Cerulli Predicts More Use of Custom TDFs Within Large 401(k)s

August 10, 2012 (PLANSPONSOR.com) - Cerulli's latest research study of the large and mega defined contribution (DC) plan marketplace projects assets of custom target-date funds (TDFs) within these plans will reach $218 billion by 2016.

This is a 22% increase from the 2011 asset level of $46.4 billion.

Most survey results that have been published suggest that the overall percentage of plan sponsors that have already implemented a custom target-date strategy to be about 10%. However, there is bifurcation in the market, in which plans with more than $1 billion in assets are more likely to use custom target-date strategies than plans with less than $1 billion, according to the research report "The State of Large and Mega Defined Contribution Plans: Investment Innovation and the Plan Sponsor Perspective." Cerulli estimates that there is $139.5 billion in target-date assets in the mega market segment.

Plan sponsors in the high end of the mega market (greater than $5 billion in plan assets) have more resources to focus on the defined contribution plan, and, therefore, are more likely to implement custom target-date funds and/or retirement income products.

"We believe that plan sponsors will add custom target-dates at a rate of 2% per year for the next two years," said Kevin Chisholm, senior analyst and lead author of the Cerulli study. "The use of custom target-date funds provides access for DCIO [Defined Contribution Investment Only] asset managers to the growing pool of DC assets. In addition, these products also allow new asset managers to participate in this market, outside of the few that have dominated the space since the Pension Protection Act of 2006 blessed these funds as Qualified Default Investment Alternatives (QDIAs)."

Cerulli's research also notes that custom target-date funds open the door for alternatives in DC plans as alternative asset classes have long been missing from these plans' investment lineups. Custom target-date funds may choose alternative structures (such as collective trust funds) over mutual funds, but mutual funds are expected to remain the product of choice for the majority of choices in plan investment lineups.

The fact is that investment vehicle is a secondary consideration, and if savings from a collective trust is

not significant, then plan sponsors are likely to continue to use mutual funds, especially in the large market ($250 million to $1 billion in plan assets) where mutual fund use as a percentage of assets is higher than in the mega market ($1 billion +).

Assets in standalone investment choices will remain relatively flat as target-date funds continue to garner assets. Investment menus will continue to evolve, opening the door for products that have had limited success in defined contribution plans, such as alternatives and managed accounts. Asset managers should expect that best-in-class funds based on performance in traditional asset classes will continue to win mandates, but in the long-term, a fund's role in an asset allocation strategy will become more important.

Consultants are the primary source of information for plan sponsors. Only 12% of plan sponsors indicate that conferences are the initial source of defined contribution plan information.

Cerulli contends an outsourced CIO solution makes sense for plans that lack the time and resources to effectively manage the defined contribution investment menu.

Rebecca Moore
editors@plansponsor.com