Institutional Investor

May 23, 2016

Exclusive Insight on Pension Fund Activity, Mandates & Trends

Money Management Letter

The bi-weekly issue from Money Management Intelligence

www.moneymanagementintelligence.com

Consultant Spotlight

Kelly Coffing

Retirement Plan Innovation That Opens Up Investment Possibilities

*By **Kelly Coffing**, principal, **Milliman***

If you manage investments for retirement plan funds, it is likely difficult to meet your clients' needs these days. With traditional defined benefit plans, your hands are somewhat tied by the sponsor's desire for high returns and low volatility. With defined contribution plans, it is difficult to find funds that meet the wide variety of participant investment needs and levels of sophistication. What if you could work with a plan that allows you to maximize the advantages of pooled retirement risks and your professional management skills? What if you could be more effective in contributing to the retirement security of plan participants?

Structural problems have contributed to the retirement crisis

We have a retirement crisis in this country. The first generation of "DC-only" Americans are beginning to move from the active workforce into retirement—workers who have had only DC plans over their careers. Predictions about the retirement preparedness of these folks are dire.

Forty years ago, DB plans dominated. They provided good, stable, lifetime benefits to retirees, but because assets and liabilities were mismatched, employer contribution requirements were very volatile (especially as plans matured). As a result, employers shifted to DC plans. These plans provided employers with the stable, predictable contributions they were seeking but have left participants to cope with all of the major retirement risks alone—risks they are ill-equipped to manage.

> "What if you could work with a plan that allows you to maximize the advantages of pooled retirement risks and your professional management skills?"

Despite participant education, auto-enrollment and auto-escalation features, DC plans remain plagued by insufficient savings, failure to fully utilize the employer matching contributions, poorer returns than professional management and leakage (early cash-out of benefits). In addition, retirees do not know how much they can spend each year, because they do not know how long they will live. The result: retirement income that can be 20-30% less than it should be.

Some employers who have stayed in DB plans have looked to asset-liability management strategies to smooth out their contribution volatility—but this comes at a high cost. Because DB plan liabilities are bond-like in nature, the very high fixed-income allocations required reduces expected asset returns. Benefits are more expensive for employers than they could be with a more balanced portfolio.

We can do better

Hybrid regulations published in September 2014 have paved the way for true retirement innovation that turns asset-liability management on its head. New plan designs allow benefits to move up and down with market returns on the plan's assets (even for retirees). Liabilities and assets move together keeping the plan funded in all market conditions. This frees the investment advisor and the sponsor to use investment strategies that may have greater volatility when determining asset allocation to maximize returns for a given amount of risk, without jeopardizing plan funding.

We have helped sponsors implement the *Milliman Sustainable Income Plan*™ (SIP) — a variation on the basic design that keeps liabilities and assets in balance while dramatically reducing the chance of retiree benefit decreases. There is growing interest among sponsors in the corporate, public and **Taft-Hartley** sectors.

The future

These new sustainable plan designs offer:

- ❏ Professional asset management throughout participants' working and retired years
- ❏ Maximized retirement benefits per dollar of employer contribution
- ❏ Lifelong inflation-protected income, and
- ❏ Stable, predictable contributions for sponsors.

The true sweet spot would be to have a SIP for employer contributions and a DC plan for tax-advantaged personal savings. This innovation gives investment advisors access to more options for maximizing results for clients and can take us back to a place of retirement security, back on track to solve our retirement crisis.

__Kelly Coffing__ is a principal at __Milliman__, one of the largest independent consulting and actuarial firms in the world. As a consulting actuary, Coffing helps clients succeed in the complex world of retirement plan management. She is a popular speaker at professional industry events, where she brings retirement plan issues to life with humor and frank explanations. Coffing has been with Milliman for almost 20 years, but before joining the company, she taught chemistry and physics to high school students in her home state of Idaho.