Pathways

Volume IV February 2019

Aon Hewitt Investment Consulting's Newsletter for Retirement Plans

In this Issue

The opinions referenced are as of the date of publication and are subject to change due to changes in the market or economic conditions and may not necessarily come to pass. Information contained herein is for informational purposes only and should not be considered investment advice.

Reflections on 2018 and Planning for What's Next

Welcome to another edition of Pathways! This edition includes insights on capital markets, plan governance, and employee financial wellbeing.

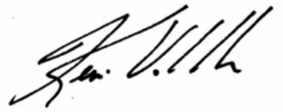
We start the issue with a 2018 year in review and an outlook for 2019, including assessments of the DB corporate, DB public, and DC marketplaces. We also hear from thought leaders in the Townsend Group, an Aon company exclusively focused on real assets, on what makes this commercial real estate cycle different.

Our coverage of governance topics includes articles on how investment fiduciaries should be aware of dividend taxation when choosing between mutual funds and collective investment trust vehicles; how, with an uptick in cybersecurity-related activity associated with Department of Labor audits, plan fiduciaries are increasingly more responsible for cybersecurity; and how fiduciary liability insurance affords critical personal asset protection.

With retirement security in crisis, we understand the desired impacts you hope to make—not only organizationally, but ultimately with your employees and retirees—so we've spent considerable resources analyzing retirement security and financial wellbeing. We're pleased to present an overview of our findings on retirement savings and employees' overall financial wellbeing.

In our next quarter's newsletter, we will explore the role alternative assets might play in a portfolio, in addition to other topics we hope you find pertinent. Please connect with your Aon investment consultant to talk further, and let us know if you have specific topics you would like us to address in upcoming editions.

Thank you,



Kevin Vandolder, CFA
Partner, Defined Contribution Client Practice Leader

Empower Results®

20190218-747708

2018 Year in Review and 2019 Outlook for Retirement Investment Programs

by Kristen Doyle, CFA, Richard Parker, FSA, EA, CFA and Kevin Vandolder, CFA

After a multi-year extended bull market, we now view markets as being in a "transition" environment

The past year was a challenging one in most investment markets, with negative returns in all of the major equity indices and weak returns for bonds, too. Markets are showing a host of risks. After a multi-year extended bull market, we now view markets as being in a "transition" environment—the key features of which include more volatility (which could occur in bouts), risky assets performing less well, markets cycling between optimism and pessimism, and market leadership changing frequently. What should investors do?

As a first step, it is worth confirming whether the investor's existing strategy remains appropriate. If the basis on which the strategy was developed still applies, then it's probably not necessary to make major changes in response to short-term volatility. However, it may be reasonable to consider the following to reflect the changing market environment:

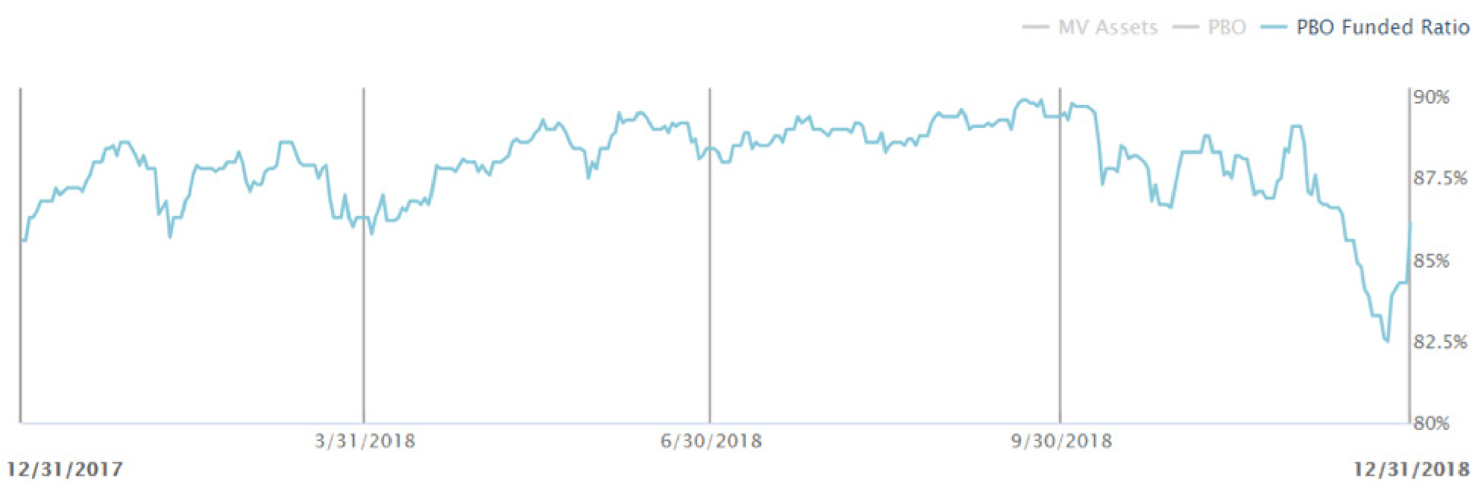
- Adopt more conservative strategies within asset classes
- Test the robustness of diversifiers (specific strategies we find attractive at the beginning of 2019 include non-directional low correlation alternative strategies such as global macro and some CTA strategies, insurance-linked securities, and bank capital relief)
- Rebalance into diversifiers while being more cautious about moving money into equities
- Consider some de-risking if equity risk in portfolios is high
- Put portfolios through stress tests to check for resilience
- Don't buy lots of government bonds yet
- Don't sell risk at any price or cost

While the general experience and outlook above could apply to many types of investors, we also go into greater detail on some specific types of retirement investment programs.

U.S. Corporate DB Pensions

In 2018, U.S. private sector pension sponsors saw their mid-year funded ratios increase to the highest level in nearly five years, according to Aon's Pension Risk Tracker[1] (Exhibit 1). This trend was fueled primarily by discretionary cash funding, positive market performance in Q2, and higher interest rates, which reduced pension liabilities. The increase led many pension sponsors to de-risk their pension programs at an opportune time prior to late-year market turbulence.

Exhibit 1: PBO Funded Ratio of S&P 500 Pension Plans



	31 Dec 2013	31 Dec 2014	31 Dec 2015	31 Dec 2016	31 Dec 2017	31 Dec 2018
PBO Funded Ratio	88.2%	81.3%	81.1%	80.9%	85.6%	84.9%

Source: Aon's Pension Risk Tracker as of 12.31.2018. A Projected Benefit Obligation is an actuarial measurement of what a company will need at the present time to cover future pension liabilities.

[1] *https://pensionrisktracker.aon.com/*

The opinions referenced are as of the date of publication and are subject to change due to changes in the market or economic conditions and may not necessarily come to pass. Information contained herein is for informational purposes only and should not be considered investment advice.

20190218-747708

2018 Year in Review and 2019 Outlook for Retirement Investment Programs (cont'd.)

Sponsors that de-risked significantly during the year likely fared better by reducing the impact of poor market performance in late 2018. Sponsors that retained equity and interest rate risk into late 2018 likely saw their funded ratios fall below previous high watermarks.

Key developments among Aon's discretionary clients in 2018 included:

- 6% reduction in return-seeking asset allocations[2]
- 14% increase in hedge ratios[2]
- 50 pension risk transfer deals[3]

The key challenge for pension sponsors in 2019 will be to manage through the transitional phase in global markets. In this environment, we expect sponsors to further tailor their pension risk management strategies to their goals.

We therefore expect continued emphasis on customized hedging strategies that focus on managing end-game risks.

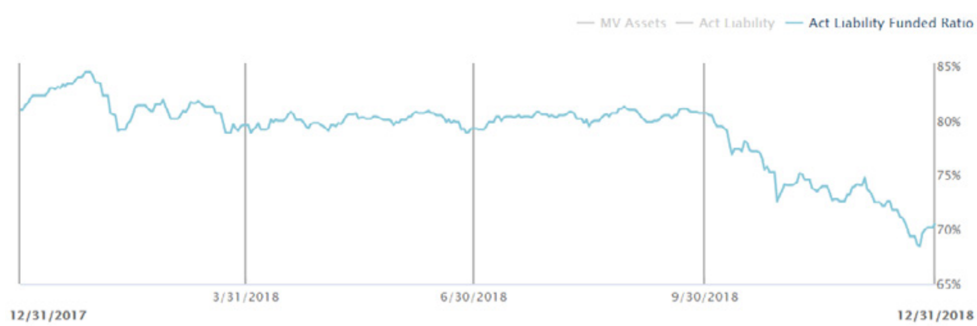
Short-term pension goals like settlements are susceptible to short-term market volatility, since a significant market swing in the time leading up to a settlement transaction could have a direct cash consequence. We therefore expect continued emphasis on customized hedging strategies that focus on managing end-game risks.

Over the long term, we continue to favor diversified return sources and dynamic implementation based on sponsor risk preferences and market conditions.

Exhibit 2: Aon U.S. Discretionary DB Client Average Results During 2018 ($-Weighted)

Characteristics	12/3/17	6/29/18	12/19/18
Sample Size	157	163	171
Funded Ratio	83%	88%	87%
Return-Seeking Asset Allocation	48%	45%	42%
Interest Rate Hedge Ratio	46%	57%	60%

Exhibit 3: Funded Ratio of Average U.S. Public Pension Plans During 2018 (market value of assets divided by actuarial accrued liability)



Source: Aon's Pension Risk Tracker as of 12.31.2018.

U.S. Public DB Pensions

Exhibit 3 shows how the funded ratio moved throughout the year for the universe of public defined benefit plans, going from about 81.0% at the beginning of 2018 to 70.5% at the end of the year. The reason for the decline in funded status over the one-year period is due primarily to the downturn in the equity markets toward the end of 2018. While other forces come into play over longer periods of time—like changes to the actuarial assumed rate of return (in which we have seen a steady decline over the past few years), contribution policies and behaviors, and benefit changes—the recent market activity has had the largest impact on funded status over short-term history.

We believe that public DB plans will continue to maintain a healthy allocation to public equities, given that public DB plans have long time horizons and require liquid assets because they are typically cash flow-negative. However, like recent history, we expect many public pension programs to continue to make strong use of alternative assets, especially those that can be most effective as equity diversifiers.

[1] *Source: Aon; data as of December 19, 2018 for Aon U.S. discretionary DB investment clients (See Exhibit 2)*
[2] *Source: Aon; data as of December 13, 2018*

The opinions referenced are as of the date of publication and are subject to change due to changes in the market or economic conditions and may not necessarily come to pass. Information contained herein is for informational purposes only and should not be considered investment advice.

20190218-747708

2018 Year in Review and 2019 Outlook for Retirement Investment Programs (cont'd.)

U.S. DC Plans

DC plans are fundamentally different from DB plans because of their participant-directed nature, and the focus of plan sponsors is on the choices provided and the choice architecture that influences how participants behave.

> We saw continued investment innovation. Many DC plan sponsors also streamlined investment options and re-examined the merits and pitfalls of managed account platforms with new perspectives.

In 2018, we saw continued investment innovation as some of our clients made changes to increase total return opportunities, better manage risks, and re-examine overall costs. Many DC plan sponsors also streamlined investment options and re-examined the merits and pitfalls of managed account platforms with new perspectives from our updated research.

As we enter 2019, three top areas of focus are:

1. Further innovation. As scale through growth in asset size continues, we expect to see continued enhancements to the investments offered to DC participants. An example is an $8 billion public sector DC client that is moving toward the adoption of private equity and infrastructure in its DC plan to improve retirement outcomes for its members.

2. Preparing for legislation and regulation. We are hopeful that we will receive new guidance in 2019, whether it is the Department of Labor and Treasury thinking through ways to encourage the development of Multiple Employer DC plans (MEPs) or proposed legislation pending in Congress such as the Retirement Enhancement and Savings Act (RESA) that focuses on lifetime income provisions.

3. Financial wellbeing. Our researchers and clients are digging deep into financial wellness by examining the merits of a "retirement income" tier, re-evaluating retirement outcomes for their participants, and challenging themselves with their own governance of "financial wellness."

Meet Aon's 3 Honorees for Top Knowledge Brokers

Each year CIO Magazine identifies 15 top knowledge brokers in the industry. This year we have three honorees, Jack Koch, Laura Flaum and Michael Golubic, on CIO's list of 2018 Knowledge Brokers, more than any other firm.

Jack Koch

Jack is a Partner of The Townsend Group, an Aon Company, and Head of Townsend's Global Advisory Services, as well as lead partner and primary relationship manager for a number of the firm's Advisory Consulting clients, which include U.S. and international public pension plans, taxable investors, and foundations. Jack creates and implements real asset investment policies, strategies and guidelines.

Laura Flaum

Laura is a Senior Consultant, located in Aon's Chicago office. She was honored, along with Michael Golubic, as one of the New Guards, a quickly rising star in the industry. Laura consults with a number of clients with assets ranging from $750 million to $45 billion. Her clients include corporate and public pension funds, defined contribution plans, and foundations. She consults on topics like performance evaluation, investment manager selection, asset allocation, and investment policy development.

Mike Golubic

Michael Golubic joined The Townsend Group, an Aon company, in 2003 and is a Partner of the firm. Michael is a primary senior relationship manager and portfolio manager to discretionary clients of the firm with real asset allocations exceeding $1 billion. He also evaluates global real asset strategies with a focus on infrastructure.

20190218-747708

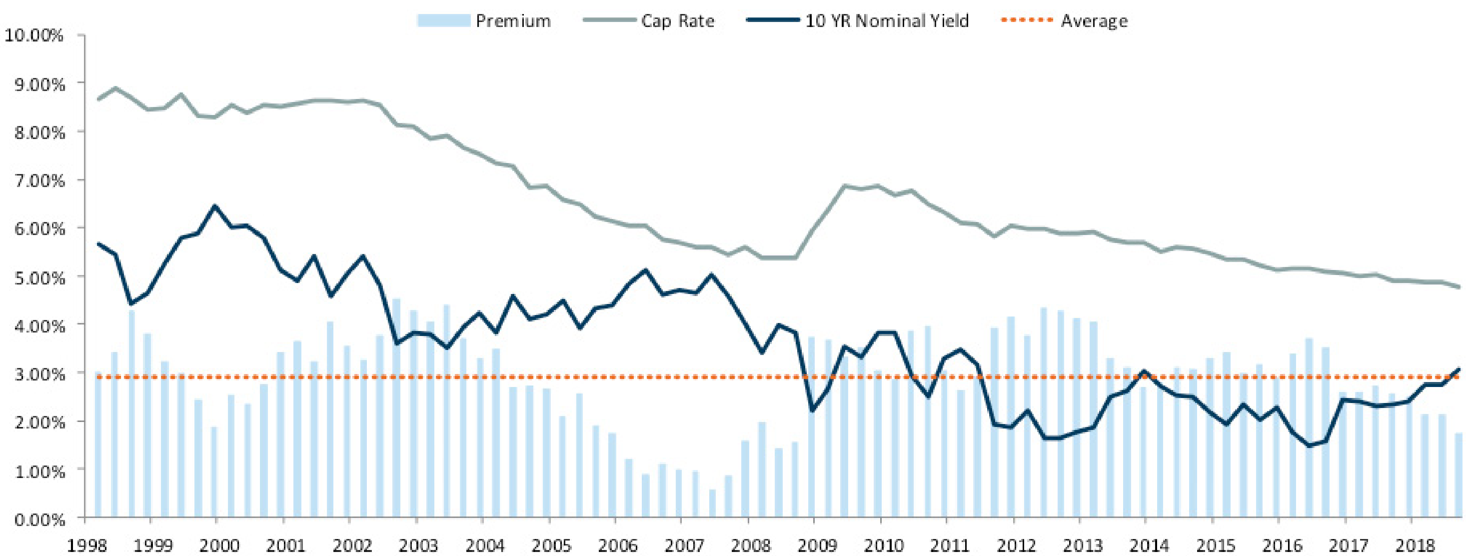
What Is Different About This Commercial Real Estate Cycle?

by Christian Nye and Prashant Tewari

Nearly a decade after the global financial crisis, investors and investment managers remain acutely focused on the cyclical nature of real estate. The previous downturn was especially harsh on the commercial real estate market. Real estate experienced a demand-driven recession with a halt in economic expansion, which was exacerbated by the overuse of leverage in combination with risky borrowing practices and extremely compressed risk premiums.

The length of the current economic expansion has generated growing pessimism about its persistence and the impact of economic uncertainty on pro-cyclical assets like real estate. When we review current indicators of the issues that wreaked havoc in 2008, it appears that in this cycle, the market has taken a more broadly tempered approach to investing in real estate.

U.S. Property Risk Premium (Q4 1998-Q3 2018)



Source: NCREIF NPI, Bloomberg as of 12.31.2018.

Real Estate Valuation

Rising Treasury yields have diminished the premium of cap rates over Treasuries, but spreads relative to Treasury yields remain reasonable. In the last cycle, the cap rate spread over 10-year Treasuries diminished to 56 basis points, while the current spread over 10-year Treasuries remains at 173 basis points—117 bps above the previous cycle low, even though cap rates are below historical levels. Furthermore, during periods of strong economic growth or high inflation, it is normal for the cap rate premium over Treasuries to compress for extended periods of time and then follow the long end of the yield curve over the medium term.

Taking a step back, the U.S. and many developed nations face structural challenges, including decreasing population and productivity growth. Technological innovation and labor-replacing automation have reduced long-term inflation expectations. In our view, the flattening of the yield curve is a direct result of short-term, pro-growth fiscal policy competing with longer-term structural issues. While fiscal policy has increased short-term growth expectations, theoretically the additional debt burden has increased the risk premiums ascribed on the long end of the curve. However, in spite of the growing deficit, we expect the structural headwinds to anchor longer-term nominal interest rates. Thus, we expect the yield curve to be anchored in the 3%–4% range as opposed to the 5%–6% yields of the past.

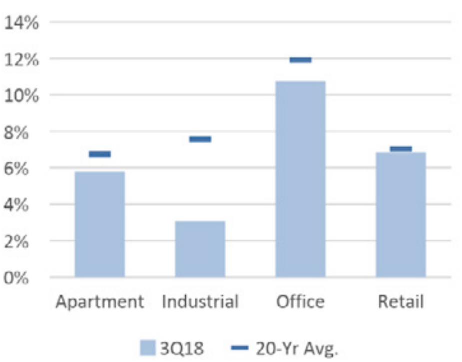
The opinions referenced are as of the date of publication and are subject to change due to changes in the market or economic conditions and may not necessarily come to pass. Information contained herein is for informational purposes only and should not be considered investment advice.

20190218-747708

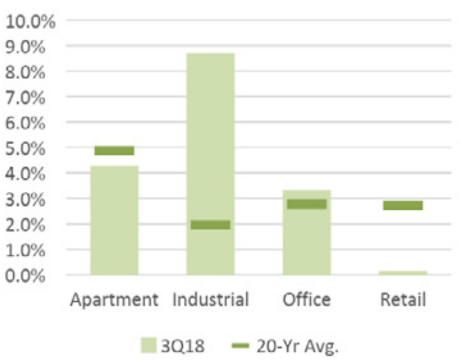
What Is Different About This Commercial Real Estate Cycle?

(cont'd.)

Vacancy Rates By Property Type



TTM NOI Growth By Property Type



Source: NCREIF NPI as of 12.31.2018.

Real Estate Fundamentals

While returns have moderated as cap rate compression has ceased, real estate fundamentals remain healthy. With exception of the retail sector, vacancy rates across property types are well below long-term averages. Similarly, NOI growth remains strong, with positive NOI growth projected across all major sectors going forward[4].

Given initially weak fundamentals and limited liquidity early in the cycle, supply was tepid—but there are now some excess supply-driven concerns in certain markets and property types. As a result, the Townsend Group, an Aon Company, continues to selectively pursue investment opportunities in cities with favorable supply and demand dynamics.

Regulatory Shifts in Lending Environment

The U.S. banking system changed as a result of regulations written in reaction to the global financial crisis. The Basel III standard was introduced (2009) and continues to be implemented to strengthen the resiliency of the U.S. banking system. Basel III pushed banks to tighten lending standards and stifled construction lending. Further, investors and investment managers previously burned by leverage overuse have chosen to pursue leverage more conservatively (Exhibit A).

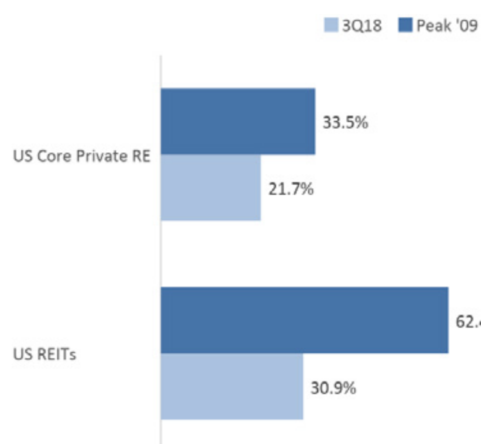
This more conservative use of leverage has lowered the risk of default in the commercial real estate market. Core positions are now even more strongly based in equity, to the extent that a global financial crisis-type write-down would not create enough distress to threaten ownership of an asset. In addition, the borrowing practices are more conservative, with most managers either limiting or completely avoiding cross-collateralized borrowing.

Conclusion

With more conservative leverage, relative valuation metrics remaining reasonable, and healthy fundamentals, U.S. commercial real estate markets remain on solid footing. Long-term impediments to higher interest rates, such as population growth, give us more comfort with the long end of the Treasury curve, which commonly dictates the direction of cap rates over medium-term periods of time.

Structural differences in lending have subdued the use of leverage, and initially have dampened construction activity as well, but we're beginning to see supply become a drag in certain markets and submarkets. Given the current pricing of commercial real estate, finding investment opportunities has become more challenging and Townsend is selective in themes and managers.

Exhibit A: U.S. Commercial Real Estate Leverage



Source: NCREIF NFI-ODCE, Bloomberg, The Townsend Group

[4] *Source: Green Street Advisors*

The opinions referenced are as of the date of publication and are subject to change due to changes in the market or economic conditions and may not necessarily come to pass. Information contained herein is for informational purposes only and should not be considered investment advice.

20190218-747708

Considering International Taxation on Dividends When Selecting an Investment Vehicle for Passive Equity

by Chris Riley and William Ryan, MBA, CAIA, SPHR

When a plan sponsor evaluates a non-U.S. equity index fund for its ERISA qualified defined benefit or defined contribution retirement plan, the primary determining factors are typically investment management fees and tracking error. As a result, a mutual fund is often utilized, given participants' desire for a ticker symbol and the ability to obtain the latest information on the fund from independent third-party services such as Morningstar. But when thinking about opportunities to save on investment management costs, plan sponsors have recently begun considering a passively managed strategy over the historic actively managed equity market strategies.

Within non–U.S. equity, we believe plan sponsors should more deeply analyze the type of investment vehicle that should be utilized.

When the decision is made to implement equity passively in an ERISA qualified plan, relatively little thought goes into selection of the type of investment legal structure. Most individual investors across the defined contribution (DC) landscape invest in a mutual fund. On the surface, this may seem like an appropriate decision if the mutual fund vehicle has adequately tracked its relevant equity benchmark with a reasonable fee. However, a less considered but equally important factor, because of the international tax treatment of dividends, is the type of investment vehicle.

Within non-U.S. equity, we believe plan sponsors should more deeply analyze the type of investment vehicle that should be utilized, because the international tax treatment on dividends is a hidden drag on performance—a disadvantage to mutual fund investors when compared to similarly positioned commingled investment trusts.

While most qualified plan investors are tax-exempt organizations, the investment vehicles they utilize may not be. This is certainly the case with non-U.S. equity investing. Countries outside the United States impose taxes on dividends at varying rates. Some countries levy no taxes on dividends, but Canada, for example, levies a 25% tax, Sweden levies a 30% tax, and the Czech Republic, Chile, and Switzerland levy a 35% tax.

A reduction in tax collection can significantly improve investment returns.

MSCI does not adjust the stated investment performance of its non-U.S. equity benchmarks for each country's varying dividend tax treatment. Instead, most non-U.S. equity benchmarks constructed by MSCI assume full tax collection. As a result, the dividend tax rate for mutual funds tends to mirror those levies. However, pooled investment vehicles (i.e., commingled investment trusts) with the U.S. 81-100 tax classification benefit from more favorable tax treatment. This is due primarily to the fact that qualified plan investors are the only "end investors" in a collective investment trust vehicle.

A reduction in tax collection can significantly improve investment returns. For example, while the tax levied on dividends is 25% in Canada, the tax collected on dividends for investment vehicles classified as U.S. 81-100 falls to 0%. The same holds true for dividends from Swedish stocks—Sweden's tax rate falls from 30% to 0% based upon the type of investment vehicle utilized.

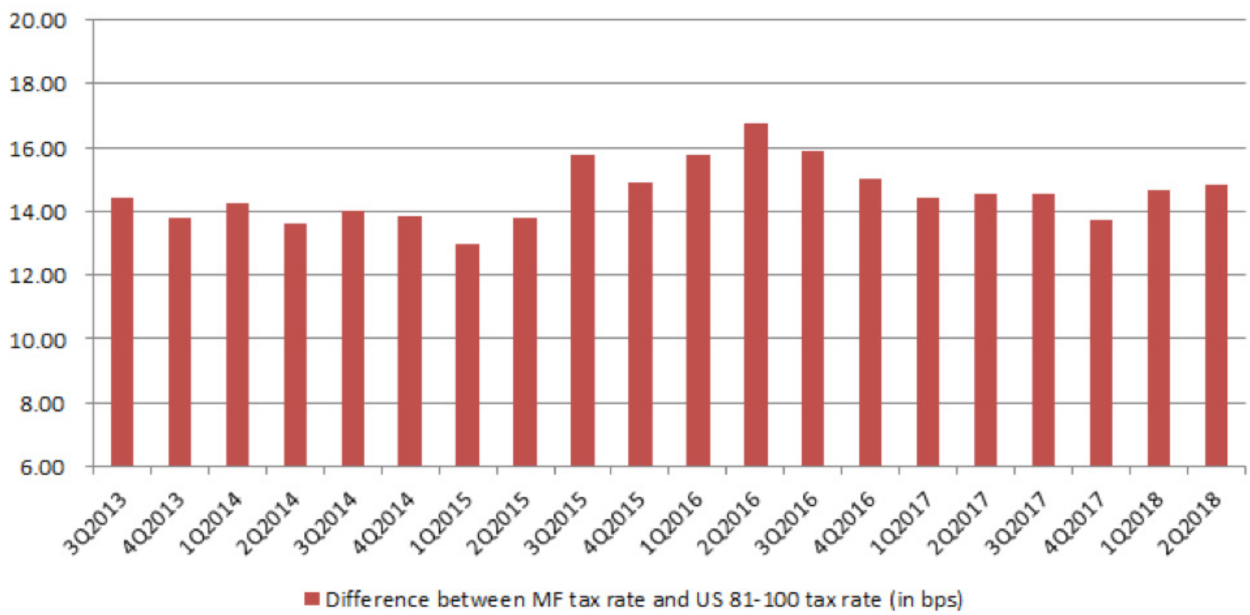
The headwinds of dividend taxation will vary over time. Looking at data based upon dividend yields and country allocations over

The opinions referenced are as of the date of publication and are subject to change due to changes in the market or economic conditions and may not necessarily come to pass. Information contained herein is for informational purposes only and should not be considered investment advice.

20190218-747708

Considering International Taxation on Dividends When Selecting an Investment Vehicle for Passive Equity (cont'd.)

Difference Between MF Tax Rate and U.S. 81-100 Vehicle Tax Rate (in BPS)



Sources: BlackRock, FactSet. Data as of June 30, 2018.

the trailing five-year period ending June 30, 2018, Aon calculated the average annualized performance deficit for mutual fund investors at roughly 15.1 basis points, using 2018 tax rates. Over the time frame analyzed, the annualized deficit ranged from 13 basis points to 16 basis points in any given quarter.

The chart above highlights the performance differential from quarter to quarter.

As investment management fees for passive investment vehicles continue to trend toward zero, the hidden cost of dividend taxation is noteworthy for passive non-U.S. equity mutual fund investors in a defined contribution plan's core investment menu. A similar obstacle also applies to passively implemented non-U.S. equity strategies within a target-date retirement fund. For example, based upon our analysis, a 30% allocation to passive non-U.S. equity within a target-date retirement fund may equate to a 4.5-basis point net performance headwind for two equally priced solutions over a five-year period.

We continue to believe that non–U.S. equity mutual fund investment vehicles remain institutionally sound.

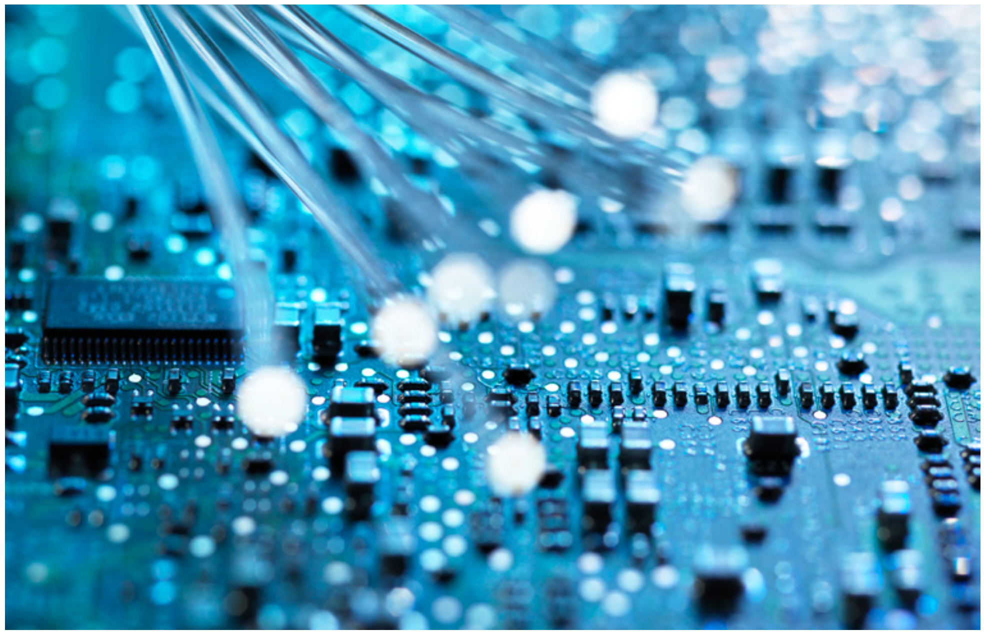
We realize that there may be circumstances (i.e., 403(b) plans) where a plan sponsor must select a mutual fund investment vehicle. As a result, we continue to believe that non-U.S. equity mutual fund investment vehicles remain institutionally sound. However, when qualified plan investors can invest in a commingled investment trust, it is important to remember there are dividend taxation advantages that may surpass the relative differences in expense ratios.

The opinions referenced are as of the date of publication and are subject to change due to changes in the market or economic conditions and may not necessarily come to pass. Information contained herein is for informational purposes only and should not be considered investment advice.

20190218-747708

Cybersecurity and the Role of Plan Fiduciaries

by Rob Wilen, FSA, EA, CFA



Plan sponsors need to understand not only the processes and safeguards in place at their vendors and other third parties but also their internal company controls.

While plan fiduciaries have always been responsible for protecting the data used to administer a retirement plan, today's environment of frequent data breaches and the associated bad publicity make security even more critical. Plan sponsors need to understand not only the processes and safeguards in place at their vendors and other third parties that may involve employee data—pension plan data, defined contribution plan data, and/or health and welfare plan data—but also their internal company controls.

Health plans have long had definitive guidance regarding the obligation to protect individually identifiable health information under the Health Insurance Portability and Accountability Act (HIPAA), but no explicit data security guidance addressed specifically to retirement plans has ever been issued. Nonetheless, there has been an uptick in cybersecurity-related activity associated with Department of Labor audits, and we expect that this activity will only increase in the future.

From the fiduciary perspective, it is important that plan sponsors examine their plans' data security safeguards. At the risk of stating the obvious, it is not acceptable for plan fiduciaries to simply rely on unverified statements made by their recordkeepers or third-party vendors (including payroll vendors) that participant data is secure. Rather, plan fiduciaries should be proactive in reviewing the data security safeguards in place—both within the plan sponsor organization and within third parties that have access to or control of the data.

Plan fiduciaries need to establish a fiduciary process to evaluate existing data security safeguards that may apply to retirement.

This review should entail, among other things, conducting an assessment and gap analysis of existing data security safeguards, and testing those safeguards and related controls to ensure that they are operating appropriately. The outcome of this assessment should also entail a proactive plan for addressing any identified deficiencies in controls and a process for addressing any real or potential breaches involving participant data.

In our view, plan fiduciaries need to establish a fiduciary process to evaluate existing data security safeguards that may apply to retirement plan data—data that is compiled for both defined benefit and defined contribution plans.

As part of this fiduciary process, we suggest that plan fiduciaries consider the following steps:

- **Inventory.** At the outset, it is important for plan fiduciaries to understand who has access to participants' plan data and how such data is viewed, transmitted, or otherwise stored or retained—both within the employer's HR and benefits organization, as well as with third parties (e.g., plan recordkeepers).

The opinions referenced are as of the date of publication and are subject to change due to changes in the market or economic conditions and may not necessarily come to pass. Information contained herein is for informational purposes only and should not be considered investment advice.

20190218-747708

Cybersecurity and the Role of Plan Fiduciaries (cont'd.)

- **Gap assessment.** Following the inventory, it is critical that plan fiduciaries conduct a gap assessment. This assessment should involve assessing existing safeguards—administrative, physical, and technical. In conducting the gap assessment, plan fiduciaries should be careful not to simply respond by saying that data security is handled by their IT department or that they rely on vendor agreements or statements made by third-party vendors. Just as it is insufficient for fiduciaries to assume that plan assets are invested prudently, they should not simply assume that their plan data is adequately protected.
- **Evaluation of findings and existing controls.** While plan sponsors may have significant safeguards in place to protect their financial and customer data, plan fiduciaries should confirm that those safeguards are appropriate with respect to plan data.
- **Documentation of process and steps taken.** Following completion of the review, plan fiduciaries should document the process they followed to demonstrate their prudence in monitoring data security safeguards. This review should entail identifying the need for any updates to existing safeguards, and should include an audit of recordkeeping contracts to confirm frequency of data security reviews and possible responses to data breaches or attempted breaches involving participant data.

The object of the data security fiduciary review is to permit fiduciaries to develop the necessary record to support existing safeguards.

ERISA plan fiduciaries have a special role when it comes to protecting plan-related data and must act in the best interests of plan participants. That means independently assessing whether plan data is adequately protected and not relying solely on the representations of the employer's IT department or third-party recordkeepers. While the scope of a data security assessment and gap analysis may be scaled to the particular plan, it is critical for plan fiduciaries to establish a written record documenting the examination of their data security safeguards and the provision of appropriate data security training to those who may have access to participant data. The object of the data security fiduciary review is to permit fiduciaries to develop the necessary record to support the prudence of existing safeguards and mitigate the risk of a data breach involving participant records.

Aon has a comprehensive data security team that can assist with the review and testing of data security safeguards that apply (or should apply) to employee benefit plans. We would be pleased to discuss how plan sponsors and fiduciaries should move forward to examine such safeguards in an effort to mitigate improper or unauthorized disclosures and ultimately establish a record of prudent plan administration.

The opinions referenced are as of the date of publication and are subject to change due to changes in the market or economic conditions and may not necessarily come to pass. Information contained herein is for informational purposes only and should not be considered investment advice.

20190218-747708

Fiduciary Liability Insurance Affords Critical Personal Asset Protection to Plan Fiduciaries

by Jay Desjardins

If you have discretionary authority for the management or administration of an employee benefit plan that is subject to the Employee Retirement Income Security Act (ERISA), or if you exercise any authority or control with respect to the management or disposition of the assets of an ERISA plan, then you are considered a fiduciary of that plan. Under ERISA, plan fiduciaries are personally responsible for fiduciary failures, meaning that your personal assets could be at risk. In a worst-case scenario, even personal bankruptcy would not offer protection.

Over 6,500 civil ERISA-related lawsuits were filed in U.S. District Courts in the past 10 years.

The U.S. Department of Labor is very active in enforcement related to ERISA-covered plans. In 2017 alone, the DOL closed over 1,700 civil investigations, with over 65% of those investigations resulting in fines or corrections. In addition, plan participants and beneficiaries remain litigious. In fact, over 6,500 civil ERISA-related lawsuits were filed in U.S. District Courts in each of the past 10 years. Common allegations include securities fraud (employer stock drop cases), improper plan valuation, and wrongful plan amendments and terminations. Also of great concern among plan sponsors is the proliferation of the so-called "excessive fee" litigation in which plaintiffs allege that plan fiduciaries have overpaid for administration and/or investment services provided to their 401(k) plans. No industry sector is immune from excessive fee litigation, and more than 100 such lawsuits have been filed since 2006. Alarmingly, close to 20 excessive fee lawsuits have settled for more than $10 million each.

A notable misperception exists that an ERISA fidelity bond provides coverage for these risks. While it is true that ERISA requires plan fiduciaries and those who handle plan funds or assets to be bonded, such bonds offer protection to the plan only from losses caused by dishonest or fraudulent actions. ERISA fidelity bonds do not protect you from losses arising from breaches of fiduciary duty (such as the failure to prudently invest plan assets) or from plan administration errors. These exposures require specific fiduciary liability insurance.

Fiduciary liability insurance is designed to provide insurance protection for:

- The company/sponsor organization and its subsidiaries
- Covered plans, including:
  - Qualified plans—e.g., welfare (such as medical, dental, life insurance, disability, and accident plans) and pension (defined benefit and defined contribution plans)
  - Non-qualified plans—e.g., deferred compensation programs, supplemental executive retirement programs, and top-hat plans
- Insured persons—i.e., any natural person serving as a past, present, or future director, officer, partner, or employee of the sponsor organization or a plan, in his/her capacity as a fiduciary, administrator, or trustee of a plan

Claims covered under fiduciary liability insurance include:

- Breaches of fiduciary duty—violations of fiduciary obligations, responsibilities, or duties under ERISA and similar laws worldwide (where permissible)
- Administration—acts, errors, or omissions in the administration of a plan such as:
  - Advising, counseling, or giving notice to employees, participants, and beneficiaries
  - Providing interpretations
  - Handling records
  - Activities affecting enrollment, termination, or cancellation of employees, participants, and beneficiaries under the plan

So, if you are a fiduciary of your employer's retirement and/or welfare plans, ask your risk management department if your employer has purchased a fiduciary liability insurance policy. Remember, your personal assets are on the line.

The opinions referenced are as of the date of publication and are subject to change due to changes in the market or economic conditions and may not necessarily come to pass. Information contained herein is for informational purposes only and should not be considered investment advice.

20190218-747708

The Reality of Retirement Savings and Employees' Overall Financial Wellbeing

by Melissa Elbert, FSA, EA

Since the birth of the 401(k) plan 40 years ago, we've seen a gradual movement from defined benefit to defined contribution plans as the primary employer-provided retirement vehicle—a shift that forces employees to take a more active role in planning for their future financial security. Employers have made saving easier over time, incorporating features like automatic enrollment, automatic escalation, and target-date investment options. But is that enough? Are current employees saving adequately for a comfortable retirement? How are they coping with today's financial stresses?

Aon's 2018 *Real Deal* study on retirement income adequacy shows that only one in three employees will be adequately prepared for a comfortable retirement. The reality is that employees are juggling multiple financial priorities, and retirement savings often take a back seat. Employers need to recognize the challenges their employees face if they want to effectively help employees improve their financial wellbeing. So, to better understand their perspectives on retirement and financial wellbeing, we recently partnered with Ipsos, a global market research and consulting firm, to conduct a study of more than 1,000 full-time employees in the U.S.

One notable takeaway was that more than half of those surveyed feel they are not saving enough for their long-term needs, despite identifying retirement as their top savings priority. Many report putting off saving for retirement while they save for other goals, missing those critical early years of retirement savings that create the greatest impact through compound interest.

And our survey identified several other hurdles early-career employees face when it comes to retirement savings. For example, younger employees are more likely than their older counterparts to find financial matters difficult to understand. Six in 10 report that dealing with money is stressful and overwhelming. More than half have outstanding debts that prevent them from saving for retirement—an alarming 50% report carrying credit card debt and nearly 40% have student loan debt.

Supporting the overall financial wellbeing of employees can lead to increased productivity and lower workplace stress.

Encouragingly, younger employees are also more likely to trust their employers and look to them for help. Three out of four believe their employer is genuinely trying to help them optimize retirement savings. But employers have an opportunity to do more—about 60% of early-career employees want their employers to provide support in managing their day-to-day finances.

Finding the right balance of saving for retirement while also meeting today's basic financial needs is a challenge for employees. How can employers help? Plan design is often used to encourage more robust retirement savings. Many younger employees take cues from their employers on how much to save, with 47% saving at the plan default or up to the match level. Plan features such as automatic contribution escalation and stretch-matching formulas can significantly improve retirement savings levels. However, they are not a panacea. Some employees may actually be saving at healthy levels for retirement but are still unable to cover emergency expenses or pay off their credit card balances.

While many employers first started thinking about employee wellbeing from a physical health perspective, we now see an emerging employer focus on financial wellbeing. In addition to retirement plans, employers are providing education, access to planning tools, and even new benefits as part of a broader financial wellbeing program—addressing needs such as emergency savings, student loans, and college savings for future generations.

Supporting the overall financial wellbeing of employees can lead to increased productivity and lower workplace stress while simultaneously improving retirement readiness. How well do you understand the full range of financial challenges your employees are facing?

Some progressive employers are already using their 401(k) plans to support broader financial wellbeing. For example, some plans are beginning to offer assistance with student loan repayment strategies. Financial education and planning tools are also being delivered in conjunction with 401(k) plan communications.

How will 401(k) and integrated financial wellbeing programs evolve over the next 40 years to address financial challenges beyond retirement savings? Discover more with the Aon resources below:

The Real Deal
Read more about the 2018 study at
www.aon.com/TheRealDeal.

Dream Report
Read more
www.aon.com/LivingTheDream.

The opinions referenced are as of the date of publication and are subject to change due to changes in the market or economic conditions and may not necessarily come to pass. Information contained herein is for informational purposes only and should not be considered investment advice.

20190218-747708

Contacts

Investment Solutions Practice Leaders

Beth Halberstadt
DC Practice Solution Leader
+1 781.906.2386
beth.halberstadt@aon.com

Bryan Ward, CFA
Corporate DB Practice Solution Leader
+1 847.442.3646
bryan.ward@aon.com

Kristen Doyle, CFA
Public DB Practice Solution Leader
+1 312.381.1283
kristen.doyle@aon.com

Contributors

Melissa Elbert, FSA, EA
Partner
+1.312.381.4882
melissa.elbert@aon.com

Jay Desjardins
Managing Director, Deputy National Practice Leader
Aon Risk Solutions
+1.215.255.1763
jay.desjardins@aon.com

Christian Nye
Associate
Townsend, an Aon Company
+1.216.430.4628
christian.nye@aon.com

Richard Parker, FSA, EA, CFA
Associate Partner
+1.312.381.1328
richard.parker@aon.com

Chris Riley
Partner
+1.312.381.1246
chris.riley.2@aon.com

William Ryan, MBA, CAIA, SPHR
Partner
+1.312.381.5022
bill.ryan@aon.com

Prashant Tewari
Partner
Townsend, an Aon Company
+1.216.430.4652
prashant.tewari@aon.com

Kevin Vandolder, CFA
Partner
+1.847.398.4752
kevin.vandolder@aon.com

Rob Wilen, FSA, EA, CFA
Senior Partner
+1.732.302.2169
robert.wilen@aon.com

Empower Results®

20190218-747708

Disclaimer

Investment advice and consulting services provided by Aon Hewitt Investment Consulting, Inc. ("AHIC"). The information contained herein is given as of the date hereof and does not purport to give information as of any other date. The delivery at any time shall not, under any circumstances, create any implication that there has been a change in the information set forth herein since the date hereof or any obligation to update or provide amendments hereto.

Diversification cannot ensure a profit or protect against loss in a declining market. It is a strategy used to help mitigate risk.

The information contained herein is for informational purposes only. Nothing contained herein should be construed as legal or investment advice; please consult your investment professional for any such advice. This information has been obtained from sources believed to be reliable, but is not necessarily complete and its accuracy cannot be guaranteed. Any opinions expressed are subject to change without notice. This document is not intended to provide, and shall not be relied upon for, accounting, legal, or tax advice or investment recommendations. Any accounting, legal, or taxation position described in this presentation is a general statement and shall only be used as a guide. It does not constitute accounting, legal, and tax advice and is based on AHIC's understanding of current laws and interpretation.

This document is intended for general information purposes only and should not be construed as advice or opinions on any specific facts or circumstances. The content of this document is made available on an "as is" basis, without warranty of any kind. AHIC disclaims any legal liability to any person or organization for loss or damage caused by or resulting from any reliance placed on that content. AHIC reserves all rights to the content of this document. No part of this document may be reproduced, stored, or transmitted by any means without the express written consent of AHIC.

Aon Hewitt Investment Consulting, Inc. is a federally registered investment advisor with the U.S. Securities and Exchange Commission. AHIC is also registered with the Commodity Futures Trading Commission as a commodity pool operator and a commodity trading advisor, and is a member of the National Futures Association. The AHIC ADV Form Part 2A disclosure statement is available upon written request to:

Aon Hewitt Investment Consulting, Inc.
200 E. Randolph Street
Suite 1500 Chicago, IL 60601
ATTN: AHIC Compliance Officer

About Aon

Aon plc (NYSE:AON) is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance.

www.aon.com

Empower Results®

20190218-747708