

Opportunities Amid Challenges ...

Finding the Silver Lining



WESTERN PENSION & BENEFITS CONFERENCE
SPRING SEMINAR - Wednesday April 22, 2009



Investment Policies, Performance Monitoring & Market Turmoil

1:15 pm – 2:15 pm

Moderated by:
Norman S. Milks
Partner

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Today's Speakers

Marlow B. Kee

Director of Finance

Marlow is the Director of Finance for PATH in Seattle. Prior to joining PATH, he was the Director of Finance and Systems at the University of Washington School of Medicine in Seattle. Earlier he was the Executive Director for the Department of Internal Medicine at Washington University in St. Louis. He is a CPA and earned an MBA from the University of Missouri – Columbia. He has over 20 years of experience in the non-profit, university and health care settings. He serves on the Boards of Health Alliance International, Lifelong AIDS Alliance and Village Reach.



Valentina Zackrone, SPHR

HR Director

Valentina is the Director of Human Resources with Pacific Medical Centers. Prior to joining PacMed, she worked in a variety of HR roles for Holland America Lines (subsidiary of Carnival Corporation) and other international employers. Her key areas of expertise are Global Compensation and Benefits, and HRMS systems. She is an active member of SHRM and WPBC and holds a dual Master's degree in Teaching and Linguistics from the University of St. Petersburg. She serves on the Board of Directors for Eastside Baby Corner.



Douglas M. Love, JD

Partner

Doug specializes in Employee Benefit law in the Seattle office. After graduating from Pacific Lutheran University, he earned a JD and an MBA from the University of Washington. He is a member of the Seattle Pension Roundtable and Bethany Lutheran Church on Bainbridge Island.



Mary Ellen Mullen, CFA

Principal

Bridgebay Consulting LLC

Mary Ellen provides investment consulting services to institutions, focusing on treasury and retirement plans. She graduated from Mt. Holyoke College and earned an MBA in Finance from the University of Washington. She has over 25 years of institutional investment experience and is a member of the Investment Committees of the Board of the Pacific Science Center and the City of Bellevue. She is Treasurer of the Western Pension & Benefits Conference, Seattle Board and a member of the CFA Institute.



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Investment Policies, Performance Monitoring & Market Turmoil

Agenda

- I. Legal Framework
- II. Investment Principles
- III. Plan Sponsor Perspectives
 - A. PATH
 - B. Pacific Medical Centers

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Legal Framework

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- ▶ **Unlike Funding Policy, Investment Policy Statement (“IPS”) Not Expressly Required by ERISA**
- ▶ **However, Dept. of Labor (“DOL”) believes IPS is required to meet ERISA fiduciary duties under ERISA Sections 402, 403 and 404**
- ▶ **ERISA Reg. Section 2509.94-2 sets forth DOL’s views on Proxy Voting, Investment Policy Statements and Shareholder Activism**

▶ Proxy Voting

- ▶ IPS States Who Votes Proxies
- ▶ Named Fiduciary (e.g., Employer, Pension Committee) duty to monitor actual voting (not just general voting procedures), documentation of same

▶ **What is an IPS?**

- ▶ Gives fiduciaries responsible for investment
 - ▶ Guidelines, general instructions concerning types or categories of investment management decisions
 - ▶ Not directions to buy or sell specific securities at a specific time

- ▶ **Fiduciary must follow IPS to extent consistent with ERISA**
- ▶ **Named Fiduciary must still prudently select and monitor investment manager's performance, documentation of same**
- ▶ **Policy must consider funding and liquidity needs in addition to prudence, diversification**

▶ **Two Edged Sword**

- ▶ If do not have one, claim not prudently managing investments
- ▶ If have one and do not follow it, claim breached fiduciary duty
- ▶ Thus, only put terms in policy you intend to follow

- ▶ **Who is subject to IPS?**
 - ▶ Not directed trustees
 - ▶ Not mutual fund managers
 - ▶ Yes Investment Managers
 - ▶ Yes named fiduciary that picks investment funds (often the same pension committee that adopts the IPS)

▶ Content of IPS

▶ Investment goals

- ▶ ERISA 404(c)
- ▶ Broad mix
- ▶ Large, Small, Value, Growth, Foreign
- ▶ Bond Ratings
- ▶ Mutual funds, individual stocks and bonds
- ▶ Brokerage windows
- ▶ Prohibitions (e.g., options, short sales, securities lending, junk bonds)

▶ **Expectations**

- ▶ Rate of investment return
- ▶ Risk (volatility, deviations)
- ▶ Benchmarks
- ▶ Comparison to like investments (e.g., must be in top quartile of similar funds)
- ▶ Timeline of comparison (e.g., 3 years)

▶ Treatment of Struggling Funds

- ▶ When put on watch list
- ▶ When remove fund from plan
- ▶ Foregoing should be guidelines, not strict rules, goal is to avoid paralysis but not box self in

▶ Hecker v. John Deere and Fidelity

- ▶ Class action asserting excessive plan investment fees and undisclosed revenue sharing
- ▶ Case dismissed because plaintiffs failed to state a claim
 - ▶ Case in 7th Circuit (which favors employers)
 - ▶ We are in 9th Circuit (employee friendly)

- ▶ Fidelity Trust was directed trustee and record keeper
- ▶ Fidelity Research was investment advisor to Fidelity mutual funds
- ▶ Plan had 26 core funds, including 23 Fidelity mutual funds, 2 other Fidelity-managed funds, and Deere stock fund
- ▶ Plan had brokerage window, access to 2,500 mutual funds

- ▶ Expense ratios ranged from .07% to 1.0%, were disclosed
- ▶ Not disclosed was Fidelity Research's sharing of part of its compensation from mutual funds with Fidelity Trust
- ▶ Participants controlled investment of their own accounts

▶ **Court holds:**

- ▶ ERISA 404(c) does not require disclosure of revenue sharing
- ▶ Participants only need to know total investment fees, not how fees allocated
- ▶ Court does not determine if named fiduciary of 404(c) plan must prudently select and monitor funds

- ▶ Mutual funds were retail, meaning fees had to be reasonable to attract investors
- ▶ Fees need not be lowest (as lowest fee funds might have other problems)
- ▶ With 2,500 funds to choose from and investment fees from .07% to 1.0%, participants could find funds with reasonable risk/return characteristics net of fees

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BridgebaySM
Investment Consulting Services

Investment Principles

Mary Ellen Mullen, CFA
Principal

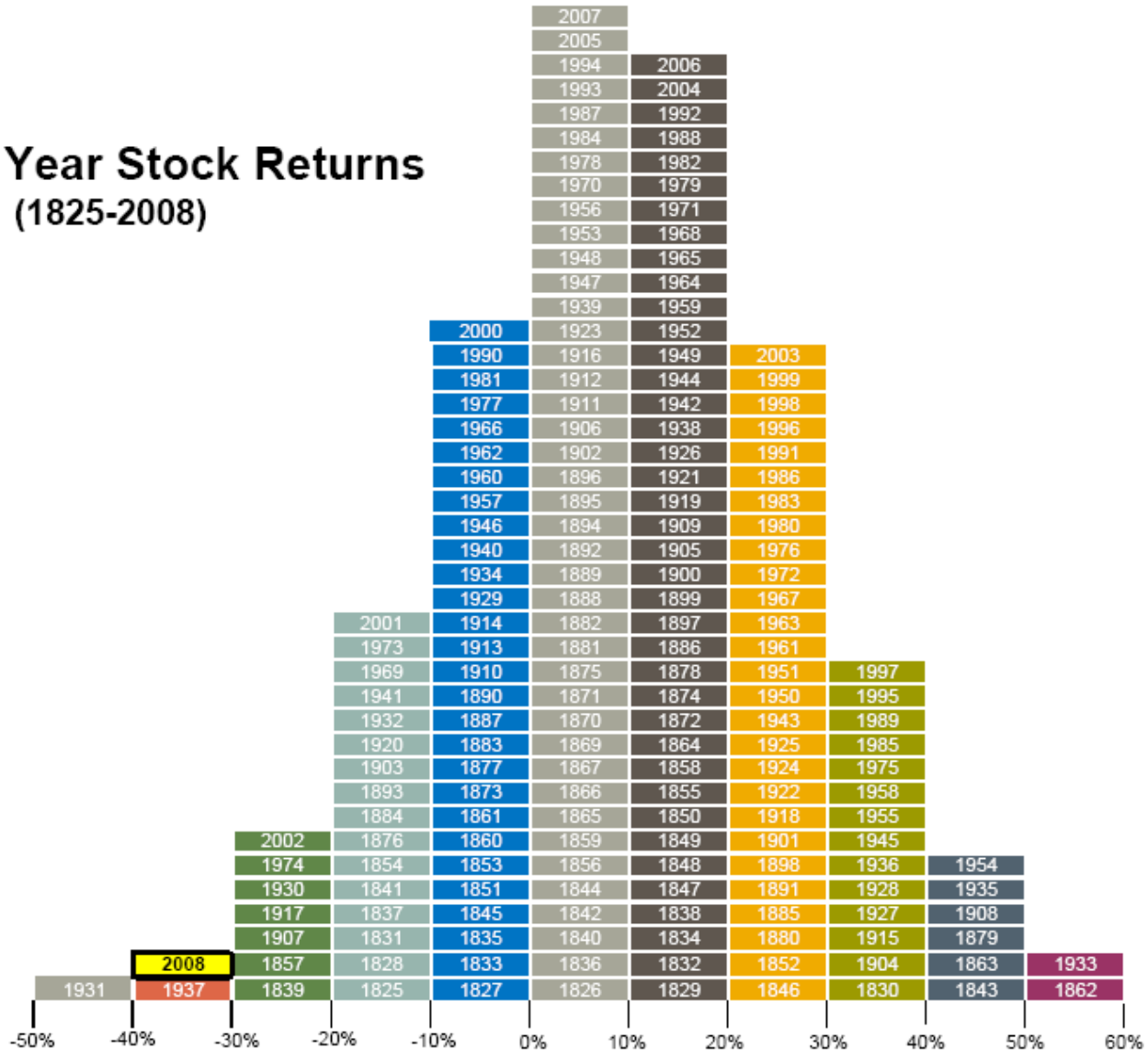
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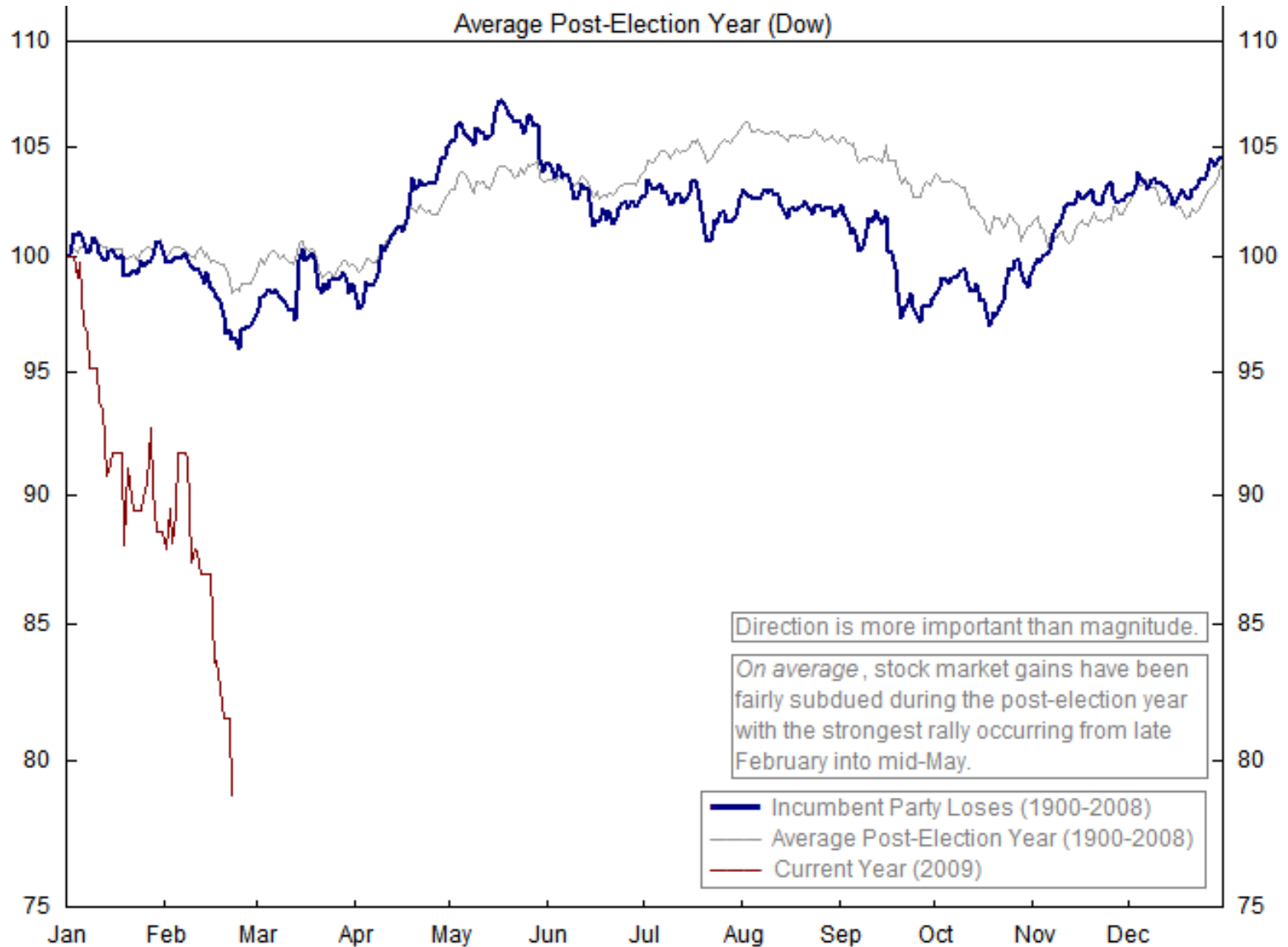


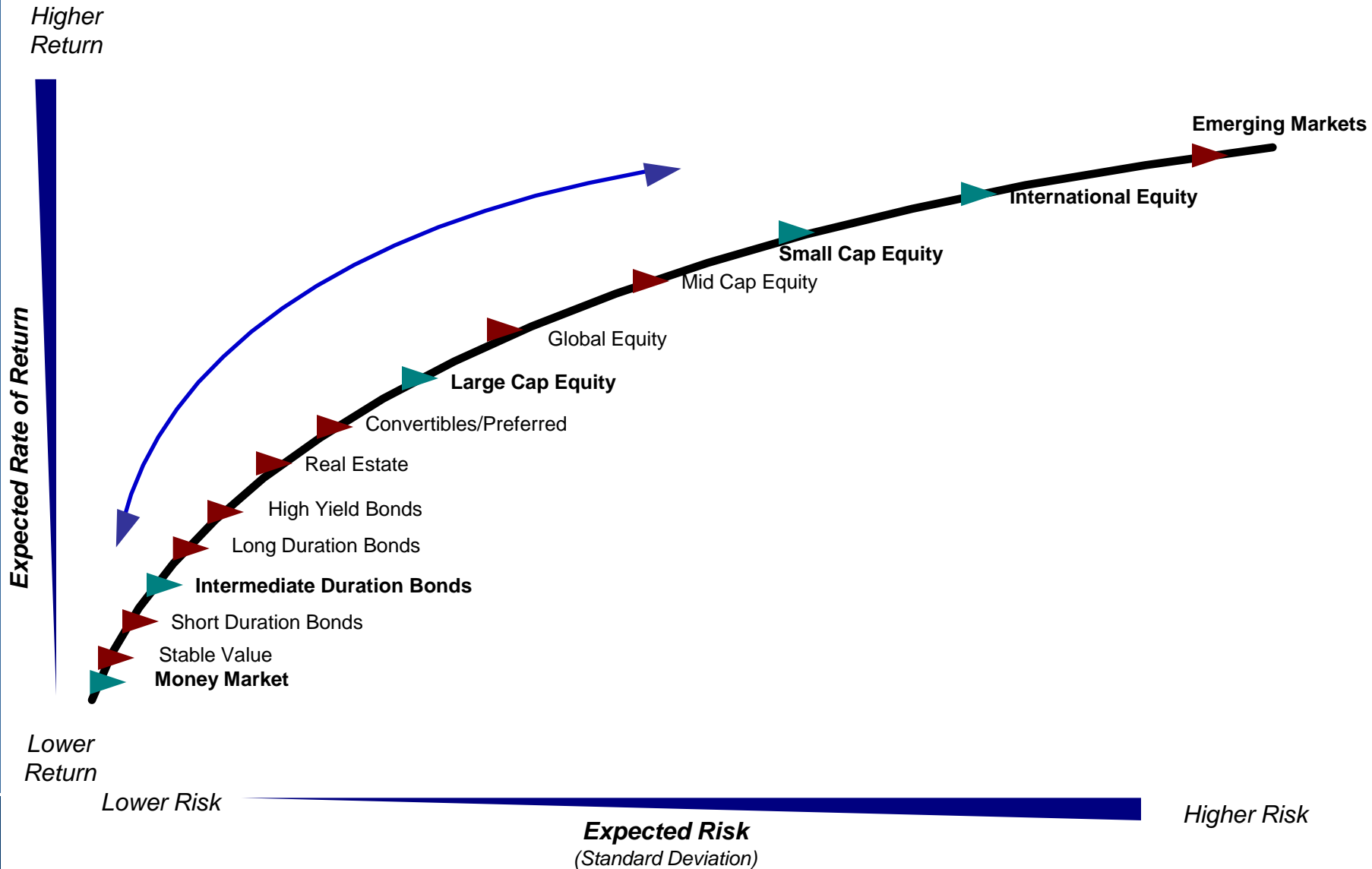
History of US Stock Market Returns

Calendar Year Stock Returns (1825-2008)



Source: Robert Shiller, FMRCo (MARE) as of 12/31/2008.







Correlation Coefficients: 10 Years

12/31/98 – 12/31/08

	Large Cap ¹	Small Cap ²	Large Value ³	Large Growth ⁴	EAFE ⁵	Bonds ⁶	EME ⁷	Hedge Funds ⁸	Real Estate ⁹
Large Cap	1.00	0.91	0.91	0.94	0.88	-0.52	0.87	0.59	0.49
Small Cap		1.00	0.87	0.84	0.80	-0.51	0.81	0.50	0.38
Value			1.00	0.72	0.80	-0.39	0.77	0.53	0.53
Growth				1.00	0.81	-0.54	0.84	0.57	0.40
EAFE					1.00	-0.42	0.87	0.69	0.51
Bonds						1.00	-0.42	-0.21	-0.23
EME							1.00	0.61	0.45
Hedge Funds								1.00	0.69
Real Estate									1.00

¹ S&P500

² Russell 2000

³ Russell 1000 Value

⁴ Russell 1000 Growth

⁵ MSCI EAFE

⁶ Barclays Aggregate

⁷ MSCI Emerging Markets

⁸ CS/Tremont Multi-Strategy World

⁹ NCREIF National Property Index

Source: Barclays, CS/Tremont, JP Morgan, MSCI, NCREIF, Russell, S&P



Calendar Year Total Returns

1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
40.4	65.0	29.1	59.9	18.4	74.8	8.1	37.6	35.3	34.8	35.0	66.4	49.7	13.9	32.1	56.3	31.6	34.5	35.1	39.8	5.2
28.6	38.3	9.0	46.1	17.4	32.9	5.3	37.0	33.9	33.4	28.6	40.9	26.4	8.4	10.3	47.3	26.0	25.6	32.6	32.7	-26.4
27.9	34.7	-1.3	41.7	14.9	19.7	3.2	36.6	23.0	28.7	20.3	33.8	11.6	4.5	3.8	39.2	20.7	14.0	26.9	11.6	-33.8
25.0	31.7	-3.1	39.2	14.6	18.9	2.2	28.4	21.9	22.4	13.5	27.3	8.0	2.5	-1.9	37.1	18.3	12.2	22.3	11.4	-36.3
23.6	24.2	-4.4	35.7	11.4	18.7	1.3	20.5	21.6	20.3	8.7	21.3	-3.0	-2.4	-6.0	31.1	17.3	6.9	18.4	7.0	-37.0
16.6	16.3	-8.8	30.5	7.6	16.7	-1.0	20.3	16.5	13.3	3.0	21.0	-5.1	-4.3	-15.2	31.0	16.9	5.2	15.8	5.5	-37.7
13.5	14.5	-10.6	25.4	7.4	10.1	-1.8	18.5	11.3	9.7	-2.5	6.7	-9.1	-11.9	-15.7	28.7	10.9	4.9	11.8	2.2	-38.4
13.4	10.8	-15.4	16.0	5.2	9.7	-1.9	15.3	6.4	2.1	-17.5	2.5	-14.0	-19.6	-20.5	28.1	10.9	4.6	9.5	-1.0	-43.1
12.0	8.8	-19.5	12.5	4.4	3.7	-2.9	11.6	6.0	-11.6	-25.3	-0.8	-22.4	-21.2	-22.1	20.7	6.9	2.7	4.3	-1.6	-46.5
7.9	2.3	-23.2	-6.1	-11.8	-12.3	-7.3	-5.2	3.6	-14.1	-35.7	-4.6	-30.6	-31.9	-28.0	4.1	4.3	2.4	-15.1	-15.7	-53.2

Large Cap Stocks	Growth Stocks	Developed Country Stocks	High Yield Bonds	Real Estate Stocks
Small Cap Stocks	Value Stocks	Emerging Markets Stocks	Investment Grade Bonds	Commodities

You cannot invest directly in an index. See appendix for important index information. Past performance is no guarantee of future results. **Large Caps** – S&P 500 Index; **Small Caps** – Russell 2000 Index; **Growth** – Russell 3000 Growth Index; **Value** – Russell 3000 Value Index; **Developed Country Stocks** – MSCI EAFE Index; **Emerging Markets** – MSCI Emerging Markets Index; **High Yield** – Merrill Lynch U.S. High Yield Master II Index; **Investment-Grade Bonds** – Barclays Capital Aggregate Bond Index; **Real Estate** – NAREIT Equity-Only Index; **Commodities** – S&P GSCI Commodity Index. Source: FMRCo (MARE) as of 12/31/08.

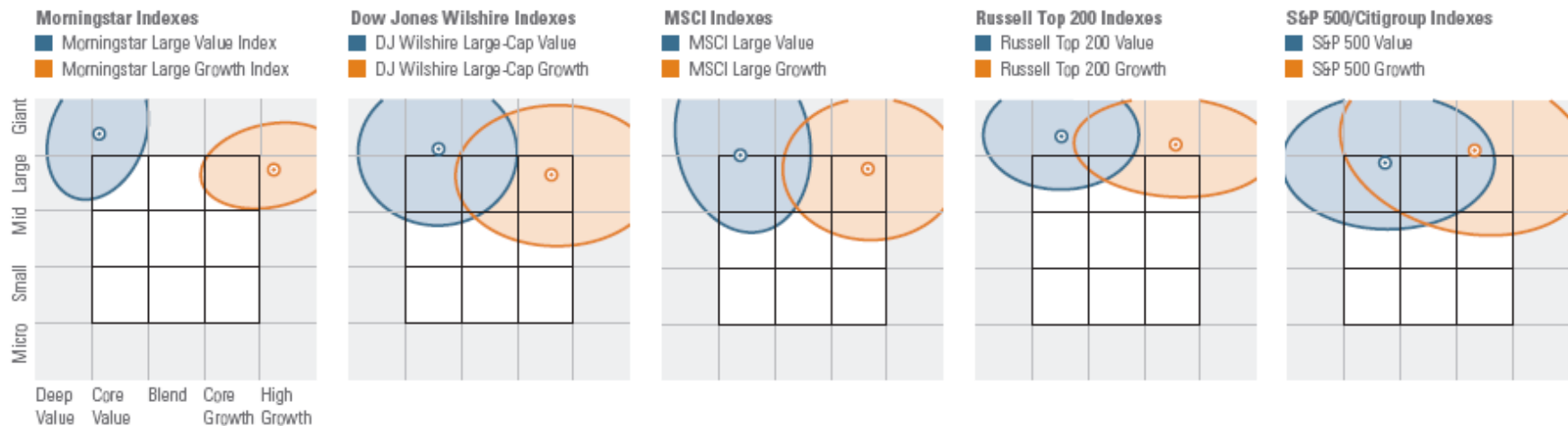


▶ 2 Benchmark Types

- 1. Market Index – relative to unmanaged**
- 2. Peer Universe – comparison to competitors**



Large Cap Domestic Equity Style Benchmarks Ownership Zones



HIGHLIGHTS

Despite shared labels, each large cap index series differs in returns, volatility, overlap, composition, philosophy, reconstitution timing, launch date and length of history. Value Indexes vary by Price/Earnings, Price/Book and Price/Sale ratios and Dividend Yields. Growth Indexes vary by Earnings, Book Value, Sales and Cash Flow Growth.



January 1991 – March 2008



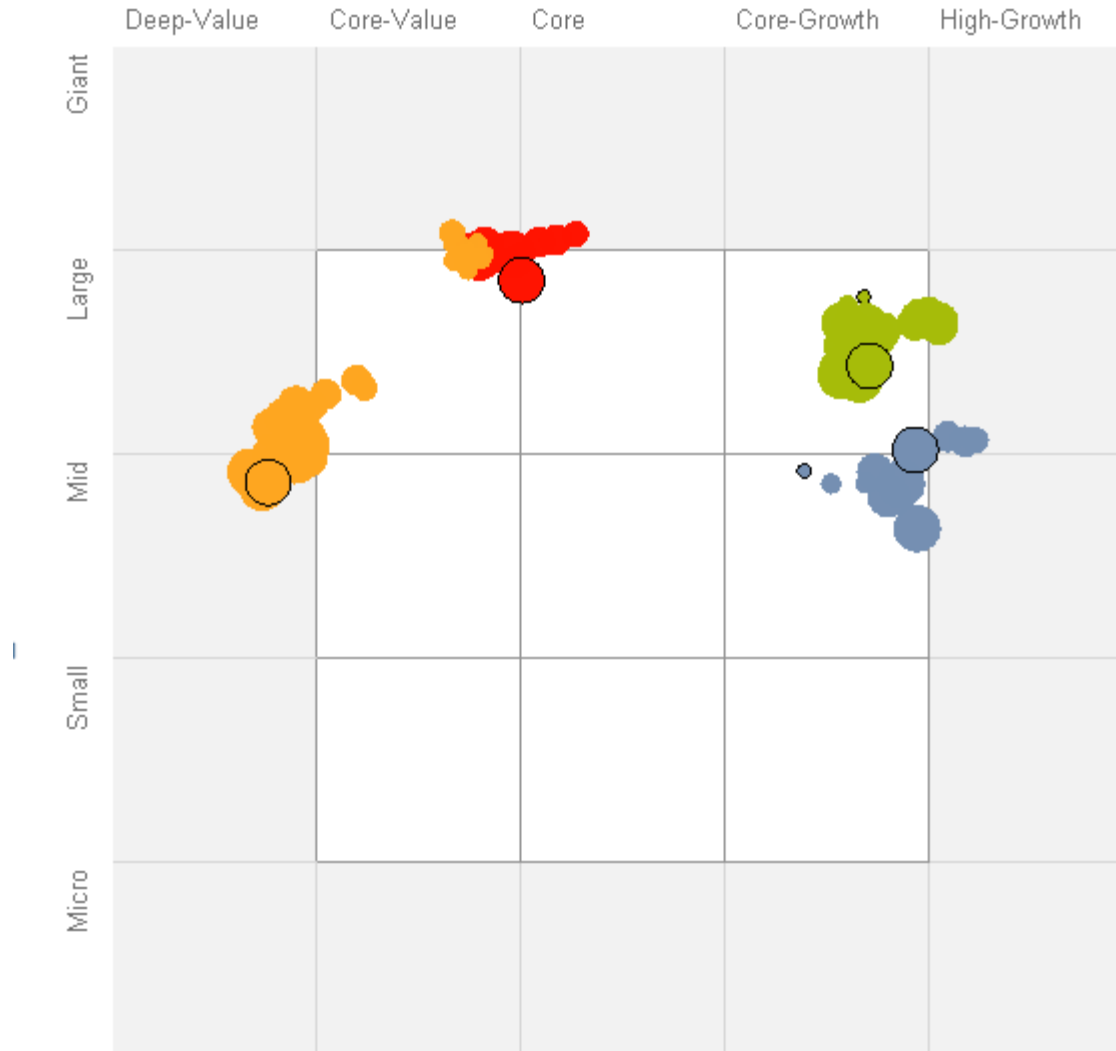
Source: Morningstar



Weightings 9/30/08	RJ/CRB	S&P GSCI	DJ-AIG
Energy	39%	76%	35%
Grains	13%	11%	19%
Industrial Metals	13%	6%	18%
Precious Metals	7%	2%	10%
Softs	21%	3%	9%
Livestock	7%	3%	9%
	100%	100%	100%
Components	19	24	19
Live Date	2005	1991	1998
Historic Date	1994	1970	1991
Methodology	Fixed Target	World Production	Liquidity (2/3) World Production (1/3)
Rebalancing	Monthly	Annually	Annually
Characteristics	4 Tiers: Oil, Economic, Liquidity, Diversification	Energy Heavy	2-33%/Group 15%/Individual



Holdings Based Style Trail





Principal Preservation Options

+

-

1. Money Market Mutual Funds

1. Strong Government Support
2. SEC Regulation (Rule 2a-7)

1. Low Relative Returns
2. Unresolved Toxic Assets

2. Bank STIFs

1. Trust Protection (12 CFR 9.13(b))

1. FDIC pass-through insurance (12 CFR 330.14)

2. FDIC pass-through

2. Transparency

3. Stable Value Funds

1. All-time High Yield Advantage vs. Money Funds

1. Book Value/Market Value Ratio Declining

2. Plan Economics

2. Wrap Capacity Tight

3. Insurance Guaranty Association Potential (RCW 48.32A)

3. No State or Federal Government Guarantee

Money Market Fund Assets

As percentage of S&P 500 Index Total Market Capitalization





- ▶ **United States Department of the Treasury – Temporary Guarantee Program**
- ▶ **Exchange Stabilization Fund (“ESF”)**
- ▶ **Eligibility**
 - ▶ Investment Company Act Rule 2a-7
 - ▶ Each Investment Company Registrant (1940 Act “811” Number)
- ▶ **Fund’s Investment Company Board Applies**
 - ▶ Templates: Demographic, Portfolio Holdings, Shadow Pricing
- ▶ **Program Participation Payments:**
 - ▶ Initial – 1.0-1.5 basis points based on NAV
 - ▶ Extension - ≥ 99.75 @ 1.5 basis points, ≥ 99.50 @ 2.3 basis points
- ▶ **Covers:**
 - ▶ Shares Outstanding on September 19, 2008
 - ▶ Termination Date: December 18, 2008 & April 30, 2009, September 18, 2009 Extension
 - ▶ Many Treasury funds are ending participation April 30, 2009
 - ▶ Single Ownership Structure
 - ▶ \$3 Trillion of Fund Assets as of 3/31/09

<http://www.treasury.gov/press/releases/archives>



- ▶ **FDIC Pass Through Insurance – 12 CFR 330.14**
- ▶ **Employee Benefit Collective Short Term Investment Funds - 12 CFR 9.18(a)(2)**

- **Rules:**

- \$250,000 per Participant
- Institution's deposit account records must reflect employee benefit plan ownership.
- Ascertainable participants' beneficial interests

- **Coverage**

- Based on each participant's share of the plan. Plan participants normally have different interests in the plan
- Insurance coverage NOT = number of participants X \$250,000

- **Calculations:**

- Determine which participant has the largest share of the plan assets, then divide \$250,000 by that percentage. e.g. if a plan has 20 participants, but 1 participant has an 80% share of the plan assets, the most the plan can have on deposit in a single bank and still remain fully insured is \$312,500. ($\$250,000 / .80 = \$312,500$)

- **Example — Employee Benefit Plan that Qualifies for Pass-Through Coverage**

Account Title				Balance
Happy Pet Clinic Benefit Plan				\$700,000
Plan Participants	Plan Share	Share of Deposit	Amount Insured	Amount Uninsured
Dr. Todd	35%	\$245,000	\$245,000	\$0
Dr. Jones	30%	\$210,000	\$210,000	\$0
Tech Evans	20%	\$140,000	\$140,000	\$0
Tech Barnes	15%	\$105,000	\$105,000	\$0
Plan Total	100%	\$700,000	\$700,000	\$0



Structures:

1. **Separate Managed Account**
2. **Commingled Fund**

Contract Types:

1. **Guaranteed Interest Contract (GIC)** – insurance company owns in general account.
2. **Separate Account Contract** – insurance company owns, sets assets aside in a separate account solely for the benefit of the specific contract holder.
3. **Synthetic GIC** - Plan sponsor and participants own the underlying invested assets supporting the fund. Interest rate volatility protection by contracts (wraps) from banks and insurance companies.

Risk Events:

1. **Credit** - Security Defaults and Downgrades
2. **Corporate** – Employer driven, i.e. early retirement programs, layoffs, bankruptcy

Bankruptcy:

1. **Plan Sponsor** – considered a “Corporate Event”
2. **Stable Value Fund Issuer** – claim at policyholder level, in front of general creditors
3. **Wrap Issuer** – provides \$1.00 pricing, Plan owns portfolio

Regulators:

1. **Banks** – Office of the Comptroller of the Currency (OCC)
2. **Insurance Companies** – Various States, e.g. Washington State Office of the Insurance Commissioner
3. **Commingled Funds** – SEC, Investment Company Act

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Plan Sponsor Perspective

Marlow B. Kee
Director of Finance

PATH

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Programs for Appropriate Technology in Health

PATH is an international nonprofit organization that improves the health of people around the world.

PATH started in **1977** with a **Ford Foundation** grant of \$250,000. In 2008, total program projects exceeded \$250 million.

PATH's Diverse Funding Sources – include the US Government; other governments, other nonprofit organizations, and multilateral agencies such as the World Health Organization; individuals; and interest from investments.

PATH maintains the highest standards for efficiency and transparency

- ▶ **Forbes' Top 200 Charities** - high marks for keeping operating costs low and channeling supporters' investments into the real work of improving global health.
- ▶ **Charity Navigator** (America's largest independent evaluator of nonprofit organizations) - four stars for financial stewardship, five consecutive years!

Source: www.path.org



**“To improve the health
of
people around the world by
advancing technologies,
strengthening systems,
and
encouraging healthy behaviors.”**



- ▶ **Improves accuracy**
- ▶ **Reduces over-treatment and drug resistance**
- ▶ **Shortens illness**



- ▶ **Insecticide-treated nets**
- ▶ **Indoor residual spraying**
- ▶ **Malaria in pregnancy**
- ▶ **Better malaria drugs**





▶ Retirement Plan History

- Inception 1981
- Single Defined Contribution Plan
- Money Purchase Pension Plan Transferred into 401(k)
- Default Fund - Primarily Employer % of Salary Contribution
- Adopted Target Date Default Option in 2007
- Hardship Withdrawals vs. Loans



Key Plan Metrics

- **\$33 million at 3/31/09**
- **19 Core Funds + Target Date Series**
- **404 (c) Intent**
- **Mutual Funds - liquidity, diversification and cost efficiency**
 - ❑ **At least \$100 million in assets under management**
 - ❑ **Well-diversified (Don't like to see concentrations in a single name, Specialty Funds)**
 - ❑ **Minimum of 5 years of verifiable investment performance, unless specifically exempted by the Administrative Committee.**
- **Approx. 600 participants with balances**
- **Central Payroll**
- **World Headquarters in Seattle, WA**
 - ❑ **Domestic locations include Washington, DC and Bethesda, MD**



- **Administrative Committee**
 - Fiduciary
 - CEO, COO, Director of Finance
- **Investment Advisory Committee (IAC)**
 - Chair
 - 10 Employee Volunteers
 - Ex-Officio
- **Investment Consultant**
 - Quarterly Meetings with Investment Advisory Committee (IAC)
 - Ongoing Resource
 - Independent, “Prudent Expert” per ERISA
- **Investment Fund Managers**
 - Actively Managed and Passively Managed
 - Bundled Provider’s Family and Outside
- **Bundled Provider (Trustee, Recordkeeper)**
- **Auditor**
- **Attorney**



MULTI-FACTOR MODEL SUPPORTS REVIEW & ACTION PROCESS STEPS



1. Performance vs. Investment Objectives

- Market Index Benchmark > 1, 3, 5, 10 year periods

2. Performance vs. Investment Objectives

- Peer Universe Benchmark > 1, 3, 5, 10 year periods

3. Style Drift vs. Investment Objectives

- Check for inconsistency

4. Portfolio Manager Changes

5. Fund Family Organizational Changes

6. Legislative and Regulatory Changes

7. Unique Plan Characteristics – Socially Responsible Investments

8. Fund Operations and Economics

9. Additional Provider Services



- ▶ **An Investment Policy Statement that sets a framework for a rational, prudent process is a Fiduciary's best protection.**
- ▶ **Creates a high level of transparency that meets ERISA standards.**
- ▶ **IPS sets the standard for a formal due diligence process that can withstand the scrutiny of the participants and regulators.**
- ▶ **IPS establishes the fiduciary roles, responsibilities, and constraints that maintain the plan compliant.**

Never assume that your plan participants are not watching!

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Plan Sponsor Perspective

Valentina Zackrone, SPHR

HR Director

Pacific Medical Centers

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- ▶ **PMC Overview/ History**
- ▶ **Retirement Program Overview**
- ▶ **Investment policy dos and don'ts**
- ▶ **Investment performance monitoring and reaction to market turmoil**
- ▶ **Questions & Answers**



Beacon Hill Tower



First Hill



Northgate



Renton



Totem Lake



Women's
Diagnostic
Center



Lynnwood



Federal Way



Sleep Center

- ▶ **Founded in 1933**, PMC has a long and rich history. The historic Beacon Hill Tower was the first U.S. Public Health Service (PHS) Hospital in the Seattle, assigned care of injured war veterans and performed health exams for newly arriving immigrants.
- ▶ Effective July 1, 2003, **PMC converted to a not-for-profit 501(c)(3) corporation.**
- ▶ Today **PMC is a multi-specialty group practice with 9 locations and over 120 physicians, 60% primary care and 40% specialists.**
- ▶ **Key Company Metrics:**
 - ▶ Patient Satisfaction **80th % nationwide**
 - ▶ Physician Satisfaction **59th % nationwide**
 - ▶ Achievement of quality targets **68 % breast cancer screening**
67 % colon cancer screening
 - ▶ 7 out of 100 Seattle Top docs practice at PMC
 - ▶ 92% of Employees would recommend PMC as employer and healthcare provider to their family and friends
- ▶ **PacMed accepts all major insurance coverage**

- ▶ **DC Plans: 401a Money Purchase Plan and 403b Tax-Deferred Investment Plan**
- ▶ **401a company contribution based on formula**
- ▶ **403b employee contribution only (up to IRS maximum)**
- ▶ **Both Plans managed as ERISA Plans since inception (404c intent)**
- ▶ **Trust Committee, Independent Investment Advisor, ERISA Counsel, Auditors**
- ▶ **On-going participant communication: over 50% responded “I understand the Benefit well”**
- ▶ **76% participation in 403b as of 12/31/08 (without auto-enrollment feature)**
- ▶ **Almost 700 active plan participants**



- ▶ **19 funds (actively and passively managed, broad range of risk and return spectrum)**
- ▶ **Lifestyle/ risk based funds**
- ▶ **QDIA – risk based model**
- ▶ **Loans and hardship withdrawals**
- ▶ **SDBA/ Self-directed brokerage accounts**
- ▶ **Ability to change % and fund allocation bi-weekly**
- ▶ **Prospectus and fund performance information available on line (PMC customized website)**
- ▶ **Morningstar retirement planning tools + individual retirement planning meetings**
- ▶ **User friendly on-line interface, enhanced reporting functionality, direct link to SDBA vendor**



▶ Do:

- ▶ Consider the policy in conjunction with other documents addressing Plan Governance and Operation: Plan document, Trust Committee charter and Vendor Service Agreements
- ▶ Consult both your ERISA counsel and Investment Advisor on changes/ revisions
- ▶ Consider special issues (e.g. SDBA accounts and the need to restrict investment options)
- ▶ Be intentional about the level of detail covered in the policy (e.g. defining roles and responsibilities)
- ▶ Use the policy as framework for investment performance monitoring discussions (macro-level picture/ place in portfolio & overall portfolio performance, benchmarking methodology)
- ▶ Follow the process for periodic review of the policy and its components



▶ Don't:

- ▶ Make redundant or conflicting statements (e.g. investments offered vs. impermissible investments)
- ▶ Make commitments you are not able to keep
- ▶ Make statements not relevant to your Plan (e.g. employer stock)
- ▶ Fail to outline the process for periodic service provider review
- ▶ Forget about your participants
- ▶ Put the policy on a shelf



- ▶ **Quarterly Trust Committee meetings supplemented by monthly Flash reports and/or conference calls**
- ▶ **In depth analysis of fixed income funds**
- ▶ **Extensive participant communication explaining Trust Committee decisions, including communication from the Executive team and the CEO**
- ▶ **Retirement planning group and individual meetings, intranet communications**
- ▶ **Retirement refresher courses in conjunction with open enrollment**
- ▶ **Personalized outreach to retiring participants and new hires**
- ▶ **Added retirement component to new supervisor/ manager orientation**
- ▶ **Plan design changes to further improve plan design and provide additional benefit to participants**



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Thank you!

Questions?

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