

# PUBLIC SUBMISSION

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## General Comment

See attached file(s)

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## Attachments

**EBSA-2010-0053-DRAFT-0001.1:** Comment on FR Doc # 2010-29509

Bear markets make for greater scrutiny in the financial markets and, more specifically, financial products.

Since the early part of the decade, TDFs have seen their assets swell at parabolic rates. Unfortunately, many mutual fund companies (in the face of stiff competition) increased more risky asset classes in exchange for more attractive performance records during the bull markets of 2003 to 2007.

Many investors and plan sponsors were evaluating these investments the way the fund companies anticipated they would – based on performance. Let’s face it, who in their right mind would buy a 2030 fund that was under performing a competitor’s 2030 fund? The problem is no two TDFs are created equal. For example, in a bull market a “go-go” 2030 fund comprised of 70% stock should outperform its counterpart at another firm with a 50% stock exposure. However, the converse will hold true in a market decline and will be more profound as the declines steepen.

The variations in returns illustrate the radical differences in allocations to stocks in the same target date category with equity exposure ranging drastically from 65% to 25%. Take for example the market turmoil of 2008 when investment losses for funds with a target date of 2010 were as high as -41% and as low as -9%, with an average loss of -23% according to Morningstar.

The legislative guidance in the Pension Protection Act of 2006 made target date funds a Qualified Default Investment Alternative (QDIA) providing safe harbor protection for plan fiduciaries. They have quickly become staples in the retirement plan marketplace. As in the case of plan sponsors and fiduciaries who monitor funds and when necessary remove certain funds from a plan’s investment options, similar oversight is required for target date funds but it is often mismanaged. There tends to be general and vague language describing the selection and monitoring of target date funds

The majority of plan sponsors take great pride in their fund review process as outlined in their Investment Policy Statement but tend to fall short in this area when it comes to target date funds. The reason is simple. Most target date funds are comprised entirely of proprietary funds of the underlying fund family and/or its affiliates. So by design, the sponsors have limited oversight capabilities pertaining to the holdings – at no fault of the plan sponsors. However, according to ERISA attorney Fred Reish, “A plan sponsor must also be aware whether the management of the target date fund is limited in its ability to select the underlying investments and/or has embedded conflicts of interest (for example, is the manager of the target date fund required, either as a practical matter or a written restriction, to select only the mutual funds of the affiliated manager?).”

It is unlikely for one investment management company to have the best in class offering across the entire range of asset classes. Most would agree the premier retirement plan investment menu is comprised of a multi-family, best in class investment lineup – the target date strategy should not be any different. Unfortunately, most plan sponsors include a single family target date line up that invests completely in proprietary funds. For example, the three largest target date fund families invest completely in their own proprietary funds as underlying assets.

## **Glide Path**

The glide path is a predetermined allocation based on stocks, bonds and cash; the younger a participant, the more exposure to stock. As the participant nears retirement, the allocation automatically shifts to a lower concentration in stock and to more conservative bond and cash investments.

The concept with the “through” approach is investors will need to have their assets grow throughout retirement. Conversely, the “to” strategy provides less risk for investors at retirement for those who do not have the tolerance for riskier allocations to stock.

I am not sure how many of us can say we consciously decided on which style (to or though) was best for the plan when the TDF strategy was chosen, especially if they were chosen over three years ago. One reason was because there weren't many tools available to do so - until now. I believe we're judged on the decisions we make based on the prevailing circumstances at the time the decisions were made. So not having the tools available makes the actions understandable *then*.

ERISA does not impose a duty of clairvoyance on fiduciaries. However, since times have changed and so too have the circumstances, plan sponsors can't continue the old course of action as though they are still best practices today. Yesterday's best practices generally aren't tomorrow's so procedures in evaluating and choosing the TDF strategy should also evolve.

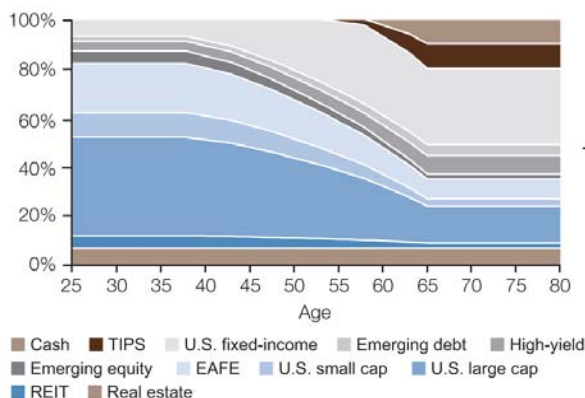
## Quadrant & Glide Path Analysis

Since the tools are now readily available to determine the appropriate target date style, the prudent and documented selection process should include:

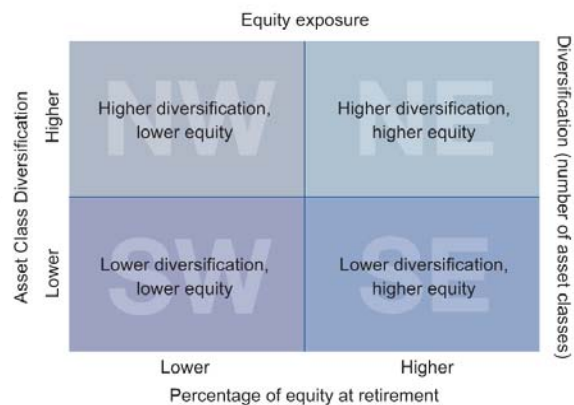
1. Asset allocation analysis
2. Glide path analysis
3. Needs, ages and participants behavior
4. Evaluation and monitoring of fees

Each target date has a unique glide path and falls into one of four equity exposure quadrants. It is incumbent upon plan sponsors and consultants to know and document the decision they've made regarding both.

Glide path decision



Target Date Fund exposure



Source: Lipper, a Thomson Reuters Company and industry prospectuses. For illustrative purposes only.

These tools and reports are designed to provide a framework for identifying and evaluating target date funds that align more closely to a plan's overall goals and its participants' needs. The goal of the tool is to help plan sponsors assess their retirement plan's desired level of equity exposure for participants at or near retirement and asset class diversification – two important characteristics of TDFs.

The framework also encourages plan sponsors to understand and consider the characteristics and behaviors of their workforce as part of the target date selection process – factors the Department of Labor (DOL) has also stated fiduciaries should take into account when designing the investment menu for a defined contribution plan.

## **Proposed DOL Regulations**

On November 30, 2010, the Department of Labor proposed new regulations requiring plan fiduciaries to provide enhanced disclosures about target date funds to retirement plan participants. The proposal would also amplify the investment information that must be disclosed about a plan's qualified default investment alternative, even if it is not a target date fund.

This transparency is intended to help participants make more informed decisions about their investments. However, the majority of participants investing in TDFs do so because they do not have the time, knowledge or inclination to analyze and manage their investment portfolio on a regular basis. Only time will tell if providing participants with more information on a subject they rely on others to handle will create the results the DOL anticipated.

The proposed regulations do not encourage a revision of the target date strategies but do create additional transparency and oversight. In other words plan participants will still be offered the same strategies but with government mandated disclosures creating the same investment outcome as before.

The solution is to change the strategy and/or the process in producing it and not endorse the current product with greater government regulation. In the multi-manager target date fund structure, the underlying mutual funds are chosen from a broad universe of investment managers. Taking it a step further, custom target date models create the target date funds using the investments offered in the menu of options (typically multi-manger) which are already being monitored by the plan committee and, if applicable, an independent investment consultant. This gives greater fiduciary oversight and control to the plan sponsor thus helping them fulfill their fiduciary obligations and making them better stewards for the participants.

The fiduciary oversight should be required by plan sponsors and consultants to ensure the product is appropriate at the plan level – either a pre-package target date product or a custom model. In either example, the legislation should focus on the “what” and also the “why” when it comes to the appropriateness of certain target date funds at the plan level. In other words, the process not the product might be more important to legislate or monitor. Just like the process is critical in investment selection, monitoring and removal at the plan level, the same process standards should be required in the target date selection.