

CUSTOM VS. OFF-THE-SHELF TARGET DATE FUNDS

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The Department of Labor (DOL) has provided guidance to retirement plan fiduciaries to help select and monitor target date funds (TDFs). Among the guidance is the DOL's suggestion that plan sponsors determine whether custom TDFs would better fit their plan's participant base than off-the-shelf TDFs.

Key considerations in determining if custom TDFs would be appropriate are whether the plan is of adequate size and its population homogenous. Custom TDFs are a viable option for defined contribution plans with assets of \$100 million or more. According to PIMCO, 40 of the 100 largest defined contribution plans use custom TDFs, with usage increasing to 50% for plans with assets greater than \$10 billion. Also,

when plan populations have wide variation in salaries and retirement ages, it can be challenging to design a 'one-size-fits-all' glide path.

Incomplete knowledge of participants' true financial condition (such as outside assets and benefits) also makes it difficult to design the ideal glide path.

Defining a Custom Target Date Fund

Custom TDFs are investment options designed by the plan sponsor or its advisor to better take into account knowledge about participant base. The main types of customization are below:

Full Customization

- The glide path is designed to suit a plan's demographics (such as availability of defined benefit plan, company stock expected retirement age, etc.). Generally, an investment manager designs and manages the glide path. AB (formerly Alliance Bernstein) estimates that the average cost of designing and managing a custom glide path is about 0.10%.
- The plan's consultant or the plan sponsor selects the underlying investment managers.
- The plan's record keeper or custodian manages the cash flows and portfolio rebalancing.

Semi Customization

Although, there are many variations of semi customization, the key types relate to the glide path and investments:

- **Glide Path:** The plan sponsor or the consultant selects the underlying funds but uses an off-the-shelf glide path.
- **Investments:** Minor changes are made to an off-the-shelf glide-path (such as stock-bond mix, 'landing' point, etc.). In addition, the plan sponsor may change the underlying fund line-up and/or add additional asset classes (such as high-yield bonds and real assets).

	Full Custom	Off-the-Shelf
Glide path	Designed to take into account the specific needs of the plan participants.	No control over glide path design.
Underlying Investments	Can have 'best-in-class' multi-manager line-up. Flexibility to choose asset classes and active/passive mix.	No control over manager line-up or the asset classes. Typically, one investment manager.

	Full Custom	Off-the-Shelf
Fees	<p>Potential for lower fees:</p> <ul style="list-style-type: none"> • By controlling active-passive mix • With potential economies of scale resulting from using the same managers across DB and DC plans <p>Three major components of fee are:</p> <ul style="list-style-type: none"> • Custom glide path design/management (-0.10%); • Unitizing costs of about \$60,000/year; and • Underlying investment management fees. 	Fees are dependent on the assets in TDFs.
Recordkeeping Platform	Fewer recordkeeping platforms can accommodate custom TDFs.	Most recordkeeping platforms offer a wide variety of off-the-shelf TDFs.
Administration	Ongoing management, oversight and reporting require greater involvement and are more complex.	Plan sponsor involvement is lower.
Participant Communications	<p>The plan sponsor, glide path manager or the record keeper provide the participant communications.</p> <p>Communications are typically customized and can result in additional costs.</p>	Record keeper provides participant communications.

Summary

Designing custom TDFs can result in superior retirement outcomes for plan participants, whether through better glide path designs, better investment structures and manager selection or through cost containment. Custom TDFs, however, require TDF assets of at least \$100 million and a participant base that is relatively homogenous. Careful consideration should be given to the plan sponsor's ability to oversee the development and management of custom TDFs.

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