

Oversimplification in Target Date Funds Endangers Participants' Retirement Savings. How are custom solutions evolving to mitigate risk?

Since the Pension Protection Act of 2006, target date funds (TDFs) have increasingly found their way into retirement plans as the preferred qualified default investment alternative (QDIA) for participants who make no election. Not only have plan sponsors widely adopted TDFs as the plan's QDIA, but participants have also gravitated to this type of fund option because of its ease of use as a "one-stop shop," allowing the selection of one fund option based on expected retirement date. A TDF diversifies and grows more conservative over time as the participant approaches the named retirement date in the fund. The target date is the approximate date when investors plan to start withdrawing their money. The principal value of the fund(s) is not guaranteed at any time, including at the target date. At present, TDFs can be found in the majority of retirement plans and are expected to increasingly become the primary if not only vehicle for most retirement plan participants.

The simplicity of TDFs for plan sponsors and participants has been of paramount importance and a key driver for success on all levels, including adoption, utilization and regulatory compliance. But are TDFs really a "silver bullet" for plan sponsors and participants? Has the attempt to lessen certain risks in saving for retirement instead introduced new risks?

Version 1.0: Inception of TDFs

BlackRock created the first TDF in 1993. Every aspect of a TDF, from the glidepath (asset allocation) to the underlying investments, was managed by BlackRock. This single-manager, single-glidepath model is version 1.0 of the TDF. This model has seen the most growth over the past 20 plus years, as managers like BlackRock and others have built proprietary TDFs to support this fast-growing industry. Version 1.0 continues to remain the most common TDF in defined contribution plans today. One reason is the simplicity of version 1.0 TDFs. The entire investment solution is in one place, efficiently packaged. Another reason is because early on in the development of TDFs, recordkeepers typically only offered one proprietary TDF, usually their own, on their recordkeeping systems. This limited plan sponsors and participants to one glidepath and one investment manager. As the TDF industry has matured, fiduciaries and the DOL have increasingly become more concerned about the version 1.0 design because of its inherent and sometimes unseen, or misunderstood, risk to the plan sponsor and participants.

As version 1.0 providers have multiplied, the number of glidepaths has increased as well. Interestingly, there is a stark difference among glidepath providers when it comes to asset allocation; for example, an allocation to equity at retirement varies as much as 50 percent. Because there is a lack of uniformity among TDF providers, participants in one TDF series are likely on a very different glidepath to retirement, or have a very different asset allocation, than participants in another TDF series.

For example, T. Rowe Price, a large equity manager, has one of the more aggressive glidepaths of version 1.0 TDF providers, with approximately 55 percent equity exposure at retirement. PIMCO, on the other hand, a large bond manager, has approximately 20 percent equity exposure at retirement (with a large percentage in bonds). Certainly, investment management skill and expertise in their business segments likely drive the allocation.

These large differences in equity exposure create significant variance in participants' retirement outcomes because equity risk is the primary driver of glidepath risk. To date, the message around TDFs has been that they grow more conservative over time. In this simplicity, the degree and magnitude of this shift to more conservative assets has been overlooked. Participants on different glidepaths face different risks; the biggest risk is driven by asset allocation to risk-based assets like stocks versus more conservative assets like bonds and cash.

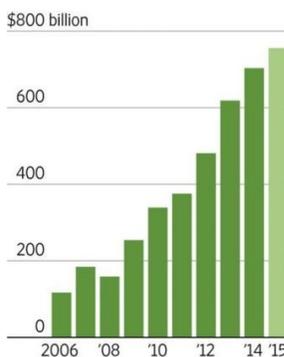
TDF providers under version 1.0 not only determine the single glidepath or asset allocation, they also select and populate the TDF series with their own investment product. While the glidepath may be the biggest driver of retirement outcomes, it is the investment product within the TDF that typically dictates the fees paid to the provider.

As more and more attention has turned to the underlying investment strategies within a TDF, more evidence suggests that plan sponsors make accommodations for underperforming investment strategies. Clearly, better fiduciary governance can be applied at the TDF level. Unfortunately, even if applied, version 1.0 allows no flexibility to fiduciaries to ensure that there are glidepath options for the individual or that underperforming managers can be replaced. More flexibility is needed if plan sponsors are to treat TDFs the same as they do other investments offered within the plan.

Aiming to Retire

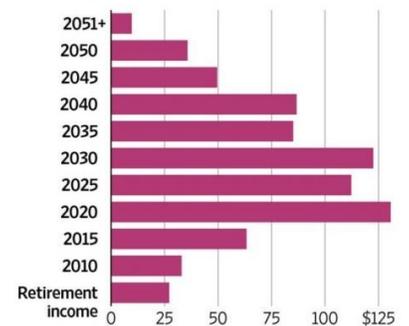
Target-date mutual funds have become popular among retirement savers, and have amassed the most assets in funds aimed at investors planning to retire within the next 15 years.

Net assets in target-date funds*



*As of year-end for each year through 2014 †As of April 30
Source: Morningstar

Net assets by target-date category, in billions†



THE WALL STREET JOURNAL.

Wall Street Journal—This is an excerpt of flexPATH Strategies’ white paper, Oversimplification in Target Date Funds Endangers Participants’ Retirement Savings - How are custom solutions evolving to mitigate risk? To view the white paper in its entirety, please [click here](#).

Shedding Light on Collective Investment Trust Funds

Early collective investment trusts (CITs) were pools of securities, traded manually, and typically valued only once a quarter. While popular in defined benefit plans, CITs were not as widely accepted in defined contribution plans due to operational constraints and a lack of information available to plan participants.

Today, there is growing concern over how 401(k) plans are structured and the costs involved. Due to operational improvements, competitive fees, and accessible information, we are seeing a resurgence in the popularity of CITs. Here we look at some of the myths these investment products still carry and shed some light on their benefits and how they should be used.

What is a Collective Investment Trust Fund (CIT)?

A CIT is a commingled (i.e., pooled) investment vehicle designed exclusively for use in qualified employee benefit plans that is administered by a bank or trust company and is regulated in the same manner as the administering bank or trust company. CITs are not guaranteed by the bank or FDIC and are subject to the same risks as any investment. CITs are also subject to oversight from the Internal Revenue Service (IRS) (Revenue Ruling 81-100) and Department of Labor, and are held to ERISA fiduciary standards with respect to plan assets. As bank-maintained funds, CITs are exempt from registration with the Securities and Exchange Commission (SEC) under the Investment Company Act of 1940.

Myth vs. Reality

CITs are a relatively new investment option that is not widely available.		CITs have long been popular in defined benefit plans, and are increasingly a choice in defined contribution plans.
CITs lack the reporting and transparency necessary to fulfill ongoing due diligence requirements.		CIT managers have worked diligently with Morningstar and other databases to report fund level data on a regular basis.
CITs are not regulated and are risky investments.		CITs have bank regulatory requirements, as well as additional oversight from the IRS and Department of Labor.
CITs provide fees comparable to mutual funds without any added value.		CIT fees tend to be more cost effective and may offer flexible pricing.

The Advantages of CITs

Designed to streamline management and mitigate risk

- Similar structure as mutual funds and other pooled vehicles – assets of investors with similar objectives are commingled in a single portfolio
- Portfolio is professionally invested by a third party based on the select objective
- Broad array of strategies available to meet demand
- Only for retirement plan investors so all share a long-term investment perspective

Trustees may provide additional fiduciary protection within the meaning of sections 3(21) and/or 3(38) of ERISA

- CIT trustees and sub-advisors serve as ERISA fiduciaries with respect to the assets invested in CITs
- Must comply with ERISA fiduciary standards to avoid conflict of interest
- Act solely in best interest of plan participants and beneficiaries

Cost advantages and greater pricing flexibility relative to mutual funds

- Can be quicker and less expensive to create as costly registration fees and public disclosure requirements are eliminated
- Often have lower administrative, marketing, and distribution costs than mutual funds
- Savings offered by CITs can be passed on to plan sponsors and participants
- Fees may be negotiable, especially for large institutions

Risks Associated With CITs

- Plan participant assets cannot be rolled into the same investment vehicle if the participant changes employers
- CITs typically have shorter performance track records and the performance track record may be difficult to verify due to lack of SEC regulation.



For more information on CITs, please contact your plan advisor.

This article was originally published by Manning & Napier. Slight modifications were made for compatibility purposes. <https://www.manning-napier.com/Corporate/Insights/OurView/Article/tabid/310/Article/356/Shedding-Some-Light-on-CITs.aspx>

Participant Corner: Financial Wellness Series — Cryptocurrency 101

This month's employee memo is a crash course on the elusive bitcoin cryptocurrency. Download the memo from your Fiduciary Briefcase at fiduciarybriefcase.com.

CryptoCurrencies, Blockchain, Hash Generator, BTC, Ethereum.... If you weren't sure if this was English, you are not alone. While Bitcoin is one of the biggest stories in today's world, many still don't understand what it is or how it works. To try and demystify this complex topic that has cemented itself within the daily news cycle, we have broken down some of the most commonly used jargon from this new technology:

Blockchain- a shared database, often viewed as a ledger, where the summation of all transactions in the network are recorded.

Node- A computer connected to the blockchain network who, jointly with all other nodes, maintain the blockchain

Miner- Special nodes where the computer does complex computations to compete to be the one who creates the next block (entry) in the blockchain. They are rewarded when their computer is the one who is able to create the next block.

Coin- The reward for being the miner who completes a block often takes the form of a coin or token. Because this coin can be hard to earn, some view it to hold value and so it's called a cryptocurrency. It's secured through a key (password/identifier).

Bitcoin (BTC) – Largest cryptocurrency by market cap.

Ether (ETH) – Next largest cryptocurrency. It is the reward/currency on the blockchain Ethereum. It differentiates itself through the ability to use



“Smart contracts” or programmable money that automatically transacts or transfers ownership when agreed upon conditions are met.

Now the next time you hear the word Bitcoin on your nightly news or it appears on your newsfeed, the jargon won't be so intimidating. While Bitcoin and blockchain are exciting developments in technology, they are still in their infancy. Many are uncertain about the future of the technology and what regulations or pitfalls may await. Also due to its unusual nature, valuating such an asset has proved difficult as can be seen by its drastic price movements. Much of the current discussion regarding this technology is speculation of what it may be and how it may be used.

Will I see Bitcoin as an investment option in my employer's retirement plan?

For now the answer is: No. The vast majority of participants do not have the knowledge or expertise to make an informed and prudent allocation to this sector. The volatility that is seen in the sector can lead to a bumpy participant ride and poor participant outcomes. This level of volatility is not the ride you want.

Call or email your plan consultant if you have questions or need assistance.

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