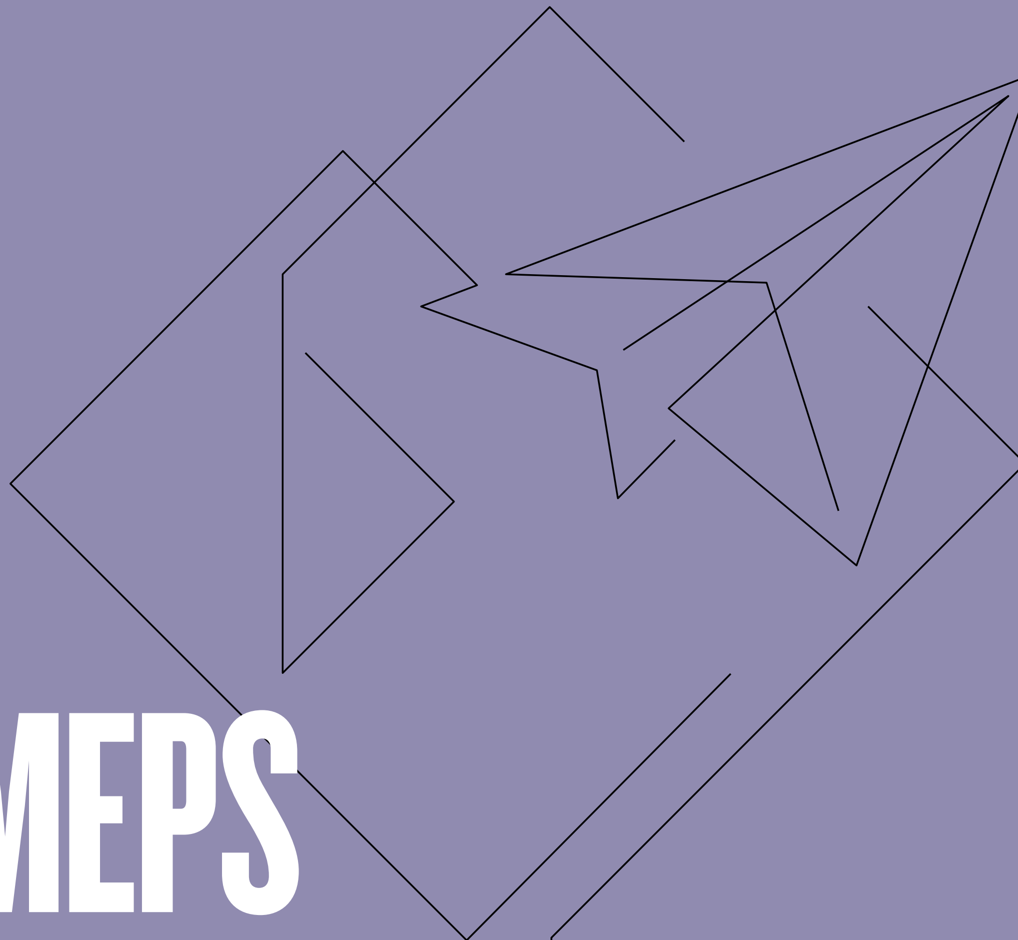
HOW MEPS WILL CHANGE RETIREMENT



Providing Retirement Plans to Uncovered Workers

by Brian Griggs, FRM, *Investment Strategist*
and Catherine Reilly, CFA, *Investment Strategist*

STATE STREET GLOBAL ADVISORS

Finding a way to deliver a good or service to a new base of customers has played an integral part in the economic history of the United States. Ford Motor Co. (Model T), Microsoft (Windows Operating System) and Netflix (home DVD delivery) all disrupted their respective industries by meeting the needs of a market segment that at the time was being ignored by competitors.

In today's retirement plan industry, the unaddressed segment of the market is the one–third of private sector workers without access to retirement benefits[1], and Multiple Employer Plans (MEPs) are the disrupting force that can meet their needs.

WHERE WE'VE BEEN

Coverage Depending on Employer Size

In the history of the retirement industry, public policy has often been the catalyst for change. For example, the Revenue Act of 1926, which exempted income of pension trusts from taxation, led to more widespread use of defined benefit plans as a way for large, industrialized enterprises to build workforce continuity and transition older workers out of their jobs.[2]

However, whether policy driven disruptions are positive for retirement savers is not always clear. Many small employers that are unequipped to comply with the Employee Retirement Security Act (ERISA) of 1974, or unwilling to pay the added costs of plan provision, have forgone offering a retirement plan altogether. The so-called "Gig Economy," a group of workers that is predicted to grow to 40 percent of the US workforce by 2020[3], also represents a growing population of uncovered workers that has yet to be addressed by the retirement industry. This lack of retirement coverage — or more specifically, retirement coverage dependent on the size of the employer — has created a new challenge for policy makers to address.

THE 'GIG ECONOMY'

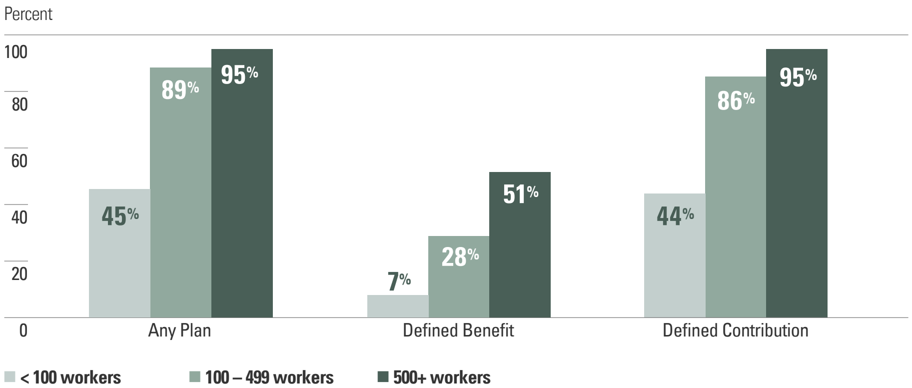
Independent Contractors

Day Laborers

Temp Staffing Workers

Contract Freelancers

US Establishments Offering Retirement Benefits
by Number of Workers



Source: US Bureau of Labor Statistics, March 2016.

A TIPPING POINT

By international standards, the way in which workplace retirement plans are offered in the US is unique. First, both provision and participation are voluntary; the employer can choose whether to provide a plan, and the employee can choose whether to participate and how much to contribute. Second, the majority of employers have to sponsor their own plan and act as the plan fiduciary in some capacity.

While this system works for those employers who are large enough for in-house benefits committees and ERISA counsel, it can be costly and complicated for small businesses and does not address the needs of the Gig Economy. A more platform-based system, similar to that seen in the United Kingdom, Netherlands and Australia, could improve upon the current ERISA framework. New legislation allowing "open" multiple employer plans (MEPs) would be a step in this direction.

In the absence of federal action, four states (California, Illinois, Oregon and Massachusetts) have already enacted their own legislation that establishes similar programs targeting uncovered workers. If a national requirement for employers to automatically enroll employees in a plan (like we are already seeing in some states) were enforced, MEPs could help facilitate this transition and reduce the burden on small employers.

Last year, the Retirement Enhancement Savings Act (RESA) passed the Senate Finance Committee unanimously, and will likely reach the Senate floor in the coming year. Certain provisions of RESA remove the hurdles to open MEPs that the US Dept. of Labor outlined in a 2012 bulletin; specifically, the commonality requirement among MEP participants. Today, the DOL allows the formation of MEPs only by employers who share a common affiliation (e.g., members of the American Bar Association). Open MEPs will make it considerably easier for small employers to offer a retirement plan.

CURRENT SYSTEM → **Employer** ERISA 402(a) Named Fiduciary

FIDUCIARY RESPONSIBILITIES	Plan Administrator ERISA 3(16)		Trustee ERISA 403(a)	Investment Manager ERISA 3(38)	Directed Trustee ERISA 403(a)(1)
CURRENT SERVICE PROVIDERS	Recordkeeper	Third Party Administrator (TPA)	Financial Advisor (or Consultant)	Bank, Insurance Co. or RIA	Custodian
RESPONSIBILITIES	Tracking contributions, earnings and investments on a participant level Directing the Directed Trustee or Custodian to execute trades	Overseeing annual ERISA compliance testing Filing Form 5500 Plan document maintenance Participant notices	Managing and controlling all plan assets (unless outsourced) May work with FA or Consultant	Selecting and monitoring all investments When hired, Trustee is no longer responsible for assets controlled by 3(38)	Holding, but not controlling, plan assets Subject to direction from Named Fiduciary or 3(38)

Required Employer Responsibility | Plan Administration | Investment Advice | Asset Custody | Optional

Bundled Fiduciary, Unbundled Service Providers

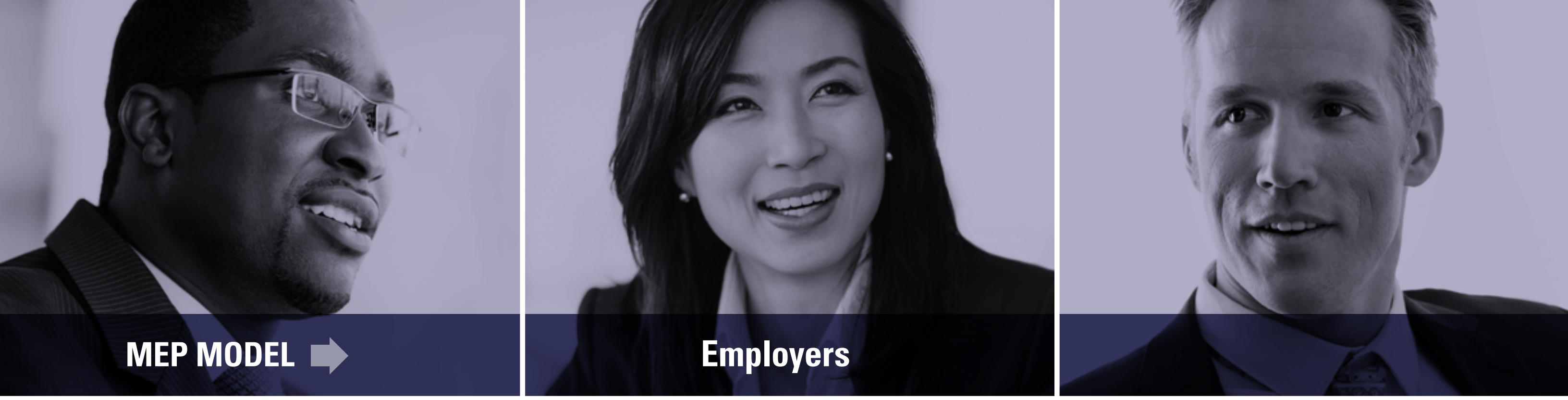
Compared to larger plans, small plans tend to use a single vendor for all 401(k) services to keep costs down, using investment management fees paid by their participants to offset the administrative costs of running the plan. Among plans with fewer than 250 participants, 85 percent rely on a bundled service provider.[4] While using a bundled provider is simple for the business owner, there is no guarantee that their recordkeeper's proprietary investment options are the most prudent for their participants.

On their own, small plans cannot access the "scale" — or the ability to spread the fixed costs of plan administration across a larger number of participants — that large plans enjoy.

Through a MEP, small business owners can access simplicity, scale, and best-in-class investment options for their participants. The MEP provider will not only act as an outsourced CIO, taking ERISA 3(38) fiduciary status, but also a fiduciary on the administrative and custody aspects of the plan.

Open MEPs may help address an important deterrent to offering a plan: litigation risk. While many employers want to provide retirement benefits for their employees, the increasingly litigious environment in the US is making it less appealing to do so. Legislation allowing MEPs will pave the way for a market of total plan fiduciary outsourcing. These sponsors will be equipped to be an ERISA 403(a) trustee, as well as take on the fiduciary responsibility for plan administration, investment management and custody.

To give employers further peace of mind that they have chosen a quality MEP for their employees, the DOL could even create a "Qualified Default Investment Plan" designation for MEPs that meet certain criteria. This would provide employers with a safe harbor for MEP selection.



Multiple Employer Plan
One Plan Fiduciary

Asset Manager | **Custodian** | **Recordkeeper***

Plan Administration | Investment Advice | Asset Custody | Optional

* Outsourced Recordkeeper and TPA (i.e., trade association) if MEP Sponsor cannot provide this service in-house

MEPs

Not just for small plans!

An interesting question in this environment is the future of current employer-sponsored plans. Would employers still want the expense and fiduciary responsibility of running their own plan if they were able to outsource this to a professionally run MEP? While initially we would expect employers that currently have large investment staffs to keep their current plans, in the long run they may well prefer to offload the administrative and fiduciary burden to a MEP. For example, the UK introduced automatic enrollment in 2012 and, since then, the use of Master Trusts (the UK equivalent of open MEPs) has increased steadily. At the same time, the growth in employer-sponsored plans has come to a stop and some large employers have already started to use Master Trusts rather than their own plans.

POTENTIAL MEP SPONSORS

Trade/Labor Organizations

Consultants

Financial Advisors

Recordkeepers/Payroll Providers

SETTING THE STAGE FOR MEPS

An Improved DC User Experience

While the industry waits for legislation allowing open MEPs, some of the key benefits of MEPs — lower fiduciary and administrative burdens, lower costs, and an improved retirement saving experience — have already emerged. Some of the trends that we expect to continue are...

Omnibus Accounting

By aggregating individual client (or employer) accounts, plan administrators are able to achieve scale and give smaller plans access to lower pricing on investment options — a key benefit of MEPs.

Improved Efficiencies

Across the industry, recordkeepers are using new technology to streamline administrative tasks. Once "paper-driven" processes such as document signing, client onboarding, disclosures and notifications are now being digitized. We've seen the launch of many "Fin–Tech" startups that use the latest technologies to offer small businesses low-cost, easy to implement 401(k) plans that can integrate with payroll systems.

Packaged Investments and Financial Wellness

Working assumptions around prudent DC plan investment lineup construction are changing. The idea that "the more options, the better" is being replaced by simplified investment menus built around passive target date options. The investment menus of the future will continue to be constructed with fewer, more outcome-oriented choices for participants. In 2016, the average number of investment managers included in DC plan lineups dropped to 3.8.[5] Participants today demand more holistic solutions — not just a retirement savings solution, but also an emergency fund, student loan assistance and income solutions in retirement — and require fewer investment choices.

Individualization

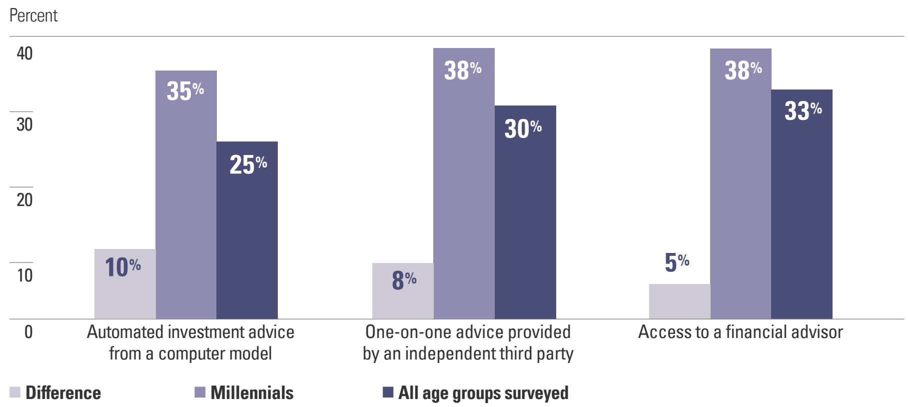
Plan administration will continue to become a digitized industry that relies on data — not just data security, but data integration with participants' other accounts. Data aggregation, where users provide their login info to other websites so that an analytical tool can "scrape" and aggregate data, has come under pressure from some banks, and in some cases blocked entirely, because of security risks. However, we believe data aggregation will become more accepted as service providers harness the power of "Big Data" to create a more personalized user experience.

GETTING CLOSER

Still, participants are expecting more from their 401(k) plan, with employee demographics playing an important role in shifting the demand curve for a better retirement saving experience. Contrary to popular belief, not all millennials are demanding more digital tools and assistance. In fact, while the "digital native generation" is more comfortable with technology–driven advice, they are also more likely than their predecessors to want access to a human financial advisor.[6] For this reason, we believe that DC plan advisors are prime candidates to set up MEPs. By doing so, they can streamline their plan setup process, give their clients access to lower costs on investment options, and free up their time for more one-on-one consultations with plan participants.

Plan Features Not Offered, but Desired by Participants

Percentage of survey respondents who ranked missing feature as highly desirable



Source: Cogent Wealth Reports

1 Bureau of Labor Statistics, March 2016 — Private industry workers includes the self-employed

2 EBRI Databook on Employee Benefits, Legislative History, ebri.org/pdf/publications/books/databook/dbappxe.pdf

3 Study by Intuit

4 401khelpcenter.com

5 Cogent Wealth Reports

6 Cogent's webinar, "Unlocking DC Growth Opportunities in an Evolving Regulatory Era"

7 Stacy C. Davis, Susan W. Diegel & Robert G. Boundy (June 2011). "Transportation Energy Data Book: Edition 30" (PDF). Office of Energy Efficiency and Renewable Energy, US Department of Energy.

A SECURE RETIREMENT

Accessible and Achievable for All Americans

In 1905, three years prior to the release of the Ford Model T, there were approximately 0.11 vehicles per 1,000 people in the United States. In 1930, three years after the end of the Model T's unprecedented 19-year production run, the number was 217[7] and Ford Motors had become the industry leader. Similar to Ford's story, finding a service model that can deliver quality retirement benefits to uncovered workers is not only attractive from a commercial standpoint, but will also greatly increase the quality of life for consumers; or in our case, retirement savers. Thanks to potential changes in regulation and technological advances, we as an industry are closer than ever to this turning point.

ssga.com/definedcontribution

State Street Global Advisors Worldwide Entities

Australia: State Street Global Advisors, Australia, Limited (ABN 42 003 914 225) is the holder of an Australian Financial Services Licence (AFSL Number 238276). Registered office: Level 17, 420 George Street, Sydney, NSW 2000, Australia. T: +612 9240 7600. F: +612 9240 7611. **Belgium:** State Street Global Advisors Belgium, Chaussée de La Hulpe 120, 1000 Brussels, Belgium. T: 32 2 663 2036. F: 32 2 672 2077. SSGA Belgium is a branch office of State Street Global Advisors Limited. State Street Global Advisors Limited is authorised and regulated by the Financial Conduct Authority in the United Kingdom. **Canada:** State Street Global Advisors, Ltd., 770 Sherbrooke Street West, Suite 1200 Montreal, Quebec, H3A 1G1, T: +514 282 2400 and 30 Adelaide Street East Suite 500, Toronto, Ontario M5C 3G6. T: +647 775 5900. **Dubai:** State Street Bank and Trust Company (Representative Office), Boulevard Plaza 1, 17th Floor, Office 1703 Near Dubai Mall & Burj Khalifa, P.O Box 26838, Dubai, United Arab Emirates. T: +971 (0)4 4372800. F: +971 (0)4 4372818. **France:** State Street Global Advisors France. Authorised and regulated by the Autorité des Marchés Financiers. Registered with the Register of Commerce and Companies of Nanterre under the number 412 052 680. Registered office: Immeuble Défense Plaza, 23-25 rue Delarivière-Lefoullon, 92064 Paris La Défense Cedex, France. T: (+33) 1 44 45 40 00. F: (+33) 1 44 45 41 92. **Germany:** State Street Global Advisors GmbH, Brienner Strasse 59, D-80333 Munich. Authorised and regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht ("BaFin"). Registered with the Register of Commerce Munich HRB 121381. T: +49 (0)89 55878 400. F: +49 (0)89 55878 440. **Hong Kong:** State Street Global Advisors Asia Limited, 68/F, Two International Finance Centre, 8 Finance Street, Central, Hong Kong. T: +852 2103 0288. F: +852 2103 0200. **Ireland:** State Street Global Advisors Ireland Limited is regulated by the Central Bank of Ireland. Incorporated and registered in Ireland at Two Park Place, Upper Hatch Street, Dublin 2. Registered Number: 145221. Member of the Irish Association of Investment Managers. T: +353 (0)1 776 3000. F: +353 (0)1 776 3300. **Italy:** State Street Global Advisors Limited, Milan Branch (Sede Secondaria di Milano) is a branch of State Street Global Advisors Limited, a company registered in the UK, authorised and regulated by the Financial Conduct Authority (FCA), with a capital of GBP 71'650'000.00, and whose registered office is at 20 Churchill Place, London E14 5HJ. State Street Global Advisors Limited, Milan Branch (Sede Secondaria di Milano), is registered in Italy with company number 06353340968 - R.E.A. 1887090 and VAT number 06353340968 and whose office is at Via dei Bossi, 4 - 20121 Milano, Italy. T: 39 02 32066 100. F: 39 02 32066 155. **Japan:** State Street Global Advisors (Japan) Co., Ltd., Toranomon Hills Mori Tower 25F 1-23-1 Toranomon, Minato-ku, Tokyo 105-6325 Japan. T: +81 3 4530 7380. Financial Instruments Business Operator, Kanto Local Financial Bureau (Kinsho #345), Membership: Japan Investment Advisers Association, The Investment Trust Association, Japan, Japan Securities Dealers' Association. **Netherlands:** State Street Global Advisors Netherlands, Apollo Building, 7th floor Herikerbergweg 29 1101 CN Amsterdam, Netherlands. T: 31 20 7181701. SSGA Netherlands is a branch office of State Street Global Advisors Limited. State Street Global Advisors Limited is authorised and regulated by the Financial Conduct Authority in the United Kingdom. **Singapore:** State Street Global Advisors Singapore Limited, 168, Robinson Road, #33-01 Capital Tower, Singapore 068912 (Company Reg. No: 200002719D, regulated by the Monetary Authority of Singapore). T: +65 6826 7555. F: +65 6826 7501. **Switzerland:** State Street Global Advisors AG, Beethovenstr. 19, CH-8027 Zurich. Authorised and regulated by the Eidgenössische Finanzmarktaufsicht ("FINMA"). Registered with the Register of Commerce Zurich CHE-105.078.458. T: +41 (0)44 245 70 00. F: +41 (0)44 245 70 16. **United Kingdom:** State Street Global Advisors Limited. Authorised and regulated by the Financial Conduct Authority. Registered in England. Registered No. 2509928. VAT No. 5776591 81. Registered office: 20 Churchill Place, Canary Wharf, London, E14 5HJ. T: 020 3395 6000. F: 020 3395 6350. **United States:** State Street Global Advisors, One Lincoln Street, Boston, MA 02111-2900. T: +1 617 786 3000.

The views expressed in this material are the views of Brian Griggs and Catherine Reilly through the period ended January 31, 2017, are subject to change based on market and other conditions. The information provided does not constitute investment advice and it should not be relied on as such. All material has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. This document contains certain statements that may be deemed forward-looking statements. Please note that any such statements are not guarantees of any future performance and actual results or developments may differ materially from those projected.

Investing involves risk including the risk of loss of principal.

The information provided does not constitute investment advice and it should not be relied on as such. It should not be considered a solicitation to buy or an offer to sell a security. It does not take into account any investor's particular investment objectives, strategies, tax status or investment horizon. You should consult your tax and financial advisor. All material has been obtained from sources believed to be reliable. There is no representation or warranty as to the accuracy of the information and State Street shall have no liability for decisions based on such information.

STATE STREET GLOBAL ADVISORS®

ID8841-DC-3669 0217 Exp. Date: 02/28/2018