

## Where there's SPARKs there's fire

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Yesterday the Society of Professional Asset-Managers and Record Keepers (SPARK) submitted an opinion letter to the DOL regarding its proposed disclosures for target date funds. The letter is available at [SPARK Institute letter to the DOL](#). It raises some valid concerns and in the process reveals the serious shortcomings of the current offerings. Until now, fund companies, rather than employers, have set unrealistic objectives that call for high equity exposure, translated high fees. The objectives of managing longevity risk or replacing pay cannot be taken seriously in a one-size-fits-all TDF because TDFs have no influence on, or relationship to, mortality or savings. These objectives are better suited for individualized managed accounts. **Confirming their absurdity these objectives are never stated in disclosure documents like fund factsheets and prospectuses because they are hopes rather than objectives.** An objective without a viable plan of action is a hope. As a result, the SPARK letter asks the DOL to remove the requirement to disclose *“any assumptions about a participant’s or beneficiary’s contribution and withdrawal intentions on or after such date.”* The assumptions that are being made must be complicated, as pointed out in the SPARK letter, but also these assumptions can only realistically apply to the “typical” participant, whatever that means.

The SPARK letter also asks for deletion of the risk of loss statement: *“may lose money by investing in the alternative, including losses near and following retirement, and that there is no guarantee that the alternative will provide adequate retirement income.”* This is because TDFs are not currently designed to avoid risk near the target date, but they could be. Of course, there are still no guarantees, but it is important to protect account balances near retirement because life styles are at stake. So a risk disclosure statement could comply with the DOL proposal and add a description of what risk controls are in place at the target date. But this will only happen if fiduciaries ask for it.

Fiduciaries need to take back control of TDFs by setting objectives that can be realistically achieved like the following:

1. Deliver at least accumulated contributions plus inflation at the target date. Strive to achieve this objective with high conviction (i.e. low risk). In other words, don't lose employee money.
2. Grow assets as much as possible without jeopardizing the primary preservation objective. Focus on this objective when the horizon (term to target date) is long, but sacrifice growth for safety as the target date nears.

The investment policies for achieving these objectives stand far apart from current industry practices. Critically, the preservation objective demands a real\* "to" (accumulation only) fund that ends at the target date entirely in inflation-protected assets, like TIPS and T-bills. By contrast, the TDF industry offers 20-70% in equities at the target date. Even 20% in equities is too risky when preservation is the objective – preserve and protect at the target date.

The next issue is which fiduciaries need to act first. For the most part, plan sponsors rely on their advisers for choosing TDFs. But advisers have business risk in recommending anything newer or smaller, even if it is better. Branding and marketing are powerful influencers. So the demand for better product may need to start with sponsors directing advisers to open up and seek improvements.

Fiduciaries, not participants, choose target date funds, and it's time for fiduciaries to take back control. SPARK argues that participants will not understand the proposed disclosures, but participants do not choose TDFs. Participants who refuse to choose, and therefore who won't read disclosures, are defaulted into QDIAs, the most popular being target date funds.

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\* The target date fund industry has defined "to" as "flat equity allocation beyond the target date." Anything with the word "beyond" in it cannot be a real "to" fund since "end" and "beyond" do not play well together. Flat 100% equity is a "to" fund by this definition.