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What a Fiduciary Should Know About Target Date Asset-Allocation Funds

With Health Care Reform dominating the political landscape, the minefield of Target Date Funds (TDFs) has taken a back seat of sorts. However, back burner or not, risks still exist, and fiduciaries are looking for assistance in managing such TDF-related risks.

According to the Department of Labor (DOL), a fiduciary has important responsibilities and is subject to standards of conduct because they act on behalf of participants in a retirement plan and their beneficiaries. These responsibilities include:

- ❖ Acting solely in the interest of plan participants and their beneficiaries, with the exclusive purpose of providing benefits to them;
- ❖ Carrying out their duties prudently;
- ❖ Following the plan documents;
- ❖ Diversifying plan investments; and
- ❖ Paying only reasonable plan expenses.

So with these responsibilities as a backdrop, what does a fiduciary need to do with TDFs to minimize potential risk?

TDFs have varying configurations, construction, investment philosophies, and management strategies. A plan sponsor should understand these structural and philosophical differences when choosing their plan's TDF. Questions and answers

related to these types of questions are increasingly important as TDFs continue to be designated as a plan's Qualified Default Investment Alternative (QDIA). Here are some important questions to consider:

1. How does the TDF fit with your Investment Policy Statement (IPS)? The IPS is a guidepost for monitoring and managing the plan's investments menu. Does your IPS establish the benchmark and process for monitoring your TDFs?
2. What benchmarks or third-party evaluation should be used in reviewing your TDF? The benchmarking and evaluation of TDF is an emerging science and is difficult to benchmark for many reasons, not the least of which is diversification.
3. What is an appropriate asset allocation for a TDF? This is a simple question, but it requires a review of the complex mix of stocks, bonds, cash, and foreign investments. This mix changes over the life of the TDF and is known as the Glide Path. All Glide Paths are not created equal, and the plan sponsor's fiduciaries need to understand the underlying philosophy in order to determine which TDF is right for the investment menu.
4. What are the fees and expenses charged by the TDF? Does your TDF have a wrap fee, fund charges, delivery charges, and other extra expenses? Make sure your consultant is keeping you abreast of all the costs associated with offering a TDF.
5. Does your Proprietary or Open Architecture TDF offer "lifestyle" options? In addition to targeting specific retirement date goals, TDFs are now offering participants the choice to select an Aggressive, Moderate, or Conservative Glide Path. These solutions help move the TDF from one-size-fits-all to a better fit for each participant. Plan sponsors will need to be aware of additional education needs as they offer more sophisticated TDFs.

Last year, Lockton began to independently and objectively research this unique universe of funds. Lockton, with support from the Center for Applied Economics at The University of Kansas, developed a comprehensive guide to aid plan sponsors in the evaluation of target date funds. The *Target Date Resource Guide* brings in-depth analysis to the target date fund review process to help plan sponsors understand the design of the funds and determine which strategy benefits their unique group employees.

The *Target Date Resource Guide* (the Guide) is broken into three parts—a plan sponsor questionnaire, a variety of key fund comparisons, and fund family fact sheets. The questionnaire facilitates an assessment of the plan sponsor's risk tolerance and the investment behavior of their employee population. This assessment plays a key role in allowing the plan sponsor to understand fund families that might be appropriate for their specific plan participants.

The Guide provides a comparative analysis of the funds' design at core levels, including fixed income, risk, and diversification. It does not take a "check the box and compare" approach to assess diversification. Instead a regression analysis is employed to evaluate the fund holdings' true impact on portfolio performance.

Please contact Lockton for assistance with your TDFs or for more information regarding this unique resource guide.

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