ITEM 3

# Target Date Fund Committee Education

December2016

# *Agenda*

# Fiduciary Best Practices

**Regulatory**

Operate the plan in the best interests of participants

**Governance**

Operate the plan so that it is consistent with the goals and objectives of the organization

**Stewardship**

Operate the plan with an understating that a well-run plan helps to build employee trust and loyalty

Though not technically governed by ERISA many governmental plans will implement these best practices:

- Prudent
- In the sole interest of the plan participants and beneficiaries
- Diversified investment offering to minimize the risk of large losses
- Operate in accordance with the plan document

# *Follow a "Prudent Process"*

- Analyze
- Decide
- Document
- Monitor
- Hire and enlist experts where they are needed

# QDIA Overview

# *Selecting the right QDIA*

| | Risk Based Allocation | Target Dates "To" | Target Dates "Through" |
|---|---|---|---|
| What this looks like in practice: | 3-5 fund options ranging from conservative to aggressive allocations | Funds available in 5-year increments from 2000 to 2060 | Funds available in 5-year increments from 2000 to 2060 |
| Goals: | Manage to a set risk tolerance | Get participants to a balance that they can retire on | Help participants mitigate the risk of outliving their assets |
| Key features: | Participants have to change their selection as their risk tolerance changes | The vehicle gets more conservative over time and becomes most conservative at the stated target date of mutual fund. | The vehicle gets more conservative over time and becomes most conservative at some point after the stated retirement target date. |
| Key assumptions: | Participants control their risk level | Assumes participants cannot withstand large fluctuations in their portfolio balance as they approach retirement age | Assumes participants can withstand large fluctuations in their portfolio balance as they approach retirement age |

# What is a QDIA

- QDIA= Qualified Default Investment Alternative
  - ERISA section 404(c) and the corresponding DOL regulations define how a plan sponsor can establish protective relief from liability as a fiduciary for investment decisions made by plan participants
  - Introduced in the Pension Protection Act of 2006, plan sponsors have the option to designate a default fund, qualifying as a QDIA
  - If the plan complies with the requirements of the regulation, the fiduciary will not be liable for the losses that result from investments in the QDIA
- What is a default
  - When a participant fails to make investment elections and decision must be made to invest on behalf of the participant
  - Examples of when this would be appropriate:
    - Incomplete enrollment forms
    - Beneficiary/alternative payee balances
    - QDROs (divorce)
    - Removal of investment options from the plan
    - Rollovers
- Types of QDIAs
  - Lifecycle or target date fund
  - Managed Account
  - A balanced fund

# Fiduciary Considerations When Selecting Target Date Funds as QDIA

Plan sponsors, as fiduciaries, are subject to the prudent selection and monitoring of a plan's investment options (including TRDs)

Specifically, as the DOL has recently advised, it is important to understand the design and operation of TRDs relative to the Plan demographics

- Design and operation areas of focus include:
  - Explanation of the asset allocation and how it changes over time
  - Point in time the glide path will reach its most conservative allocation;
  - Sub asset class allocation
  - Fees
- Plan demographic areas of focus include:
  - Plan participant funding level
  - DC Plan dependency
  - Goal of DC Plan
  - Participant actions at or near retirement
  - Record keeper distribution capabilities

## What to Remember When Choosing Target Date Funds

- Establish a process for comparing and selecting TDFs
- Establish a process for the periodic review of selected TDFs
- Understand the fund's investments− the allocation in different asset classes (stocks, bonds, cash) and how they will change over time
- Review the fund's fees and investment expenses
- Inquire about whether a custom or non-proprietary TDF would be a better fit for your plan
- Develop effective employee communication
- Document selection and review process

# Universe of Target Date Funds

›Originated in the mid-1990’s (20+ year history)

›Created as a single fund solution for Defined Contribution (DC) plan participants seeking professional management

›According to BrightScope*, as of February 2015, TRD assets in mutual fund vehicles grew to over $700B, an increase of 12% over last year

›Under the Pension Protection Act (PPA) of 2006, the Department of Labor (DOL) established TRDs as one of three options to serve as a qualified default investment alternative (QDIA) providing plan sponsors fiduciary protection in directing assets to these funds

**BrightScope is a leading provider of independent financial information and investment research*

Designed to provide a simple way to invest in a broadly diversified portfolio that will automatically adjust to become more conservative as the investor approaches the retirement date

TRDs are typically offered in increments of 5 or 10 years, with funds corresponding to future retirement dates such as “2020”

Participants need to make a single decision - what year do you expect to retire - and then select the TRD that aligns closest with that year

Asset allocation of the portfolio automatically gradually changes by replacing equity with fixed income investments as the target retirement date gets closer to reduce risk

› This asset allocation change over time is known as the “glide path”

## TRDs with the same retirement date can look very different

- This is primarily due to the fund managers philosophical and risk management views on how to balance market, longevity and inflation risks

## Some of the biggest differentiating factors include:

- Amount of equity at and near the retirement date
- Point in time the glide path stops “gliding”; this distinction is known as a “To” or a “Through” glide path
  - A “To” glide path transitions to the final, most conservative allocation at the retirement date
  - A “Through” glide path continues to transition for several years (10-20) after the retirement date
- Asset classes represented in the portfolios (traditional versus alternative)
- Strategic asset allocation versus Tactical
- Use of active and/or passive investment management
- Multi-manager (open architecture) vs. single fund family managed funds
- Fees

## As an alternative to investing in a pre-packaged product solution, plan sponsors are increasingly implementing customized TRD solutions

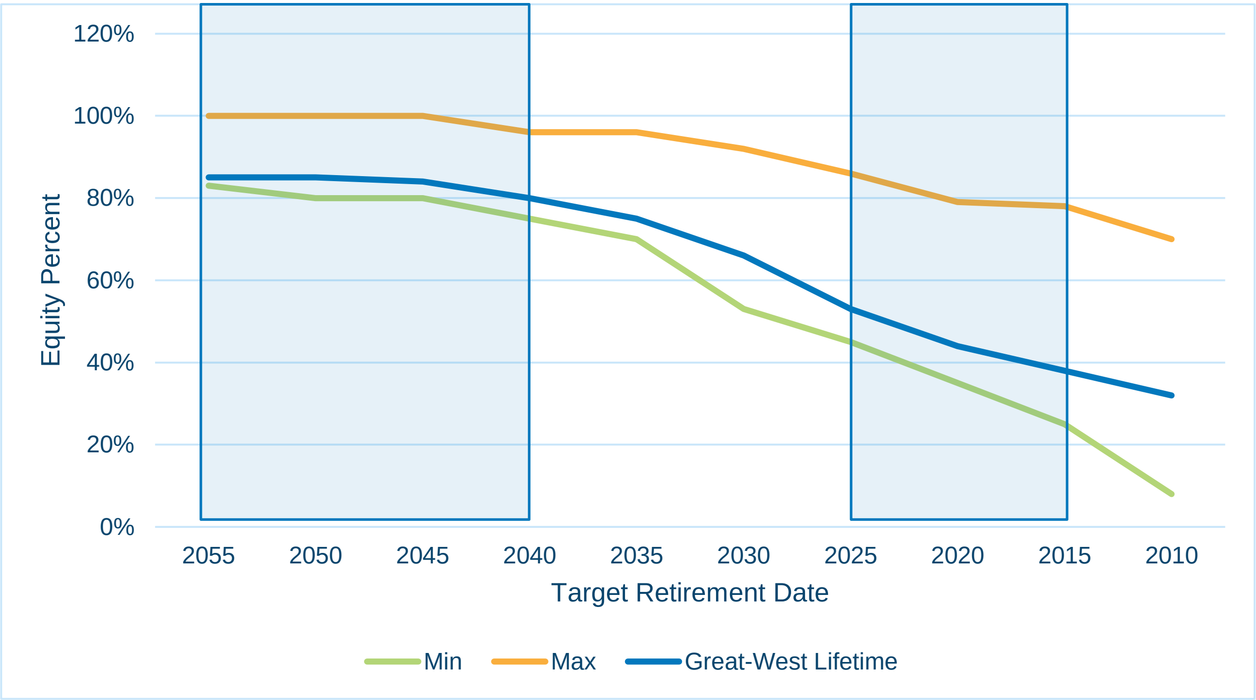
- Plan Sponsor have the option of selecting a pre-packaged “product” solution from dozens of mutual fund providers
  - Convenience of reviewing an established performance track record
  - Ticker symbols for each portfolio that can be easily tracked in Morningstar and Quicken
  - Brand-named recognition

## Reasons plan sponsors implement a customized TRD solution include:

- Ability to create a more diverse asset allocation
- Incorporate the plan's existing core funds in the TRD option
- Maintain control over underlying managers
- Construct the glide path to address unique plan demographics (e.g. existence of a defined benefit plan)
- Alleviate fiduciary concerns over buying pre-packaged product solutions
- Provide better fee transparency
- Private-label portfolios to the plan, e.g., Fresno County's Target Date Portfolios

# *Equity At and Near the Retirement Date*

*Longer dated funds (2040-2055) show little difference in the amount of equity across the different provider glide paths, while the dispersion in shorter dated funds(2015-2025) is much greater*



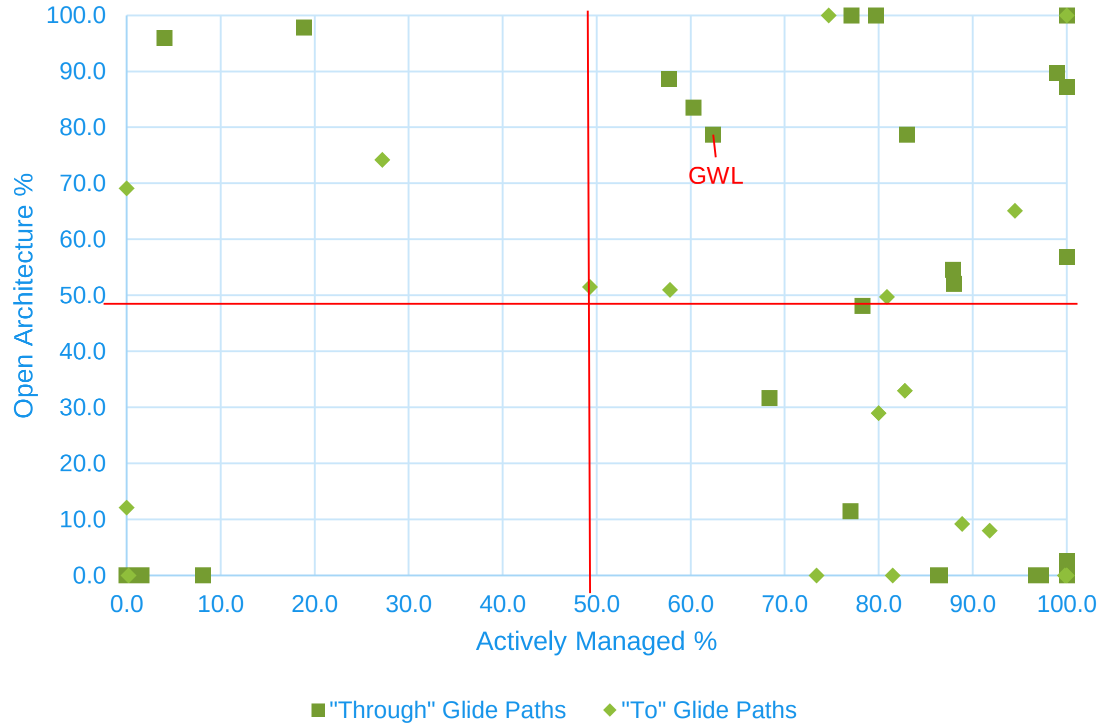

NWCM

# Other Differentiating Factors

## "To" vs. "Through"

## Active vs. Passive

## Open Architecture vs. Single Fund Family

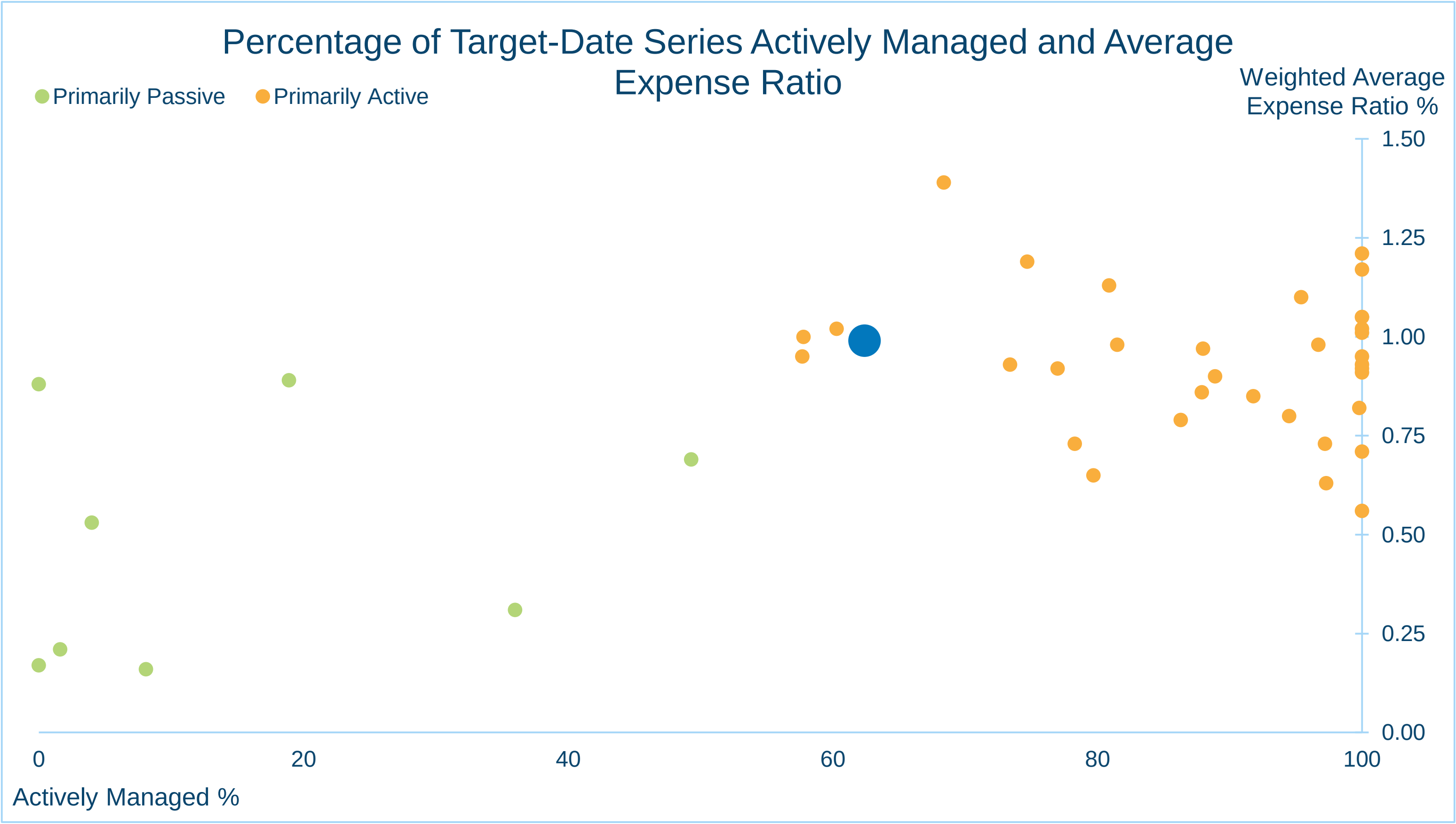



Of the 49 total glide paths analyzed in the 2014 Morningstar Target-Date Research Paper1

- 29 are "Through" (including Vanguard, T. Rowe Price and Fidelity); 20 are "To"
- 40 are primarily actively managed (approx. 50%+); 9 are primarily passive (including Vanguard)
- 23 are primarily open architecture (approx. 50%+ in non-proprietary funds)

There is a wide variance in fees across the 49 glide paths analyzed in the 2014 Morningstar Target-Date Research Paper[1]

› Fees range from 0.16% on the low end to 1.39% on the high end

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**Big three still dominate[1]:** Fidelity, T. Rowe Price and Vanguard combined represent 75% of TRD assets under management

**Shift to passive strategies[1]:** Actively managed strategies comprise 67% of the market share, down from 90% in 2005

- Approximately 75% of TRDs have at least some exposure to an index-based fund

**Notable change in domestic vs. international exposure[1]:** Funds still have a home country bias, but have recently increased international exposure

**Expenses continue to fall[1]:** TRD expenses have fallen for five years in a row since Morningstar started tracking the data in its annual survey

**Use of custom vs. pre-packaged product solutions continues to increase**

# *Summary*

There are several varieties of TRDs with some of the major sources of differentiation being:

› the glide path structure and shifting allocations over time;
› the asset classes represented and resulting diversification benefits;
› the use of active vs. passive;
› open architecture (multi-manager) vs. single fund company; and
› fees

The largest driver of the performance variation is due to the glide path and how it changes over time

It is important as a plan sponsor to understand your provider's glide path and be comfortable that it is a good fit for your participant demographics

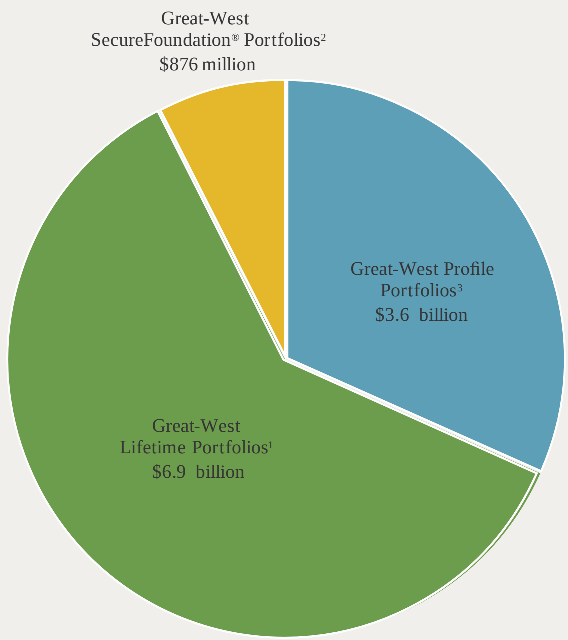
Another option gaining a lot of traction is custom target retirement date solutions

# Fresno County's Target Fund Overview: Great-West Lifetime Portfolios

- Organization overview
  - Experience
  - Team
  - Process
- Glidepath
- Asset Class Components
- Active / Passive and Propriety / Non-Proprietary
- Fees
- Fresno Demographics

# Asset allocation solutions

AUM as of March 31, 2016




Great-West Financial® has a long history of developing asset allocation solutions designed for retirement investors

- 1997: Great-West Profile Series I
- 1999: Great-West Profile Series II
- 2009: Great-West Lifetime Funds
- 2009: Great-West SecureFoundation® Funds
- 2011: Great-West Lifetime and SecureFoundation® Trusts

1 Includes Great-West Lifetime Funds and Great-West Lifetime Trusts offered by Great-West Funds, Inc. and Great-West Trust Company, LLC, respectively.

2 Includes Great-West SecureFoundation Funds and Great-West SecureFoundation Trusts offered by Great-West Funds and Great-West Trust, respectively.

3 Includes Great-West Profile Funds and other unregistered, risk-based asset allocation portfolios offered by GWL&A.

# The Great-West Lifetime Portfolios are managed by and experienced investment team

| ASSET ALLOCATION COMMITTEE | YEAR ENTERED INDUSTRY | YEAR JOINED FIRM |
| --- | --- | --- |
| Catherine Tocher, CFA<br>*Senior Vice President and Chief Investment Officer, Great-West Financial Separate Accounts and Great-West Capital Management, LLC (GWCM)* | 1985 | 1987 |
| Jack Brown, CFA<br>*Portfolio Manager* | 1995 | 2015 |
| Jonathan Kreider, CFA<br>*Portfolio Manager* | 2005 | 2012 |
| Andrew Corwin, CFA<br>*Assistant Portfolio Manager* | 2009 | 2011 |

# Our four core beliefs …

Translate into our key differentiators for the Lifetime Portfolios

| FOUR CORE BELIEFS | | FOUR KEY DIFFERENCES |
|---|---|---|
| Effective diversification allocates across managers in addition to asset classes | → | Open architecture |
| Asset allocation is critical to retirement savings success | → | Third-party expert asset allocation consultation in the development of the glide paths |
| There are benefits to both active and passive management | → | Blend of active and passive management |
| Asset allocation is not a one-size-fits-all decision | → | Two glide paths |

# Great-West Capital Management (GWCM) views target date investing as a continuous process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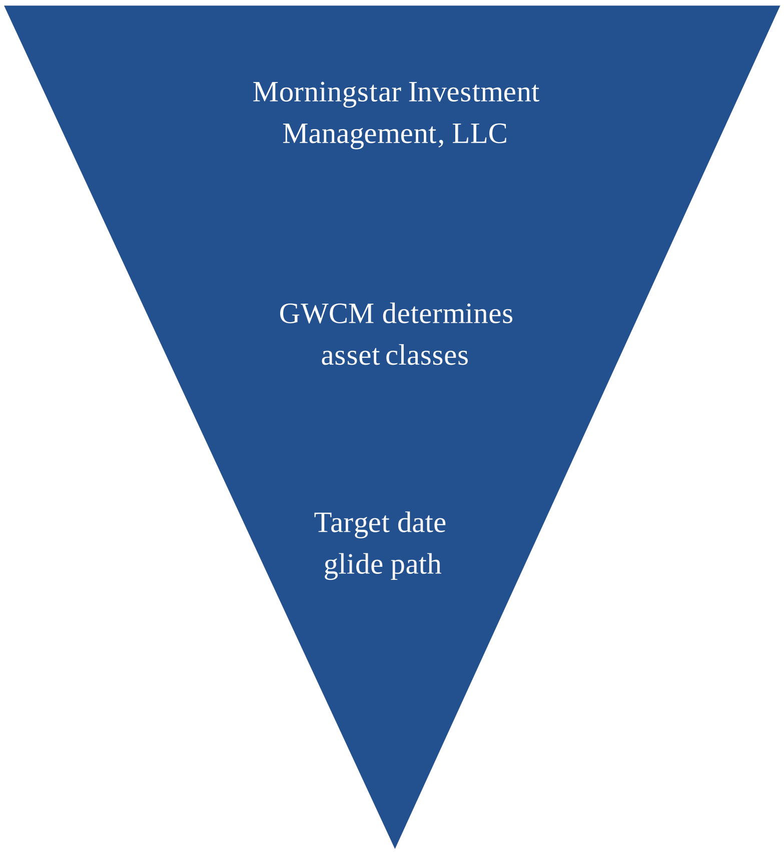
# Great-West Lifetime Funds: Process

› Great-West has retained Morningstar Investment Management, LLC to consult in the development of their asset allocation

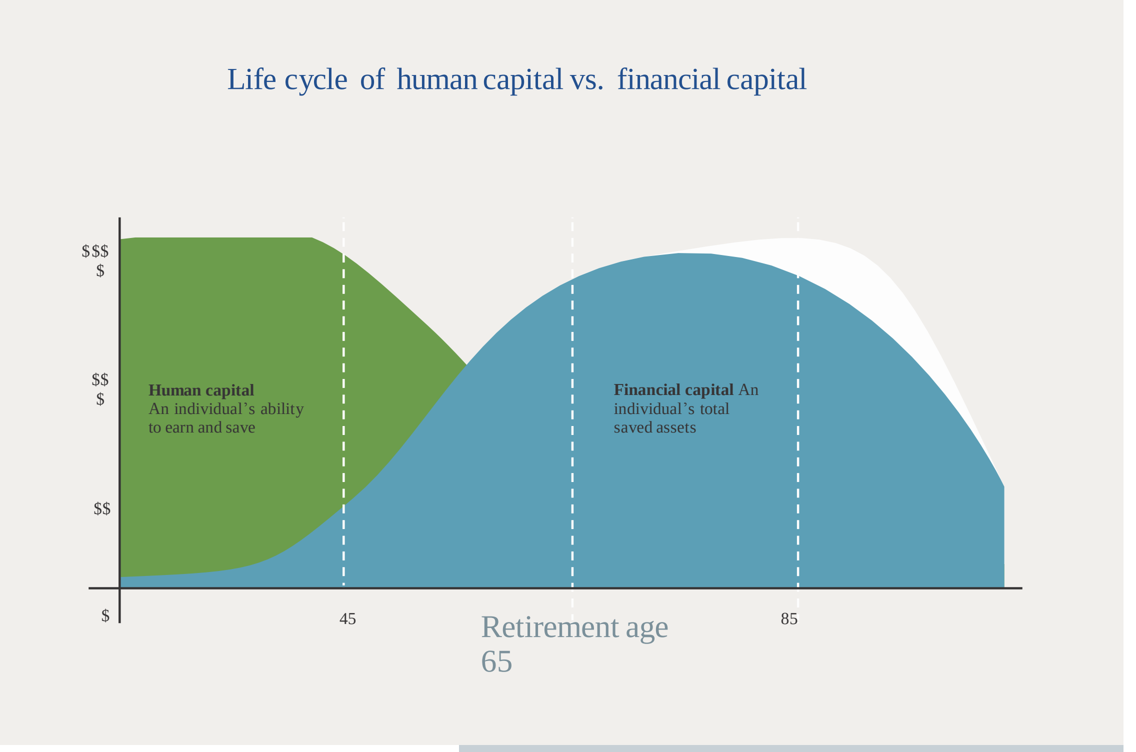



- Morningstar Investment Management, LLC is retained by GWCM for its expertise in asset allocation and glide path services.*
- The GWCM Asset Allocation Committee holds final authority for the asset allocation decisions.
- The committee determines input into which asset classes are utilized in the funds and trusts.
- Morningstar Investment Management, LLC constructs proposed optimized asset allocations and glide paths for the portfolios.
- Each year Morningstar Investment Management, LLC updates its set of capital market assumptions, resulting in a newly optimized set of glide paths for the portfolios.

* Morningstar Investment Management, LLC is a registered investment adviser and a subsidiary of Morningstar, Inc. Morningstar Investment Management, LLC and Morningstar are not affiliated with GWCM, its parent company Great-West Life & Annuity Insurance Company, or any other affiliated companies and/or subsidiaries

# Morningstar Investment Management, LLC is and industry leader in the asset allocation space

- Morningstar Investment Management, LLC is a leading provider of investment advisory services
  - — $59.9 billion in assets under advisement for investment consulting[1]
  - — $43.1 billion in assets under management for managed accounts, with services available to more than 10 million participants[1]
- Part of Morningstar Investment Management, LLC proprietary process includes analysis of one's human capital vs. financial capital to set the appropriate allocations
- Experienced investment professionals
  - — Staff averages 10 years of investment experience
  - — Most have a Ph.D., CFA, MBA or combination
- Award-winning research
  - — Two patents granted for asset allocation and human capital
  - — 75 research papers written or co-authored

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1 Source: Morningstar Investment Management, LLC
March 31, 2014

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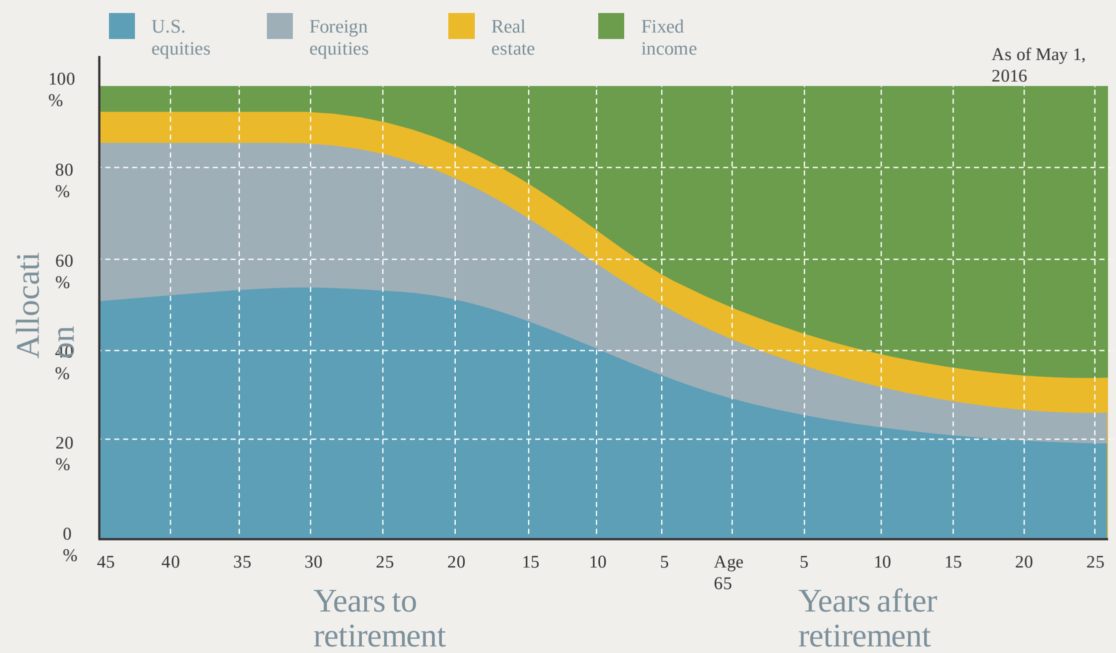
# The glide path for Great-West Lifetime Portfolio

- The glide path begins steepening approximately 30 years from the target date.
- As investors move down the glide path, international equity is reduced relative to domestic equity.
- Real estate is utilized throughout the glide path, but it increases slightly toward retirement.

**As investors move toward their retirement date, the allocations adjust automatically with less equity exposure and more fixed income exposure.**



# Portfolios utilize 20 distinct asset classes

Current strategic asset class allocation: Great-West Lifetime 2035 Portfolio

**Equity asset classes**

- U.S. equity
  - Large-cap
    - Large value 8.7%
    - Large blend 15.81%
    - Large growth 7.12%
  - Mid-cap
    - Mid value 3.72%
    - Mid blend 6.77%
    - Mid growth 3.05%
  - Small-cap
    - Small value 3.08%
    - Small blend 4.74%
    - Small growth 1.66 %
- Non-U.S. equity
  - International large value 5.79%
  - International large blend 10.53%
  - International large growth 4.74%
  - Diversified emerging markets 6.46%
- Real estate
  - Real estate 4.04%
  - Global real estate 1.4%

**Fixed income asset classes**

- Intermediate-term bond 7.35 %
- High-yield bond 1.45%
- Global bond 1.94%
- Inflation-protected bond 0.86%
- Short-term income/cash 0.79%

The data in the tables above is illustrative and reflects the strategic allocations for the Great-West Lifetime 2035 III Fund as of March 31, 2016. Strategic allocations vary by fund.
The Great-West Lifetime Trusts use the same allocations as their Great-West Lifetime Fund counterpart with the same target date and allocation strategy.



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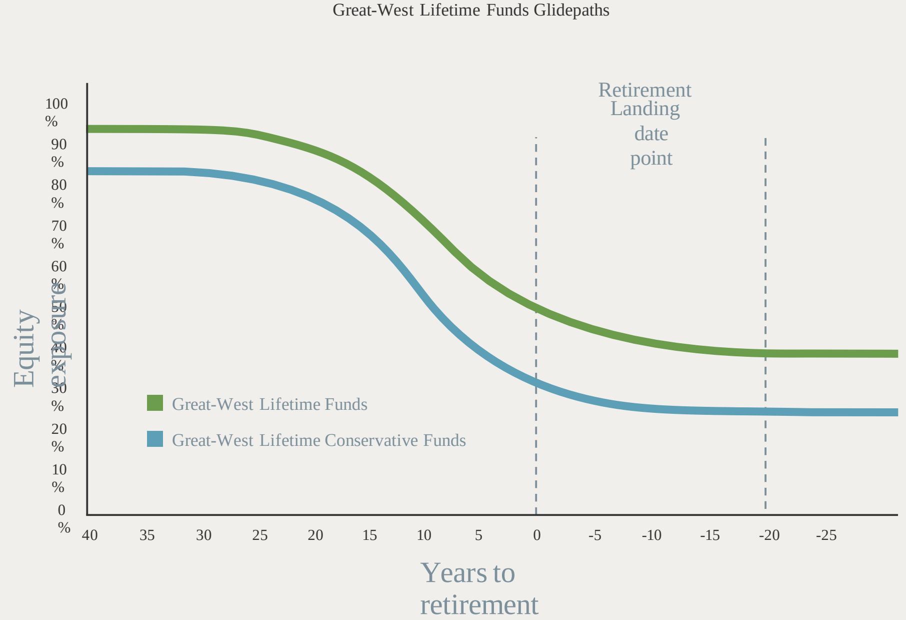
# The Lifetime Portfolios offer multiple glide paths for plan sponsors to match to participant needs

- We recognize that different plans have different workforces — a single glide path may not provide a close match with participant needs.
- The Great-West Lifetime Portfolios allow flexibility for plan sponsors to tailor their target dates and equity exposure to participant needs.

## Two glide path options

As of May 1, 2016



# The area of manager selection is a key tenet of Great-West Financial's value-add to the target date fund space

- Largest true open-architecture target date provider[1]
- Depth and breadth of investment management experience
- Diversification across investment firms
- Manager selection flexibility

**Investment manager partners**

1 Source: Morningstar® Direct℠

The investment advisers listed above include managers and sub-advisers of underlying funds for Great-West Lifetime Funds and/or Great-West Lifetime Trusts. The companies represented on this page, other than Putnam Investments, are not affiliated with Great-West Life & Annuity Insurance Company or its subsidiaries or affiliates.



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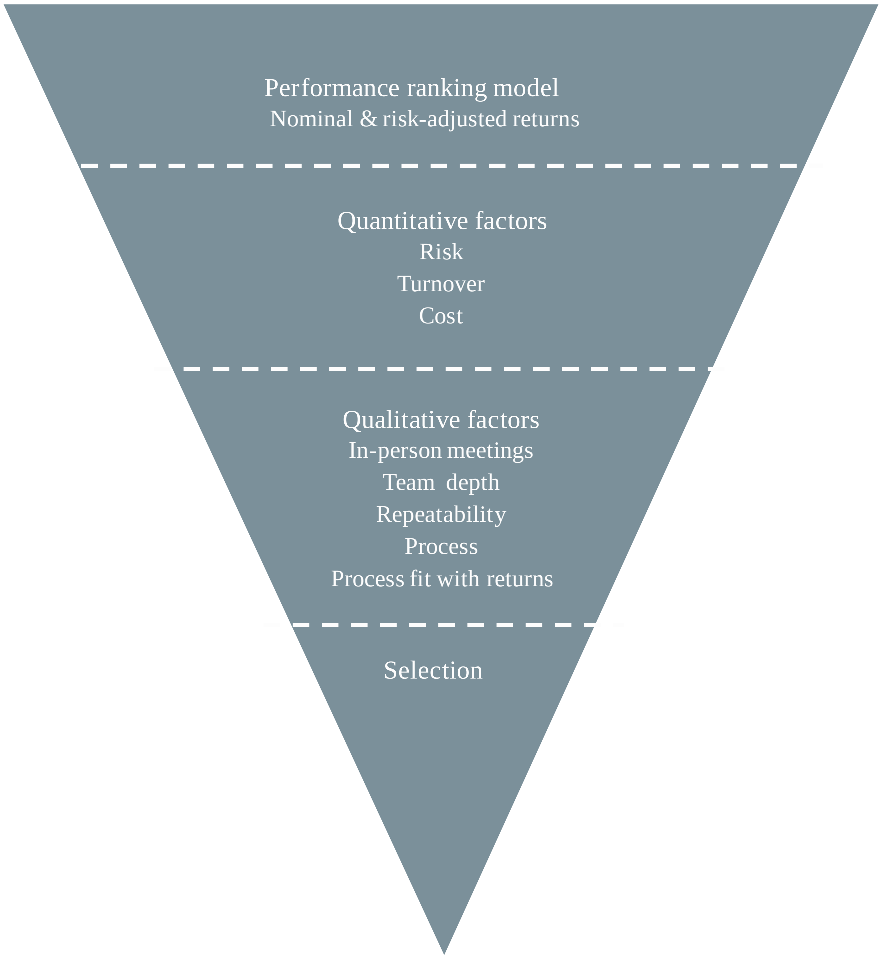
# GWCM’s approach to manager selection




**We seek to identify and select managers who have:**

- Delivered long-term and consistent value to investors.
- A clearly defined and repeatable investment process.
- The necessary infrastructure and teams in place to continue to deliver exceptional investment performance.

# Manager selection

How does GWCM evaluate potential new managers?

1

### Proprietary performance-ranking model

- Used throughout the organization to evaluate the record of each investment strategy
- Incorporates both nominal and risk-adjusted returns over the long term
- Designed to favor both strong long-term returns and consistency in performance

2

### Incorporate additional quantitative metrics not considered in the model

- Cost
- Tenure of the manager(s) on the strategy
- Consistency with respect to investment style
- Risk
- Turnover

3

### Qualitative factors

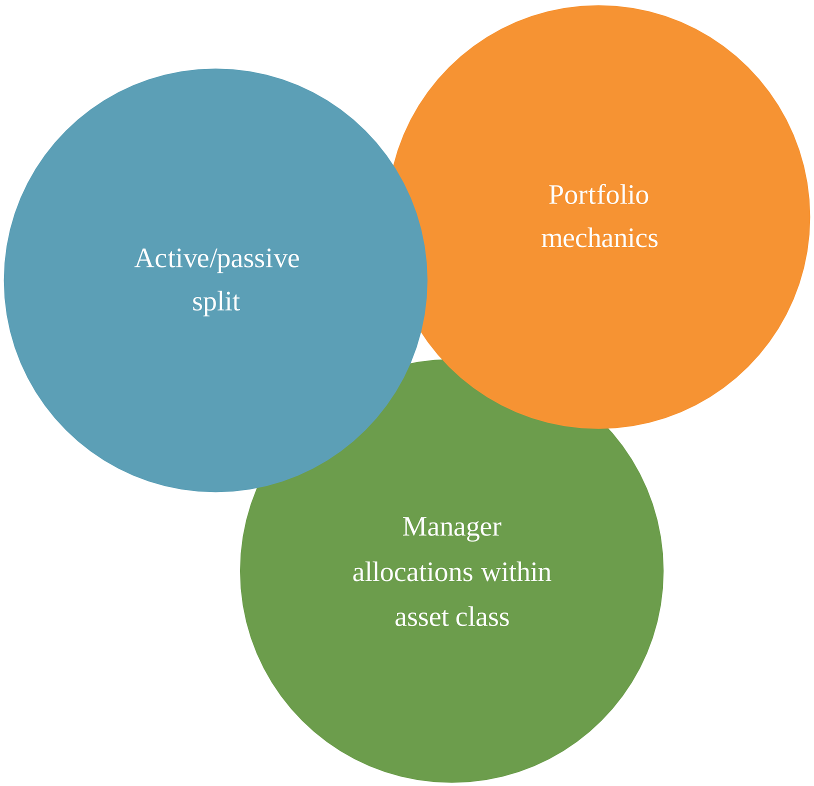
- In-person investment personnel meetings
- Depth of team
- Evidence supporting repeatability in process
- Alignment of risk management with portfolio management process
- Process description fits pattern of returns

# Underlying funds have been replaced for a variety of reasons

| ASSET CLASS | ACTION | RATIONALE |
|---|---|---|
| Core bond | Fund addition | Added a fixed income fund with a broad mandate to combat difficult interest rate environment |
| Small growth | Fund replacement | Replaced fund after the majority of portfolio management team left |
| International large-cap value | Fund replacement | Replaced fund after significant period of underperformance that was inconsistent with track record |

See Appendix for more details.

# Once asset allocation and manager selection decisions have been made, the next step is portfolio construction



# GWCM’s portfolio construction methodology is then applied to the investment options

| ACTIVE/PASSIVE ALLOCATION | UNDERLYING MANAGER ALLOCATION | DAY-TO-DAY MECHANICS |
|---|---|---|
| Active management can add value over the long run | Determine underlying fund weights within asset classes | Open architecture |
| Passive management helps reduce costs | Each underlying fund will approach investing in its asset class in a slightly different manner | Each fund is rebalanced to its target allocation on a periodic basis |
| Approximately 40% of Lifetime Portfolios are passively invested | | Majority of underlying funds have securities-lending programs that add incremental returns |

# GWCM has chosen to split asset class allocations between active and passive mandates

- GWCM believes that active management can add alpha to a portfolio over the long run.
- However, we also recognize that in periods of high correlation within markets (such as those experienced over recent years), it can be difficult for active managers to generate benchmark-beating returns.
  - — In these types of market environments, a passively managed strategy is often the better investment option.
- In addition, in the target date space cost is a key consideration for investors, plan sponsors and their advisors.
  - — A blended mix of active and passive strategies in a portfolio allows us the opportunity to generate alpha from the active strategies while lowering costs to our investors.

**Example of small-cap manager allocations**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› Fresno County's Utilization

- 9 target date options to choose from

| Years To Retirement | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Funds | 40 (2055) | 35* (2050) | 30 (2045) | 25* (2040) | 20 (2035) | 15* (2030) | 10 (2025) | 5* (2020) | 0 (2015) | -5 | -10 | -15 | -20 |
| GWL Lifetime | 93% | 93% | 92% | 90% | 84% | 74% | 63% | 54% | 47% | 42% | 38% | 36% | 35% |
| Fees | 0.46% | 0.46% | 0.46% | 0.46% | 0.46% | 0.46% | 0.46% | 0.46% | 0.46% | 0.46% | 0.46% | 0.46% | 0.46% |
| Assets | $845K | - | $2.4M | - | $3.5M | - | $5.1M | - | $2.6M | N/A | N/A | N/A | N/A |
| % of Assets | 0.40% | - | 1.18% | - | 1.71% | - | 2.44% | - | 1.25% | N/A | N/A | N/A | N/A |
| # of participants | 402 | - | 524 | - | 443 | - | 295 | - | 167 | N/A | N/A | N/A | N/A |

**1. 2014 Morningstar Target-Date Research Paper**

› http://corporate.morningstar.com/us/documents/MethodologyDocuments/MethodologyPapers/2014-Target-Date-Series-Research-Paper.pdf