



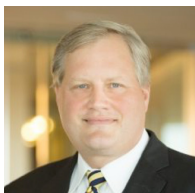
Q&A PANEL

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Retirement benefits insights
to inform your decision-making.



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A New Paradigm **DELIVERING RETIREMENT BENEFITS TO HEALTHCARE AND HIGHER EDUCATION EMPLOYEES**

The retirement benefits environment is dynamic and growing more complex given an increasingly litigious operating environment coupled with the broad shift toward 403(b) retirement plans as the primary retirement savings vehicle for many healthcare and higher education professionals. Simultaneously, employees nationwide are experiencing greater financial stress and expressing a need for benefits programs that are designed to promote financial health.

At T. Rowe Price, we believe we have a duty to help our clients deliver a secure retirement for their employees. To help our clients achieve that goal, we consider the holistic delivery of retirement benefits with the aim of promoting positive retirement outcomes. We assembled a diverse panel of experts to explore this theme from the perspective of an asset manager, an advisor, and a leading ERISA attorney.

COMPLEXITY OF 403(b) PLAN MANAGEMENT

Q: We continue to hear more about 403(b) litigation contributing to the complexity of managing retirement benefits. What is required by ERISA when making and monitoring retirement plan design and investment decisions?

David Kaleda: Please note that my comments are focused on considerations under the Employee Retirement Income Security Act of 1974 (ERISA), which largely impacts plans offered by for-profit and nonprofit employers (401(k)s, 403(b)s, etc.) but not governmental plans. However, many of our governmental plan sponsor clients follow state and local laws that mirror or are very similar to ERISA, so what I say may be of relevance to such plans too.

The recent spate of class action ERISA lawsuits against 403(b) plan fiduciaries highlights the complexity of plan management and plan monitoring—as well as the fact that costs of the plan matter. There have already been approximately 22 cases

“The complexity in management of retirement benefits is increasing, but a focus on optimal retirement outcomes for participants should always be your guide.” — Michael Davis

filed. However, ERISA does not mandate that a plan fiduciary select the lowest-cost investment options. Costs should be one of many factors, including performance, holdings, manager tenure, peer rankings, etc. Note that ERISA requires a plan fiduciary to do what a prudent person with appropriate expertise would do under the same circumstances. ERISA does not state that the selection of the lowest-cost investments, service providers, etc., is required. Indeed, several courts have acknowledged that the consideration of costs is important, but a higher-cost option is not, per se, in violation of ERISA. It is more important that the plan fiduciaries can justify why they made the decision they did. A good governance process will help them do that.

EMPLOYEES ARE EXPERIENCING MORE FINANCIAL STRESS

Q: How are employers designing 403(b) retirement plans to promote behaviors that contribute to increased savings and decreased financial stress for their employees?

Michael Davis: There is a growing industry focus on simplifying the retirement plan investment lineup to promote positive savings behaviors. According to the Plan Sponsor Council of America's (PSCA) 2017 403(b) Plan Survey, the average number of investment options in 403(b) plans continues to fall—plans now offer an average of 23 funds, down from 25 in 2015 and 27 in 2014.¹ This provides added efficiencies for plan sponsor oversight and may also increase participant engagement with the plan.

More plans are also seeking to align their plan objectives with their broader mission, and some are creating retirement benefit plan philosophies. This is not the same as an Investment Policy Statement. A retirement benefit plan philosophy is meant to be more general and address the broader

“It is encouraging to see that more 403(b) plan sponsors are recognizing the importance of good governance processes in the management of their retirement programs.” — David Kaleda

question of what you want the plan to achieve (e.g., Why do you have the plan, and who is it meant to serve? Would you prefer to keep participants in the plan after retirement? How does the plan connect to the broader mission of the larger organization and its strategic goals?). Given the strong mission conviction that many of our healthcare and higher education clients have, this alignment can create a greater sense of purpose, energy, and enthusiasm for the plan.

403(b) PLANS: THE PRIMARY RETIREMENT SAVINGS VEHICLE

Q: More 403(b) plan sponsors are thinking about the overall financial health of their employees. What are the implications of this for retirement benefits plan design?

Michael Davis: 403(b) retirement plans are becoming more central to retirement benefits delivery, so they have to do more things for more people. The centrality of the 403(b) plan is another factor contributing to the complexity of retirement benefits management. As a result, retirement benefits leaders are thinking more holistically about the role of the retirement plan in conjunction with other savings needs. Plan sponsors are considering programs to help plan participants manage debt, student loans, college savings for dependents, and rising healthcare costs, among other financial needs.

IMPROVED RETIREMENT PLAN DESIGN

Q: What are some ways 403(b) plan sponsors are designing their plans to make saving for retirement easier for their employees?

Michael A. Webb: We are seeing 403(b) plan sponsors reduce the number of retirement plans they maintain as well as the number of recordkeepers who work with such plans. Many plan sponsors now maintain a single 403(b) plan as their primary retirement plan, often with a single recordkeeper. Such actions greatly simplify the participant engagement experience and reduce barriers to voluntary savings. We are also seeing more plan sponsors implement features such as auto-enrollment, which defaults employees into the qualified default investment alternative, known as the QDIA, in the plan at a predetermined rate.

FIDUCIARY OVERSIGHT

Q: From a legal perspective, what factors should be on the minds of 403(b) plan sponsors if they are considering features such as auto-enrollment or auto-escalation?

David Kaleda: Decisions about whether to add features like auto-enrollment and auto-escalation are nonfiduciary or “settlor” decisions that are not governed by ERISA. However, the implementation of such features involves fiduciary conduct. For example, the plan fiduciary should determine whether the plan's

¹ PSCA's 2017 403(b) Plan Survey of 608 403(b) plan sponsors.

“We should encourage better financial health and improved retirement savings and consider how to support income in retirement.”

— Michael A. Webb

recordkeeper can properly deploy these features on behalf of the plan. Additionally, implementation of such features tends to lead to decisions that are fiduciary in nature. For example, when such features are implemented, normally a decision is made to add a QDIA to the plan. The selection of the QDIA is clearly a fiduciary decision. It is important for benefits professionals to understand what decisions are nonfiduciary versus fiduciary. This helps minimize the risk of becoming an inadvertent fiduciary.

Q: When working with plan sponsors, what are common themes you focus on from a governance perspective to aid them in meeting their fiduciary responsibilities?

Michael A. Webb: A common theme from a governance perspective is implementing and documenting a plan governance framework designed to ensure diligence and prudence in the evaluation, selection, and monitoring of investments and all plan-related vendors, starting with an Investment Policy Statement. Such a framework includes proper benchmarking of all critical plan elements, including investment performance, asset growth, median account balances, etc., and conducting regular reviews of the plan’s Investment Policy Statement to ensure

alignment with plan mission, goals, and objectives as they change over time. It also includes paying significant attention to noninvestment-related fiduciary items, such as recordkeeping and other administrative fees; plan utilization; and making certain that the plan document is followed in plan operation. Although it is not an official requirement under ERISA, most have come to see this as a best practice, and if you have an Investment Policy Statement, it is important to follow it.

David Kaleda: A key point to consider is the importance of demonstrating procedural prudence and process. Sponsors will wish to demonstrate how they, as fiduciaries, arrived at decisions; documented the decisions and considerations; and showed how a number of factors, such as costs, performance, manager tenure, and comparison to peers, factored into their decisions.

Q: As you work with investment committees, what are common themes that you see related to governance strategy and execution?

Michael A. Webb: Broadly speaking, plans benefit from developing a standard cadence for reviewing recordkeeping, advisory, investment, and other plan-related service providers. This enables plan sponsors to keep pace with changes in investment offerings, technology and plan tools, platform security, and value-added services for participants and helps to ensure that investments in the plan lineup continue to meet the asset allocation needs of participants and deliver value for cost.

Michael Davis: Another trend we are seeing is the inclusion of both human resources and finance/treasury professionals on retirement plan governance committees to ensure that those who are responsible for oversight of the investment options and those charged with communicating them

to participants are fully aligned with important action items surrounding the plan.

David Kaleda: Members of investment committees should have the appropriate expertise. They should fully understand the retirement benefits philosophy of the organization and investments. Importantly, the members do not have to be experts in investments (and ERISA does not require this), as long as the committee engages a third party with appropriate expertise.

TARGETED EMPLOYEE BENEFITS COMMUNICATIONS

Q: How are leading plan sponsors designing and approaching employee benefits communications?

Michael A. Webb: This is an area of growing interest, focus, and innovation. More and more plan sponsors are understanding the need to “market” their message to employees. Different employees can have very different savings and spending needs that influence what they are focused on in terms of their overall financial wellness. By speaking to their unique needs and circumstances, you can have a better chance of driving action. Using proven behavioral finance techniques to motivate plan participants is also critical.

Michael Davis: This often means taking a segmented approach to communicating with employees—plans might segment based on age cohort; based on demonstrated savings behaviors; or in conjunction with major life events, such as a marriage or promotion. Taking a segmented approach that speaks to the unique profile and needs of your employees can encourage more optimal savings outcomes.

RETIREMENT BENEFITS GOVERNANCE FRAMEWORK



Checklist

- Establish a retirement benefits philosophy
- Think about the retirement plan holistically in the context of the broader benefits equation
- Consider opportunities to achieve value for cost when evaluating plan design
- Develop a governance framework and formal cadence monitoring and reviewing retirement plan elements
- Create a strategic benefits communications strategy that incorporates segmentation tactics

Q: What does the Department of Labor (DOL) think about electronic communications with plan participants?

David Kaleda: To date, the department has been slow to adopt changes to its electronic disclosure safe harbor regulation, which has become outdated considering changes to how people consume content, including the devices they use, such as smartphones. However, under the current administration, there seems to be a genuine interest in allowing for commonly used devices to provide required disclosures and to enhance the participant communication experience. The president issued an executive order on August 31, 2018, requiring the DOL to consider making electronic disclosure more widely available.

CURRENT THEMES IN THE MARKET AND A PATH FORWARD

Q: What are practices you see from healthcare and higher education plan sponsors when they are consolidating recordkeepers?

Michael A. Webb: Well, a couple things: first, “clean breaks.” When consolidating recordkeepers, plan sponsors generally

seek to close legacy recordkeeping platforms to new participants or to new investments entirely. The purpose of this is to minimize the legacy assets being maintained on the legacy platform. This helps to direct and streamline investments to a new, typically consolidated plan lineup designed to encourage better retirement savings outcomes. Second, we see plan sponsors move away from individual annuity contracts and custodial account agreements, which cannot be transferred off the legacy recordkeeping platform, and move toward group contracts or, in some cases, away from individual contracts entirely.

Q: What are we hearing from plan sponsors with respect to retirement income and annuities?

Michael Davis: 403(b) plans have their heritage in providing a retirement income solution, especially annuities, to their employee participants. The challenge is that the financial circumstances associated with retirement are increasingly complex and the needs of participants are becoming more differentiated, so plan sponsors are looking at a wider variety of retirement income solutions to address the diversity of needs they observe.

As such, we do not believe there is a single silver bullet solution that will meet the needs of all of your employees. We envision a range of income solutions that could include target date funds that support income throughout retirement, bond ladders, or endowment-like solutions that provide a fixed income stream but offer liquidity and portability. Annuities could deliver value for various participants as well.

Q: Has the DOL provided any guidance for retirement income solutions?

David Kaleda: One concern of plan fiduciaries is that there is no direct guidance or safe harbors established in connection with selecting lifetime income options in an ERISA-governed plan. At this time, no formal guidance from the DOL has been provided. I should point out that a number of plans include lifetime income features. They look to existing guidance as a basis for making related fiduciary decisions. For example, they look to the annuity provider selection safe harbors in the event the lifetime income option has an insurance component. They are not a perfect fit and not the best long-term solution, but they can be reasonably relied upon in many situations.

Q: 403(b) plan sponsors are expressing an interest in access to collective investment trusts (CITs) available to 401(k) plan sponsors. What is piquing this interest, and what are the implications?

David Kaleda: We can hypothesize that the tide of litigation related to fees has spurred interest in CITs because CITs are often lower-cost institutional investment vehicles relative to mutual funds. A CIT is a pooled investment vehicle maintained by a bank in which a number of employee benefit plans invest. CITs look and operate a lot like mutual funds. However, they are not subject to the securities laws applicable to mutual funds. If an ERISA-covered

401(k) plan invests in a CIT, the CIT remains exempt from the securities laws requirements. Efforts are underway to convince Congress and/or the SEC that ERISA-covered 403(b) plans should be allowed to invest in CITs, while allowing the CIT to remain exempt from the securities laws similar to ERISA-covered 401(k) plans investing in a CIT. One such effort is legislation introduced to the U.S. Senate in December 2018 by Senators Ben Cardin (D-MD) and Rob Portman (R-OH)—The Retirement Security and Savings Act of 2018. This act includes amendments to the Internal Revenue Code and to the Investment Company Act of 1940, Securities Act of 1933, and Securities Exchange Act of 1934.

Q: What considerations for higher education and healthcare 403(b) plan sponsors would you like to close with?

Michael Davis: Higher education and healthcare retirement leaders support a growing employee population with diverse financial needs. In meeting these needs, it is important to seek good value for cost and to meet participants where they are through a thoughtful participant communication strategy and good investment offerings. The complexity in managing retirement benefits is increasing, but a focus on optimal retirement outcomes for participants should always be your guide.

Michael A. Webb: We should encourage better financial health and improved retirement savings and consider how

to support income in retirement. Plan sponsors can take immediate steps by evaluating auto-enrollment, auto-escalation, defaulting plan participants into target date funds, and considering the appropriateness of financial advice platforms offered through the retirement plan.

David Kaleda: It is encouraging to see that more 403(b) plan sponsors are recognizing the importance of good governance processes in the management of their retirement programs. They are also improving plan design and participant communications. These steps combined result in better retirement outcomes and better relationships with employees and thus help reduce fiduciary liability risk.

MORE ABOUT OUR PANEL



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Mr. Davis is a vice president of T. Rowe Price Group, Inc., and T. Rowe Price Associates, Inc., overseeing the team responsible for expanding the firm's reach and engagement with the U.S. institutional defined contribution investment-only segment. Beginning in 2009, Mr. Davis spent four years at the Department of Labor, where he served as deputy assistant secretary for the DOL's Employee Benefits Security Administration.

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