The Latest on TDFs (from Vanguard, ASPPA, SPARK, et al)

By Editor Test *Wed, Jan 19, 2011*

The DoL's January 14 deadline for comments on proposed new rules for target-date fund disclosures has produced a flurry of research, recommendations and opinion about TDFs.

Most target-date fund investors understand the funds' basic design and their risks, but need "education about the highly diversified nature of a single-target date fund," according to a new study by Vanguard, the second-largest manager of target-date funds in the U.S.

In its *Investor Comprehension and Usage of Target-Date Funds: 2010 Survey*, Vanguard also found "opportunities exist to improve investors' knowledge of target-date fund (TDF) mechanics at and around the target date, and the implications of combining TDFs with other assets."

The study showed that only 62% of plan participants who owned TDFs had ever heard of a TDF. That finding didn't surprise Vanguard, since most of those participants were probably defaulted into TDFs and, ipso facto, didn't need to know or understand them.

"Participants who are not aware of TDFs are likely to be unengaged investors—and these funds are intended to provide such investors with a prudently diversified portfolio," said John Ameriks, head of Vanguard Investment Counseling & Research.

New round of debate

The release of the study roughly coincided with the end of the period for comments on Department of Labor proposed regulations on TDF disclosures, on January 14. The deadline produced a new flurry of recommendations by retirement industry groups such as the American Society of Pension Professionals and Actuaries and the SPARK Institute.

TDFs, of course, have been under scrutiny since they failed to protect near-retirement investors from significant losses in the 2008-2009 financial crisis. The funds had carried a certain assumption of safety—at least for those near retirement—especially after they became a QDIA (qualified default investment alternative) for 401(k) plans.

ASPPA, the American Society of Pension Professionals and Actuaries, recently made several recommendations to EBSA regarding TDF disclosures. For instance, ASPPA believes that merely disclosing the asset allocation of a target date fund does little for the many plan participants who take a lump sum at retirement and roll it into an IRA. ASPPA also suggested advising participants that a TDF that seems appropriate for them might not be appropriate if they have much younger spouses.

The SPARK Institute, an association of plan service providers, recommended removing disclosure language that emphasized the risk of loss from investments in TDFs. "All plan investment options involve varying degrees of risk and EBSA should not single out target date funds, since they may be a good choice for many participants," ASPPA's Larry Goldbrum said.

Ron Surz, president of PPCA, Inc., in San Clemente, Calif., and an advocate of TDFs that contain zero equities at the target retirement date, also released comments. "Fiduciaries need to take back control of TDFs by setting objectives that can be realistically achieved," he wrote in an email.

Surz continued: [They should] "deliver at least accumulated contributions plus inflation at the target date… [and] "grow assets as much as possible without jeopardizing the primary preservation objective." [But] "the investment policies for achieving these objectives stand far apart from current industry practices."

Vanguard's findings

For its study, Vanguard in January 2010 surveyed 4,700 Vanguard IRA owners and participants in Vanguard-administered retirement plans, some of who owned TDFs and some who didn't.

Among Vanguard's findings:

- Some 95% of TDF investors in IRA accounts reported having "heard of a target-date fund," versus 62% of TDF owners in defined contribution retirement plans. Vanguard wasn't surprised, because participants are frequently defaulted into TDFs.
- Only 24% of the participants knew that the asset allocation of most TDFs continues to change after the target year.
- 61% of participants said they chose TDFs because they wanted "a balanced portfolio, simplicity, and convenience."
- Among investors who hold other investments along with a TDF, 56% said they did so to hold "more aggressive investments." Another 41% thought they needed a mixed portfolio for adequate diversification.
- 75% of participants said they intended to gradually draw down their target-date fund assets.
- more than 90% of the respondents plan to have an equity position in their portfolio at retirement.

- 77% knew that the asset allocation becomes more conservative as the target year approaches, showing an understanding of these funds' changing asset allocation.
- 68% recognized that target-date funds offer a diversified mix of stock and bonds. (Diversification does not ensure a profit or protect against a loss in a declining market.)
- 87% believed target-date funds involve "some risk" or more; less than 1% felt they were risk-free.
- Only 8% of participants incorrectly believed that target-date funds provide "guaranteed income" and only 4% of participants incorrectly indicated that TDFs provide a guaranteed return or become risk-free at the target date.