Considerations for Evaluating Target Date Glide Paths

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Things to Keep in Mind

- We are introducing a framework for target date evaluation.
- We are focusing on the equity exposure—the main driver. (And recognize there are many other important factors).
- We will consider highly stylized cases, and in reality, plan sponsors face variety in their process.
- We will focus on how goals and behavior interact with target date evaluation and outcomes.
Target Date Evaluation Is Getting Complicated

Lots of Research

Wide Range of Choices

Media Buzz

Target Date Evaluation

Government Involvement

Should Retirees Rely on Target-Date Funds?

Careful attention needed when choosing target-date funds

DC plans move to custom target-date portfolios

Participants need to be informed about target-date funds

Department of Labor
Misleading Single Drivers of Target Date Evaluation

- Longevity risk
- Fees
- Market risk
- Rollover behavior at retirement
- Undersaving
- Inflation risk
- Time diversification
- Component selection
What’s Important in Driving Retirement Outcomes?

- Behavior
- Goals & Preferences
- Equity Exposure
- Active/Passive
- Fees
- Glide Path Shape

RETIREMENT OUTCOMES
Need to Consider Everything Simultaneously

- Goal
- Risk Focus
- Savings Behavior
- Environment
- Equity Exposure
Plan Sponsor Determines Goal

- What’s the purpose of my plan?
- Why do our employees value having a 401(k)?
- How do we measure success—the balance or income stream?
- Do we want our employees to stay in the plan when they leave?

GOAL

RETIREMENT INCOME
Focus on ability to obtain a reliable income stream in retirement

BALANCE ACCUMULATION
Focus on balance at the time of leaving employer (retirement or job change)
Both Retirement Income and Balance Risk Are Impacted by Market Risk

Real World Risk Drivers
Uncertainties that need to be included in the analysis

Risks Experienced by Participants
What ultimately matters from participants’ perspective

- Retirement Income Risk
- Balance Risk
- Inflation Risk
- Longevity Risk
- Market Risk
What Is “Good” Behavior?

- Leads to stronger asset growth potential
- Social Security is phased out at higher levels
- The results:
  - Replace lower income percentage for high earners
  - Higher earners demand more from 401(k) to maintain standard of living in retirement

Sponsors impact savings behavior—*the cash flows in and out of the plan.*
Capturing the Environment Appropriately

WHY THIS MATTERS

- Represent “how the world works”
- Must capture correctly
- Empirical exercise
- Modeling work for the Target Date provider

- Model the uncertainties (“risks”) to capture the distribution of these factors
  - Better way to be conservative than a fixed “pessimistic” assumption
Equity exposure actually hedges retirement income risk.
Good behavior makes it easier to address balance risk.
Challenging behavior forces a tough choice between goal and risk.
Equities can potentially help balance accumulation if sponsor is not concerned about risk.
Risk tolerance drives equity exposure with accumulation goal.
Read the full research paper:

Evaluation of Target-Date Glide Paths Within Defined Contribution Plans
What’s ACTUALLY Happening?
What is your priority in target date design between asset growth to support **lifetime income generation** vs. **capital preservation**?

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<td>Exclusive emphasis on capital preservation</td>
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Exclusive emphasis on capital preservation

Both objectives equally important

Exclusive emphasis on lifetime income generation

(A) 4%  (B) 0%  (C) 36%  (D) 27%  (E) 34%
Participants Have a Retirement Income Focus Too

84% 65-year-old Terminated Participants are out of plan in 3 years

92% Assets remain invested in the retirement system
Participants Don’t React to Market Events

86% 97%

Non-Target Date investors did nothing
Target Date investors did nothing
How Do Participants Behave?

As of December 31, 2012

Percentage of participants contributing to their plan stays in the mid-80% regardless of market performance.

Source: PSCA’s 56th Annual Survey of Profit Sharing and 401(k) Plans (2013), reflecting plan year 2012
How Do Participants React?

As of December 31, 2012

Participant contribution amount stays around 5% regardless of market performance.

We Need to Close the Gap

As of December 31, 2012

Participants are not saving nearly enough

The Tradeoff

We can’t have our employees save 2% more. That would mean a 2% drop in their lifestyle; they can’t handle that!

Implied framing:
No Treatment (Do Nothing)

- David ($40,000 salary): Age 25
  - $0 balance
  - 0% contribution rate
  - 0% employer contribution

- When David starts withdrawals at age 65, what percent of his salary will he replace?
David, Age 25

Employer match of 50%, up to 6%; 7% rate of return; 3% inflation. Current lifestyle is 90% of current salary (remainder lost to payroll taxes, rounded off to 10%) minus final savings rate; 25% of current salary is replaced by Social Security and Other sources (e.g., DB plan or wages). Number shown is percent of lifestyle covered by savings at age 65 with a 4% initial withdrawal amount. This chart is for illustrative purposes only and not meant to represent the performance of any specific investment option.
Reframe the Trade-off

- It’s not 2% vs. 0%
- The choice is 2% vs. 72%!
David, Age 25

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Who Is Being Helped by Auto Solutions?

Current

New

Improve savings behavior by including all employees in auto solutions.
Here’s What You Need to Remember

- You should consider plan goals and risk focus when evaluating target date glide paths.
- Most plan sponsors and participants still display a retirement income focus—implying a healthy equity exposure is appropriate for them.
- Behavior is a key input for target date evaluation, and it drives retirement outcomes.
- Plan sponsors can overcome challenging savings behavior with intelligent plan design.
Call 1-877-804-2315 to request a prospectus, which includes investment objectives, risks, fees, expenses, and other information that you should read and consider carefully before investing.

The principal value of target-date investments is not guaranteed at any time, including at or after the target date, which is the approximate date when investors plan to retire. These investments typically invest in a broad range of stocks, bonds, and short-term investments and are subject to the risks of different areas of the market. In addition, the objectives of target-date investments typically change over time to become more conservative.