AllianceBernstein
Defined Contribution Investments

Rethinking Retirement Plan Menus

What to Consider When You're Taking a Fresh Look at Your Plan's Investment Lineup

- Investment menus play a crucial role in guiding participants to diversified retirement portfolios.
- Plan sponsors should use periodic menu reviews as opportunities to enhance their menus' design.
- Menus should be streamlined and straightforward, and accommodate wide-ranging participant needs.

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Designing an Effective Investment Menu

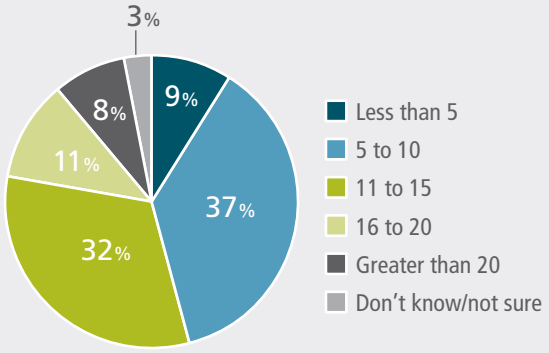
The investment menu is a key element in retirement plans, given the ability of a well-designed menu to guide participants to better outcomes. It should be organized clearly, to help participants make appropriate investment choices.

Adhere to Core Design Principles

Every plan sponsor has to account for participants' needs when creating a menu that makes sense for their plan. But there are a few guiding principles that can inform the effort:

- Menus shouldn't be overwhelming or confusing to participants—choices should be relatively streamlined and straightforward. While the trend in the past was to have as many investment options as possible, best practice today is to avoid "choice overload."
- Menu design should accommodate the needs of participants with wide-ranging attitudes, from Accidental Investors, who lack confidence in making investment decisions (63% of participants), to Active Investors, who enjoy doing it themselves (38%).
- The menu, including all individual offerings, should be evaluated regularly to ensure that it remains sound and effective for participants.

How many investment options should a diverse plan have?



Target-date funds are counted as one investment option.
Source: AllianceBernstein research, 2011

Organize and Rationalize Menu Options

- Plan menus should be limited to a reasonable number of options.
- Nearly 70% of sponsors feel that either 5 to 10 or 11 to 15 options are needed. Half of sponsors feel their plan has the right number of options. Nearly 25% think their menu needs more options.
- There's a drawback to overstocking. Too many options can lead to choice overload, and research indicates that plan participation tends to decline as investment choices increase.
- Plan menus should be organized and presented clearly. A tiered approach might be helpful:
  - **QDIA:** The plan's qualified default investment alternative, a comprehensive solution that's especially helpful in guiding Accidental Investors to a diversified investment allocation.
  - **Core Menu:** A well-organized and diverse set of individual options that satisfy specific objectives. These options are geared toward Active Investors, who prefer to build their own portfolios.
  - **Noncore Options:** This tier might be considered when presenting menu choices that are meant to diversify core investments but not account for more than a certain portion of the overall portfolio.

Best practice today is to avoid "choice overload."

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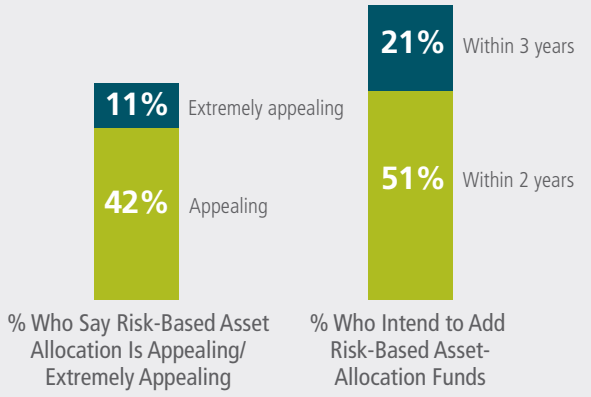
Determining the Basic Structure

Menus should guide less confident investors into diversified QDIAs, while providing "do-it-myself" investors with a diverse set of building-block options designed to satisfy specific roles in an overall portfolio.

Make the QDIA Connection

- The selection of QDIAs has become critical to ensuring that participants have diversified investments. The QDIA has helped both Accidental Investors, who need help creating a fully diversified portfolio, and Active Investors, who prefer a professionally managed solution, to achieve their objectives.
- Target-date funds are the most commonly selected QDIAs, but plans can choose a default option from a number of long-term investment types covered under the Labor Department's "safe harbor" protection, including:
  - Lifecycle or target-date funds
  - Professionally managed accounts with appropriate asset mixes
  - Risk-based or balanced funds
- Plan sponsors are intrigued by risk-based funds enhanced to reduce the impact of extreme market volatility. More than half (53%) of the sponsors we surveyed in 2011 found such a QDIA appealing or extremely appealing. Almost three-quarters (72%) would consider adding one within the next three years.

A Call for Risk-Based Asset-Allocation Funds



Among plans with less than $50 million in assets
Source: AllianceBernstein research, 2011

Draw Core and Noncore Menu Options from Investment "Food Groups"

- Non-QDIA options are geared to Active Investors, who prefer more control by creating their own asset allocation. Plan fiduciaries have a duty to offer them a diversified menu.
- Plan sponsors might consider informing their menu design by drawing on different investment "food groups" that play various roles in a portfolio strategy:
  - **Return-Seeking:** These include many stock strategies, but also some bond strategies that blend higher-income sectors such as high-yield bonds and emerging-market debt
  - **Risk-Reducing:** Bond-focused strategies whose objectives include stability or capital preservation. Also, some equity strategies that seek a lower level of volatility than that of the equity markets
  - **Diversifying:** Strategies with lower correlation to both return-seeking and risk-reducing strategies; some portion of this group falls under the definition of alternative investments
- Many plans also combine these categories in balanced investment strategies, which are offered as either the plan's QDIA or as a stand-alone menu choice.

Plan fiduciaries have a duty to offer a diversified menu to minimize the risk of large investment losses.

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The Investment "Food Groups"

Instead of following the traditional asset-class and style-box perspective, plan sponsors may consider building a menu of investments based on the role each plays in an overall portfolio—return-seeking, risk-reducing or diversifying.

Return-Seeking Investment Options

- Many stock strategies are return-seeking. These include strategies defined by traditional style-box parameters based on market cap and investment style, such as growth, value and core.
- Return-seeking equities are designed for appreciation, which is important throughout participants' lives, but particularly for young workers, who have longer time horizons and generally higher risk tolerance.
- Some bond strategies are return-seeking. These include individual or blended high-income strategies such as high-yield corporates and emerging-market debt. These strategies often act more like stocks than like traditional high-quality core bonds.

Risk-Reducing Investment Options

- These investment options include the most common core, or high-quality, bond strategies that seek stability or capital preservation and serve as a counterbalance to equities.
- DC fixed-income options are typically US-oriented. One avenue for increasing diversity could be global bonds, which can be beneficial to a fixed-income allocation.
- Some equity strategies seek to moderate volatility or reduce exposure to the fluctuations of equity markets by seeking a lower beta, or market sensitivity. These include some low-volatility and equity-income strategies.

Diversifying Investment Options

- The risk/return characteristics of some investments are less dependent on broad market cycles. If these are included in a menu in a thoughtful way, they can offer valuable diversification.
- These investments can include alternatives, such as market-neutral and long/short equity strategies, and real-asset strategies offered in liquid vehicles, such as mutual funds. In the past few years, the variety of alternative investments used in DC plan menus has expanded significantly.
- Other illiquid alternatives, such as private equities and direct real estate, as well as more exotic strategies, offer limited liquidity, pricing frequency, transparency or investor suitability. They're generally challenging to implement in DC plans.
- Diversifying investments should be used to supplement core investments. Their allocations should generally be modest, perhaps up to 20% of a participant's total assets—individual circumstances permitting.[1]
- Plan sponsors should dissuade participants from too much exposure to diversifiers by separating diversifiers from the core menu, offering guidance on what's reasonable and appropriate, and perhaps offering diversifiers only as an allocation within a QDIA or model portfolio.

Potential Allocation Ranges for Participant-Selected Investment Options

This is hypothetical and for illustrative purposes only, and does not represent the performance of any specific investment, including any AllianceBernstein product. Actual allocations for any individual participant should be based on his or her individual goals and risk tolerance. Allocations should be adjusted over time as circumstances change. Source: AllianceBernstein

[1]It is important to remember that diversification does not guarantee a profit or ensure against loss.

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Reinforcing and Updating the Menu

While it's vital to have a well-thought-out set of investment options, there's more plan sponsors can do to guide participants to appropriate choices—and ensure that menus remain effective and evolve to meet changing needs.

Guide Participants to Appropriate Choices

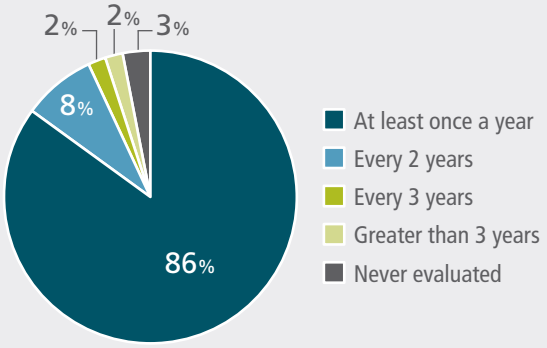
Participants' saving efforts will be vastly more effective if participants are guided into reasonable, appropriate investment options and allocations. Plan sponsors have a number of tools at their disposal:

- Use automatic enrollment and a designated QDIA to steer participants into an appropriate long-term saving strategy—this is particularly helpful for Accidental Investors.
- Incorporate a "best practices" multi-asset option into the plan menu that's designed and maintained with the help of a financial advisor or consultant.
- Design the menu so that it clearly delineates the categories of investments—for example, QDIA, Core and Noncore. Offer guidance on the appropriate uses for each group.
- Maintain a strong communications program with investment education and guidance for participants, including enrollment materials. Education alone isn't enough, but it's still an important part of effective plan management.

Perform Menu Checkups Regularly

- No matter what kind of investment menu design a plan sponsor chooses, regular investment reviews are critical to making sure that the menu and all of its options remain effective.
- Almost 90% of plan sponsors surveyed said that the ongoing monitoring and review of investment options is an important or very important service for their plans—and a similar percentage said that they conducted a review at least once per year.
- Almost 60% of sponsors either have an Investment Policy Statement (IPS) or plan to create one very soon. Clearly, many plan sponsors value the guidance an IPS provides on which investment options to make available and how to monitor them.
- Many aspects of investment options should be examined carefully, including absolute or relative returns, peer group rankings, and key guidelines, including asset-allocation targets, permitted investments, turnover and transaction costs.
- Investment reviews are a team effort. Among plan sponsors, half use the expertise of a financial advisor and 34% use a consultant. Among smaller-plan sponsors, where fiduciaries may be wearing more than one hat, investment menu advice from financial professionals is clearly valued.

How Often Plan Sponsors Evaluate the Current Investment Menu



Percentages may not sum up tp 100% due to rounding.
Source: AllianceBernstein research, 2011

Return-Seeking Investment Options	Core Opportunities (ADGAX)	Discovery Growth (CHCLX)	Discovery Value (ABASX)	Growth & Income (CABDX)	High Income (AGDAX)	Select US Equity (AUUAX)
Risk-Reducing Investment Options	Equity Income (AUIAX)	Global Bond (ANAGX)				
Diversifying Investment Options	Real Asset Strategy (AMTAX)					

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About AllianceBernstein's Plan Sponsor and Participant Research

Unless otherwise noted, the data cited in this content are from AllianceBernstein's 2011 surveys of plan sponsors and plan participants. The plan-sponsor responses in this document are derived from a subset of respondents representing DC plans with assets up to $50 million.

A Word About Risk

Market Risk: The market values of the portfolio's holdings rise and fall from day to day, so investments may lose value.

Interest-Rate Risk: Fixed-income securities may lose value if interest rates rise or fall—long-term securities tend to rise and fall more than short-term securities.

Credit Risk: A bond's credit rating reflects the issuer's ability to make timely payments of interest or principal—the lower the rating, the higher the risk of default. If the issuer's financial strength deteriorates, the issuer's rating may be lowered and the bond's value may decline.

Inflation Risk: Prices for goods and services tend to rise over time, which may erode the purchasing power of investments.

Foreign (Non-US) Risk: Investing in non-US securities may be more volatile because of political, regulatory, market and economic uncertainties associated with such securities. These risks are magnified in securities of emerging or developing markets.

Currency Risk: If a non-US security's trading currency weakens versus the US dollar, its value may be negatively affected when translated back into US-dollar terms.

Diversification Risk: Portfolios that hold a smaller number of securities may be more volatile than more diversified portfolios, since gains or losses from each security will have a greater impact on the portfolio's overall value.

Derivatives Risk: Investing in derivative instruments such as options, futures, forwards or swaps can be riskier than investing in traditional investments, and may be more volatile, especially in a down market.

Leverage Risk: Trying to enhance investment returns by borrowing money or using other leverage tools—magnifying both gains and losses, resulting in greater volatility.

Below-Investment-Grade Securities Risk: Investments in fixed-income securities with lower ratings (commonly known as "junk bonds") tend to have a higher probability that an issuer will default or fail to meet its payment obligations.

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13–2372

DCI–7010–0913

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