



FEDERAL RETIREMENT THRIFT INVESTMENT BOARD
77 K Street, NE, Washington, DC 20002

July 16, 2015

MEMORANDUM FOR: BOARD MEMBERS KENNEDY, BILYEU, JONES, MCCRAY,
AND JASIEN

FROM: Greg Long
Executive Director

A handwritten signature in blue ink, appearing to be "G. Long", written over the printed name and title.

SUBJECT: AON Hewitt Report on Advisory Services for the TSP

Summary:

We retained AON Hewitt Investment Consulting to conduct a review of investment advisory services, identify potential risks and rewards associated with offering investment advisory services, and assess whether such services should be considered as an offering within the Thrift Savings Plan. This memorandum summarizes¹ the AON Hewitt report and recommendations. AON Hewitt believes that offering "help" tools such as target date funds and investment advice beneficially impact retirement readiness.

The purpose of this memo is to provide the TSP fiduciaries with an understanding of the types of advisory services offered in the marketplace and the pros and cons associated with these services. This is an important first step toward eventually making an informed decision on behalf of TSP participants.

TYPES OF ADVICE:

Investment advisory services take two principal forms - self-service (on-line) advice and managed accounts.

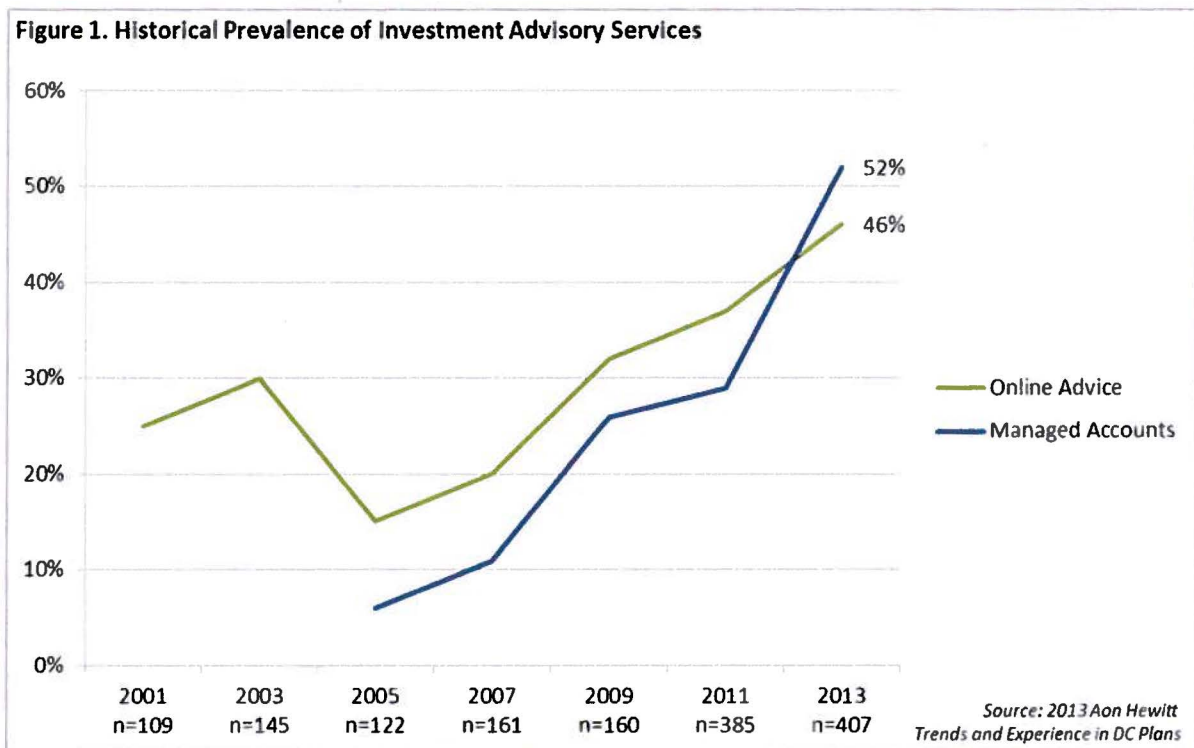
- Self-Service Advice is typically provided through an on-line tool that makes recommendations to participants on both appropriate contribution rates and appropriate investment choices. To the extent that participants input the data, the tool can consider the participants' other assets, investments, retirement plans, projected social security benefits and, in applicable cases, spousal assets/accounts. The participant retains the sole discretion for execution and implementation of self-service (on-line) advice.

¹ Much of the material in this paper was prepared by AON Hewitt and is synopsized verbatim.

Participants are not typically directly charged individually for self-service advice. Instead, costs associated with online advice are typically borne by the plan.

- **Managed Accounts** and the recommendations generated from this type of service are typically based on the same advisory software provided through the self-service advice tool. However, service is typically delivered person-to-person through phone conversations. Additionally, managed accounts also involve a delegation from the participant to the advice provider that authorizes the advice provider to implement the advice and make necessary adjustments on an on-going basis. Participants are typically charged a fee for managed account services using a basis point schedule.

AON Hewitt advises that offering both types of advice is becoming increasingly prevalent among defined contribution plans.



BENEFITS OF ADVICE:

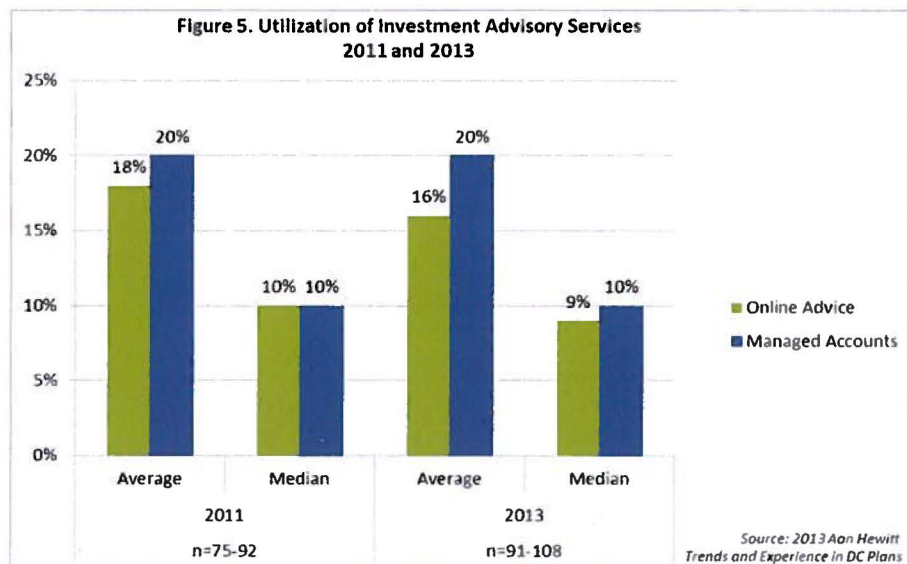
AON Hewitt found three principal benefits of advice:

- **Increased savings rates.** Investment advisory services help participants understand the impact the deferral rate/savings rate can have on their final retirement goals. The average deferral rate for “non-help” participants is 6.6% while those utilizing managed accounts deferred 7.5% on average, and the deferral rate for those using online advice was on average 9.0%.

- **Better investment results.** Investment advisory services can assist participants with the improvement in the efficiency of their individual investment allocations.
 - The annual median returns, net of fees, for “help” participants was 3.32 percentage points higher, on average, than “non-help” participants during a five year period between 2006 and 2012.
 - Targeting efficient risk/return levels is an area where personalized investment advice may be advantageous, especially when taking into account the impact of outside plan assets, including other retirement and non-retirement assets, spousal assets, social security benefits, etc.
- **Retirement planning.** Investment advice services help participants determine the most appropriate income distribution strategies.

LOW USAGE RATES:

Despite these benefits, AON Hewitt determined that usage rates for advice are low.



AON HEWITT RECOMMENDATIONS:

AON Hewitt recommended that the TSP consider both forms of advice:

- Online advice appeals to participants who have higher level of interest and involvement with their retirement goals and are comfortable with a “Do It Yourself” (DIY) approach to transaction execution.

- Managed accounts appeal to participants with potentially more complex financial situations and looking for professional investment advisory support requiring low level of involvement from the participant.

INITIAL IMPRESSIONS:

The AON HEK report confirms that advice generally leads to higher deferral rates and better investment returns. It also made clear that advice is becoming far more common in private sector plans and that an advice offering may be an important factor toward meeting future participant expectations. Additionally, advice services are designed to also lead to better de-accumulation choices.

The benefits of providing advice should be weighed against the challenges noted by AON Hewitt:

- Increased fiduciary effort;
- Cost:
 - On-Line Advice = cost typically borne by the plan and shared by all participants
 - Managed accounts = cost typically borne by the participant;
- Potential for low usage; and
- Operational complexities.

My impression and recommendation to the fiduciaries is that offering on-line advice appears advantageous and merits further study. Conversely, my impression of managed account services is that, largely because of the typical fee structure, are much less likely to fit with the TSP's focus on low costs.