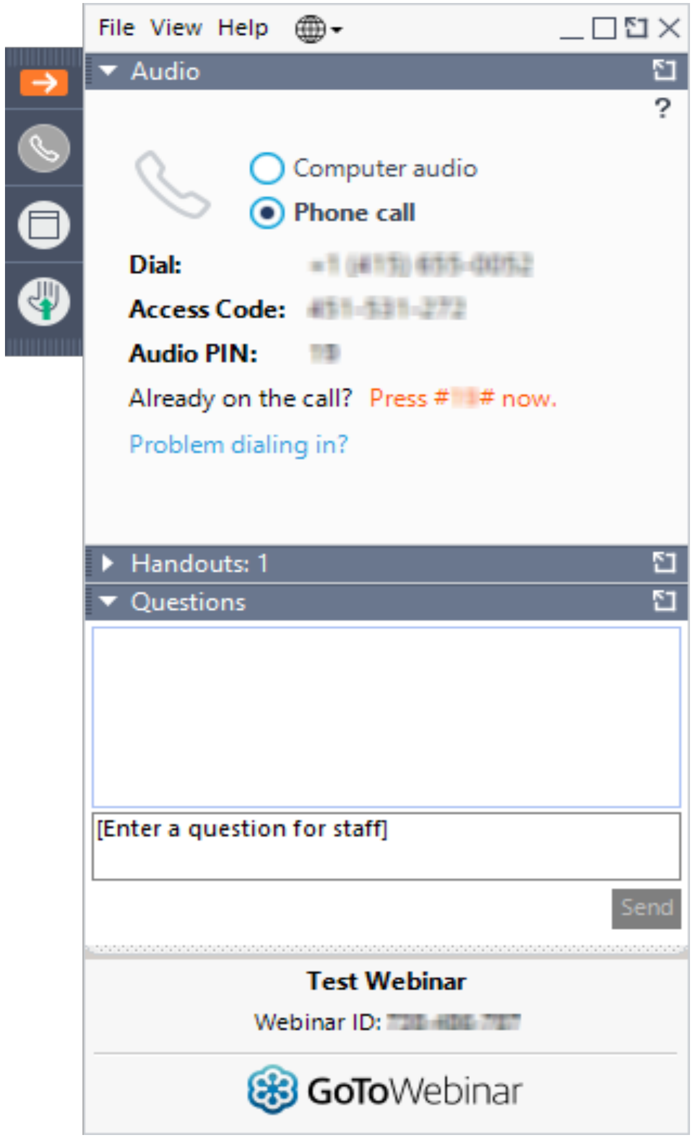
# FIDUCIARY TRAINING PART III: RETIREMENT PLAN INVESTMENT MENUS

August 2023

# Information about Today’s Session

- Select “Phone call” to dial in.
- All attendee lines are automatically muted.
- Questions can be asked by typing them into the questions pane on the control panel, and there will be time at the end of the session to answer questions.
- Submitted questions will not be visible to other audience members.
- Today’s session is being recorded.



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# Identifying Plan Fiduciaries

According to ERISA, a fiduciary is any person(s) who:

- Has discretionary authority over the management or administration of the plan or its assets
- Exercises any control, authority or influence over the management or administration of the plan or its assets
- Renders investment advice for a fee or other compensation that is received directly or indirectly

# Who May Be a Fiduciary?

Identifying Plan Fiduciaries

- Named fiduciary
- Plan sponsor
- Trustee
- Plan committee
- Investment advisor who is paid to give advice
- Parties interacting with participants
- Plan administrator (normally the plan sponsor)
- Board members

# Fiduciary Obligations

## Fiduciary Risk Management

Every fiduciary has certain obligations. It is important that corporate officers, directors, and their retirement committee members:

- Clearly understand their fiduciary obligations
- Have the appropriate tools and resources necessary to perform their duties with integrity and competence
- Ensure they meet their responsibilities to participants in a prudent and objective manner

# Distinguish Fiduciary Decisions from Settlor and Business Decisions

Fiduciary: Plan operation/administration and management of plan assets/investments.

Settlor: Plan design, amendment, termination, and funding are free from fiduciary scrutiny.

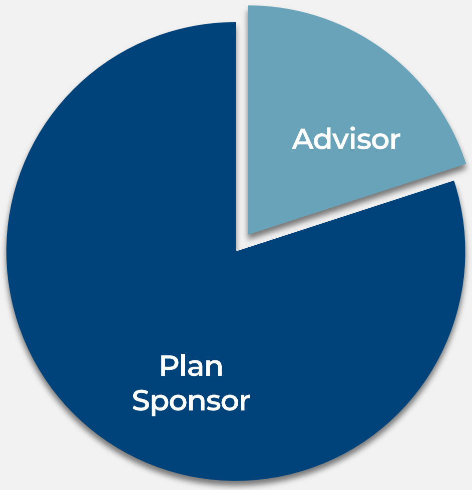
Business: Company business decisions (e.g. strategic plans, merger & acquisitions activity) whether they implicate the plan, are not subject to fiduciary duties.

*Two Hats* Doctrine: ERISA expressly recognizes dual roles as settlor and fiduciary.

# CAPTRUST Fiduciary Solutions

**Plan sponsors can choose to maintain discretion over their retirement plans or shift responsibility to an advisor. This choice will determine whether the advisor will serve in a 3(21) or 3(38) fiduciary capacity as defined by ERISA.**

### 3(21) Investment Advisor (non-discretionary)




Recommends and monitors investment options based upon investment policy statement

### 3(38) Investment Manager (discretionary)


Selects investment options; monitors and replaces investment options per the process outlined in the investment policy statement

# ERISA Conformity

Your plan's Investment Policy Statement (IPS) sets the guidelines and objectives for the ongoing investment management of your plan. A well-designed IPS ensures a sound decision-making process in keeping with fiduciary best practices.

Your Plan's Name Here

INVESTMENT POLICY STATEMENT

STATEMENT OF PURPOSE

The purpose of the IPS is to establish the objectives and guidelines for investment management of the plan. The document is established in accordance with fiduciary requirements set forth in the Employee Retirement Income Security Act of 1974 and is intended to meet the regulations defined under ERISA Section 404(c) adopted by the Department of Labor in 1992.

A diversified mix of investment options are traditionally offered in accordance with Modern Portfolio Theory, which suggests that optimal portfolios can be crafted given a range of alternatives with distinct risk and return characteristics. Investments are selected, monitored, and terminated based on a defined set of criteria.

POLICY GOALS & OBJECTIVES

Performance Objectives

Each investment offering aims to exceed a specified point total outlined as part of a comprehensive scoring system and designed to provide a broad gauge of overall performance.

Selection Criteria

A general set of selection criteria is initially used to determine the suitability of all investment options in the plan. These criteria include:

- Management experience
- Style consistency
- Relative investment performance
- Volatility
- Fees
- Assets under management
- Investment family stewardship

Monitoring Benchmarks

A set of monitoring benchmarks are used in order to measure investment options appropriately against their performance objectives. Each set of monitoring benchmarks is customized to the investment options offered in the plan.

Termination Criteria

Investment options are considered for termination and alternatives are sought if the stated performance objectives are not successfully met.

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# Types of Investors

**Do It for Me**

**Do It with Me**

**Do It Myself**

# Investment Menu Construction Influences

A tiered approach is used to solve for different types of plan participants—from the disengaged to the highly engaged. By including both active and passive management, engaged participants have multiple ways to build diversified portfolios.

| | ALLOCATION TIER (1 OPTION) | PASSIVE TIER (4 OPTIONS) | ACTIVE TIER (9 OPTIONS) | OTHER |
|---|---|---|---|---|
| **ASSET CLASSES** | • Target date fund <u>or</u><br>• Risk-based series | • Intermediate term bond<br>• Domestic large cap stocks<br>• Domestic mid- and small-cap stocks<br>• International stocks | • Capital preservation<br>• Intermediate term bond<br>• Large-cap value<br>• Large-cap growth<br>• Mid-cap value<br>• Mid-cap growth<br>• International large cap<br>• Small-cap value<br>• Small-cap growth | • Self-directed brokerage account<br>• Mutual fund window<br>• Loan |
| **RATIONALE** | • For disengaged participants that desire a premade diversified portfolio (do-it-for-me)<br>• Can qualify as a qualified default investment alternative (QDIA) for auto-enrolled participants | • For investors who do not wish to take on active management risk in addition to market risk<br>• For investors who only want low-cost market exposure<br>• All major asset classes are represented (same as active) | • Gives investors the opportunity to outperform passive index options<br>• All major asset classes are represented, so engaged participants can create diversified portfolios (do-it-yourself) | • <u>Optional tier</u><br>• May not be appropriate for all defined contribution plans<br>• Satisfies highly engaged investors without adding unnecessary investment options to the core lineup |

# What's Next for QDIA?

Following the Pension Protection Act (PPA) in 2006, qualified default investment alternatives (QDIA) and target-date funds (TDFs) became core retirement plan offerings. Sixteen years later, plan sponsors should reassess and understand what's next for QDIAs.

## HISTORY OF QDIA

QDIA regulations were issued to encourage the use of autoenrollment features among plan sponsors.

The final regulations allow four types of QDIAs—a lifecycle or target date fund, a professionally managed account, a risk-based fund, or a capital preservation product (with restrictions).[1]

**83%** of plans are using a QDIA[3]

**87%** of plans use a TDF as their QDIA[3]

**37%** of plans use passive TDFs[3]

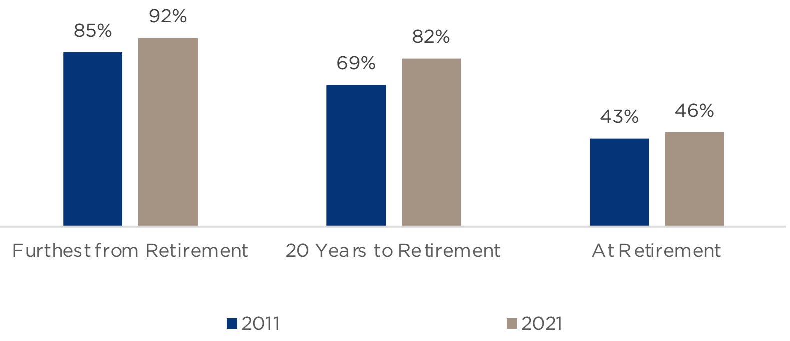
## EVOLUTION OF TDFs

Collective investment trust (CIT) strategies made up 79% of all target-date net inflows in 2022 and will soon overtake mutual funds as the most popular target-date vehicle.

The average asset-weighted fee for TDFs was 0.32% in 2022, down from 0.51% six years ago.

Target-date strategies have adopted more equity-heavy and more gradual glidepaths over the last ten years ending in 2021.[2]

**Median Percent of Equities (TDFs)**




## WHAT'S NEXT?

**Managed Accounts -** The next generation of QDIA is likely to be a hybrid of TDFs for younger employees and managed accounts for those closer to retirement who may benefit from more customized portfolios. A future state could also incorporate guaranteed annuities.

**Target-Date Funds -** Some TDF managers have altered their series to be more retirement income-friendly, offering different landing points at retirement, incorporating guaranteed annuities into the glidepath, or launching new series altogether.

**48%** of plans offer managed accounts[3]

**4.6%** of plans use managed accounts as a QDIA[3]

[1] United States, Department of Labor. "Default Investment Alternatives Under Participant Directed Individual Account Plans." 72 FR 60452

[2] Morningstar, "Target Date Strategy Landscape" 2022/2023

[3] Plan Sponsor Council of America's 65th Annual Survey of Profit Sharing and 401(k) Plans, PSCA

# Best Practices for Target Date Fund Selection

## CAPTRUST CHECKLIST FOR DOL TARGET DATE TIPS RELEASE

A checklist for plan sponsors offering target date funds based on the Department of Labor's Employee Benefits Security Administration *Tips for ERISA Plan Fiduciaries* release

### SECTION 1: TARGET FUND SELECTION

**1. Review Investment Performance**

- ☐ Review investment risk and return for each target date year in question over one-, three, and five-year trailing periods and since inception against appropriate target date peer groups and indices

**2. Review Glidepath and Series' Underlying Funds**

- ☐ Against appropriate peer groups
- ☐ Against assumptions (in connection with glidepath construction)
- ☐ Understand the mix of stocks, bonds, cash, and other assets within the target date series, and how this mix changes over time
- ☐ Understand the manager's rebalancing methodology and approach to tactical asset allocation (if applicable)
- ☐ Identify when the series' glidepath will reach its most conservative point – at retirement or sometime after retirement
- ☐ Understand the underlying investments of the target date series
  - ☐ Asset classes utilized
  - ☐ Active versus passive management

**3. Review Management Team and Process**

- ☐ Team tenure
- ☐ Approach to asset allocation as well as manager and/or security selection
- ☐ Roles and ownership of responsibilities
- ☐ Fund firm

**4. Review Plan Demographic Data and Additional Externalities**

- ☐ Employee ages and average retirement age
- ☐ Deferral/contribution rates
- ☐ Savings amounts
- ☐ Employee turnover rate
- ☐ Withdrawal patterns
- ☐ Consider the existence of supplemental retirement plans

**5. Review the Availability and Applicability of Custom or Non-Proprietary Solutions**

- ☐ Inquire with providers as to whether custom and non-proprietary TDFs are available

  a. Weigh the costs and the benefits of custom or non-proprietary target date funds (to include non-financial costs such as administrative burden and complexity for participants and benefits such as the ability to use the plan's core line up as building blocks for the target date series)

**6. Review the Series' Fees**

- ☐ Document the series' total cost, including any underlying fund's investment management fees
- ☐ Document any non-investment management fees and their purpose

**7. Review Employee Communications**

- ☐ Provide information that describes what a target date fund is and its purpose in the plan
- ☐ Distribute information to participants regarding the specific target date series offered in the plan

### SECTION 2: ONGOING MONITORING PROCESS

**1. Periodically Review the Selected Target Date Fund Series**

- ☐ Periodically review, at a minimum, whether there have been any significant changes to the selected target date fund series such as changes to:

  a. Management
  b. Asset allocation/glidepath
  c. Investment philosophy
  d. Fees
  e. Underlying funds
- ☐ Periodically review investment risk and return

# Provider Search and Selection Process

## Select methods to pay plan expenses

| | Revenue Sharing | Institutional Share Class (or zero revenue sharing) Lineup | Revenue Sharing Rebated At The Plan Level | Revenue Sharing Rebated At The Fund Level | Plan Sponsor Pays |
|---|---|---|---|---|---|
| **Description** | Revenue sharing from plan investments or fund companies pays fees | Cheapest available share classes are used to remove revenue sharing | Revenue sharing is collected and rebated back to plan participants—typically on a pro rata basis | Revenue sharing is collected and rebated back to the funds it was derived from | Plan expenses are paid by the plan sponsor from non-plan dollars |
| **Explicit Charge on Participant Statement?** | No | Yes | Yes | Yes | No |
| **Fee Calculation at Participant Level** | Typically a percent of account balance | percent of account balance OR per head | percent of account balance OR per head | percent of account balance OR per head | percent of account balance OR per head |
| **Equitable Distribution of Fees** | Typically no | Typically yes, but varies | Typically yes, but varies | Yes | Depends on methodology selected |
| **Notable Considerations** | Trend is squarely moving away from revenue sharing approach** | Removing 100% of revenue sharing is not always feasible | Potential for participants who don't contribute to revenue sharing to receive rebates | Specifics vary widely by recordkeeper | While it requires extra budget, this approach is arguably the most beneficial to participants |
| **Provider Considerations** | Bundled pricing model | Flat fee or fixed basis point pricing model | Flat fee or fixed basis point pricing model | Flat fee or fixed basis point pricing model | Flat fee or fixed basis point pricing model |

* This is not meant to be a comprehensive list of ways to pay for plan expenses; other methods may be utilized including payment directly from the plan sponsor. Additionally, hybrid methods that incorporate two or more of the above payment methods may be used.

** A recent report from Cerulli Associates shows a shift from revenue sharing share classes to "Institutional" or low to non-revenue sharing share classes. In 2014, Institutional share classes captured $165B of asset inflows, eight times that of the next highest flow share class. Source: "The Cerulli Edge; U.S. Monthly Product Trends Edition," August 2015

# Informing and Educating Participants

Required notices:

- Summary Plan Description (SPD)
- Summary Annual Report (SAR)
- Fee disclosure notice
- Quarterly statements
- As applicable:
  - Safe Harbor
  - QDIA
  - Automatic enrollment
  - Fee change notice
  - Investment change notice
  - Blackout notice

## How Can Plan Sponsors Support Education Efforts?

- Identify and leverage record keeper resources where applicable.
- Consider a comprehensive financial wellness and advice solution.
- Ensure education resources are easily accessible and widely promoted.

# QUESTIONS

THANK YOU

# Disclosure

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