MANNING & NAPIER®

Manning & Napier's Risk-Based Strategies as a Qualified Default Investment Alternative (QDIA)

A White Paper by Manning & Napier

www.manning-napier.com

Unless otherwise noted, all figures are based in USD.

Introduction

The provisions of the Pension Protection Act (PPA) of 2006 defined balanced and risk-based funds as one of three types of qualified default investment alternatives (QDIA) for use in qualified retirement plans. While the final regulations require plan fiduciaries to meet several technical and operational requirements to qualify for safe harbor protection, the following addresses the appropriateness of Manning & Napier's risk-based options as QDIAs and offers guidance on selecting a Manning & Napier risk-based offering as a QDIA for a plan.

Manning & Napier's risk-based options are representative of the Manning & Napier Fund, Inc. Pro-Blend® Series (proprietary mutual funds), and the Manning & Napier Pro-Mix® Collective Investment Trust Funds (investment vehicles offered through an affiliate, Exeter Trust Company, and only for use within certain qualified employee benefit plans).

QDIAs as Defined by the Department of Labor (DOL)

The DOL chose to define QDIAs in terms of mechanisms for investing participant monies, rather than as specific products. The final regulations provide for four types of QDIAs (with the last option serving only as a temporary solution). The four types of QDIAs include:

1. A product with a mix of investments that takes into account the individual's age or retirement date (an example of such a product could be a lifecycle, targeted-retirement-date fund, or age-based fund);
2. A product with a mix of investments that takes into account the characteristics of the group of employees as a whole, rather than each individual (an example of such a product could be a balanced fund or a risk-based option);
3. An investment service that allocates contributions among existing plan options to provide an asset mix that takes into account the individual's age or retirement date (an example of such a service could be a professionally-managed account); and
4. A capital preservation product for only the first 120 days of participation (an option for plan sponsors wishing to simplify administration if workers opt-out of participation before incurring an additional tax).

It is worth noting that the DOL's position in the adopting release of the final regulations is that any of the four types of QDIAs are appropriate and "....the rule does not require a plan fiduciary to undertake an evaluation as to which of the qualified default investment alternatives provided for in the regulation is the most prudent for a participant or the plan." The DOL generally requires a QDIA to include a mix of stocks and bonds that recognizes the trade-off between capital appreciation and capital preservation.

Process for Selecting a Risk-Based Product as a QDIA

While the first and third types of QDIAs (e.g., target date funds and managed accounts, respectively) require the plan fiduciary to consider the individual participant's age when selecting the QDIA, the second type of QDIA defined in the adopting release of the final regulations (e.g., balanced products or risk-based options) requires the plan fiduciary to select a single investment product with "a target level of risk appropriate for the participants of the plan as a whole." Since Manning & Napier's risk-based options include four distinct investment options covering the full risk/reward spectrum, the key questions for plan fiduciaries are (1) which of Manning & Napier's risk-based options qualify as QDIAs and (2) which option would be appropriate as a QDIA for a specific plan. Table 1 outlines the risk management priorities for each of Manning & Napier's risk-based options, as well as the expected equity allocation ranges, and midpoint for each of the options.

Table 1

Risk-Based Options	Risk Management Priorities	Expected Equity Range
Pro-Blend® Conservative Term Pro-Mix® Conservative Term CIT	1. Primary goal of capital preservation 2. Secondary goals of income generation and long-term capital growth	5% - 35% Midpoint: 20%
Pro-Blend® Moderate Term Pro-Mix® Moderate Term CIT	Equal emphasis on: 1. capital preservation and 2. long-term capital growth	20% - 60% Midpoint: 40%
Pro-Blend® Extended Term Pro-Mix® Extended Term CIT	1. Primary goal of long-term capital growth 2. Secondary goal of capital preservation	40% - 70% Midpoint: 55%
Pro-Blend® Maximum Term Pro-Mix® Maximum Term CIT	1. Primary goal of long-term capital growth 2. Distant secondary goal of dampening volatility in extreme market environments	70% - 95% Midpoint: 85%

As to the first question relating to which of Manning & Napier's risk-based options will qualify as QDIAs, we believe that both Moderate Term or Extended Term options would be considered "balanced" funds under any reasonable definition of "balanced" and would be suitable QDIAs for many plans. Furthermore, in select circumstances, the Conservative Term options might also be appropriate QDIAs. However, the DOL's statement in the adopting release that, "… the Department believes that when an investment is a default investment, the investment should provide for some level of capital preservation through fixed income investments", seems to suggest that the Maximum Term options, which have a minimum 70% equity allocation, would generally not qualify as QDIAs.

Fortunately, when it comes to answering the second question regarding which risk-based option would be appropriate, the DOL has provided clear direction on factors to consider in using a balanced or risk-based fund as a QDIA. In the adopting release of the final regulations, the DOL states, "the second alternative requires a fiduciary to take into account the demographics of the plan's participants, and would be similar to the considerations a fiduciary would take into account in managing an individual account plan that does not provide for participant direction….. The Department understands that the only information a plan fiduciary may know about its participant population is age. Thus, when determining a target level of risk appropriate for participants of a plan as a whole, a plan fiduciary is required to consider the age of the participant population. However, a plan fiduciary is not foreclosed from considering other factors relevant to the participant population, if the fiduciary so chooses." Manning & Napier has worked with many trustee-directed plans over its 50+ year history, and in most cases either its Moderate Term or Extended Term options have been used by plan fiduciaries faced with selecting an option consistent with the needs of the participant base as a whole.

Determining the age of the participant population as a whole can likely be accomplished by considering the average or mean age of the participants, the median age of the participants, and/or the range of participant ages. As a practical matter, most plans are likely to have some combination of young and old participants, meaning that the QDIA should consider the trade-off between capital growth and capital preservation. We believe that Manning & Napier's Moderate Term options (which place an equal emphasis on capital preservation and capital growth) serve as a reasonable starting point in selecting a QDIA for most plans (e.g., those with average/median participant ages between 40 and 62 years old), while our Extended Term options (a primary goal of long-term capital growth with a secondary goal of capital preservation) may be appropriate for plans with average/median ages between 20 and 55

years old. The significant overlap between the average/median ages for the Moderate Term and Extended Term options is in line with the degree of overlap between the expected equity allocation ranges for the options (i.e., they overlap in the 40%-60% equity range) and further supports the notion that either of these options could fit in the "balanced" category. Finally, our Conservative Term options may be best suited for plans with average/median participant ages of 55 years or older.

Beyond average/median age, other factors that plan fiduciaries may want, but are not required, to consider in selecting a risk-based strategy to serve as the plan's QDIA include: (1) dispersion of participant ages, (2) participants' eligibility for other retirement benefits (e.g., pension), (3) prevalence of lump sum distributions, (4) participant behavior during times of market distress, and (5) participant turnover rate.

As a general matter, we believe that plan fiduciaries looking to utilize one of Manning & Napier's risk-based options as a QDIA should begin the selection process with its Moderate Term option as the 'default' default choice, and if appropriate, adjust their selection either up the risk ladder to Extended Term or down the risk ladder to Conservative Term based on the demographics of their plan participants as a whole. The graphic below illustrates the process that we encourage plan fiduciaries to use when selecting the appropriate Manning & Napier risk-based option for the QDIA of their plan.

Starting point

Moderate Allocation Option

Goal: Balance capital preservation and long-term capital growth
Target equity allocation range: 20%-60%
Midpoint equity allocation: 40%
Average/Median age between 40 and 62 Years

If your plan has the following characteristics...

Average/median age > 55 years
High incidence of lump sum distributions
High percentage of participants 60 or older
High levels of employee turnover
High incidence of emotional investment decisions based on short-term market volatility

Average/median age between 20 and 55 years
High percentage of participants 40 or younger
Participants eligible for other retirement benefits and/or who have other outside assets
Relatively sophisticated participant base

Conservative Allocation Option

Primary goal: capital preservation
Secondary goals: income and long-term capital growth
Target equity allocation range: 5% - 35%
Midpoint equity allocation: 20%

Growth Allocation Option

Primary goal: long-term capital growth
Secondary goal: capital preservation
Target equity allocation range: 40% - 70%
Midpoint equity allocation: 55%

Conclusion

We believe that Manning & Napier's Moderate Term and Extended Term risk-based options satisfy the requirements for a QDIA under the DOL's final regulations and would be appropriate for most plans. Furthermore, under select circumstances Manning & Napier's Conservative Term options may also be appropriate QDIAs for a plan. Each of Manning & Napier's risk-based options utilize an active asset allocation approach that allows for coordinated adjustments to the overall portfolio based on fundamental changes to the market and economic environment. The fact that Manning & Napier accepts responsibility for adjusting each option's asset allocation based on the risks most prevalent in the prevailing environment, rather than maintaining a predetermined allocation in all environments, allows our risk-based options to meet the target risk level appropriate for the participants of the plan as a whole for a wide range of plan demographics. Additionally, we believe that relative to a more passively managed allocation strategy, this active asset allocation approach should also reduce the need to change the QDIA as plan demographics change.

For more information about any of the Manning & Napier Fund, Inc. Series, you may obtain a prospectus at www.manning-napier.com or by calling (800) 466-3863. Before investing, carefully consider the objectives, risks, charges and expenses of the investment and read the prospectus carefully as it contains this and other information about the investment company.

Manning & Napier's risk-based offerings include mutual funds (Manning & Napier Fund, Inc. Pro-Blend® Series) and affiliate collective investment trusts (CIT) (Manning & Napier Pro-Mix® CITs).

All investments involve risks, including possible loss of principal. Because risk-based funds invest in both stocks and bonds, the value of your investment will fluctuate in response to stock market movements and changes in interest rates. Investing in risk-based funds will also involve a number of other risks, including issuer-specific risk, foreign investment risk, and small-cap/mid-cap risk. Investments in options and futures, like all derivatives, can be highly volatile and involve risks in addition to the risks of the underlying instrument on which the derivative is based, such as counterparty, correlation and liquidity risk. Also, the use of leverage increases exposure to the market and may magnify potential losses.

This material is for educational purposes only and does not constitute a recommendation or investment advice. It is not impartial and does not consider plan specific circumstances or suggest a specific course of action. Manning & Napier Advisors, LLC (Manning & Napier) provides investment advisory services to Exeter Trust Company (ETC), Trustee of the Manning & Napier Collective Investment Trusts. The Collectives are available only for use within certain qualified employee benefit plans. **The Manning & Napier Fund, Inc. is managed by Manning & Napier. Manning & Napier Investor Services, Inc., an affiliate of Manning & Napier and ETC, is the distributor of the Fund shares.**