PLANSPONSOR®
October 29, 2019 | Jake Gilliam, Charles Schwab & Co., Inc | PLANSPONSOR.com

5 Things to Consider When Selecting TDFs for Your Retirement Plan

A checklist of five things for retirement plan sponsors to consider when choosing target-date funds (TDFs).

As the default investment option for many Americans' 401(k) plans, target-date funds (TDFs) have emerged as important and popular investments to help people meet their retirement goals. These funds have strong appeal for plan sponsors balancing fiduciary responsibilities as they seek to drive better outcomes for participants.

For that reason, sponsors have been very responsive to the guidance that the Department of Labor (DOL) issued regarding TDFs in 2013 and have been working closely with consultants and advisers to better understand TDF choices and options. What may seem like small matters of nuance during the selection process could translate to significantly different outcomes over time.

Here's a checklist of five things we think are important for sponsors to consider when choosing TDFs:

1) Evaluate funds with your participants in mind. First, ask your provider how it can help ensure that its TDFs are a good fit for the specific demographics of your employee base. And because demographics shift over time, revisit this question as part of your regular TDF evaluation process.

Get a sense of how the TDFs could protect your older employees in down markets. Make sure you're making a conscious and deliberate decision about risk exposure especially as the glide path nears the target date. And be sure to consider not only high-level equity or fixed-income allocations, but also allocations to more volatile sub-asset classes such as emerging markets equity and high-yield bonds.

Additionally, ask your provider if it factors participants' emotions and behavioral biases into its investment process. The range of threats to retirement savings include things such as market risk, longevity risk, sequence risk, inflation risk, tail risk and interest rate risk. But human decisionmaking concerning those risks differs depending on the person's stage of life. Those behavioral patterns can and should be factored in to a TDF's design to help drive toward successful outcomes for retirement savers.

2) Know that plans of every size have access to low-cost investments. There are TDF cost-saving opportunities today that didn't exist just a short time ago, both in mutual fund and collective investment trust (CIT) structures. Larger plans served by consultants, committees and regular review processes are clearly capitalizing on the opportunities to lower investment costs. But plans of every size have access to low-cost choices and are no longer bound by minimums of days gone by. Small plans in particular need to understand that today the industry offers index TDFs in both mutual fund and CIT flavors with expenses under 10 basis points (bps) and no minimum investment levels.

3) Do a deep dive on the underlying strategies. Implementation of a TDF can be fully passive, fully active or a hybrid of the two. Each has its merits. Therefore, it's important to have a thorough understanding of the strategy and how it's being implemented.

This is particularly important when you're considering active strategies, as approaches there can vary widely. Are there multiple fund families represented or only one? Additionally, ask your provider what its process is for selecting and removing the underlying active funds, and if that has ever been enacted. After all, you've probably made fund changes in your plan's core lineup. If your TDF provider

---

This feature is to provide general information only, does not constitute legal or tax advice, and cannot be used or substituted for legal or tax advice. Any opinions of the author do not necessarily reflect the stance of Institutional Shareholder Services (ISS) or its affiliates.

has never made any changes to its underlying funds, be sure you find out why.

4) Choose "to" or "through," and understand why you did. There's a lot that's misunderstood about the difference between TDFs that have glide paths that extend to or through a retirement date. So consider the issue closely. Make sure you have a rationale for why you prefer one over the other for your plan.

Contrary to common belief, TDFs with to glide paths are not always more conservative than those with through paths. In fact, a through fund may potentially provide better downside protection, while benefiting investors well past its target date.

When making a final decision, consider the asset allocation, architecture type and methods for managing absolute risk.

5) Make sure you trust the choices your provider has made about the underlying funds in its TDFs. TDF providers often use their own proprietary funds within their TDF solutions, and in many cases that makes perfect sense. When considering TDFs that use active strategies, make sure there are no compromises. In those cases, we like the flexibility that an open architecture format offers, but every plan sponsor needs to do its own gut check. One rule of thumb as you evaluate TDFs is to ask yourself if you would be comfortable offering each of the underlying funds in your core lineup as a stand-alone fund choice.

Conclusions

As a fiduciary, you must consider all aspects of TDFs to ensure they're well-suited for your plan. Be careful about what may seem like easy choices. There are no shortcuts, so do your due diligence. This checklist is a good place to start. ■

Jake Gilliam is head client portfolio strategist, multi-asset strategies, with Charles Schwab & Co., Inc.

The values of target date funds will fluctuate up to and after the target dates. There is no guarantee the funds will provide adequate income at or through retirement.

Target date funds are built for investors who expect to start gradual withdrawals of fund assets on the target date, to begin covering expenses in retirement. The principal value of the funds is not guaranteed at any time, and will continue to fluctuate up to and after the target date.

Target date funds asset allocations are subject to change over time in accordance with each fund's prospectus.

The Funds are subject to market volatility and risks associated with the underlying investments. Risks include exposure to international and emerging markets, small company and sector equity securities, and fixed income securities subject to changes in inflation, market valuations, liquidity, prepayments, and early redemption.

Information provided herein is for general information purposes only and should not be considered an individualized recommendation or personalized investment advice. The investment strategies mentioned may not be suitable for everyone. Each investor needs to review a security transaction for his or her own particular situation.

Investors should consider carefully information contained in the prospectus, or if available, the summary prospectus, including investment objectives, risks, charges and expenses. You can obtain a prospectus, or if available, a summary prospectus by visiting schwabfunds.com. Please read it carefully before investing.

Charles Schwab Investment Management, Inc. (CSIM), the investment advisor for Schwab Funds, and Charles Schwab & Co., Inc. (Schwab), Member SIPC, the distributor for Schwab Funds, are separate but affiliated companies and subsidiaries of The Charles Schwab Corporation.

PLANSPONSOR.com is not affiliated with CSIM or The Charles Schwab Corporation.

(0120-9FT2)

This feature is to provide general information only, does not constitute legal or tax advice, and cannot be used or substituted for legal or tax advice. Any opinions of the author do not necessarily reflect the stance of Institutional Shareholder Services (ISS) or its affiliates.