New Fiduciary Rules Create Opportunities for Retirement Plan Advisors

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Article Summary

The Department of Labor recently issued a must-read guide on target date funds for defined contribution plan fiduciaries. These new rules clarify several safe harbor provisions, as well as provide several opportunities for proactive investment advisors.

Article Body

Target date funds have grown phenomenally in the past five years from virtually zero in 2007 to about $1 trillion today, half in mutual funds and the rest in custom funds and collective investment trusts. And it's just beginning. Now is the time to get on board if you haven't already.

According to a Recent Study by Casey Quirk and Associates, target date funds will represent half of the roughly $8 trillion in defined contribution assets by 2020. Casey Quirk partner David Bauer says, "*There is tremendous opportunity but managers must thoroughly examine the market complexities before jumping in*."

We've been waiting for four years for guidance-- ever since the joint SEC/Department of Labor (DoL) hearings in June 2009 -- so this new document is a very big deal. In the following I first suggest ways that advisors can benefit from the DoL's new "Tips for ERISA Plan Fiduciaries ." Then I summarize the key points in the guidance with comments directed to financial advisors.

Safe harbors

Some of the opportunities for advisors arise from dispelling commonly held misperceptions about safe harbors. This new DoL document clears up two widespread safe harbor misconceptions:

1. **It's not true that any Qualified Default Investment Alternative (QDIA) will do.** You need to vet your selection.

2. **Safety in numbers is not safe in reality**. T. Rowe, Fidelity, and Vanguard do not provide fiduciary insulation. Even worse, mutual funds are not plan fiduciaries.

This guidance can be a threat or an opportunity for financial advisors. Advisors can ignore it, or embrace it, but if you don't capitalize on this opportunity, someone else will. Here are some of the ways you can benefit:

1. **Gather comparisons of the "Big Three" competitors**. Provide a service to vet target date funds, especially potential alternatives to the Big Three (Fidelity, Vanguard and T. Rowe Price). You can get information from the Center for Fiduciary Due Diligence. Consider collective investment funds (CIFs) for their lower costs and fiduciary protection. CIFs stand as fiduciaries to the pension plan whereas mutual funds do not.

2. **Create custom target date funds**. Use non-proprietary funds on the client's existing platform.

3. **Document the risk you think is appropriate for the average participant at their retirement date**. Do it whether or not they are sophisticated enough to understand the risks.

4. **Develop a statement of investment policy**. Visit the Fiduciary Corner and see this sample TDF Policy Statement.

5. **Brag about implementing the DoL guidance**. It's good fiduciary practice--good for both you and your client.

The specific DoL tips are as follows. For further clarification, please see the Fiduciary Guide and visit the Fiduciary Corner.

1. **Establish a process for comparing and selecting TDFs.** Be sure to include reviews of fund prospectuses and their "objectives" as stated in the prospectuses. You'll be surprised to see that these objectives do not include pay replacement or longevity risk which are the "objectives" used to market TDFs. The reality is that these marketing "objectives" are actually hopes--an objective without a realistic plan is a hope. Accordingly, prospectuses do not contain these hopes.

2. **Establish a process for the periodic review of selected TDFs.** Pay special attention to their adherence to the stated strategy and progress toward achieving their objectives. Again, please note that stated objectives in prospectuses are typically as shallow as "earn a return commensurate with the risk" or "track the asset allocation glide path on page xx."

3. **Understand the fund's investments.** Note the allocation in different asset classes (stocks, bonds, and cash), individual investments, and how these will change over time. This speaks to the very important glide path. Like everyone else, the DoL believes that

there is a Difference between TO and THROUGH funds, but they're wrong. The reality is that the equity allocations at target date of most "To" funds are just as high as "Through" funds, and most participants withdraw their accounts when they retire.

4. **Review the fund's fees and investment expenses.** Be sure to include the fees for the underlying funds as well as the fees to manage and administer the TDF. The impact of required fee disclosures is yet to be felt. Stay tuned.

5. **Inquire whether a custom or non-proprietary target date fund would be a better fit for your plan.** This is your invitation to customize a solution, to build something special for your clients. It's a gift to advisors..A custom target date fund begins with a glide path, which is a schedule of asset allocations through time, to stocks, bonds, etc. Then specific funds are assigned to fill the asset class "sleeves." In many cases these funds can be found on the existing platform. The patented Safe Landing Glide Path® serves as an example,

6. **Develop effective employee communications.** Tell employees what you have done and why. Another gift from the DoL to advisors because it's another service that can be offered to plan sponsors..

7. **Take advantage of available sources of information to evaluate the TDF and recommendations you received regarding the TDF selection.** Another advisor opportunity, as stated above – TDF due diligence. Manager search for an appropriate TDF is more important than a manager search for an individual manager because TDFs are generally not participant directed; they are chosen by fiduciaries as defaults..

8. **Document the process.** The DoL guidance concludes with a recommendation that the selection and monitoring process be documented, meaning you should have an investment policy statement, like the one above. TDFs are employer-directed rather than participant-directed so the overall IPS does not do the job because it is focused on supplying choices for the participant, whereas TDFs are chosen by the fiduciary.

The benefits of target date funds are diversification and risk control (professional management), preferably at a reasonable cost, all of which a participant is unlikely to achieve on his or her own. These benefits could be dramatically improved. The industry is moving at glacial speed toward low cost diversification (like Fidelity's new product), but risk controls have not changed in response to 2008 – the vulnerable remain in peril as they approach retirement.

The DoL guidance gives advisors a roadmap for making TDFs all that they can, and should, be, and the beauty is that it's win-win-win. Advisors earn fees. Plan Sponsors do the right thing. Participants are protected.