Strengthening defined contribution plan lineups

Financial professionals can be of vital assistance to plan sponsors in evaluating and improving the investment offerings in defined contribution (DC) retirement plans. Vanguard believes four best practices will help advisors guide their clients to sound portfolio decisions.

Step 1: Identify plan objectives

DC plan sponsors seek to offer a valuable benefit to participants and have a fiduciary duty to put participants' interests first in selecting and monitoring investments. Participants, the end users of the plan, want to maximize its value for their individual circumstances.

At the highest level, sponsors and participants have similar goals:

- Readiness for retirement.
- Reasonable, competitive investment choices.
- Low-hassle decision-making.
- Competitive fees.

Default options, streamlined choices, and managed account advisory services have greatly improved the portfolio diversification of many plans. A sound investment menu can provide the structure for participants who seek options beyond automatic enrollment.

Step 2: Review investing fundamentals

The elements of long-term investment success apply as much to DC plans as to any investment planning:

- **Asset allocation.** It's widely accepted that the vast majority of an investor's long-term return—assuming the use of broadly diversified investments—is derived from asset allocation rather than security selection or market-timing.[1] Thus, a DC plan that enables participants to select a mix of investments by asset class can improve the participants' odds of meeting their investment objectives, subject to their individual circumstances.
- **Diversification.** Exposure to different asset classes and markets whose returns may vary widely at any given time is an effective strategy for managing investment risk. Making it possible for participants to invest in diversified holdings can help them reduce the risks associated with a particular company, sector, or segment.
- **Cost.** Minimizing cost is critical to improving investment outcomes for participants. Every dollar paid for management fees or trading commissions is a dollar less of potential return. In addition, periodic plan sponsor and participant fee disclosure is required.

[1]Source: Joseph H. Davis, Francis M. Kinniry Jr., and Glenn Sheay, *The Asset Allocation Debate: Provocative Questions, Enduring Realities*. Vanguard, 2007. Originally published as Yesim Tokat, Nelson Wicas, and Francis M. Kinniry, 2006. "The Asset Allocation Debate: A Review and Reconciliation," *Journal of Financial Planning*, 19(10):52–63. This paper is a revised and updated version.

Step 3: Create a tiered investment structure

To help participants navigate the selection process, financial professionals can organize the plan's investment options in logical groupings or tiers. A tiered lineup can reduce complexity for participants and reflect the plan sponsor's philosophy on retirement investing.

A basic framework for a tiered plan lineup includes:

Tier I: A single-fund solution	A qualified default investment alternative (QDIA) that's appropriate for all investors in a plan, such as a target-date fund (TDF), target-risk fund, or balanced fund—indexed or actively managed.
Tier II: Building blocks	Broadly diversified options for straightforward portfolio customization, such as the underlying individual mutual funds in the plan's TDF offering or an active/index mix.
Tier III: Supplemental choices	Additional strategies, though not essential for creating fully diversified portfolios, but that offer more specialized access to investment styles, asset classes, or individual securities.

Step 4: Ensure active, ongoing oversight

Financial professionals typically assist or manage the selection and monitoring of investments within a retirement plan to provide fiduciary support for plan sponsors.

The plan sponsor responsibilities a financial professional may be called upon to help with include:

- Ensuring the plan lineup aligns with the sponsor's identified goals and objectives.
- Specifying criteria by which funds will be selected and evaluated.
- Maintaining a disciplined process for hiring, evaluating, and terminating investment managers for the plan.
- Confirming the QDIA is appropriate and considering reenrollment if changing the QDIA or establishing one for the first time.
- Documenting the preceding steps in an investment policy statement and revisiting the policy regularly with the plan's investment committee.
- Staying abreast of new products as well as changes in the investment and regulatory landscape.

Final thoughts

The best practices outlined here will help financial professionals and their plan sponsor clients develop and offer robust investment lineups that suit the plan sponsor's organization and provide participants with the right tools to make sound retirement decisions. The adjacent checklist can help you implement the best practices.

To learn more about how you can add value for your plan sponsor clients, please **contact us**.

Checklist for DC plan investment lineup

1. A focus on fundamentals

☐ Asset allocation	Allocation offers exposure to primary asset classes.
☐ Low cost	Plan investment options are low cost.
☐ Automatic enrollment	Plan automatically enrolls new participants.
☐ Automatic increase	Plan uses automatic increase for new participants.
☐ Reenrollment	Plan has completed a reenrollment since last QDIA (qualified default investment alternative) update.
☐ Saving rate	Plan meets Vanguard-suggested saving rate.

2. Participant-friendly lineup

☐ Tiered lineup	Presence of tiered lineup.
☐ Tier I: Single-fund solutions	Low-cost, transparent, risk-controlled options.
☐ Tier II: Building blocks	Straightforward and efficient exposure to portfolio construction.
☐ Tier III: Supplemental choices	Options are reasonable; usage is reviewed.
☐ Managed accounts	Low-cost complement to TDF suite.

3. Active, ongoing oversight

☐ Goals and objectives	Align investment lineup and plan objectives.
☐ QDIA review	Monitor industry trends and peer benchmarking.
☐ Active fund review	Maintain process for manager evaluation.
☐ Documentation	Document process (investment policy statement—IPS), regulatory updates.

Source: Vanguard.

Vanguard®

100 Vanguard Boulevard, PA 19355

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