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Open Letter to Congress and the Government Accountability Office (GAO) Regarding Target Date Fund Risk and Practices

Thank you to your staff for acknowledging my first unsolicited response to your request for a GAO review of target date fund risk and practices. This second letter makes specific recommendations, also unsolicited.

On May 6, 2021 Senator Patty Murray (D-WA), Chair of the Health, Education, Labor, and Pensions (HELP) Committee, and Rep. Robert C. "Bobby" Scott (D-VA), Chair of the House Education and Labor Committee, sent this letter to Gene Dodaro, Comptroller the GAO, seeking answers to 10 questions dealing with concerns that some aspects of TDFs may be placing American retirement savers at risk. They are seeking answers to 10 questions dealing with concerns that some aspects of TDFs may be placing American retirements at risk. They wrote:

"…we write to request the General Accountability Office (GAO) conduct a review of target-date funds (TDFs). The employer-provided retirement system must effectively serve its participants and retirees, and we are concerned certain aspects of TDFs may be placing them at risk."

Congress should be applauded for proactively addressing this vitally important issue to millions of Americans. Please see my initial response to Congress and my June 21 recommendation to require standardized risk disclosures that Congress regulates. I follow up these communications with this video and the short summary below:

1. **Fully quantify and explain the importance of Sequence of Returns Risk and the Risk Zone that can undermine a dignified retirement.**

Sequence of Return Risk

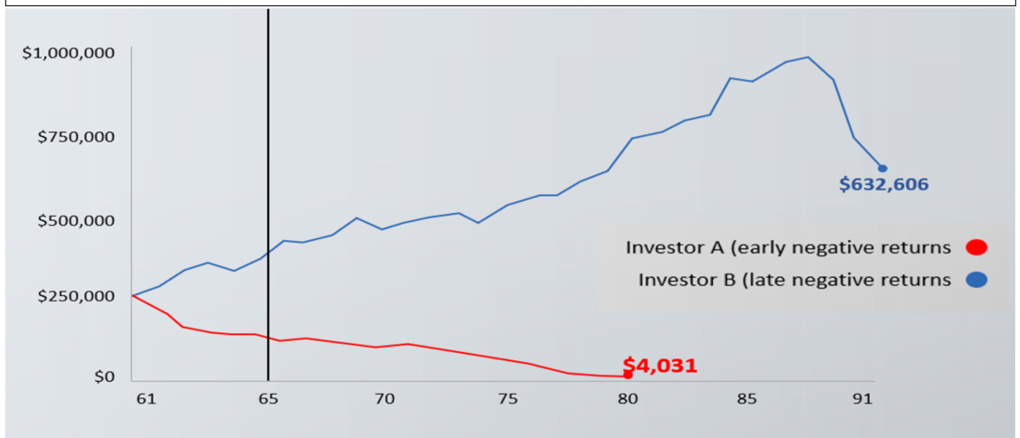
This chart shows two 30-year income scenarios. The red line shows a withdrawal plan that started off with three years of negative returns in a row. The blue line represents a withdrawal plan with the negative years at the end.
Both plans started with $250,000 and both took out $12,500 per year ($1042/month) inflated by 3% for inflation. No other actions were taken to manage income withdrawals.
Both plans had a 6.6% average annual rate of return on the underlying investment for the 30-year period.

Source: MFS Research

An Annuity Purchased at Age 65:

Investor A: Lifetime Annuity generates only $670/month due to Sequence of Returns Risk and a lower Annuity crediting rate as the Federal Reserve cuts rates to stimulate the economy after the three-year stock market selloff. The Investor feels the planned dignified retirement slipping away accompanied with higher levels of stress and health concerns. $670 does not cover $1042/month planned spending.

Investor B: the Annuity pays $2000/month placing the investor on the path for a dignified retirement with social security and other savings/income.



In the Risk Zone, when approaching a participant's target date, apply a Thrift Savings Plan (TSP) like glide path reducing risky assets, namely equities and long term bonds, to less than 30%. At $770 billion TSP is the largest defined contribution plan in the world. This glidepath recognizes each participants *riskiest day* financially speaking as retirement day when one's liability is the greatest and decumulation (i.e., withdrawals) start while one's assets are also likely the greatest and paychecks stop. In order to avoid outliving one's assets and reducing the associated worry and stress, this glide path will allow:

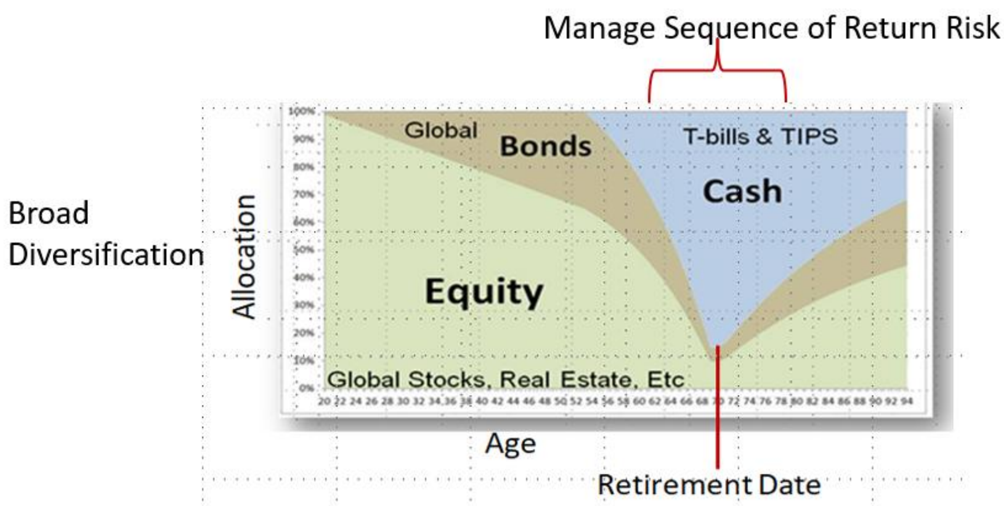
a. Defense against Sequence of Returns Risk
b. The planned purchase an annuity to create a pension-like lifetime income stream

I recognize that Congress cannot mandate a glidepath, but it can require disclosures that encourage prudent fiduciary selections. TSP safety at the target date should be encouraged as the chosen QDIA. Riskier glidepaths could be provided for non-defaulted participants.

2. For those participants remaining in the plan, the Optimal Post-retirement Path is Rising which Extends the Path to "Through" consistent with research conducted by Professor Wade Pfau and Michael Kitces. As participants frequently withdraw all their assets upon retirement and termination, many engage a financial advisor to create a *truly customized financial plan*. Therefore,

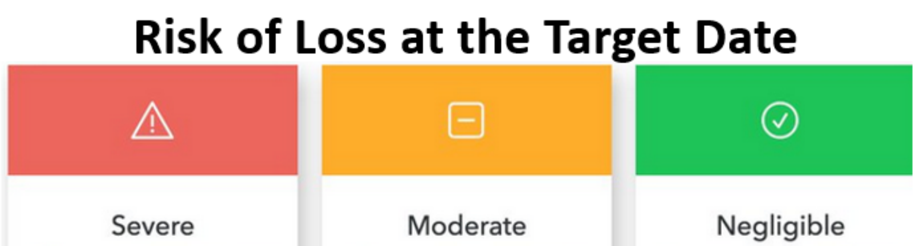
the glidepath should defend at the Target Date (see Recommendation #1) while re-risking coming out of the Risk Zone to protect participants opportunity for dignified retirements.

Again, this glidepath recommendation cannot be mandated. Re-risking is a response to the concern that retirees cannot live another 30 years on low paying safe assets.



3. Multiple TDFs should be provided. A Low Risk TDFs should be chosen as the Qualified Default Investment Alternatives (QDIAs) for the less financially literate participants. Low, Moderate and Growth Risk versions should be offered as options to non-defaulted beneficiaries. This addresses the one-size-fits-all deficiency.

4. **With this background in mind, Congress should consider requiring clear and simple disclosures of TDF risk at the target date, perhaps even developing rules/standards for straightforward risk assignments to Low, Middle and High Risk Tolerances. Congress could appoint a committee to assign risk grades. In our opinion, only Low Risk TDFs should be chosen as QDIAs, with Middle and High versions offered as options to non-defaulted beneficiaries.**



Recommendation

Simple disclosure and quantification of risk at the target date

Sincerely,

Ron Surz