ALGER

PART 2: IMPROVING RETIREMENT OUTCOMES

THINK FURTHER FOR RETIREMENT

A Properly Structured QDIA May Enhance Retirement Readiness

Choosing the right investments for your employees is crucial to improving outcomes and maximizing a participant's chance of reaching their retirement goals.

HELPING **PLAN SPONSORS** THINK FURTHER FOR THEIR RETIREMENT PLAN

This is Part 2 of a two-part series focusing on steps that plan sponsors can take to promote retirement readiness and structure investments to improve retirement outcomes. This paper helps plan sponsors **Think Further** about default plan investments to help participants potentially maximize their savings and meet their retirement goals.

1 WHAT IS A QDIA?

A Qualified Default Investment Alternative (QDIA) is a default investment used in a 401(k) plan when a plan participant has not made an active investment election from the plan's investment menu.

2 EVOLUTION OF DEFAULT PLAN INVESTMENTS

Prior to the passage of the Pension Protection Act of 2006 (PPA), unless a participant exercised actual control over their retirement account, plan fiduciaries were not protected under Section 404(c) of the Employee Retirement Income Security Act of 1974 (ERISA). Not being protected meant they could be held liable for losses incurred if default investments were deemed "imprudent." As such, plan sponsors often adopted conservative investment options that were considered "safe," such as money market and stable value funds, as the default investment vehicle in retirement plans.

The PPA amended ERISA to provide a safe harbor for plan fiduciaries who invest participant assets in appropriate default investments, and the Department of Labor (DOL) issued a final regulation detailing the categories of investments that qualify:

- Balanced Funds
- Life-Cycle or Target Date Funds (TDF)
- Professionally Managed Accounts (or Retirement Managed Accounts, RMA)[1]

Capital preservation products, such as qualifying stable value funds, can also be used as a QDIA, but only during the first 120 days of plan participation to give participants time to reallocate the money to other investments. Plans with automatic enrollment features that choose to use a QDIA must have one of the other QDIA options for cases where the participant takes no action after the first 120 days.

3 BALANCED FUNDS

Characteristics
• Easy diversification
• Low volatility
• No customization

- Professionally managed portfolios that allocate a predetermined, fixed percentage of their assets to stocks and bonds.
- They are straightforward investments that provide participants with an easy way to diversify their 401(k) holdings with one investment.
- They are not tailored to individual needs, such as retirement date, and tend to be less volatile than straight equity securities.

4 TARGET DATE FUNDS

Characteristics
• Easy to use and understand
• Limited investment diversification
• Little to no customization

- TDFs are popular QDIA options because they are simple solutions for plan sponsors and participants.
- TDFs are collective investment portfolios that use an age-appropriate mix of equity and debt investments to construct an asset allocation model based on an individual's age, life expectancy or years until retirement age.
- As the retirement date approaches, the investments automatically rebalance to be more conservative, i.e., they move from equities to bonds. The management of this rebalancing is known as the "glide path," and investment providers typically offer a series of these portfolios with different "target" retirement dates and glide paths in 5- or 10-year increments, such as 2025, 2030, 2040, etc.
- Participants choose the target date series based solely on their anticipated retirement date, and they get a complete investment portfolio that automatically rebalances according to the glide path as they get closer to retirement. Participants can "set it and forget it."

While easy to use, their simplicity makes it difficult for TDFs to meet the retirement needs of all individual investors. Perhaps the biggest drawback of TDFs is the single variable of retirement date because there is no guarantee that a person will retire in the year of the fund. Also, no two investors are alike—even ones that do retire in the same year. Each investor has different risk tolerances, investment goals, non-retirement assets, and retirement income needs. Finally, some TDF assets are held in funds managed by a single investment manager, as opposed to a diverse mix of funds where asset classes are managed by "best in class managers."

5 RETIREMENT MANAGEMENT ACCOUNTS

Characteristics

- Easy to use
- Fiduciary oversight and investment diversification
- Customized for better results
- Perceived to be expensive

There is a growing desire for customized retirement portfolios as opposed to one-size-fits-all options, which is why Retirement Managed Accounts (RMA) are compelling QDIA options that are fueling the next evolution of plan design.

- An RMA is an investment account owned by an individual investor and overseen by a hired professional money manager.
- The professional asset manager takes on a fiduciary role and, based on a number of individual factors (including age, salary, contribution rate, outside investments and risk tolerance), develops an appropriate asset allocation for each participant. Over time, if inputs dictate, the allocation will be adjusted to meet the participant's individual circumstances and changing needs.
- As opposed to a one-size-fits-all strategy, participants receive a personalized investment solution that is tailored to their needs. Since the portfolio is managed by an ERISA 3(38) investment manager with discretionary control, participants do not need to research and select their own investments or monitor or adjust their portfolio. They only need to keep their inputs up to date to allow the manager to properly adjust allocations.

Adoption of RMAs has been increasing but one concern some plans have is the perception that RMAs are more expensive than other options because they have a management fee in addition to the costs of the underlying investments. While true, the customization of RMAs potentially allows for better participant outcomes, which can offset the additional costs, particularly over a long investment lifecycle.

6 THE FUTURE OF QDIAS

Custom Target-Date Funds

One strategy that has been gaining in popularity is custom target-date funds that employ more efficient investment designs. Such an approach can be constructed from the complete plan line-up by an advisor, recordkeeper or fiduciary provider to create an open architecture fund that includes multiple, "best-in-class" asset managers and a tailored, more diversified asset allocation, including less liquid assets such as real estate or healthcare portfolios. This provides more flexibility to meet specific allocation needs of a plan and its participants, including the creation of customized asset allocations and glidepaths that account for additional plan level portfolio assets, such as Health Savings Accounts (HSAs) and pensions plans, to create more bespoke portfolios.

Dynamic Managed Accounts

Another strategy allows participants to invest in a TDF in their earlier years and move from a standard TDF to an RMA a few years before retirement. This design allows younger participants to benefit from lower-cost options that promote saving early while providing them with more personalized investment advice near retirement when it's arguably most needed.

Conclusion

The proper QDIA may help plan sponsors improve their participants' retirement readiness and retirement outcomes. Choosing, designing, and managing the right QDIA for a specific plan, including selecting the core investment options, can be a daunting proposition, which is why it is prudent to seek professional assistance, such as a financial advisor who specializes in retirement plans and who can provide fiduciary services to your plan and plan participants. In order to address the retirement savings deficit in the U.S., we must encourage investors to save early and allow them to potentially maximize the growth of their retirement savings. Plan design changes such as automatic enrollment and auto escalation can help improve participation and increase savings rates. And seeking professional advice that looks at a participant's entire financial picture and choosing a properly structured QDIA can help encourage savings, drive growth, and close the retirement gap.

To learn more about the steps you can take to promote retirement readiness with your employees, reach out to your Alger contact, email us at retirement@alger.com or visit us at www.alger.com.

[1] Department of Labor, *Qualified Default Investment Alternative*, 29 C.F.R. § 2550.404c-5 (October 2007).

The views expressed are the views of Fred Alger Management, LLC ("FAM") and its affiliates as of June 2022. These views are subject to change at any time and may not represent the views of all portfolio management teams. These views should not be interpreted as a guarantee of the future performance of the markets, any security or any funds managed by FAM. These views are not meant to provide investment advice and should not be considered a recommendation to purchase or sell securities.

This material must be accompanied by the most recent fund fact sheet(s) if used in connection with the sale of mutual fund shares. Fred Alger & Company, LLC serves as distributor of the Alger mutual funds.

This document contains a general, high level summary of certain considerations applicable to qualified retirement plans. This summary does not purport to be a complete description of all the considerations applicable to a plan, plan sponsor, fiduciary or participant and it should not be considered to be guidance of any kind regarding a specific plan or situation and should not be relied upon as such. The summary is based upon general principles in the Internal Revenue Code of 1986, as amended (the "Code"), the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), as well as certain guidance issued under the Code and ERISA that may be applicable, all as currently in effect at the time that this summary was drafted, and all of which are subject to change or to differing interpretations, possibly retroactively, which could affect the continuing validity of this summary. There should be no anticipation that this summary has been, or will be, updated for any developments in the law or interpretation.

Tax and ERISA matters are very complicated and the consequences to plans, plan sponsors, fiduciaries and participants will depend on the facts of a particular situation. We encourage retirement plan sponsors, fiduciaries and participants to consult their own advisors regarding these matters, including applicable federal, state, local and foreign laws and the effect of any possible changes in the law.

ALPFIROBR2-0622