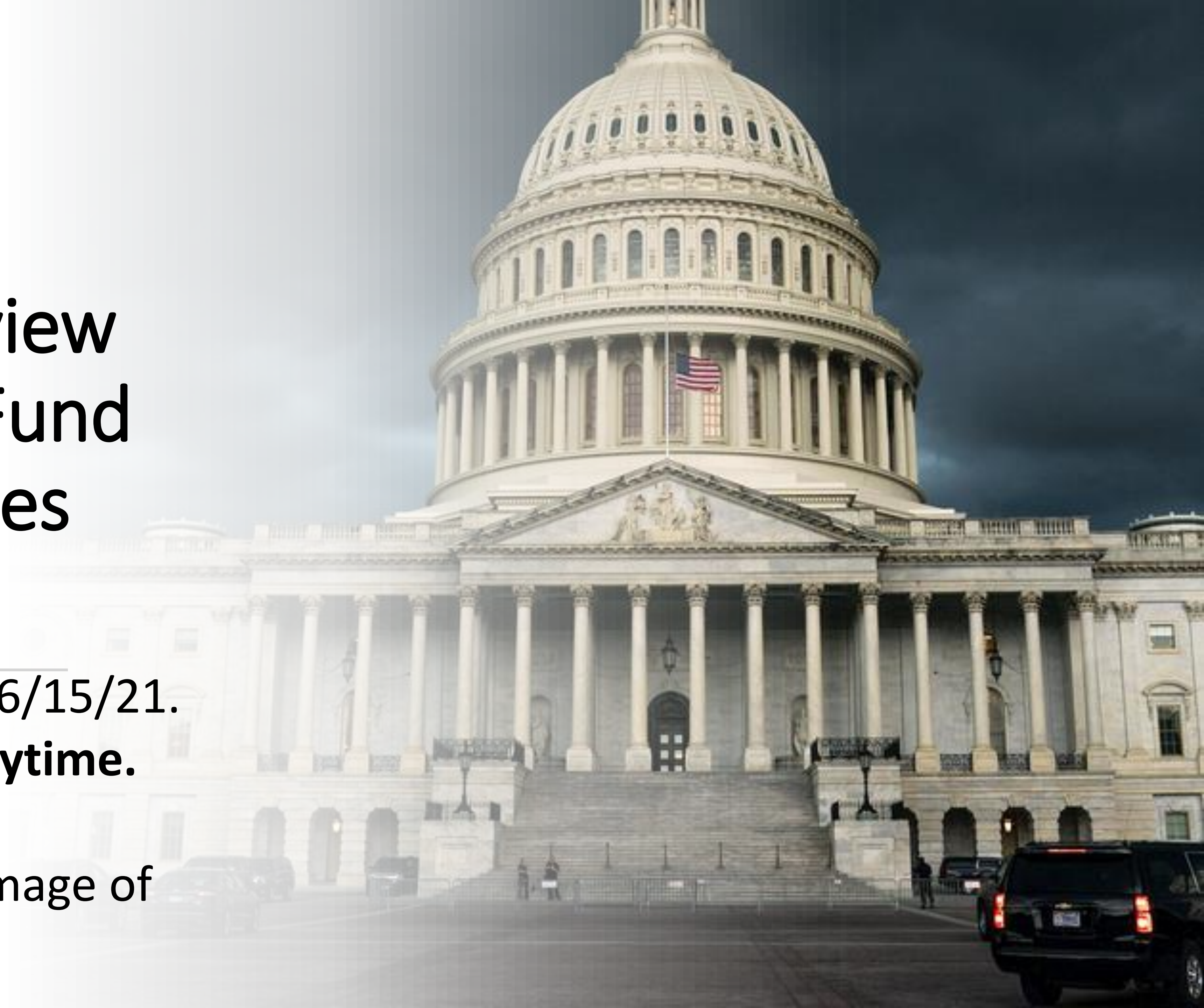
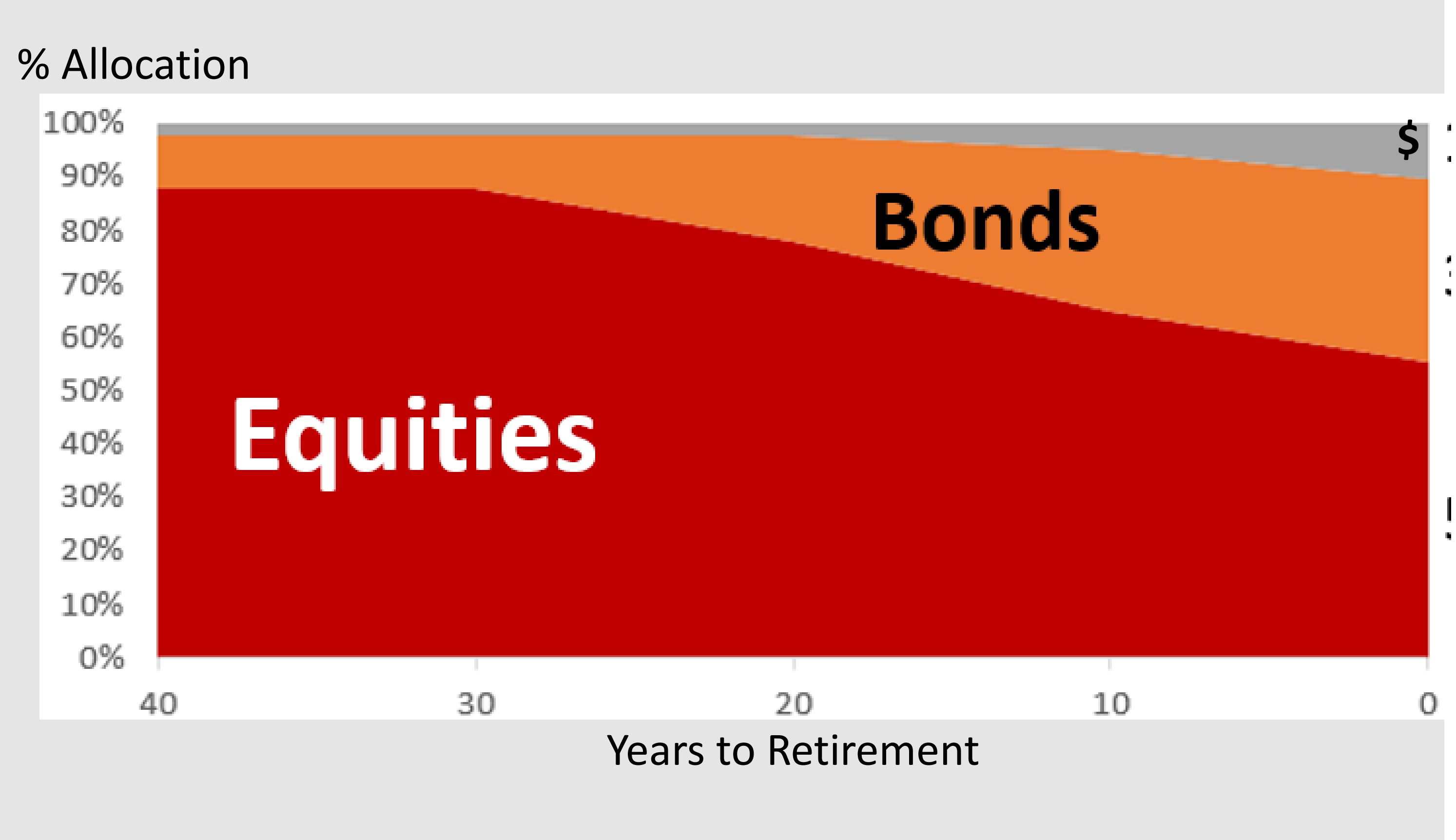
Congressional Request for Review of Target Date Fund Risk and Practices



Watch live at 1:00 EST on 6/15/21.

Replays on demand anytime.

Click < HERE > or on the Image of the Capitol.



What are Target Date Funds

- Asset allocation on cruise control, reducing risk as retirement approaches
- Most popular Qualified Default Investment Alternative (QDIA) in 401(k) plans at $2.5 trillion
- Congress is concerned about risk at the target date (year 0 in the graph)

10 Questions

Congress of the United States
Washington, DC 20510

May 6, 2021

The Honorable Gene Dodaro
Comptroller General of the United States
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Dodaro:

Patty Murray

Chair of Senate Committee on Health, Education, Labor & Pensions (HELP)

Robert C. "Bobby" Scott

Chairman, House Committee on Education & Welfare

See full letter < HERE > See my published response < HERE >

10 Questions

1. What percentage of total defined contribution (DC) plan assets are invested in TDFs? What percentage of plan participants are offered, and participate in, TDFs? What percentage of plan participants defaulted into TDFs?

2. To what extent have participants approaching retirement age who are invested in TDFs been affected by market fluctuations as a result of the COVID-19 pandemic? How much variation is there in the performance of TDFs of the same vintage (*i.e.*, target retirement year), particularly for TDFs at or near the target retirement date? To what extent have TDF providers taken steps to mitigate the volatility of TDF assets?

3. How often do investors with default investment TDFs in their DC plans reassess their investments, and what, if any, is the cost of a passive investment stance in a tumultuous market? Are TDFs properly structured to withstand major stock turbulence?

4. How does the asset allocation and fee structure vary across those TDFs used as default options in 401(k) plans? How do TDF fee structures compare with other investment products? In the years approaching retirement (*i.e.*, age 55 and older), to what extent do TDFs shift the allocation of equities to more conservative investments like fixed income in order to protect these participants from losses near retirement?

5. How are TDFs marketed and advertised? Are participants sufficiently aware of the cost and asset allocation variation among TDFs?

6. What percentage of plan sponsors select off-the-shelf TDFs? What percentage of plan sponsors select custom TDFs? Is there a material difference in the performance of off-the-shelf versus custom TDFs?

7. To what extent do TDFs include alternative assets, such as hedge funds or private equity? What information is typically available to participants and plan sponsors about the risks and benefits of asset allocations in TDFs? How do plan sponsors select and oversee TDFs to ensure these funds have a suitable risk level for participants?

8. What steps has the U.S. Department of Labor taken to ensure that plan sponsors appropriately select and use TDFs and that sponsors provide appropriate information and education about these funds to plan participants?

9. When provided the option to invest in TDFs alongside an array of other investment fund options, how often and to what extent do plan participants rely primarily—or exclusively—on TDFs? In these scenarios, how many investment alternatives are provided? How many TDFs do plan sponsors generally offer in their investment options?

10. What are possible legislative or regulatory options that would not only bolster the protection of plan participants, who are nearing retirement or are retired, but also achieve the intended goals of TDFs?

I responded

TDS
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Wednesday, May 26, 2021

Submitted Electronically to
Senator Patty Murray
Representative Robert C ("Bobby") Scott
The Honorable Gene Dodaro

Dear Senator Murray and Representative Scott,

Read more < HERE >

Current Conditions

Safe TSP: Thrift Savings Plan

2 TDF Groups

It Really is Different This Time.

Riskiest bonds ever

Consider the **Federal** Thrift Savings Plan (TSP)

The Largest Retirement Savings Plan in the World

“One 2020 TDF, which has over $16 billion in assets, is reportedly **60 percent invested in stocks**. Meanwhile, the Thrift Savings Plan’s (TSP’s) 2020 Lifecycle Fund had more than **60 percent allocated to its G Fund (short-term U.S. Treasury securities)** for the two years prior to its retirement”

TSP Profile

$769 Billion is largest defined contribution plan in the world

6 million participants

2 TDF Groups

TSP Group (Low Risk at Target Date)

TSP

SMART TDF Index

OPEIU

Click on yellow fund names to view details

Big 3 Group (High Risk)

Vanguard

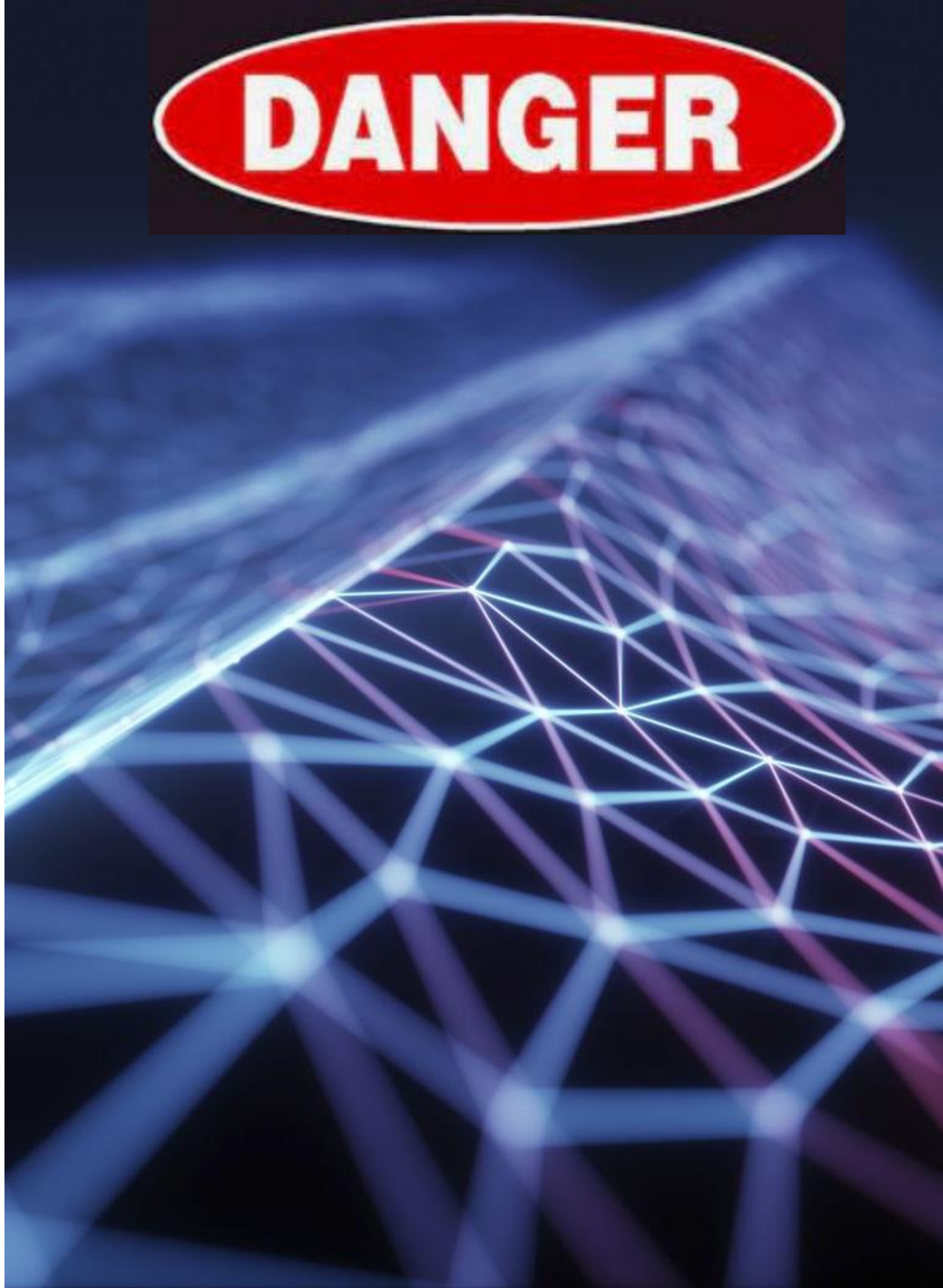
Fidelity

T Rowe Price

Is it Really Different This Time?

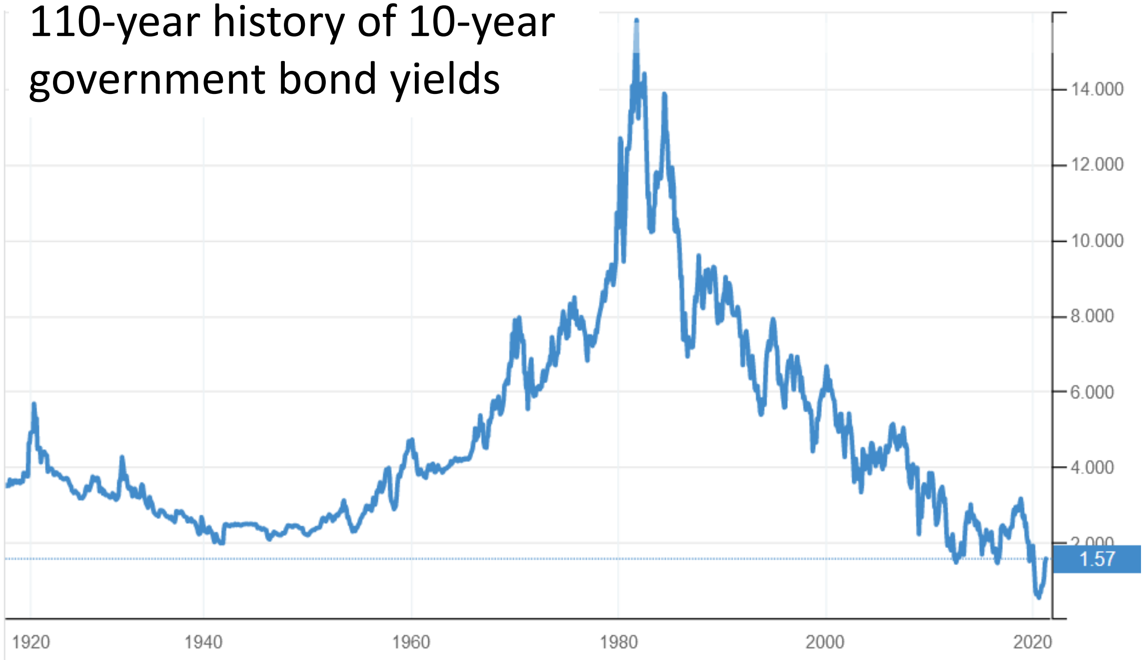
- Interest rates have never been lower
- Stock prices have never been higher
- The US has never printed more money
- The wealth divide has never been wider

The answer is a resounding **Yes**. Even though there might be a past similarity or two, all four conditions have never occurred simultaneously before, ever.



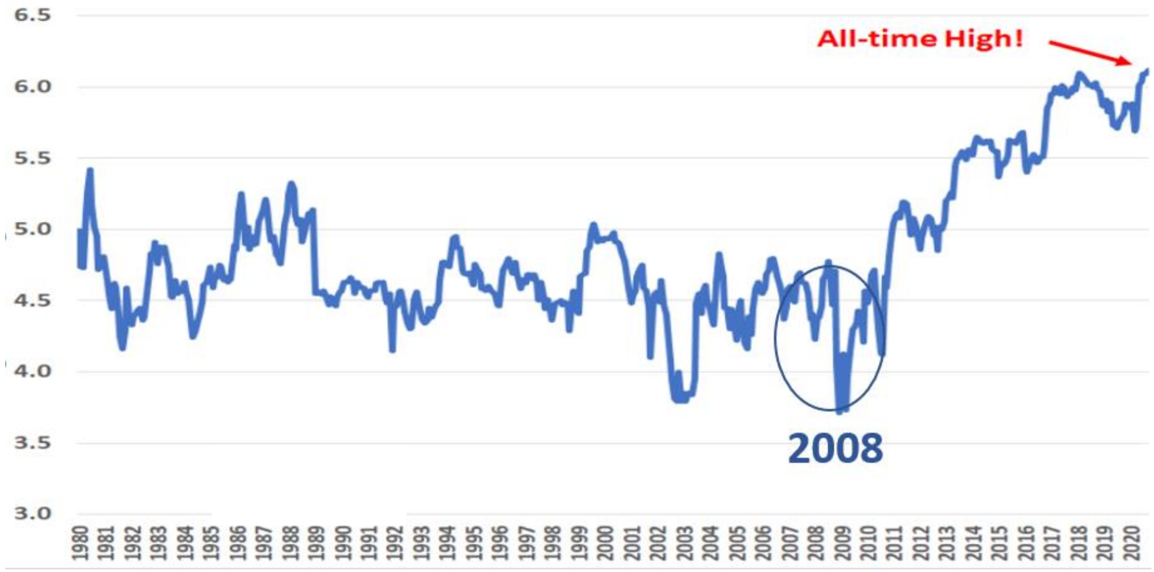
Current Risk in Long-Term Bonds: Never Riskier
When Interest Rates/Yields Rise, Prices Fall

110-year history of 10-year government bond yields



Lowest yield ever

Highest Risk Ever: Interest rate sensitivity (Duration)



70% riskier than 2008 so much less defensive

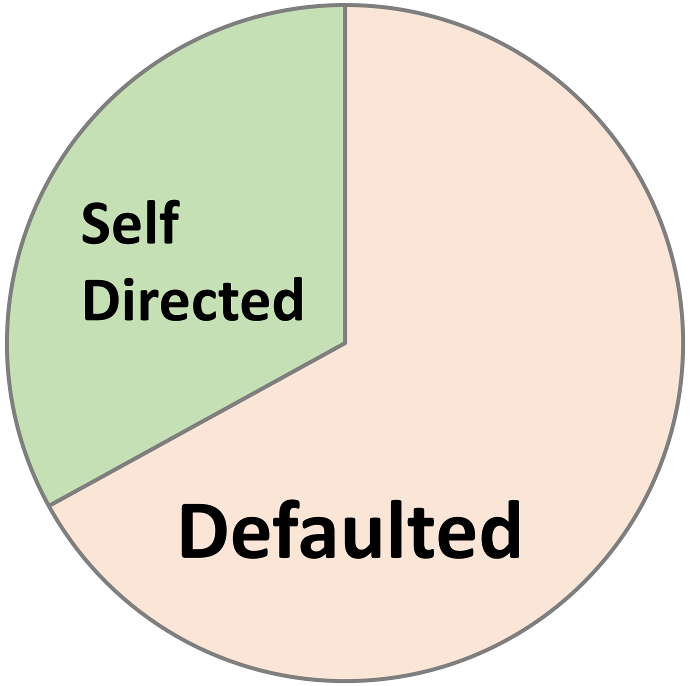
Answers

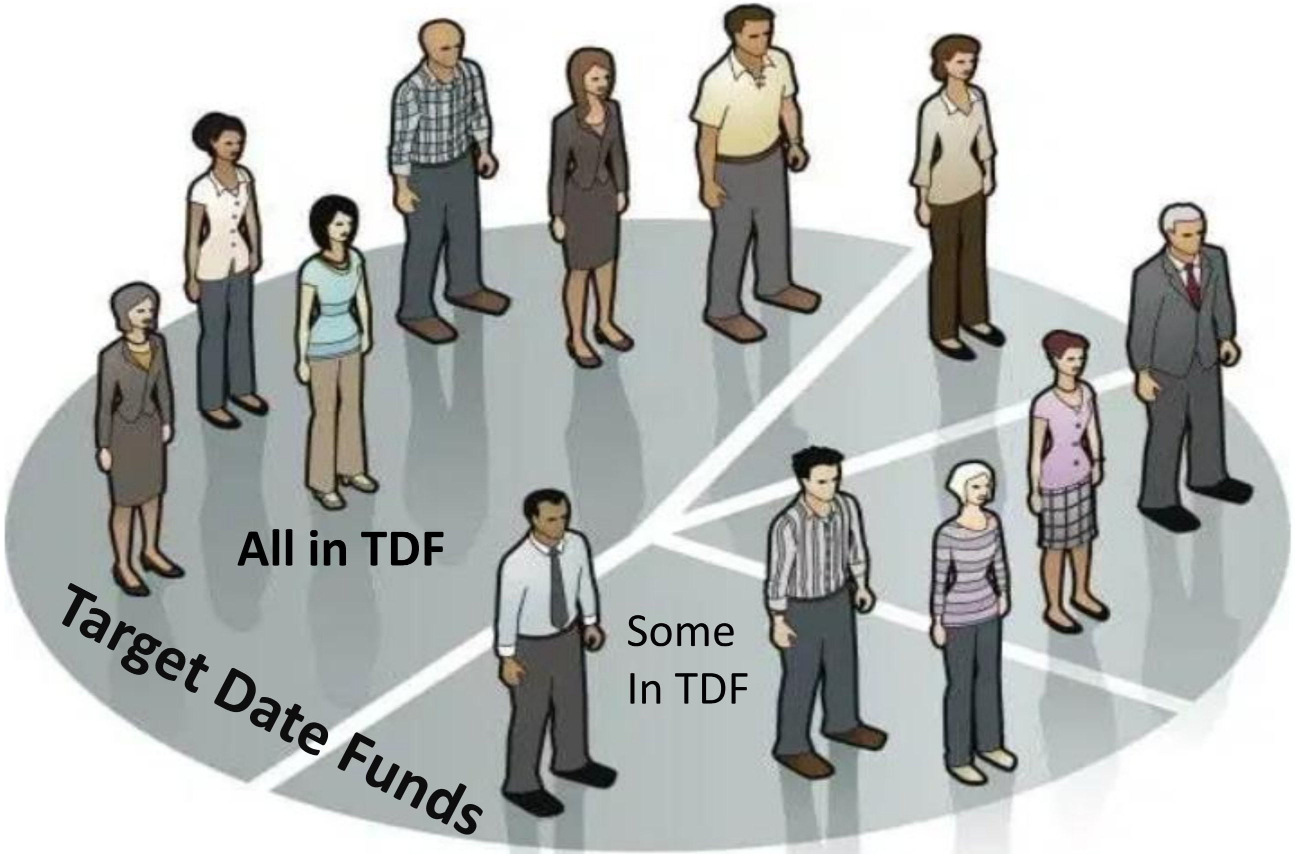
For all defined contribution plans: 401(k), 403(b), 457, etc., ,

1. **What percentage of total defined contribution (DC) plan assets are invested in TDFs? What percentage of plan participants are offered, and participate in, TDFs? What percentage of plan participants defaulted into TDFs?**

According to Investopedia As of 2020, more than 50% of 401(k) investors have all of their 401(k) assets in target-date funds, most by default as the plan's Qualified Default Investment Alternative (QDIA). More than 75% of investors have a portion of their money (retirement or non-retirement) in at least one target-date fund. The 25% that have a portion in a TDF are self directing (not defaulted).

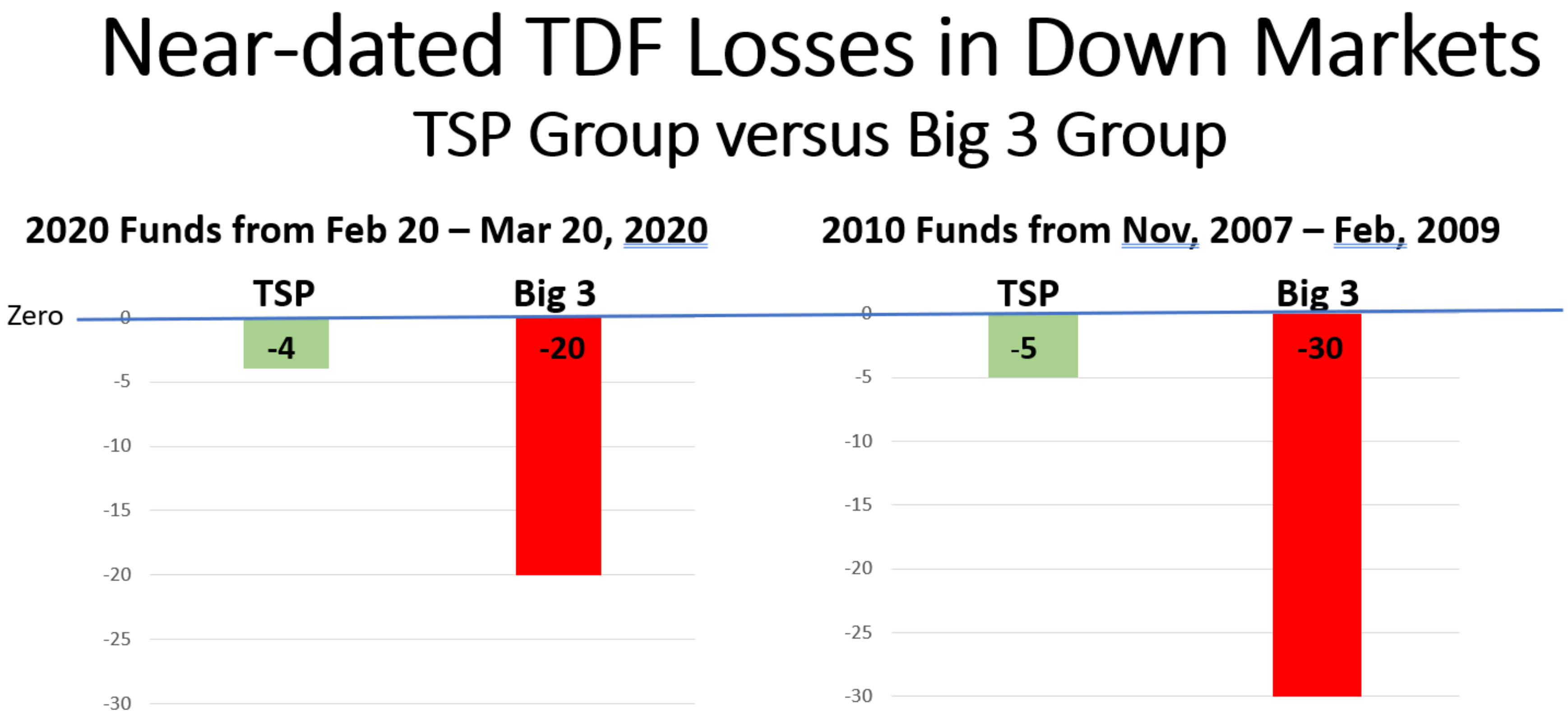
Make-up of beneficiaries in TDFs





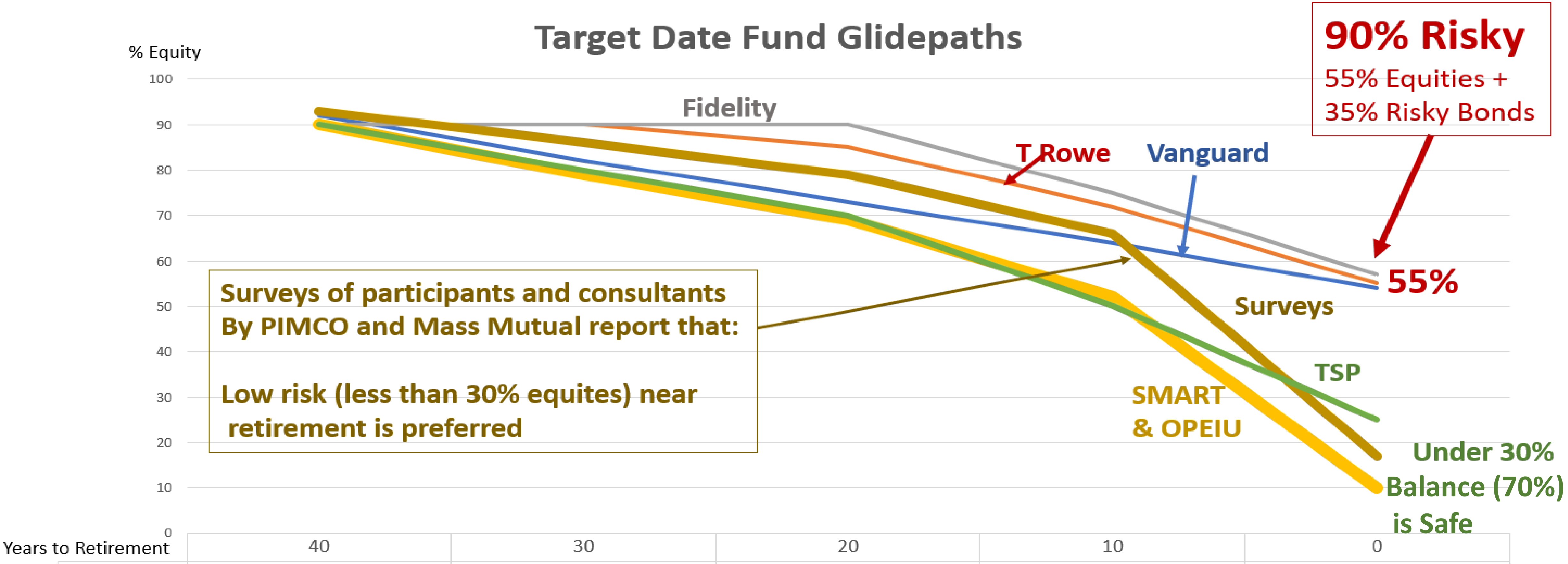
2. **To what extent have participants approaching retirement age who are invested in TDFs been affected by market fluctuations as a result of the COVID-19 pandemic? How much variation is there in the performance of TDFs of the same vintage (*i.e.*, target retirement year), particularly for TDFs at or near the target retirement date? To what extent have TDF providers taken steps to mitigate the volatility of TDF assets?**

Big3 TDFs cannot and have not withstood major stock market turbulence, but the TSP group can and has. The answer to question 4 explains why.



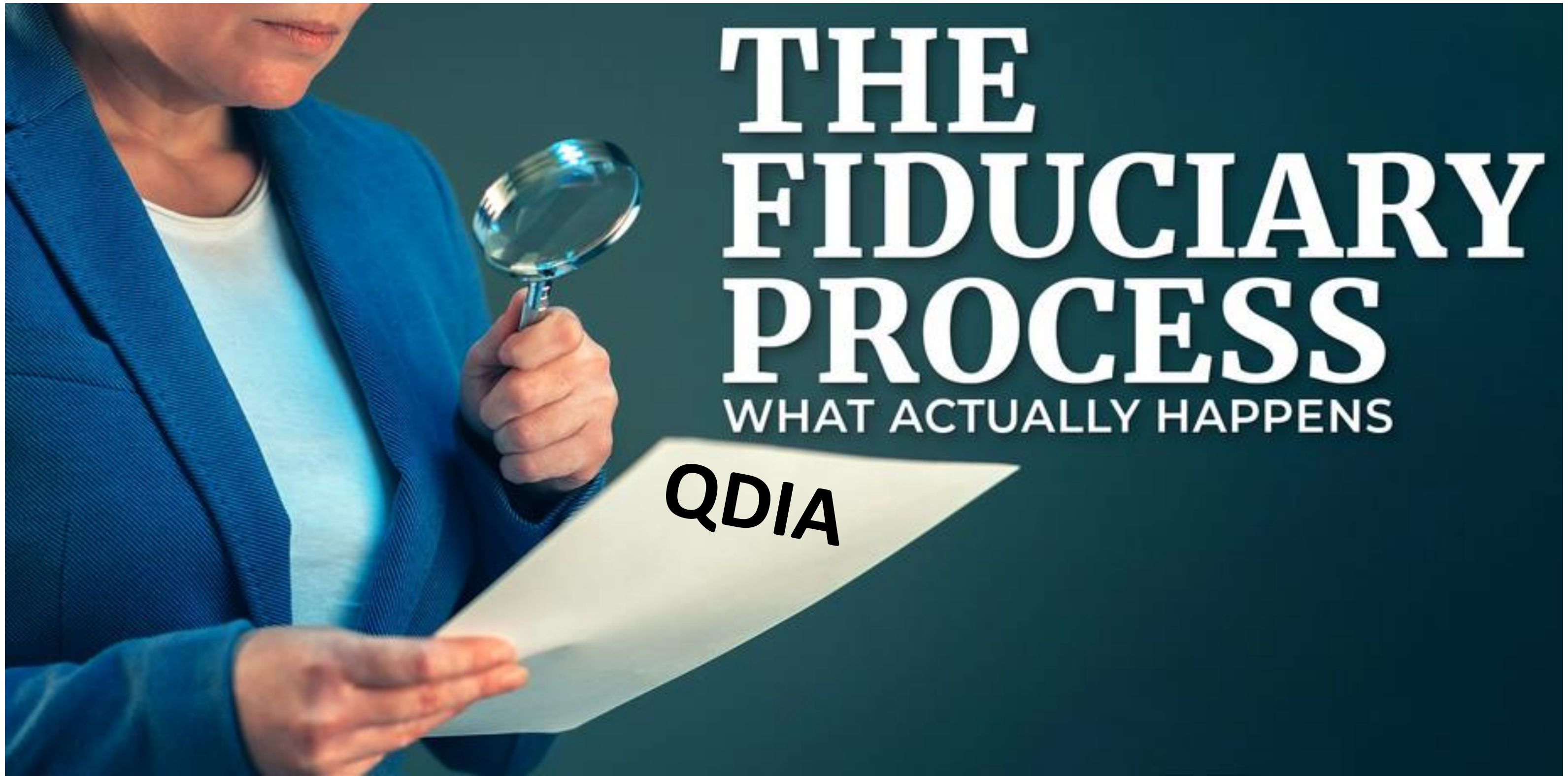
4. How does the asset allocation and fee structure vary across those TDFs used as default options in 401(k) plans? How do TDF fee structures compare with other investment products? In the years approaching retirement (*i.e.*, age 55 and older), to what extent do TDFs shift the allocation of equities to more conservative investments like fixed income in order to protect these participants from losses near retirement?

Fees average about 65 basis points, fairly low due mostly to successful excessive fee lawsuits. The following picture shows glidepaths and contrasts them to surveys of beneficiaries and advisors by PIMCO and Mass Mutual. These surveys report a strong preference for conservatism near the target date, in line with the TSP group.



3. **How often do investors with default investment TDFs in their DC plans reassess their investments, and what, if any, is the cost of a passive investment stance in a tumultuous market? Are TDFs properly structured to withstand major stock turbulence?**

Investors do not choose TDFs. Plan sponsors choose them, and rarely, if ever, reassess. A few sponsors choose more than one TDF as options for self directed (non defaulted) beneficiaries. See answer to question 2 for exposure to market turbulence. A few TDFs purport to react to tumultuous markets, otherwise known as timing, which is not the same as "Risk Management", adjusting to investor risk capacity. Timing has a history of failure, but it can help marketing.



5. How are TDFs marketed and advertised? Are participants sufficiently aware of the cost and asset allocation variation among TDFs?

Participants are generally unaware of TDF costs and allocations because they do not choose TDFs. TDFs are marketed to plan sponsors as one-size-fits-all-set-it-and-forget-it Qualified Default Investment Alternatives (QDIAs). They are the most popular choice of default investments because most plans use TDFs, they seem so simple and they are on automatic pilot, adjusting asset allocation through time. A few sponsors address the one-size-fits-all limitation by providing several TDFs as options for self directing beneficiaries.

6. What percentage of plan sponsors select off-the-shelf TDFs? What percentage of plan sponsors select custom TDFs? Is there a material difference in the performance of off-the-shelf versus custom TDFs?

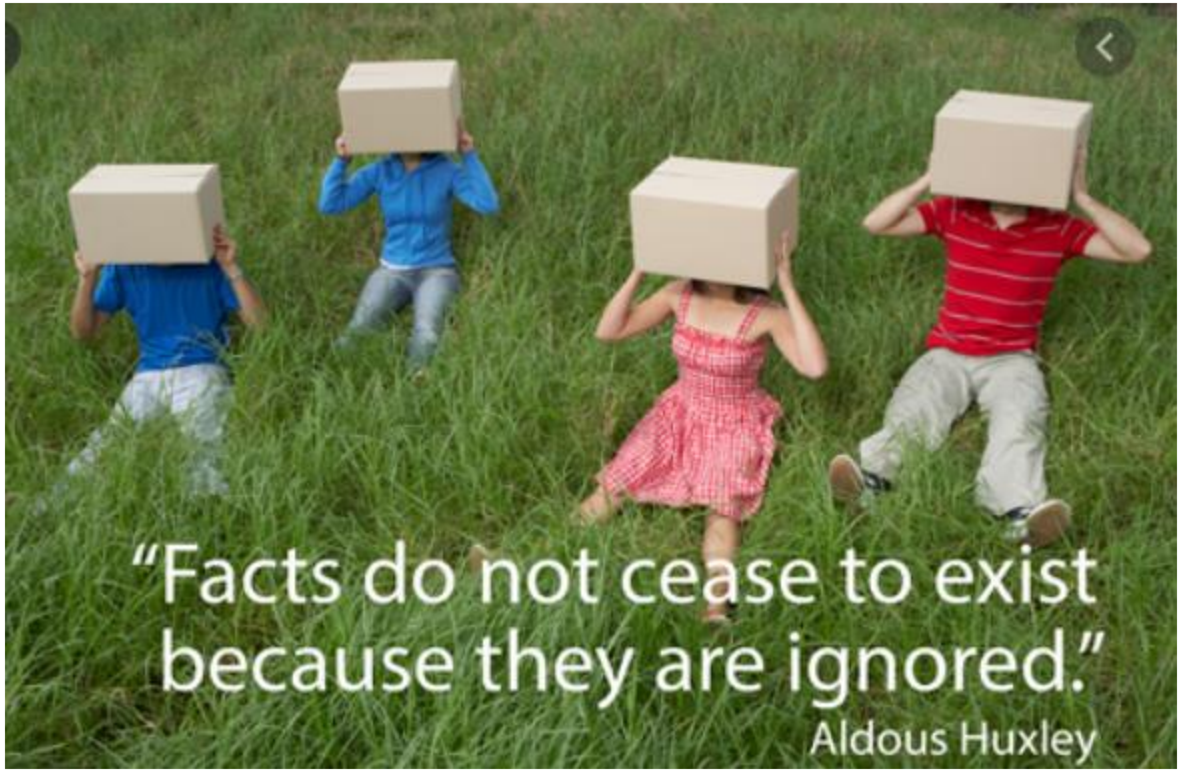
A 2019 Callan Associates survey reports that 87.3% of institutional defined contribution (DC) plans **use target date** strategies as their default investment vehicle and that 17.3% of plans are **using "custom" target date** strategies. Custom TDFs are a money grab by consultants. Morningstar finds little difference in their performance versus off-the-shelf.

There's a newer concept for customization called Personalized Target Date Accounts (PTDAs) that use an advice service to help individual beneficiaries select and move among low, middle and high risk TDF glidepaths, tailoring risk decisions to individual needs and desires.

Personalized is newer and better than custom

7. To what extent do TDFs include alternative assets, such as hedge funds or private equity? What information is typically available to participants and plan sponsors about the risks and benefits of asset allocations in TDFs? How do plan sponsors select and oversee TDFs to ensure these funds have a suitable risk level for participants?

There is very little use of alternatives, mostly because they are expensive. Fund prospectuses are readily available so anyone can see risks and benefits, but these are rarely viewed. Fiduciaries should know the relevant facts like fees, risks and benefits. See answer to Question 10 for a discussion of TDF characteristics that should be prominently disclosed. TDFs are generally selected on the basis of "Procedural Prudence" which means the most popular. TDFs should be selected for their suitability, as discussed in the next answer.



8. What steps has the U.S. Department of Labor taken to ensure that plan sponsors appropriately select and use TDFs and that sponsors provide appropriate information and education about these funds to plan participants?

See answer to Question 10 for a discussion of regulatory steps.

Appropriate selection should be guided by these 2 facts. Also see "Why TDFs should be safe at the target date" :

The DOL advises demographic match. There is **only one match**: All defaulted beneficiaries are **financially illiterate.** They need protection as they near retirement. There is a duty to protect the vulnerable.

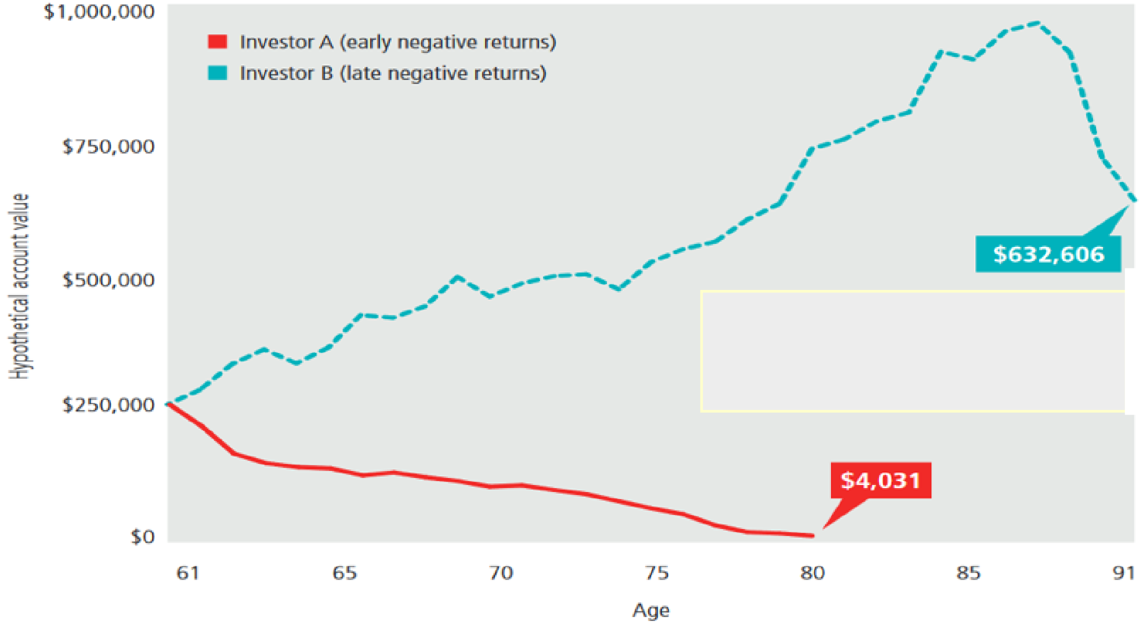
Retirement experts have identified a **Risk Zone** near retirement when

Sequence of Return can ruin lives**.**

High Risk near the target retirement date is just plain **wrong**.

It is unconscionable that regulators and TDF providers do not even attempt to warn and quantify sequence of return risk and the Risk Zone for the many unsophisticated defaulted investors who want a “dignified retirement”

Sequence of Return Risk



This chart shows two 30-year income scenarios. The solid line shows a withdrawal plan that started off with three years of negative returns in a row. The dotted 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 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. Ending value with no withdrawals is $1.7 million.

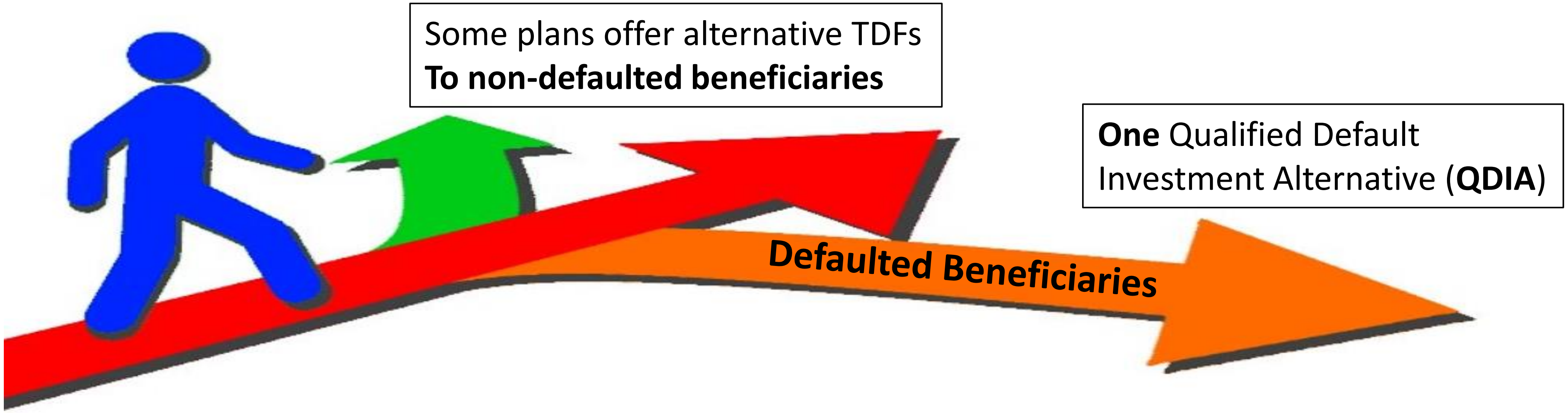
Source: MFS Research

In this example, the “time-weighted’ (TW) returns are identical at 6.6%, but the “Money-weighted” (MW) returns are significantly different. You can’t eat TW returns because they are designed to eliminate the effects of cash flows. Investment performance reviews use TW, but success or failure for the beneficiary is best measured by MW returns that are heavily influenced by gains or losses early in retirement when account balances are their highest. Investor A MW return is -100, investor B is 8%.

9. When provided the option to invest in TDFs alongside an array of other investment fund options, how often and to what extent do plan participants rely primarily—or exclusively—on TDFs? In these scenarios, how many investment alternatives are provided? How many TDFs do plan sponsors generally offer in their investment options?

Self directing beneficiaries have the option of investing in TDFs alongside other investment fund options. Most assets in TDFs are there by default from participants who are not considering TDFs against an array of options. Most sponsors offer only one TDF but a few offer TDF choices to non-defaulted participants. For example, the OPEIU National Savings Retirement Plan offers self directing participants a choice of conservative, moderate or growth glidepaths. The conservative path is the default. This addresses the one-size-fits-all limitation.

The commonly offered single TDF used as the QDIA should be classified as high risk in our opinion. But if alternatives are offered, the QDIA is typically identified as "moderate."



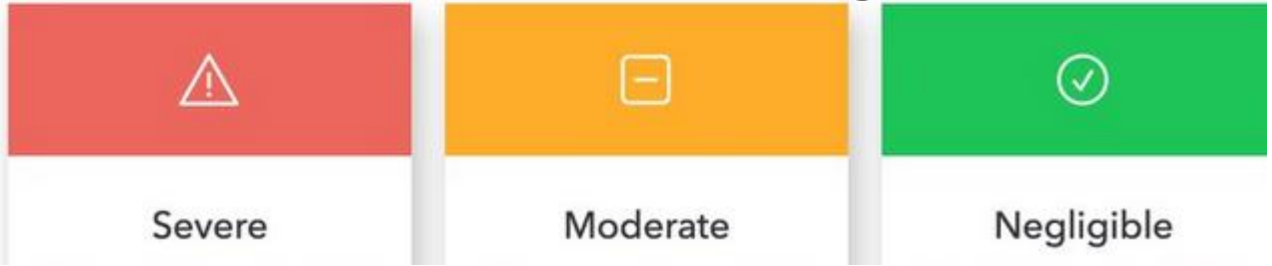
10 What are possible legislative or regulatory options that would not only bolster the protection of plan participants, who are nearing retirement or are retired, but also achieve the intended goals of TDFs?

On June 18, 2009, the SEC and DOL held an all-day Hearing on Target Date Funds and Similar Investment Options after which opinions were sought on incorporating a risk disclosure into fund names, since it was believed that fiduciaries needed clear and prominent risk information. One such thought was to include the ending equity allocation in the fund name. For example, the "XYZ 2050 Fund Ending 60% in Equities." The response was overwhelmingly negative, contending that there is more to risk than equity exposure, which is certainly true today since long-term bonds are very risky.

After that, nothing happened until the February 28, 2013 release of the Department of Labor Target-Date Fund "Tips" for Plan Fiduciaries. Although somewhat helpful, "tips" are mere suggestions. More alarming, the "tips" fail to mention, warn and quantify sequence of return risk, as well as the Risk Zone, for the many unsophisticated defaulted investors who seek a "dignified retirement" as noted above. Hopefully, this initiative will have a more meaningful impact.

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. 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.

Risk of Loss at the Target Date



Recommendation

Simple disclosure and quantification of risk at the target date

Summary of Recommendations

- The Thrift Savings Plan (TSP) serves as a standard for risk near the target date, reducing risky assets, namely equities and long-term bonds, to less than 30%.
- A lifetime annuity option should be provided to retiring beneficiaries.
- For those participants remaining in the plan, the Optimal Post-retirement Path is Rising which extends the path to “Through” consistent with research. (See section below on glidepaths)
- **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 to address the one-size-fits-all problem .**

Then and Now

Do not let this end with no action, as it did in 2009

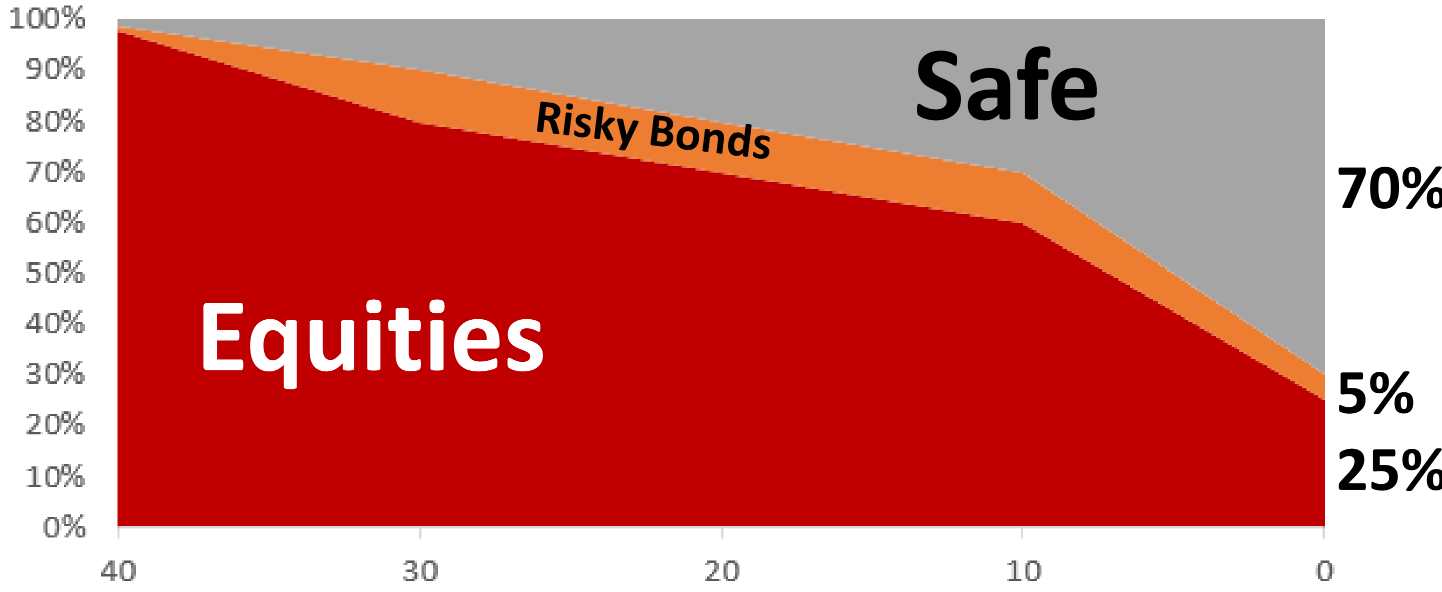
	2009 Hearings	This Presentation
Recommend	Disclose ending equity allocation in fund name:	Appoint committee to define a **risk of loss** at the target date:
Example	ABC 2050 Fund Ending 60% in Equities	ABC 2050 Fund with Moderate Risk of Loss at the target date
Disposition	Fought on basis that equity allocation is poor measure of risk.	<u>Independent</u> committee decides on simple rules that providers must follow & document.

Beyond the 10 Questions

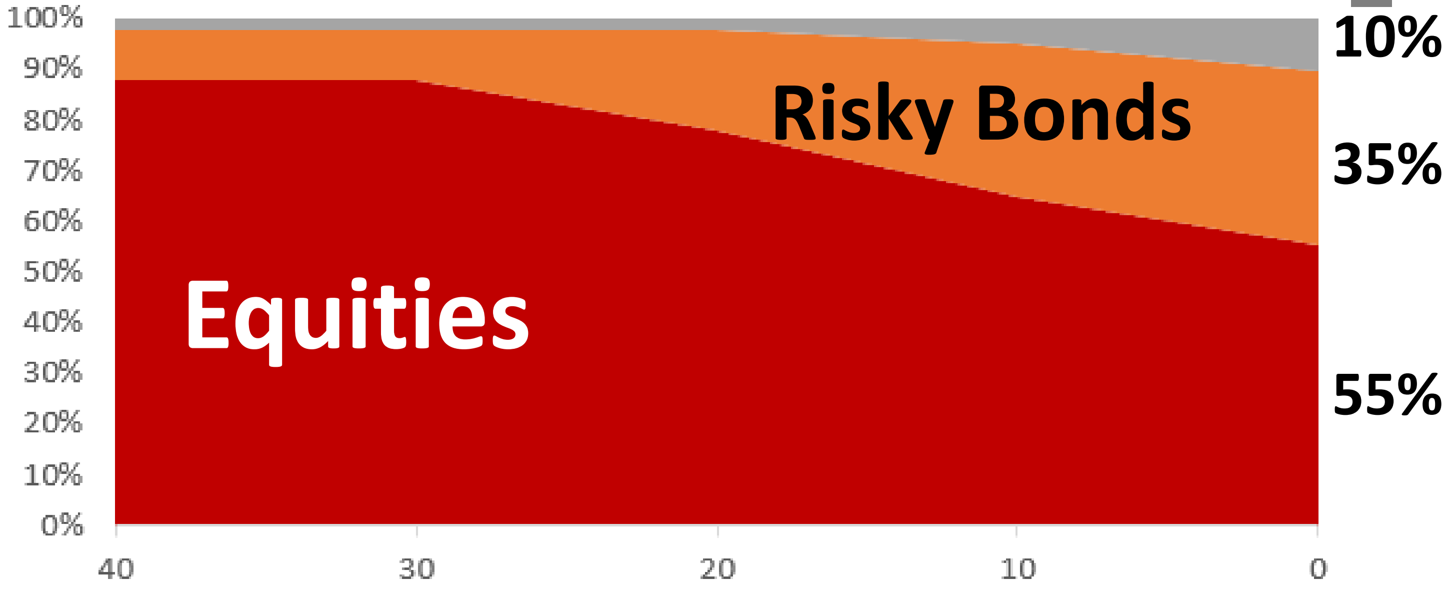
Why Glidepaths Differ

Up Close Glidepath Comparisons:

Big 3 “Risk Mitigation” is in Risky Bonds



TSP is 70% Safe at the Target Date



Big 3 is 90% Risky Throughout

Glidepaths are Differentiated as “To” or “Through”

“**To**” ends at the target date. Fred Reish, ERISA attorney and popular author, says most TDFs are *de facto* “To” funds because most participants withdraw their accounts at the target date.

“**Through**” views the target date as a speedbump on the highway of life. This path ends at death so high risk at the target date is justified, or so it was explained at the 2009 TDF hearings.

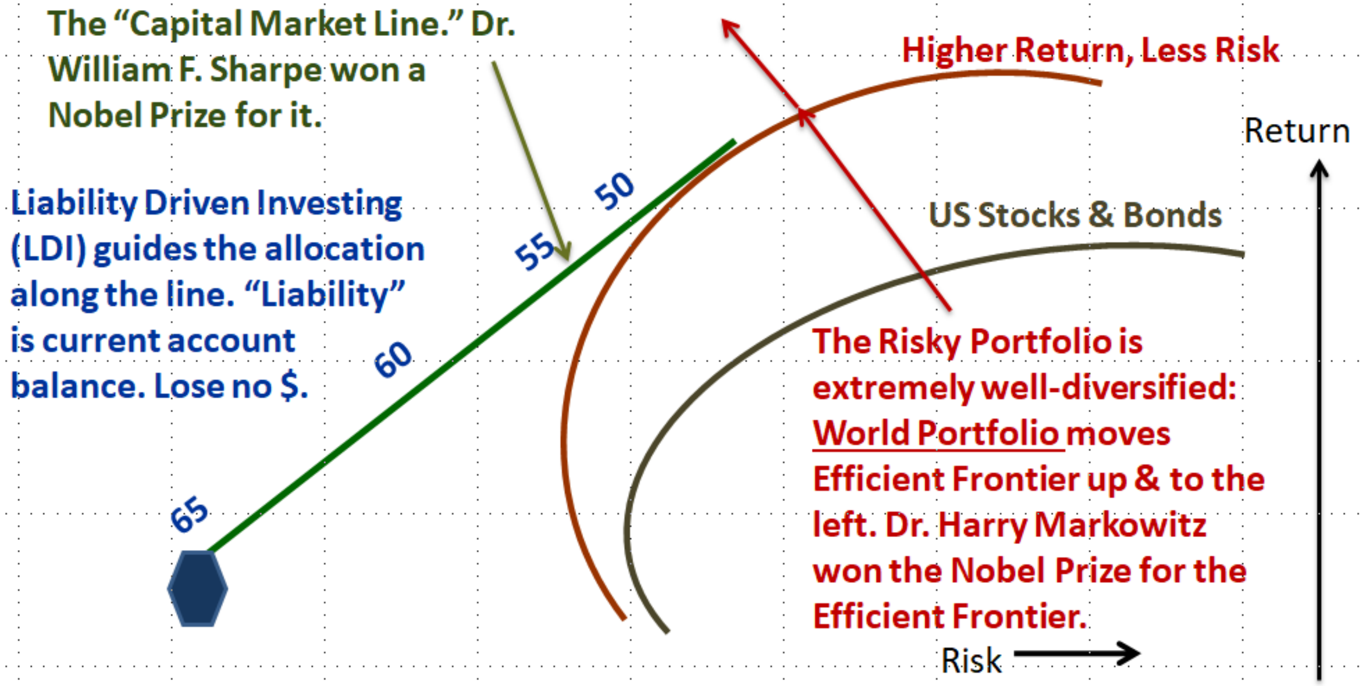
In practice some “To” funds are higher risk at the target date than some “Through” funds, so DOL guidance to use this distinction is somewhat misguided.

Financial Engineering in the Patented Safe Landing Glidepath

A “TO” Fund

Patented Safe Landing Glide Path®
Unique Investment Structure: Patent 8352349

Integrates 2 Nobel prize (1990) winning discoveries with principles of modern finance

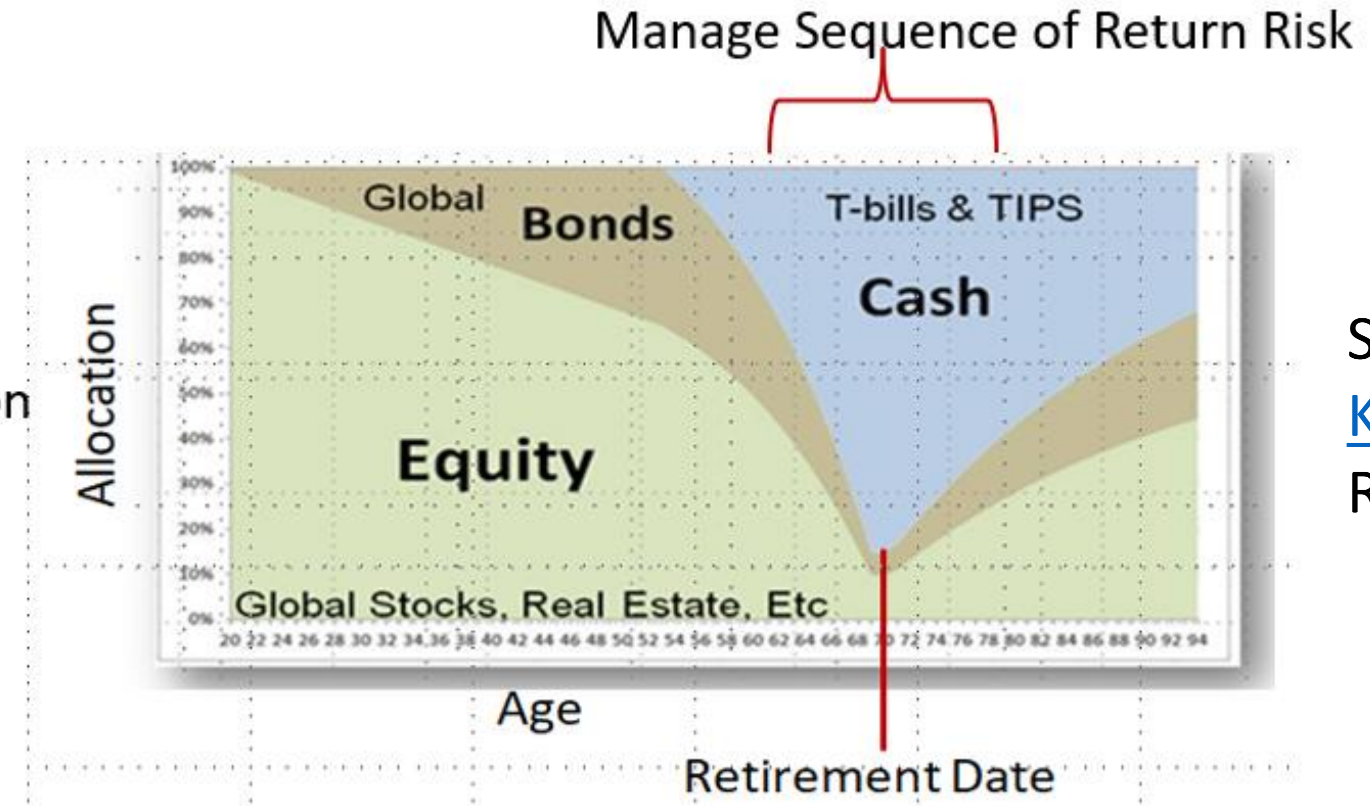


Objective: Deliver at the target date accumulated contributions plus growth of at least inflation

The Optimal Post-retirement Path is Rising: Extending the Path to "Through"

A Lifetime Income Annuity Should Also be an Option

Broad Diversification



See Kitces and Pfau: Re-risk

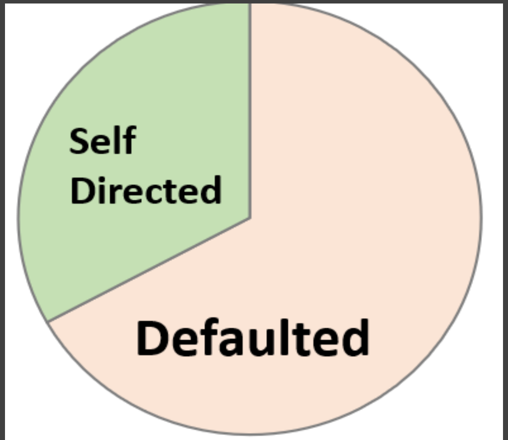
See Patent 8352349 for details

This is Both a "To" **and** a "Through" Glidepath

Beyond the 10 Questions

Why Multiple Glidepaths

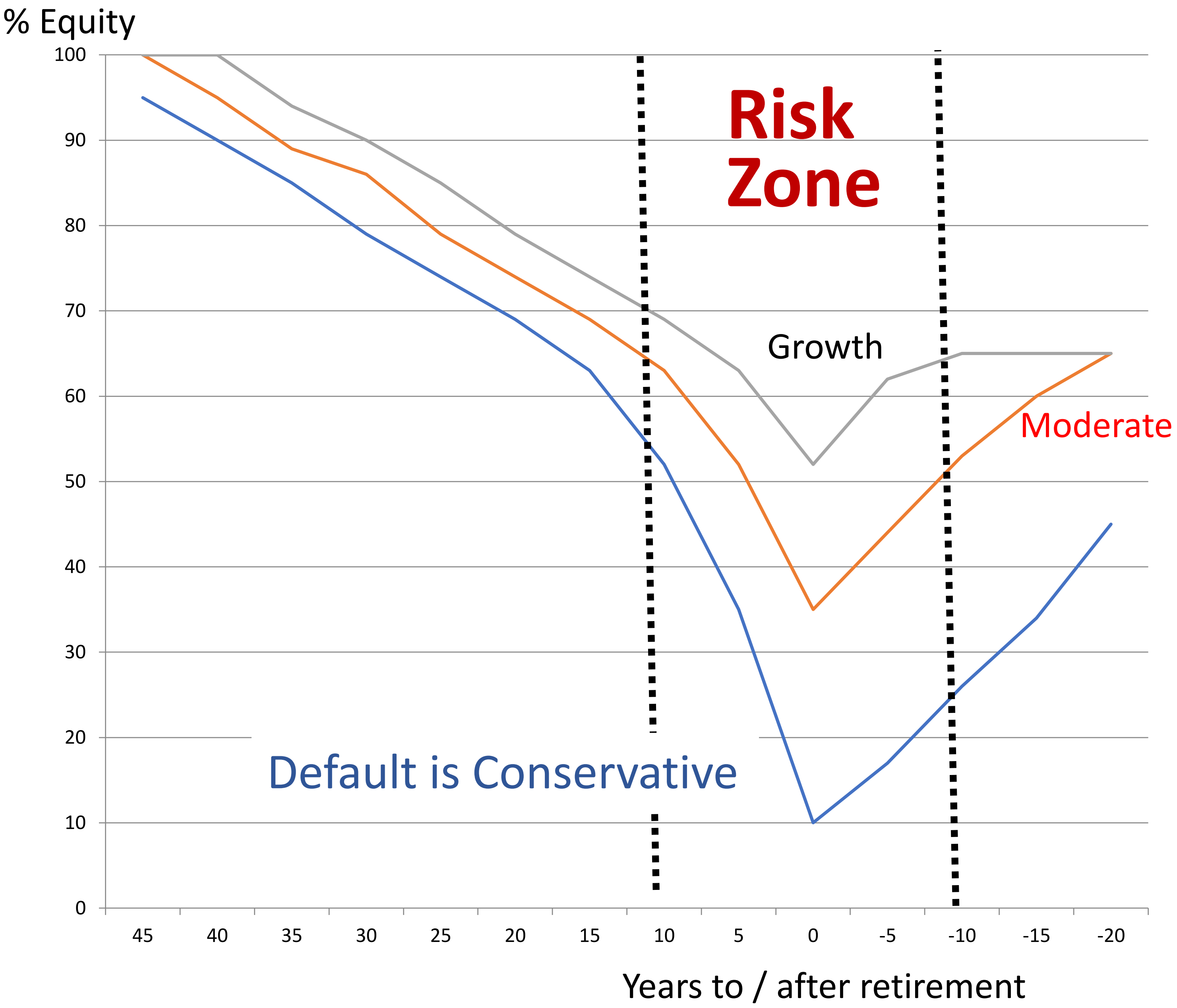
TDFs for Self Directing Beneficiaries



A default glidepath needs to be the same for all defaulted beneficiaries because it would be impractical and complicated to segment them

But some non-defaulted beneficiaries choose TDFs. They should not be limited to a one-size-fits-all. Sponsors should provide TDF options for self directing beneficiaries, plus guidance on selection.

The Complete Solution Set



This Section is for Fiduciaries (and Their Beneficiaries)

6 Reasons a QDIA Should be Very Safe at the Target Date

Fiduciaries Should Choose TDFs That Are Classified as "**Negligible**" Risk of Loss at the Target Date

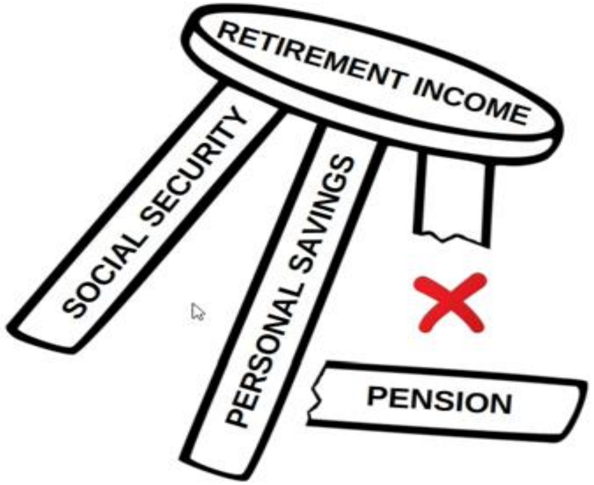
A Fresh Start to the Rest of Life:

Annuity &/or IRA Rollover

Dropping the Baton is **Catastrophic** – end of game

401(k)

Replaces the former 3rd leg of the Retirement Income Stool



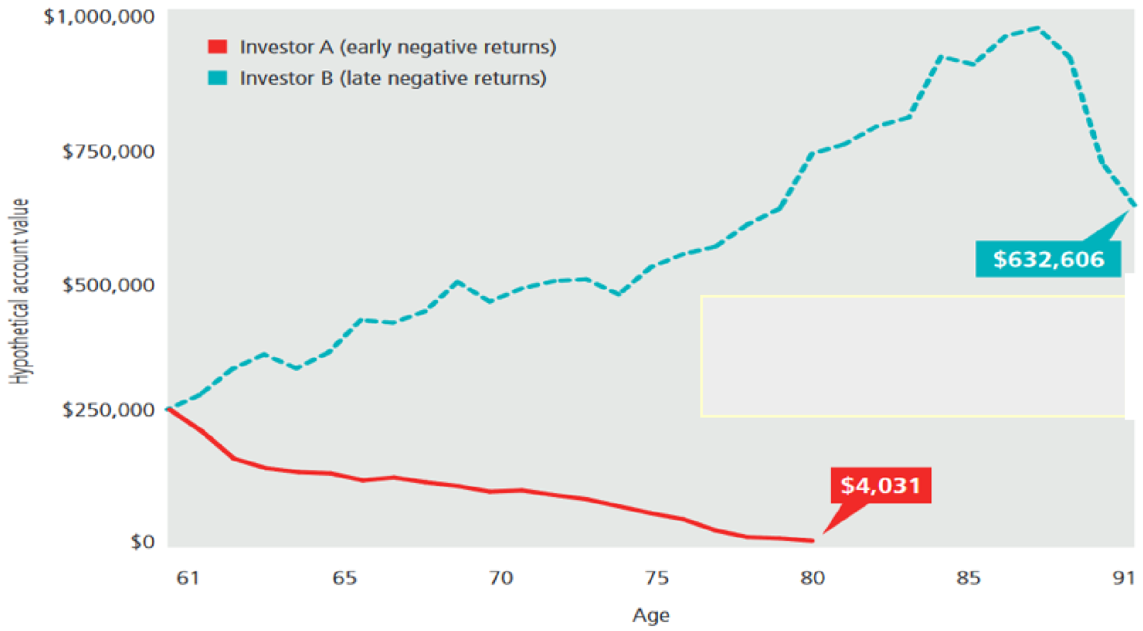
Risking assets during the baton pass is akin to investing one's new home down payment in risky assets while awaiting the home closing. A significant investment market selloff could result in the inability to close due to insufficient funds. Similarly, down payments (savings) to fund a lifetime of living with dignity should be largely backed by low risk, safe assets.

Most Withdraw Their Entire 401(k) Balance

High Risk near the target retirement date is just plain **wrong**.

It is unconscionable that regulators and TDF providers do not even attempt to warn and quantify sequence of return risk and the Risk Zone for the many unsophisticated defaulted investors who want a “dignified retirement”

Sequence of Return Risk



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Source: MFS Research

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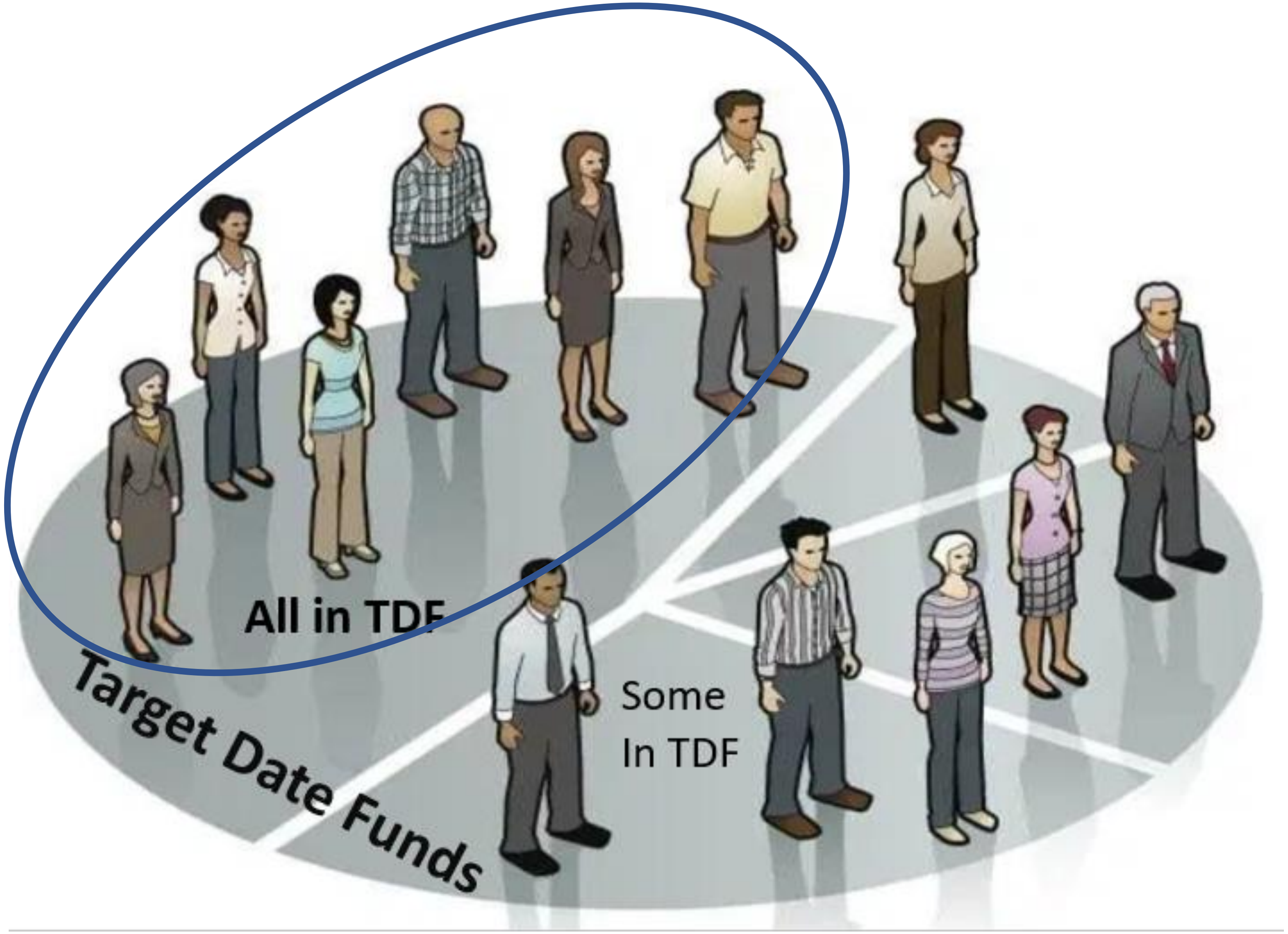
DOL tips: Demographics

Georgia DOL DEPARTMENT of LABOR

There is **<u>only one demographic</u>** that all defaulted beneficiaries have in common:

Financial Naiveté

They are **economically vulnerable and need protection.**

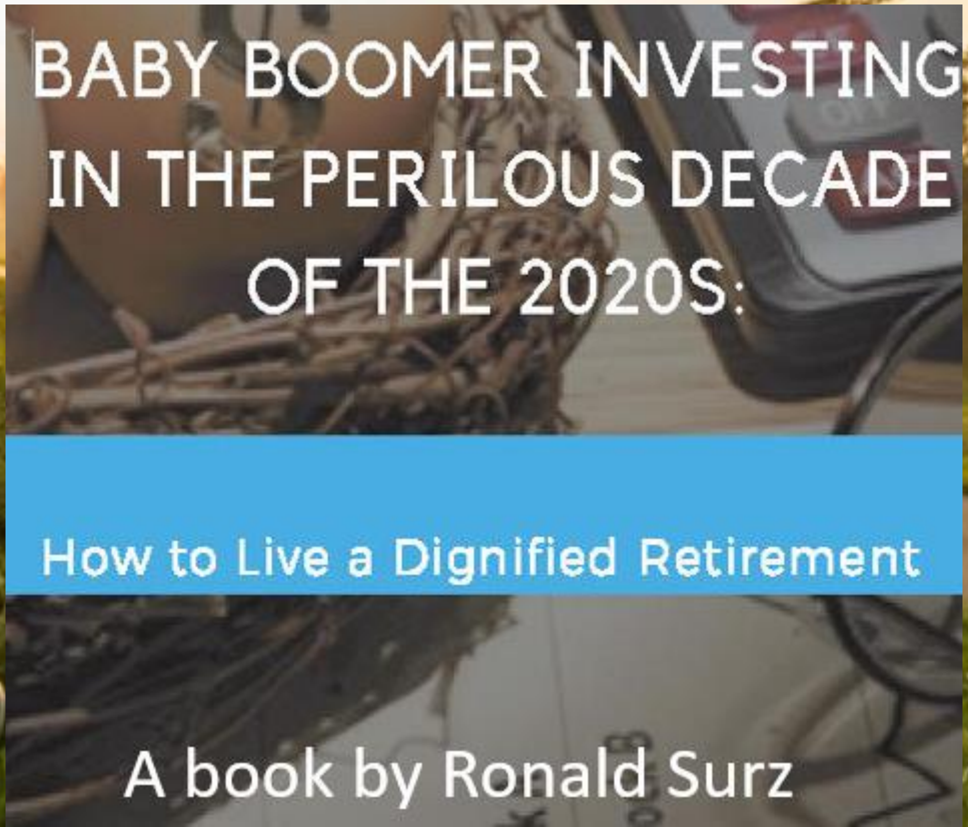


The Retirement Crisis

- Baby Boomers are the first generation to depend on defined contribution savings plans
- Whatever they have saved has to be "enough" because that's all there is. See this video.
- 70% of boomers (55 million people) have saved less than $300,000. **Risking it makes it worse**
- See this SEC Report . The answer isn't more risk. It's more savings and protecting those savings

Baby Boomers Will Spend Much of This Decade Transitioning Through the **Risk Zone**.

They Might Not Recover From the **Market Crash That is Likely in This Decade**.



Baby Boomers in the Perilous 2020s. Boomers Get Just One Shot.

It's Happened Before

Lost Decades

Stocks, bonds and cash all lost value in the decades of the 1910s and 1970s

200 years of real (above inflation) returns by decade

Time Frame	Stocks	Bonds	Cash	Commodities
1800-1809	11.09%	8.74%	5.16%	-
1810-1819	4.56%	5.87%	4.72%	-
1820-1829	9.05%	7.76%	5.86%	-
1830-1839	3.23%	0.10%	2.20%	-
1840-1849	10.82%	10.75%	7.94%	-
1850-1859	0.07%	3.64%	3.74%	-
1860-1869	13.58%	2.66%	0.81%	-
1870-1879	10.20%	8.57%	6.50%	-
1880-1889	6.80%	5.50%	3.04%	-
1890-1899	5.23%	3.30%	2.19%	-
1900-1909	7.36%	-0.73%	0.63%	-
1910-1919	-2.78%	-4.72%	-4.29%	-
1920-1929	15.87%	6.65%	4.87%	-3.42%
1930-1939	1.60%	3.27%	2.67%	1.37%
1940-1949	3.45%	-2.63%	-4.63%	0.52%
1950-1959	16.67%	-1.80%	-0.20%	-1.57%
1960-1969	5.11%	-0.15%	1.51%	-2.22%
1970-1979	-1.51%	-1.21%	-0.85%	2.88%
1980-1989	11.78%	7.32%	3.84%	-6.75%
1990-1999	14.83%	4.90%	1.95%	0.24%
2000-2009	-3.42%	3.75%	0.18%	3.39%
2010-2019	11.61%	2.31%	-1.15%	-5.78%

Source: Deutsche Bank


Standards
quality control
VECTOR ILLUSTRATION

A Lack of a Benchmark

Please see our Journal of Performance Measurement Article
And The Best Performing Target Date Funds are the Riskiest

What is the objective (purpose) of a TDF?

We believe it's to deliver accumulated contributions plus reasonable growth at the target date. Do not lose beneficiary savings.

Given this objective, TSP is an excellent benchmark for evaluating TDF return and risk.

We Discussed Target Date Funds on the 3/17/2020 Baby Boomer Investing Show:

The Next 401(k) Scandal

Kudos to Congress for Addressing the Issues

Please Visit Our Fiduciary Library

(Click on Image)

A Risky Leap of Trust

Conclusion

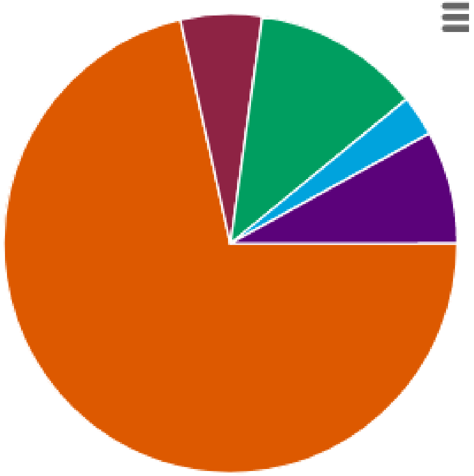
Most TDF Beneficiaries are at Risk

Appendix

Federal Thrift Savings Plan (TSP) Target Date Fund (Fund L) Allocations (Glidepath)

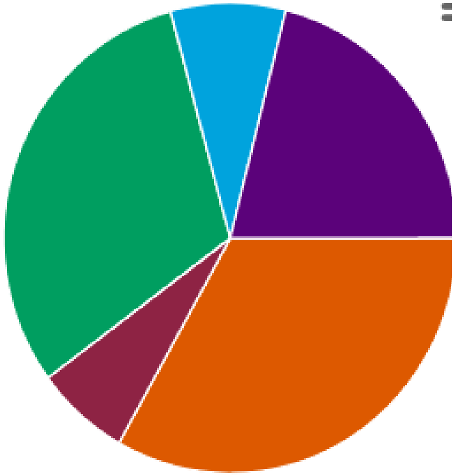
G is Government Securities with Government Guaranteed Return of Principal
F Is Fixed Income Tracking the Bloomberg Barclays Aggregate Bond index with 5 Year Average Maturity
C is US Stocks Tracking the S&P500
S is Small Company US Stocks Tracking the Dow Jones U.S. Completion Total Stock Market Index.
I is International Stocks Tracking EAFE

	Today	2030	2040	2050	2060 (new)
$Billions	30	47	39	25	1



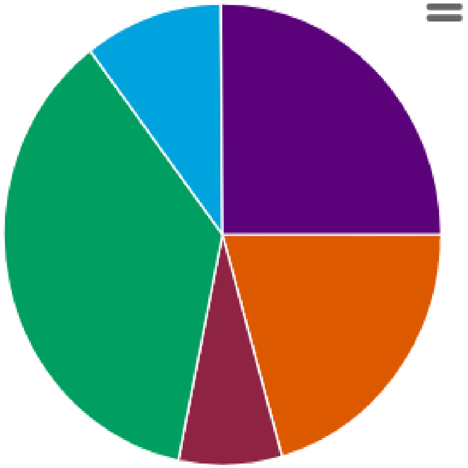
April 2021

- G Fund 71.46%
- F Fund 5.79%
- C Fund 11.92%
- S Fund 2.87%
- I Fund 7.96%



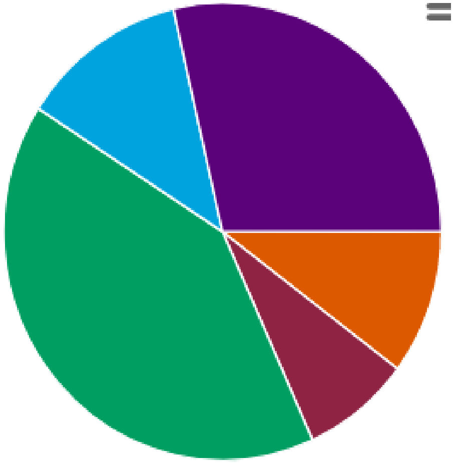
April 2021

- G Fund 33.16%
- F Fund 6.72%
- C Fund 30.88%
- S Fund 8.20%
- I Fund 21.04%



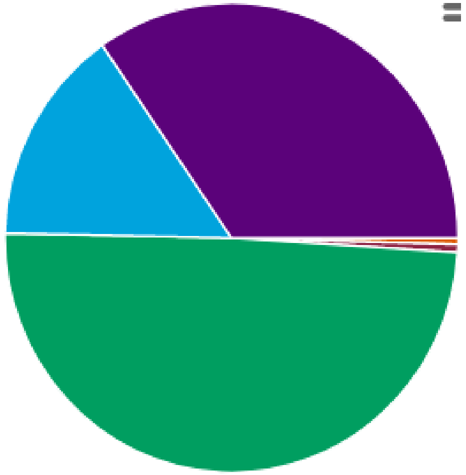
April 2021

- G Fund 20.61%
- F Fund 7.64%
- C Fund 36.40%
- S Fund 10.24%
- I Fund 25.11%



April 2021

- G Fund 10.25%
- F Fund 8.00%
- C Fund 40.81%
- S Fund 12.33%
- I Fund 28.61%



April 2021

- G Fund 0.44%
- F Fund 0.56%
- C Fund 49.32%
- S Fund 15.03%
- I Fund 34.65%

Source: TSP.Gov https://www.tsp.gov/funds-lifecycle/

Who Should Design Target Date Funds?

Independent Financial Engineer:

Conform to Retirement Researchers–
Protect in the Risk Zone

See This Article

Investment Manager:

Profit

Conflicting Interests

See This Article

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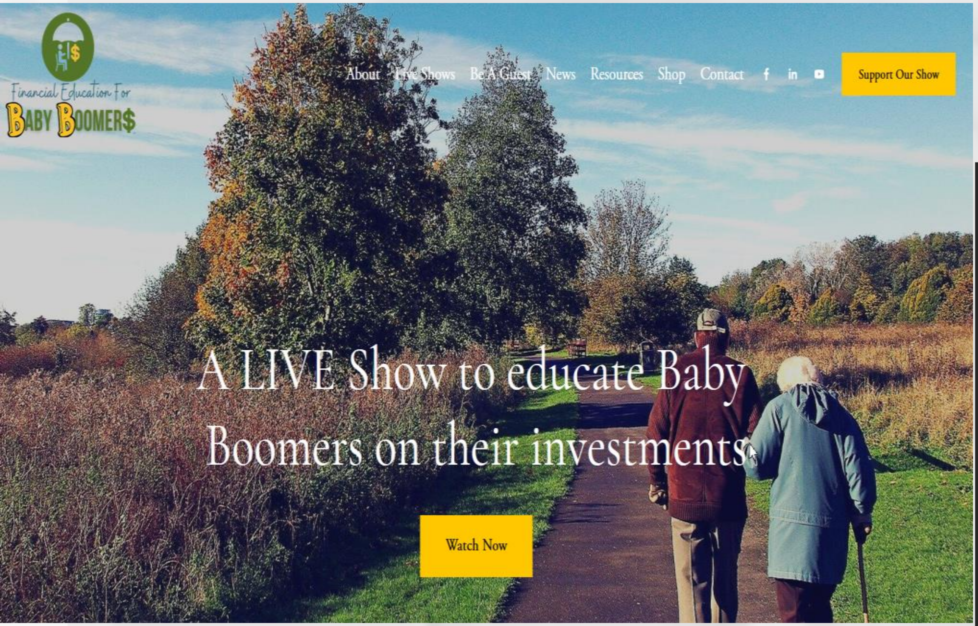

We can help you

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- Browse to "GlidePath Wealth Management" for consulting help. Get your **free eBooks** on "Selecting an Advisor" , "Retiring a Millionaire" and "Lessons from COVID-19."
- Fiduciaries visit **SMART Funds**
- Contact Ron Surz Ron@PPCA-Inc.com
- Watch our "*Baby Boomer Investing Shows*" every other Tuesday

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