Goldman Sachs Asset Management

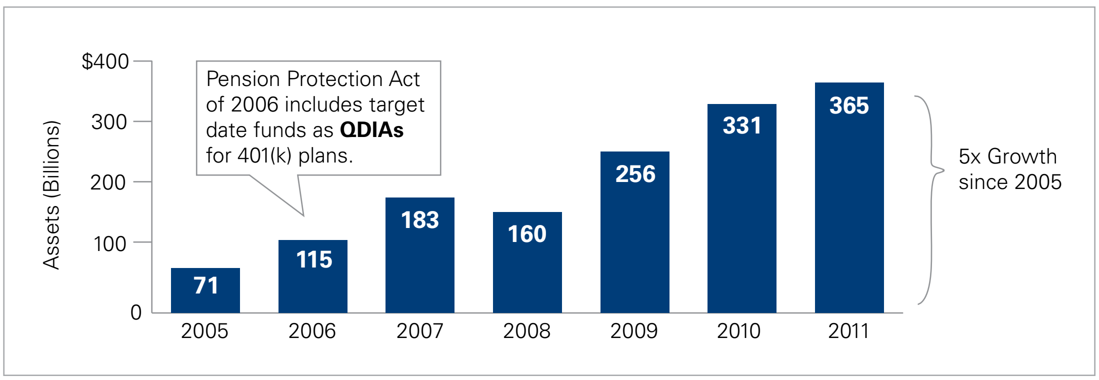
RETIREMENT SERVICES GROUP

Building Your Practice with Custom QDIAs: As Complicated as You Think?

Target date funds continue to grow in popularity as more and more plan sponsors use them as qualified default investment alternatives (QDIAs) in their retirement plans. As a dedicated retirement plan advisor, you may want to consider custom target date or target risk capabilities with clients as recordkeeping platforms begin to offer the capabilities to support them.

Plan sponsors' growing interest in custom models make it important to understand what's available in the marketplace and the degree of customization you may be able to support. It is even more important for plan sponsors to understand and assess potential risks and other considerations as they evaluate custom options. Your guidance can play a key role.

Target Date Funds Continue to Proliferate



Source: Cerulli Associates: "Cerulli: Custom Target-Date Funds in 401(k)s Expected to Rocket 370% by 2016," As of August 10, 2012. Represents mutual fund and bank collective trust (BCT) assets.

Sponsor Questions & Custom Options

As target date funds continue to be used in 401(k) plans, sponsors may have questions about these options, including:

- Can I have greater transparency into my target date fund's underlying assets?
- Can I gain more control over my target date fund's risk level, glidepath or asset classes?

With these questions in mind, the use of custom default options appears to be increasing. In fact, Cerulli projects that 22% of target date fund assets, or $218B, will be in custom portfolios by 2016, up from 13% ($46.4B) in 2011.[1] This projected growth may have you asking…

Q How might I differentiate my practice by helping plan sponsors with their plans' QDIAs?

[1] Cerulli Associates: "Cerulli: Custom Target-Date Funds in 401(k)s Expected to Rocket 370% by 2016," As of August 10, 2012.

Consider discussing a custom approach to target date funds with plan sponsors.

Potential Benefits of a Custom Approach

Flexible Menu Construction
A plan sponsor can select a custom asset allocation or glidepath approach that is most appropriate for its participant base.

Access to the Best Performing Underlying Funds
A plan sponsor can select the fund manager for each underlying asset class within the custom fund rather than have the same manager for every asset class.

Increased Transparency & More Effective Due Diligence
A plan sponsor can change particular asset classes without having to replace the entire target date fund option. The greater transparency of a custom fund may also make a plan sponsor's due diligence in monitoring the fund more effective.

Risk Management through Broader Diversification
With a custom fund, a plan sponsor can diversify the fund's risk using asset classes not traditionally found in DC plans (e.g., commodities, emerging markets, REITs, etc.) alongside traditional equity and fixed income components. While diversification does not protect an investor from market risk and does not ensure a profit, it can contribute to the overall risk management of a participant's portfolio.

Implementation Does Not Have to Be Complicated

Depending on the recordkeeper with whom you or your plan sponsor clients are working, different degrees of customization may be available and there may be different aspects of these options you can support. The following is a brief review of certain considerations that might be helpful as you think about potential implementation.

Are You a Fiduciary?
You should clearly communicate your role and responsibilities to your clients, including your responsibilities as a fiduciary under ERISA if applicable. You should consult your legal counsel with any questions about the standard of care that applies to you in supporting customization options for clients. To the extent there are changes to the definition of a fiduciary (including under ERISA), it will be important to consider the impact of any such changes on your practice.

Choosing a Recordkeeper
Each recordkeeping platform has a unique value proposition. One may depend on the capabilities offered when it comes to developing custom default options and there are important questions you may want to ask:

- Can the platform support both age-based and risk-based models?
- Is the platform "open architecture" and how is that defined? How broad is its list of available funds? Is there flexibility when it comes to asset allocation models or glidepaths?
- How will the platform report custom options on participant statements? Will aggregate performance be reported for a custom default option or individual performance of underlying funds?

Asset Allocation

Another important consideration is the degree of flexibility that may be offered in determining the asset allocation for a custom option. Many providers offer some flexibility to advisors who want the ability to make adjustments to asset allocation models within a custom option. You should have a clear understanding of the asset classes available to choose from on a platform. One of the potential benefits of having a custom default option is the ability to deliver broadly diversified exposure that goes beyond traditional DC asset classes.

Fund Selection

One of the most important benefits of using custom models is the ability to select (or replace) the underlying funds without having to replace the entire target date or target risk fund. Unlike many "off-the-shelf" options, a custom option can provide the ability to add or remove underlying funds based on range of factors including, but not limited to, fund performance and changes to asset allocation and/or glidepath.

Glidepath Selection & Management

A number of recordkeeping providers may only offer a limited set of glidepaths for advisors and sponsors establishing a default investment option on their platform. Alternatively, some advisors may want to provide and manage the glidepath themselves. If you're an advisor who wants to take responsibility for the glidepath component of a custom model, you will want to consider carefully the requirements associated with managing a glidepath for a target date fund and the impact that may have on the plan over time, your practice and your role as a fiduciary to the plan.

How GSAM Can Help

GSAM can work with you to understand the range of available platform providers and the capabilities/level of flexibility they offer. More importantly, GSAM can also provide insights on the markets, portfolio and menu construction, risk allocation and the potential benefits of broader diversification.

GSAM representatives do this by:

- **Understanding Your Practice Model** – Having a clear picture of your value proposition helps GSAM provide the most relevant education and analyses that may be helpful in enhancing your practice.
- **Incorporating Clients' Investment Objectives** – GSAM can offer education and analysis to help you identify and understand the investment objectives that clients may have.
- **Helping Identify Sources of Risk** – GSAM can provide insight on the role of equities in the risk profile of certain portfolios[2] and the potential benefits of using custom solutions.
- **Delivering Broad Diversification through Asset Allocation** – GSAM can offer educational guidance that may be able to help you and your clients build portfolios across the efficient frontier using a core and satellite investing approach and capital market assumptions.

Given their increasing reliance on default target date and target risk portfolios for their plans' QDIAs, we believe today's plan sponsors need strategic insights and a thoughtful approach to help them decide whether or not a custom default option might work for them. GSAM can help you work with clients to develop a solid understanding of what's available, including potential new opportunities to enhance and diversify their plans.

To learn more about how GSAM's insights and support can enhance your value proposition please contact your GSAM sales representative.

[2] Core equity is the dominant risk in most portfolios that most needs to be diversified. Dynamic strategy presentation: "Traditional equity portfolios tend to be dominated by equity risk," Goldman Sachs Asset Management, 2011.

Risk Considerations:

Investments in foreign securities entail special risks such as currency, political, economic, and market risks. These risks are heightened in emerging markets.

An investment in real estate securities is subject to greater price volatility and the special risks associated with direct ownership of real estate.

Investments in commodities may be affected by changes in overall market movements, commodity index volatility, changes in interest rates or factors affecting a particular industry or commodity.

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