

As the advisor to the plan you will play a key role in helping the plan sponsor decide if off-the-shelf or custom target date funds are a better fit for the plan.

## Target Date Funds – Off-the-Shelf or Custom?

Target date funds offer a number of advantages for 401(k) plan sponsors and participants. They offer a one-stop option for participants who are looking for a professionally managed fund. Target date funds are geared towards the “average” investor who will retire around the fund’s target date.

For example, an off-the-shelf 2040 target date fund is designed for someone who will retire around that time, probably someone who is around age 45 today. This is fine except that not everyone who is the same age has exactly the same financial situation, the same risk tolerance or the same level of retirement readiness.

Many plan sponsors have decided that custom target date funds are a better option for their plan participants.

### Custom glide paths

Off-the-shelf target date funds have a single retirement glide path for the entire fund family. Custom target date funds allow for glide paths tailored to the plan’s employee population including multiple glide path options if needed.

If the company offers a defined benefit pension plan in addition to their defined contribution plan, the glide path can be adjusted to take the pension benefit into account.

### Multiple managers and strategies

Off-the-shelf target date funds typically use only mutual funds from the fund family offering the target date series. In some cases the TDFs consist only of actively managed funds or exclusively of index funds.

Using a custom target date fund allows for the use of multiple managers and investment approaches. Actively managed portfolios can be combined with index portfolios. There is no constraint in terms of using managers exclusively from a single fund company.

In some cases a plan sponsor might want to leverage relationships they have with managers used in the company’s DB plan, if they have one, to manage a portion of the custom target date fund.

Plan sponsors can make a change at the manager level within the custom target date fund while keeping the rest of the managers and investment styles being used intact. This type of granular fine tuning is just not possible with an off-the-shelf target date fund

If the plan sponsor and their investment advisor feel it is appropriate for their plan participants, they can use alternative asset classes as part of the custom target date fund such as private real estate, absolute return strategies and others. This typically is not an option with an off-the-shelf target date fund.

## Lower expenses

In some cases, a custom target fund can lower expenses. An off-the-shelf target date fund will have an expense ratio for the overall fund, plus the expense ratios of the underlying mutual funds in target date fund come into play as well.

A custom target date fund allows for greater control over expenses through manager selection.

## The role of the plan advisor

As the advisor to the plan you will play a key role in helping the plan sponsor decide if off-the-shelf or custom target date funds are a better fit for the plan. You can provide a thorough analysis of the pros and cons of each approach. You are in a good position to help the plan sponsor evaluate the needs of their employees in terms of the range of their financial situations, retirement readiness and other factors that will go into the decision process.

If the decision is to go the custom route, your expertise will be crucial in helping select the best managers and appropriate asset allocations for the various funds. Moreover, your ongoing monitoring process for the plan's investment menu will dovetail well into a monitoring and evaluation process for these custom target date funds, and the performance of each underlying manager.

For many plans there is nothing wrong with a family of the off-the-shelf target date funds. They offer professional management for participants who are not comfortable making their own investment decisions. However, some plans want and need something more tailored to the needs of various groups of employees. In that case a custom target date fund might be the best solution.

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Calamos Advisors LLC  
2020 Calamos Court | Naperville, IL 60563-2787  
800.582.6959 | [www.calamos.com](http://www.calamos.com)  
[caminfo@calamos.com](mailto:caminfo@calamos.com)

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