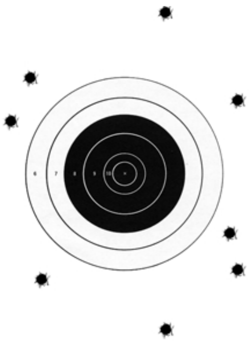

Most Target Date Funds Miss Their Target Date On Purpose

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The June 18 SEC and DOL joint hearings on target date funds (TDFs) uncovered an important distinction. Most TDFs are "**THROUGH**" funds, designed to serve investors past retirement, to the grave. These funds would be best re-labeled as "target death" or "lifetime" funds, and the date in the fund name should be changed accordingly, perhaps using the investor's birth date. It remains to be seen how the SEC will react to this need for clarification. Because **THROUGH** funds are designed for a lifetime they are somewhat aggressive at target date, with the average 2010 fund allocated 45% to equities in 2008. This led to an average 25% loss in 2008, which prompted the joint hearings. 2010 funds are earmarked for those retiring between 2005 and 2015. The majority opinion of the witnesses at the hearings is that **THROUGH** is the way to go because participants need to be protected against longevity risk, and fund companies know the appropriate glide path to provide this protection because they have run sophisticated computer simulations.

But there is an alternative called a "**TO**" fund that deserves consideration by plan sponsors. Plan sponsors are the only ones with the fiduciary responsibility for selecting and monitoring TDFs. **TO** funds are designed to end at the target date with no equities, requiring the plan participant to do something quite extraordinary – think and act. There's a good chance that plan participants and sponsors thought they were buying **TO** funds, if for no other reason than the date in the fund name. Certainly those who have purchased target date funds for college tuition believe they are buying **TO** funds. The perspective of a **TO** fund provider is that a well-constructed generic glide path can serve the majority during their working lives, but retirement is far too complex for a one-size-fits-all solution. It further presumes that plan participants are not all brain dead, so they can in fact make their own decisions about matters that affect the rest of their lives.

Academics recommend very safe investments in retirement, lockboxes of TIPS and T-bills to secure retirement needs. This works well for the wealthy. Everyone else must make a choice between insuring by buying annuities, and self-insuring by investing on their own behalf. Older **THROUGH** funds are self-insurance funds which may be OK, but the plan participant really should be educated about his or her choices. Competing with older **THROUGH** fund offerings is a new breed that converts to annuities at target date, taking a new view that insurance is the "right" solution. So **THROUGH** funds offer an all-or-nothing retirement option – entirely annuities or entirely managed assets. Those who have thought through the insurance trade-offs advocate a laddered annuity program to protect against future inflation, with the participant designing a custom path that gradually moves through time from mostly self insurance to mostly annuities. This retirement program is best designed by the retiree with cash in hand delivered by a **TO** fund at retirement. There is no opportunity for this custom design with a no-stopping-here **THROUGH** glide path. Of course the participant could sell out of his **THROUGH** TDF in order to customize an investment program, and we would hope that it is not after a 2008-like experience because it's too late then.

The transition from accumulation to distribution is the most critical time for investor wealth and well-being because account balances are at their highest. Anything that jeopardizes asset value during the 5 years on either side of retirement is a risk that plan participants should not be taking. Plan participants and sponsors should recognize the need to protect asset value during this critical transition phase. Witness the unfortunate calamity experienced by 2010 investors last year.

Plan sponsors need to drive this bus. Until now, the **THROUGH** solution has been sold because it provides the seller with an extended revenue stream. Consequently, **THROUGH** funds appear to be the only game in town, but this is simply not true – there are indeed **TO** funds. It comes as no surprise that there are choices in this relatively new product offering. The good news is that one of the critical choices is straightforward: **THROUGH** or **TO**. Now you know.