T.RowePrice®
INVEST WITH CONFIDENCE

Get philosophical about target date evaluation:

How to align the best product with each retirement plan.

The target date landscape has become increasingly complex for defined contribution (DC) plan sponsors. Products designed to simplify the investment selection at the participant level have left sponsors grappling with the responsibility of selecting the “right” target date product for their plan.

The demand is growing among plan sponsors for a resource that can ease the burden of selecting an appropriate suite of target date products. Advisors can add significant value by helping plan sponsors navigate the evaluation process.

IT'S NOT JUST A NUMBERS GAME

Providers have come to increasingly rely on quantitative analysis as the first (and sometimes only) step in the target date evaluation process. All too often, they focus their clients' attention on two key data points: performance and cost.

However, data and analytics can be easily attained through home office screeners, proprietary tools, asset manager resources, and third-party services. In effect, these quantitative evaluation components are being commoditized. Advisors will find it increasingly difficult to add value simply by leaning on a quantitative overlay.

That is why T. Rowe Price believes that a genuine and thorough evaluation of target date funds should begin with a conversation about plan objectives and participant investment risks. This starts the decision-making process off on the right track—and it provides the advisor with a platform on which to showcase their added value.

The numerous criteria for choosing target date funds—from "to versus through" to active versus passive, custom versus proprietary, and higher equity versus lower equity—has given advisors a unique way to showcase their investment expertise.

THREE ESSENTIAL CONSIDERATIONS

To kick off a conversation about target date funds, sponsors must decide where they stand with respect to three key considerations: plan objectives, investment risks, and participant preparedness.

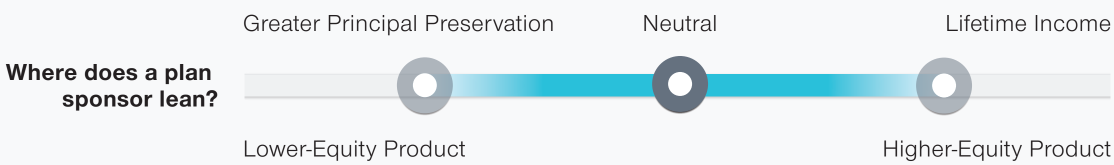
PLAN OBJECTIVES

Plan sponsors usually have one of two primary objectives for their retirement plan:

1. Providing their participants with adequate lifetime income to sustain a potentially lengthy (25 to 30 years) retirement.
2. Providing their participants with greater principal preservation by moderating volatility at or near the target retirement date.

The primary challenge for sponsors is striking a balance between these two plan objectives.

Identify Plan Objective



A sponsor whose objective is to provide lifetime income may align with a higher-equity target date product, whereas a sponsor who prefers the chance for greater principal preservation near retirement may be better aligned with a more moderate equity product.

INVESTMENT RISKS

Once sponsors determine the plan objective, they can prioritize the three primary investment risks that participants face while investing for retirement:

1. **Longevity risk**—The risk that participants will outlive their retirement savings.
2. **Inflation risk**—The risk of losing purchasing power over time due to insufficient capital appreciation.
3. **Market risk**—The risk of principal loss due to negative market fluctuation.

Prioritize Investment Risk

Prioritizing these investment risks will essentially serve to advance the selection process—either pushing sponsors further to one side or bringing them back closer to the starting point.

PARTICIPANT PREPAREDNESS

Several plan design and demographic factors can also influence the evaluation process:

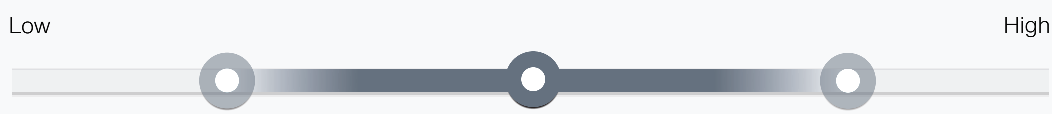
- Current account balance (as a percentage of salary)
- Savings levels (employee and employer money)
- Other retirement income (Social Security or defined benefit plan)

For example, Social Security replaces a higher percentage of income for low wage earners than for high wage earners. As a result, high wage earners must save a larger percentage of salary to maintain their preretirement standard of living. Thus, with all else being equal, the income replacement goal is a heavier burden for DC plans in which participants tend to have higher salaries.

Similarly, considerations should be given to savings rates, company match structure, and the existence of an accompanying defined benefit plan—all of which can affect the preparedness of participants.

If a plan has high savings rates, a generous match, and a defined benefit plan and the sponsor is really focused on longevity and inflation risks, then they may lean toward a higher equity product because the “very prepared” participants can afford higher equity. Conversely, if a plan has high savings rates, a generous match, and a defined benefit plan but the sponsor is really focused on market risk, then they may lean toward a lower equity product since they want to protect higher balances at or near the target retirement date.

Participant Preparedness



The higher the level of preparedness, the more flexibility the sponsor has in staying true to its prioritization of investment risks. If a plan’s participants are not saving enough and have no defined benefit plan, for example, the sponsor’s hand may be forced into selecting a higher-equity product as part of the solution to give participants the potential for greater accumulation in the years leading up to retirement.

FINALIZE FUND SELECTION USING QUALITATIVE AND QUANTITATIVE SCREENING

Once the target date evaluation narrows the available fund choices that align with the objectives, risk priorities, and level of participant preparedness, you and your sponsor can use quantitative and qualitative screening and analysis to help make the final decision. Following robust analytical guidelines, you can emphasize the following considerations:

- Underlying investment components
- Diversification across sectors and asset classes
- Performance versus the benchmark
- Performance versus peer group
- Fees versus peer group
- Management tenure
- Well-respected, third-party industry evaluation

ADD VALUE TO YOUR SPONSOR RELATIONSHIPS

The challenge of target date selection has historically been met through quantitative screening based on performance and cost. Those two factors, in addition to a bevy of other analytical data, are critical components of the evaluation and selection process—but they shouldn't be the first (or only) ones. Sponsors will appreciate advisors who offer both objectives-based, and quantitatively based, criteria for evaluating target date funds.

By helping sponsors think about plan objectives and prioritizing investment risks, you can simplify an otherwise daunting and increasingly complex task.

> "A good decision is based on knowledge and not on numbers."
>
> –Plato

The principal value of target date funds is not guaranteed at any time, including at or after the target date, which is the approximate date when investors plan to retire. These funds typically invest in a broad range of underlying mutual funds that include stocks, bonds, and short-term investments and are subject to the risks of different areas of the market.

In addition, the objectives of target date funds typically change over time to become more conservative.

Call 1-800-638-7780 to request a prospectus, which includes investment objectives, risks, fees, expenses, and other information that you should read and consider carefully before investing.

For Additional Target Date Perspective

As assets proliferate and the target date space continues to mature, sponsors will increasingly turn to advisors in an effort to stay apprised of relevant issues. Whether you're looking for academic research or an overview of the solutions we offer, let T. Rowe Price deepen your knowledge of the target date space and support your best practice recommendations.

Visit **troweprice.com/tdf** and let us put our DC and target date experience to work for you.

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