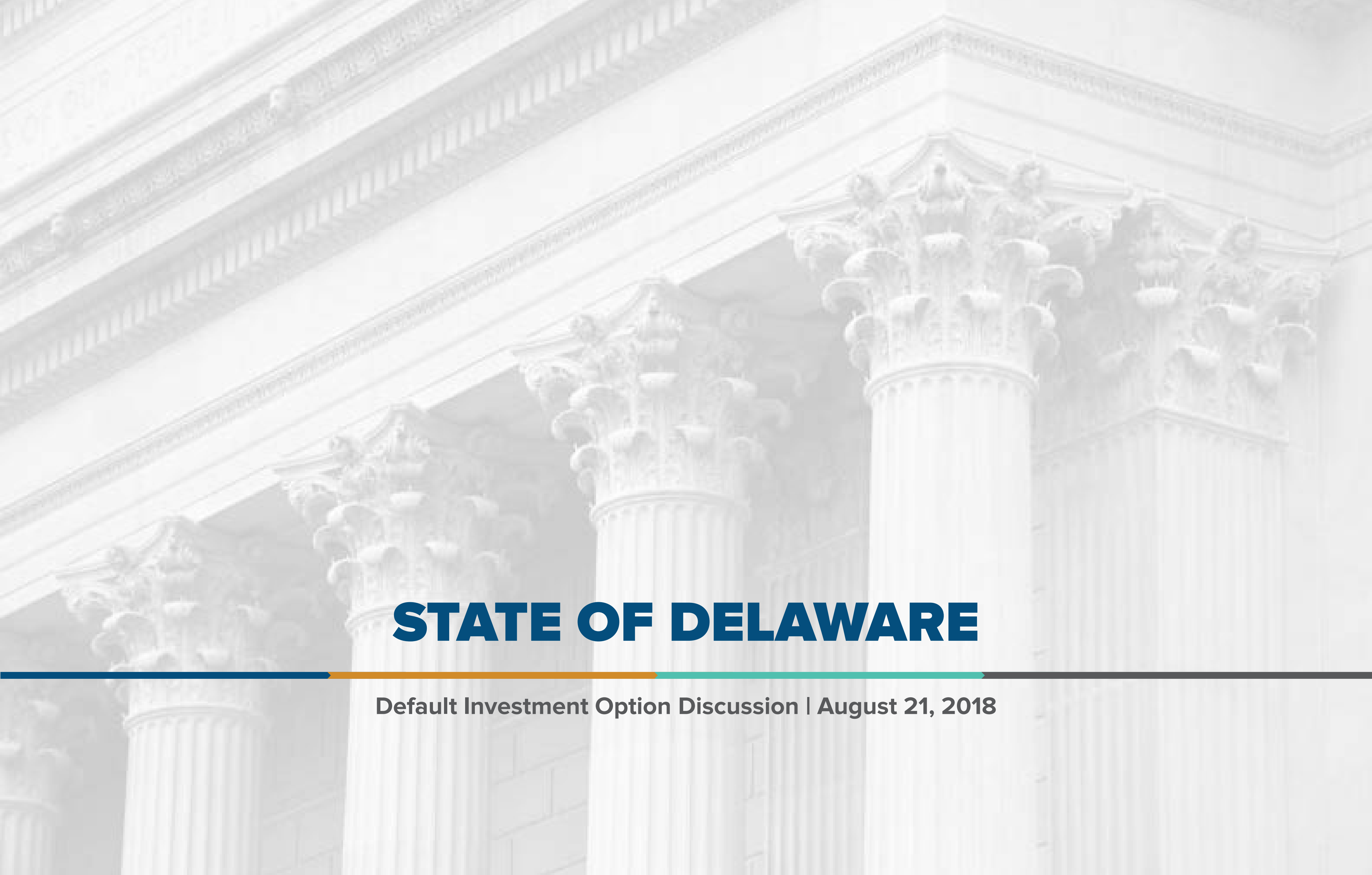


STATE OF DELAWARE

Default Investment Option Discussion | August 21, 2018

CAMMACK RETIREMENT

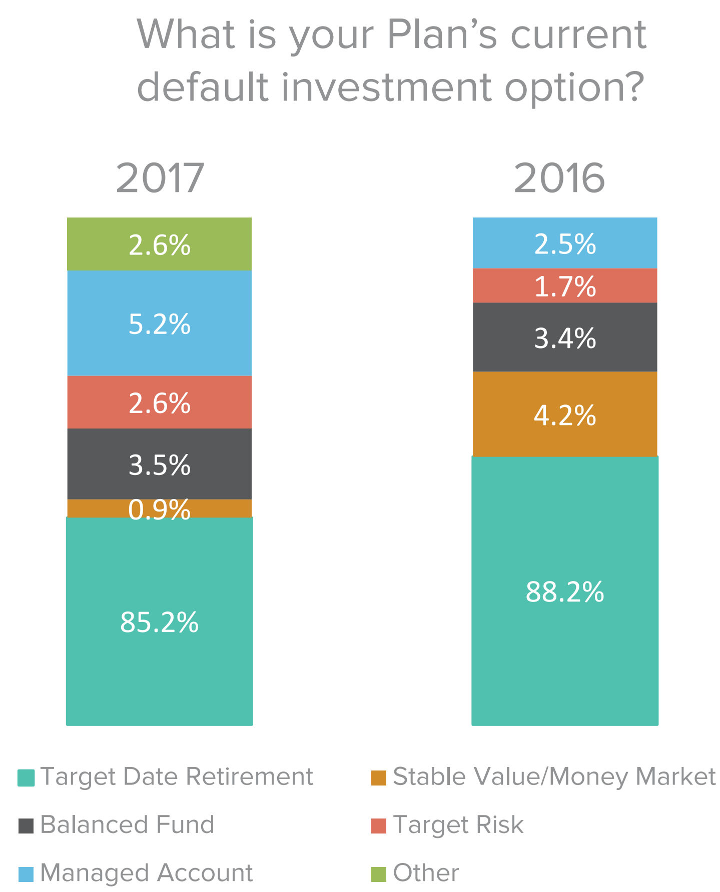
AGENDA

- Default Investment Options
- History of the State of Delaware's Target Date Fund Manager Selection Process

DEFAULT INVESTMENT OPTION

Key Considerations

- Used to encourage participant investment in appropriate vehicles for long-term retirement savings
- Take advantage of inertia since participants rarely make changes after their initial default or active choice
- Default options often capture up to 85% of all employees contributions
- **Target Date Funds (TDFs):** A changing mix of equities and fixed-income investments with an automatic rebalance feature that shifts to a more conservative allocation as the participant approaches retirement
- **Target Risk / Balanced Funds (TRFs):** Mix of equity and fixed-income that align to a particular targeted risk level, e.g., Aggressive, Moderate, Conservative
- **Managed Accounts:** A customized asset allocation strategy managed by investment advisory firm that considers personal data and adapts to changes (usually carries higher cost than TDFs or TRFs)



Survey Source: 2018 Defined Contribution Trends by Callan Institute.

HISTORY

The investment arrays were reviewed across the multiple vendor structure and a detailed analysis was performed; key considerations included:

- The goals as set forth by the Deferred Compensation Council (DCC) and the Investment sub-Committee during the initial phases of the project
- The current asset classes used by participants in the Plans
- Investment behavior of the participants, including the Plans' stable value/fixed annuity fund
- Industry best practices and trends for public governmental defined contribution and defined contribution plans
- The identification of opportunities to reduce costs to participant

Cammack Retirement employed a comprehensive qualitative and quantitative screening process. Key steps in the Target Date Fund manager selection process included:

- Define Plan goals / examine the purpose of the Target Date Series
- Review the investable universe to create a diverse group of potential managers
- Compare selected subgroup of potential managers
  - Active vs. passive management
  - Glide Path construction
  - Underlying strategies (e.g., nontraditional asset classes)
  - Investment strategy
  - Portfolio management team and organization structure
  - Historical Track Record and Statistics
  - Fees

HISTORY

As a result of the work between Cammack Retirement, State of Delaware Office of the State Treasurer (OST), and the DCC Investment Sub Committee, the following represent the target date fund related recommendations made by Cammack Retirement to the OST and the DCC:

Recommendation – Tiered investment structure

Adopt an investment menu structure that satisfies different investor types, and allows for an optimal usage of the Plans post transition. Communication and education are a core tenet of a defined contribution plan's success; organize the new arrays in the following manner:

- Tier 1: Target Date Suite
- Tier 2: Array of active and passive investments
- Tier 3: Self Directed Brokerage Window

Recommendation – Select the American Funds Target Date series for Tier 1

The American Funds target date series is designed to manage assets through retirement and employs a risk mitigation strategy which reduces the susceptibility of the holdings to poor performance during market declines versus other target date funds with similar equity exposures. Volatility management is a key tenet of the portfolio management team.

Recommendation – Perform a re-enrollment of the Plans upon Plan transition

Map/transfer existing and future contributions into the Plans' Tier 1 (TDF) selection. This allows participants a window of time to make their own investment selection, or selecting investment options from the new, streamlined array. Defaulted participants are given opportunity to have a professionally managed asset allocation that is designed for a specified age. A recent Vanguard study, "Improving plan diversification through reenrollment in a QDIA" also provided evidence of success.

APPENDIX

TARGET RISK AND BALANCED FUNDS

General Summary

- In 2017, 6.1% of plans use a target risk funds ('TRFs') or balanced funds as their default investment option.[1]
- Similar to TDFs, Target Risk Funds give participants a simplistic way to invest in a diversified portfolio
- Mix of equity and fixed-income that align to a particular targeted risk level – Aggressive, Moderate, Conservative
- Static Glide Path – reduction of risk will not happen automatically
    - Requires participants to make decisions and take action to make changes at right time if/when risk tolerance changes
- TRFs change according to market conditions in order to maintain risk tolerance level assigned to fund.
- TRFs provide a more consistent exposure to certain amount of risk over time.

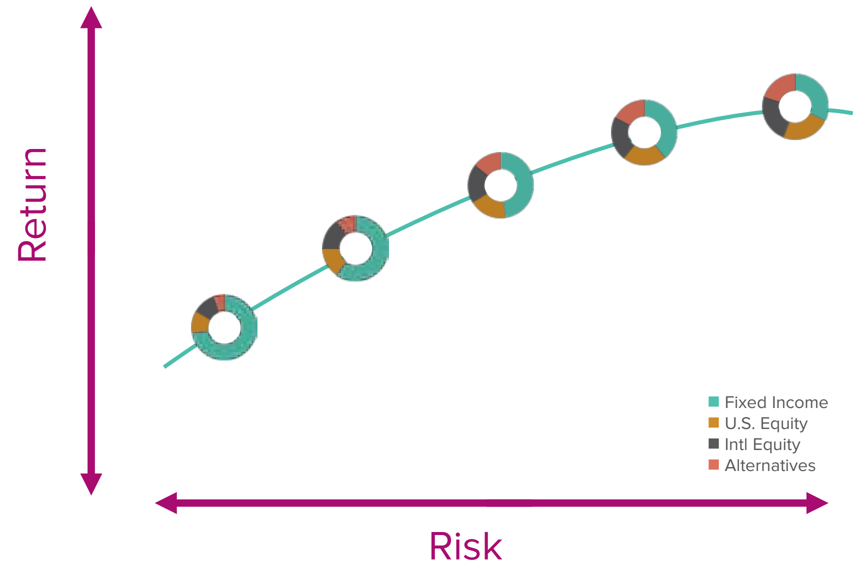


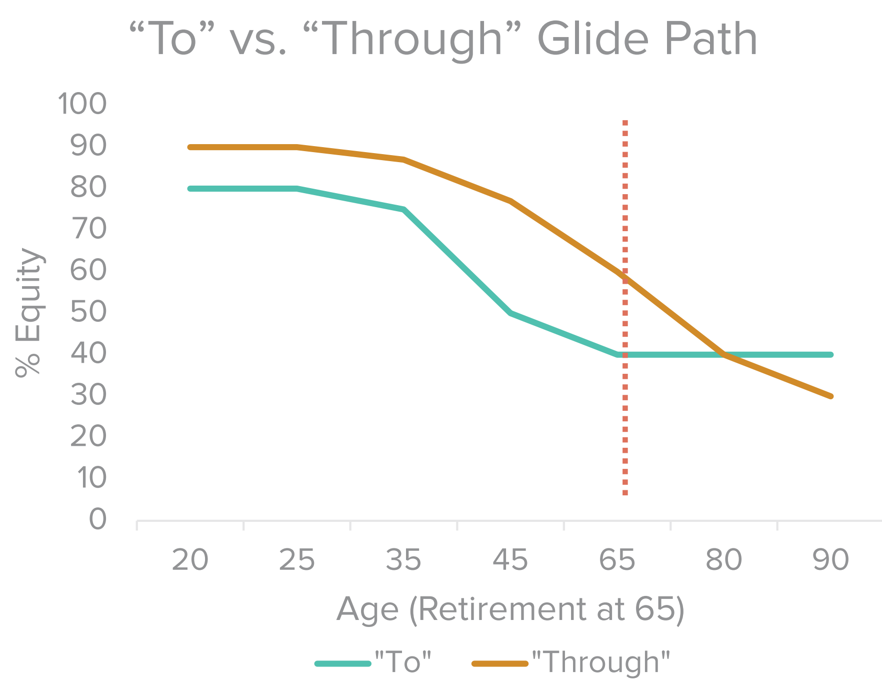
Chart Source: Cammack Retirement Group. For illustrative purposes only.

[1] Source: 2018 Defined Contribution Trends by Callan Institute.

TARGET DATE FUNDS

General Summary

- Over the past 10 years, target date funds ('TDFs') have received net inflows of $509 billion. In 2016, TDFs had net inflows of $65 billion and ended the year with assets of $887 billion.[1]
- In 2017, 85.2% of plans use a target date fund as their default investment option.[2]
- Invest in a changing mix of equities and fixed-income investments with an automatic rebalance feature that shifts to a more conservative allocation as the participant approaches retirement
- Invests using a fund-of-funds approach
- Assess participant behavior and risk tolerance
- Consider plan demographics, compensation levels, contribution rates and turnover patterns



- "To": Reach most conservative asset allocation on date of fund's name and allocation is static throughout retirement
- "Through": Rebalance and reach most conservative asset allocation after target date

Chart Source: Cammack's model used for illustrative purposes only.

[1]2017 Investment Company Institute Fact Book.
[2]2018 Defined Contribution Trends by Callan Institute.

MANAGED ACCOUNTS

General Summary

- In 2017, 5.2% of plans use a managed account as their default investment option.[1]
- According to a 2015 report by Cerulli Associates, the spread between managed accounts and target date funds fees can be upwards of 50 basis points.[2]
- Offers a customized asset allocation strategy managed by investment advisory firm that considers personal data and adapts to changes
- Can help address the needs of participants with more complex financial situations and/or who wish to utilize a more tailored approach
- Flexible shifts in portfolio to adjust for market environment or participant needs
- Education is necessary
- Typically higher fee levels than TDFs or TRFs
- Lack of a clear benchmark – difficulty in evaluating effectiveness of service

Key Characteristics

- ✓ Participant Age
- ✓ Participant Gender
- ✓ Contribution Rate
- ✓ Financial Situation
- ✓ Risk Tolerance
- ✓ Savings/Spending Pattern
- ✓ Salary
- ✓ Outside investments – DB Plan

[1] Source: 2018 Defined Contribution Trends by Callan Institute.
[2] Cerulli Associates, The Cerulli Report, 2015 Retirement Markets: Growth Opportunities in Maturing Markets.

TARGET DATE FUND MANAGER SELECTION PROCESS

Investment Due Diligence: Key Considerations

- **Portfolio Management Team and Organization Structure**
  - Firm stability and history
  - Manager experience/tenure in asset allocation funds
- **Investment Strategy**
  - Understanding the fund security selection and monitoring process.
  - Ability for active managers to add alpha
  - Tactical allocation vs. strategic allocation
  - Dynamic approach to add greater flexibility along strategic glide path
  - Rebalancing policy - when to rebalance and by how much
- **Historical Track Record and Statistics**
  - Total return (quarter, year-to-date, 1-3-5-10-year periods)
  - Risk-adjusted returns
  - Relative return
  - Risk characteristics
- **Fees**
  - Relative to peers
  - Higher equities may lead to long-term return but may increase fees
  - Inclusion of non-traditional asset classes my increase fees

TARGET DATE FUND MANAGER SELECTION PROCESS

Investment Due Diligence: A Deeper Look

❖ Active vs. Passive Management

- All target date providers make active asset allocation decisions when creating the glide path. The active vs. passive management applies to underlying strategies.
- Passive management offers limited choice (level of asset class diversification), limited tactical flexibility, and no alpha potential in different asset classes. Some asset classes are not accessible as passively managed investments. Since they focus on tracking an index, they are not designed with retirement outcomes and participant behaviors.
- Active management in certain asset classes, such as emerging markets, may prove to be helpful in mitigating risks as economic conditions change.
- Consider Active and/or Blend strategies

❖ Glide Path Construction

- Consider range of aggressive to conservative managers
- Evaluate the changes in risk/return expectations from early investment years to retirement
- Evaluate the speed of transition from higher risk/reward (equities) to lower risk/return (fixed income)
- Consider the degree of tactical asset allocation – tactical ability to enhance returns and/or reduce risk by adjusting asset allocation to take advantage of market changes
- Development of asset allocation strategy incorporates real-world, participant statistics and research

❖ Underlying Strategies

- Inclusion of non-traditional asset classes can offer diversification and may increase the probability of adding incremental returns, which may enhance return potential and risk efficiencies. Offering an asset class sleeve in the TDF that may not be available in the core investment menu as a stand-alone option may be beneficial to members.
- Evaluation of correlation characteristics and how well the underlying strategies fit within the asset class and portfolio

TARGET DATE MONITORING PHILOSOPHY

Investment Due Diligence: Top Down Investment Selection

- **Examine the purpose of the Target Date Series**
  - Identify the targeted demographic who will be utilizing the Target Date Series
  - Define plan goals by examining characteristics about the plan/participants and evaluating how these factors can shape considerations
    - Return expectations, volatility management, investment knowledge, average account balances, risk exposure at retirement, etc.

- **Review the investable universe to create a diverse group of potential managers**
  - Consider how Cammack's proprietary risk classification subsets would best fit with plan goals
  - Examine the smaller risk subsets through a quantitative measuring system to identify top performers
  - Investment analysts perform qualitative/quantitative reviews of investment managers
  - Examine the historical and future scenarios where different Target Dates are best poised to meet plan goals

- **Compare selected subgroup of potential managers**
  - Meet with target date managers (primarily on a quarterly basis) to keep current with management trends and forecasts
  - Review economic developments to understand their implications on the underlying holdings of the selected target date series
  - Track the consistency and conviction of managers across both the short, mid, and long-term using both quantitative and qualitative metrics
  - As economic conditions continue to change and develop, periodically repeat this process to ensure long-term optimization of investment selections

The information contained herein has been obtained from sources that are believed to be reliable. However, Cammack Retirement Group does not independently verify the accuracy of this information and makes no representations as to its accuracy or completeness.

New York, NY

40 Wall Street, 56th Floor

New York, NY 10005

P: 212.227.7770

Wellesley, MA

100 William Street, Suite 215

Wellesley, MA 02481

P: 781.237.2291

Lexington, KY*

948 Village Green Avenue

Lexington, KY 40509

P: 859.492.1765

Investment products available through Cammack LaRhette Brokerage, Inc.
Investment advisory services available through Cammack LaRhette Advisors, LLC.
Both located at 100 William Street, Suite 215, Wellesley, MA 02481 | p 781-237-2291

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