

Ibbotson's Reaction to the Joint SEC DOL Target-Date Fund Hearing



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I watched the joint SEC and DOL hearing on "Examining Target Date Funds" on June 18. While there were a wide variety of opinions, five themes emerged from the majority of the panelists:

1. The panelists believe that target-maturity solutions are a great innovation for investors;
2. The panelists are open to greater required disclosure;
3. The panelists are against any sort of mandated one-size-fits all or "range" requirement for target-date funds;
4. The panelists believe that target-date funds should not only contain equity at the point of retirement, but that glide paths should continue to evolve during retirement; and,
5. The panelists agreed that the participant's savings rate is the most important factor influencing a successful retirement.

In general, Ibbotson shares the majority opinion on these issues: Target-maturity solutions are extremely beneficial to the majority of plan participants; better disclosure is necessary; customization and choice are good and mandated asset allocations are bad; the glide path should continue to evolve after retirement to meet the changing needs of retirees; and a proper savings rate during accumulation is the most important determinant of future retirement success.

There was considerable consensus around these themes, but we think that it is important to address one of the dissenting opinions regarding whether or not glide paths should continue to evolve during retirement. Joseph Nagengast of Target Date Analytics said that the only acceptable goal of target-maturity solutions is to get the participant "to" the retirement date. Furthermore, he said that he believes the glide path should stop gliding at the point of retirement and retirees' equity should be invested entirely in fixed-income vehicles. We strongly disagree for three reasons. First, in the vast majority of potential future outcomes, such a strategy will significantly reduce the quality of an investor's retirement. Next, a significant and growing number of participants remain in their 401(k) plan after retirement, and a large percentage of participants tend to "do nothing;" thus, the strategy should continue to evolve throughout retirement for those that remain in the funds. We should note that it is often beneficial to remain in a 401(k) plan after retirement, given that retail rollover accounts often come with higher fees. Finally, investing entirely in fixed income at retirement suggests that all investors are identical. The economic situations and risk preferences of investors vary significantly.

Whether target-date funds should be managed "to" retirement or "through" retirement was mentioned by a large number of panelists. Most of the panelists that touched on this subject expressed the opinion that target-date funds should be managed "through" retirement. Some panelists referred to funds that evolve through retirement as "lifecycle" or "lifetime" funds. Two panelists called for naming conventions that distinguish between funds that are managed "to" retirement and those that are managed "through" retirement. Ibbotson has always felt that the use of a target retirement date in fund names is less than ideal, and Ibbotson advocates the use of birth date as a superior convention. Additionally, we prefer to use the word "lifetime" in the naming of our solutions to emphasize that our solutions continue to glide throughout an investor's lifetime.

Several secondary themes and points of contention were also apparent from the panelists' testimony.

A number of panelists expressed the position that retirement plans' widespread use of proprietary target-date funds in which all of the underlying managers are from the same fund manufacturer represents a step backward. Numerous 401(k) plan sponsors and consultants advocate the advantage of open-architecture plan lineups and investment solutions. Panelists identified self-dealing and conflicts of interest for off-the-shelf funds that design a glide path and then implement the glide path with proprietary managers. The primary fear

is that the glide paths from these conflicted providers may have larger-than-warranted allocations to asset classes associated with higher fees, such as equity asset classes or various alternatives. Secondary concerns, include channeling the funds to underperforming internal managers and the seeding of new startup managers. Panelists from asset-management firms dismissed these potential conflicts of interest, but we think the potential conflicts are clear.

Building on the idea of best practices, several panelists applauded the movement of large 401(k) plans to custom target-maturity solutions. Clearly, Ibbotson believes that the movement of large plan sponsors to a custom target-maturity glide path that is developed by an independent third-party asset-allocation expert and then implemented with the plan sponsor's best-in-class institutionally priced investment options is beneficial to plan participants.

Several panelists discussed the innovative work that is being done to combine target-maturity solutions with insurance guarantees, and the hurdles (single-carrier risk, portability, and cost) such products face. Ibbotson believes that insurance products can play an important role in reducing the longevity risk faced by retirees, and we hope that regulators will encourage such innovations.

A couple of panelists stated their belief that "managed accounts" are a superior alternative to target-maturity solutions. Ibbotson offers both managed accounts and target-maturity solutions, and we believe that managed accounts are superior, especially when participants provide us with enough information on their unique financial circumstances. Target-maturity solutions are an excellent alternative to managed accounts. We believe that target-maturity solutions and a managed accounts program can be complementary: Younger participants would start in a target-maturity solution and then transfer into managed accounts as their financial situation becomes more complicated.

Interesting survey-based data highlighted that many investors do not understand the risks associated with target-date funds, with some investors thinking that traditional target-date funds offer some form of guarantee or minimum. Ibbotson thinks that it is incorrect to attribute this type of confusion directly to target-date funds; rather, this type of investor confusion speaks to the overall lack of understanding of retirement plans and investment products. Not many investors know the difference between defined contribution (DC) plans and defined benefit (DB) plans--there is a lack of knowledge about which kind of plan provides a guaranteed income and whether or not 401(k) plans are DC or DB plans.

Finally, and not surprisingly, there was no agreement regarding the best glide path or how to develop it.

About Ibbotson

Ibbotson Associates is a leading independent provider of asset allocation, manager selection, and portfolio construction services. The company leverages its innovative academic research to create customized investment advisory solutions that help investors meet their goals.

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