

# Customized Target Date Funds: The Next Generation of Retirement Saving

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Target date mutual funds have garnered significant attention and inflows since their debut as qualified default investment alternative (QDIA) options on retirement platforms. As target-date strategies continue to evolve, many plan sponsors have come to acknowledge that “one size does not fit all” when it comes to retirement solutions. As a result, customization, which can bring institutional-quality asset management to defined contribution plans, is a growing trend.

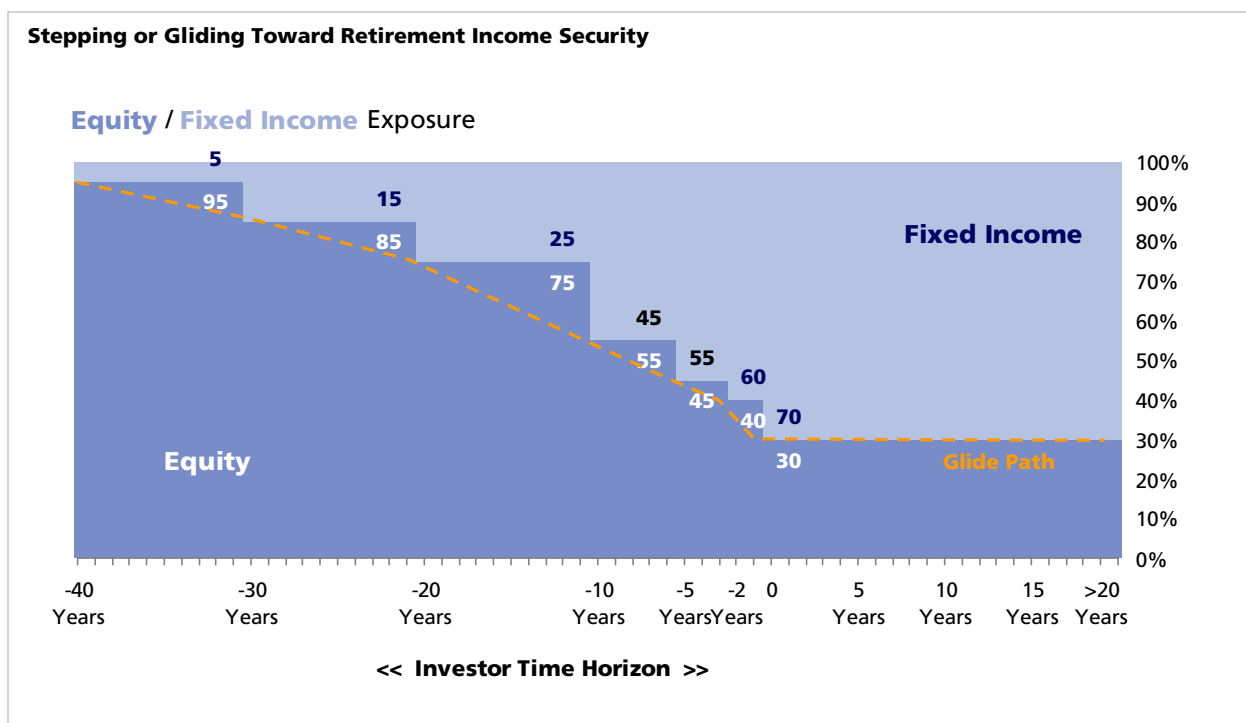
### Benefits of Customization

Target date funds can be customized in a number of ways that may allow them to match participants’ risk profiles better than off-the-shelf solutions, helping to achieve the overarching objective of sufficient replacement income in retirement.

Funds can be customized at the individual or plan level. According to Cerulli, 36% of asset managers surveyed believe it is highly likely that the next generation of target date/ lifecycle and risk based/lifestyle funds will be customized at the plan level (up from 0% in 2008), and 29% expect customization at the individual level (up from 0% in 2008.)<sup>1</sup>

Some customized solutions can take into account additional factors such as participants’ demographics, salaries, current asset allocation, plan contribution and matching rates, access to defined benefit plans, ownership of company stock, and loan/withdrawal patterns.

According to Callan Associates, portfolio construction, or the “glidepath,” of regular target date funds ranks as the most important criterion for plan sponsors when selecting or retaining target date retirement funds.<sup>2</sup> In fact, glidepath customization by large plans is one of the biggest trends observed by the chief investment officer and director of research and product development for Ibbotson Associates.<sup>3</sup> Part of portfolio construction involves the decision to employ a “step” or a “glide” design. A “glide” path typically results in a gradual reduction in the allocation to equity as an investor approaches retirement. Alternatively, a “step” transition maintains exposure to the target allocation for several years, with less frequent but steeper adjustments to asset allocations over time. The “step” process provides longer equity exposure over time, potentially resulting in higher ending wealth compared to the “glide” option.



As part of asset allocation customization, a plan sponsor may choose from a range of investment options including alternatives and non-traditional asset classes; they may also address their level of concern regarding long run inflation. The decision to use passive or active management or some combination of both may also be addressed during customization.

Depending on the asset manager's product offering, underlying funds may be selected by the plan sponsor's investment committee, a consultant, or by the target date fund manager themselves. Some asset managers will allow plan sponsors to use existing funds on their platform while others may offer access to a broad range of "best of breed" managers.

A plan sponsor is unlikely to find the mix of asset managers and investment options that is best for their participants in an off-the-shelf solution; customized funds are therefore becoming a popular option.

### Potential drawbacks

Customized approaches may incur additional fees, which are often offset by using lower-cost collective investment trusts or by incorporating passive management. Judging the performance of a customized provider with regard to strategic and tactical allocation, glide path, and underlying fund selection may be difficult. Some consultants take a "one size fits all" approach to allocation and glide path recommendations and only customize the underlying funds in the plan.

### Increasing levels of interest

Plan sponsor demand for customized target date funds is growing. According to Callan Associates surveys, 64.4% of plan sponsors offer target date funds as their asset allocation vehicles; of those that

offer target date or target-risk funds, 25.4% use or plan to use custom target strategies.<sup>4</sup>

In fact, some large defined contribution plans are dropping target-date funds in favor of their customized counterparts: the \$1.6 billion 410(k) plan of Akzo Nobel Inc., the \$8.5 billion New York City Deferred Compensation Plan, and the \$10 billion 401(k) plan sponsored by Pfizer Inc.<sup>5</sup>

Consultants also predict increased interest in customized target date funds. Among U.S. consultants focused on defined contribution plans, nearly 90% expect moderate or significant QDIA search activity for customized target date funds in 2009.<sup>6</sup>

### Outlook

Although target date funds have come under scrutiny due to high equity weights and losses incurred by investors who were nearing retirement, it is unlikely that these popular products will disappear. Ultimately, plan sponsors, as fiduciaries, must consider their participants' long term retirement goals and objectives and decide for themselves whether customized target date funds are more appropriate for their employees than their packaged counterparts. ■

7 Cerulli Associates, "Retail Products and Strategies 2009."

8 Callan Associates, "2009 Defined Contribution Trends Survey," February 2009.

9 [http://www.ignites.com/articles/20090408/plan\\_sponsors\\_asset\\_protection\\_survey](http://www.ignites.com/articles/20090408/plan_sponsors_asset_protection_survey)

10 Callan Associates, "2008 Callan Defined Contribution Fee Survey," October 2008 and "2009 Defined Contribution Trends Survey," February 2009

11 <http://www.pionline.com/apps/pbcs.dll/article?AID=/20080526/PRINTSUB/61510866/1031/TOC>

12 Casey Quirk, "2009 Consultant Search Forecast."

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