Fiduciaries Foster the Other 401(k) Scandal

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A new 401(k) scandal has emerged in the past seven years, compounding the widely publicized excessive fee disgrace. Target date funds have rapidly attracted $1 Trillion despite their iniquity. Interests are misaligned: participants bear the risk while fund companies enjoy the profits. Win or lose, fund companies are paid and they're paid more to manage risky products so they are incented to take risk in TDFs, especially near the target date when account balances are their highest. The pretext for high risk is inadequate saving.

Because most assets in TDFs are there by default, their selection is employer-directed rather than participant-directed so fiduciaries are complicit in the scandal.

Target date fund equity allocations are all similar at 10 years or more prior to the target date. The big differences exist as the target date nears, so let's take an enlightened look at objectives and risks for TDFs **near the target date**.

Risk is the possibility of failing to achieve objectives

The typical target date fund is invested 50% in equities at the target date. The objectives are to replace pay and manage longevity risk, but you won't find these stated in prospectuses or factsheets – just in sales pitches. Importantly, no "glide path" can reasonably be expected to replace pay or manage longevity risk, so there is a high risk of failure. **The Sad Comedy of Target Date Funds** portrays the problem in a short video. The right course of action for achieving these objectives is to save enough.

The good news is that there is a universal objective that can be achieved with reasonable confidence.

The Universal Objective

<u>Capital preservation is the universal objective of TDFs, the "perfect fit" for this "one-size-fits-all</u>." It's the one objective that we all have in common – don't lose our money. Of course we all want to earn as much as we can but we are most fearful of loss as we near retirement. Accordingly, the presumption for target date fund design near the target date should be that participants have saved enough to support a lifestyle that is acceptable to them. Some may plan for a humble lifestyle while others see yachts in their future. It's all the same. A plan is a plan.

Protection is Key

Prior to the Pension Protection Act of 2006, the most common investment default was cash, but now the risk pendulum has swung too far for those nearing retirement. 2008 is all the proof I need.

The Center for Fiduciary Due Diligence recently surveyed investment advisors and found that the majority want no risk of loss for those nearing retirement.

Summary: Repudiation of an Unprofessional and Ignorant Statement

In a June 18, 2013 Morningstar blog, John Rekenthaler, Vice President of Research, states "***For his part, Surz recommends a 0% weighting in stocks at the target date. Some might say that there's a warm place in Hell for those who offer extreme investment solutions. Not me, of course, but some."*** This statement is not only very unprofessional; it also reveals Mr. Rekenthaler's ignorance of the importance of safety at the target date. Here are some of the reasons why zero risk at target date is imperative. By "zero risk" I mean no stocks and no bonds, just short term TIPS and T-bills.

Incontrovertible Imperatives for Zero Risk at the Target Date

1. There is no fiduciary upside to taking risk at the target date. Only downside. The next 2008 will bring class action lawsuits.
2. There is a "risk zone" spanning the 5 years preceding and following retirement during which lifestyles are at stake. Account balances are at their highest and a participant's ability to work longer &/or save more is limited. You only get to do this once; no do-overs.
3. Most participants withdraw their accounts at the target date, so "target death" (i.e. "Through") funds are absurd, and built for profit.
4. Save and protect. The best individual course of action is to save enough and avoid capital losses. Employers should educate employees about the importance of saving, and report on saving adequacy.
5. Prior to the Pension Protection Act of 2006, default investments were cash. Has the Act changed the risk appetite of those nearing retirement? Surveys say no.
6. Ignoring the past (especially 2008) and hoping it's different the next time is not an option, and it's certainly not an enlightened view of risk management.

The patented Safe Landing Glide Path® is currently the only choice for enlightened fiduciaries.