

Fiduciary Corner

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It is imperative that Committees have a comprehensive strategy for choosing and evaluating the Target Date Fund option



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Target Date Funds - Fiduciary Issues

By Scott Fremer, CEBS and James R. Sotell, AIF

Comperio recognizes that Target Date Funds ("TDFs") have quickly become that fastest growing asset class in 401(k) plans and serve as the qualified default investment alternative ("QDIA") for many plans. According to a recent survey by the Investment Company Institute, 71% of all 401(k) plans offer Target Date Funds, 41% of employees utilize Target Date Funds and 15% of plan assets are currently invested in Target Date Funds.

With the growth rate of these strategies continuing to accelerate, it is imperative that Committees have a comprehensive strategy for choosing and evaluating the Target Date Fund option of choice. Many plan sponsors have not conducted, nor have an independent resource to conduct, a comprehensive review of their Target Date Fund and Qualified Default Investment Alternative selection. With the Department of Labor's February 2013 publication of *Target Date Retirement Funds - Tips for ERISA Plan Fiduciaries*, the traditional response used by many plan sponsors of "we use the Target Date Fund family provided by our recordkeeper" is no longer an option. It is critical that plan sponsors answer the following questions to ensure they have a prudent process for TDF selections.

Questions to ask for Target-Date Fund selection:

1. What process did you undertake to select your Target Date Funds?
2. What criteria did you use in that process?
3. How many Target Date Fund families did you evaluate in your analysis?
4. Did you document the process for your Target Date Fund selection?
5. Have you revisited your Target Date Fund selection/criteria (many additional ways of evaluating them are available today)?

Target date strategies available in today's marketplace vary wildly in terms of equity allocations during the accumulation phase, at the point of retirement and during retirement. Most sponsors are familiar with the "To vs. Through" debate on glide path determination, but this simple label doesn't adequately explain the complex structure of the Target Date Fund universe. Plan sponsors that currently utilize a Target Date Fund series or are considering adding Target Date Funds to the investment menu need to conduct extensive due diligence by looking under the hood of these options.



Plan Sponsors should consider contribution levels, savings rates, account balances and distribution characteristics in choosing an appropriate target date glide path

The process of determining which target date options are appropriate for your plan includes:

1. An analysis of the complete Target Date Funds' glide path (all vintages) and assesses the risk and allocation for the various ages of participants.
2. Reviewing each of the asset classes being utilized and determining if there is a meaningful allocation to diversifying assets.
3. A thorough review into each of the underlying funds being utilized, including an attribution analysis that can determine if these individual funds added value over their respective benchmark.
4. Fee Review - conduct an analysis of overall fees versus Peers across the vintages. Furthermore, fees for active management versus indexing should be considered in determining the added value, if any, active management is providing to employees.

In the search for an appropriate glide path for your employee population, Plan Sponsors should consider specific plan characteristics (plan eligibility, company contribution levels and deferral rates), participant characteristics (savings rates, account balances and the availability of outside retirement assets), specific goals of the Committee and distribution characteristics (will employees leave assets or rollover?) in aligning a Target Date Fund glide path to employee demographics.

Many tools have been introduced into the marketplace that claim to provide the ability to analyze Target Date Funds.

A wide majority of the tools used by advisors/consultants are created by the fund companies that also offer a Target Date Fund series for sale. We have reviewed many of these target date tools and have determined that these tools tend to have biases tied to the manufacturer and lack a complete in-depth analysis of the Target Date Funds. If you are working with an advisor or consultant, ask them to provide an explanation of the source and methodology of the tools that were used to provide the report.

Getting the target date decision right, particularly if it's your plan's default investment option, is crucial. After choosing an appropriate target date strategy, it is imperative to periodically review your choice. For example, investment firms like BlackRock and Fidelity have made significant changes to their respective glide paths over the past 24 months. Sponsors not aware of those changes and the implications to employees could be unnecessarily increasing liability.

Please contact either Jim Sotell or Scott Fremer if you have questions or would like additional detail on Target Date Fund analysis.