A Guide for Plan Sponsors Offering Target-date Funds

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Abstract

Over the past twenty years, there is shift from defined-benefit (DB) to defined-contribution (DC) plans as primary retirement funding vehicles private sector workers in the US. This shift also coincides with regulatory changes that assist employers and plan sponsors in offering DC plans. First, new rules permit automatic enrollment of employees in pension plans. Second, plan participants can be offered default retirement saving vehicles in DC plans. One such set of default investment vehicles is target date funds (TDFs).

I this paper, plan sponsors contemplating including target date funds as part of a DC plan are provided with guidance in three areas. First, recent litigation points to an increased need for establishing due diligence and the discharge of fiduciary duties. The initial section of the paper discusses this aspect. Second, TDF design is grounded in two complementary set of theoretical constructs. The first is premised on the individual converting human capital into financial capital over a lifetime. The second, liability driven investing (LDI) which is steeped in the defined benefit plan management where the goal is to manage the retirement portfolio to meet anticipated liabilities. Finally, a review and analysis of 36 plan families demonstrates the need for review and monitoring of available options. Sponsors can add significant welfare benefits through by offering TDFs that match the broad utility profile of the workforce. Two key hypothesis of the analysis test for preference for open architecture platforms and index funds for the underlying components of TDFs. Technology, regulation and competition are facilitating the trend towards TDFs that tailor offerings to individual participant profile.