Executive Summary – Fully Integrated Financial Wellness

TRI-SIGNAL EQUITY INVESTMENT ANALYTICS

Why choose TRI-SIGNAL investment analytics?

Because of our superior results	Because of our technology	Because we help assure financial wellness

Modern benefit programs offer financial wellness as part of their human capital strategy to attract and retain employees. Currently, financial wellness programs are typically implemented in a stand-alone fashion with a focus on education, behavioral modification and a motivational component akin to "an advertisement for weight loss." After all, an employer can increase financial wellness immediately by just increasing payroll or announcing a bonus which is typically done after year end payable in March/April of the following year. Labor economics informs us that total compensation expense for a firm will be in general equilibrium with the market and that only a shortage of skilled labor results in overall total compensation increase past general labor market.

In this paper, we explore financial wellness from a fully integrated benefit viewpoint (employer and employee) with 2 goals: a) delineating requisite features and b) highlighting those that are missing in current stand-alone financial wellness offerings. Financial wellness is usually defined as "as the ability to manage day-to-day finances, achieve important financial goals, and protect against key financial risks."

Financial wellness from the fully integrated viewpoint is defined as "the ability to manage and control: expense risk, shortfall in income risk and accumulated wealth devaluation risk in both short-run and long-run."

Without 100% control granted to employee over all benefits excluding compensation determination, there can never be true 100% financial wellness. As an example, an employee optimally manages expenses given expected annual income only to have 401(k) balance devalued as last seen in fall 2018 and spring 2020. Just like a weight-loss program, the employee does all that was recommended and has nothing to show for all the effort, even worse, overall financial wellness has decreased from prior levels. If such a situation were unavoidable then counseling "the employee to accept results and try again" is prudent. However, if the devaluation situation was forecastable, then employees should be empowered to take direct control to ensure their own financial wellness. We'll make the case that enabling 100% control combined with making available informational tools to employees within a fully integrated benefits framework is superior to all other types of financial wellness programs.

Each employee, if given a choice and assuming rationality, would choose a path leading to higher levels of financial wellness sooner rather than later but this is not always the case e.g. choosing higher cost health plan with higher benefits rather than lower cost health plan with lower benefits. Benefit offerings are typically pre-determined with premiums actuarially determined. During benefit enrollment, employees with knowledge of their expected wage level are presented with various benefits with associated cost-sharing. Benefit elections are made based on employee expected income, employment status, health status, family health status, retirement defined contribution plan and household expenses. In this context, financial wellness takes some form of "savings/deferred consumption" but may be wholly or partially defeated by externality e.g. state income tax increase or layoff. A requirement for "engendering savings/deferred consumption" is the expectation of reducing consumption utility today in exchange for higher expected future utility. If expected future consumption utility is believed to be remote or non-existent, then current savings rates will be overall lower. For example, employees will typically defer pretax wage percentage to capture 100% of employer match to defined contribution plan regardless of expected fund return performance. From past experience, employees know expected fund level returns but also know they are subject to downturn risk and thus will not typically commit more funds.

The optimal integrated financial wellness program provides employees the ability, if they so desire, to monitor and control all aspects of expense risk, income risk and investment risk. Current employee benefit plan offerings share a common worst-case phobia – that enabling employees to monitor and control their own financial wellness destiny might have poor results.

A review of IRS 5500 filings for plan years 2008 and 2019 demonstrates that poor financial wellness results is not driven by enabling employee monitoring and control." We would argue that a financial wellness framework that does no worse than current 100% plan control scenario and allows for employee monitoring and control, if so desired by individual employees, is superior to today's non-integrated financial wellness plans.

Furthermore, where employees have success in capturing investment gain, financial wellness is increased with the observation that the timing is also under employee control. Now if the employer offers an incentive for such employees to "share their success insights with other employees via corporate website" undoubtedly employee morale and financial wellness for the group will increase.

DC plan sponsor benefit planning process typically results in a combination of record-keeper and fund advisors(selected at lowest cost to plan rather than expected highest performance) that lead to designs that offer "investment menu choice overload", default enrollment into target date fund (TDF) and limited fund concentration to no more than 25%-50%. Only 10% to 33% of the largest plans incorporate some form of direct brokerage within the defined contribution plan.

Employees under plan dominated control rarely may have the ability to directly observe fund performance on daily, weekly, monthly or quarterly basis. ERISA does require a minimum of semi-annual reporting. Employee control is limited to overall deferral rate and fund selection.
Commonly, fund gross investment return is reduced by record-keeper/fund manager expenses which results in lower net investment rate to employees and zero plan expenses to employer, more importantly without employee say as to record keeper/fund manager selection. Many class-action ERISA lawsuits have resulted from this practice starting in 2016.

In the fully integrated financial wellness environment, the DC investment menu is the centerpiece of investment decision-making for all plan participants and is linked to financial wellness strategy. By offering employees a means to earn excess investment return (pre-tax and post-tax), the employer benefit budget constraint is no longer fully restrictive. Where employees can earn excess return and share such knowledge (with employer incentive to voluntarily do so but under no obligation), higher deferral rates and participation rates are likely which results in higher financial wellness. All this is viewed as a supplemental layer over a base layer. Notice employees do not have to wait for a target date to accumulate. Higher 401(k) balances will lead to: faster student loan repayment, down payment on house or emergency funds.
Additionally, employers should allow up to one-month gross salary advance as loan with 401(k) money pledged as collateral. This benefit structure serves as a guide for participants who seek options beyond the designated default option or an all-in-one TDF.

This paper proposes three steps for fully integrating financial wellness with DC investment menus in this new environment:

1. Identifying plan objectives.
2. Focus on investing – long-run and short-run.
3. Ensuring active, ongoing oversight.

Before focusing on the three steps we'll review the typical stand-alone financial wellness offering for shortcomings.

Typical Financial Wellness Offering – little likelihood of success
The typical stand-alone financial wellness offering focuses on process rather than focusing on the solution. Why? Simply, common logic informs us that, “any meaningful solution is to advise the firm to pay their employees more or tell employees to simply save more.” The blowback from the firm or employees for pointing out the obvious and wasting everyone’s time will be immediate and justified.

“Every employee desires an immediate, guaranteed high level of financial wellness.” – no characteristic (age, sex, martial-status) or label (generation, position title) is needed. Remove “guaranteed aspect” and you have the behavioral basis for the success of lotteries.

Some financial wellness program vendors will offer “sweeteners” such as “special / exclusive” low interest rate credit cards, “special / exclusive” lower interest rate loans or “special loan underwriting option – cars, boats, house.” Financial wellness is about budgeting and saving and not about making it easier to accumulate more debt, employees do like this option as it is appealing but rationally it is self-defeating.

The first step is to assess the situation by gathering information:

1. A direct survey is the best information tool.

A survey provides fresh data and informs the work force that the firm is seriously looking at financial wellness out of concern for the employees. A survey using the corporate internet with an incentive has tremendous positive results and immediately boosts morale as you announce the winner of the incentive. At a minimum some amount of energy (“buzz”) is injected and lasts for about 1 week or less depending on the size of the incentive e.g. $ 25 is worth 5 minutes, $ 100 is worth 1 day and $ 1,000 is worth 1 week. It goes without saying to announce the winner on a Monday or Tuesday and never on a Friday for optimal impact.

If no survey, then typically the process is as follows:

2. Understand the demographic makeup of your workforce.

Gathering information is a starting point for any project.

Knowing the age, generation, life stage, marital status, family structure, income and financial circumstances of your employees is the only way to design a program that’s relevant to everyone’s priorities.

3. Analyze data on your existing benefit plans.

Review participation rates, contribution rates, average balances or coverage amounts can reveal whether or not your employees really have the protection they need. Current contribution rate is a function of past fund performance.

Remember that in the current “gig” economy, many employees have two jobs and / or working spouse which means the data and analysis are performed under incomplete information. Employees have balances from past employers which may be substantial, and they are not going to share this information.

From employee's viewpoint, "what is the firm going to do for me now and into the future is the only concern" , it must be tangible.

4. Assess your employees' financial knowledge

To truly understand your employees' financial challenges, you'll need to understand more about their financial behaviors, like how they approach basic money management, investing, retirement and taxes. In-depth surveys, observations or focus groups can be a great way to gather this information.

If an employee prefers to spend 50% of gross income to live in a location or fashion of their choice, that is their right and no amount of counseling or lecturing is likely to change the situation.

Plan Objectives

Employers provide valuable benefits at significant cost to plan participants and are duty-bound to put participants' interests first in selecting and monitoring investments for their retirement plan.

Participants want to maximize the plan's value for their individual circumstances given expected annual income and expected employment status.

Participants want to:	Plan sponsors want to:	Objective for both:
Have a comfortable retirement.	Help participants achieve retirement readiness.	Ensure adequate plan contributions.
Have access to a reasonable set of investment choices. Additionally, self-directed must be included.	Offer a range of investment choices consistent with the sponsor's investment philosophy and employee's philosophy.	Have access to optimal investments not just competitive investments.
Want to make investment choices quickly and effortlessly including ability to self-direct (brokerage).	Encourage well-diversified portfolios (e.g. through defaults, fund managers, wealth advisors).	Self-direct option available to all. Simplify participant decision-making with a diversified, low-cost default option.
Monitor fund performance daily, weekly and monthly using internet. Change deferral % and fund allocation anytime. Investment analytics tools to monitor and act as second opinion to fund manager but accessible to employee	Monitor fund performance daily, weekly and monthly using internet. Investment analytics tools to monitor and act as second opinion to fund manager and accessible to Plan Trustees	Guard against devaluation. Measure rate and timing of investment gains. Access to actionable investment information using investment analytics tool independent of record keepers / fund managers analytics. Congruence of independent models increases accuracy and consistency.

Opportunity to increase return when event is forecastable, opportunity to avoid downturn when event is forecastable. Select equities to enhance return / sell to avoid loss or LOCK in GAIN	Opportunity to increase return when event is forecastable, opportunity to avoid downturn when event is forecastable.	Guard against devaluation, measure rate and timing of investment gains.
Performance is first criteria. Good performance = higher fees. Poor performance = lower fees	Offer investments at competitive, reasonable fees.	Performance related fees. If passive index = lowest fee or $ 0

The highlighted rows indicate the additional requirements for fully integrated financial wellness over a stand - alone financial wellness program.

Integrated financial wellness requires granting a high degree of participant control combined with investment analytic information to enable execution which supplements a base plan.

With availability of equity investment analytics such as TRI-SIGNAL to Plan trustees and participants, a "two-way" communication channel replaces the old one-way channel from record-keeper/fund manager to Plan and participants.

In order to monitor fund manager, adequate and timely fund information is required to be made available to Plan Trustees and plan participants. Plan trustees can and should negotiate for this information as ultimately it is determinative of participant performance and any claim of proprietary is misleading at best. The fact that employees are partially paying for administrative costs out of reduced investment return also justifies the requirement.

Using TRI-SIGNAL, each employee, can monitor funds for short-run and long-run gain / losses. This is in addition to fund manager. Logic indicates that more monitoring using investment analytics will lead to better performance which benefits all parties. Competition between the between plan participants and wealth advisors / fund managers likely results in higher returns.

Fully integrated financial wellness solves the biggest problem: "**Employees believe that the firm, Plan trustees and fund managers should protect their fund balances as a first priority and cannot phantom that time and again they suffer devaluation when it was forecastable and preventable."**

New trade advisory role:

Plan trustees can now identify investment opportunities using TRI-SIGNAL and advise fund managers of trade selections. Fund managers are free to provide their own independent advisory. A two-way discourse should lead to smarter investment decisions, higher returns and avoidance of devaluations. Propensity for ERISA litigation will significantly decrease as participant has full control at their exercise.

New investment manager monitoring role:

Using investment analytics, Plan Trustees can avoid or mitigate the fund manager performance conundrum: "top-performing managers experience periods of underperformance." Furthermore, participants are free to monitor and take control to enact their own strategy on-demand independent of Plan trustee actions.

New fund performance monitoring role:

Plan Trustees and participants can monitor fund performance each trade-day. Where fund return is insufficient, the Plan can take immediate action to manage the situation rather than managing after the fact. Failing Plan Trustee action, a participant is free to independently monitor performance and take independent action at any time to capture gains or avoid losses.

Plan participants are likely to increase their plan contributions (that is, increase their savings rate) under integrated financial wellness where downsize risk is minimized than under traditional financial wellness where the result of increased savings is wiped out by market effects which were forecastable and avoidable.

Focusing on investing – Long-run and Short-run

The case will be made for a portfolio foundation consisting of a long-run base portfolio that is well diversified with proper asset allocation with a top short-run equity layer for boosting investment returns using TRI-SIGNAL.

Long-run:

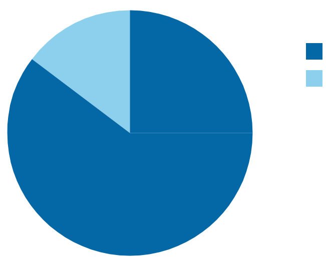
Three elements that influence long-term investment success form a logical foundation for portfolio construction decisions: asset allocation, diversification, and cost. As such, they should also serve as the foundation for an effective plan lineup.

Asset allocation. When developing a portfolio to meet an identified objective, it's critical to enable participants to select a combination of assets that offers the best chance of meeting their objective, subject to their individual circumstances. The "top-down" asset allocation decision under active or passive largely determines long-term success or failure of meeting the investor's objective. In fact, assuming investors use broadly diversified investments, the vast majority of an investor's return over time is derived from asset allocation, as opposed to either fund/security selection or market- timing, according to a landmark study on the determinants of portfolio performance.

Figure 1. Investment success is largely determined by long-term asset mix

Percentage of portfolio return variability attributable to:

85.5% Asset allocation
14.5% Security selection and market-timing



Source: https://blogs.cfainstitute.org/investor/2012/02/16/setting-the-record-straight-on-asset-allocation/

Diversification. Diversification is an effective strategy for managing investment risks. For example, diversification across asset classes (stocks, bonds, and short-term reserves) reduces a portfolio's exposure to the risks common to a single asset class. Diversification within an asset class (U.S. and international stocks; market capitalization and style within stocks; U.S. and currency-hedged international bonds; credit quality and maturities within bonds) reduces a portfolio's exposure to risks associated with a particular company, sector, or segment.

Cost. Minimizing investment cost is critical to improving investment outcomes for participants. Every dollar paid for management fees or trading commissions is a dollar less of potential return.

Some combination of mutual fund , passive index or target date fund serves as base long-run portfolio with additional information monitoring requirement made available to Plan Trustees and participants.

Short run:

Short-run equity gain / loss is all about equity selection and timing. The plan participants require investment analytic information to alert for potential short-run gains as well as avoiding losses which are 100% absent in current stand-alone financial wellness plans. TRI-SIGNAL enables low risk return enhancement.

You have no doubt heard "you can't consistently time the market" which was true in the past but with new technology and machine learning, we can confirm that it is possible to consistently time the market to capture short-run gains while avoiding downturns but only using TRI-SIGNAL. Accuracy exceeds 85%.

Less Propensity for ERISA Litigation – TRI-SIGNAL predictive equity analytics protects the employer, protects the Plan and helps employees.

Under U.S. ERISA fiduciary law, plan sponsors are responsible for actively selecting and monitoring investments offered within a retirement plan. Plan trustee due diligence on investment menu is straightforward.

A few key steps:

- Ensure that the investment menu facilitates the goals and objectives identified by creating an investment policy statement.
- Specify criteria by which funds will be selected and evaluated as well as timing and publication of findings.
- Maintain a disciplined process for hiring, evaluating, and terminating record keepers, wealth advisors and fund managers for the plan.
- Enable employees' access to TRI-SIGNAL to monitor markets and monitor fund performance.
- Enable self-directed investments via brokerage window and allow participants to use TRI-SIGNAL predictive equity analytics for informed predictive trade execution.
- Develop Plan capability to advise/direct fund advisors in on-going investment activities customized to Plan's demographics, risk tolerance and goals.
- Confirm the plan's qualified default investment alternative (QDIA) and consider implementing a reenrollment if establishing a QDIA for the first time or changing an existing QDIA .
- Document all of the preceding steps in an investment policy statement (IPS) and revisit the policy regularly with your investment committee – a minimum of semi-annually if not quarterly.
- Stay abreast of new products as well as changes in the investment and regulatory landscape.

Conclusion

Integrated financial wellness programs can help employers do a better job of managing their workforce and can optimize their investment in their overall employee benefit program. Most large employers have already implemented stand-alone financial wellness programs with deferred reporting of results due to novelty. We would advocate that employer groups adopt the fully integrated financial wellness program and implement investment analytics (TRI-SIGNAL) with full brokered trading within DC plan outlined above as they continue to build their program capabilities in ways that benefit both their employees and their businesses.

For more information on financial wellness, DC plans and TRI-SIGNAL predictive investment analytics, please contact IHA Consultants.

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