

## TARGET-DATE TROUBLES

*As stocks dive, fund companies are revisiting 401(k) target-date strategies and plan sponsors are fretting about possible lawsuits.*

By [Janet Aschkenasy](#)

One recent attempt to solve the problem of workers' paltry retirement savings—target-date funds—is showing some cracks amid the market meltdown. CFOs and other plan officials are increasingly concerned that such funds rely too heavily on stocks at a time when equity values have plummeted and that their use may expose plan sponsors to legal liability. Meanwhile, some fund companies are moving to modify the asset allocations of their target-date funds.

It comes as a blow to plan officials and employees alike that professionally managed target-date funds are not the safe havens lawmakers and experts expected they would be, given that the funds are designed to shift to a more conservative asset allocation as participants move closer to retirement and are rebalanced regularly to keep to their asset-allocation targets.

Last February, U.S. Senate Special Committee on Aging Chairman Herb Kohl (D-Wis.) unveiled findings from the committee's investigation of funds designed for people planning to retire in 2010, which revealed "a wide variety of objectives, portfolio composition and risk within same-year target-date funds." Indeed, equity allocations among 2020 funds range from 51% to 90%, according to a recent study by Boston-based consultant Financial Research Corp. (FRC).

Across the target-date universe, the average fund posted a 16% decline through the first three quarters of 2008 and lost 10% during last year's third quarter, slightly higher than the 8.4% loss for the S&P 500, according to Ibbotson Associates data FRC quoted late last year.

Companies' legal concerns stem from protections afforded to plan officials under The Pension Protection Act (PPA) of 2006, which added a new fiduciary protection to Erisa for Qualified Default Investment Alternatives (QDIA), such as target-date funds, employed when participants fail to pick their own investments, as often occurs with auto-enrollment.

"Officials at companies of all sizes are concerned about the possibility of lawsuits stemming from the movement of participant funds to a target-date QDIA," says Pam Perdue, an attorney and employee benefits expert with Summers Compton Wells in St. Louis, Mo.

"Employers, particularly large employers, have been under assault for the last few years by plaintiffs claiming that they failed to perform sufficient due diligence with the selection of investments regarding the fees charged," Perdue says. "I think employers are concerned that the same types of forces may now target—no pun intended—target-date funds."

Erisa Section 404(c) says a plan fiduciary is not liable for plan losses resulting from a participant's selection of investments in his or her own account. According to the PPA, when

participants have an opportunity to direct their own 401(k) investments but fail to do so, fiduciaries may enjoy a 404(c) defense anyway if fund officials invest participants' funds in a QDIA. The list of QDIAs includes balanced funds and managed accounts as well as target-date funds, but target-date funds have become by far the most popular employee default, experts say.

One might expect, says Perdue, that "the extension of the 404(c) protection means that by defaulting a participant into an eligible QDIA, the fiduciary will not be responsible for the consequences that flow from that default.

"However, as is the case where participants affirmatively elect investment options made available under the plan, it is the Department of Labor's position that the selection of the QDIA itself is still a fiduciary act subject to challenge as a fiduciary breach," she says.

So, a participant could sue on the grounds "that the selection of a [particular company's] target-date fund was not appropriate because the funds were inherently too risky across the board," Perdue adds.

"My clients are concerned, not only from a lawsuit standpoint, but also from the standpoint of watching their employees' account balances drop in such significant numbers," she says.

Some fund providers are changing their target-date strategies. "Manufacturers are already retooling their asset allocations in response to the market, a trend that we will watch unfold over the next few quarters," FRC wrote in its third-quarter 2008 report on target-date and target-risk funds. Lynette DeWitt, FRC's research director and the author of the report, says "one firm representative of the fast movers is DWS Investments."

"In its September 30 performance review of the DWS LifeCompass Target Date Series, the firm notes a number of portfolio changes," according to the FRC report. "These include increased allocations to fixed income and [Treasury Inflation-Protected Securities] for the firm's Retirement, 2015, 2020, and 2030 funds, along with reduced exposure to domestic equity (specifically core equities) across these funds."

American Funds, the fourth-largest target-date complex nationwide with net sales of \$476 million for the quarter, has also made changes, DeWitt says.

"American Funds changed its prospectus in January 2009 to allow for higher allocations to cash (up to 20%) and removed limits on defensive measures the portfolio managers could take to respond to market events," she wrote. "Within the past year the firm also has made its glidepaths [asset allocation strategies over time] more conservative." The report added that "it can be expected that other firms will also reallocate," though some will try and "keep it under the radar."

MFS Investment Management is also in the process of shifting its target-date allocations, says MFS spokesman Dan Flaherty.

One of the largest target-date fund providers is sticking to its guns, though, reasoning that over time funds with larger equity allocations will provide better retirement returns. T. Rowe Price has been meeting with dozens of corporate retirement investment committee members to reinforce its commitment to its funds' asset allocation strategy and existing equity exposures. T.

Rowe is the second largest target-date provider after Vanguard, based on fourth-quarter 2008 net target-date sales of \$1 billion, according to FRC.

T. Rowe admits its target-date formulas are considered to be on “the high end in terms of equity exposure,” with a 55% equity allocation at expected retirement age, according to Jerome Clark, portfolio manager of the T. Rowe Price Retirement Date funds. Nevertheless, Clark argues that “many people are focused on a very unusual bear market, which is just a short-term snapshot within decades of retirement savings and withdrawals.”

<http://www.treasuryandrisk.com/Issues/2009/April%202009/Pages/Target-Date-Troubles.aspx?PrintPreview>

*Pamela Perdue is quoted as expert on employee benefits in April Treasury & Risk, though name of the Tax & Accounting business of Thomson Reuters does not appear. She is a major WG&L/RIA author and writes a newsletter for company, but is also a practitioner.*