State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
DEFINED CONTRIBUTION PLAN COMMITTEE MEETING

Location:
Robert B. Atwood Building
Conference Center, 1st Floor
550 West Seventh Avenue
Anchorage, Alaska

September 19, 2018

ATTENDANCE

Committee Present: Bob Williams, *Chair*
Tom Brice
Robert Johnson
Norm West

Committee Absent: Commissioner Leslie Ridle

Department of Revenue Staff Present:
Bob Mitchell (Chief Investment Officer)
Shane Carson (State Investment Officer)
Stephanie Alexander (Board Liaison)

Department of Administration Staff Present:
Ajay Desai (Director, Division of Retirement & Benefits)
Kathy Lea (Chief Pension Officer, Division of Retirement & Benefits)

Others Present: Commissioner Sheldon Fisher
Liz Davidsen (Alaska Director, Empower Retirement)
Chris Dyer (T.Rowe Price)
Victoria Fung (T.Rowe Price)
Wyatt Lee (T.Rowe Price)
John Plowright (T.Rowe Price)

I. CALL TO ORDER
CHAIR BOB WILLIAMS called the meeting to order at 2:27 p.m.

II. ROLL CALL
Four committee members were present at roll call to form a quorum.

III. PUBLIC MEETING NOTICE
MS. ALEXANDER confirmed public meeting notice requirements had been met.

IV. A. Approval of Agenda

Chief Investment Officer BOB MITCHELL requested to move Items VII A. and VII B. earlier in the agenda. CHAIR WILLIAMS suggested they be moved after Item V. There was no objection to the amendment.

MR. JOHNSON moved to approve the agenda as amended, moving Items VII A and VII B after Item V. MR. BRICE seconded the motion. A roll call vote was taken, and the motion passed unanimously.

B. Approval of Minutes - March 28, 2018

MR. BRICE moved to approve the minutes of the March 28, 2018 meeting. MR. WEST seconded the motion. A roll call vote was taken, and the motion passed unanimously.

V. PUBLIC/MEMBER PARTICIPATION, COMMUNICATIONS, AND APPEARANCES

There were no public comments or communications to the Committee.

VII. TREASURY UPDATE

A. ARMB Retiree Income Analysis

MR. MITCHELL introduced the team from T.Rowe Price, CHRIS DYER, VICTORIA FUNG, WYATT LEE, and JOHN PLOWRIGHT, who will present the study findings comparing the retiree income options. MR. MITCHELL requested State Investment Officer SHANE CARSON provide an overview of the issue before the T.Rowe Price presentation and then after the presentation proceed to the staff summary analysis. MR. CARSON explained the focus today contains four areas:

- Define the objectives of achievement in the distribution retirement income options.
- Review the collaborative process to-date between Division of Retirement & Benefits (DRB) and Treasury Division.
- Examine the T.Rowe Price detailed analysis.
- Recommend next steps in moving forward.

MR. CARSON noted the two phases of defined contribution retirement are the accumulation phase, during which assets are saved, and the distribution phase, during which assets are consumed. The end goal is to accumulate a maximum dollar value according to each member's level of risk. At time of distribution, members decide which payment option to elect based on individual circumstances. The currently available payment options for deferred compensation and supplemental annuity plan are defer payment, lump sum, direct transfer/rollover, annuity, and periodic payment. PERS DCR / TRS DCR has all options available now, except the periodic payment option. It is pending.

MR. CARSON informed participants have been requesting the Treasury Division offer additional payment distribution options. In September of 2017, staff from Treasury and DRB formed a team and identified the objective to administer cost effective, flexible, and customized options that provide participants with a reliable and forecasted monthly distribution, and provide for survivor benefits, while minimizing counterparty risk.

MR. CARSON reviewed the process timeline DRB and Treasury conducted with eight best-in-class managers regarding retirement income solutions and products. The products reviewed included target date strategies, bond ladders, endowment models, fixed or deferred annuities, and guaranteed minimum withdrawal benefits. The team continued strategy discussions and determined a stochastic modeling analysis from Capital Group and T.Rowe Price would be beneficial. Today's presentation by T. Rowe Price will report on the evaluated results.

MR. MITCHELL expressed appreciation to T.Rowe Price for conducting the study and acknowledged their efforts. MR. DYER thanked MR. MITCHELL and MR. CARSON for being good partners over the last seven months. MR. DYER highlighted the background of each member of his team present today. He believes retirement income analysis is currently an extremely important topic in the defined contribution world. MS. FUNG commended the plan sponsors on addressing members' concern of longevity risk. The industry is still in the early days of moving into the decumulation phase to support investments, operations, and communications. MS. FUNG noted a 65-year-old male is expected to live to about 84 years old, and a 65-year-old female is expected to live to about 86 years old. One in four 65-year-olds is expected to live until 90 years old, and one in 10 65-year-olds is expected to live until 95 years old.

MS. FUNG explained there is no simple or single remedy that can fully address the complexity of retirement income needs of a diverse participant base. The chart on page three of the presentation provides a high level summary of the conclusion of retiree needs; secure reliable income, lifetime income, purchasing power preservation, market appreciation, flexibility, liquidity, portability, and legacy survivor benefits. MS. FUNG explained the main considerations for ARMB include determining the goals and risks to address, design aspects of the solution, participant preferences, participant education, and fiduciary aspects.

MR. LEE informed the analysis presentation is more dense and text heavy than usual. The decision was made to provide a framework for the discussion today and also to provide enough information for future reference and examination. The goal of a retirement income solution is to secure a long-term income stream that is sufficient to maintain an individual's desired standard of living. MR. LEE described each of the retirement income strategies evaluated.

* Withdrawal strategies using Target Date Funds (TDFs)
    * Endowment Spending Strategy
    * 4% Initial Withdrawal Strategy with Annual Cost of Living Adjustment (COLA)
    * 4% Initial Withdrawal Strategy including a Deferred Income Annuity (DIA)
* Bond Ladder Plus a Deferred Income Annuity
* Guaranteed Minimum Withdrawal Benefit (GMWB)

MR. LEE discussed the analysis compared each strategy to a common benchmark in retirement. This is effectively trying to replace what an individual spends during the working career to have a baseline common measurement. MR. LEE encouraged Committee members to focus on the relative tradeoffs among strategies and not on the specific numerical outcomes shown. The actual numerical outcomes are very sensitive to the inputs and could change depending on the input. The directional differences among the strategies will remain relatively consistent. MR. LEE advised each solution offers a benefit from a long-term income outlook. The question regards which ones of these benefits are valued the most by the participants, in terms of what becomes the more appropriate solution from an income-oriented perspective.

MR. LEE commented if income sufficiency is really the goal, the best way to solve this is through overall adequate savings. The more a participant saves out of the paycheck, the less the participant is spending, which equates to the less the participant has to replace, as well as giving the ability to grow a bigger nest egg. No retirement income strategy can truly solve for meaningful under-savings during an entire working career. Retirement income strategies are not a replacement for the savings strategy.

MR. LEE discussed the investor preferences and definitions of income level, income volatility, income durability, legacy objective, and liquidity. The analysis describes a range of metrics that quantitatively captures the benefits. MR. LEE defined the metrics of success rate, average lifetime payout, catastrophic shortfall risk, average catastrophic payout, and median remaining liquid assets. He showed the investor preferences related to the range of metrics.

MR. LEE advised the summary of analysis is focused on retirement income and moving from a working career to a retirement period. All of the income during the working career does not have to be replaced. The income used for consumption needs to be replaced. The analysis uses a common benchmark of consumption replacement, which is defined as replacing the pre-retirement salary less the assumed savings rate, adjusted for inflation.

MR. LEE provided a detailed definition of each of the five strategies and discussed their characteristics and appeal. The two graphs at the top of slide 11 model the income for each strategy at a 25% savings rate and a 15% savings rate. The dark blue line represents the outcome at the median scenario. The orange line is the 10^{th} percentile income, almost a worst case scenario. The dark gray line is the benchmark of the consumption replacement target. The dotted gray line is a catastrophic outcome of 60% of the consumption replacement target. The two graphs at the bottom of slide 11 represent the portfolio balance at any point in time. [*See presentation entitled Alaska Retirement Management Board Defined Contribution Plan Committee Retirement Income Analysis, dated September 19, 2018, on file at the ARMB office]*

The Endowment Spending Strategy combines an investment in the Alaska Target Date Funds with a withdrawal strategy that adapts to market conditions. The annual withdrawal is calculated as 5% of the preceding average 60-month portfolio balance. The withdrawal rate is recalculated annually and may rise or fall depending on market conditions. This strategy is fully liquid. It offers balance, but not income stability and is generally insufficient inflation protection. This strategy does not address the concern of extreme longevity. This strategy is for well-funded investors and aims to offer sufficient baseline income while maintaining a sizable portfolio balance. The strategy does not deplete by design. The strategy does not generally meet the baseline income targets for underfunded investors. It offers higher real spending amounts early in retirement.

CHAIR WILLIAMS asked if the traditional assumption bears out in actual experience that retirees spend more in the early years of retirement and less in the later years of retirement. MR. LEE agreed that spending pattern is accurately seen over time.

The next strategy is known as the 4% Rule or the 4% Initial Withdrawal with Annual Cost of Living Adjustment. It combines the Alaska Target Date Funds and a fixed withdrawal of 4%. Every year, the withdrawal is increased by the previous year's inflation to provide an inflation adjusted income stream over time. This strategy is fully liquid and aims to have a sustainable income stream over the long-term, and places more value on the inflation protection. This strategy is most sensitive to adverse market conditions and the possibility of extreme longevity. This strategy works best for well-funded investors.

MR. LEE described the next strategy addresses the concerns of adverse market conditions and extreme longevity in the two previous strategies by adding an insurance component. The 4% Withdrawal with Annual Cost of Living Adjustment Plus Deferred Income Annuity, also known as a Qualified Longevity Annuity Contract (QLAC), combines the flexibility seen in the first two strategies with a longevity protection of an insurance product on the end. Participants would take 15% of their balance and buy a DIA, which starts paying out at age 85. The remaining 85% of the assets would stay invested in the Alaska Target Date Funds and use the 4% withdrawal strategy for the 20 years from age 65 to 85. The portion of assets in the Target Date Funds are fully liquid. The tradeoff for this strategy is approximately 15% lower income early on in retirement. This strategy can meet the consumption target for well-funded investors. There are regulatory limits regarding this strategy.

CHAIR WILLIAMS inquired if the strategy can reflect better pricing if more members elect this method and participate. MR. LEE acknowledged institutional pricing is available and more attractive compared to the retail pricing for income annuities. MS. FUNG noted an expressed concern of plan sponsors is the small institutional marketplace for this type of product. MR. LEE continued the DIA is a powerful income generator for those who live longer and who have a legacy motive.

MR. CARSON requested additional detail regarding pricing dynamics between a fixed annuity versus a QLAC. MR. LEE described the overall upfront payment for a QLAC is less than a fixed annuity. The QLAC does not pay out immediately and the relative expected payments are fewer. The mortality factor is calculated and roughly half of QLAC contracts are not realized. This contributes to better pricing.

MR. LEE described the Bond Ladder Plus Deferred Income Annuity strategy is built upon a portfolio of 85% U.S Treasuries with different maturities up to 20 years, structured in such a way to provide an equal payment every year for the duration of the 20-year bond ladder. The remaining 15% of the portfolio would be placed in a DIA. This strategy is not guaranteed from an insurance perspective, but is very safe and provides an annuity-like payment stream. The payout amount would be dependent upon prevailing interest rates. The price of the portfolio may fluctuate over time, but the income will remain constant. This strategy provides the highest income over the first 20 years because the bond ladder is fully decumulating and the principal will be paid out after 20 years. This is a liquid strategy and all the principal will be fully harvested by age 85, at which time the DIA will activate. For well-funded investors, MR. LEE believes this strategy contains more insurance than what most participants need. For more under-funded individuals, this could be a valuable strategy because it fully decumulates the portfolio over time. MR. LEE noted the importance of coupling the bond ladder strategy with the annuity to provide adequate longevity protection overall. Late in life, in the absence of other assets, there is relatively limited flexibility because the annuity payment becomes the only income.

The last strategy is the Guaranteed Minimum Withdrawal Benefit. This investment strategy provided by insurance companies seeks to offer a compromise of liquidity and longevity protection. It is a combination of an investment policy and an insurance policy. The investment policy is designed to support a 5% withdrawal high water mark, based on the performance of the portfolio. In the event of an adverse market environment, the insurance company will continue to pay the 5% payment over time. The cost for the benefit is typically a 1% insurance charge annually beginning at age 55. The strategy allows flexibility and works best for a well-funded portfolio. This strategy is not advised for investors who are relatively poorly funded. The GMWB strategy is liquid.

MR. LEE reviewed the chart comparing the income approaches regarding income tradeoffs, participant preferences, and sponsor considerations. The bond ladder tends to yield the highest for the first 20 years. The GMWB tends to pay out the lowest over time. All of the strategies provide some balance stability. The endowment method has the highest overall balance stability. The bond ladder is probably the most predictable over time. The strategies with insurance protection have the highest baseline income. The 4% strategies exposed to market risk have the lowest baseline income. Income approaches that have higher income predictability generally have higher costs because of the insurance component overall. The strategies with guaranteed insurance benefits sacrifice some liquidity, flexibility, portability, and are less transparent. In general, greater income predictability leads to greater complexity of the plans which are not easily understood. Insurance products bring counterparty risk, as well. MR. LEE reiterated there is no one strategy that performs best on every metric. The choice of an appropriate solution for a sponsor or for an individual is dependent on their objectives and preferences.

MR. LEE emphasized the importance of the journey of implementation and participant experience, which is critical in making any choice work very well and serve participant needs.

CHAIR WILLIAMS commented on the dangers of a participant under-saving because the participant misinterprets the strategy's leverage during retirement. MR. LEE agreed under-saving for retirement is an issue and savings in the solution.

MR. JOHNSON asked if this brochure will be used for participant education. MR. LEE noted the information provided to the Committee is very technical and participant communication will be different.

MR. BRICE expressed concern with the modeling based on a very high rate of 25% savings. He asked for more information on the process of determining a 25% savings rate. MR. MITCHELL informed the 25% is roughly what PERS participant with SBS would be saving. It is the total amount of savings from all sources.

MR. DYER expressed appreciation for presenting to the Committee and looks forward to continued engagement regarding this important topic.

CHAIR WILLIAMS recessed the meeting from 3:31 p.m. to 3:36 p.m.

B. Staff Summary Analysis of Available Retiree Income Options

MR. CARSON directed the Committee's attention to page seven of his presentation entitled "Defined Contribution Committee Retiree Distribution" and reviewed the consumption replacement target of salary minus retirement contributions. He reiterated the graphs should be viewed from a relational perspective compared to each other and compared to the consumption replacement target, rather than strictly looking at the numbers. MR. CARSON walked the Committee through the comparison charts on slides eight and nine. The key takeaway is several of the distribution options in the median outcome of the modeling achieved the consumption target rate. If the distribution options did not account for inflation, they tended to decrease and fall below the consumption target. In the 10^{th} percentile scenarios, every distribution option fell below the consumption target.

MR. CARSON reviewed the implementation considerations by the team. These include the diversity of participant circumstances and retirement goals, fiduciary liability, qualified investment alternatives, annuity provider selection, obtaining scale, record keeper integration, and participant communication.

MR. CARSON discussed the overall staff recommendations. Staff recommends the target date fund remains the default option during the accumulation and the decumulation phases. The distribution options are opt-in versus opt-out. Staff recommends providing an array of distribution options that are broad and flexible. Staff recommends focusing on participant experience and quality communication.

MR. WEST shared anecdotes of various retirement scenarios.

MR. MITCHELL reiterated these strategies are in the early stages of development. He encouraged a bias toward strategies that are adaptable in the ultimate recommendation.

MR. BRICE commented on his first ARM Board meeting and the restrictions on options available. He expressed appreciation to staff for the effort put forth and expansion of options and disbursement strategies during his six-year tenure.

CHAIR WILLIAMS commented he is encouraged by the pathways presented. He expressed appreciation to staff.

MR. CARSON detailed the next steps of the process. Staff will engage Empower and explore the feasibility of offering the different payout solutions of the set percent periodic payment with inflation adjustment, endowment, and customized options. Staff will engage T.Rowe Price to identify risks within existing TDF, and evaluate options for addressing these risks within the TDF glidepath. Staff will further assess and potentially recommend at upcoming meetings the implementation of the following products/strategies:

- Bond Ladder strategy
- Guaranteed Minimum Withdrawal Benefit strategy
- QLAC or deferred annuity

MR. JOHNSON inquired as to the status of the joint coordination with Department of Administration (DOA) regarding these obligations. MR. MITCHELL commented this presentation is from a DOR perspective. He believes DOR has been working very well and collaboratively with DOA DRB.

MR. BRICE commented an exciting effect of these offerings is the ability to benefit from institutional pricing. MR. MITCHELL agreed the institutional pricing will be more favorable than retail pricing. However, the full benefit of institutional pricing will not be realized because the offers are anticipated to be opt-in and not default options. MR. MITCHELL noted the implementation of the strategies can be explored further with the Committee if a different direction is desired.

MR. BRICE expressed hope that participants will know how they want to distribute their income at retirement. Chief Pension Officer in the Division of Retirement & Benefits, Department of Administration, KATHY LEA, informed the experience is the majority of participants do not know how they want to distribute their income at retirement. She informed only about 60% of the participants communicate with DRB. A problem with utilizing a default is the resultant default behavior by about 80% of participants making no change. If the conclusion is these strategies are not one-size-fits-all, then defaulting participants into a solution that may not be appropriate is risky.

Director of Division of Retirement & Benefits AJAY DESAI commented the DB plan has a set date for retirement based on eligibility. The DC plan does not have any barriers. The default option needs further scrutiny because the success is dependent on the participant’s circumstances and situation. MR. DESAI believes the DOR has done fabulous work in developing the analysis and research in a relatively short period of time. He was impressed with the presentation. MR. DESAI requested the possibility be explored to ask Empower to create a dollar value worksheet from the presentation. This would be used to counsel participants regarding scenarios based on age, salary, and different stages in their lives.

MS. LEA reported a large number of participants are taking their funds and rolling them over because sufficient options are not available. She echoed the appreciation to Treasury for their diligence in addressing the need for retiree distribution options.

VI. REVIEW / DISCUSS PROPOESD LEGISLATION

MS. LEA informed no proposed legislation is being reviewed at this time. Previous discussions have occurred regarding auto enrollment amendments for the DC plan and more research is expected before a proposal is brought forth. Additional information will be presented at the December Committee meeting.

MS. LEA announced the employer conference will occur October 3rd through 5th. There are currently 66 employers registered. The key note speaker is from Empower and will discuss financial wellness. The theme of the conference is "Better Together." MS. LEA noted recognition of the shortfall of efforts in communication and education is at the employer level. The employers will have an opportunity to discuss with Empower their needs and impediments to employee education and communication.

MS. LEA discussed the additional marketing that has been rolled out for the DCR plans, which will eventually be leveraged to all of the employers. MS. LEA introduced Alaska Director of Empower Retirement LIZ DAVIDSEN to review the strategy being used with Department of Public Safety (DPS). MS. DAVIDSEN explained the ambassador program addresses the need of DPS to attract more troopers into the system. Feedback has been given regarding issues raised during conversations and negative talk around the "water cooler" about the DCR plan. MS. DAVIDSEN said informational flyers have been distributed and informational videos will be created to better publicize the DCR plans.

MS. LEA added it is imperative for employers to engage employees about plan education. The new overview videos should be on the new website by next month. The seminar length videos will be comprised of nine segments. MS. LEA noted the National Retirement Security Week is at the end of October and DRB will participate as usual with outreach enrollment and education. Individual financial readiness reviews will occur and have increased in demand.

MS. LEA announced the acceptance of Empower's contract proposal to wrap the remaining six months and four annual reviews together. This will lower the record keeping fees from .0657% to .055%, and add two retirement plan advisors to the Anchorage office to complete financial readiness reviews. MS. DAVIDSEN reviewed the licensing characteristics of the advisor representatives and highlighted their fiduciary capacity to act in the best interest of the participants.

CHAIR WILLIAMS asked for the number of school districts who have opted in to the DC plan. MS. DAVIDSEN informed there are 10 employers and two of those are school districts. She feels school districts are showing more interest and an entire section of the employer conference will focus on the DC plans and its benefits. MR. BRICE commented it is a wonderful opportunity to roll over other financial aspects of employment into savings.

CHAIR WILLIAMS expressed concern regarding the low response in participation for the DC plan offering. He believes there is significant benefit to participants. He asked for feedback regarding this opinion. MR. MITCHELL agreed the plan is beneficial. The investment management cost to participants is relatively low for the plan based on Callan's determination. He feels the low response is a function of outreach and communication. MR.

JOHNSON suggested more interaction with target groups would be helpful. MS. DAVIDSEN and MS. LEA agreed and reported recent outreach activity.

MS. LEA advised a retiree survey is ongoing until the end of the month that focuses on retirees' experience compared to their plans at the time of retirement. It reviews issues and successes including shortfalls, sufficient protection, and inadequate protection. There are currently 120 respondents.

MS. LEA announced the PERS and TRS plan documents are poised to be amended to include the periodic payment withdrawal option. This option is not available in the DCR plans. It is the most popular option in the DC and SBS plans. The understanding is this is not an investment and therefore, does not need to come before the Board. MS. LEA noted this option has been requested by PERS and TRS members. MR. JOHNSON informed this is the analog of the legislation passed last session during which he and MR. WEST testified.

VIII. OTHER MATTERS TO PROPERLY COME BEFORE THE COMMITTEE

None

IX. PUBLIC / MEMBER COMMENTS

CHAIR WILLIAMS expressed appreciation to members for a quality meeting.

X. ADJOURNMENT

The meeting was adjourned at 4:34 p.m. with no objection.

Note: An outside contractor recorded the meeting and prepared the summary minutes. For in-depth discussion and presentation details, please refer to the recording, staff reports, and written presentation materials on file at the ARMB office.