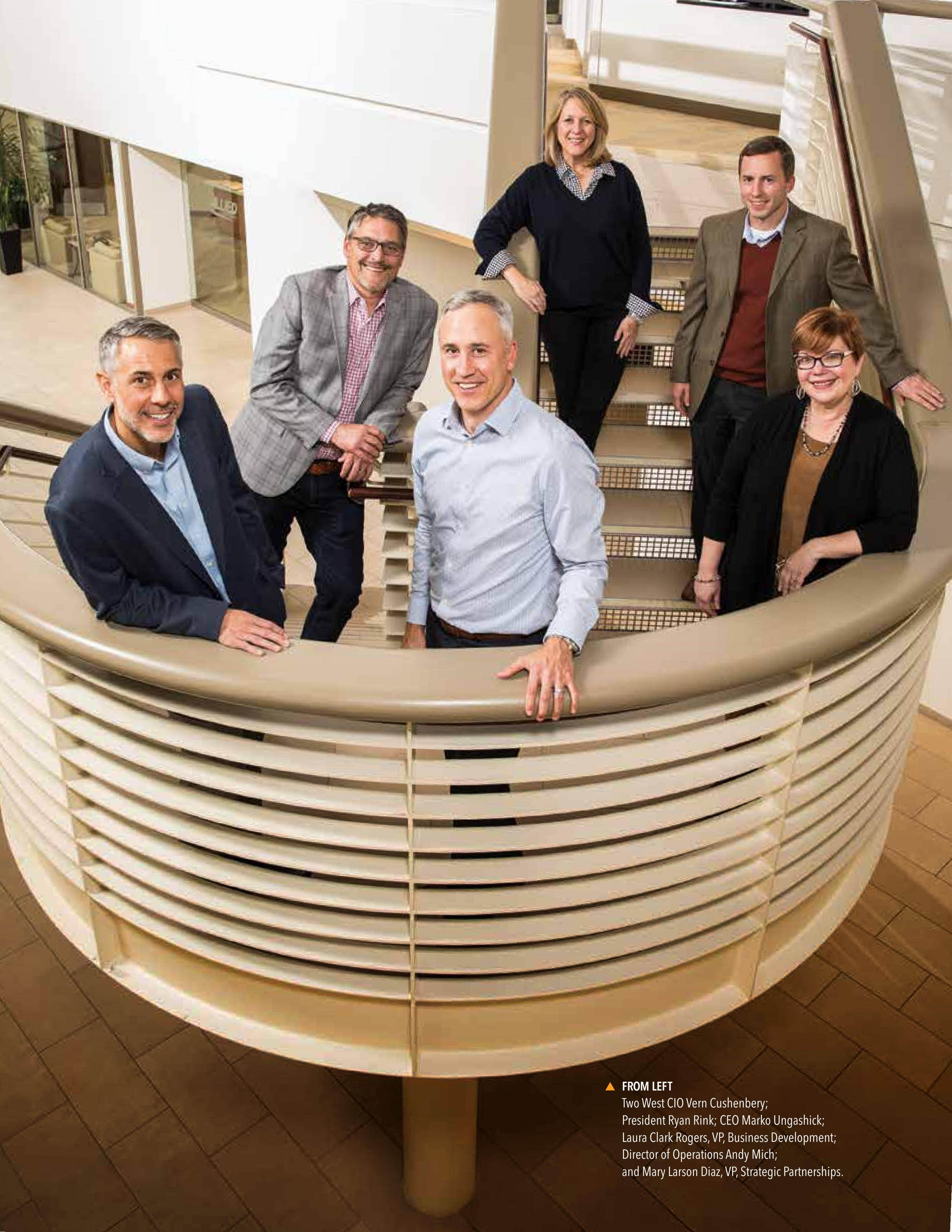
Reprinted from
DC DIMENSIONS

Focusing on Income for Better Outcomes

Innovative advisors want to change the way plan sponsors and participants prepare for retirement by providing solutions that focus on sustainable income.

By **Ashish Shrestha**
Vice President, Dimensional Fund Advisors -

WINTER 2018



▲ **FROM LEFT**
Two West CIO Vern Cushenbery;
President Ryan Rink; CEO Marko Ungashick;
Laura Clark Rogers, VP, Business Development;
Director of Operations Andy Mich;
and Mary Larson Diaz, VP, Strategic Partnerships.

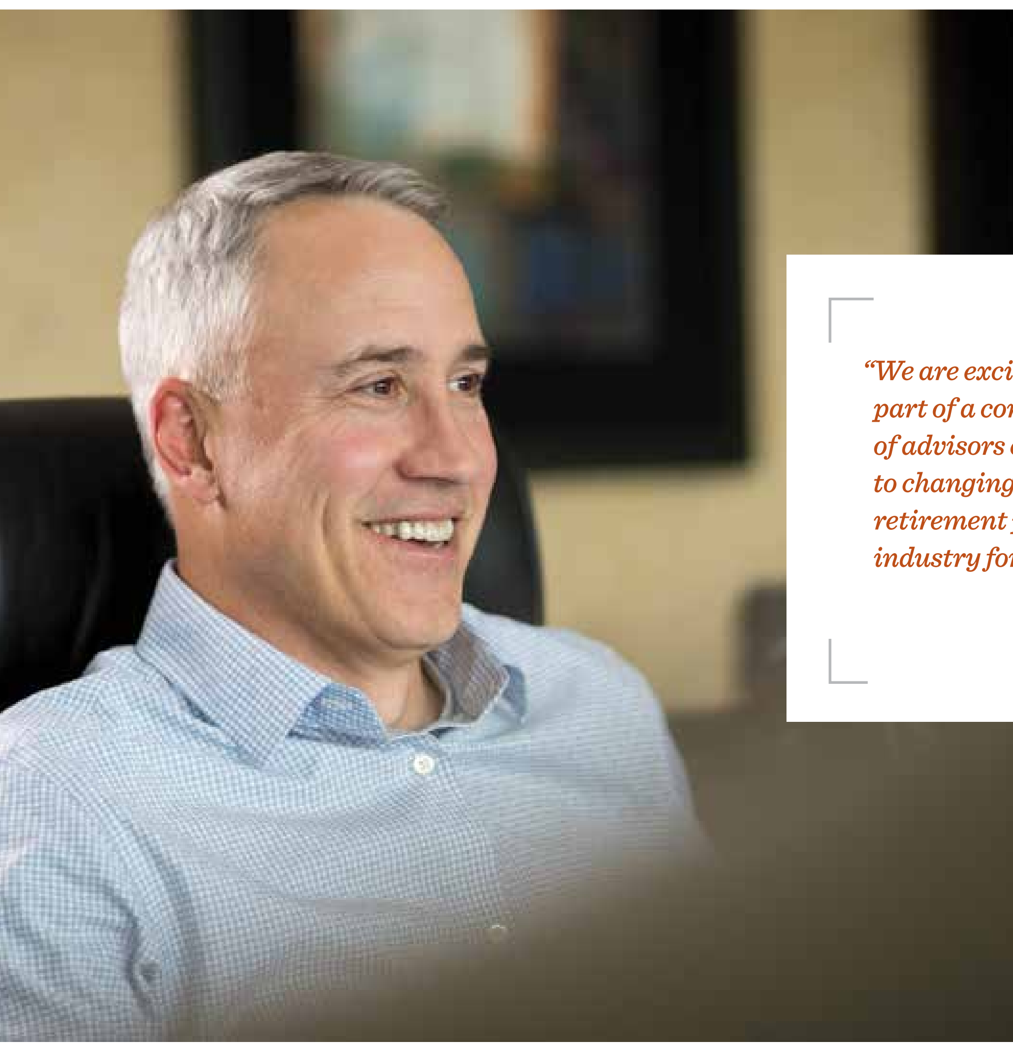
FOCUSING ON INCOME FOR BETTER OUTCOMES

Two West Advisors in Kansas City wants plan sponsors, advisors, and plan participants to shift their focus to what really matters: *sustainable income in retirement.*

By **Ashish Shrestha**
Vice President, Dimensional Fund Advisors

Two West Advisors, a firm based just outside of Kansas City, has big ideas. The firm's leaders believe America's retirement plan system is failing and needs a makeover. Outcomes are not what they should be, in their view, because the industry is not focusing on income. So Two West spends its energy on two key endeavors: [1] educating plan sponsors and participants and [2] providing tools and investment solutions to help shift their focus to what really matters: a sustainable income in retirement.

Here, in an extensive discussion with CEO Marko Ungashick, AIF®, and CIO Vern Cushenbery, CFA, CPA, we explore their views on the keys to solving this income puzzle and how they hope to spread the word to other industry players.



"We are excited to be a part of a community of advisors committed to changing the retirement plan industry for the better."

MARKO UNGASHICK

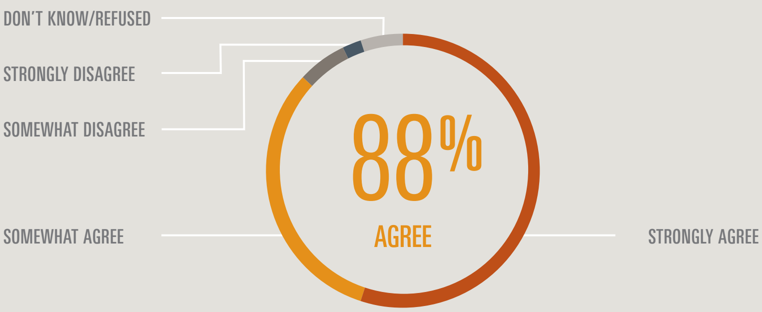
Some of our readers will be familiar with Two West as a pension consultant and a turnkey asset management provider (TAMP) in the retirement plan space. Yet you have branded your firm as the "Income TAMP." Why income?

VERN CUSHENBERY That branding was actually the result of a passing comment made by (Dimensional Co-CEO) Dave Butler. We had been invited to Austin in 2016 to share some of our insights in rolling out a liability-driven investment (LDI) approach based on Dr. Robert Merton's life cycle research at MIT.[1] This work was done in partnership with TIAA and required a complete retooling of our internal package of tools and services, including marketing collateral, investment analysis, investment policy statements (IPS), and advisory agreements. I think it was Dave who first suggested we share what we had built with other advisors, and the Income TAMP was born.

This is one of the most exciting opportunities I've worked on in my career. Why? Because, in our opinion, the American retirement system has room for improvement. *(See **Exhibit 1,** page 5, for evidence of Americans' concerns about retirement.)*

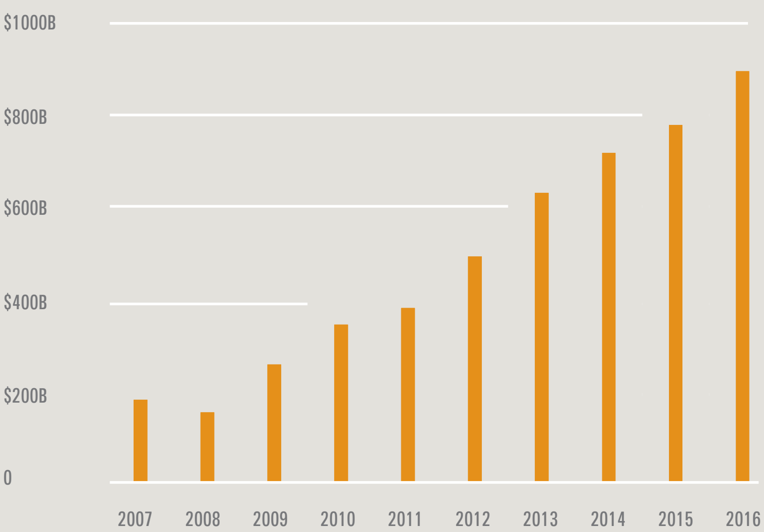
We have a real opportunity to change the shape of our industry by creating better outcomes for retirees, and the best part is that the investment philosophy underpinning these strategies is not new. For instance, the same LDI strategies have powered many defined benefit plans for decades.[2] As Two West and other advisors continue to push forward, I think we could see fund flows into these and similar solutions match the amounts that flowed into target date funds in the wake of the Pension Protection Act of 2006 *(see **Exhibit 2,** page 5).* And that's something to get excited about!

Exhibit 1 **Percent of Americans Who Say the Nation Faces a Retirement Crisis**



Source: "Retirement Security 2017: A Roadmap for Policy Makers," National Institute on Retirement Security, 2017.

Exhibit 2 **Net Assets of US Target Date Funds**
2007–2016, Assets in Billions (USD)



Source: Morningstar, "2017 Target Date Fund Landscape," tinyurl.com/mstar-tdf.

MARKO UNGASHICK Your question "Why Income?" is bigger than that, though. It goes back to our DNA. Our focus on income is another step in the evolution of our firm.

Early on, we adopted many of the values that James P. Owen writes about in *Cowboy Ethics: What Wall Street Can Learn from the Code of The West*—one of which is "Riding for the Brand." In the code of the Old West, that meant putting the interests of others first. Translating that into 21st-century language sounds a lot like the Department of Labor fiduciary rule. This approach of putting the client first and serving as an independent fiduciary was a part of our early success.

As early as 2002, we recognized the disparity in the service models that bigger plans ($50 million and over) were getting compared to smaller plans, which were predominantly served by proprietary broker-dealer models. We noticed a hole in the market and brought the independent fiduciary-minded approach to smaller plans, implementing a best-practices approach by focusing on clients first.

We supplemented this service model with a package of financial wellness tools for participants, which at the time was very innovative. So, yes, we wholeheartedly believe in income, but it's more accurate to say we believe in continually striving to efficiently serve our clients' interests—in other words, we "Ride for the Brand." Income is just the latest manifestation.

How have clients received this income-based approach?

CUSHENBERY Early adopters have been enthusiastic. They get it and have been excited to bring this new focus to retirement plan participants. However, there are times when individuals on retirement plan committees may be skeptical of new solutions. Our experience has been that when we are given the chance to explain the approach and compare it to the successes of LDI strategies in defined benefit pension plans, plan sponsors are willing to engage.

Exhibit 3

How Do You Measure the Success of Your Plan?

"Retirement Income Adequacy" is not a key metric of success for plan sponsors. (Scale: 5 is most important.)

MOST IMPORTANT

4.0	Participation Rate/ Plan Usage
3.5	Contribution/ Savings Rate
3.5	Investment Performance
3.2	Cost Effectiveness
3.2	Investment Diversification
3.1	**Retirement Income Adequacy**
3.0	Employee Satisfaction
3.0	Avoidance of Fiduciary Issues
2.9	Benchmark against Other Plans
2.6	Ability to Attract/ Retain Employees

LEAST IMPORTANT

Source: "2017 Defined Contribution Trends Survey," Callan Institute Survey, https://www.callan.com/wp-content/uploads/2017/01/Callan-2017-DC-Survey.pdf.

In that light, the only new part of what we are doing in the DC marketplace is educating participants and providing tools to help shift their focus to what matters: a sustainable income in retirement. Even some plan sponsors lose sight of the fact that income is in the name of the act; ERISA stands for the Employee Retirement Income Security Act. *(See **Exhibit 3** at left for details on how plan sponsors rank income in evaluating the success of their plans.)* It's been encouraging to see a greater focus coming out of Washington on income-based solutions. We are currently working with a lobbyist group to help create awareness within state and local governments. For organizations whose participants are extremely underfunded, this focus on income could have a big impact.

How are you moving forward?

CUSHENBERY We continue to push towards what we believe will be an eventual tipping point in our industry. That means widespread adoption of income-focused solutions. As we get more plan participants to a retirement-ready status, this process will naturally unfold. It will take a lot—and I mean a lot—of education on our part, both with the plan sponsor and plan participant.

For the plan sponsor, we are actively gathering supporting data. We have a lot of anecdotal data, but as we begin to aggregate this income-focused strategy plan by plan, I believe that the power of this approach will be self-evident.

For plan participants, we are building a library of education materials, webinars, and calculators designed to refocus their attention on income. It's a huge job because we are fighting decades of contra-education that has taught retirement plan participants to focus on their account balance rather than sustainable income. But it can be done. Starbucks taught the nation that venti means large, and we can teach the nation that income is what matters.

How do you handle benchmarking an income-focused strategy?

CUSHENBERY Historically, target date funds have been evaluated by total return or risk-adjusted return over a period of time. Yes, glide paths are compared, but in most cases over the past three, five, and seven years, usually the best-performing target date funds were simply the ones that had the highest equity allocation. However, that is not always what is most important to clients who are nearing retirement; rather, we believe a focus on income as opposed to account balance is what truly matters.

What we find is most important to many clients is the understanding of and confidence in the retirement income they can afford at retirement. Any benchmarking program needs to address these issues.

Instead of reviewing returns, we review portfolios' correlation to the price movement of future income. While many target date funds are competing on total return and boosting their equity allocation, we find our clients want peace of mind and certainty of income expectations, so we believe the typical target date fund is not the right choice for those seeking clarity in outcomes. In our opinion, the industry needs to change its focus to income sensitivity and not total return for those people who will be retiring in one to 15 years.

Can others benefit from your experience working with early adopters of this strategy?

UNGASHICK As a TAMP, we've been fortunate to be able to share much of what we've built at Dimensional's DC conferences over the past few years, and many advisors have been appreciative of our insights. We have also benefited from the community of advisors working with Dimensional, who share our commitment to "Riding for the Brand." We are excited to be a part of a community of advisors committed to changing the retirement plan industry for the better.

"We have a real opportunity to change the shape of our industry by creating better outcomes for retirees, and the best part is that the investment philosophy underpinning these strategies is not new."

VERN CUSHENBERY

(LEFT)

VERN CUSHENBERY
Chief Investment Officer

Vern Cushenbery has more than 16 years of experience in portfolio management and research. As CIO for Two West, he leads the firm's investment committee in the implementation of its evidenced-based investment philosophy. Cushenbery is a CFA® charterholder and Certified Public Accountant. He holds an MBA and a master's in accountancy from the University of Missouri at Kansas City and a BS in finance from Kansas State.

In 2007, he founded CUSH Capital Management. Before that, he served as Chief Investment Officer with Legacy Investment Management and was formerly with Kornitzer Capital Management and DeMarche & Associates.

(RIGHT)

MARKO UNGASHICK
Co-Founder/Chief Executive Officer

Marko Ungashick has more than 20 years of experience working with small to medium-sized business owners in all phases of the business life cycle. As CEO, he focuses on the core functions of the organization to enable it to achieve its long-term vision. Ungashick is an Accredited Investment Fiduciary® and has a bachelor's in business from Indiana University.

Prior to founding Two West, Ungashick spent nine years as the COO of a nationally recognized sports marketing company and then as President and CEO of his family's longtime commercial linen and supply business.

1. Robert C. Merton is a consultant to Dimensional Fund Advisors LP and Resident Scientist at Dimensional Holdings Inc.
2. For more information, see "Next Generation DC" (white paper, Two West Advisors, 2015), tinyurl.com/twowestldi.

To read other articles from the magazine or for more information about Dimensional's DC services, please visit us at *us.dimensional.com/defined-contribution.*

dimensional.com

Dimensional

RMXXXXX 02/18