Finally, a Definitive Answer to the Target Date Fund Risk Question

- Until now, target date fund providers have told beneficiaries what they need, and it's no surprise that they need expensive product.
- Thanks to this important survey we now know what beneficiaries want, & it's not what fund companies are selling.
- In the balance between growth and safety, safety is the winner near retirement.

Until now fund companies have told TDF beneficiaries that they need to take substantial risk near the target date because savings are inadequate: risk is the medicine they need to replace pay and manage longevity risk. By "substantial" they mean 55% in equities with most of the balance in risky long-term bonds. This is riskier than the mix that lost 30% in 2008.

But someone has finally asked beneficiaries what they really want, and it's not substantial risk near retirement. Survey respondents understand the risk they face as they transition from working life to retirement, so in the tradeoff between growth and safety beneficiaries want safety. Unfortunately beneficiaries are not getting what they want, although they probably think they are.

The Survey

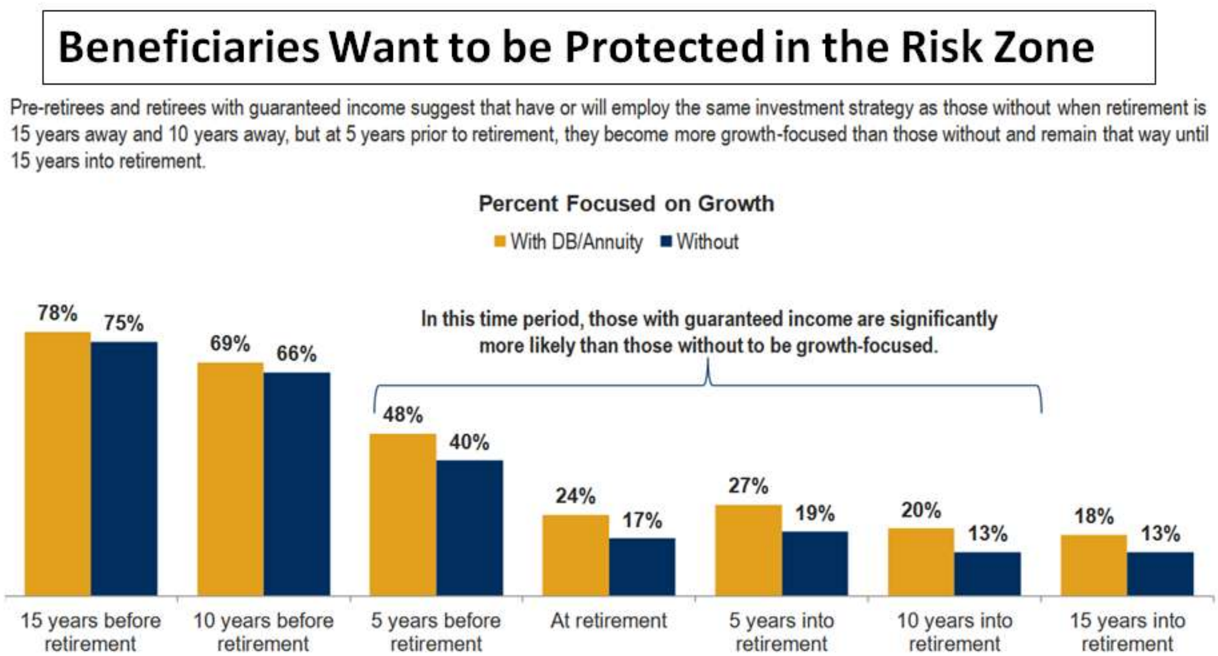
The MassMutual Retirement Savings Risk Study examines beneficiary risk preferences in 401(k) plans. The methodology is as follows:

> *On behalf of MassMutual, Greenwald & Associates, an independent research firm, conducted an online survey that included 804 pre-retirees and 801 retirees. Respondents were drawn from ResearchNow's online panel. To qualify for the survey, all respondents had to be at least 40 years old.*

Pre-retirees were required to have a household income of at least $40,000, work full-time for a private sector employer, and be participating in that employer's DC retirement plan.

Retirees were required to have total investable assets of at least $100,000. They had to be retired from a private sector employer and participating in that employer's DC retirement plan at the time of retirement.

One of the most informative tables in the report shows beneficiary preference for safety over growth in the "Risk Zone" that spans the ten years before and after retirement:



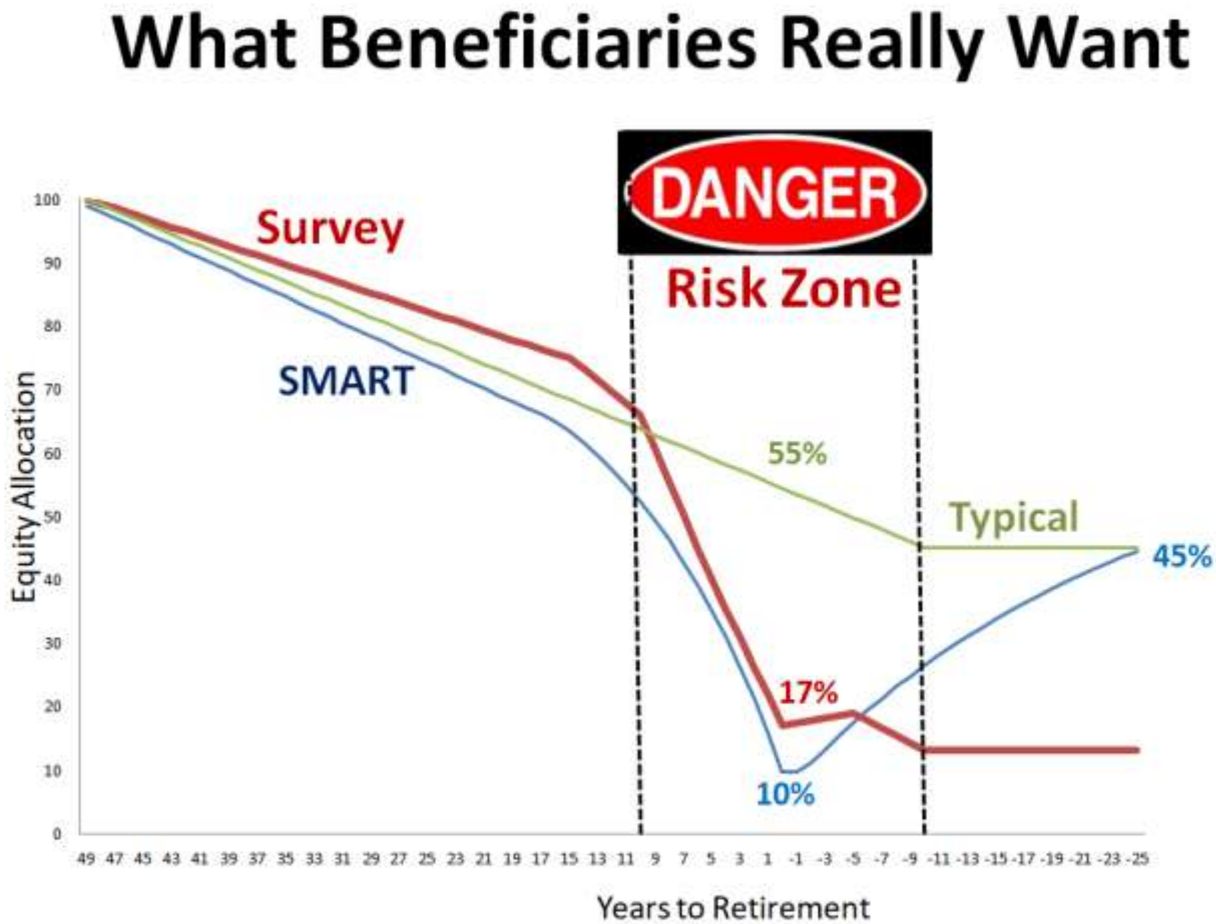
Source: Mass Mutual

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.

Many product providers embrace "Voice of Client" (VOC.). The client has spoken, and it's not the product that is currently being sold (with one exception).

Implications for Target Date Funds

The preferences in the table above can be used as proxies for preferred equity allocations along the glide path. The following graph shows these preferences in contrast to the typical TDF and the SMART TDF Index described in another article.



What's Next?

Plan fiduciaries need to take this survey to heart. Importantly, many beneficiaries are not aware of the risk they're exposed to in their default TDF. Change really needs to take place soon, although the TDF oligopoly stands in the way.

Fiduciaries should recognize that their dependents are not interested in the thrill of running with the bulls when a lifetime of savings is at peril in the Risk Zone.

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