

Our last Investment Insight piece, which appeared in the March 2011 issue of PMI News, looked at how target date funds (TDFs) can deliver a highly sophisticated asset allocation strategy for pension savers and providers alike. We argued that TDFs are flexible, diversified and ‘future proof’. We suggested that the best TDFs should be able to adapt seamlessly, not only to the saver’s circumstances as they age, but also to the market and regulatory environment. Crucially, they should do this in a way that is simple and effective for both the pension provider and the pension member.

But for TDFs to be able to offer this fund-for-life service, a lot has to happen under the bonnet. The investment design that we discussed in March is just the starting point. In order to implement that design successfully, while offering the simplicity, price and ‘future-proofing’ that are essential from the users’ perspective, three critical areas need to be considered:

- Operational integration
- Command and control
- Oversight and governance

We wanted to look at each one of these areas in a bit more detail.

Operational integration

To be successful, a modern TDF needs to knit together a huge number of disparate elements, each of which must meet exacting standards. At its heart, the structure must be able to deal with many sub funds if it is to create the investment diversity that is essential to the design of a successful TDF asset allocation strategy. Each fund must be either constructed or vetted to ensure it is suitable. The structure or platform on which the funds sit must be flexible, open architecture and have market-leading blending capabilities if it is deliver the best features of TDFs. Operational processes must also be aligned with those of business partners, like third-party administrators and platform providers. This means ensuring that effective checks and balances are in place so that the various operational teams truly work as one integrated partnership and not at arm’s length from each other.

Command and control

To run a mechanism as complex as a range of TDFs requires a sophisticated and transparent command and control structure. This means having in place a set of clearly-defined, rules-based processes to ensure that the manager does what he is mandated to do – and be seen to be doing it. So there needs to be secure processes to allow timely and accurate transmission of trades across all the different target date funds (or ‘vintages’) and their sub-funds. And, once the trades are made, there must be clear daily processes to keep track of investment positions across all the funds and their components. And, to keep the scheme on course, any management information system must allow the portfolio manager to assess allocations against targets and successfully deploy volatility management tools as required.

Oversight and governance

One of the most appealing aspects of TDFs is that they remove many of the day-to-day administrative and investment burdens from providers and trustees, allowing them to devote more time to their main oversight role. This obviously puts a premium on good governance. Providers, trustees and their consultants must have a clear view of what is happening with the target date funds, but joined-up governance also means ensuring that business partners, fund platform partners and others involved are integrated into the process. Everyone must understand what needs to be done, when, how and by whom. With so many moving parts, the aim should be clear and simple reporting from which informed and timely decisions can be made.

The end result should be like a finely-tuned car. Easy for the driver to understand and operate but, underneath, an incredibly sophisticated machine. The best TDFs package best-of-breed technology to create a single fund for life: easy for the saver, provider and trustee to use, but hiding enormous sophistication within. That should make life easier for providers, trustees and members alike, while ultimately delivering a pension much more able to cope with the challenges of this century. ■



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