



The Ideal Target Date Fund

Target date funds (TDFs) have earned Five Stars for their popularity in 401(k) plans, but that doesn't mean they are problem free. Here are some of the problems with TDFs:

- One size fits all
- Fees
- Excessive risks

In case you don't agree with this list, I'll try to convince you in the following. Unlike some previous articles that merely identify the problems, I conclude with a solution to these problems that is actually being implemented. The Ideal TDF actually exists. Nothing is perfect, but there are remedies for current TDF imperfections.

Problems

One size fits all is the most recognized shortcoming of TDFs. Beneficiaries have unique circumstances and goals that are generally not met by TDFs. Some TDF designers have tried to remedy this problem with custom funds and "hybrids" that roll old people out of TDFs and into managed accounts. These help, but there is a better way employed by the Ideal described below

Fees have come down substantially, motivated by successful lawsuits and bolstered by a growing preference for passive investing. Average fees have decreased from 90 bps to 65 bps in recent years, but as you'll see in the Ideal described below, fees could be reduced below 20 bps.

Excessive risk was obvious in 2008 when the typical 2010 fund lost 30%. TDFs have become riskier since. Why not? Fund companies do not bear this risk, and fees are higher for taking risk -- it's a win-win for fund companies. Also, the performance horserace favors risk. The Ideal is far safer, especially at the target date, since this date is in the middle of the Risk Zone that spans the 5 years before and after retirement.

The Ideal

The Ideal uses a glide path with an innovative shape, coupled with a unique investment structure.

To address **the excessive risk problem**, the glide path is U-shaped, reaching its lowest equity allocation at the target date, and then re-risking in retirement to extend the life of savings. This is an innovation that could revolutionize the target date fund industry. The Conservative path is 10% equities at the target date, which compares to 55% for the typical TDF. Note that the U shape is both a “To” and “Through” glide path because it reaches its lowest equity allocation at the target date and serves beneficiaries for life. All glide paths are extensively globally diversified.

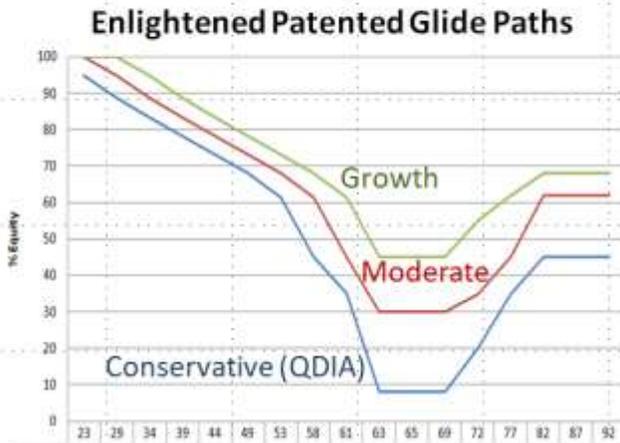
To solve **the one-size-fits-all problem**, the investment structure marries managed accounts with glide paths. This too is an innovation that could revolutionize the TDF industry. Each participant chooses from a family of glide paths with different risk levels, so each participant holds a **personalized target date account**. Defaulted participants are invested in the Conservative path. The recordkeeper is the glue that holds this marriage together, trading each account to move along its designated glide path. Note that this construct removes the need for imprecise age bands, placing participants precisely on their age along the path. It also allows a non-defaulted participant to change risk preference.

As for **high fees**, you’d think that the fees for this innovative structure would be high, but they can be maintained below 20 basis points. In fact, the first live Ideal costs less than 10 bps. Much of the cost saving derives from the elimination of layers of fees associated with unitization that must be paid by mutual funds and collective investment funds.

A Real Deal

Target date funds are a good idea with some serious implementation problems, but these problems can and have been solved. The Ideal described here is being implemented by the new [Office and Professional Employees International Union](#) (OPEIU) National 401(k) Multiemployer Plan. The first live Ideal is underway at the OPEIU Plan.

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Ronald Surz is president of Target Date Solution (TDS) that holds patent on the Safe Landing Glide Path® (SLGP) tracked by the SMART Fund® Target Date Index collective investment trust on Hand Benefits and Trust, Houston. TDS also provides an on-line application called Age Sage that facilitates do-it-yourself target date funds.