CLIENT CASE STUDY

LESS IS MORE: SIMPLIFYING WHILE ENHANCING THE DC OFFERING

Russell Investments

PUBLIC UTILITY IMPLEMENTS OCIO

The organization

A California-based utility was considering new ways to manage its defined contribution (DC) plan investments and support participant retirement readiness. The organization sponsors a 401(k) savings plan and a 457(b) deferred compensation plan totaling more than $400 million in assets for 2,100 employees, most of whom are civil servants who also participate in the state's public pension system.

The plans are overseen by a Deferred Compensation Committee whose primary motivation in hiring a discretionary investment consultant was to allow it to focus on more strategic issues while also implementing changes to the investment line-up that could benefit participants.

The challenges

The plans' core investment menu primarily contained actively managed funds, including seven U.S. equity options. There were more options than necessary to cover the full risk/reward spectrum, and participants who wanted to use passively managed funds did not have the ability to create a diversified portfolio.

The plans did not offer target date funds. Rather, a series of three risk-based portfolios ranging from conservative to aggressive was used. The committee members wanted to revisit this decision, but first they wanted to ensure that off-the-shelf target date funds could adequately reflect the access employees had to the state's defined benefit (DB) plan. Heavy emphasis was placed on the selection of the qualified default investment alternative (QDIA) because the committee was interested in conducting a full plan re-enrollment into the new QDIA. The committee's view was that most of the participants were not experienced or well-informed investors. Given this, the committee believed the best way to help participants determine the most appropriate asset allocation was to guide most of them to professionally managed, age-appropriate portfolios that automatically de-risked over time, unlike the current risk-based funds where the participants were responsible for de-risking over time.

The plans originally offered four investment tiers:

1. Risk-based funds – Conservative, Moderate and Aggressive
2. Passive core options – Fixed income and S&P 500
3. Active core options
4. Specialty options – Real return, emerging markets and a brokerage window

Some of the challenges

- More equity options than necessary
- No target date funds
- Investment menu needed simplification
- Selection of QDIA
- Internal resource constraints
- Needed to re-evaluate capital preservation option

To simplify the existing menu of single-manager mutual funds, the committee wanted to explore multiple-manager investment options that could help provide downside risk management. White-labeling the investment menu by using asset class names instead of fund brand names was also a consideration to make it easier for participants to understand each fund's investment strategy and allocate to it properly.

The committee believed in the potential for active management to add value over time and was committed to maintaining a well-defined mix of actively and passively managed options. However, specific to its oversight responsibility of the actively managed funds, the committee believed they lacked the internal resources to implement investment decisions on a timely basis.

The committee also wanted to re-evaluate stable value as the choice of a capital preservation option in light of the recent dramatic decline in interest rates.

The strategic solution

Russell Investments presented a comprehensive DC plan structure review, which included education about current DC trends in menu design. The committee's investment beliefs were aligned with our recommended baseline investment structure, which includes three tiers and a streamlined active and passive mirror for the core menu. From a core menu standpoint, the best way to help inexperienced participants is to structure the core menu to simplify their decision-making process.

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The Committee agreed to collapse the core investment menu down to three U.S. equity options and two fixed income funds, eliminate the target-risk funds and reenroll all participants into the age-based target date funds, which resulted in most assets moving to the plan's QDIA. Stable value was retained, supported by our analysis of the benefits of stable value relative to other capital preservation options.

The decision to hire Russell Investments as the delegated investment consultant resulted in several additional enhancements to the DC plans.

These enhancements included:

1. Re-tiering the DC plan menu
2. Consolidating style-based U.S. equity funds (i.e., growth and value) into core multi-manager/multi-style funds
3. Consolidating emerging markets and developed markets equity
4. De-branding the investment menu by using asset class names instead of brand name funds
5. Re-enrolling participants into the new target date funds
6. Adding more passively managed options

Accordingly, responsibilities and tasks that were once the purview of the committee and investment staff were transferred to Russell Investments as the outsourced chief investment officer (OCIO) for both the 401(k) and 457(b) plans. The Investment Policy Statement, which governs the committee's responsibilities, was also updated by Russell Investments to reflect the external resources gained through the OCIO arrangement and the new balance of roles and responsibilities to ensure all parties remain fully aligned and accountable.

Exhibit 1: Simplifying options while increasing investment manager diversification

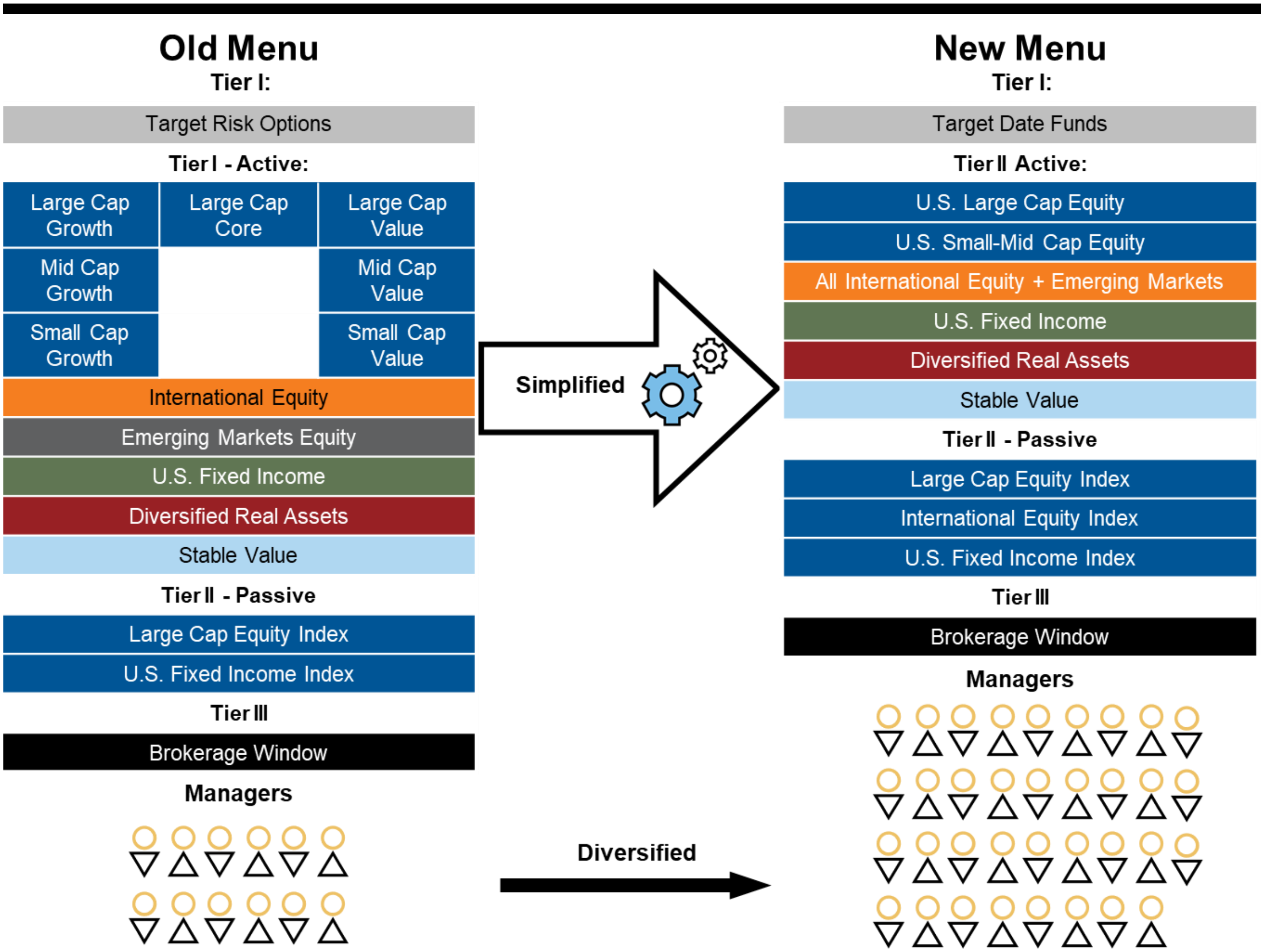
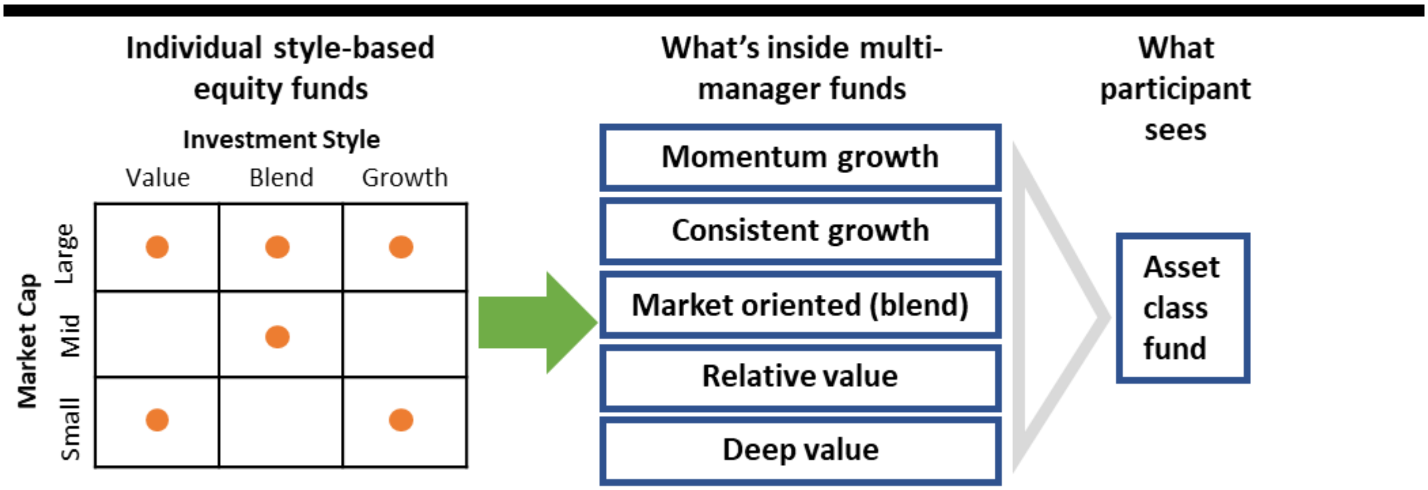


Exhibit 2: Consolidating style-based equity funds into core multi-manager funds



Results

The “less-is-more” investment menu accommodates the investment needs of most plan participants. The resulting plan structure simplifies participant investment decisions and maintains economies of scale with plan assets invested in fewer options. The multiple-manager funds allow complexity to be embedded into the funds, rather than being presented directly to participants, resulting in increased diversification with fewer fund options. The fiduciary oversight provided by Russell Investments shifts the responsibility for selecting underlying fund managers away from the committee and ensures constant monitoring of investment managers and asset allocations.

The enhanced plan was delivered at a lower price tag. The investment fees paid by participants were reduced by $921,000 annually, which represented a 47% reduction in cost. Custom communications were created by the plans’ recordkeeper together with Russell Investments to explain the changes and to highlight the benefits of the new plan design to participants.

QUESTIONS?

Call Russell Investments at **855-771-2966**
or visit **russellinvestments.com/DC**

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