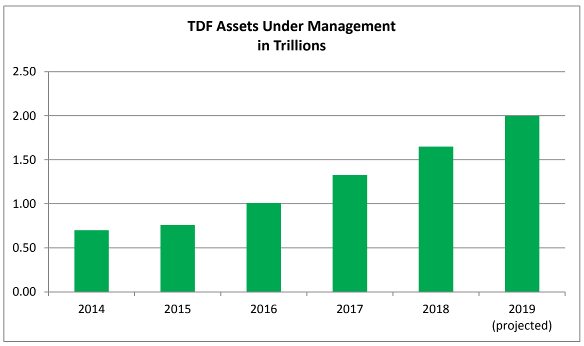
# Why are target date funds so popular—and what should plan sponsors know?

According to the working paper *Opting out of Retirement Plan Default Settings* by the RAND Corporation, 97.6% of retirement plans featured a TDF as the default investment alternative in 2016, and the popularity of these funds continues to increase. Morningstar projects that TDFs will have 2 trillion dollars of assets under management by 2019.




The table shows assets under management in trillions of U.S. dollars. Source: Morningstar mutual fund data.

Many plan participants prefer target date funds because of how they work. TDFs provide asset diversification to participants by investing in multiple asset classes, generally including stocks, bonds and cash. Furthermore, the fund manager (or investment firm) actually changes how the assets are allocated between stocks, bonds and cash over time. TDFs become more conservative as the fund approaches the maturation date, which is the year nearest to when the participant will turn age 65.

Arguably, the biggest benefit for a plan participant is that the fund manager adjusts the allocation of the asset classes based on the participant's age over his or her life span. This adjustment in the allocation is called the "glide-path." While there are numerous fund managers, such as Fidelity, Vanguard, T.Rowe Price and JP Morgan, each one has its own philosophy on how to construct a glide-path strategy. Plan participants must pay careful attention to how a fund's glide-path could affect their investments and retirement goals.

## What should plan sponsors know?

Retirement plan sponsors should be aware that TDFs are not a perfect solution. Potential problems with TDFs include the inability to factor in the individual risk tolerance of a particular participant and to take into account other sources of income, assets or debts to which the participants are subject over the course of their careers. As a result, the DOL issued guidance for plan sponsors in the report *Target Date Retirement Funds – Tips for ERISA Plan Fiduciaries*. According to the DOL guide, when selecting and monitoring TDFs, plan sponsors should:

- Align the TDF and participant characteristics
- Understand underlying investments
- Review fees and investment expenses
- Consider custom or non-proprietary options
- Develop effective employee communications
- Document the process

It's crucial to realize that all target date funds are made differently. While it is difficult to ensure every participant understands what they are getting, the best

*Continued >>*

Associated
Benefits and Risk Consulting



*Please see final page for important disclosure information >>*

way for a plan sponsor to fulfill its fiduciary duty is to know exactly what is inside the TDFs it has selected for the organization's retirement plan. This includes knowing:

- What underlying funds are used in the TDF
- The exposure to different asset classes
- The glide-path structure
- Investment management fees
- Fund managers' philosophy

## How do plan sponsors select the most suitable TDFs?

Choosing the most suitable TDF for plan participants can be complicated. A trusted advisor can help plan sponsors through this selection process, taking into consideration plan objectives, plan demographics and participant behavior to determine the TDF risk profile.

Like the selection of any plan investment choice, plan sponsors should first establish a process for comparing and selecting TDFs. This will include analyzing:

- Past performance
- Fees
- Glide-path risk posture
- Asset class coverage
- Active versus passive approaches

Plan sponsors should also periodically review the TDFs they have selected, using a similar process. The DOL cautions that frequent turnover or a major overhaul in a TDF's fund management could signal a reason to scrutinize the TDF and consider a change.

The DOL does not require plan fiduciaries to be experts in investments. However, fiduciaries should consider the advice of an independent third-party expert to meet "prudent expert" standards if internal expertise is not available. The DOL judges fiduciaries on the process they follow, not the results achieved. This is where a trusted investment advisor can help ensure plan sponsors are fulling their fiduciary duties.

Figuring out what to save for retirement is different for every working American. TDFs can make it easier for some employees, and it's ultimately up to them to determine whether or not that strategy works. Plan sponsors need to make sure they are putting their plan participants in the best position to reach their retirement goals by doing their due diligence and fulfilling their fiduciary obligations by properly selecting and monitoring TDFs, as they do with all of the plan's investments.

**For more information, contact us.**

Associated
Benefits and Risk Consulting

Phone: **800-258-3190** | Email: **Info@AssociatedBRC.com**