It's All About the Beneficiaries

Target Date Funds: Fiduciary Responsibilities and the Need for Simplification

Ron Surz, President
Target Date Solutions
Ron@TargetDateSolutions.com
(949) 488-8339

annual Conference May 4-6, 2011
Fiduciaries, not fund companies, need to establish objectives:

**Safety or Growth**
Approach: Work Smarter

*Everything should be made as simple as possible, but not simpler.*

- Albert Einstein
Agenda

• Complexities and Confusion

• Simplification: What Matters & Why

• Implementing a Better Solution

• Live Results

• Fiduciary Imperative
The “To – Through” Nonsense

“To” is flat allocation after the target date.
The “To – Through” Nonsense

The graphs illustrate the concept of "To – Through" in relation to equity over age (retirement at 65). The curves show how equity changes from age 20 to age 90, with "To" and "Through" indicating specific time periods or strategies.
Regulatory Focus

1. Risk (Equity Exposure) at Target Date: End of the Glide Path

2. Underlying Assumptions: Shape of the Glide Path
Assumptions

• **Savings for the Typical Participant (Pay Replacement Objective)**
  - Current savings
  - Other sources of retirement income
  - Desired pay replacement at retirement
  - Current pay and projected pay increases
  - Savings pattern through time, employee plus employer

• **Spending for the Typical Participant in Retirement (Longevity Risk Objective)**
  - Spending discipline, perhaps as a fixed percent of current market value
  - Other assets, like Social Security
  - Life expectancy
  - Life events, like medical costs, college funding, whatever … stuff happens

• **Capital Markets**
  - Asset classes: stocks, bonds, …
  - Sub-asset classes: styles, countries, alternatives
  - Risk & return & correlations
  - Glide path shape: linear, geometric, step, Mobius strip
A Closer Look at Objectives

• Replacing Pay: Key is Savings, much more important than investments

• Longevity Risk: The Hemlock Fund

• Neither can be managed with a one-size-fits-all set-it-and-forget-it vehicle
Let’s **NOT** Forget 2008

2010 Funds Are the Focus of SEC and DoL Hearings
Average Equity Allocation = 45%

(S&P Return: -37%)

Fund companies assure all is OK
Forget 2008: Losses Have Been Recovered

• 2008 was a wake-up call. Ignoring it is like smoking after a heart attack – not smart, and bad for your wealth.

• The lost are lost: many moved to cash.

• The emotional toll cannot be recovered.

• Lifestyles have been irreversibly diminished.

• The (annoying) hype doesn’t check out: Down 25% in 2008, “recovering” 30% in 2009-10, is NOT 5% above water. It’s a loss of 2.5%.

• What are the objectives?
Everything should be made as simple as possible, but not simpler.
Current Solution is WAY TOO SIMPLE and WAY TOO RISKY

Choose Bundled Provider

T. Rowe Price 55%
Vanguard 60%
Fidelity 30%

Bundled is Bungled
Agenda

• Complexities and Confusion

• **Simplification: What Matters & Why**

• Implementing a Better Solution

• Live Results

• Fiduciary Imperative
Simplification: Goals-Based

Objectives:
1. Preserve Assets
2. Risk-controlled Growth

Diversification

Safe Landing Glide Path®
The Transition from Accumulation to Distribution is Critical

Qualified Default Investment Alternatives (QDIAs) should protect as retirement approaches since savings are especially dear then.

With **REAL** “To” funds, someone needs to make a decision during the Transition Phase

- **Accumulation**
  - Assets Grow
  - Working Life

- **Distribution**
  - Longevity Risk
  - Assets Deplete
  - Retirement Years

- Annuities
- Guaranteed Payouts
- Etc.
The Journey: Glide Path

If we can agree on the destination (safety first at the target date) let’s discuss the best way to get where we’re going:

Equity Exposure (%)

Years to Target

Landing gear is deployed
Agenda

• Complexities and Confusion

• Simplification: What Matters & Why

• Implementing a Better Solution

• Live Results

• Fiduciary Imperative
Safe Landing Glide Path
Unique Investment Structure

Using Separate, Diversified Segments

The “Capital Market Line.”
Dr. William F. Sharpe won a Nobel Prize for it. Liability
Driven Investing (LDI) guides the allocation along the line. It is the Safe Landing Glide
Path®.

The Risky Portfolio is extremely well-diversified:
World Portfolio moves Efficient Frontier up & to the left.
Dr. Harry Markowitz won the Nobel Prize for the Efficient Frontier.

The Reserve Asset protects against losses, both absolute & against inflation:
TIPS and Treasury Bills
Two Separate, Well-Diversified Portfolio Segments for (1) Growth and (2) Safety

The World Market Portfolio
- Designed to provide *growth potential* in early years
  - Broad diversification
  - US stocks and bonds, Foreign stocks and bonds, Global real estate and commodities, Opportunistic
  - Mostly Passive

Liability-Driven Investing

The Reserve Portfolio: 15 years from target
- Designed to *preserve assets* as retirement nears
  - Treasury securities to mitigate credit risk
  - TIPS to protect against inflation
  - Lock box discipline avoids whipsaws
Safe Landing Glide Path

- **Non-US Stocks**
- **US Stocks**
- **Non-US Bonds**
- **US Bonds**
- **3 Alternatives**

Years to Target Date:

- 40
- 39
- 38
- 37
- 36
- 35
- 34
- 33
- 32
- 31
- 30
- 29
- 28
- 27
- 26
- 25
- 24
- 23
- 22
- 21
- 20
- 19
- 18
- 17
- 16
- 15
- 14
- 13
- 12
- 11
- 10
- 9
- 8
- 7
- 6
- 5
- 4
- 3
- 2
- 1
- 0

Portfolio Allocation:

- 100%
- 90%
- 80%
- 70%
- 60%
- 50%
- 40%
- 30%
- 20%
- 10%
- 0%

Risk Zone

TIPS

Safe Landing Glide Path Solutions
Safe Landing Glide Path
Agenda

• Complexities and Confusion
• Simplification: What Matters & Why
• Implementing a Better Solution
• Live Results
• Fiduciary Imperative
5-Year Return and Risk through 12/31/10

SLGP track record is Brightscope On-Target Index for 2006-2007
And SMART collective investment funds for 2008-2010
Agenda

• Complexities and Confusion
• Simplification: What Matters & Why
• Implementing a Better Solution
• Live Results
• Fiduciary Imperative
There is no Fiduciary Upside to Equity Exposure at the Target Date

Only Downside

Losses can lead to Litigation

Loss-Suits

No Fiduciary has ever been sued for protecting beneficiaries.
Fiduciary Considerations

• Objectives: (1) Don’t lose money  
    (2) Earn as much as practical

• Policies: (1) All safe at target date  
    (2) Diversified growth at long dates

• Investment Policy Statement: TDFs are NOT participant-directed. They are employer-directed.
Summary

1. The key decision is Safety near target date.

2. Investment managers are mostly providing “Growth” products. Profits are a probable reason.

3. Plan sponsors are responsible for selecting & monitoring. Convenience and familiarity with the plan’s bundled provider are not suitable criteria.

4. The Safe Landing Glide Path exemplifies a good target date fund glide path.
Believe in Change

Fiduciaries have a responsibility to choose GOOD Target Date Funds (TDFs). Status as a Qualified Default Investment Alternative does not mean that any TDF will suffice.

Fiduciaries, not fund companies, need to establish objectives:

Safety
(Give up a little Growth)
A Key Decision: Choosing a GOOD Target Date Fund

Plan sponsors have a fiduciary duty to select and monitor GOOD target date funds.

It’s All About the Beneficiaries: What are Their Objectives?

Bundled is Bungled with excessive risk.