<u>OREGON RETIREMENT SAVINGS BOARD</u>
PLAN DESIGN WORK GROUP

Notes of discussion from 3/31/2016 meeting

(1) <u>Type of Plan</u>

The group discussed the pros and cons of a traditional vs Roth IRA structure. The major concern with a Roth is that some employees will be over the income cap for a Roth contribution – this might include business owner/employees, other highly compensated employees, employees with a high-earning spouse, and married employees filing separately. Auto-enrollment creates the risk of penalties for excess contributions. However, these concerns will not apply to most participants who will not reach the income limits.

With respect to the different tax treatment, data from other states indicates that the up-front tax advantage of a traditional IRA was likely not to be a major factor for most participants. One group member commented that for younger workers, the Roth tax benefit might be more valuable if their income increases later.

Group members discussed the impact on participants who need to take money out in an emergency. On the one hand, the penalties for early withdrawal from a traditional IRA might serve as a disincentive to withdraw. On the other hand, group members felt that those who need the money for an emergency will take it out anyway. If the account is a traditional IRA, it won't stop emergency withdrawals but will impose a heavy cost.

A Roth IRA seemed to be the best fit for most participants. However, it might be helpful to have a traditional IRA available as a non-default option.

(2) <u>Default Investment Choice (accumulation phase)</u>

The group consensus was that an age-appropriate target date fund should be the default investment choice.

Another option discussed was a managed choice that could be more tailored to the individual participant's situation. However, this would require more interaction with individual participants which may not be feasible with auto-enrollment.

Group members commented that target date funds can be expensive and the ORSB should therefore negotiate fees. In addition, not all target date funds are the same and attention should be paid to factors such as active vs passive investments, and the selection of the glide path. Caution should be taken not to select an overly aggressive mix, even for younger investors.

Note: Discussion of investment choices during retirement/decumulation will be discussed at a later meeting.

(3) Additional/Optional Investment Choices

The group discussed what additional investment options (if any) should be available for participants who do not want the default choice. The general consensus was that most would stick with the default choice anyway.

Some group members felt that no other investment choices should be offered, since a target date fund is best suitable for all participants. Others felt that some additional choices should be offered; reasons included (1) some participants may want other choices and the plan should not force them to switch to an outside (and potentially higher cost) provider to get other choices; (2) participants who stick with the default choice may be more comfortable knowing "I can change it later" (even if they never do so); (3) there may be political reasons/it may create a better appearance to offer other choices; (4) some participants may want an investment choice that meets special needs, e.g. value-based or socially responsible investing. (It was noted that the NEST program in the UK provides a "green" option and an all-stock option which is Sharia-compliant.)

One possibility would be to offer a "safety" option and a "growth" option in addition to the target-date default option. It was noted that most people will tend to pick the option in the middle which would be the target-date default. Group members suggested looking at the TSP and the Oregon College Savings Plan for specific options. Additional investment choices could be added in future years as the plan grows and if there is participant demand for them.

(4) Safety Corridor

The group spent considerable time discussing whether there should be a different and safer default investment initially, such as a stable value fund. The concern is whether plan participants, many of whom will be new to investing, would be scared off permanently by a market drop shortly after they enroll. Options for such a "safety corridor" would be (a) a safer investment during the first year or two of the program (not participant-specific); (b) a safer investment for each participant during his or her first year or two of enrollment; or (c) a safer investment for each participant until his or her account balance reached a particular dollar threshold. Future investments would automatically switch to the regular default investment choice (e.g. target date fund) once the threshold was passed.

Most group members felt that a safety corridor was not appropriate because it would deprive the participant of investment growth during the initial period. It would also be complicated to explain to participants. Group members commented that these are long-term funds and participants should be educated to expect some volatility. If they are not willing to take any risk, they can opt out of the default choice. In addition, a balanced target-date fund will reduce the risk of a large loss.