# INNOVIEWS

A quarterly newsletter for benefit plans by INNOVEST

FALL 2019

## IN THIS ISSUE



## NEW CLIENTS

**Colorado State University**

**Pueblo Water**

**City of Boulder**

**Longmont Community Foundation**

**Women First, Inc.**

**City of Tucson**

**City of Aurora**

*It is not known whether the listed clients approve or disapprove of the services provided. The new clients on page one and in the Nonprofit Spotlight are listed with their approval and permission.*

# MAKING INDEXING LESS VEXING:

## CONSIDERATIONS FOR PASSIVE INVESTING


**Kristy LeGrande, CFA, MBA**
PRINCIPAL, DIRECTOR

**Ryan Murphy**
VICE PRESIDENT


Jack Bogle, Founder of the Vanguard Group, devised the first index-tracking mutual fund in 1975. His invention would democratize investing, providing everyday investors access to low-cost, diversified investment options. In January 2019, Jack Bogle passed away at the age of 89, but his fight against high fee investments persists. In April, assets invested in passive U.S. equity funds equaled that of active U.S equity funds for the first time, a symbolic milestone for Bogle's campaign. Since 1975, passive investing has assumed new shapes. With investors facing an expanded menu of passive investment options, discerning their merits requires careful consideration of investment vehicles, fees, liquidity, tax characteristics, and customization.

### Vehicles

During its 44-year history, passive investing has evolved into different forms. Bogle's indexed mutual fund is no longer the only game in town. Today, different fund vehicles, including exchange traded funds (ETFs), collective investment trusts (CITs), and customized indexing through separate accounts, are viable alternatives for indexed exposure. Each passive investment vehicle possesses its own advantages and disadvantages, as demonstrated in the chart shown (on page 2).

### Fees

Passive investment fees are in a race to zero. Indexed investment providers continue to undercut each other's fees, in

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| INVESTMENT VEHICLES | MUTUAL FUNDS | EXCHANGE TRADED FUNDS (ETFS) | COLLECTIVE INVESTMENTS TRUSTS (CITS) | CUSTOMIZED INDEXED SEPARATE ACCOUNTS |
|---|---|---|---|---|
| THE PROS | • Expedited trade settlement | • Tradeable intra-day<br>• Tax efficient | • Plan-level pricing flexibility<br>• Daily valued and liquid, akin to mutual funds | • Ability to tax-loss harvest or selectively exclude securities. |
| THE CONS | • Risk of capital gains distributions<br>• Not traded intra-day | • Risk of price deviations from net asset value<br>• Potential liquidity risk | • Not SEC regulated<br>• Fewer disclosure requirements than mutual funds | • More expensive<br>• Elevated tracking error risk (varies, depending on indexing methodology)<br>• Higher investment minimums |

the fight for headlines, investor assets, and platform customers. For investors, fees are a crucial consideration when evaluating both investment providers and vehicles (mutual fund or ETF, etc.). There is no hard and fast rule for which investment vehicle is cheaper, as fee structures vary across investment providers; comparisons need to be made on a case-by-case basis. For retirement plans considering CITs, the typical lower fees associated with the CIT must be weighed against the vehicle's shortcomings, including, but not limited to, reduced transparency and portability (i.e. whether the CIT may be transferred to a different retirement plan).

### Liquidity

Indexed investment vehicles have different liquidity profiles. When comparing mutual funds to ETFs, key liquidity differences include trading and settlement. While ETFs trade intra-day on a secondary market, mutual fund transactions occur directly with the fund company and are executed once daily following the market's close. ETFs uniquely pose additional risks of limited trading volume (i.e. liquidity risk) and price deviation from net asset value. These risks are largely mitigated by investing in large, established ETFs managed by reputable providers.

With regards to settlement, mutual funds have the advantage, providing settlement within one trading day of the transaction date (T+1), compared to two trading days (T+2) for ETFs. For retirement plan participants invested in a CIT, the vehicle's liquidity profile typically mirrors that of mutual fund, through daily valuation and trading. Lastly, customized indexed separate account liquidity depends on the liquidity of its underlying stock holdings. Stocks, like ETFs, settle within two trading days of their transaction date (T+2). Therefore, provided its stock holdings are sufficiently liquid, customized indexed separate accounts can be liquidated in two trading days.

### Tax Considerations

While passive investing's buy-and-hold approach improves tax efficiency relative to active investing, tax efficiency varies across passive investment options. When comparing mutual funds and ETFs, ETFs are generally more tax efficient due to their ability to facilitate in-kind redemptions. Through in-kind redemptions, ETFs can satisfy redemption requests through the delivery of individual securities, as opposed to cash. In doing so, the ETF can offload highly appreciated securities to redeeming investors, reducing the fund's embedded tax gain and likelihood of a capital gains distribution. These transactions are typically restricted to redemptions of significant size. In contrast, indexed mutual funds are often forced to sell securities and realize gains to fulfill redemption requests*. For highly tax conscious investors, a customized indexed separate account may provide tax benefits in excess of an ETF, as discussed in the following section.

### Customization

Passive investment options continue to adapt to consumer demand. For investors seeking vanilla index exposure, low cost mutual funds, ETFs, or CITs are often suitable. However, investors may desire additional features from their indexed exposure may benefit from a customized indexed separate account. For example, taxable investors may want to have their index manager provide opportunistic tax-loss harvesting of their customized indexed separate accounts to improve after-tax returns. Customized indexed separate accounts can also allow for the owner of the accounts to make donations of highly appreciated securities. Furthermore, through customized indexing, investors may modify the composition of the underlying index, typically by excluding specific securities in pursuit of an ESG (environmental, social and governance) or SRI (socially responsible investing) mandate. In exchange for customization, investors pay a surcharge over vanilla indexing and assume heightened tracking error (differences in performance between their separate account and the performance of the underlying index).

Four decades ago, passive investing was in its infancy and only accessible through a mutual fund vehicle. Today, passive investments are abundant, and Jack Bogle's indexed mutual fund format has serious competition. Passive investing is commonly associated with simplicity, but at times it can feel just the opposite. Understanding the nuances of indexed investment options can lead to more desirable investment outcomes. As passive investing continues to garner greater market share, it is in investors' best interest to become more familiar with developments in the passive investment landscape.

*Note: Vanguard indexed mutual funds are an exception to the notion that indexed mutual funds are less tax efficient than indexed ETFs. Vanguard has patented a fund structure that bolts its indexed ETFs onto its indexed mutual funds as a separate share class. Through this innovation, Vanguard mutual funds are as tax efficient as its ETFs for all intents and purposes.

*NONPROFIT SPOTLIGHT:*

# THE SOCIETY OF ECONOMIC GEOLOGISTS (SEG)

***The Society of Economic Geologists, Inc., (SEG) is an international organization of individual members with interests in the field of economic geology. SEG originated from a 1919 gathering of a group of Geological Society of America (GSA) members who were especially interested in economic geology.***

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Headquartered in Littleton, Colorado, The Society of Economic Geologists, Inc., (SEG) is an international organization of individual members with interests in the field of economic geology. Members benefit from the organization's annual conferences, field trips, short courses, research materials, and publications. The Society's membership includes representatives from industry, academia and government institutions. Student memberships are available for those studying geology and provide mentorships along with opportunities for field trips and real-work experience. To learn more about SEG, visit www.segweb.org.

Innovest has provided investment consulting service to The Society of Economic Geologists for nearly 20 years. Innovest creates custom solutions for nonprofits by developing an in-depth understanding of their individual goals, time horizons, risk tolerance and cash flow needs. Visit www.innovestinc.com/nonprofits for further information about our services for nonprofits.

## *THE OBJECTIVES OF SEG*

To advance the science of geology through the scientific investigation of mineral deposits and mineral resources and the application thereof to exploration, mineral resource appraisal, mining, and mineral extraction.

To disseminate basic and applied scientific information arising from investigations of mineral deposits and mineral resources through SEG conferences, field trips, short courses, workshops, lecture series, and publications.

To advance the status of the profession of economic geology, and to maintain a high professional and ethical standard among its members.

# CYBER SECURITY

## PROTECTING YOUR RETIREMENT PLAN INFORMATION FROM CYBERTHIEVES

**Gordon Tewell, CFA, CPC, ERPA**
PRINCIPAL

As technology becomes the main way that plan sponsors, providers, and participants access retirement plan information, the threat of cyberattacks increases. Names, birthdates, addresses, Social Security numbers, bank accounts and other sensitive information are all common data points especially attractive to hackers. In addition, as the retirement industry finds solutions, hackers find new ways to circumvent the solutions. Despite these challenges, how can the retirement industry protect its participants?

**Challenges to Cybersecurity**

The focus of cyberattacks on the retirement plan industry has shifted from targets such as recordkeepers to plan sponsors and participants, who often lack the extensive cybersecurity defenses of their vendors.

As noted in the introduction to the Pension Research Council working paper, "Benefit Plan Cybersecurity Considerations," there is no set framework or standard for how retirement benefit plan information should be protected.

In addition, experts agree that it will be challenging to create a national solution for the retirement industry. The tasks include determining a regulatory body for cybersecurity, coordinating state and federal rules, and possibly setting a required level of insurance coverage.

Lawmakers also will need to consider whether failing to protect plan data would result in plan sponsors breaking their fiduciary obligations.

**Opportunities**

Knowing the risks to their information, many industry organizations have joined the Society of Professional Asset Managers and Recordkeepers (SPARK), a nonprofit advocacy association for the retirement plan industry. SPARK helps shape national retirement policy by developing and advancing positions on critical issues that affect plan sponsers, participants, service providers and investment providers, including cybersecurity. SPARK provides monthly cybersecurity briefs and just announced new workshops to help protect employee data.

The fiduciary obligations of plan sponsors regarding plan and participant data have not been clearly defined; however, a variety of entities including the Securities and Exchange Commission, Department of Labor, industry organizations, and several states have been working on guidelines and regulations for retirement benefits plans. Hopefully, these efforts will thwart future cyberattacks.

Industry experts concur that successful cybersecurity is about process, such as regularly reviewing the internal access to data and the use of that data across the organization. It includes conducting regular reviews of the list of active users able to access the data and their responsibilities and activities. Generally, the industry has embraced a multi-level cyber security approach that constantly evolves to meet new threats. The trend is that cyber security comes from a combination of technical security protocols and internal processes.

***INDUSTRY EXPERTS CONCUR THAT SUCCESSFUL CYBERSECURITY IS ABOUT PROCESS, SUCH AS REGULARLY REVIEWING THE INTERNAL ACCESS TO DATA AND THE USE OF THAT DATA ACROSS THE ORGANIZATION.***

**Summary**

The cybersecurity environment for retirement plans continues to change at an accelerating pace. Efforts are underway to clearly define the fiduciary obligations of plan sponsors regarding plan and participant information, as well as to increase protections. Plan sponsors should be vigilant with their recordkeepers to understand and implement the necessary safeguards.

## PROTECT YOURSELF: KNOW THE ATTACK

Cyberattacks can come in many forms. According to a Pension Research Council working paper, they can include:

### PHISHING

Cybercriminals pretend to be a trusted financial organization or vendor and request personal data.

### MALWARE

This broad term refers to any type of malicious code that destroys or steals data, or locks up computers or networks.

### PASSWORD IDENTIFICATION

If cyber thieves can decipher passwords, they can easily access sensitive information.

### MAN IN THE MIDDLE

By impersonating an organization's login page, cybercriminals can access all information communicated between an organization and an individual or another organization.

# STUDENT LOANS: WHAT YOU NEED TO KNOW ABOUT CONSOLIDATION

**Marianne Marvez, RPA**
VICE PRESIDENT

What is the most talked about benefit in 2019? Student loan assistance programs. Recent surveys confirm that student loans are a top concern among employees, especially recent grads; however, loans are not just an issue for millennials. Many baby boomers have cosigned loans for their children or returned to school themselves, incurring debt at a time when they should be preparing for retirement.

According to a Society for Human Resource Management survey, 8% of companies currently offer employer student loan repayment assistance programs, double the percentage of companies which offered the benefit a year ago.

It is vital to understand that student loan repayment programs are not the same as employer tuition reimbursement programs. Employer-sponsored tuition reimbursement benefits are tax deductible up to an annual limit of $5,250 per employee, but current student loan repayments are taxable to the employer. The Employer Participation in Repayment Act of 2019, a bipartisan bill, is currently being considered by Congress. If enacted, the bill would allow employers to give tax-free student loan assistance up to the same limits as tuition reimbursement.

Until legislation passes, what is the best option available for companies that want to help their employees with student loans? The simplest solution is to provide employees with access to organizations that will help to refinance or consolidate their student loans. According to the Federal Student Aid website, there are at least 20 different types of student loans that are eligible for consolidation. That being said, employers must keep in mind that student loans are complicated, and the various programs available today may not work for all types of employers, legally or financially.

There are pros and cons for consolidating student loans. Employees need to carefully consider what their future plans may entail because once the loans are consolidated, the transaction cannot be reversed, and employees could lose benefits that may be of assistance should their future plans change. In addition, the pros and cons for consolidation differ for federal versus private loans. Any decisions regarding consolidation need to be made thoughtfully and with careful consideration. Below we are outlining the pros and cons of consolidation for federal and private loans.

**Pros: Consolidating Federal Student Loans[1]**

- Single monthly payment
- Lower payment amount by extending the repayment time period
- Consolidating loans other than Direct Loans[2] may provide: additional income-driven repayment options, public Service Loan Forgiveness (PSLF), renewed deferment or forbearance options, a fixed interest rate or rectify a defaulted loan

**Cons: Consolidating Federal Student Loans**

- Private loans are not eligible for consolidation into Direct Loans
- Longer repayment periods may result in more interest being paid
- May cause loss of interest rate discounts, principal rebates, and some loan cancelation benefits (Perkins loans)
- Possible loss of deferment or forbearance options
- May lose credit for any payments made under income driven or Public Service Loan Forgiveness (PSLF) programs
- Once the loans are consolidated you are unable to reverse the transaction

**Pros: Consolidating Private Student Loans[3]**

- Single monthly payment (potentially lower interest rates and increase credit scores by lowering debt-to-income ratio)
- Choice of fixed or variable interest rate
- Releases co-signer
- Possibility of refinancing parent's PLUS loan into the child's name
- Potential monthly payment reduction

**Cons: Consolidating Private Student Loans**

- Strict credit requirement may need FICO credit score of 670 or higher
- May require a degree from a Title IV accredited school
- Loss of federal loan benefits, including income-driven payment options and Public Service Loan Forgiveness (PSLF)
- Shorter repayment periods – 10 to 20 years, as compared to 30 years which results in higher payments
- Potential loss of deferment and forbearance options – interest continues to accrue
- Shorter default determination period

There are multiple companies which specialize in providing student loan consolidation services. General searches online will provide an overview of the top firms and resources to review the options available to employers and employees in today's marketplace. Employers may also want to check with their defined contribution plan recordkeeper, as many of them also offer student loan repayment services.

This article is meant to provide information only and may not include all items to be considered. We recommend you consult your tax professional and school administration office for guidance prior to making a decision to consolidate student loans.

1. Federal Student Aid website https://studentaid.ed.gov
2. Direct Loans are from the William D. Ford Federal Direct Loan Program
3. www.finaid.org/loans/privateconsolidation.phtml

## *TYPES OF FEDERAL LOANS THAT MAY BE ELIGIBLE FOR CONSOLIDATION*

1. Subsidized Federal Stafford Loans
2. Unsubsidized Federal Stafford Loans
3. PLUS loans from the Federal Family Education Loan (FFEL) Program
4. Supplemental Loans for Students
5. Federal Perkins Loans
6. Nursing Student Loans
7. Nurse Faculty Loans
8. Health Education Assistance Loans
9. Health Professions Student Loans
10. Loans for Disadvantaged Students
11. Direct Subsidized Loans
12. Direct Unsubsidized Loans
13. Direct PLUS Loans
14. Federal Family Education Loan (FFEL) Consolidation Loans and Direct Consolidation Loans (only under certain conditions)
15. Federal Insured Student Loans
16. Guaranteed Student Loans
17. National Direct Student Loans
18. National Defense Student Loans
19. Parent Loans for Undergraduate Students
20. Auxiliary Loans to Assist Students

Disclaimer: This information was gathered from third-party sources and may not be a complete list.

*EMPLOYEE SPOTLIGHT:*

# JOE LEMMING

***Senior Analyst and Kickball King Joe Lemming is a member of the Portfolio Accounting Team. His team is tasked with maintaining the Portfolio Accounting software system used for performance reporting,***

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**Where is your hometown?**

I was born and raised in Denver, CO.

**Tell us something unique about you:**

Other than when I was attending college, I have never lived outside of Denver proper despite moving five times.

**What do you like best about working at Innovest?**

My favorite part about Innovest is our focus on serving others. Innovest sponsors volunteer opportunities throughout the year. I also value our culture of teamwork and community where my coworkers inspire me with their knowledge and dedication to improve daily.

**How do you give back to the community?**

I regularly participate in volunteer events at my church, at Innovest, and I support FOCUS. I serve as the Secretary and Treasurer on the board of directors for Catholic Young Adult Sports, an organization that emphasizes building community through friendly competition.

**What are your hobbies and interests?**

I spend most of my time outside hiking and playing sports. I especially enjoy baseball, soccer, volleyball, kickball and disc golf. I am an avid Rockies and Broncos fan. I also enjoy traveling and spent a semester abroad in Florence, Italy, while in college.

**Tell us about your family:**

I have two younger brothers who are 17 and 19 respectively. My girlfriend, Sara, is the events coordinator at St Mary's of Littleton Parish.

**What is your favorite ice cream flavor:**

My favorite ice cream flavor is peppermint ice cream from Bonnie Brae ice cream.

INNOVEST

4643 South Ulster Street,
Suite 1040
Denver, CO 80237

www.innovestinc.com

303.694.1900



**EDITORS**

Christine Hudek
Kelly James

**DESIGNER**

Stephanie Corder



# AROUND THE FIRM

**Speaking Engagements**

Several staff members attended Colorado Public Plan Coalition's Annual Conference in Beaver Creek. VP Jared Martin spoke about Fiduciary Responsibility and President Wendy Dominguez spoke about Retirement Plan Fees.

Jared Martin, Paul Nacario and Gordon Tewell attended National Association of Government Defined Contribution Administrators in New Orleans. Gordon was a panelist about Retaining Retirees.

Innovest hosted the Southwest Nonprofit Conference in Phoenix on 9/17 in conjunction with Snell & Wilmer and Eide Bailly. Scott Middleton spoke about The Economy and its impact on Nonprofit Organizations.

**Giving Back:**

Innovest team members volunteered and participated at Muckfest, a 5k mud run to benefit the National MS society.

Innovest clients and team members donated to our annual school supply drive. We were able to provide hundreds of supplies to students in need.

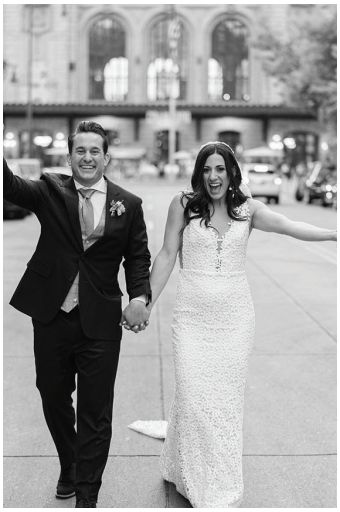
**Featured in:**

Innovest's President and Co-Founder, Wendy Dominguez was a finalist for Denver Business Journal's Outstanding Women in Business

**Fun News:**

Vice President, Natalie Roderick's daughter, Cassidy, completed her undergrad degree in 3 years, with a double major.

Lead Senior Analyst, TJ Berge, was married in a beautiful summer ceremony in August. (pictured right)




**Innovest employees were traveling and doing other various activites during August. See the collage above (created by Office Manager Carol Van Gytenbeek) to get a glimpse.**