

DC Investment Forum  
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Toronto

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US & Canada

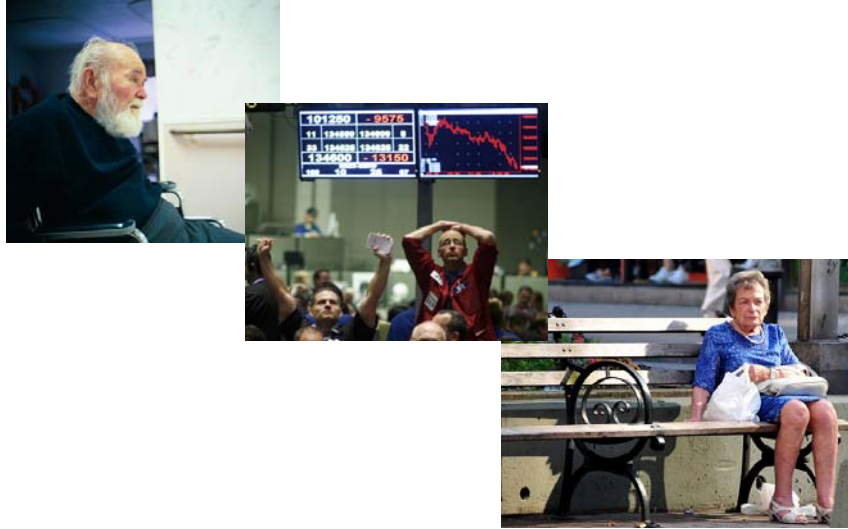
## Investing and the Individual: A Balancing Act

BLACKROCK

### Retirement Dreams



## Retirement Realities



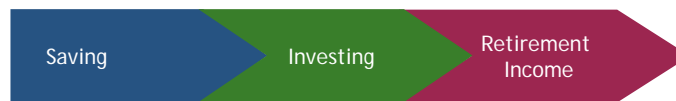
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## Retirement Responsibility

DB - Investment Professionals

DC - Individuals



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## Investing and the Individual

### Balancing Act

#### Investing and the Individual



## The Individual

How do I get from here to retirement?



## Just Do the Math

85% can calculate interest

80% can't calculate compound interest

And...

Two-thirds don't know what happens to interest rates when bond prices fall

Source: Financial Literacy and Retirement Preparedness: Evidence and Implications for Financial Education; Annamaria Lusardi and Olivia S. Mitchell; January 2007.

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## My Employees Are Smarter

Question:

Which is safer, investing in a single company stock or investing in a stock mutual fund?

25% of those who ranked themselves "highly knowledgeable" got this wrong

Source: Americans' Financial Capability; Annamaria Lusardi (Dartmouth College and NBER) Report Prepared for the Financial Crisis Inquiry Commission February 26, 2010

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## Let's Educate Them



Good intentions, bad outcomes

“I’ll enroll in the plan”

100% → 14%

“I’ll change my fund election”

47% → 15%

Source: Financial education procrastination: Choi, Lalson, Madrian, Metrick (2004)

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## How Do You Measure Good Communication?

Would newspapers still exist if only 26% of people read the newspaper and found it useful?



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## The Reality of Communicating to Participants

**A simple WAY TO SAVE FOR RETIREMENT**

Having well-communicated for the benefit doesn't have to be difficult. Because the reality is that you're not alone in the challenge of putting together a diversified equity portfolio, the iShares® portfolio were created to help make some of these decisions for you. Rather than trying to mix and manage a collection of different funds, you only need to select one iShares portfolio to receive a well diversified investment mix.

**HOW TO PICK A FUND**

iShares portfolios have been set up to fit your investment goals from 2010 to 2030, with the intention that you purchase the fund listed below your "target year" for your entire investment amount from your account.

For example, if you wanted to invest in 2017 and you plan to retire in 2030, you would target year in 2030, and you'd probably choose the iShares 2030 Portfolio. If you target year falls between two portfolios, you can choose in the portfolio that is closest to your target date, or you can split your funds between the two closest portfolios. For example, if your target year is 2027 you might invest 50% of your funds in iShares 2025 and 50% in iShares 2030.

**Each fund holds a range of assets**

Asset mix adjusts on your age

- US Large Cap Equities
- US Small/Mid Cap Equities
- International Equities
- US Bond
- US Inflation-Protected Bonds
- Money Market
- US Real Estate

26% of participants say they "read and value" the savings plan communication materials

Nearly half of that group identified as "knowledgeable" about investing

To whom are we communicating?

Source: BlackRock 2010 Participant Attitude and Behavior Survey

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## Responding with Psychology and Plan Design

How do we get people to save and invest for retirement?

Don't ask, nudge

Trends

- ✓ Auto-enrollment - get people in the plan
- ✓ Auto-escalation - automatic savings increases

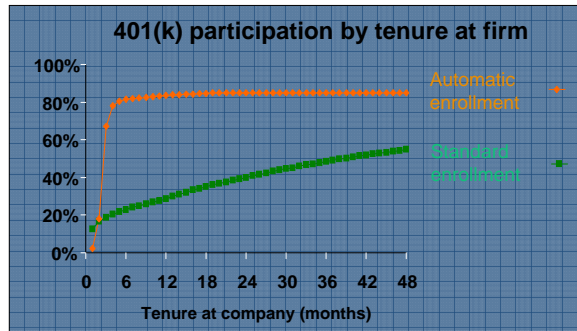
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## The Value of Action and Automation

Which would you want?

80% success or 60% success



Source: Madrian and Shea (2001) Choi, Laibson, Madrian, Metrick (2004)

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## Trends: Auto-Enrollment and Auto-Escalation

### Canadian Trends

- 37% of employees are now immediately eligible for enrollment in DC plans, up from 34%<sup>3</sup>
- 69% of employers make enrollment in the DC plan mandatory, up from 61%
- 48% of plans have implemented some form of automatic increases<sup>4</sup>

### US Trends

- 59% of plans auto-enroll, more than double those in 2006 (up from 24%)<sup>1</sup>
- Auto-enrollment dramatically increases participation:
  - participation under opt-in: 40% - 70% vs under opt-out: 85% - 95%<sup>2</sup>
- Nearly 60% of plans use some form of auto-escalation<sup>1</sup>

<sup>1</sup> Profit Sharing/401(k) Council of America (PSCA): 51st and 52nd Annual Survey, 2008 and 2009

<sup>2</sup> Bechters, John, James J. Choi, David Laibson, Brigitte C. Madrian (2006). "The Importance of Default Options for Retirement Savings Outcomes: Evidence from the United States"

<sup>3</sup> Canadian Institutional Investment Network 2009 CAP Benchmark Report

<sup>4</sup> Canadian Institutional Investment Network 2007 Benchmark Report

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## Managing Investment Risk

### Retirement Investing Risks

Adequate Savings

Managing  
Performance

Asset Allocation

Inflation Risk

Longevity Risk

## How Well Do Participants Manage Asset Allocation?

What might cause equity allocation to go from 43% to 69%?

Rebalance?

Asset allocation?

Market move?

It's choice

## Asset Allocation in Action

### Canadian defined contribution investors

“Imagine all your old investment choices have been eliminated and you have \$100,000 to invest.  
How will you allocate?”

#### Group 1

- Government bond fund
- Corporate bond fund
- Stock fund

43% mean allocation to equities

#### Group 2

- Bond fund
- Growth stock fund
- Value stock fund

69% mean allocation to equities

“We conclude that many future retirees are confused by asset allocation decisions and are swayed by whatever fund menu is available to them”

Source: “Unraveling a Knotty Problem: The gap between self-directed plan members’ actual and perceived levels of investment knowledge can cause retirement plans to come undone.” Professor Richard Deaves, professor of finance at McMaster University in Hamilton, Ontario: Spring 2005 Canadian Investment Review

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## Better Off

### What might help 75% of investors have better outcomes?

The “what if” test

- 200,000 participants at age 55 in 2000
- Invest them in 2010 “well designed target date fund” for 8 years, including 2008

75% of participants did worse if they “did their own thing” vs. being invested in the target date fund

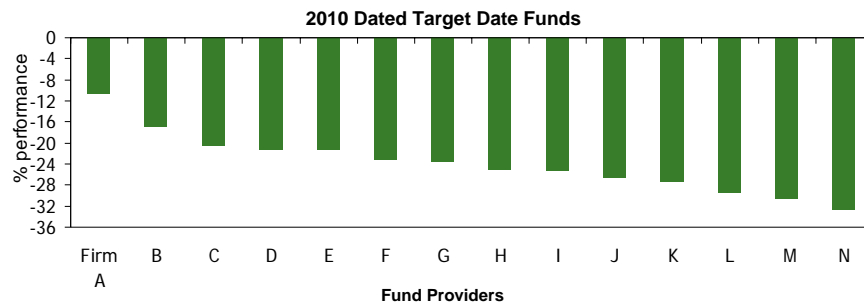
Assumptions: Based on simulations relating to EBRI’s 2.1 million participant database that tracks participants and their investment activity from 2000-2008. This simulation included participants that were 55 years old and placed them in LifePath 2010 for the years 2000-2008. The results are based on LifePath CTF allocations over the 8 year period in the LifePath 2010 fund. That simulation uses actual fund returns, including fees and trading costs.

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## Same Product Category, Different Outcomes

### US Case Study: Performance of Target Date Funds In 2008



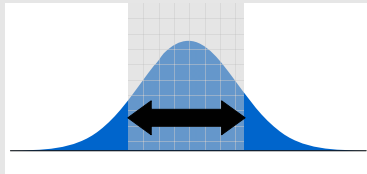
Source: Morningstar Direct, BlackRock Institutional Trust Company (BTC). Allocations are estimates based on information provided on target-date fund providers' websites, fund prospectuses, and information on investment databases. The following analysis compares Target Retirement Funds of various provider (mutual funds) with BTC's US LifePath Index funds (commingled trust funds). Unlike mutual funds, which are registered with the SEC, commingled trust funds (CTFs) are unregistered investment vehicles and, as such, fees and expenses are typically lower than those of registered products.

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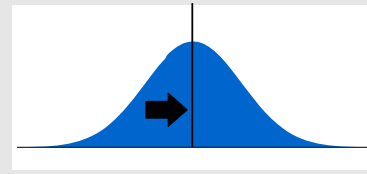
## Target Date Fund Objective

### Objective: Providing Reasonable Outcomes in Diverse Market Environments



- Reasonable outcomes in diverse market environments
- Participants feel loss 2X as much as a gain
- Leads to a more *conservative* glidepath as retirement approaches

### Objective: Maximizing Wealth in Average Markets



- Focus on maximizing wealth
- Emphasis on mean returns suggests higher allocations to higher expected return asset classes (equities)
- May result in more extreme outcomes (positive or negative if markets significantly deviate from average, e.g. 2008)
- Generally leads to a more *aggressive* glidepath

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## A Framework for Evaluating Target Date Funds

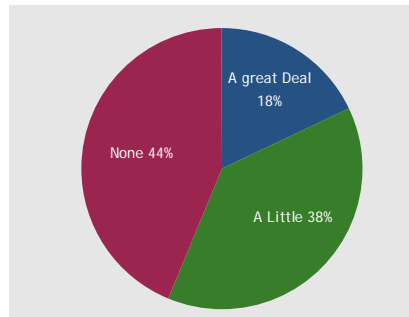
- While there is no one 'right' method of constructing a target date fund, a plan sponsor should choose the fund family that is most appropriate given:
  - Participant population
  - Plan resources
  
- The following criteria are outlined as the key areas of comparison across providers:
  - Fund Objective
  - Asset Class Diversification
  - Tactical vs. Strategic Glidepath Implementation
  - Index vs. Active Exposures
  - Participant Communications
  - Track Record
  - Performance

## Participants are Ill-Prepared to Spend the Lump Sum

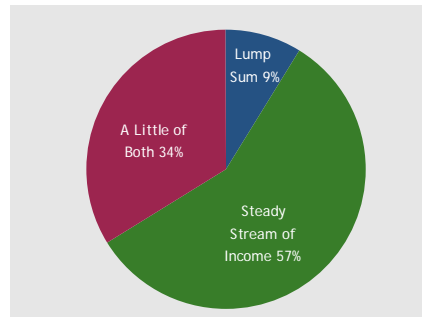
How experienced are participants in managing large sums of money, say around \$100,000?

- A. I'd say at least half could manage a lump sum
- B. I suspect about 20% could handle managing a lump sum**
- C. They don't typically choose to annuitize on their own, so I suspect they have some confidence of managing a lump sum on their own

How experienced are participants in managing large sums of money, say around \$100,000?



Which of the Following Would You Prefer to Receive at Retirement?



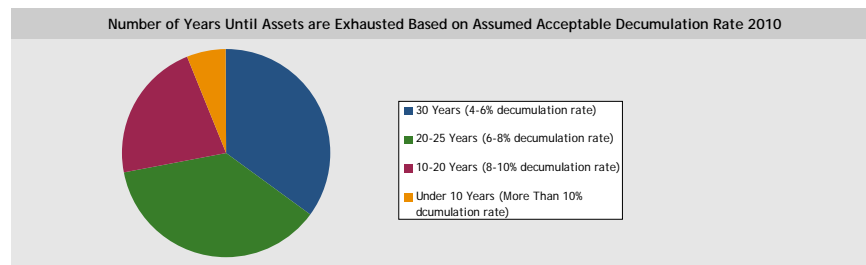
## Survey Says...Participants risk of running out of money

When given the options of the following draw down rates in retirement (4-6%, 6-8%, 8-10%, and more than 10%), which of the following do you think best categorizes how participants might have responded?

- A. About 50% probably know it is 4-6% per year -- only 35% indicated a proper draw down rate
- B. About 35% suggested 6-8%**
- C. About 30% suggested 8-10% -- actually 22%
- D. Less than 5% suggested they could withdraw 10% or more -- 6% think they can draw down 10%

The respondents' decumulation rates translate to nest eggs being exhausted in under 25 years for 65% of respondents (chart below)

Given their own longevity estimates, 42% of respondents will outlive their assets



Source: BlackRock 2010 Participant Attitude and Behavior Survey

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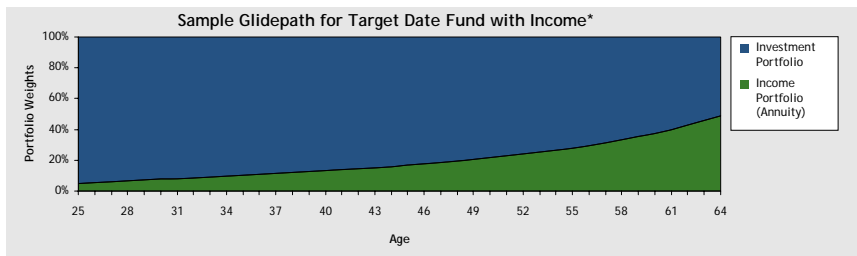
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## Target Date Fund with Income

Glidepath utilizes an Asset minus Liability framework to increase the annuity exposure over time, decreasing the risk of the portfolio

Four key steps of determining landing point:

- Determine desired consumption patterns in retirement
- Understand how different market environments would affect ability to consume
- Establish "utility" of participants under these different outcomes
- Take into account range of longevity exceptions



Smooth transition from initial allocation to the "Annuity Landing Point"

\*For illustrative purposes only

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## Evaluating Retirement Income Products

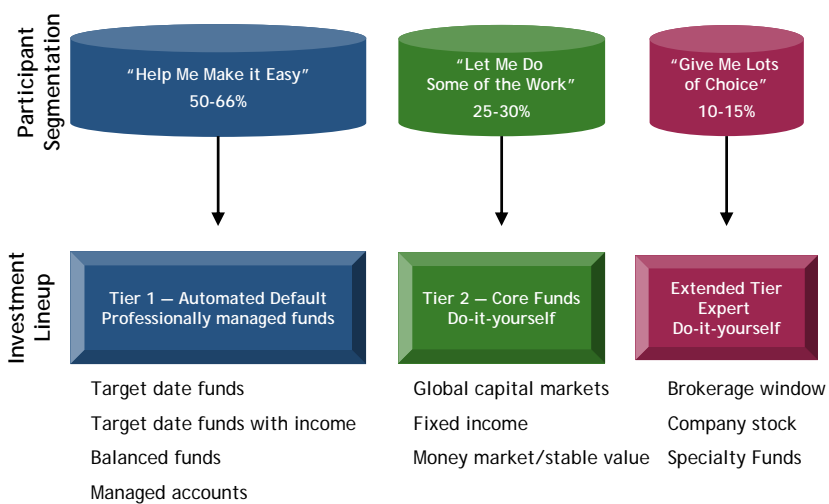
Addressing participant and plan sponsor needs

Questions to Ask	Evaluation Criteria
Secure Income	Income guarantee
	Inflation protection
	Manages credit risk
Growth of Assets	Diversified underlying investments
	Institutional pricing
	Flexibility
Ease of Use	Transparent valuation
	ODIA eligible
	Easy to communicate

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## Individuals and Investing: Finding Balance with Optimal Plan Design



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Survey methodology:

BlackRock's 2010 Participant Attitudes and Behaviors Survey was conducted via the Internet by Boston Research Group during March 2010. The BlackRock survey is fielded to 1,000 workers who are actively contributing to a 401(k) plan; the poll has a maximum sampling error of +/- 3 percentage points at a 95% confidence level. The poll examined participant views and behaviors regarding retirement planning and saving, retirement confidence levels, and the "spend down" phase of retirement, with key implications for potential plan improvements.