CONNECTICUT RETIREMENT SECURITY BOARD DISCUSSION GUIDE FOR ANNUITY AND IRA ACCOUNT TYPES

November 4th, 2015

Rashid Hassan
Neil Lloyd

Hartford, Connecticut

MERCER'S RECOMMENDATION ON RETIREMENT INCOME TO CRSB

Mercer recommends that the Program design focus on a holistic retirement income strategy, which includes annuities but also addresses a range of issues that are listed below:

1. The Program be designed to promote maximizing lifetime retirement income by implementing a retirement income strategy with a focus on preventing poverty in retirement.
2. The specific strategy along with its key components and features should be determined during the implementation.
3. Legislature require the implementing Board to consider at a minimum the following options in developing a retirement income strategy:
   a) A default option aligned with the Required Minimum Distribution requirements;
   b) Social security optimization guidance and tools;
   c) A need for access to emergency funds;
   d) Annuitized benefits with options for guaranteed minimum withdrawal benefits (if the legal, counterparty, and fee concerns can be overcome),
   e) Conversion to lump-sum payout upon retirement, spousal benefit, and pre-retirement death benefit;
   f) An annuity exchange to ensure competitive pricing;
   g) The potential to use laddered bond portfolios, target payout funds and/or Future Starting Bonds among other products available in the market place in the design of the Program's target date fund;
   h) Asset consolidation tools to bring non-Program assets into the Program; and
   i) The option for financial assistance in planning for retirement.

KEY CONSIDERATIONS IN ASSESSING IRA ACCOUNT TYPES

- Restrictions and penalties
- Tax effects
- Access to accumulated savings

IRA ACCOUNT TYPES

	Traditional	Roth
Income limits	None	Single: $116k – 131k[1] Married, filing joint: $183k – 193k Married, filing separate: $0 - $10,000
Contribution limits	$5,500 (<50 years old) $6,500 (50 + years old) $0 (70 ½ + years old)	$5,500 (<50 years old) $6,500 (50 + years old)
Tax deductibility	Contributions for federal and state taxes fully deductible for single filers with a modified AGI of $61k or less or married filers with a modified AGI of $98k or less. The deduction is phased out for higher income earners. The deduction may also be limited if the participant's spouse participates in an employer-provided plan. Withdrawals taxed as ordinary income.	Contributions are made with post-tax income, so contributions are not deductible. Earnings and withdrawals are generally tax free after 59 ½ and 5 years after first contribution.
Withdrawal restrictions	Typically a 10% penalty plus taxes for withdrawals before 59 ½.[2]	No restrictions or penalties on withdrawing contributions before 59 ½, but earnings attract taxes and are subject to a 10% penalty (unless an exception is available).
Withdrawal requirements	Required minimum distributions (RMD) at age 70 ½.	No requirements until after death of the participant.
Ability to consolidate assets into the Program	Participants can roll traditional 401(k) and other pre-tax balances into the account.	Participants can roll Roth 401(k) or Roth IRA assets into the account.
Ability to move assets to other retirement plans	Participants can roll to another traditional IRA or an employer provider retirement plan (e.g., 401(k) plan).	Participants can roll to another Roth IRA. Assets cannot be rolled into an employer provider retirement plan.

[1] The bottom of the range reflects the income point at which the contributor must begin to phase out contributions.
[2] Exceptions do exist. For example, withdrawals due to disability, death, long-term unemployment expenses, certain major medical expenses, first-time home purchase or to pay for an education can be exempt from the penalty.

INCOME TAX EFFECT – ACCUMULATION PHASE
TRADITIONAL IRA VS. ROTH IRA

Below is an example of income tax effect for an individual earning $43,000, median income for an uncovered worker in State of Connecticut:

Traditional IRA			Roth IRA				
Salary	$43,000	$43,000	Salary	$43,000	$43,000		
Contributions	3%	6%	Effective Tax Rate	21.0%	21.0%		
Contributions	$1,290	$2,580	Tax Owed	$9,030	$9,030		
Taxable Salary	$41,710	$40,420	Net of Taxes Salary	$33,970	$33,970		
Effective Tax Rate	21.0%	21.0%	Contributions	3%	6%	Difference in take-home Pay	
Tax Owed	$8,759	$8,488	Contributions	$1,290	$2,580	3%	6%
Take-home Pay	$32,950	$31,931	Take-home Pay	$32,680	$31,390	$270 (0.63 %)	$541 (1.26%)

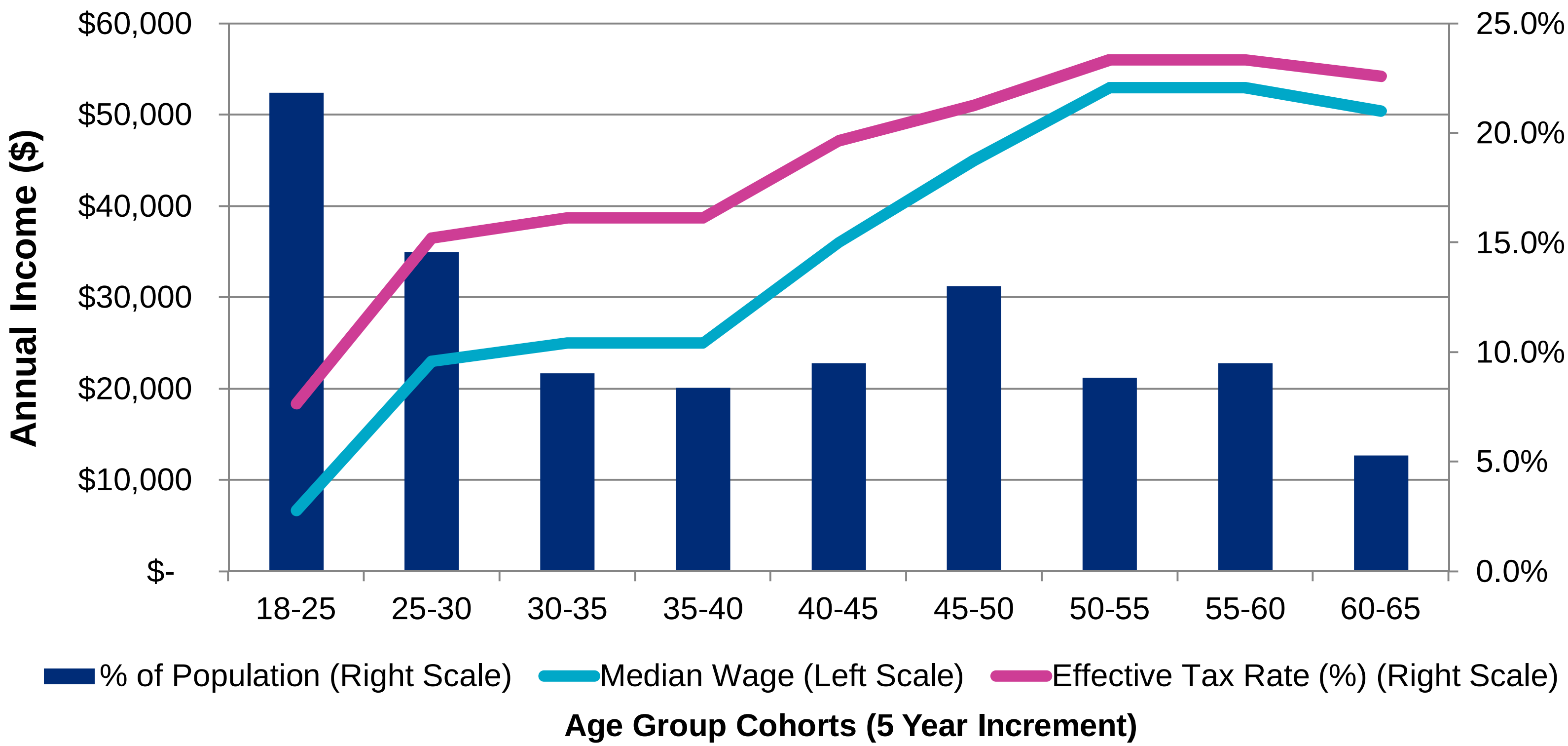
Tax rate calculation assumes single, 1 personal exemption, 0 dependents, and 1 standard deduction.

ARE TAX INCENTIVES IMPORTANT?

- The Center for Retirement Research (CRR) found no significant differences in opt-out rates between the two options
- An EBRI brief assessing how participants would behave if tax deductions were reduced or eliminated found that people in the lowest household income category ($15,000 - $25,000) had the largest percentage of respondents classifying the tax deductibility of contributions as very important (76.2%)

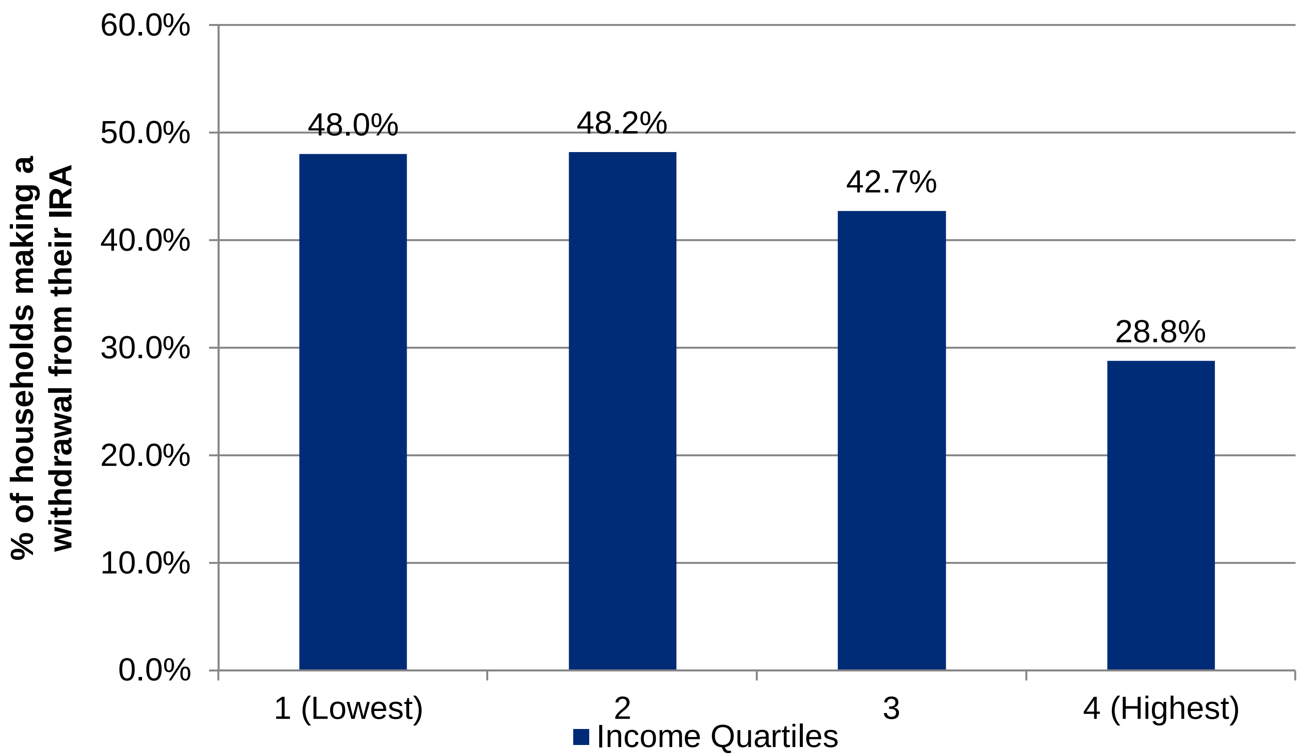
Not clear how the target Connecticut population will think about this benefit.

TAX RATES OVER THE ENTIRE ACCUMULATION PHASE SHOULD BE CONSIDERED



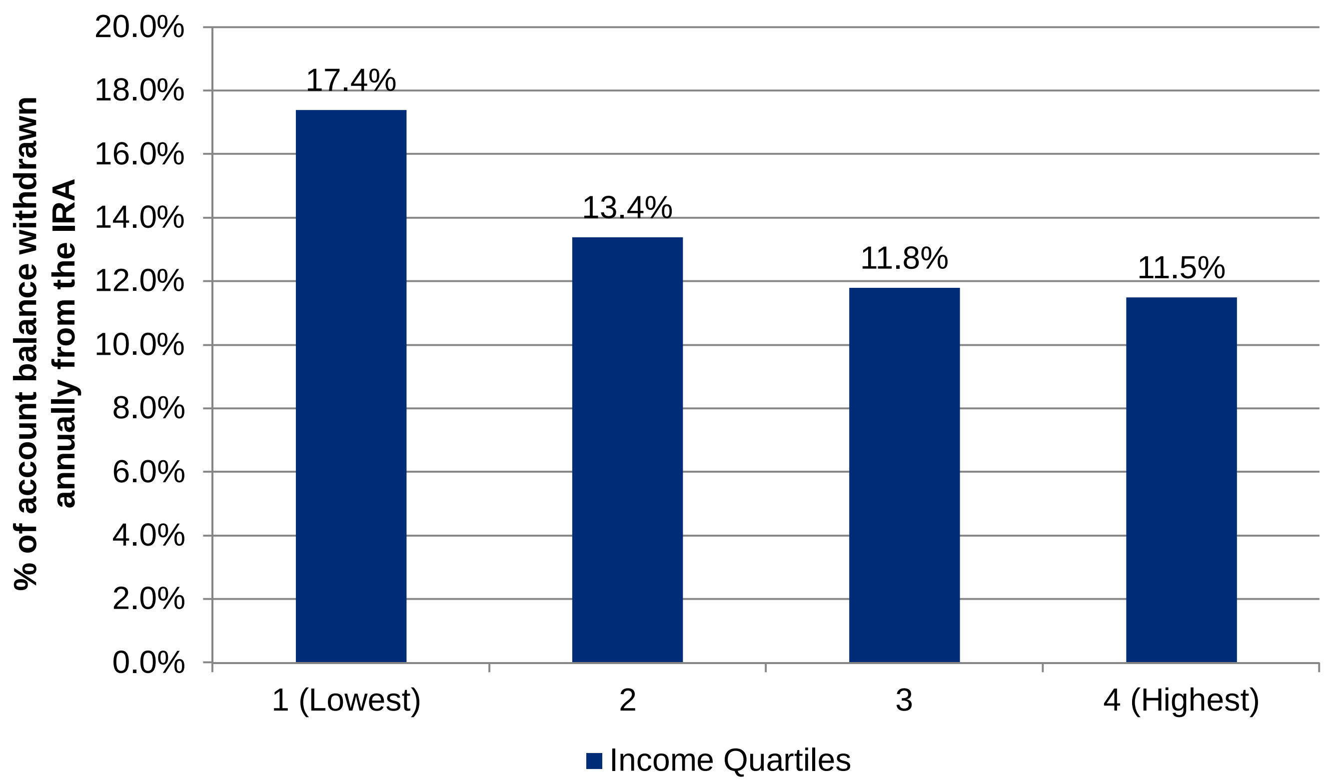
Source: US Census Connecticut data and Mercer's calculation of uncovered population
Tax rate calculation assumes single, 1 personal exemption, 0 dependents, and 1 standard deduction

LOWER INCOME HOUSEHOLDS NEED TO ACCESS THEIR SAVINGS SOONER (AGES 61-70)



Source: Employee Benefit Research Institute estimates from Health and Retirement Study (HRS), 2002 to 2010

LOWER INCOME HOUSEHOLDS WITHDRAW LARGER AMOUNTS (AGES 61-70)



Source: Employee Benefit Research Institute estimates from Health and Retirement Study (HRS), 2002 to 2010

OPERATIONAL CHALLENGES WITH A ROTH IRA

- IRS restricts Roth IRA contributions to individuals below specific income levels
- Legal counsel has noted that, from an operational standpoint, the Program administrator will have difficulty determining whether a potential participant exceeds the contribution limits
- The CRSB and the Legislature should consider how an individual’s compliance issues might reflect on the State’s overall reputation

DECISIONS ON IRA ACCOUNT TYPES

1. Agree that IRAs are feasible
2. Decide whether to make a recommendation on the default. If yes, what will be the recommendation?

IMPORTANT NOTICES

References to Mercer shall be construed to include Mercer LLC and/or its associated companies.

This contains confidential and proprietary information of Mercer and is intended for the exclusive use of the parties to whom it was provided by Mercer. Its content may not be modified, sold or otherwise provided, in whole or in part, to any other person or entity, without Mercer's prior written permission.

The findings, ratings and/or opinions expressed herein are the intellectual property of Mercer and are subject to change without notice. They are not intended to convey any guarantees as to the future performance of the investment products, asset classes or capital markets discussed. Past performance does not guarantee future results. Mercer's ratings do not constitute individualized investment advice.

Information contained herein has been obtained from a range of third party sources. While the information is believed to be reliable, Mercer has not sought to verify it independently. As such, Mercer makes no representations or warranties as to the accuracy of the information presented and takes no responsibility or liability (including for indirect, consequential or incidental damages), for any error, omission or inaccuracy in the data supplied by any third party.

This does not constitute an offer or a solicitation of an offer to buy or sell securities, commodities and/or any other financial instruments or products or constitute a solicitation on behalf of any of the investment managers, their affiliates, products or strategies that Mercer may evaluate or recommend.

For the most recent approved ratings of an investment strategy, and a fuller explanation of their meanings, contact your Mercer representative.

For Mercer's conflict of interest disclosures, contact your Mercer representative or see www.mercer.com/conflictsofinterest.

Mercer universes: Mercer's universes are intended to provide collective samples of strategies that best allow for robust peer group comparisons over a chosen timeframe. Mercer does not assert that the peer groups are wholly representative of and applicable to all strategies available to investors.

MAKE
TOMORROW,
TODAY

MERCER