Are Target-Date Funds Undermining Retirement Saving?

New research suggests some education gaps for participants about their target-date funds.

By Nevin Adams

A recent report by Alight Solutions, LLC, reveals some eye-opening findings about how some 2.5 million target-date fund (TDF) investors are saving — and investing.

The report, titled *Five Surprising Facts About Target-Date Funds*, winds up being a report perhaps more aptly titled *Five Surprising Facts About Target-Date Fund INVESTORS*. Here's what stood out to me.

People Who Use Target Dates Save Less

Perhaps the biggest eye-opener in this report is that people who use target-date funds contribute less than those who don't. It may be a function of participants who are not only defaulted into TDFs, but who are defaulted in at lower deferral rates than those who make active enrollment decisions. While that's still a reality in many cases, the disparity in savings rates applies even when accounting for factors like age (generally speaking, younger workers contribute less) and automatic enrollment (generally speaking, the default deferral rates are less than what participants elect voluntarily).

In fact, on average, full TDF investors contribute 6.2 percent, compared to 8.4 percent for other investors, according to the report. For those automatically enrolled, TDF investors contributed 5.3 percent (on average), compared with 7.6 percent. For those under age 30, TDF investors deferred 5.6 percent (on average) compared with 7.7 percent for those who forego that option (and 7.5 percent who are partial TDF users).

People Who Use TDFs Don't Stay with Them

One of the great challenges of participant self-direction is that, even those who take the time to make investment allocations tend not to (ever) revisit those decisions. However, Alight found that fully half of those who invest fully in TDFs move out of that option within a decade.

The More Precise the Target-Dates, the More Likely the Utilization

This one is a bit of a head-scratcher, but the folks at Alight note that — at least among those with account balances greater than $50,000 — individuals are more likely to use TDFs when vintages are offered in increments of five years rather than 10 years.

How much of a gap? Well, Alight found that 55 percent of those with balances above $500k invested in TDFs when there were five-year increments, while only 38 percent did when their choices were expressed only in 10-year increments.

Even When People Leave TDFs, They Don't Completely Leave

Alight notes that, in 2018, when people switched from full TDF usage, three-fourths left at least some money in those investments. Now, it may be worth noting that some *did* move fully away from TDFs, and that those were most likely to be close to retirement age. Specifically, more than one-third (36%) of people age 60 or older who changed from full TDF use chose not to use TDFs at all.

So, what do those who left TDFs do with their money? Well, almost half (46 percent) invested their entire balance in equities. Younger workers were just as likely as older workers to choose an all-or-nothing equity strategy, but they were more likely to completely invest in equities.

All in all, older participants were least likely to have their entire balance invested in a TDF; among those age 60 or older, just 25 percent had their entire balance in a TDF.

There's little question that the target-date fund concept, writ large, has had a significantly positive impact on both the quality of diversity in American workers' retirement savings. The Alight report suggests that education gaps remain in this powerful tool — and that participants, while they may well be better off, run a risk of misusing this strategy in a way that might do more harm than good, but may well be causing some harm.

Nevin E. Adams, JD, is the Chief Content Officer for the American Retirement Association.