Retirement Consulting Insights

USI CONSULTING GROUP

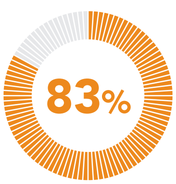
Navigating Target Date Funds & Qualified Default Investment Alternatives

Target Date Funds (TDFs) offer a single product structure that automatically diversifies, adjusts and rebalances retirement savings allocations over a long period of time. Introduced in 1994, TDFs have grown both as a percentage of plan assets, as well as in importance over the last several years, in large part due to the passing of the Pension Protection Act of 2006, which named target date funds as one of several eligible Qualified Default Investment Alternatives (QDIAs).

$3.5 TRILLION

TDFs are the fastest growing and largest asset class, hitting a record $3.5 trillion in assets at the end of 2023.[1]

The number of retirement plans offering TDFs has grown substantially, rising from 57% in 2006 to 96% in 2023. And a staggering 98% of designated QDIAs were TDFs in 2023.[2] There are 57 asset managers in the industry who offer a TDF for use within retirement plans. These asset managers provide the retirement industry with a single diversified investment solution that is deemed suitable as a QDIA by the Department of Labor (DOL), specifically the Employee Benefits Security Administration (EBSA).



Even more important has been the increase in utilization among retirement plan participants. Since 2006, the percentage of participants holding TDFs has more than doubled – reaching 83% in 2023.[2] Although partially due to the increased popularity of auto-enrollment provisions within plans, many participants have migrated towards TDFs independently. For many plans, TDFs will have a significant effect on the retirement success of participants.

Approach to TDFs' Complexity

Industry trends are supportive of TDFs playing an even greater role in the future. The observed growth and a likely continuing trend of growing utilization makes it crucial that retirement plan fiduciaries establish a process for the selection and monitoring of TDFs. The diverse nature of TDFs requires due diligence that far exceeds the standard selection criteria. These funds require a thorough evaluation.

The DOL has provided governance framework for selecting and monitoring TDFs. Among the DOL's tips is to conduct a regular review of the TDFs to evaluate the provider's glide path, investment management and fees among other characteristics. Although the DOL's tips were not technically formal guidance, it prompted fiduciaries to take a closer look at the TDFs being utilized in their plans.

TDFs can be actively or passively managed. The plan sponsor chooses a TDF series that would be most representative based on their plan (i.e., demographics, participant behavior, income objectives, open or closed architecture, asset diversification, risk tolerance and fees). The main distinction amongst the TDF providers is the curve of the glide path and how it reaches its landing point.

Constructing a well-diversified portfolio can be challenging, even for financial professionals, and most participants lack the desire and the knowledge to develop their own portfolio. Studies show that even if plan sponsors offer efficient investment menus, participants fail to construct efficient portfolios. This leads to the reduction of retirement wealth by 20% due to poor investment decisions. In addition, the average investor pays a penalty of 2-4% on their annual returns through

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trading at the wrong time. Therefore, the most effective way to address this challenge is to have these assets managed by an investment professional. To accomplish this goal, you, as the plan sponsor, need to select an appropriate TDF series.

With demographics ranging widely across defined contribution (DC) plans, selecting the appropriate TDF series for participants is key. USI Consulting Group (USICG) is committed to providing investment consulting services to retirement plan sponsors through USI Advisors, Inc. (USIA), a privately owned SEC registered investment advisory firm. USIA has worked with current and prospective clients alike in reviewing the suitability of their current TDF option in relation to their plan's demographics. glide path, underlying fund architecture, performance and fees are included in this review.

Performance of the TDF series is dependent on the success of the strategic and tactical allocation decisions of the portfolio managers as well as the strength of the underlying funds' performance in their respective asset classes on a relative and absolute basis. The ultimate success of the TDF series will be if, together with solid fund performance, it achieves its respective participant's goal.

Ongoing performance monitoring at both the glide path and underlying fund levels is conducted in line with USIA's proprietary due diligence process. Performance measurement is based on maintenance of the glide path, underlying funds ability to meet our due diligence expectations and the persistence and consistency with which risk adjusted results are generated. Fee assessments are typically done by comparing viable options for your plan. Again, there is no absolute rule for selection; the DOL has indicated that fees are only one aspect of selection so simply picking the lowest cost fund is not sufficient. Plan fiduciaries must also consider the investment risk and return, among other items.

> Our QDIA review was created to help you fulfill your obligation as a fiduciary and more importantly, help you to create a plan which is designed with your participants' interests in mind.

On an annual basis, we evaluate TDF options with our clients by applying our proprietary 5P framework as well as additional glide path considerations to each suite.

The 5P process helps employers make educated decisions about investment strategies through rigorous asset manager research. Various metrics include management teams, glide path design, open or closed architecture, active or passive, strategic and tactical allocation, absolute and risk adjusted performance relative to peers, volatility and expenses.

glide path design, coupled with underlying investment manager selection and performance, are key areas of focus when evaluating TDFs. The glide path describes how a fund changes its allocation from more aggressive to more conservative investment options as the target retirement date approaches. Frequently this is illustrated by showing the change in equity and fixed income allocation that occurs as investors in the TDF age. Each TDF suite has an established glide path. There are two main glide path designs, and the distinction is relatively straightforward:

- A "To" glide path design manages and adjusts the asset allocation to the target date.
- Conversely, the "Through" glide path design continues to make changes to the asset allocation after the retirement date has been reached. Typically, with varying landing point depending on glide path design.

Both designs have a terminal point at which the allocation then becomes neutral in retirement.

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How we can help

With regulatory compliance, fiduciary risk, complex evaluation and litigation risk, there's nothing simple about TDF governance. But an annual TDF review could reap benefits for your organization, including mitigating fiduciary risk, reducing long-term costs and improving benefits for your employees.

To learn more about how we can help you, contact your local USICG representative or reach out to us directly at information@usicg.com.

[1] Morningstar Manager Research, Target-Date Strategy Landscape, 2024.

[2] Vanguard Institutional, How America Saves Report, 2024.

Target date funds are an asset mix of stocks, bonds, and other investments. The portfolio moves from a more aggressive, growth-oriented strategy during the accumulation phase to a more conservative, preservation-oriented strategy near retirement. Target date funds are intended as long-term investments which involve risk including the possible loss of principal. The principal value of the fund(s) is not guaranteed at any time, including at the target date.

This content has been prepared for informational purposes only. It is not designed to be a comprehensive analysis of any topic discussed herein and should not be relied upon as the only source of information. Additionally, it is not intended to represent advice or a recommendation of any kind. Neither USI nor its affiliates and/or employees/agents/registered representatives offer legal or tax advice. Prior to acting on this information, we recommend that you seek independent advice specific to your situation from a qualified legal/tax professional.

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