

# TARGET DATE FUNDS – 10 YEARS LATER AND BEYOND

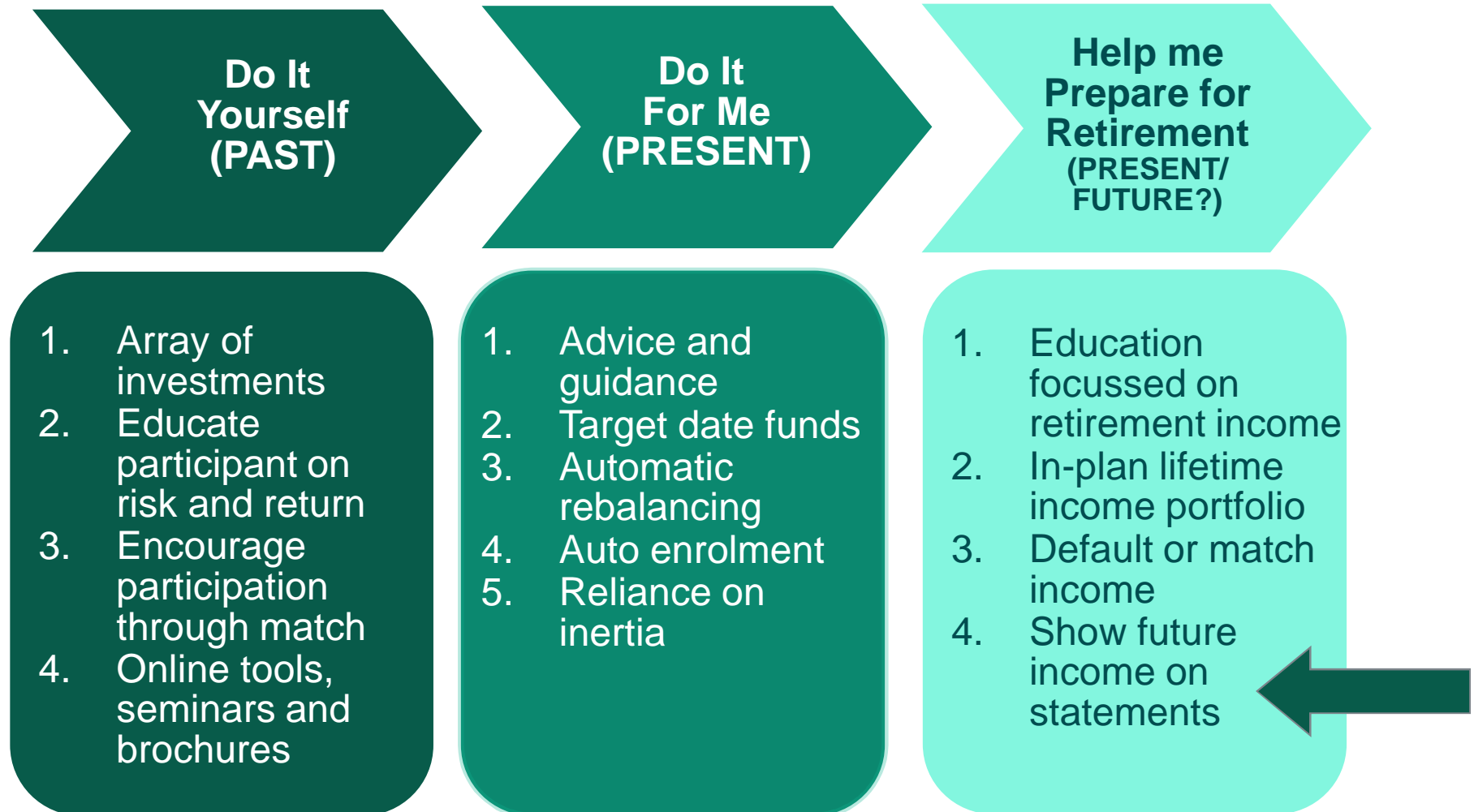
## CPBI SOUTHERN ALBERTA P.D. DAY

29 May 2014

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# Evolution Of DC Investments

## A change in focus



**Next step: Individualized target date funds ?**

## A Modern Perspective On Investment Structure

- Rarely reviews portfolio
- No engagement in investment allocation decisions
- Invested in default
- Maybe:
  - Lacking in investment knowledge; or
  - No time or inclination to make investment allocation decisions



**“Do it for me”**  
**“50%-80%”**

- Reviews overall investment allocation occasionally; wants control over major shifts
- Disengaged on implementation, rebalancing and other shorter-term issues



**“Help me do it”**  
**“20%-35%”**

- Frequently reviews portfolio
- Utilizes full range of investment options
- May want more investment options
- Wants to control all key investment allocation decisions

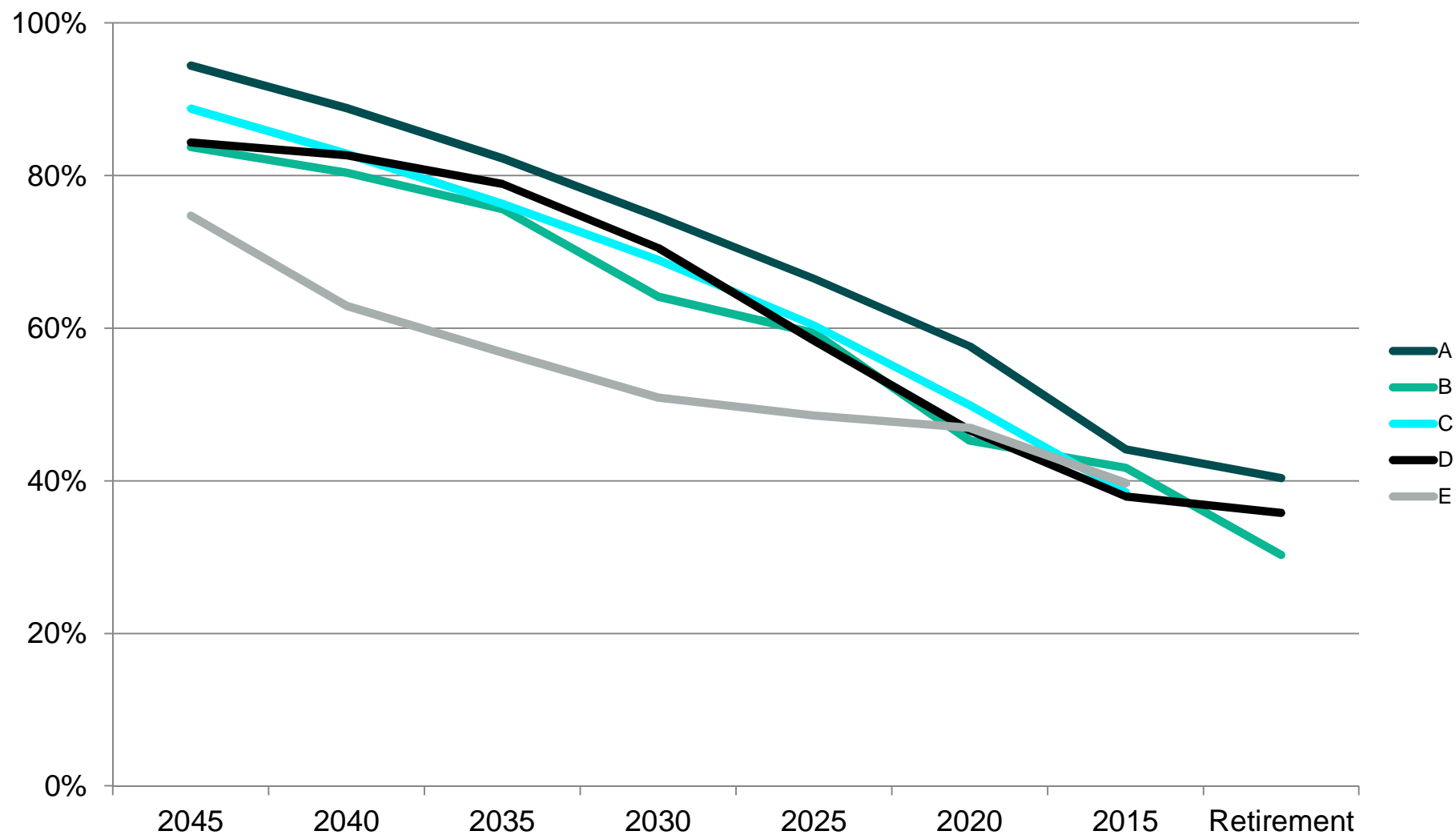


**“Leave me to it”**  
**“5% -20%”**

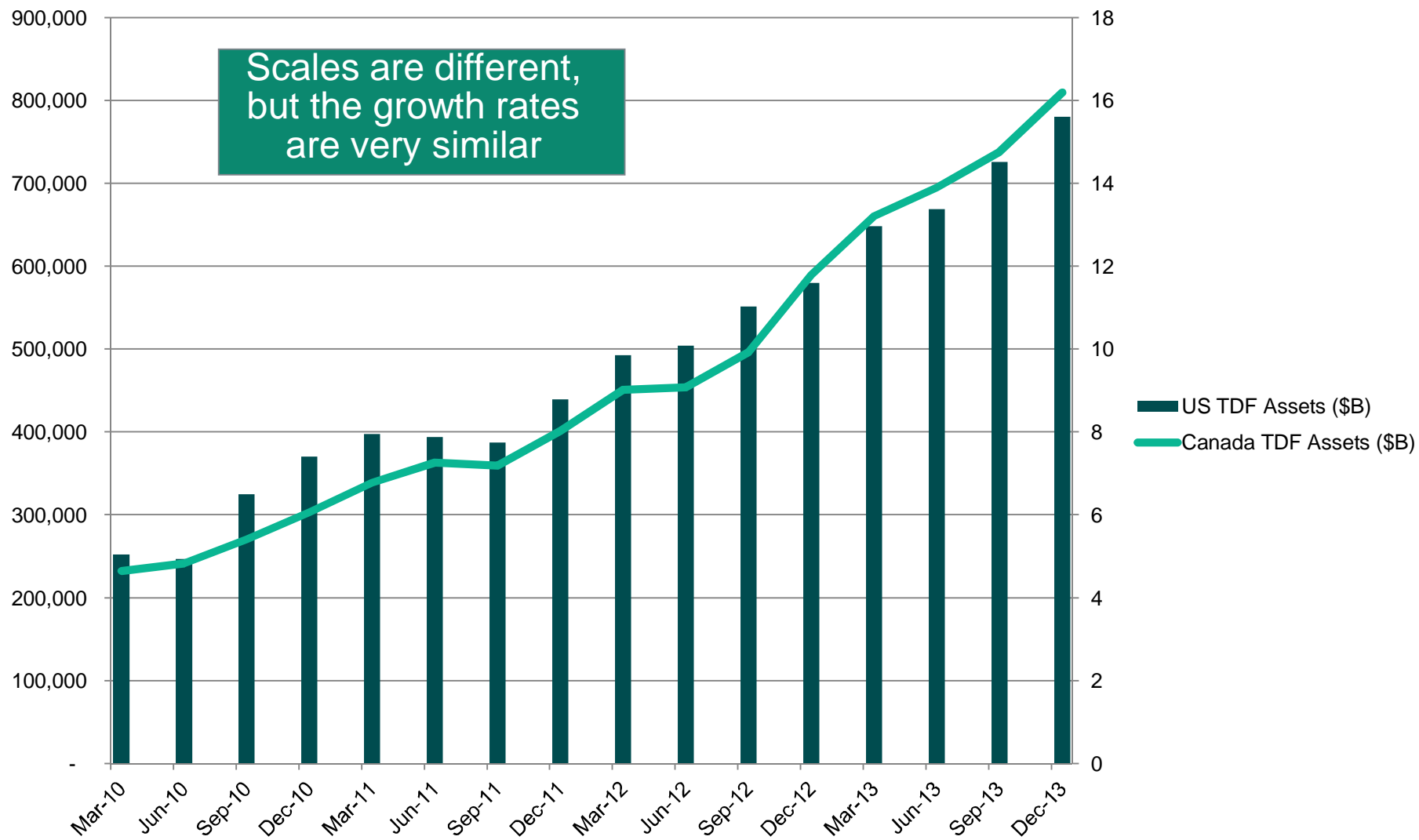


**Predominant view: Target date (or Lifecycle) option**  
**But which target date fund.....and is that the end of the story?**

# What Do Canadian Target Date Funds Look Like?

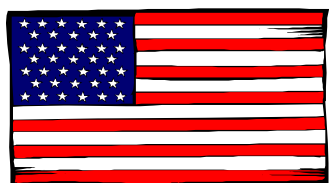


# Total Target Date Program Assets Of Managers Surveyed US and Canada



Sources : US : Mercer Target Date Fund Surveys  
Canada : Mercer Pooled Fund Surveys

# Evolution Of Target Date Funds And How Does Canada Compare



US is primarily here with many of the larger plans having custom

UTC

**Proprietary TDFs**

**“Best in class” TDFs**

**Custom TDFs**

**Custom TDFs with alternatives**

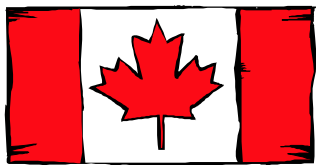
**Custom TDFs with annuity/drawdown**

Pretty much all recordkeepers have these

Need a formal rating process to identify these

Some customisation has taken place and increasing interest

Nothing in Canada



## US Guidance

### Department Of Labor Issued “Target Date Retirement Funds – Tips For ERISA Plan Fiduciaries”: February 2013

1	Establish a process for comparing and selecting TDFs
2	Establish a process for the periodic review of selected TDFs
3	Understand the fund’s investments and the allocation in different asset classes (stocks, bonds, cash), individual investments and how these will change over time
4	Review the fund’s fees and investment expenses
5	Inquire about whether a custom or non-proprietary target date fund would be a better fit for your plan.
6	Develop effective employee communication.
7	Take advantage of available sources of information to evaluate the TDF and recommendations you received regarding the TDF selection
8	Document the process

Not a bad roadmap for Canadian Plan sponsors

## So Why Would You Customize?

Why Customize?	Concerns with “off the shelf”
Can tailor fund to own participant demographics	Complex to monitor (except with Mercer)
Use freestanding options – limited additional monitoring	Difficult to separate glide path construction and underlying performance of asset classes
Easier to include additional asset classes – improve efficiency	Some asset classes often not “best in class” managers (“seed capital”)
Easier to access good active management	Still need to compare against other target date funds and review choice
May leverage existing DB or other investment structures	But
But	Less need to re-evaluate glide path in annual SIPP Reviews
Review glide path and underlying construction in annual SIPP Reviews	Reasonable for the “average member”
Review in-depth every 3-4 years	Simple to implement (cheaper?)



## So Why Would You Customize? Why Might You Tailor To Your Own Employee's Circumstances?

- Is the Plan their main source of retirement income?
- If members have some DB benefits
- Lower paid workers, CPP/OAS may provide good guaranteed coverage
- If members have a large share purchase plan
- Hybrid DB/DC plan?
- What are members currently doing with their assets at retirement, or what do you expect them to do?

Are your employees/members typical?

## What Is A Suitable Target Date Assessment Process (Ideally)

STEP	
1	Consider the characteristics of likely investors in <u>your</u> target date fund
2	Consider the different investment phases of <u>your</u> members
3	Assess likely outcomes for <u>your</u> members (and try and improve them)
4	Clarify what other objectives are important to <u>your</u> members
5	Perform in-depth modelling to understand how <u>your</u> objectives are met

An “off the shelf” fund outsources these steps to a provider.

Sponsors need to evaluate whether the provider meets your needs

## A Simplification: Three Basic Components To A Target Date Approach

### Growth Portfolio

The portfolio used in the earlier years where returns are the key consideration, primarily to build up retirement assets


### Glide Path

The transition from the growth portfolio to the retirement portfolio

### Retirement Portfolio

The portfolio which would suit members at or near retirement ideally links to what will happen in retirement

Design needs to work back from Retirement Portfolio  
Need to know where you are going



## Consider The Different Investment Phases Of Your Members

Age	First job (20)	Established career (~40+)	Pre-retirement (~60+)	“Active” retiree (~65-75)	“Passive” retiree (~75-85)	“Frail” retiree (~85+)
Investment strategy	Unimportant	Important	Very important		Less important	
Value of human capital	Very high	High to Medium	Medium to Low	Low	.....→	Low
Need for inflation protection	Very low	Medium (own salary inflation)	High (own salary inflation)	Retiree inflation	.....→	Aged care / healthcare costs
Relevance of investment risk	Low	Moderate	High	High	Moderate	Low
Tolerance for complexity	Moderate	Moderate	Moderate	Low	.....→	Very low
Tolerance for short-term volatility	Depends	.....→	Depends	Low	.....→	Very low
Income in retirement focus	Very low	Low	Fairly High	High	.....→	Very high

## Perform In-depth Modelling To Understand How Your Member's Objectives Are Likely To Be Met

### Stochastic replacement ratio analysis

- Links lifecycle approach to member outcomes
- Distribution of retirement outcomes
- Based on replacement ratios
- Likelihood of exhausting assets
- Likelihood of income falling below desired or minimum levels

### Diversification of risk factors

- Analysis of underlying risk and return factors across the glidepath
- High level heatmap for each target date fund if required
- Consistency with Best Practice Investing approaches

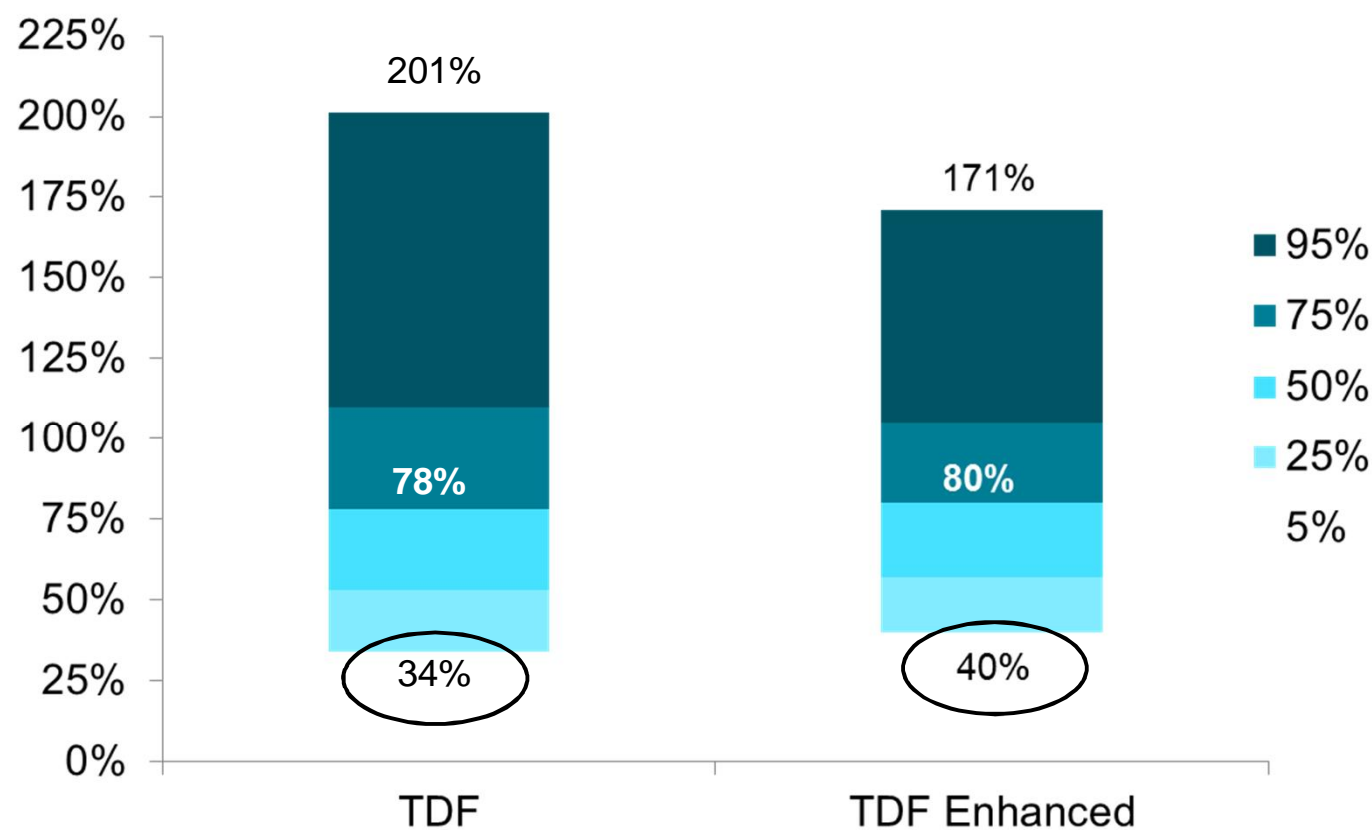
### Stress Testing

- Highlights weaknesses in portfolio construction across time and TDFs
- Consider impact of inflation
- Distribution analysis and associated link to member outcomes

Other relevant analysis, may include reducing absolute volatility near retirement. Minimising worst drawdowns.

## Assess Likely Outcomes For Your Members (And Try And Improve Them)

- Consider the relative utility of good versus poor outcomes




## Assessment Of “Off The Shelf” Funds

- For many clients, the key issue is which “off the shelf” TDF should be selected.
- The 5 step process can be followed but the number of options can be limited
- Hence key considerations include:

- How do the various TDFs address the needs of your employees?
- How much attention is being focussed on these TDFs? (Is the provider itself following a similar process?)
- Are the underlying funds sufficiently diversified?
- How is the post-retirement period taken into account?
- How many of the underlying funds are related to the TDF provider?
- What are the fees?

## Assessment Of “Off The Shelf” Funds Present And Future

Not that hard to assess how TDFs compare at a single point in time



But TDFs do and should evolve over time



Insight can be obtained by considering:

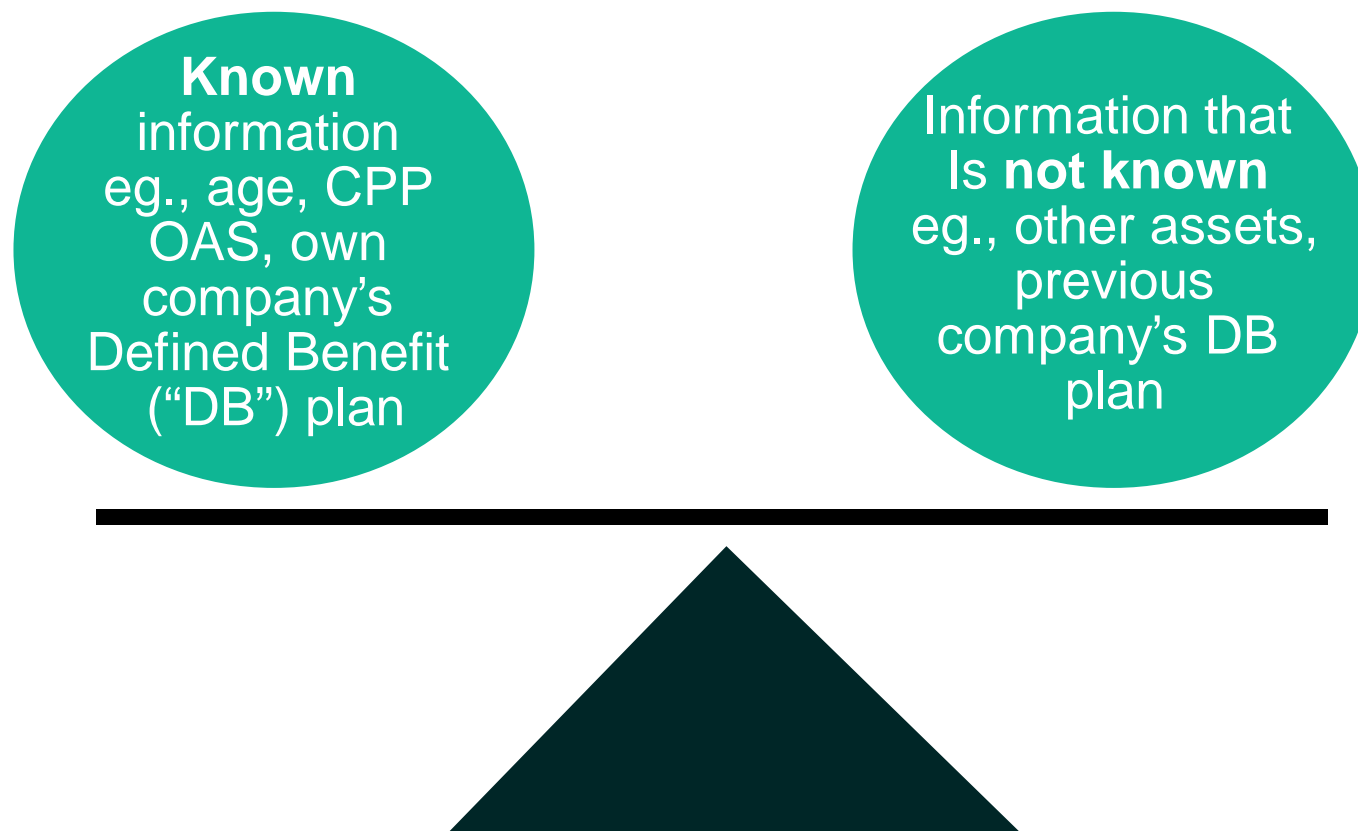
- The provider’s focus on TDFs
- The evolution of the current funds
- The resources applied to research and the research agenda



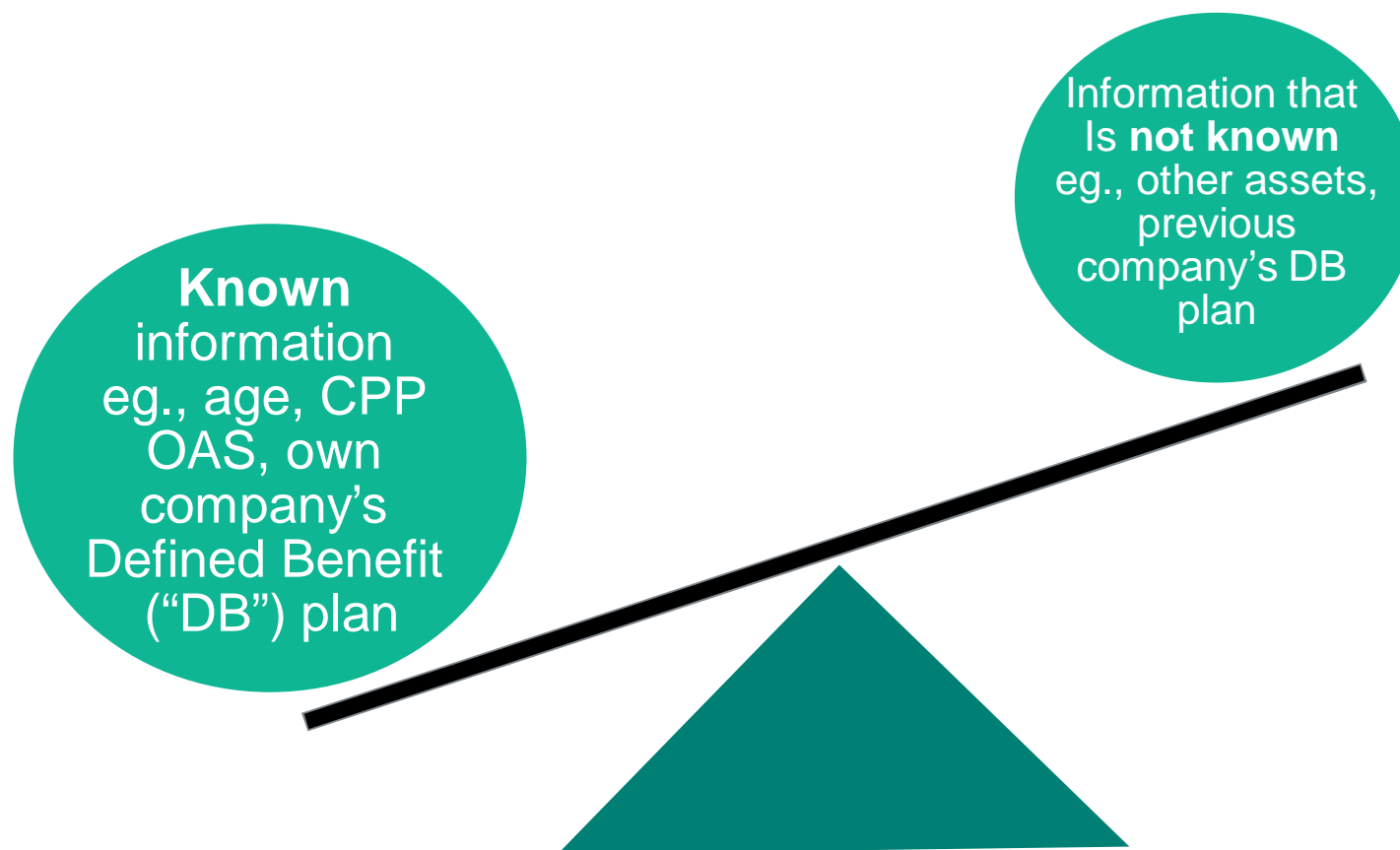
## The Next Dimension ? Adaptive Investing/Individualized Target Date Funds

In an ideal world would develop an individual's strategy to their specific circumstances.

When tailoring/customising need to find a balance between adjusting based on information that is known versus what is not known

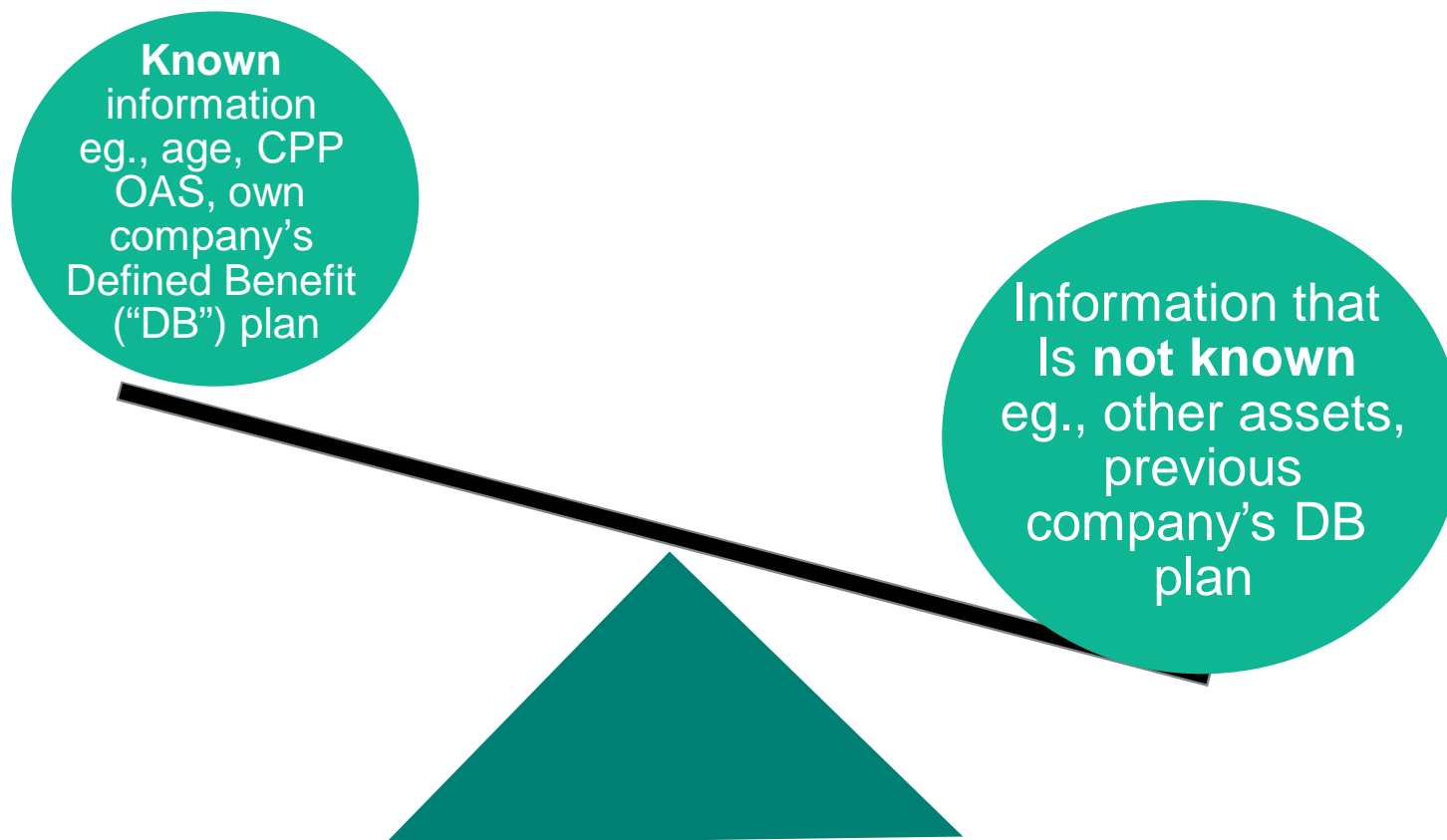


## The Next Dimension ? Adaptive Investing/Individualized Target Date Funds



**Asset allocation changes can be more material  
e.g., working with an adviser**

## The Next Dimension ? Adaptive Investing/Individualized Target Date Funds



**Asset allocation can be adjusted but changes more likely to be "averaged" e.g., customised target date funds**

## The Next Dimension ? Adaptive Investing/Individualized Target Date Funds

	Equity	Fixed Income
Allocation before event	70%	30%
Event		
Equities jump 30%	25%	75%
Equities fall 30%	80%	20%
Yield curve drops 100bps	75%	25%
10% salary increase	25%	75%

The investment changes can be quite confusing  
Resolve the issue by not telling you the asset allocation!

## Wrap-up

### TDFs can and should continue to evolve, a good process for any fiduciary to follow

- Establish a process for comparing and selecting TDFs
- Establish a process for the periodic review of selected TDFs
- Understand the fund's investments and the allocation in different asset classes (stocks, bonds, cash), 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.
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- Take advantage of available sources of information to evaluate the TDF and recommendations you received regarding the TDF selection
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With credit to the US Department of Labor's publication "Target Date Retirement Funds – Tips for ERISA Plan Fiduciaries": February 2013

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