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Department of Employee Trust Funds

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**CORRESPONDENCE MEMORANDUM**

**DATE:** January 7, 2008  
**TO:** Wisconsin Deferred Compensation (WDC) Board Investment Committee  
**FROM:** Shelly Schueller, Director  
Wisconsin Deferred Compensation Program  
**SUBJECT:** Managed Accounts / Reality Investing

At the May 2007 meeting, the Board learned about managed accounts, a new type of service potentially available to WDC participants. After some discussion, the Board delegated further analysis of this proposal to the Investment Committee. Department staff has reviewed the features of Great-West Retirement Services' (GWRS) managed account services, called "Reality Investing," and suggests that the Investment Committee consider recommending that the Board add Reality Investing to the WDC Program.

**Background**

The Pension Protection Act (PPA) of 2006 clarified that financial advice may be offered to participants via professionally-managed accounts. Managed account services use computer programs to automatically manage investment portfolios that are tailored to match an individual's age and risk tolerance. These accounts are managed and rebalanced over the course of a participant's life. Managed accounts typically take into account any other retirement income that a participant expects to have, including retirement annuities (like the Wisconsin Retirement System), Social Security earnings, individual savings, etc. Under the PPA, if the firm providing the advice is prudently selected, plan sponsors are not liable for the advice provided to participants.

The Board's 2005 Administrative Services Request for Proposal (RFP) included an optional question regarding cost and availability of managed account services, in case the Board decided at a future date that it would like to offer a managed accounts option to participants. All three firms responding to that RFP included a managed account feature in their proposals.

**Reality Investing**

Reality Investing is a sequence of managed account services designed to provide interested individuals with an integrated source of both retirement planning and investment allocation advice from an independent financial expert. It is based on data resulting from the methodologies and software developed and employed by Ibbotson (a subsidiary of Morningstar as of 2006) and provided through Advised Assets Group (AAG), a subsidiary of Great-West Life. An overview of the Ibbotson Managed Account and Advice Fund Selection system is included with this memo for your reference as Attachment 1.

Reviewed and approved by Jean Gilding, Deputy Administrator,  
Division of Retirement Services

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Date

Board	Mtg Date	Item #
DCIC	01/15/2008	1

Participants using Reality Investing receive a retirement portfolio designed for their personal situation, timeframe and overall financial situation. It can take into account outside assets, lifestyle expenses, and spousal information. Portfolios are automatically managed each quarter and asset allocations are adjusted as a participant's lifestyle or circumstances change. Each participant using Reality Investing has access to the AAG Education Center and receives annual progress reports on savings goals.

Ibbotson has developed the following seven investment allocation model portfolios:

<b>Ibbotson Model Portfolios</b>							
<b>Basic Asset Classes</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>6</b>	<b>7</b>
<b>Large Cap</b>	7%	19%	26%	31%	36%	42%	46%
<b>Mid/Small Cap</b>	0%	4%	8%	13%	18%	22%	27%
<b>International</b>	3%	7%	11%	16%	19%	23%	27%
<b>Bond</b>	70%	60%	47%	35%	27%	13%	0%
<b>Cash/Short Term</b>	20%	10%	8%	5%	0%	0%	0%

Attachment 2 of this memo shows examples illustrating how AAG would manage the investment allocations for four hypothetical WDC Program participants, including an individualized asset allocation glide path for each participant as they reach retirement at age 65.

### **Fiduciary Protection**

If the Board were to decide to offer Reality Investing, AAG and Ibbotson Associates would accept fiduciary responsibility for the service and the advice being given to WDC participants. A sample Reality Investing agreement is included for your review as Attachment 3. In addition, any WDC participant opting to use Reality Investing will be asked to agree to the terms of service. A sample of this document is also included as Attachment 4.

### **Use of Managed Accounts in Defined Contribution Plans**

Interest in offering managed accounts is growing. The National Association of Government Defined Contribution Administrators (NAGDCA) asked questions about the use of investment advice and management in the *2006 NAGDCA Biennial State and Local Government Defined Contribution Plan Survey*. According to the NAGDCA report, just over half (33 of 65) of the responding plans offer investment advice. Of the 32 plans that do not offer advice, 17 reported that they expect to offer it within the next year or two. The most common delivery method used is a web-based approach. Twenty-one plans reported that the cost to a participant for using the service was less than \$25 per year.

Thirteen plans offering advice reported that less than one percent of their participants use the service, seven reported that one to five percent use the service, and five reported that six to ten percent use the service. Only two plans reported that more than 30% use the service.<sup>1</sup> The table at the top of the next page provides data from GWRS regarding use of Reality Investing by participants of eight other large s. 457 defined contribution plans.

<sup>1</sup> 2006 NAGDCA Biennial State and Local Government Defined Contribution Plan Survey p. 7

<b>GWRS Reality Investing Use</b>				
	<b>Implementation</b>	<b>Adoption Rate</b>	<b>Assets Under Management (3/31/07)</b>	<b>Total Reality Investing Participant Accounts</b>
Plan A	July 2006	7%	\$13,295,349	3,307
Plan B	Dec. 2006	10%	\$34,229,433	3,752
Plan C	April 2005	24%	\$590,365,187	5,723
Plan D	Feb. 2005	3%	\$11,218,143	1,656
Plan E	Sept. 2005	6%	\$8,162,865	1,920
Plan F	Sept. 2005	3%	\$6,949,424	817
Plan G	Oct. 2005	7%	\$26,421,251	1,034
Plan H	Dec. 2004	15%	\$17,018,275	1,444

**Costs**

At the Board's request, staff has completed a market analysis of managed account service providers in the defined contribution arena. All five of the major administrative service/recordkeeping firms now offer some form of managed accounts. The table below provides a comparison.

<b>Managed Account Services</b>					
	<b>AAG</b>	<b>AIG/Valic</b>	<b>CitiStreet</b>	<b>ICMA</b>	<b>NRS</b>
<b>Product Name</b>	Managed Accounts	Guided Portfolio Services	CHART	Guided Pathways	RIA Managed Account Service
<b>Starting Fee</b>	0.60%	1.25%	0.60%	0.60%	1.50%
<b>Annual Fee on \$100,000 Account (Example)</b>	\$600	\$1,250	\$600	\$600	\$1,500
<b>Independent Financial Expert</b>	Ibbotson Associates	Ibbotson Associates	Financial Engines	Ibbotson Associates	Wilshire Associates
<b>Assets Under Mgmt.</b>	\$1 Billion +	\$3 Billion +	N/A	New	\$80 million
<b>Online Access</b>	Yes	Yes	Yes	Yes	Yes
<b>Integrated w/ Recordkeeping System</b>	Yes	Yes	Yes	Yes	Yes
<b>Advice/Guidance Offered</b>	Yes	Yes	Yes	Yes	Yes

Because the managed accounts feature was included in the Board's contract with GWRS and there are no additional system implementation costs for Reality Investing, there would be no additional charge to the WDC if the Board decided to make Reality Investing available to participants. Participants who chose to use these optional features would be charged on an individual basis. Quarterly fees would be taken from participant accounts as follows:

<b>Reality Investing Participant Fees</b>		
	<b>Quarterly Fee</b>	<b>Total Annual Fee</b>
Reality Investing Managed Accounts	0.60% bps to 0.30% bps (based on account balances)	Varies based on account balance
Reality Investing Online Advice	\$6.25	\$25

### **Participant Experience**

During the summer of 2007, AAG completed a twelve-month Reality Investing performance study. The study involved over 100,000 participants of five large government plans on GWRS' recordkeeping system. The goal was to further GWRS' understanding of the behavioral aspects of defined contribution plan participant investing patterns. The study compared the investment performance results of a non-user of advisory service tools and a user of the advisory service tools (guidance, advice or managed accounts).

As shown in the table below, AAG's study indicates that participants enrolled in managed accounts have higher individual rates of return than other groups. As the table indicates, the individual rate of return for participants choosing to use just the guidance feature was 1.07% higher than those not using any Reality Investing feature, and those using the full managed account feature enjoyed individual rates of return that were 4.21% higher than those not using any of the services.

<b>AAG Participant Experience Study<sup>2</sup></b> <b>April 1, 2006 through March 31, 2007</b>			
<b>Participant Enrollment Status as of 3-31-07</b>	<b>Average Annual Individual Rate of Return</b>	<b># Participants</b>	<b>% Participants</b>
Guidance	8.34%	368	0.4%
Advice	9.57%	154	0.1%
Managed Accounts	11.48%	9,451	9.2%
No Reality Investing Services	7.27%	93,159	90.3%

### **Plan Sponsor Perspectives**

Department staff solicited information from several s. 457 plans currently offering Reality Investing to their participants. Only the City of Austin, Texas, responded. Austin has provided Reality Investing since February 2005 and provided the following responses to staff's questions:

1) How many of your participants use the features (and which ones)? What is most popular and why, from your perspective?

*1,870 (20%) of the 9,452 participants in the City of Austin Deferred Compensation Plan are currently utilizing the Reality Investing (RI) suite of investment advisory and account*

<sup>2</sup> AAG conducted this study to review the performance of Reality Investing services, net of fees. The study encompassed participants using Reality Investing service across five defined contribution plans similar in size to the WDC. To fully account for the study population, also shown is the average annual rate of return for plan participants not using any Reality Investing services.

*management services. Of the participants using RI, 95% are using the Managed Accounts Service. Attached is information detailing RI participation by service, participant age, and participant account balance. During the first half of 2007, one half of the new enrollees in the Plan selected the Managed Accounts Service, rather than electing to select their own investment options. I believe this is due to most employees lacking the knowledge, interest, time, and/or inclination to manage their accounts. They just want somebody to do it for them.*

2) What sort of reaction have you received from participants regarding the cost?

*While some participants are concerned about the cost, most think it is fair and reasonable for the service provided. Participants whom are knowledgeable understand the fees are low, when compared to outside investment advisors. In a 2006 survey of Plan participants, 76% of the respondents indicated they were satisfied with the RI service in which they enrolled.*

3) How well you thought the roll-out/implementation campaign was organized?

*The City of Austin implemented RI in February 2005. The implementation campaign was well thought out and now utilizes an award-winning set of education and information material.*

4) Who provides education for your participants -- if it is Great-West, would you share your feelings on whether your local service providers now focus on "selling" RI or if they remain focused on educating participants?

*Great-West representatives educate our participants about the plan and RI. Because we feel it is appropriate for each participant to have a proper asset allocation, RI has been integrated into all of our Plan's communication materials and educational sessions. We have shared with Great-West our concern about their representatives "selling" RI and they are careful to maintain a proper balance between education and selling.*

5) Please share any other comments or insights you might have regarding Reality Investing.

*...believe in RI and have personally been a Managed Accounts participant since 2005. I recommend the service to any participant who lacks the knowledge, interest, time, and/or inclination to manage their own account. A recent analysis of City of Austin RI usage indicated that the RI participants had significantly improved investment performance for the years ending 4/30/2006 and 4/30/2007, when compared to participants managing their accounts completely on their own. Based on this data, the City's Deferred Compensation Committee has started discussions of making Managed Accounts the Plan's "default" investment option.*

### **Recommendation**

Staff suggests that the Investment Committee consider recommending that the Board offer WDC participants the option of using Reality Investing. Staff will be available at the meeting to discuss this memo and recommendation.

If the Board decided to offer Reality Investing, amendments to the Board's contracts with both GWRS and AAG would be needed, as neither specifically addresses managed account services. There would not be an additional cost to the WDC, however, as the costs for

managed accounts are borne by the participants using the services. Department staff would also work with GWRS to ensure that a thorough marketing and education campaign to inform WDC participants of the new services is planned and implemented. This would include providing Reality Investing information on the WDC's Web site, at presentations and in the WDC's quarterly newsletter.

Attachments: 1) Ibbotson Associates Portfolio Construction Overview  
2) Reality Investing Participant Examples  
3) Sample AAG Reality Investing Agreement  
4) Sample Participant Terms and Conditions Agreement

