The New Defined Contribution Plan
Just-in-Time Retirement Funding™

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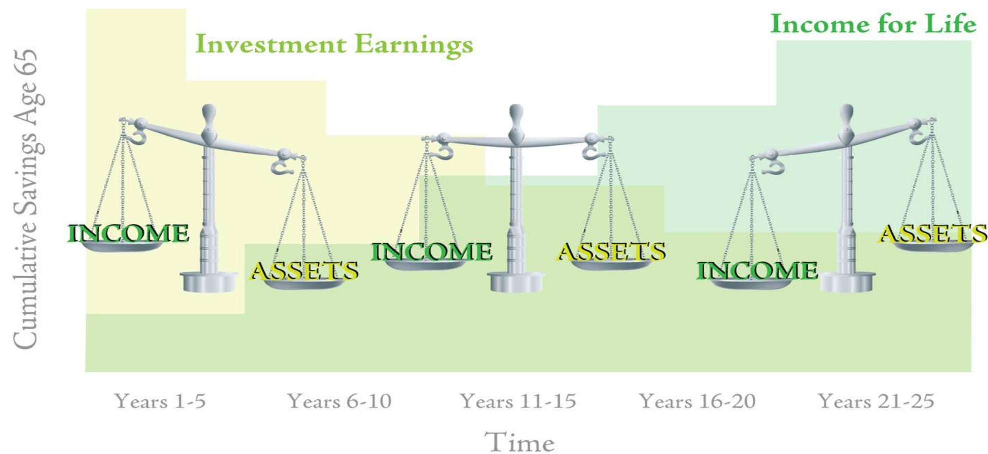

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Just-in-Time Retirement Funding™

INTRODUCTION

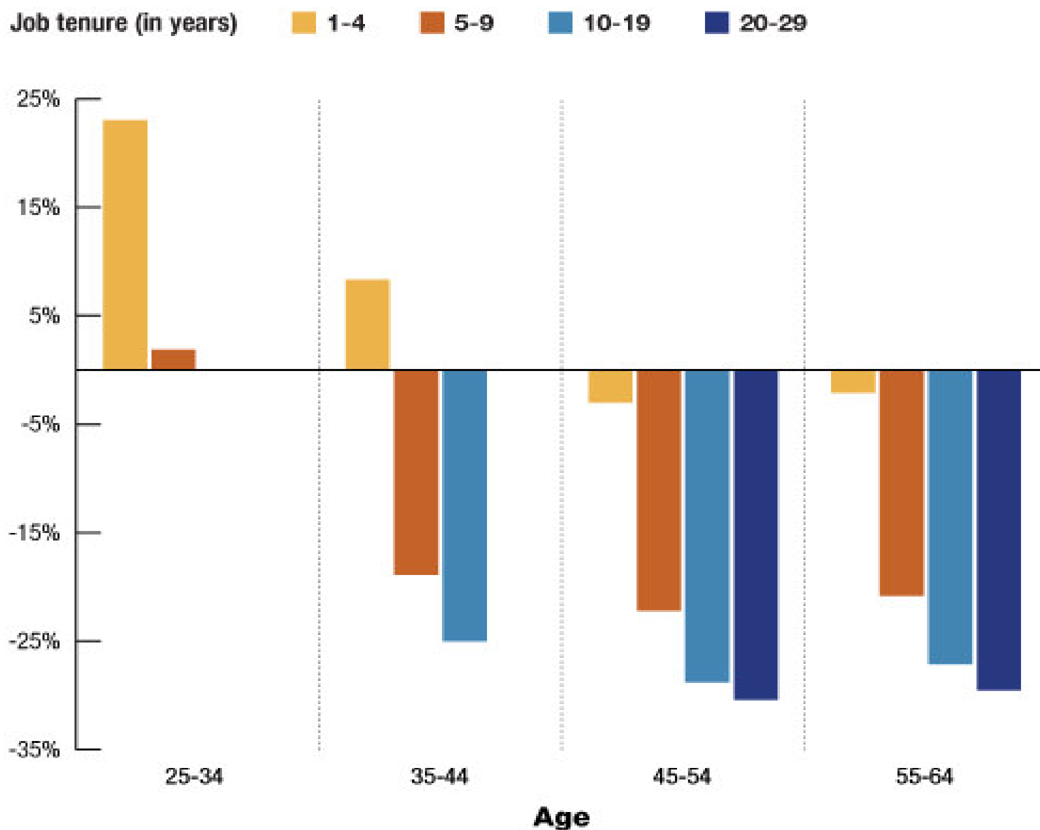
The Landscape of the Defined Contribution Plan is changing and it is important that plan sponsors be informed about these changes. There are new target date funds in store and the Department of Labor is calling for mandatory fee transparency and stricter guidelines to avoid conflicts of interest from vendors to brokers and others who manage these plans. This paper reviews these conflicts and proposes a unique solution - just-in-time. In fact, the "solution" is called Just-in-Time Retirement Funding™, a risk management strategy that's long overdue in light of two market bubbles, two recessions, and a massive world-wide government effort to thwart a global depression.

According to the Employee Benefit Research Institute approximately $1 trillion dollars of market loss occurred in 401(k) accounts during 2008. Americans no longer want nor can they afford to invest their savings and be exposed to another decade of uncontrolled greed, corporate thievery, and terrorism. Many baby-boomers who were prepared to retire before the market collapsed must now work in lower paying jobs in unfamiliar industries for an unknown number of years with their dreams shattered by the events of corporate excess, pillaging, and theft of billions of dollars from investors. The thievery at Enron, Arthur Anderson, Tyco, Adelphia, Madoff, and the collapse of Lehman Brothers, Bear Stearns, Merrill Lynch, AIG, Citigroup, Fannie Mae, Freddie Mac, Washington Mutual, Indy Mac, Wachovia, Chrysler, General Motors, Circuit City, Linen-n-Things, KB Toys, The Bombay Company and the list goes on and on goes well beyond modern portfolio theory as a means to reduce the standard deviation of a portfolio. No! This era of decadence touched the roots of this great nation's core values and breached the trust of the American public in government, the free market system and those who are responsible for oversight and compliance.

Welcome to the new world of wealth management where financial pros find themselves promoting back-to-basic concepts and safer and more secure means of making money, from fixed-rate annuities to dividend-paying stocks….[1] Just-in-Time Retirement Funding™ (JIT) is a forward-thinking approach to the management of individual retirement assets that ties the investment strategy to the timing of future expenses. The JIT process changes the way participants save in a DC plan as they contemplate expenses associated with their lifestyle and income needs rather than subjecting assets to the uncertainties of the markets trying to increase the net value of the pool. JIT uses a laddering of fixed indexed annuity investments as the investing strategy. The funding for each step of the ladder is designed to meet essential lifestyle expenses in five-year increments thereby allowing other investments to weather economic storms over longer periods of time.

With Just-in-Time Retirement Funding™ participants would not have lost $1 trillion dollars in market value because their annuity investment provides principal protection, guaranteed fixed interest, potential interest indexed growth, annual lock in of gains and interest, and guaranteed income for life. When applying this process as the foundation for one's retirement asset pool it becomes much like the retirement fund of the past when you worked for a company and received a lifetime pension. The actual difference of course is you're funding your own defined benefit to distribute guaranteed income to help fill the gap between social security and essential lifestyle needs – just-in-time! Just-in-Time Retirement Funding™ provides a way to diversify risk and offers guaranteed options for the timing and characterization of income that minimizes exposure to stock markets and economic recession. In fact, JIT removes any risk of ever outliving your asset pool even if all the assets have been completely consumed.

Change in average 401(k) account balances from Jan. 1, 2008 – March 2, 2009 among participants who had account balances as of Dec. 31, 2007:



Source: 2007 account balances are tabulations from the Employee Benefit Research Institute/Investment Company Institute participant-directed retirement plan data collection project; 2008 and 2009 account balances are EBRI estimates. Credits: Randy Lilleston and Mor Vimmer / NPR

THE VARIED COSTS OF A DEFINED CONTRIBUTION PLAN

It is widely known that sponsors of a Defined Contribution Plan (and their participants) lack adequate information on the structure and extent of fees and expenses to make informed choices about service providers and investment options. This inadequate disclosure of information may be a factor in the existence of the large variance in fees and expenses of 401(k) plans. If you're a plan sponsor seeking to minimize fees and expenses imposed on your 401(k) plan you are constrained by a number of issues that bear on the magnitude of fees and expenses:

- Plan size
- Plan features and investment options
- Behavior of plan participants

401(k) plan fees and expenses are divided between administration and investment. The operation of a 401(k) plan involves a Third Party Administrator to do record keeping, accounting, legal and trustee services. Access to participant information is made available by telephone voice response systems, customer service representatives, and on-line electronically for plan information, daily valuation and on-line transactions. Under certain arrangements administrative fees may be covered by investment fees that are deducted directly from participant accounts. When these fees are paid directly by participants in the plan, the cost is allocated among individual accounts either pro rata (i.e., based on the value of the participant account) or fees are paid equally among all participant accounts. In either of these circumstances, plan participants are paying to fund their retirement and most don't know what they are paying for or how much is be taken from their accounts to cover these costs. The law only requires that plan fees be reasonable and no further guidance is provided. See the study sponsored by the Office of Policy and Research of the Department of Labor's Pension and Welfare Benefits Administration performed in 1998 that studies the incidence, structure, and magnitude of fees and expenses charged to sponsors and participants in 401(k) plans (reference DOL Contract # J-P-7, Task Order 1).

Investment management fees are by far the biggest expense for participants of a 401(k). As previously mentioned, advisory fees are usually charged in arrears at the beginning of each calendar quarter and assessed as a percent of assets under management. Participant accounts are debited daily which directly impacts investment returns. These fees are almost never shown on participant statements so without tracking total return it is very difficult to see the net cost of return. Unless you are getting valued financial advice and guidance from your advisor, it usually pays to invest in an index rather than reduce your account's value. Additional fees may also be assessed for loans, outside brokerage, and other services which are charged individually.

There are several methods for providing a plan and its not surprising the mostly widely seen is the bundled solution. This arrangement of one provider offering all the plan services of administration, trustee, investment choices, recordkeeping, etc. is usually more beneficial to the sponsor than to participants. For example, I've personally lost business to the banks who offer this bundled option and who promise more favorable lending terms and facilities to the business owner in exchange for plan assets. Why? Because the banks know they will recover the lost revenue of a rate cut through investment expenses charged to participant accounts in the plan. They also offer higher payouts to a broker for selling a bundled solution with surrender charges. Why? Because in the event the sponsor terminates the plan the cost for doing so will result in steep surrender charges against plan assets. Surrender periods can range from 10-20 years thereby locking- up plan assets and giving the vendor more time to earn revenues. This is how a vendor can afford to pay the broker higher commissions on all plan years. Seems everything gets passed along to the workers who put in a hard day and try to save for their future and then get buffed by trickery, greed, and decadent behavior.

When it comes to learning more about how these plans operate and how much they cost to administer you are smart to turn to a professional benefits advisor for help. An experienced benefits advisor can take control of plan costs and can protect your employees. As a sponsor you should always ask if there are mutual fund reimbursements that can be used to offset a plan's administrative expenses. You may not be told the whole story because certain funds like Stable Value include guaranteed insurance contracts (GICs). The administrative fees and expenses inside GICs are typically not disclosed because the investment management fees and distribution charges are incorporated into the computation of the guaranteed rate of return. This gets even more convoluted when a vendor offers reimbursements to administrators for plan deposits made to GICs thereby incentivizing the installation of a Stable Value fund option in the plan's line-up. Add all this up and it's clear the current structure of the 401(k) plan benefits Wall Street over Main Street but change is coming – Just-in-Time!

In February 2008, the Supreme Court decision on LaRue v. DeWolff, 06-856 overturned an earlier ruling by the 4th US Circuit Court of Appeals in Richmond, Virginia – paving the way for the right of an individual to sue for losses due to a breach in fiduciary duty. The Department of Labor (DOL) is preparing to issue far-reaching, proposed disclosure regulations under ERISA Section 408(b)(2) that will affect virtually all retirement plan service providers. With higher fiduciary risk and large losses in employee accounts from the market collapse, sponsors are growing weary and concerned about shifting costs to participants and making private deals in exchange for plan assets. In other words, sponsors are beginning to see that the risk is too high if offering a DC plan that adds nothing to the company's bottom-line and does nothing to improve labor output but instead could become a company liability.

THE BUSINESS OWNER'S LIFE RAFT

The Pension Protection Act of 2006 (PPA) is the best piece of retirement planning legislation for business owners and the self-employed to put away more tax-deferred cash for retirement. It is both business owner and fiduciary friendly. Contributions and corresponding tax deductions for business owners and other highly compensated participants can average between two (2) times to eight (8) times the stand alone 401(k) limit of $46,000 to $51,000 for 2008. In some cases, a person can put 100 percent of his income from a business into a pension plan so business owners hit by the decade of decadence can now have the means to throw their future a life line – create a cash balance pension plan.

Cash balance plans are a defined benefit whereas 401(k) plans are a defined contribution plan. The distinction is that of participation, investment risks, and life annuities. In the cash balance participation is not dependent on contributions from employees whereas a 401(k) plan depends on employee elections and investment directions in the plan. Investment risk in a cash balance plan is the responsibility of the employer and changes to the plan's investment portfolio has no direct impact on the benefits to be received by participants. In the 401(k) plan the participant bears all the risk based on the investment. And unlike the 401(k) plan, participants in the defined benefit must have the option to receive benefits as an annuity payout for life. Based on this, there are federal guarantees that the benefits promised by cash balance plans are usually insured by a federal agency, the Pension Benefit Guaranty Corporation (PBGC). If a defined benefit plan is terminated with insufficient funds to pay all promised benefits, the PBGC has authority to assume trusteeship of the plan and to begin to pay pension benefits up to the limits set by law. Defined contribution plans, including 401(k) plans, are not insured by the PBGC. Since the business owner has total control of the pension trust it has a much lower fiduciary risk profile. In light of the recent *LaRue* decision by the Supreme Court, fiduciary issues cannot be over emphasized. Plan contributions can easily reach or exceed $100,000 to $250,000. Plans using guaranteed benefit formulas have contribution limits that are even higher reaching approximately 150% of the cash balance or traditional limit. In 2008, these plans covered by the PBGC can utilize up to a 25% profit sharing plus a full elective 401 (k) deferral in addition to the defined benefit add-on making it the most business owner friendly pension legislation ever.

HOW DO CASH BALANCE PLANS WORK?

In a typical cash balance plan, a participant's account is credited each year with a "pay credit" (such as 5 percent of compensation from his or her employer) and an "interest credit" (either a fixed rate or a variable rate that is linked to an index such as the one-year treasury bill rate). Increases and decreases in the value of the plan's investments do not directly affect the benefit amounts promised to participants. Thus, the investment risks and rewards on plan assets are borne solely by the employer.

When a participant becomes entitled to receive benefits under a cash balance plan, the benefits that are received are defined in terms of an account balance. For example, assume that a participant has an account balance of $100,000 when he or she reaches age 65. If the participant decides to retire at that time, he or she would have the right to an annuity. Such an annuity might be approximately $10,000 per year for life. In many cash balance plans, however, the participant could instead choose (with consent from his or her spouse) to take a lump sum benefit equal to the $100,000 account balance.

In addition to generally permitting participants to take their benefits as lump sum benefits at retirement, cash balance plans often permit vested participants to choose (with consent from their spouses) to receive their accrued benefits in lump sums if they terminate employment prior to retirement age. Traditional defined benefit pension plans do not offer this feature as frequently. If a participant receives a lump sum distribution, that distribution generally can be rolled over into an IRA or to another employer's plan if that plan accepts rollovers. The benefits in most cash balance plans, as in most traditional defined benefit plans, are protected, within certain limitations, by federal insurance provided through the Pension Benefit Guaranty Corporation.

The complete text of the notice can be found at www.irs.gov/pub/irs-drop/n-07-28.pdf

THE NEW TARGET DATE FUND

In an effort to tackle the need for American workers to save for their retirement, President Obama is recommending that employees be automatically enrolled in their company plan beginning in 2010. Final regulations need to be issued by the IRS but there is the possibility that employers may be empowered to decide whether to offer an "opt-out" option which would have required contributions be returned to the employee within 90 days. Incorporating a mandatory contribution will help younger employees to do the right thing about their future retirement while at the same time it could benefit older employees who may had to return some of their contribution based on nondiscrimination tests required by law. Obama is also suggesting that employees be allowed to convert the value of vacation and sick days to retirement contributions as well as U.S. tax refunds.

Without question there will be more to be said on the subject of getting America to save for retirement but right now there is one outstanding issue that is being heavily debated and that is the failure of target-date funds for employees expecting to retire in the near term. Target-date funds lost substantial value in the recent correction and were found to be overly exposed to the stock market when allocations should have shifted as the investor aged over what's referred to as the investor's glide path. In February 2009, Senator Kohl's U.S. Senate Committee on Aging found "significant differences in the asset allocation of target-date retirement funds, with firms' 2010 target-date funds equity holdings ranging anywhere from 8%-68%'. Participants pay higher expense ratios because professional money managers are hired to guide the retirement allocations but now Congress and the Department of Labor are looking at what went wrong. Senator Kohl's committee also found potential conflicts of interest with the use of one fund family and their proprietary funds used to invest in the target-date fund. Why were the allocations not shifted in accordance with the investor's glide path? Why are these funds allowed as a default option when there is no standardization for target-date funds? The answer I read was that some target-date funds were never designed "TO" the year of retirement but rather "THROUGH" retirement accounting for longer life expectancy and therefore time to recover from market corrections. And, that no target-date standardization exists today avoid potential conflicts of interest and disparity among the funds. Okay, tell that to an employee who worked for 30 years and saved every month for retirement.

Target-date funds were supposed to simplify the investing process with professional money managers deciding an appropriate allocation and fund mix. As more DC plans adopt auto-enrollment more employees will elect a default investment option such as target-date funds. Researchers advise that workers want more retirement automation to include enrollment, investment, contribution, re-balancing and guaranteed income for

life. New to the DC landscape is the use of variable annuities integrated into the target-date fund as a qualified default option in the plan. The objective is to be able to convert part or all of the target-date fund value to a secure guaranteed lifetime income. Offering an insurance solution along-side the mutual fund allocation that can provide guaranteed income for life with the ability to capture high account values throughout the glide path is an excellent way to protect the account from market corrections. The income can never reverse in bad times once locked-in and participants have liquidity and beneficiaries receive the full value. Secured income target-date funds as they are being called can provide peace of mind when markets correct, income you can depend on and it allows an investor to capitalize on economic booms and protect against economic bubbles. The income guarantees are locked in and are based on a certain percentage of accumulated assets, e.g. 4%, 5% etc. This option also requires higher default contribution rate increases and cost for the income rider which is added on top of the investment management fees for target-date funds so it is not cheap.

Just-in-Time Retirement Funding™ solution there are no advisory fees, investment expenses, administrative fees, back-end or front-end loads, 12b-1 fees, wrap fees, hidden GIC fees, marketing fees, etc. Simply put there are NO FEES and 100% of all employee savings are protected from stock market risk. To learn more go to: www.justintimeretirement.com

[1]The Bureau of Labor Statistics reports that retirement is occurring 5.5 years sooner on average in 2000 than in 1950. Over the same period, the expected number of years in retirement has increased 7.1 years (according to Monthly Labor Review, October 2001). As people continue to live longer and retire sooner, they may spend as much as 30% of their living years in retirement.

Depending on the structure of the company and the number of owners involved, the owner has options as to how to structure the plan. Just-in-Time Retirement Funding™ can be added to your existing 401(k) Plan without changing anything: it is treated just like any other self-directed account. This design allows employees to self-direct savings to a principle protected investment that can grow with market indexes without subjecting those savings to stock and bond market risk. The contribution is made "before tax" just like it is with mutual funds. This complements the qualified plan where the benefits for Just-in-Time Retirement Funding™ can be paid out monthly to meet essential lifestyle expenses thereby allowing other qualified plan assets to grow longer term.

And, depending on the index selected, growth may be realized in the form of indexed interest that gets locked in annually so all subsequent growth continues tax deferred and compounds tax favored. This provides real tax advantages and guarantees all prior gains realized – we call this a Triple Compound Curve.

Just-in-Time Retirement Funding™ and No Transaction Fee Mutual Funds are designed to cut cost and enhance savings. Employees can now take comfort that 100% of their retirement savings is protected and guaranteed by Just-in-Time Retirement Funding™. So when you're looking to add a new 401(k) plan or preparing a review make sure you get the whole story on fees.

Just-in-Time Retirement Funding™

Adding Just-in-Time fixed indexed annuity to the DC plan is an option and not a replacement for the existing plan. It is an add-on feature allowing employees to elect to save in a principal protected guaranteed annuity. Employees want a safe, secure, and stable growth option for allocating some or all of their savings and to diversify risk from market corrections.

The benefits of Just-in-Time Retirement Funding™:

1. Guaranteed principal protection of all savings and growth
2. Guaranteed minimum interest growth and potential indexed interest growth
3. No investment, advisory, 12b-1, or fund expenses fees
4. Annual lock-in of all credited interest earned
5. Guaranteed income for life at time of retirement if elected (this is like a self-funded defined benefit plan)
6. Death benefit to heirs
7. Rollover options
8. Complimentary retirement income planning (a detailed analysis of drawn-down to meet essential income needs)