Selecting and Monitoring Target Date Funds

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Target date retirement funds, or TDFs, are the dominant investment option for employees who do not want to actively manage their investment portfolios, either because they are disengaged from that task or they don't feel competent to do so. It has become the norm for retirement plans to use a TDF as the Qualified Default Investment Alternative (QDIA), meaning the TDF is the option that employees are defaulted into when they don't make proactive investment selections.

TDFs currently represent around 20% of all 401(k) plan assets. Approximately 50% of all new 401(k) contributions are directed into TDFs. Plan participants like TDFs because they are easy to understand and they are a one-step investment choice with professional management features.

TDFs are designed to invest in a mix of stocks, bonds and other investments that gradually become more conservative over time. The time period during which the investment mix gradually changes is referred to as the "glide path". For example, a Target 2030 fund is designed for individuals who will be retiring in or around 2030. Investments in that fund in the year 2018 might still be heavily weighted toward stocks or more volatile investments, since the 2030 retirement date is still far in the future. However, as the 2030 date approaches, the investments will be reallocated out of aggressive investments into more conservative, and typically stable, investments. Some TDFs are designed to have their most conservative mix of investments at the target date (in our example, at 2030). These types of TDFs are referred to as utilizing a "to" approach. On the other hand, some TDFs are designed to slowly start switching to more conservative investments at the target date but don't reach the most conservative point until years later (in our example, in 2030 the allocation would start becoming more conservative, but 2030 is not the most conservative point). These types of funds are referred to using a "through"

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approach. When selecting a TDF, it is important to understand whether a "to" approach or a "through" approach is used for the glide path.

Besides the differences in glide path determination, TDFs will vary in their investment strategies and fees. There are no guidelines or requirements as to how TDFs must structure their investments or glide paths. For plan sponsors who offer TDFs as an investment alternative, it is important to understand just how a particular TDF works before selecting it as an option in the plan. Since the TDF is often used as the QDIA, employees are being invested into it without having made an affirmative investment election. For this reason, it is even more imperative that the fiduciaries to the plan understand the TDF and ensure that it is appropriate for plan participants.

Plan fiduciaries need to establish a prudent process for selecting and monitoring a TDF. Things to consider are:

- How well does the TDF's characteristics align with the ages and expected retirement dates of the plan participants?
- What are the principal strategies and risks of the fund?
- Have there been any changes to the investment strategy or management team since the fund was initially chosen?
- What is the glide path?
- What are the fees and expenses, including sales loads?

Many investment fund families offer a TDF consisting of proprietary funds for that investment vendor. It is possible, after evaluating various TDFs, that one of these "off-the-shelf" TDFs is a good fit for a particular plan. However, **in 2013 the Department of Labor issued a tip sheet about TDFs in which they indicated that plan fiduciaries should also consider whether the plan participants might be better served by a customized TDF**, where non-proprietary funds are incorporated into the various investments inside of the TDF. A customized TDF can have the advantage of diversifying participant's exposure to various fund families, instead of having all investments concentrated in only one fund family.

The full tip sheet can be found here: https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/target-date-retirement-funds.pdf.

Plan sponsors and plan advisors should review these tips as they are evaluating TDF options. It is a helpful roadmap for knowing how to select a TDF that is the most appropriate choice for the plan.

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