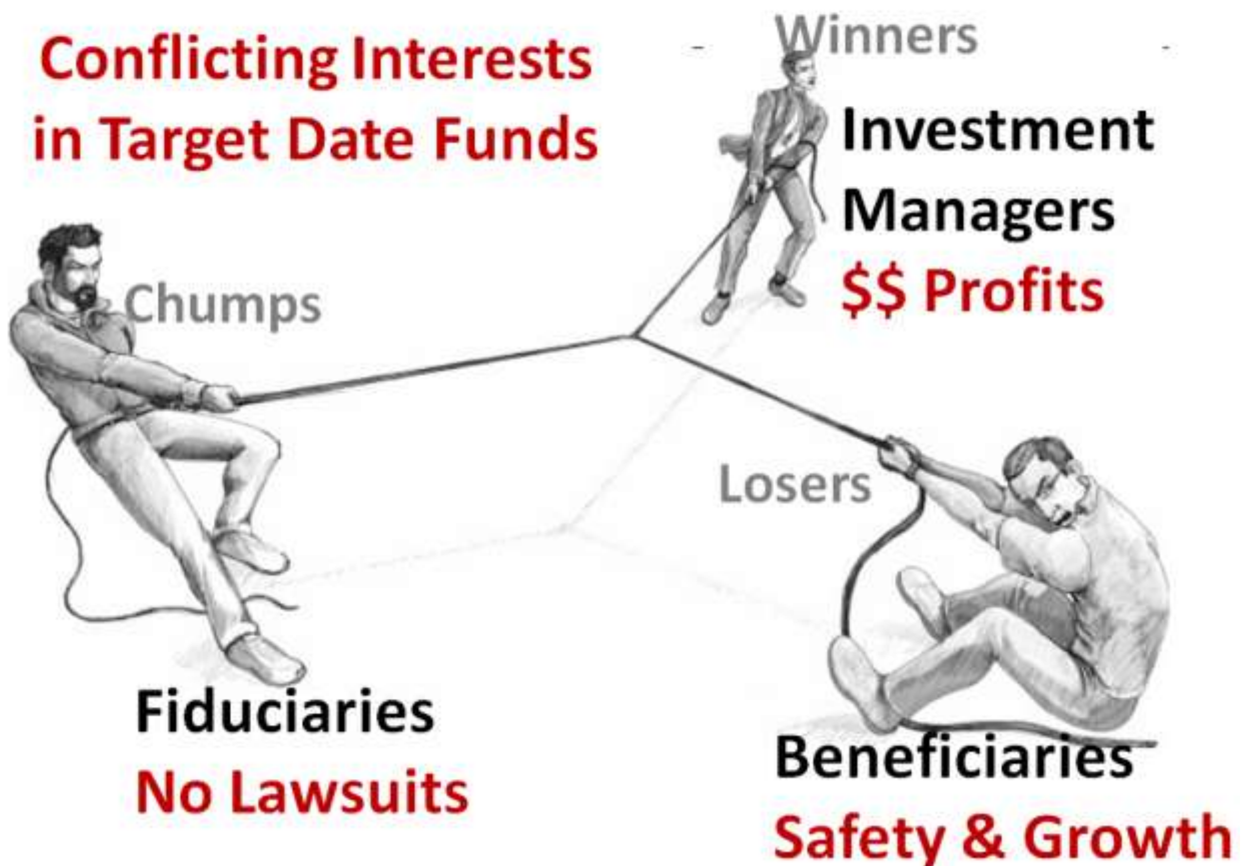
Conflicting Interests in Target Date Funds

- Target Date Funds (TDFs) have three interest groups: investment managers, fiduciaries, and beneficiaries
- The interests of these three groups are not aligned.
- Beneficiaries will be the losers in the next market correction.

Investment managers create TDFs for profit, which is after all their business. **Fiduciaries** choose TDFs, presumably for the benefit of participants, but that's not what is happening. **Beneficiaries** want to be protected, especially as they enter retirement, but they are actually exposed to substantial risk. In the following we discuss the interests of each of these groups with the intention of moving those interests toward better serving beneficiaries.



Investment Managers

Investment managers have seized upon the TDF opportunity to package product, populating glide paths with proprietary funds. The major misalignment with beneficiary best interests is at the target date, where the typical TDF is 55% in equities which is riskier than the allocation in 2008 that lost 30%. Risk is born by investors, not fund companies who get paid a premium for higher risk regardless of the outcome. Allocations at the target date are the most important because assets are likely to peak at that date. Management fees for equities are higher than those for bonds.

Investment managers sell the risky allocation as the solution for inadequate savings. Growth trumps safety because participants have not saved enough.

Fiduciaries

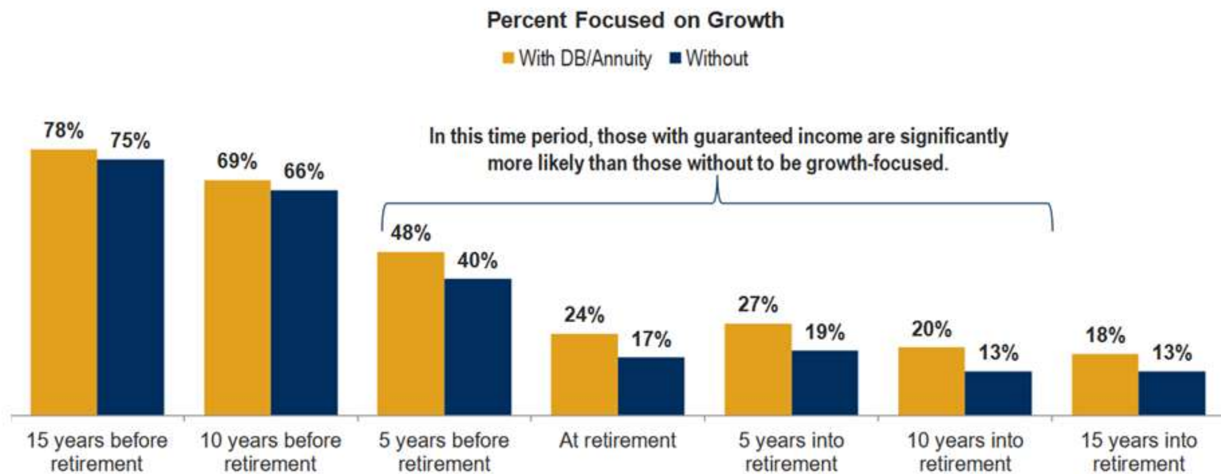
Fiduciaries, namely plan advisors and trustees, want to protect themselves against lawsuits and believe that (1) any Qualified Default Investment Alternative (QDIA) will do, and (2) you can't wrong with the Big 3 Oligopoly – Vanguard, Fidelity, and T. Rowe Price -- because everyone else is using them. This is a breach of the Duty of Care that, like our duty to protect our children, holds fiduciaries responsible for harm to our dependents that should have been prevented. Fiduciaries are duty bound to seek the best TDFs for their beneficiaries, but this is not happening. The next market correction could bring lawsuits that remedy this imprudent practice.

Beneficiaries

Beneficiaries want to be protected as they enter retirement, and may think they are, but they are not. A recent MassMutual Retirement Savings Risk Study examines beneficiary risk preferences in 401(k) plans, summarized as follows:

Beneficiaries Want to be Protected in the Risk Zone

Pre-retirees and retirees with guaranteed income suggest that have or will employ the same investment strategy as those without when retirement is 15 years away and 10 years away, but at 5 years prior to retirement, they become more growth-focused than those without and remain that way until 15 years into retirement.



Source: Mass Mutual

At 15 years to the target date, the vast majority (75%) want growth over safety, but this preference shifts dramatically so that only 17% prefer growth over safety at retirement. Also shown in the graph, those with another source of income, like a DB plan, opt for somewhat more growth, obviously because their other assets are safe.

Conclusion

Because of disparate interests, there are winners and losers and chumps in TDFs. Investment managers are winning big time since $2 trillion has poured into TDFs in just the past decade. Beneficiaries will be the big losers in the next market correction, but this could be avoided if fiduciaries refuse to be duped by mistaken beliefs of lawsuit protection.