p>
Hardship Distributions	None
Loans	None
Retirement Distribution Eligibility	Stated Normal and/or early retirement age only – Not upon separation unless small account value exception is applicable
Permitted Forms of Retirement Distributions	DB: Mandatory annuitization DC: Some level of mandatory guaranteed lifetime income (e.g., 50%); may vary by exception process (e.g., proof of other financial support) and Social Security eligibility - Periodic life expectancy payments - Very limited or no lump sums
Pre-retirement survivor benefits	Provided through DB component or separately through group term life insurance. Associated costs depends on benefit level. Decision needs to be made regarding source of funding – employer vs. employee or shared.
Post-retirement survivor benefits	Joint and Survivor features
Disability benefits	Options to consider: - Provided through existing DB disability fund - Provided through separate Long-Term Disability Insurance Decision needs to be made regarding source of funding – employer vs. employee or shared.
Administrative costs	DB: Similar to existing DB DC: Depends on eligible population – e.g., all new hires, optional for new hires, optional for current DB participants. Estimated to range from 30-50 bps with the potential for lower depending on the plan structure and whether associated with existing 457 plans to achieve greater cost efficiencies
Investment costs	DB: Similar to existing DB DC: Depends on underlying fund manager selection by BOI estimated at 10-20 bps Fund of funds administration/recordkeeping fees Estimated at approximately 5-10 bps.

Plan Design Element		Montana SAVA Interim Committee <u>Option 2 – Hybrid DB/ Risk Managed DC Pension</u> TIAA-CREF Hybrid DB/Risk Managed DC Pension Plan Feature															
Consistency with Retirement Program Goals Suggested Rating (1-10 Low to High Value)										Consistency with Retirement Plan Risk Factors Suggested Rating (1-10 Low to High Risk)							
Employee Retention	Death and disability	Professional investment management	Adequate income replacement	Lifetime income security	Maintain adequate income	HR management tool	Employee attraction	Attract entry level employees	Reward Career Employees	Cost/tax mismatch	Low bang for the buck	Increase to other costs	Contribution rate volatility	High administrative costs	Hit to bond ratings	High cont. vs. competing employers	High contr. Vs. public sector
6	8	10	7	7	6	6	6	5	6	4	4	4	4	4	6	7	7