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global
fiduciary insights

The Case for Rethinking TDFs as QDIAs



AURUM

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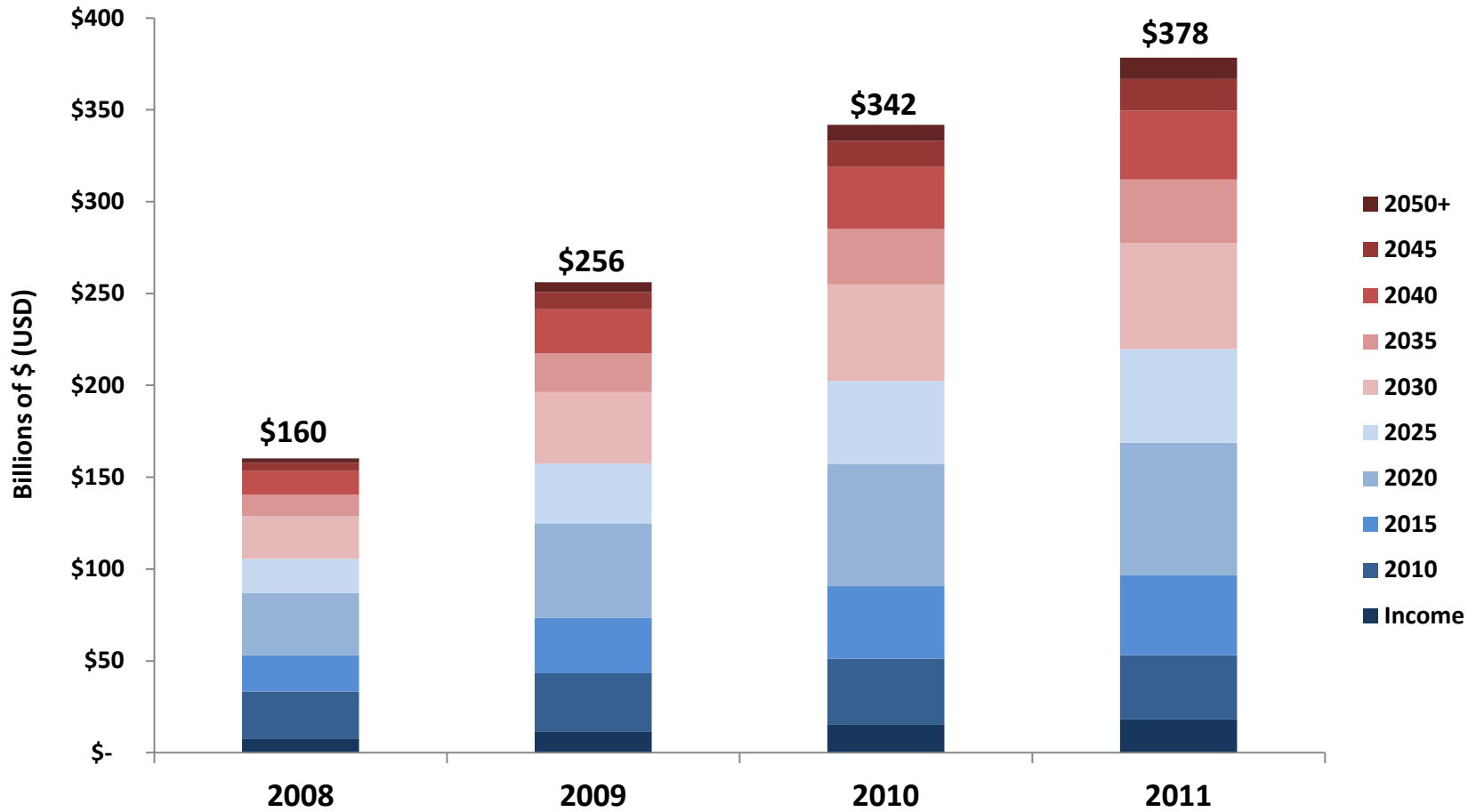
- **Overview of QDIA Landscape**
- **Investment Challenges of TDFs**
- **Fiduciary Challenges of TDFs**
- **Where Do We Go From Here**

Overview of QDIA Landscape

A Quick Look Back

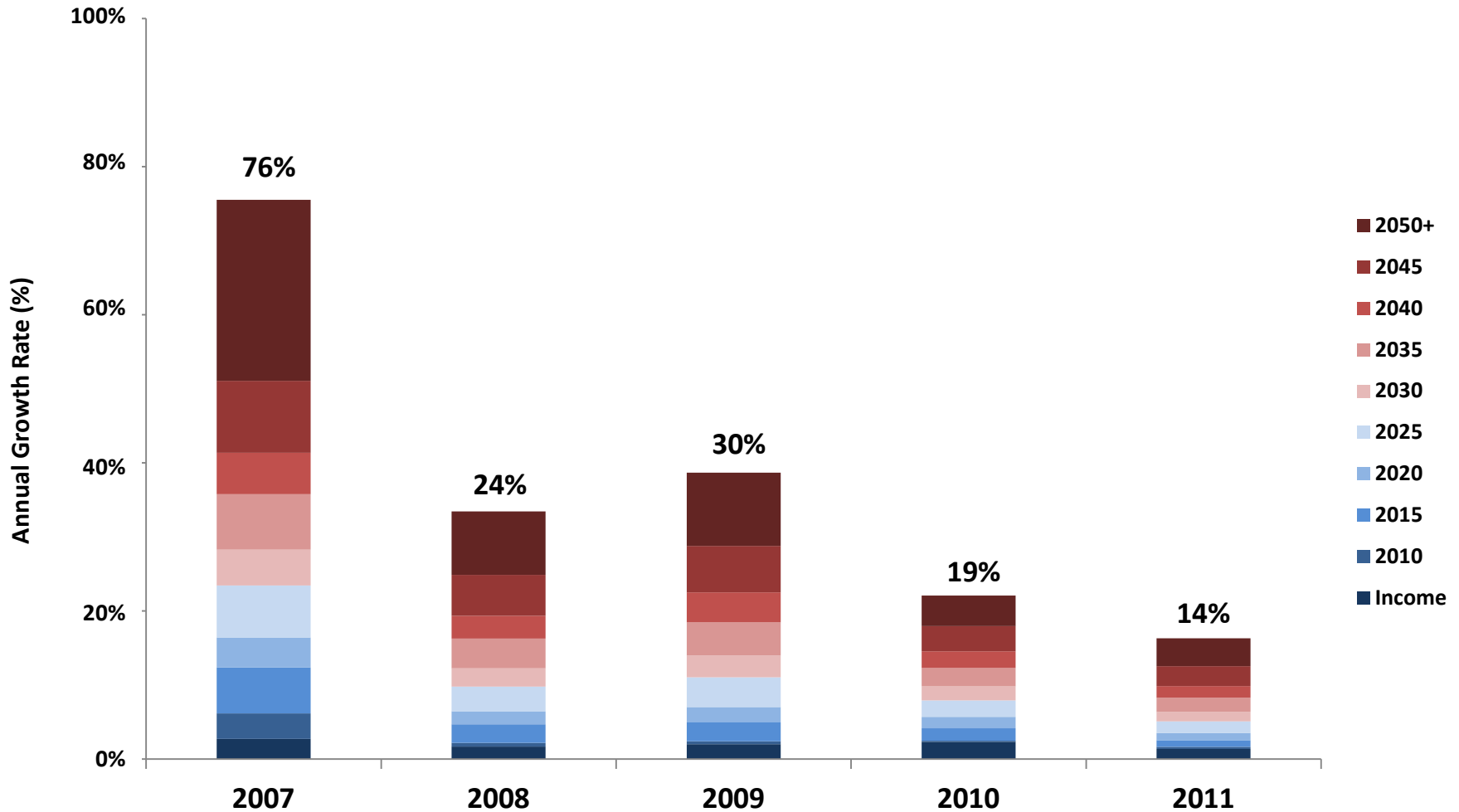
- **Pension Protection Act of 2006**
- **Importance of QDIAs**
- **Why TDFs?**

Total Net Assets



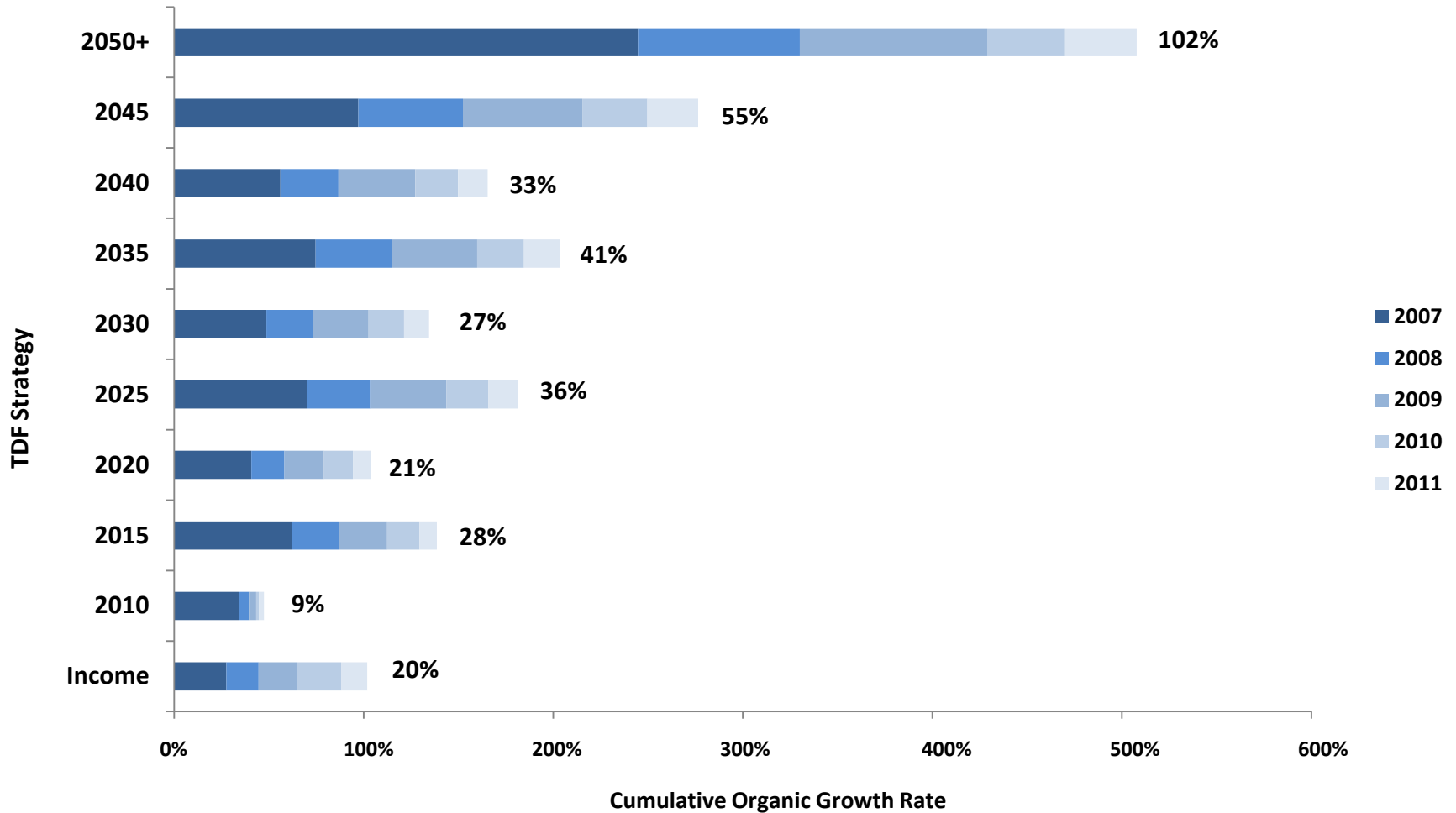
Source: Morningstar: Target-Date Series Research Paper- 2012 Industry Study. Morningstar, Inc. May 2012.

Organic Growth Rate by Year



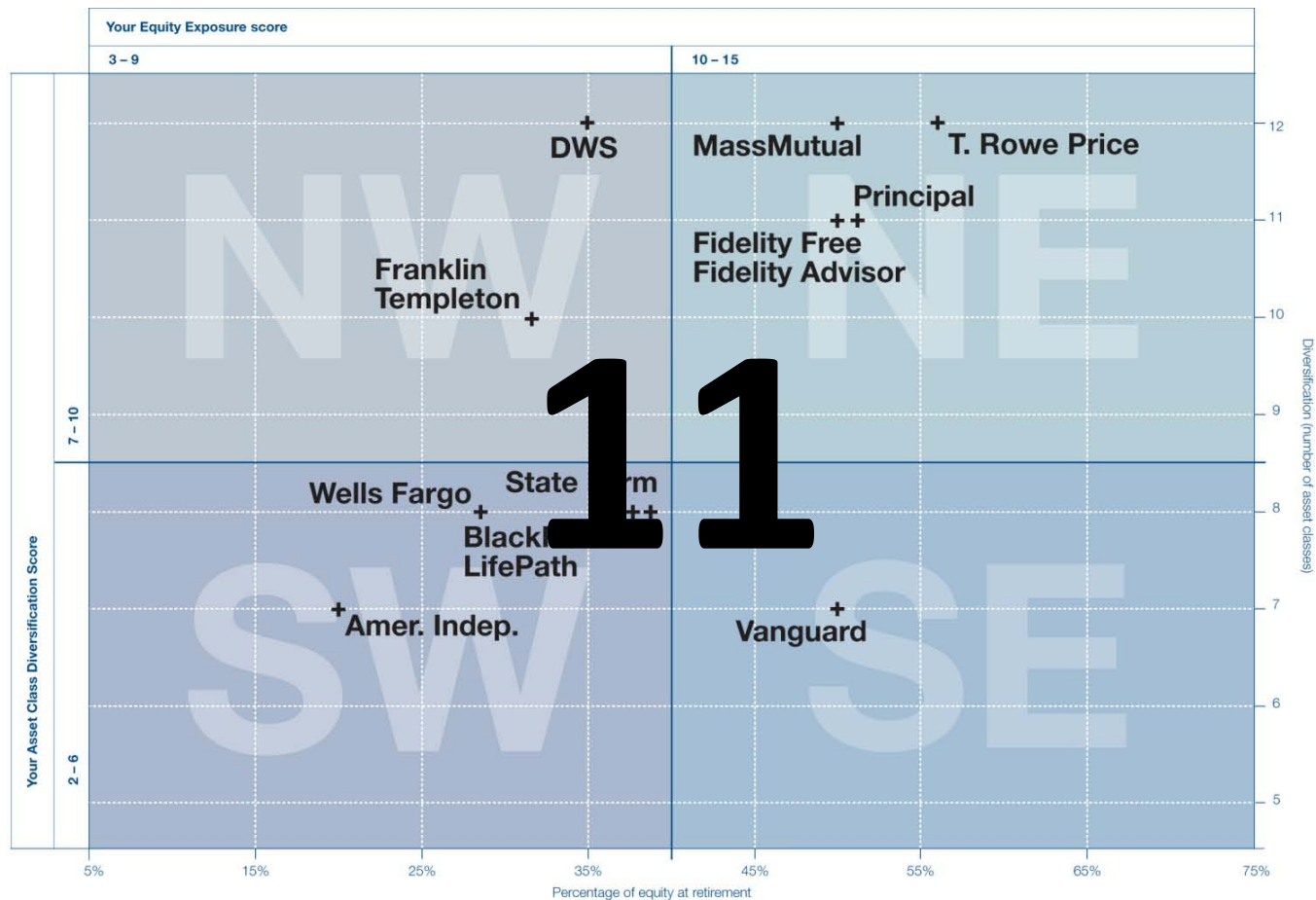
Source: Morningstar: Target-Date Series Research Paper- 2011 Industry Study. Morningstar, Inc. May 2011.

Organic Growth Rate by Strategy



Proliferation of Product

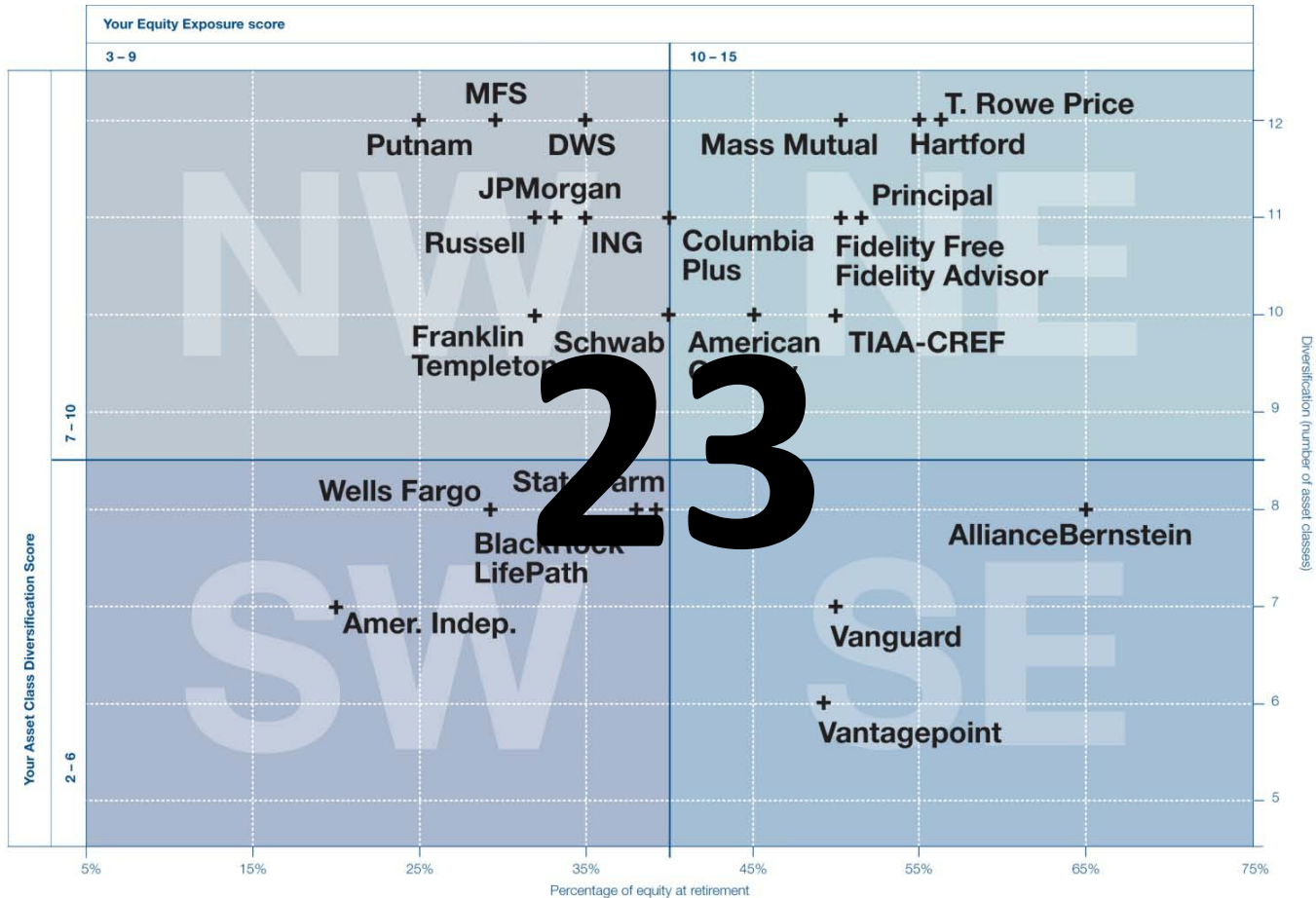
Available 5 years ago with a 3-year track record



Source: J.P. Morgan Asset Management. Data as of June 30, 2012.

Proliferation of Product

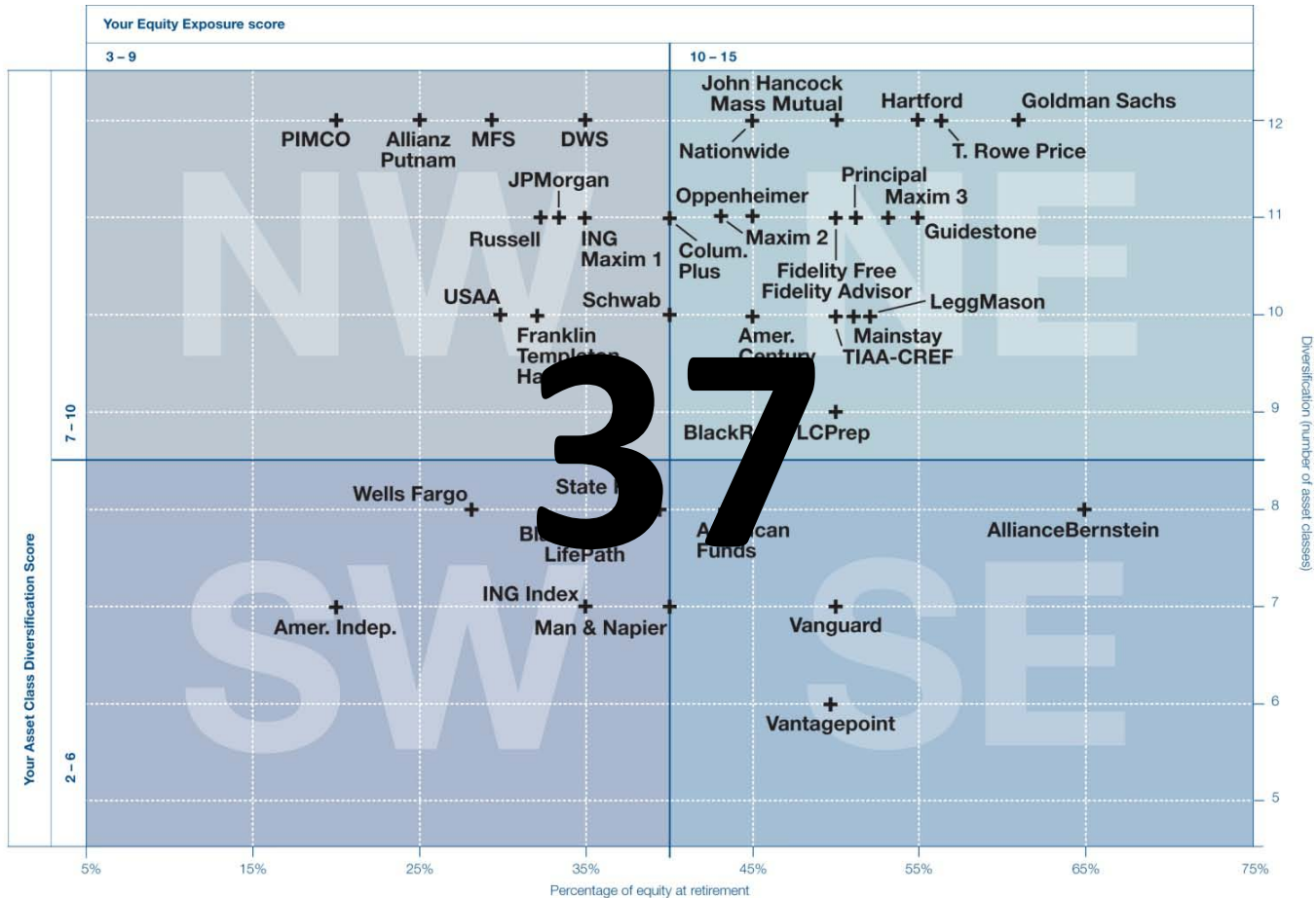
Available 3 years ago with a 3-year track record



Source: J.P. Morgan Asset Management. Data as of June 30, 2012.

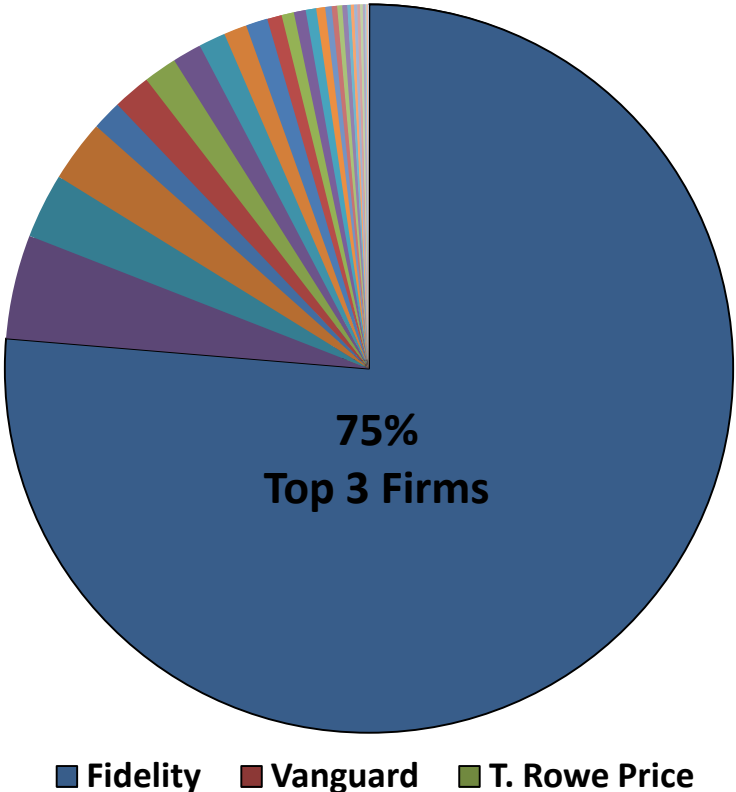
Proliferation of Product

Available today with a 3-year track record



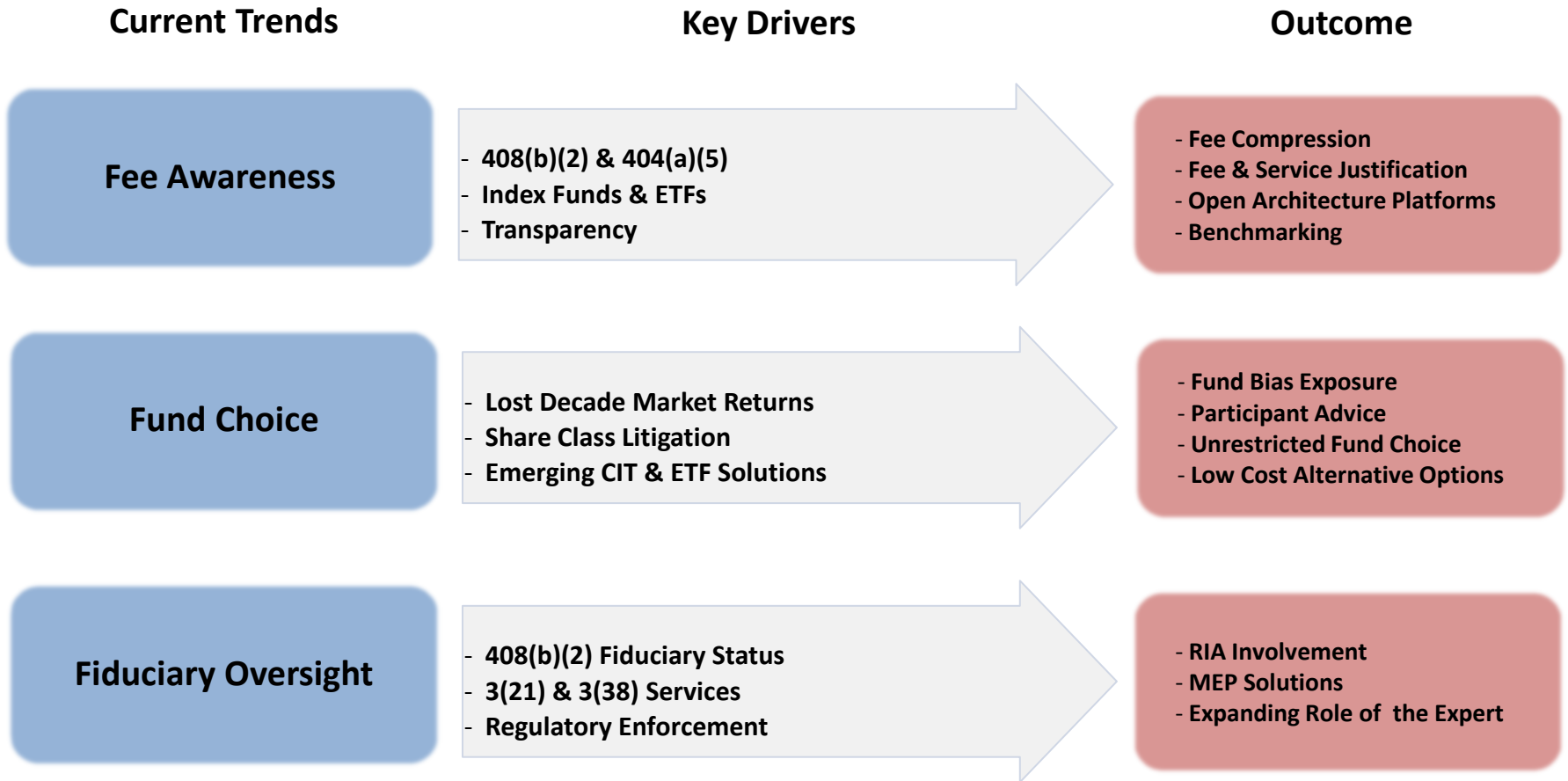
Source: J.P. Morgan Asset Management. Data as of June 30, 2012.

Market Dominance



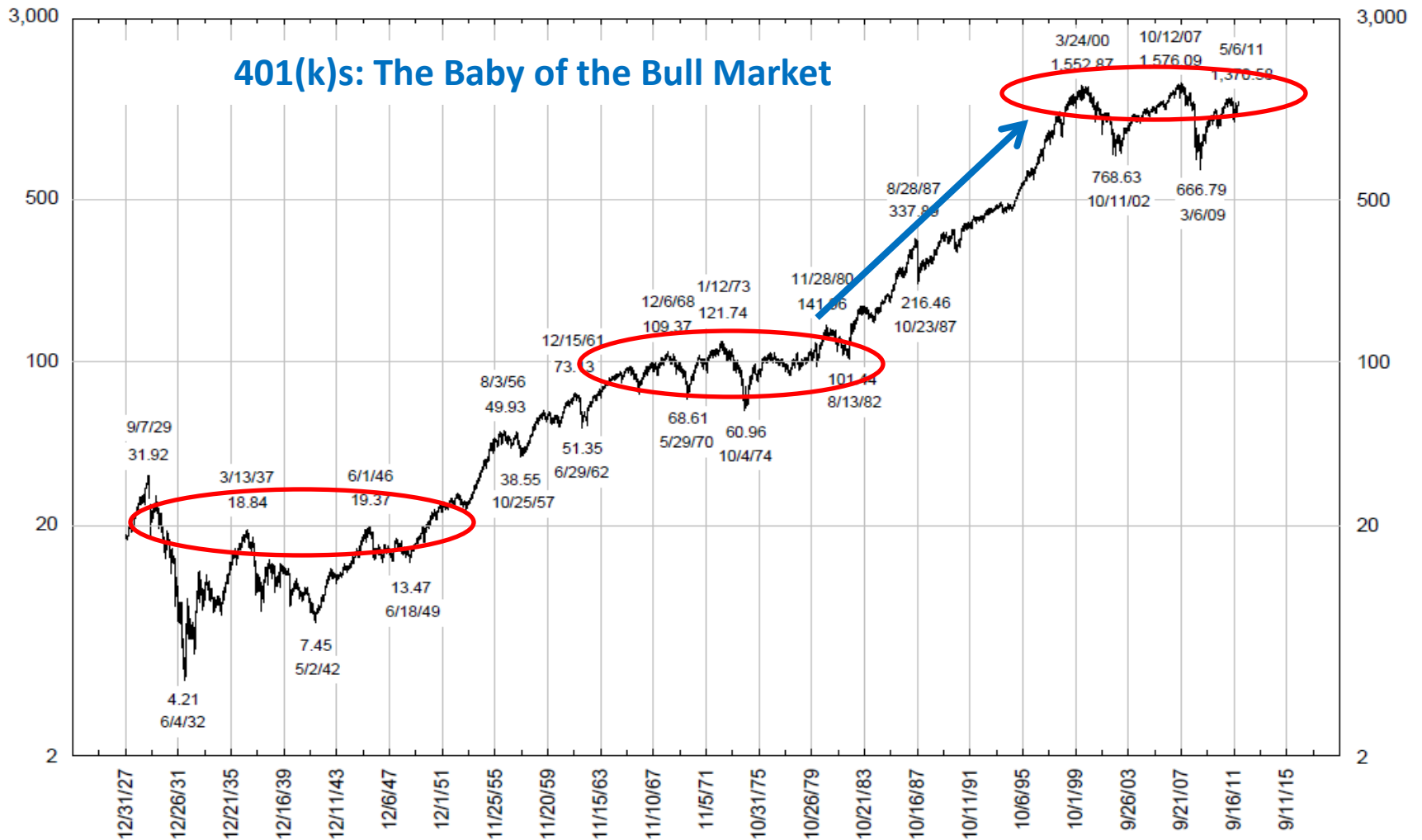
Source: Morningstar: Target-Date Series Research Paper- 2012 Industry Study. Morningstar, Inc. May 2012.

Where Are We Today?



Investment Challenges of TDFs

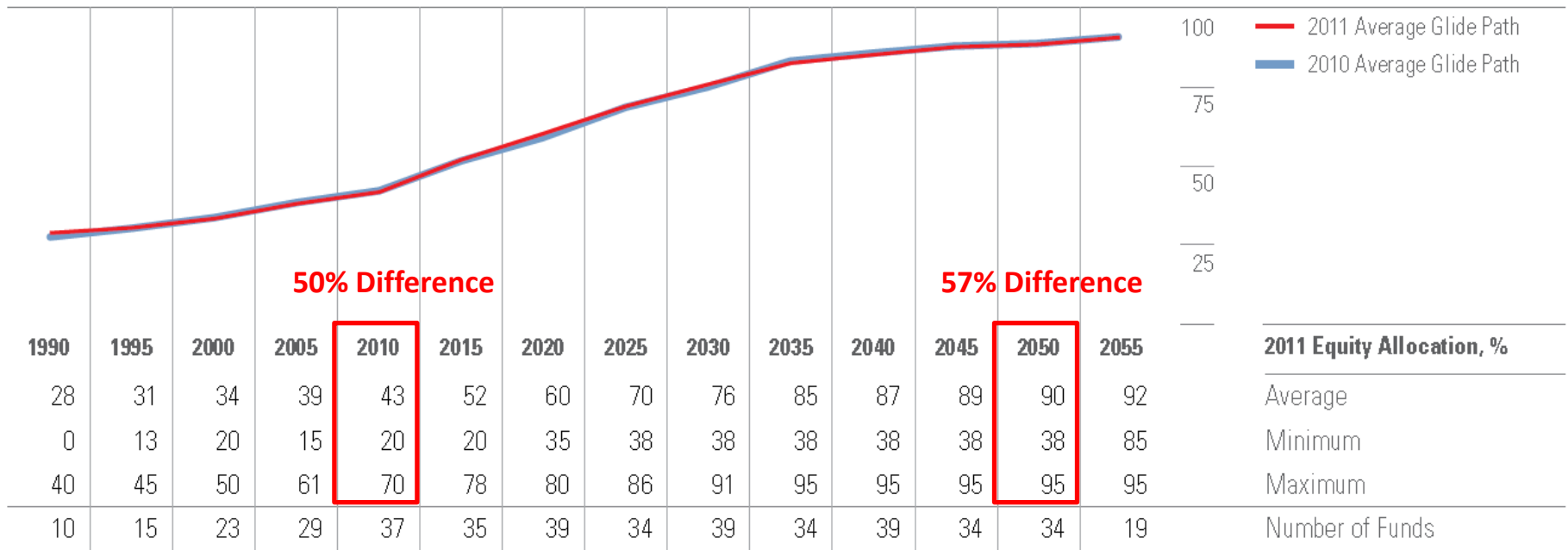
Retirement Roulette



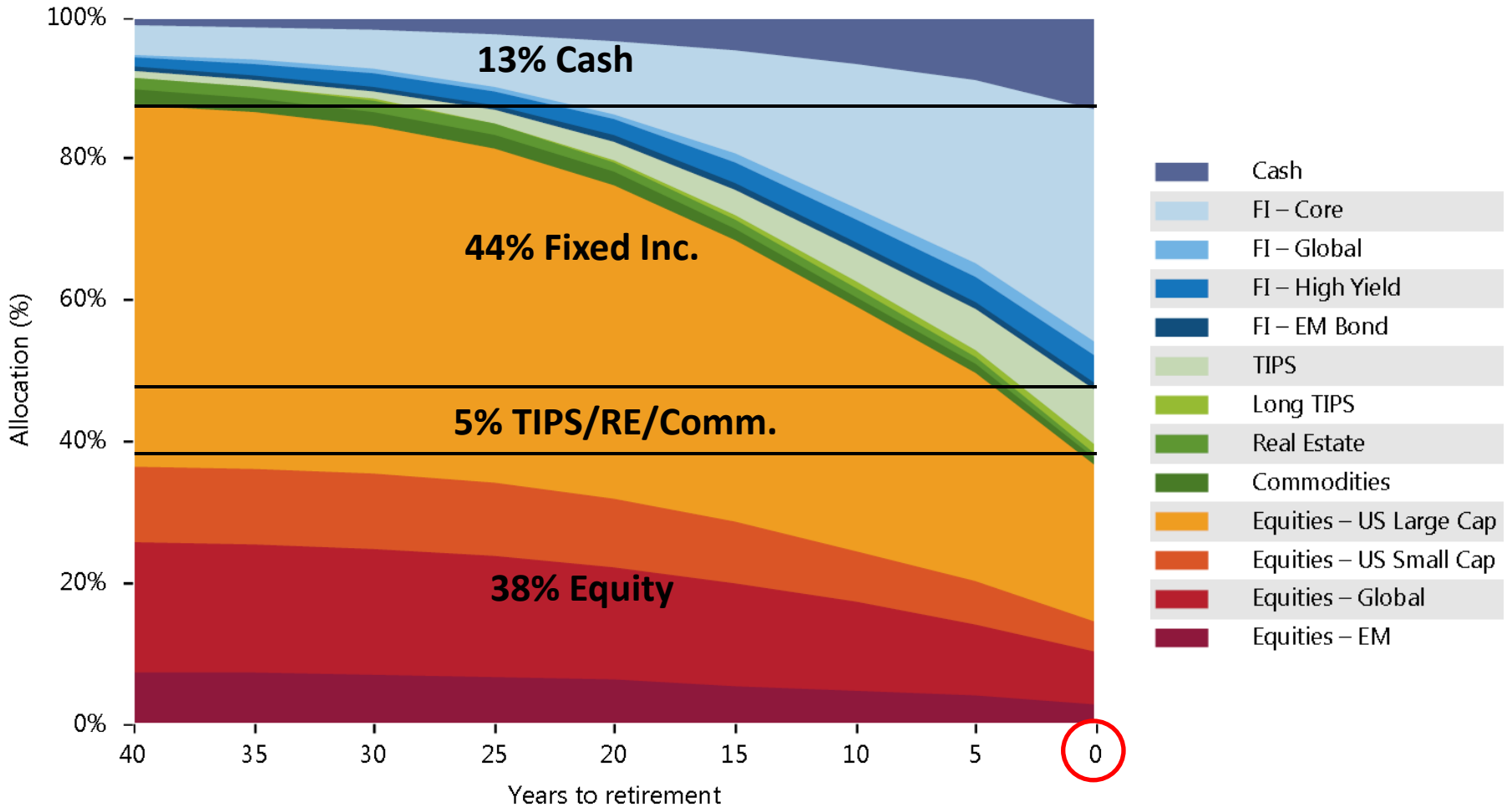
Investment Challenges of TDFs

- **Loss Potential > Loss Capacity**
- **Conflicting Definitions of Success**
- **TDFs Are Not Created Equal**
- **Glide Paths**
- **Due Diligence**

What's Normal about Glide Paths?



MarketGlide: Average Glide Path



Investment Due Diligence Process

- **Documented Due Diligence of:**
 - **Asset classes and sub-asset classes**
 - Underlying holdings (and attribution)
 - **Withdrawal and/or reinvestment assumptions of TDF**
 - **Glide Path**
 - Investment rationale for Glide Path
 - Analysis of Glide Path stability
 - Degree of tactical asset allocation

Investment Due Diligence Process

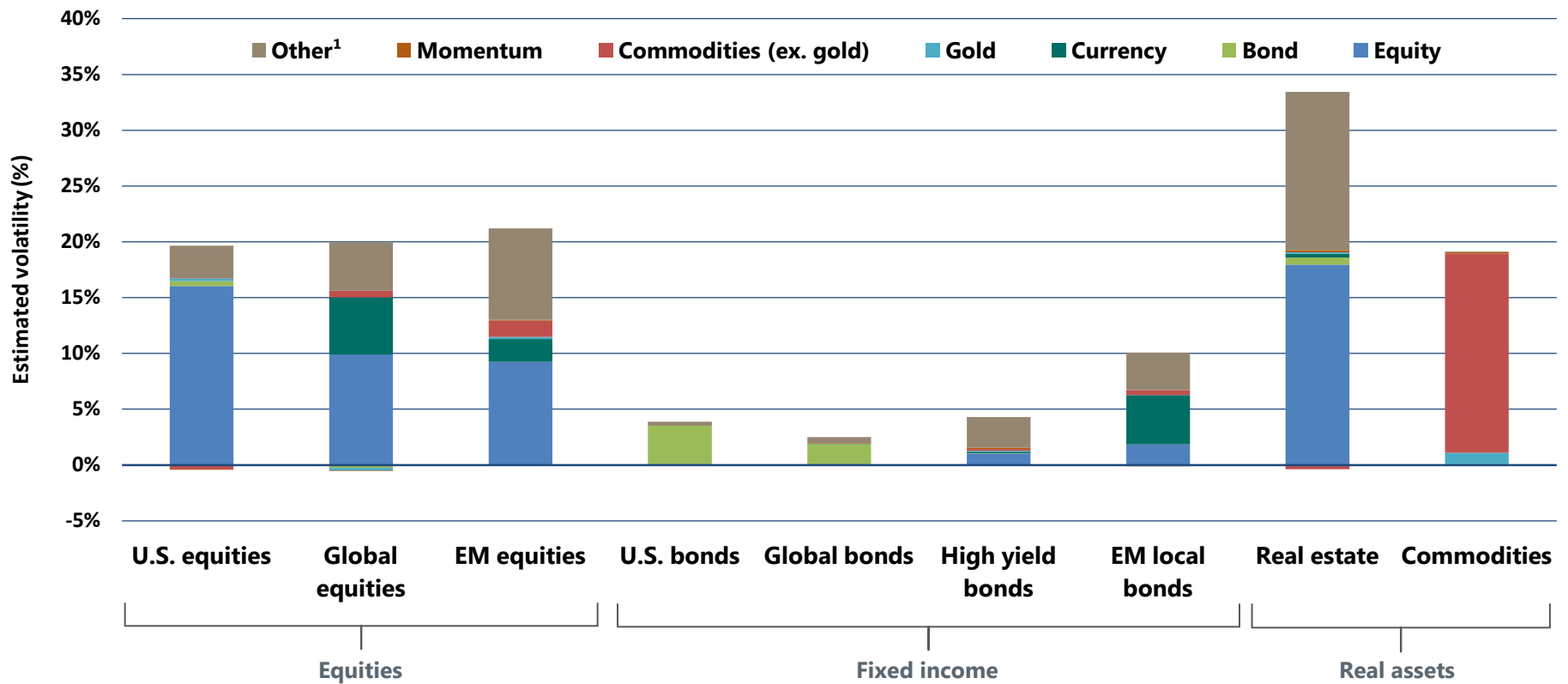
- Documented Due Diligence of:
 - Stress Testing
 - If proprietary, evaluation of underlying funds/mgrs.
 - Understanding what drives returns
 - Manager Compensation

Rewarding Performance

Short-Term	Long-Term	Gathering Assets
12	7	3

Risk Factor Analysis

Breakdown of total volatility by key risk factor (%)



Conviction in Their Own Ideas?

- **Do Fund Managers Actually Invest in Their Own Funds?**
 - **Per the Morningstar study...**
 - “In two separate 2011 studies, Morningstar found a correlation between managers who invested substantial sums in their funds and superior relative fund performance.”
 - “Of the 38 series...managers of 18 have zero dollars invested... Most fund managers don’t invest a dime in the mutual funds they run. But given the importance and growing prominence of target-date funds...this low co-investment is disappointing.”
 - “Across the industry, just one manager...meets the highest industry standard...owning shares worth more than \$1 million. One other manager... owns shares in two of [his] funds, with one investment valued between \$500,000 and \$1 million while the other is worth between \$10,000 and \$50,000.”

Fiduciary Challenges of TDFs

Plan Sponsor Awareness

- **Prudence Still Reigns**
 - *“[N]othing in [the regulation relieving fiduciaries of liability for losses resulting from a participant’s investment in a QDIA] shall relieve a fiduciary from his or her duties under part 4 of title I of ERISA to prudently select and monitor any qualified default investment alternative...”¹*
- **Fiduciary Disconnect**
- **Balancing QDIAs with Participant Education/Communication**

Fiduciary Challenges

- **Alignment with Plan Goals**
 - Risk tolerance of participants
 - Retirement readiness and needs of participants
- **Decision Making**
 - How do I choose?
 - How do I monitor? What things do I even look for?
- **Additional attention for QDIAs**
- **Direct competition with fund lineup**

What Are You Paying For?

- **Active vs. Passive**

- Active Share
- Is it a 'closet indexer'?

Active Share

100-85%	84-70%	69-55%	54-0%
26	5	6	8

- **Open vs. Closed**

- Proprietary (closed) platforms
- Mixed platforms
- Open-architecture platforms

Closed	Mixed	Open
24	10	7

How Much Are You Paying?

- What's normal? What's high? What's low?

Net Expense Ratio¹

Average	High	Low
0.83%	1.31%	0.18%

Asset Class Comparisons²

	Average	High	Low
Large Cap Core	1.26%	2.05%	0.10%
Intermediate Bond	0.90%	1.72%	0.10%
Balanced Allocation	1.38%	2.15%	0.25%

Source¹: Morningstar: Target-Date Series Research Paper- 2012 Industry Study. Morningstar, Inc. May 2012.
Source²: fi360

DOL: TDF Tips for ERISA Fiduciaries

- Establish a process for comparing and selecting investments.
- Establish a process for the periodic review of selected TDFs.
- Understand the fund's investments – the allocation in different asset classes, individual investments, and how these will change over time.
- Review the fund's fees and investment expenses.
- Inquire about whether a custom or non-proprietary target date fund would be a better fit for your plan.
- Develop effective employee communications.
- Take advantage of available sources of information to evaluate the TDF and recommendations you received regarding the TDF selection.
- Document the process.

Trickle-Down Effect

- **Shift of Burden**
- **Depends on your fiduciary status**
 - Non-fiduciary
 - 3(21)
 - 3(38)
- **Opportunity or Threat**

Where Do We Go From Here

Rethinking QDIAs

- **Redefining “Success”**
- **Drivers of QDIAs**
- **Solution rather than Product**
- **Manage Risk Exposure**
- **Prudent, Conflict-Free, Transparent**

Best Practices for Sponsors & Advisors

- **Back to Basics (mostly)**
- **QDIAs Are Different**
- **Justification of Fees**
- **Process over Outcomes**

	Good Outcome	Bad Outcome
Good Process	Deserved Success	Bad Break
Bad Process	Dumb Luck	Poetic Justice

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