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# Lifestyle Funds: Target Date and Risk-Based Investment Options for 401(k) and 403(b) Plans

**By William Small**
*Principal*
*Highland Capital Advisors*
*and*
**Ward Harris**
*Managing Director*
*McHenry Partners*

Lifestyle funds are among the most often used and least understood investment options in use today. The appeal is easy to understand – pick a fund based upon when you wish to retire based upon your risk tolerance – and leave the rest to investment professionals.

In just the last few years, hundreds of these risk and date-based products have been launched. They promise the potential for consistent returns at an appropriate level of risk. The goal? Future income based upon accumulated values through growth and income. Some of the product names used (LifePath, Freedom Funds, TargetDate, LifePoints, etc.) can be confusing and frustrating for employers, employees and even some professionals.

### A Well Kept Secret

Despite overwhelming adoption of such funds by plan sponsors and increased utilization by plan participants, an unanswered question in the retirement industry is exactly how much variability and inconsistency there is in the design, manufacture and distribution of these products. Further, the structure of these products has made sound fiduciary oversight more challenging than with other types of funds.

One challenge is that they may not work as intended. Like nuclear energy in the 1950's, lifestyle funds have been enthusiastically promoted and utilized, but may carry with them some unexpected and unintended consequences. It may take a while before we get all the kinks out of their manufacture and use. For some decision-makers, the help of an objective professional not affiliated with the solution vendor can help manage their risks and results.

A volatile investment environment and tepid returns for some lifestyle funds in recent years have resulted in questions about their use. Regulators, Congress and plan sponsors have asked for more understanding, standardization, transparency, disclosure and documentation of these new products.

### A Lot of Money

A recent report from Casey Quirk, an institutional research firm, suggests that target-date and target-risk retirement vehicles will attract 80% of new and reallocated flows into defined contribution schemes for the next decade. We have seen significant changes in plan sponsor and participant behaviors in clients retirement plans. As the result of aggressive "educational" marketing by some vendors, plan participants have reallocated over half of their existing balances into these modern marvels.

Many plans with auto enrollment and default investment features (known as QDIAs) use lifestyle funds as the destination for participants that fail to select an investment fund. Some plans have up to 80% of new contributions going to these managed options.

A basic issue for participant-directed retirement plans (401(k), 403(b), 457, some other profit sharing and money purchase or annuity plans, etc.) is how to provide investments that meet participants' goals, objectives, constraints and preferences of each individual employee/investor.

### Do it Yourself or Autopilot?

Some participants wish to self-manage their accounts through the implementation of a personal investment policy, including goal-setting, asset selection, manager selection, asset allocation, periodic oversight and rebalancing and reallocation to reflect changing personal circumstances and market conditions. That's quite an order for most employees.

Not surprisingly, many plan participants need more help, whether in the form of education, advice or someone to take on the entire management function. A well-crafted, "outsourced," solution can help a plan participant put his/her retirement investments on "auto pilot." Much of their success will be based upon the assumptions made in the design, manufacture and operation of the solution – together with the limitations of the products and the expectations of their users.

**Borrow, Buy or Build?**

All three options (borrow, buy or build) are available to plan sponsors. Each comes with risk, opportunity and potential returns. To help our readers understand their options, we will conduct a research project on the subject of lifestyle funds in the coming weeks.

Healthcare finance, HR and benefits professionals will be asked a few salient questions through a simple, confidential, online survey about their current practices and results. Just five minutes of your time will help us generate meaningful data for an upcoming research report, "**Healthcare Retirement Practices: The Good, The Bad & The Ugly**."

*William Small is a principal with Highland Capital Advisors in Issaquah, WA. His firm serves institutional clients, including healthcare retirement plans, throughout the Western United States. He was formerly a member of the management team at Howard Johnson and Company and Merrill Lynch Institutional Consulting. He can be reached at (425) 466-2946 or bsmall@hcportfolios.com.*

*Ward Harris, managing director with McHenry Partners, is a regular contributor to Healthcare News and can be reached at 925-323-6187 or ward.harris@mchenrypartners.com.*