401(k) Fiduciaries Are Breaching Their Duty of Care

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The fiduciary Duty of Care is like parents' responsibility to protect their children. Parents and fiduciaries are to blame for any harm to their dependents that should have been prevented. Current fiduciary practices in selecting target date funds are a breach of the Duty of Care. Target date funds are the most popular choice of Qualified Default Investment Alternative (QDIA). It's the choice that fiduciaries make on behalf of 401(k) participants who default their investment choice to their plan sponsor.

An analogy will make the breach clear. John has a daughter Sarah who just turned 16 and needs a car. In addition to being a parent, John is CEO of a large corporation with 10,000 employees.

There's a Dodge dealer across the street from John's office that services the company's cars, so John shops there for Sarah. A Dodge salesman explains to John that kids are always late so they need to get places fast, and the most popular kid's car is the 550 horsepower Dodge Challenger. Although the Challenger's brakes failed on about 30% of those cars in 2008, that problem has been fixed plus even more improvements have been added. John buys the Challenger for Sarah and is proud of his decision. He never even considers alternatives like the 200 horsepower BMW 320i or the Jeep Renegade Trailhawk.

The recordkeeper for John's 401(k) plan is Big3. The Big3 salesman explains to John that beneficiaries don't save enough and they live long, so they need the risk in a portfolio that is 55% in equities at the target date with the balance in risky long term bonds. Sure this mix lost 30% in 2008, but no harm, no foul—that loss has been recovered and then some. In fact the TDF is riskier today than it was in 2008. Importantly, the Big3 TDF is the most popular, with $450 billion out of the $1.5 trillion in TDF assets, so it must be prudent. John buys the Big3 TDF, and is proud of it. He never even considers

alternatives like the "Safe Landing Glide Path" TDF that ends at the target date with less than 20% equities and the balance in Treasury bills.

So where's the breach?

TDF fiduciaries are choosing their bundled service providers (Big3) out of convenience and familiarity. That would be OK if these TDFs were safe at the target date, but they are not. Beneficiaries stand to suffer the most as they near retirement because losses can wipe out a lifetime of savings. Some argue that stocks are a good bet because they deliver positive returns about 75% of the time; they make beneficiaries richer. But would you buy your child a car that breaks down 25% of the time?

Fiduciaries think that any QDIA will do, that they can throw darts at the QDIA dartboard. In my analogy, any car will do for Sarah; safety doesn't matter.

Fiduciaries are operating on 2 mistaken beliefs that they think protects them: (1) any QDIA will do, and (2) popularity is synonymous with prudence (buy the Big3). These beliefs saw 2010 funds lose 30% in 2008, although a few (safe) TDFs lost less than half that. Safer alternatives are available but fiduciaries don't even know they exist because fiduciaries are not performing adequate due diligence. I include advisors as fiduciaries.