Default Is Not Mine — I Only Live Here

Considerations regarding target-date funds as the plan QDIA.

By Jack Towarnicky

de·fault dəfôlt' / noun
1 failure to fulfill an obligation…
2 a preselected option…when no alternative is specified by the user…

In 1978, the city of Cleveland, Ohio defaulted on $15.5MM in bank loans. I once had a t-shirt that displayed the Cleveland skyline and proudly announced: "Default Is Not Mine — I Only Live Here." Times change. For most benefits professionals, that second definition has become part of our lexicon.

ERISA offers us fiduciary protections when using a "Qualified Default Investment Alternative" or QDIA. QDIAs are more prevalent when plans incorporate automatic features or make investment changes. In PSCA's *52nd Annual Survey* (2008 experience) many plans did not have a QDIA. In PSCA's *59th Annual Survey* (2015 experience), 75 percent of plans incorporated a QDIA and 76 percent of QDIAs were target date funds.

Fiduciary Duties

Given the extensive use of QDIAs, is there any "safety in numbers?" Probably not. A fiduciary must prudently select and monitor QDIAs to obtain Department of Labor "safe harbor" protections. What is best practice? It probably includes an annual review, assistance of a qualified investment professional, and evaluation of the underlying funds to confirm they:

- Are themselves diversified,
- Have materially different risk-return characteristics,
- Have "normally (age) appropriate" risk-return characteristics, and
- Tend to minimize overall risk, through diversification.

Other requirements include:

- Compliance with Generally Accepted Investment Theories, and
- Changes in asset allocations and associated risk levels over time.

There hasn't been much litigation over QDIA selection and operation (see: *Bidwell v. Univ. Med. Ctr., Inc.*, 685 F.3d 613. (6th Cir., June 29, 2012). The 2008–2009 market decline during the Great Recession exposed significant differences in TDF allocations. One study of 2010 target date funds had equity allocations that spanned: "…a startling range … — from 72 percent to 26 percent." That certainly was a surprise — many participants had little inkling of their QDIA's equity risk exposure — triggering Congressional and Agency hearings.

Today's Concerns

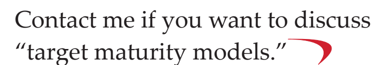
Most of your participants may not have experienced the 2008–2009 market declines. In addition to faithfully completing your fiduciary duties, you might consider:

- Periodically confirming to participants the QDIA's underlying asset allocation, or
- Changing to a "target maturity model" approach.

Here's why I prefer the "target maturity model" approach:

- **Transparency:** "Core" investment option allocations are disclosed in detail to participants.
- **Performance:** Evaluating the underlying "core" investment options is easier.
- **Familiarity:** Participants may be familiar with the plan's "core" investment options.
- **Avoids Choice "Blindness":** Minimizes the number of complex investments.
- **Administration:** Avoids mistakenly allocating only a portion of account assets to model portfolios.
- "**Open Architecture**"**:** Seldom will a single fund provider be the best at everything. Allocations across "core" options may avoid potential proprietary fund conflicts.
- **Expertise:** Third-party investment professionals with no conflicts of interest determine all allocations.
- **Cost:** Model allocations avoid a layer of expense; and, by concentrating monies in underlying "core" options, the economies of scale may enable better pricing for all participants.
- **Results:** Because of lower costs, models may generate the same or better investment performance/results.

Contact me if you want to discuss "target maturity models."



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