

M&I Institutional Trust Services Roundtable

Retirement Readiness

A PROFOUND CHALLENGE FOR
EMPLOYERS, FINANCIAL ADVISORS,
GOVERNMENT, SOCIETY AND
INDIVIDUAL RETIREES



INSTITUTIONAL TRUST SERVICES



A part of BMO Financial Group

Moderator

Jean Heinz, *Senior Reporter*
Fund Action

Panelists

Hal Cross, *Vice President-Administration*
Fike Corporation

Phyllis Klein, *Senior Director*
CapTrust Financial Advisors

George Krueger, *Director of Employee Benefits*
MacLean Fogg

Deborah Isley, *Director of Benefits and Workplace Initiatives*
Womble Carlyle Sandridge & Rice, PLLC

James Modelski, *Principal and Senior Consultant*
DiMeo Schneider & Associates

Todd Perala, *Director of Relationship Management*
M&I Institutional Trust Services



Front Row: Deborah Isley, Phyllis Klein and Hal Cross
Back Row: James Modelski, Todd Perala, Jean Heinz and George Krueger

TODD PERALA: Good morning. I'm Todd Perala, Director of Relationship Management at M&I Institutional Trust Services.

Allow me to take a moment to discuss why M&I convened this roundtable on Retirement Readiness. Everyone around this table understands that the low savings rate among retired or soon-to-retire baby boomers is a national issue with widespread implications.

In a recent Associated Press poll, 44% of baby boomer respondents indicate they have no confidence that their savings will be sufficient for their entire retirement, while 64% considered Social Security to be their primary source of income, far outpacing pensions and retirement plans. In a similar Gallup poll, a majority of baby boomers expressed doubt that they will be able to retire comfortably.

For me, personally, this is not an abstraction. As a member of the baby boomer generation, I may not have done all of the things I should have to save — and I'm in this industry. Indeed, I have talked to numerous plan sponsors and plan advisors who have confided that they, too, could probably have done more to build their own retirement savings. If professionals in our industry find saving challenging, consider the hurdles faced by a lot of folks who don't possess our background and knowledge.

The issues surrounding retirement readiness could not be more urgent. I therefore thank all of you for joining us

today. I particularly want to thank Jean Heinz of Fund Action for agreeing to act as our moderator. In our humble opinion, Jean is one of the foremost writers covering retirement plans today.

JEAN HEINZ: Thank you, Todd. Retirement readiness is increasingly a topic of interest among our readers. Before we dive into some of the more challenging issues related to retirement readiness, I will ask the panelists to introduce themselves. Phyllis, could you start us off?

PHYLLIS KLEIN: I'm Phyllis Klein, Senior Director of CAPTRUST Financial Advisors' Consulting Research Group. CAPTRUST is an independent Registered Investment Advisor providing consulting services to over 600 retirement plan clients with over \$50 billion in assets. I have oversight for our Participant Advice and Education services, Vendor Search and Selection, and ERISA Technical assistance. My career in the retirement plan industry spans over 30 years and I have worked with 401(k) plans since they were first offered as a retirement plan vehicle.

HAL CROSS: I'm Hal Cross, Vice President-Administration of Fike Corporation, which is just outside of Kansas City. I oversee Human Resources, Business Systems, Information Technology, Business Continuity Planning and Corporate Communications. In recent years Fike has recognized it needs to apply more educational planning to our 401(k)

program and related benefits activities to help employees prepare for retirement.

GEORGE KRUEGER: I'm George Krueger, Director of Employee Benefits for MacLean Fogg, where I've spent more than two decades. I used to be the Comptroller and about three years ago was put in charge of our 401(k) plan, as well as some union pensions domestically and overseas.

DEBORAH ISLEY: I'm Deborah Isley, Director of Benefits and Workplace Initiatives with Womble Carlyle Sandridge & Rice. We are one of the largest law firms in the Southeast, headquartered in Winston-Salem, NC. Previously, I worked for a division of Sara Lee Corporation, which had a very strong DB plan environment. 401(k) was

always an ancillary benefit. At my current employer, 401(k) plays a more significant role in our efforts to encourage employees to prepare for retirement.

JAMES MODELSKI: I'm James Modelski, a Principal and Senior Consultant at DiMeo Schneider & Associates. I sit on the Investment Committee and work with 401(k) plans, pensions, endowments and foundations. As a firm, we have approximately \$35 billion under advisement with over 200 institutional clients.

Ideal Deferral Rates

JEAN HEINZ: Todd mentioned the recent Associated Press and Gallup surveys indicating that many baby boomer employees lack confidence in their ability to achieve a comfortable retirement. These findings have been echoed by statistics just released by the Employee Benefit Research Institute, in which there was a significant jump in the lack of confidence of employees in recent years. Of those surveyed, 70% admit they are behind schedule in their savings, which is a dramatic 15 points higher than the 55% of workers who reported they were behind in 2005.

With that in mind, what is the deferral rate that you believe most employees need to meet their retirement goals? And, what is the current average deferral rate of your participants?

HAL CROSS: Jean, Fike Corporation has a deferral rate of 6% with a 3% match. With the help of auto-enrollment and online enrollment, we have a 90% participation rate in our plan across five different domestic locations. We have an average deferral rate of 7.7%, which includes the highly compensated,

as well. This deferral rate has not moved much in recent years, but has incrementally advanced only due to the current match level that has been in place for the last four years.

A decade ago, I think many companies were reasonably comfortable with a deferral rate in the upper single digits. According to recent statistics, however, that's probably not sufficient for most employees. We constantly struggle to convince participants to save on their own beyond the match.

GEORGE KRUEGER: Some statistics suggest that you should seek to save 12% of your paycheck the day you start working. I think that's actually low. At MacLean Fogg, 94% of our employees participate in the plan. We have a 6% match and contribute 50% on the first 6%. Automatic enrollment kicks in at 3%, and we recently instituted an escalation of 1%, assuming that many people would opt out. Surprisingly, people did not take the initiative to say yea or nay. About 89% ended up accepting the 1%.

JEAN HEINZ: I suspect that many plans would be pleased to have Fike and MacLean Fogg's participation rates.

GEORGE KRUEGER: Participation rates are an important metric, but it begs the question as to whether individual participants are actually saving enough. I believe Hal and I would agree that the answer, in general, is no.

TODD PERALA: It is important to keep in mind that 401(k) plans were never meant to be an employee's sole source of retirement savings outside of Social Security. This may work for the minority of employees who also are vested in defined benefit plans, but participants without DB plans may be unwise to consider their 401(k) as the only savings vehicle they need.

JEAN HEINZ: Good point. Deborah, I'm guessing that retirement plans are a bit different at a law firm than at the manufacturers where Hal and George run the plans.

DEBORAH ISLEY: Indeed. Pretty much by definition, law firms are very conservative. We don't have auto-enrollment yet, because law firms place a great emphasis on personal responsibility. The thought is that employees know they need to save and are aware the firm offers an advantageous means to do so. Employees who choose to ignore the plan or to under-save will have to deal with the consequences of their decisions.

A third of our workforce does not contribute. Of course, some of these individuals are very highly-paid and probably don't find it necessary, especially as we also have a profit-sharing plan, a discretionary profit sharing contribution that's 5% a year. Among the two-thirds who do participate in our 401(k) plan, we have

a 7.6% deferral rate. This is obviously inadequate, which is why we continue to discuss implementing auto enrollment.

JEAN HEINZ: As a consultant, James, how much do you believe participants should save?

JAMES MODELSKI: The general rule of thumb in our industry is that participants ought to be saving between 10 and 12%. According to a recent Fidelity survey, however, the average deferral rate of their participants is 8.2%. If we are right about the need for a double-digit deferral rate, this implies that many U.S. employees will experience a significant financial shortfall at some point during their retirement.

JEAN HEINZ: For baby boomers, that gap may be impossible to make up in the working years they have left.

JAMES MODELSKI: Realistically, there may be relatively little room for employees in their late 50s or early 60s to make up for decades of under-funding. However, it is essential to impress upon individuals in this situation that every year still counts and there are still actions they can take that can potentially enhance their retirement savings. The worst outcome is for people to become so discouraged that they do nothing.

There are a number of automated solutions to boosting participation and deferral rates, but ultimately we need to continue to focus on communication and education. For starters, we need to redouble our efforts to persuade

participants to max out on deferrals, perhaps with a hard number of \$16,500.

JEAN HEINZ: For lower salaried employees, that could be a challenge, especially if inflation continues to pick up.

JAMES MODELSKI: Nevertheless, employees who cannot max out should, at a minimum, be shown a scale demonstrating the impact this will have on their individual savings rate. That tends to be more effective than coming up with a general percentage.

JEAN HEINZ: Phyllis, what is your experience in regard to convincing participants to increase deferrals?

PHYLLIS KLEIN: Having had a front-row seat to the 401(k) plan evolution, I submit that historically our industry has done a poor job of providing deferral guidance to participants. As Deborah noted, part of the problem is the risk of coming off as too paternalistic. The generally accepted view suggests that as long as we persuaded participants to defer something, this was an achievement. While there may have been some truth to that, it has become increasingly clear that our industry has not persuaded participants to defer at a high enough rate. Everyone involved in the process needs to convince the participants to save at a rate that will allow them to achieve an income replacement amount that meets their needs.

JEAN HEINZ: Do you attempt to convince participants to max out?

PHYLLIS KLEIN: That would be optimal, Jean, but as you suggested, this is not a realistic option for many employees. If you suggest a deferral rate that would allow a participant to meet their retirement needs, many participants could decide that rate is beyond their current ability and do nothing. I generally counsel participants to enroll at a rate that will allow them to receive the full company match. If the match is on the first 6% of deferrals, enroll so you contribute at least 6% of your pay. They listen, they opt to participate, but quite often they scale back to a much lower deferral rate. While this outcome is certainly not a victory, it is better than no participation at all.

The reality of the situation is that this is a difficult challenge for both the sponsor and the participants. We simply have to do a better job of convincing participants they must defer at a higher number. Right now, Jean, I can tell you that most sponsors are not having this conversation with their employees.

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Financial Advisors

TODD PERALA: Jean, at this time there are two issues that complicate retirement readiness. First, every participant has a different price tag, which makes generic numbers problematic. Ten percent is too small for a lot of people, but may be too high for others, depending on the kind of lifestyle they expect to have in retirement. As an industry, we have to improve our ability to learn to deal with this disparity.

Second, there's the issue of behavioral risk. We've transitioned from a defined benefit system, which required nothing of the participant to receive a benefit to the 401(k), which is now the primary retirement vehicle. Increasingly, the evidence shows that behavioral risk is the biggest component to participants getting where they need to be. Ultimately, the most effective solution may prove to be strong automatic features — auto-enrollment, auto-contribution escalation and a default fund that's designed to last the participant through his entire life.

JEAN HEINZ: Behavioral risk is certainly a major issue, but another risk — which a few of our panelists have alluded to — is perhaps best referred to as low-salary risk. Deborah, what percentage of your participants are not contributing because of hardship or simply because they can't afford to?

DEBORAH ISLEY: In my organization we have a number of people who do not have the income to save. However, the firm does contribute 5% through a profit

sharing component of our retirement plan, so they're getting something. But this highlights the reality of deferrals: While it's nice to save 16.5% if you make \$150,000, it's far harder to do so if you make \$32,000.

It also is difficult if you are making \$100,000 a year but just completed law school and need to pay down \$100,000 of debt so you can get on with your life. This is even more onerous if you have student loan debt of \$100,000, but have just completed your undergrad degree and are making \$40,000. Sixteen and a half percent is probably out of the question.

GEORGE KRUEGER: Our company is not structured like a law firm, Deborah, but our employee base ranges from people who make modest salaries to those whose compensation is considerably higher. We have approximately 1,500 people in our organization, 94% of whom participate

in a profit-sharing plan. Thirty-seven of these individuals defer \$16,500 and 11 hit \$22,000. Regardless of what we tell employees, many assume that their target number is 6% because we match up to 6%. The average balance of participants is \$35,000 and no retiree can live on that.

JEAN HEINZ: George, is there any argument that moves people to defer more?

GEORGE KRUEGER: If there is a surefire argument, we haven't found it. My tactic is to urge participants to increase their percentages because Social Security may not be around when they retire, or it may be significantly reduced. Most intuitively understand that this is a real possibility. Participants acknowledge they should save more, and promise they will, but most do not take action unless we continually remind them. Left to their own devices, it rarely happens.

Responding to the Savings Crisis

JEAN HEINZ: EBRI suggests that 64% of retirees and 42% of higher-income workers will run short of money after a decade. I consider this a crisis.

PHYLLIS KLEIN: Jean, I'm going to play devil's advocate about the savings crisis. This is not a new development. The U.S. has been in a savings crisis for decades and just never admitted it. Even

at their height, pension plans covered less than half of the American workforce. Many people, especially now, refer to pension plans as if they are some sort of magic bullet that ensures workers will retire at 80% pay. While pensions do provide a lifetime benefit, it is often not as significant, in terms of income replacement, as many people believe.

Now that pension plans are unraveling per se, the savings “crisis” is more apparent. There is a tremendous savings shortfall in our nation, and that is going to dovetail into the crisis surrounding long-term health care and its attendant costs. In short, we have a crisis, and people will likely spend down their 401(k) accounts much faster than they anticipate, but this is not a new one. With longer life expectancy and prolonged health care needs, it’s likely that many people will run short of money during their retirement years.

JEAN HEINZ: Hal, would you agree with Phyllis?

HAL CROSS: On both counts. This savings crisis did not suddenly arise. And second, there are many things about this crisis we don’t fully understand. For example, I’m curious about how changing demographics have effected saving. What percentage of households are now dual-income homes versus what it’s been in the past? I assume there’s been a big shift in the last 15 to 20 years.

If we assume that two people can live more efficiently than one, this may soften the blow of under-saving, even if the 401(k) savings of both individuals are less than optimal. Statistically, we can’t just look at one participant and conclude he/she will never be able to afford retirement, based on a single account. We have to judge the two accounts together, along with dual Social Security

income streams and any other form of savings/investments the individuals might have made.

Of course, this can also work the other way. If both individuals have very little in savings, it may become very difficult in retirement to ensure both are well-fed or able to pay for the medication both may need as they age. The long-term care proposition that Phyllis outlined is indeed a future risk from a wealth protection perspective. This is a benefit/insurance consideration, and another element of retirement wellness. A severe health condition can erode the accumulated savings of even the most ardent savers.

JAMES MODELSKI: Hal, from an economic standpoint the increase in double-income has grown incrementally since the 1960s. The problem is that wages, even in two-income households, have not kept pace with inflation. As Phyllis noted, this is especially a problem with health care inflation, and we might begin to see rising energy costs have an outsized impact, as well. Rising taxes also may become a reality for retirees in the next several decades, as Washington looks at various measures to reduce the federal deficit. Even households with two 401(k) plans may be challenged if they under-saved.

JEAN HEINZ: What can our industry do to get people to save?

TODD PERALA: There definitely are things we can encourage employees to do. One option, if you haven't saved enough during your working life, is to extend your savings by postponing retirement. This reduces the number of years in which you otherwise would have relied on investment income. And, it may enable a decently allocated portfolio to continue to grow. Obviously, this isn't anyone's first choice, but the latest survey from EBRI suggests that more employees see this as a necessary option. Approximately one-quarter of workers say the age at which they expect to retire has changed in the past year and, of those, 89% expect their retirement age to increase.

Another option is to postpone Social Security benefits. Most participants are woefully under-informed about how to optimize Social Security. One of the best techniques for a couple is for the greater earner to defer taking Social Security until age 70, in order to receive the maximum monthly payout. As an industry, we need to educate employees in regard to these options.

JAMES MODELSKI: Deciding to postpone Social Security until 70 is an option today, Todd, but may become the law of the land before long. We might do participants a favor by encouraging them to plan on 70 as the operative year for receiving Social Security, regardless of their current situation.

JEAN HEINZ: George suggested before that Social Security may be reduced, as well.

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— *Todd Perala, M&I Institutional Trust Services*

TODD PERALA: George may be right, and I would be surprised if we didn't see some cuts. However, I don't think they will be dramatic. The baby boomers are too large a voting bloc to allow substantive reductions.

PHYLLIS KLEIN: Social Security is a critical issue, Jean, but retirees today may have more pressing concerns, such as their ability to pay for their health care. A possible reduction in Social Security benefits may seem less immediate for those close to retirement.

Education and the Difficulty of Gauging Savings

JEAN HEINZ: According to a recent EBRI survey, only 25% of participants have a realistic understanding of what they'll need on a monthly basis in retirement. George, why is it so difficult for employees to gauge this?

GEORGE KRUEGER: The unknown is always difficult to comprehend. At our company, participants' top questions are: How much will health care cost me when I retire? Will I have to keep working because I don't have insurance? Is there a retirement package? Pensions used to assuage some of these concerns. But after 2007, during which people didn't even want to look at their statements, 401(k) plans didn't seem too stable. These accounts have rebounded to a large extent for those participants that continued to maintain equity exposure, but many people are convinced that, "How much do I need to save?" is an unanswerable question.

TODD PERALA: There's another issue that comes into play here, George. The U.S. education system has done a horrible job of preparing people to be financially-responsible adults. We don't teach students how checking accounts work, how credit cards work — never mind how much debt is reasonable for a person to have. These are skills that everybody needs, if not

when they graduate high school, than certainly when they leave college. As a consequence, the idea of budgeting and personal finance for many employees is to calculate how much remains of a paycheck after two weeks. I mean, is it any wonder that understanding retirement needs is beyond most skill sets?

JAMES MODELSKI: Calculating how much a household needs to save can be challenging even for people who do understand credit, inflation, budgeting and other fundamental financial concepts. The mass of information and variables required for this calculation can be confusing. There are external variables — such as health care costs, the level of inflation and the tax rate — as well as personal variables. In my experience, few participants take the time to game out where they will be financially in five, 10 or 20 years.

DEBORAH ISLEY: Another challenge is that most of these variables are not static. They continually change.

JAMES MODELSKI: Exactly. Unless you revisit the variables and goals every single year, you won't have an idea of where you really stand, which will limit your ability to change your course of action. Unfortunately, the mere act

of sitting down and listing all these variables can be overwhelming, and our industry has not provided a lot of support in this regard.

DEBORAH ISLEY: Many companies believe this is not their province, that it is an employee's personal business to calculate how much she needs to save. Philosophically, this may be reasonable, but in the real world it means that many, if not most participants will lack a sound understanding of their savings requirements. 401(k) plans provide an infrastructure to help participants grasp their retirement income needs. As an industry, we have to do a better job of educating.

HAL CROSS: In most areas of education I believe our plan does a pretty good job, but we don't, on an annual basis, discuss with employees the need to review their projected retirement income needs. My guess is that very little would be accomplished even if we did, as long as the employee was left with the responsibility of performing the actual calculation. The only truly realistic solution may be to put something out in front of participants programmatically, just as we did with auto-enrollment. We all agree that education is critical, but experience has taught our industry that it is not the only answer to drive participant behavior.

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GEORGE KRUEGER: Ultimately, Hal, you are probably right, which is an unfortunate statement in regard to our ability and the ability of our society to educate people. Even if every 401(k) plan had a comprehensive education program, that would not make up for the lack of financial education provided by schools and parents. From day one, I've educated both my daughters on the importance of saving for their future. They've now graduated from college and both are successful in business. Still, I'd be upset if they didn't save the maximum \$16,500.

Cultural Shift

JEAN HEINZ: Deborah, along these lines, Does Womble disclose on statements what the 401(k) is likely to generate in monthly income?

DEBORAH ISLEY: No. We actually did at a previous employer in an annual statement. We sought to project all sources of retirement income, including Social Security, 401(k) and the DB plan in order to come up with a total value. As helpful as that may sound, few participants altered their deferrals or other financial behavior because of it.

JEAN HEINZ: Is that because no one paid attention to it?

DEBORAH ISLEY: People were just really overwhelmed by the complexity of understanding a DB plan, a 401(k) and an ESOP. Granted, people did look at it and ask a lot of questions, which was encouraging. Ultimately, though, I think a lot of the unwillingness to study their accounts and save as much as needed is cultural.

As Phyllis said, this is not a new crisis. The baby boomers were the first generation whose parents, by and large, were covered under retirement plans. For some reason, this is still an expectation for a lot of people. Many participants we talked to don't seem to fully understand that they may live a decade or more than their parents and that there is no supplement to their 401(k) plan outside of Social Security.

JEAN HEINZ: Phyllis, how do you get people out of this mindset?

PHYLLIS KLEIN: It's a complex issue. As George noted earlier, participants left to their own devices usually take little to no action. Annually, we conduct close to 4,000 individual meetings with participants where we offer one-on-one advice. More than 75% of the participants we meet with end up needing to take some action, either constructing a more diversified asset allocation or increasing their deferrals. We have had about half of those participants take immediate action.

JEAN HEINZ: That sounds encouraging.

PHYLLIS KLEIN: At first glance, you might think so. However, individual meetings tend to draw in the participants who are a bit more engaged, and therein lies the issue. We did not necessarily attract those employees who really need prompting to save. That said, any time you can meet with a participant in a one-on-one setting is a welcome opportunity. We may not transform everyone into outstanding savers, but we can make incremental progress among those who have some sense that retirement tomorrow requires action today.

JEAN HEINZ: Not every plan will support one-on-one meetings, even if they are optimal. Have mailings been effective, Phyllis?

PHYLLIS KLEIN: I know “paper” is a dirty word for some record-keepers, but we’ve actually seen a lot of action among groups with enrollment postcards that require nothing more from the recipient than to check a box and send it back. In effect, it is important to make it as easy as possible for people to become investors and to increase their deferral rates. Some of the programmatic solutions have been effective in this regard.

Deborah talked about the philosophy of individual responsibility and while there is no question that is important, employers need to consider assuming a more paternalistic role, and the industry needs to continue to simplify the process. These are some of the actions that will enable large segments of the workforce to save and retire. There are still far too many participants who look to Social Security to be their salvation.

TODD PERALA: Phyllis, we tend to forget that Social Security wasn’t designed to be a safety net for a 20-year retirement. When Social Security was first established, the average life expectancy at birth was age 65 and the program was designed to pay a benefit

for five years. It’s misguided to think, as we do, that retirement is a right that’s existed for all of history. Retirement as a concept didn’t even come into existence until the 1800s — and not here but in Europe.

JEAN HEINZ: The paradigm has been shattered, I take it?

TODD PERALA: Shattered may be too strong a word. Extensively modified might be more accurate. Remember, the first beneficiaries of Social Security never paid anything in, but it didn’t matter because the benefit was so small and time horizon was so short. Now, thanks to advances in health care, nutrition and safety regulations, people are living much longer and the viability of retirement is suddenly an issue. A confluence of events has brought retirement concerns to the fore. This includes Deborah and Phyllis’ observation that our nation doesn’t have a strong savings culture.

JAMES MODELSKI: It’s worth noting, too, that the entitlement ratio is now out of whack. In the 1950s, we had a 16:1 ratio of people paying in and people taking out. This ratio is now about 3:1 and is decreasing.

Off-The-Shelf and Customized Target-Date Funds

JEAN HEINZ: One hot topic of late is inflation and how it will factor into retirement readiness. To prevent inflation from eating into retirement savings and decreasing purchasing power, would you consider a stand-alone inflation hedging product? Or, do you mostly favor target-date funds?

PHYLLIS KLEIN: We expect target-date funds to continue to be a driving force in the defined contribution market. We conduct considerable research on the underlying makeup of target-date funds and have recently seen a real shift. The first iteration of target-date funds, introduced in the early 1990s, was very basic. The funds' focus was simply to allocate assets across a broad spectrum of investments. In recent years, these funds have begun to employ hedging strategies and bond portfolios have become more sophisticated. We see this as a positive development, but believe the best is yet to come from a product creation standpoint. So we're interested, although our attraction to these funds is not driven solely by inflation. We favor those funds that have enhanced their asset allocation and are providing greater exposure to low correlating assets.

JEAN HEINZ: James, is your and Phyllis' perspective on target-date funds the same?

JAMES MODELSKI: Within some target-date funds we're seeing more investments that can act as an inflation hedge. Off-the-shelf products are now offering real assets, such as TIPS, commodities and REITs. When combined, these should provide some protection if upward pricing pressure builds.

Plans that are big enough to customize their target-date funds can add these investments if the overseeing consultant or committee believes inflation is an issue. In general, however, off-the-shelf products have already taken this initiative.

JEAN HEINZ: So inflation is not a huge factor yet?

JAMES MODELSKI: Even though we're in a low inflation environment, Jean, it's still a concern. Plan sponsors and their consultants are well aware that gasoline and food prices in recent months have diminished retirees' purchasing power. The core CPI number may be historically low, but retirees and people who have yet to retire are feeling inflation's impact. The addition of real assets in off-the-shelf products is occurring at a good time.

JEAN HEINZ: Hal, what are the demographics of the target-date funds at Fike?

HAL CROSS: Approximately 30% of our participants invest in our target-date funds. It appears to me that this group is largely comprised of employees who are either willing to acknowledge they are not confident in their ability to select and allocate funds, want someone else to tell them what to do or don't have access to the advice they would need to make informed investment decisions.

JEAN HEINZ: How have the target-date funds performed for this group, Hal?

HAL CROSS: In general, our five target-date funds have performed reasonably well, but we haven't yet examined if the participants in these funds have fared better than their peers who use the 12 other options on our menu. That may prove to be an interesting exercise.

JEAN HEINZ: George, what percentage of participants is currently enrolled in a target-date fund at MacLean Fogg?

GEORGE KRUEGER: Twenty percent of our participants invest in target-based funds, representing about 20% of total plan assets. I'm surprised that this percentage isn't higher, given the fact that most people in our profit-sharing plan are not sophisticated with regard to selecting investments or creating their own asset class. To a large extent, this reticence may be due to the large losses

that target-date funds suffered in 2007-8. That appears to have scared away some of our participants.

“Approximately 30% of our participants invest in our target funds. It appears to me that this group is largely comprised of employees who are willing to acknowledge they are not confident in their ability to select and allocate funds, want someone else to tell them what to do, or don't have access to the advice they would need to make informed investment decisions.”

— Hal Cross, Fike Corporation

JEAN HEINZ: As a sponsor, was it difficult to select funds that could meet your participants' needs?

GEORGE KRUEGER: We have tried to make it as simple as possible for the participants. We have only seven funds, chosen with the assistance of our consultant, who also helped choose the date-driven allocations for our target-date portfolios. Three of the seven funds — money market, government bond and fixed income — are fixed in nature. We also have a diversified growth fund, a value fund, emerging market fund and a small cap fund.

JEAN HEINZ: Do you have plans to offer any investments that can act as a potential hedge against inflation?

GEORGE KRUEGER: Right now we're looking at a TIPS fund because we're concerned about rising prices and believe we will have a number of receptive participants.

JEAN HEINZ: As a consultant to MacLean Fogg, James, I assume you have some insights into George's situation?

JAMES MODELSKI: MacLean Fogg has a distinctive approach, made possible by its size. Because the company has control over the underlying assets, we were able to use the seven core funds as underlying investments within the target-date portfolios.

Right now this is an option only for certain plan sponsors. However, as plan administration within our industry continues to evolve, we may reach a point where this approach becomes cost-effective for smaller plans and more common.

TODD PERALA: Presenting the funds as an asset allocation portfolio is an economically feasible solution for a growing number of sponsors. Participants can select the 60/40 portfolio or whichever portfolio they believe best reflects their needs. Whatever portfolio they choose will drive the underlying investments. This offers simplicity and certain efficiencies, although sponsors today lack the ability to look at the portfolio as a single

investment and discern the consolidated return on the investment.

JAMES MODELSKI: Jean, this approach also allows plan sponsors to study the demographics of the participants in these portfolios. That enables George and the team at MacLean Fogg to build a glide path and portfolios that are specific to MacLean's participants, as opposed to taking something off the shelf that may not fit as well. The plan sponsor's ability to oversee and control the investment strategy can result in a better designed glide path and plan-specific approach.

TODD PERALA: The other advantage is that the underlying funds have already been vetted by the plan sponsor and their advisors. Consequently, the participants can access funds the committee is already comfortable with as the underlying investment vehicles. For some sponsors, this is preferable to buying target-date funds that contain funds selected and assembled by the manager, often from its own fund family — for better or worse.

PHYLLIS KLEIN: Another challenge of using off-the-shelf target-date funds can be the glide path, Todd, even if the underlying funds are sound. The assumptions can vary greatly among target-date fund providers. Some managers assume the money is staying for 30 years after the participant retires. Others target seven years or 15 years or the designated target date itself. Additionally, some target-date funds assume participants are saving 15% of

their pay, although this is not the case for many, if not most, employees. These assumptions are huge drivers, and often it is difficult for plan sponsors to find a target-date fund series that closely reflects their participant populations' financial needs and preferences.

For plans that are not necessarily large enough to have customized target-date portfolios, the solution described by Todd and James might be preferable, although it assumes a level of sophistication on the part of the plan sponsor and consultant.

JAMES MODELSKI: It can take a significant effort by a plan sponsor and consultant to choose an off-the-shelf target-date series with an appropriate glide path for your participants. Consider, for example, a fund family that delivers a more aggressive or higher equity allocation because it manages the target date based on longevity, rather than on the retirement date. Plans that use a target-date series with this approach often find that a sizeable number of participants withdraw their money from these funds as they near or enter retirement. Rightly or wrongly, these participants are unwilling to accept the higher volatility that is consistent with a longer time horizon. In this case, the ability to customize would provide plan sponsors with a lot more flexibility and control.

PHYLLIS KLEIN: Indeed, that's what we saw in 2008, James. Participants who were planning to retire in 2010 experienced significant losses in

certain target-date funds, especially if that fund had an extended post-retirement horizon.

TODD PERALA: One issue is that the architects of aggressive target-date funds may personally have far larger accounts than most 401(k) participants. In terms of being able to pay your monthly bills, there is a big difference between taking a 30% hit if you have total retirement savings of \$200,000 versus, let's say, \$2 million. Well-paid managers may simply find it difficult to comprehend how severe market volatility can impact near-retirees or retirees who have modest account balances. Participants who are suddenly apprehensive that they won't be able to fund the front-end of their retirement don't want to hear about the advantages of a 30-year glide path.

"Plans that use a target-date series [based on longevity rather than the actual retirement date] often find that a sizeable number of participants withdraw their money from these funds as they near or enter retirement. Rightly or wrongly, these participants are unwilling to accept the higher volatility that is consistent with a longer time horizon."

— James Modelski, DiMeo Schneider & Associates

Retired Participants

JEAN HEINZ: Hal, do you prefer target-date funds that are constructed to hit their target date or do you think it's important for these investments to continue past the retirement date?

HAL CROSS: We're seeing more and more evidence that target-date funds should be constructed to push beyond the retirement date, because it is becoming more difficult to discern when a participant will actually retire. The investment concept of target-date funds is certainly worthwhile, but once a participant reaches the proverbial retirement stage, their mix of risk/reward for an extended run beyond that will require some individual scrutiny. Our guess is that there will be more employees who seek to work beyond the traditional retirement age. Some employees enjoy work and believe 65 is simply too young to end a career that may still be vital, especially if they expect to live another two decades. Others, unfortunately, have come to the realization that they have little choice but to extend their working years.

JEAN HEINZ: What percentage of the assets in Fike's retirement plan is currently coming from retired employees? Do you encourage employees to keep their assets in the plan after they've retired?

HAL CROSS: Offhand I don't know the contribution rate of the retirees, Jean. However, we are advocates of

retirees remaining in the plan. This is advantageous to the overall program from a fee perspective and provides retirees with a source of relatively low-cost, carefully vetted investments. Everyone wins.

JEAN HEINZ: George, is this also MacLean Fogg's perspective?

GEORGE KRUEGER: It is today, but that was not always the case. In the past, our company preferred to have participants leave the plan upon retirement, for reasons of fiduciary responsibility. We now have a different philosophy. As a company, and a society, we can't simply write off individuals after they retire. We must use every tool possible to educate the participant for their future retirement. We can't wait for future generations to resolve these problems, we must commit to having individuals save for themselves. Additionally, as Hal indicated, a higher asset base helps with fees.

JEAN HEINZ: Deborah, what has been your experience at Womble?

DEBORAH ISLEY: Very few people leave their money in the plan once they retire. Personally, I have no issue with this. For those who do keep their money in the plan, it can be an administrative challenge to keep track of addresses and manage notifications. In an ideal world for plan sponsors, retirees would exit the plan after, say, 10 years.

“In the past, our company preferred to have participants leave the plan upon retirement, for reasons of fiduciary responsibility. We now have a different philosophy. As a company, and a society, we can’t simply write off individuals after they retire.”

— George Krueger, MacLean Fogg

JAMES MODELSKI: In my opinion, the personal finance media has done a poor job of explaining plan fees to participants. An employee in a plan that charges participants say, \$80 per account a year, will pay less than \$7 a month for all the services the plan provides. This is likely to be far more cost effective for the participant than if he rolls his dollars into an IRA outside of the plan. 401(k) plans are a wonderful, inexpensive investment vehicle for participants. For mere dollars a month they receive statements, impartial Web tools, education and investment vehicles selected by a committee, often with the help of investment professionals.

Compare this to the TV commercials for online services that charge \$9.99 per online trade, but without all the other services a 401(k) plan provides. The fact that 401(k)s are attractive in terms of fees needs to be better positioned and communicated in the marketplace.

TODD PERALA: There are instances where the personal finance media has focused on egregious cases or the data has been taken out of context to suggest that 401(k) participants pay too much. In reality, if I’m a participant in a retirement plan, I’m typically buying shares in a low-cost share class that may not even be available to an individual investor. When I use an advisor outside of an employer-sponsored plan, that advisor’s compensation is entirely paid from my own pocket.

If I’m among the minority of investors who use an IRA, the flat fee I pay is almost certainly higher than my 401(k) fee. If I don’t use an IRA, my advisor is most likely compensated by the funds or other products he directs into my account. Given the fact that these products can differ widely in regard to how much they pay out to advisors, this can be an inherent conflict. If an advisor selects the least expensive funds for me, he limits his own compensation. These issues do not exist in a 401(k).

JEAN HEINZ: Deborah, is there anything Womble might add to its plan to improve participation among current employees and retirees?

DEBORAH ISLEY: If we adopt auto-enrollment, this should significantly boost enrollment. We introduced target-date funds about two years ago, and we expect that to be attractive to a large segment of participants. We don’t have a lot of penetration in those funds yet, but it is early in the game.

JEAN HEINZ: George, is MacLean Fogg taking any steps to enhance its retirement plan?

GEORGE KRUEGER: The number one request from our participants is for a financial advisor, Jean. Not surprisingly, they don't want to pay for it; they want us to pay for it. The company, however, would rather offer a matching contribution to everyone than use

corporate dollars to subsidize an advisor who is likely to be used by only a small percentage of employees. We live in a society where we expect the employer to pay for everything, but as plan sponsors we have to ensure that the dollars we spend will benefit as many participants as possible.

Targeting Participants

JEAN HEINZ: I realize financial advice can be very costly for a plan. But for the participants who need it the most, who may be really off-track with their investments, are there any capabilities that can be deployed cost-effectively to influence their investing behavior?

DEBORAH ISLEY: Targeting brings up difficult issues, Jean. Sure, it is obvious to focus on the person who has 100% of his dollars in a stable value fund, but how do you target beyond that? Without talking to participants and gaining an understanding of their financial goals and risk preferences, there really is no way to know with certainty who is in the wrong fund or is imprudently allocated.

HAL CROSS: Jean, one place to start is to examine participant demographics in relation to the plan options. We recently conducted a plan review and found more participants than we expected had parked their dollars in

our money market option. During the severe market downturn in 2008 and early 2009, this was an extremely lucky place to be, even if it was not smart to allocate so much money to this option in the first place. We advocate diversification, but once participants are in the plan we have to monitor where their investments are going from time to time. It is not uncommon for participants to move into the conservative options and then lose track of when to diversify into more rewarding investments for a market upturn.

I'm not suggesting that plan sponsors should do nothing when participants have questionable asset allocations. We should be reminding participants to review their investment allocations at least on an annual basis. But as Deborah suggested, targeting is a tricky proposition.

TODD PERALA: Six or seven years ago, we started providing statistics to plan sponsors that identified any participant who was 100% invested in a single fund. One problem for sponsors, however, is that it is almost impossible to treat individual participants differently without potentially running afoul of regulatory issues. However, what sponsors can do — and we've encouraged this — is to distribute an e-mail to all participants explaining why having 100% of one's money in any fund may not be prudent.

Where it gets dicey is if the participant in question has invested in the fund as part of a total portfolio. You can look at what's in the plan and make some fairly good assumptions, but some participants may have IRAs or other investments outside the plan that challenge these assumptions. As a plan sponsor, you don't want to automatically urge the participant to diversify his concentrated position. The safer approach is to suggest that it may not be appropriate and ought to be reconsidered.

DEBORAH ISLEY: Total portfolios also may contain money that participants have left in residual plans from prior employers, instead of rolling it over into their current employer's plan. Perhaps they were happy when they worked at a former job, perhaps they felt very comfortable with the funds in a prior plan or maybe it is simply a matter of inertia. To your point, Todd, it is difficult to assess an employee's retirement readiness if we don't know her overall financial state. What if you

have two participants of the same age with the exact same asset allocation and account balance, but one has sizable loan obligations and the other has no debt? Or one has a stay-at-home spouse and the other has a spouse who was a teacher for 30 years and is poised to receive attractive pension benefits? You can't evaluate different 401(k) accounts by the same criteria.

TODD PERALA: Exactly. We can never be totally confident we are seeing the whole picture. The only way we would know is if participants voluntarily provided us with all of this information, which typically doesn't happen.

PHYLLIS KLEIN: I agree that targeting participants can be risky because it is difficult for a sponsor to truly know a participant's entire financial picture. I also understand that prudent guidance can backfire in the short-term when markets experience extreme moves. However, these risks may be minor compared to the risk that participants face when they make imprudent asset allocation or fund selection decisions. With every participant population I have ever assisted, there have been employee segments that clearly need substantial help. I believe we should review plan demographics, target participant segments with pertinent information and at a minimum, aggressively communicate to raise awareness regarding the potentially negative implications of certain decisions, or lack thereof.

Obstacles to Providing Retirement Income

JEAN HEINZ: How far along is our industry in providing retirees with sound sources of retirement income? And what are the greatest obstacles to achieving this?

GEORGE KRUEGER: I would love to have the opportunity to offer participants some type of fixed income solution that delivers a lifelong income stream similar to what defined benefit plans provide.

JEAN HEINZ: Are we talking about annuities, George?

GEORGE KRUEGER: Not per se. Unfortunately, there are significant issues with annuities, including portability, high fees, whether or not the life insurance company will survive for another three decades, and whether an annuity can throw off sufficient income over a long period against even modest year-over-year inflation.

TODD PERALA: Some annuities have inflation protection, but this privilege adds to the already considerable cost.

HAL CROSS: An endgame for participants would be really beneficial. There are a lot of employees who've worked for 30 or 40 years and gotten a paycheck all that time and it is only when they are on the verge of retiring

do they seriously wonder about the source of their monthly income. Part of the endgame is explaining or reminding participants that it is unlikely they will enjoy the same level of income in retirement. Regardless of the education we may provide, this still appears to surprise many people and is a major retirement concern.

JAMES MODELSKI: We run into the same phenomenon, Hal. The subject of retirement income and the benefits and disadvantages of annuities add another layer of complexity to our education efforts. It is essential for participants to understand how annuities work, and many of these products, unfortunately, are somewhat complex.

JEAN HEINZ: James, some target-date funds have an income rider. Does that make it a bit simpler for retirees to transition from one to the other, basically within the same product?

JAMES MODELSKI: We expect target-date funds with retirement income components to gain traction. In some target-date funds, for example, participants might be able to begin to purchase longevity insurance that can be dipped into after the retiree has withdrawn all of his/her money. We expect this would occur between ages of 75 and 85.

For the plan sponsor, this still requires due diligence. Does the insurance company providing this feature have a strong credit rating? Is this feature competitively priced? Does the insurance company have a viable customer service system with telephone reps that can help participants? These are not insignificant questions. Just as there are mediocre annuities out in the marketplace, we can expect some target-date fund retirement income solutions to be superior to others. Plan sponsors and their consultants have an obligation to attempt to discern which is which.

JEAN HEINZ: From a behavioral standpoint, do you expect participants to worry about having less control once they give away their lump sum? Will this prove to be an obstacle?

JAMES MODELSKI: For participants, this is not an unjustified concern. What if a participant opts for the retirement income feature and at some point prior to or in retirement needs to access her money? What does this do to the annuity structure and how much will the participant be penalized? Plan sponsors and their consultants have an obligation to explain these layers of complexity through education.

JEAN HEINZ: Phyllis, what challenges do you see in regard to providing participants with an annuity option?

PHYLLIS KLEIN: At this point, the term annuity has bad connotations and I expect that will continue. It is reasonable to say that many annuities in the general marketplace are difficult to understand, appear to be excessively priced and have severe penalties for early withdrawals.

The retirement income product that James described, attached to a target-date fund, is a deferred annuity. In my experience, deferred annuities are even harder for most participants to understand than the conventional immediate annuity. How the percentages work on these products can be quite confusing, even for individuals with a financial background.

The product providers realize that plan sponsors and consultants have issues as to how these vehicles are constructed and how they can be made attractive to participants. In recent years we have begun to see a definite shift in the way participants are being dealt with on this issue. From the provider's side you're more likely to hear the word paycheck rather than annuity. You're starting to see online calculators indicate, in dollars, how much of a monthly payment a participant will receive from their account balance at retirement. In my view, this change in terminology and presentation is very positive.

JEAN HEINZ: I assume that some participants who use these calculators are disappointed by the result.

PHYLLIS KLEIN: Very disappointed. But that brings us full circle to the start of this retirement readiness roundtable

Jean, when we discussed the shortfall in deferrals. A participant who has never deferred more than 3% of his salary cannot expect his annuity paycheck to provide an ample income. Even with a generous match, the numbers won't work in his favor.

Ideas for 2012

JEAN HEINZ: We have just about reached our time limit, and I would like to conclude our roundtable by asking each of you for a potentially effective idea for 2012 to help propel plans toward further retirement readiness.

I'll start us off. I would make enrollment meetings mandatory. Not in terms of participation, but at least attendance. If nothing else, this will help to ensure that all employees understand that someday their regular employment checks will stop and Social Security is unlikely to cover all their needs. Consequently, it is essential they have savings to help pay the monthly bills.

How about you, Hal?

HAL CROSS: My idea is conceptual, Jean. We just started a wellness program on our benefit side to provide incentives if employees participate in smoking cessation, weight reduction programs or other healthy endeavors. We've actually

had great success with this and the program has exceeded expectations. From a 30,000 foot perspective, this also readies employees for a better retirement.

Approaching retirement readiness from a wellness perspective would encompass many different elements: Are we providing people with the right compensation? Are we providing savings instruments other than 401(k)? Are our retirement plans competitive? All of these items encourage employee happiness and allow for the opportunity to save more. The wellness aspect, as we have discussed, would also include a consistent pattern of educational and promotional campaigns on an annual basis.

TODD PERALA: That's an interesting concept, Hal, and goes beyond retirement wellness, perhaps to overall "financial wellness." At every stage of a participant's or employee's career,

there would be an element of financial wellness that we could discuss with them, starting with, say, managing debt. After all, one of the biggest reasons people aren't participating in plans or deferring more is too much debt. The general population in this country has reduced its debt dramatically in recent years, but personal debt is still considerably higher than it was in, say, 1980. On the other hand, young people are beginning their careers with staggering debt loads, due to constant price appreciation at our universities and graduate schools.

So there may be an opportunity to do a continuum of development, where we work with employees through their whole career to help them manage debt and create a household budget that allows for savings. As they get closer to retirement, our focus would be more on ensuring that they're actually prepared. We would help them decide if they ought to put more money in the plan or pay down a debt. If we can help them with that then we're helping them make significant progress towards financial wellness.

HAL CROSS: That would be an interesting approach, although some might criticize us as being too paternalistic. However, if we expand the continuum of educational offerings in support of retirement/financial wellness as Todd outlined, it might be viewed as a value-added service or benefit by employees.

TODD PERALA: The problem is that our not being paternal has condemned many 401(k) participants to low account balances.

JEAN HEINZ: James?

JAMES MODELSKI: Jean, we've talked a lot today about retirement income, target-date funds and other instruments that center on retirement readiness. But these are all tools and readiness is largely conceptual. This may sound clichéd, but education and communication form the conceptual basis of any effective retirement plan. We need to rededicate ourselves to the basics of education. Make the workshops mandatory and break them into specific demographic targeted meetings. Have one meeting for 20-year-olds and 30-year-olds and another for 50- and 60-year-olds. Each of these groups has different investment needs.

PHYLLIS KLEIN: I agree with James that education is pivotal, but we also have to reconsider how we communicate the key educational messages, especially with younger participants. The communication style of young workers is completely different than that of their older counterparts. As much as we may joke about tweeting or texting or apps, we definitely need to think about the shifting methods of communication with the next generation.

Also, for years I've wondered why the employer match has to be applied to a 401(k) in the same manner as the

participant's deferral. Why doesn't the match become the annuity? Employers should explain that the 3% or 5% match will become part of a pool whose sole objective is to provide an income stream down the road.

JEAN HEINZ: That's an intriguing idea, Phyllis. Would this pool be like a mini defined benefit plan?

PHYLLIS KLEIN: Not at all. Defined benefit plans put the employer on the hook, and few companies would want to take that path again. But I believe the sponsor has a right to earmark the match for a common pool to provide an income stream.

DEBORAH ISLEY: I agree, Phyllis, that we ought to come up with a new generation of DB plans that do not place onerous demands on the employer to achieve a predetermined outcome. Even with strong 401(k) education programs, investing for the long-term is overwhelming to the average person. Even participants with college degrees often have very little understanding of how to invest, how much to invest and how to properly prepare themselves for retirement. That is an incredible obstacle for plan sponsors.

GEORGE KRUEGER: I don't mean to sound unoriginal, but I concur with both Phyllis and Deborah. I suggest putting company funds toward a product that will end up directly co-existing within a retirement plan framework. Participants will be eligible for a fixed dollar amount

tied in to vesting and will have access to the money if they leave the company. Of course, as we all know, it's quite tough to find participants once they leave. So we may need a national mandate for a product like this, not company by company.

JEAN HEINZ: Ladies and gentlemen, these are all interesting ideas. I want to thank you very much for participating in this morning's retirement readiness roundtable. This has been an excellent, edifying discussion.

TODD PERALA: Thank you Jean, and thanks to all the panelists who provided valuable insights to our roundtable discussion today. We have covered some critical issues in the retirement readiness area, beginning with the fact that many retirees are gravely unprepared to finance a potentially long retirement. One of the recurring themes this morning has been the extent to which plan sponsors should urge participants to save and at what point this may cross a line where we are too paternal. Some may argue that we are not paternal enough, as there are many participants who clearly are ill-equipped to save of their own volition and make prudent investment decisions. If we don't go the extra mile to help these individuals, many will not be ready for retirement, which could become a major societal challenge.

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