Are Target Date Funds the Perfect Vehicle for ‘In-Plan’ Annuities?

By Editorial Staff *Wed, Dec 2, 2020*

'Nearly two-thirds (63%) of target-date managers suggest the first-quarter 2020 period of heightened market volatility will increase client demand for guaranteed investments,' according to a Cerulli Associates analyst.

The inclusion of lifetime income products and alternative investments into target-date funds could potentially help asset managers and life insurers improve long-term outcomes for plan participants and help themselves stand out in a TDF market dominated by a handful of large players (Vanguard, Fidelity, T. Rowe Price, American Funds and JP Morgan), according to Cerulli Associates.

“Specific provisions in the SECURE (Setting Every Community Up for Retirement Enhancement) Act are designed to facilitate the inclusion of lifetime income products (e.g., annuities) in 401(k) plans and other DC plans that do not typically feature lifetime income products,” according to the latest issue of *Cerulli Edge—U.S. Asset and Wealth Management Edition*.

According to the report, most (92%) of firms expect managed payout options and annuity allocations to be incorporated into future target-date fund series. The market volatility of the first quarter of 2020 may also serve as a catalyst for lifetime income adoption by DC plans. Nearly two-thirds (63%) of target-date managers say this period of heightened market volatility will increase client demand for guaranteed investments. Providers of lifetime income products should leverage market downturns to illustrate their downside protection benefits, Cerulli suggests.

In addition to annuitization, the use of alternative investments such as private equity funds may change. A Department of Labor (DOL) information letter released earlier this year offers regulatory guidance related to the use of private equity funds within professionally managed strategies (e.g., target-date funds, target-risk funds) that may serve as a DC plan’s qualified default investment alternative (QDIA).

“Although the letter represents a key step toward giving private equity a larger presence within the DC product landscape, adoption will likely occur at a gradual pace as providers look to craft products, educational materials, and messaging for the DC market,” said Cerulli senior analyst Shawn O’Brien in a release.

In the coming months, Cerulli expects plan sponsors and retirement plan providers to engage in more detailed exploratory discussions regarding the inclusion of private equity in multi-asset-class products such as target-date funds. Providers looking to incorporate allocations to private equity should remain aware of the demands and constraints of the DC market.

"Private equity funds are typically characterized by infrequent pricing events, low liquidity, relatively high management fees, and complex investment structures," O'Brien said. "Conversely, the DC market—litigious in nature—is notoriously fee-sensitive, and the product landscape is dominated by simple, transparent, low-cost investment vehicles."

Providers must clearly demonstrate to plan fiduciaries how allocating to a certain private equity strategy within a professionally managed product can improve long-term outcomes for plan participants on a risk-adjusted, net-of-fees basis. Asset managers and consultants/advisors looking to offer professionally managed products that allocate to private equity should be prepared to educate plan sponsors on the fundamentals of private equity investing.

"It may take time for many plan fiduciaries to gain a sense of comfort with private equity investments, and therefore, thorough educational and informational engagements may be a necessary precursor to adoption in a DC market where private market investments are rare," O'Brien said.