J.P. Morgan Asset Management Finds Some Target Date Funds Overlook Critical Factors

- Real-world participant behavior at odds with standard fund assumptions makes for complex manager selection, plan design choices -

NEW YORK, Nov. 30, 2012 /PRNewswire/ -- Research released today by J.P. Morgan Asset Management confirms decade-long patterns of suboptimal savings behavior among defined contribution plan participants. Real-world activity among savers is more unpredictable than many fund managers assume in their fundamental design, often resulting in too much volatility being embedded in target date funds.

J.P. Morgan's series "Ready! Fire! Aim? How some target date fund designs are missing the market on providing retirement security to those who need it most" began reporting in 2007 and now reflects 10 years of consistent data. The research, which studies the relationship between target date glide paths and actual participant investment behavior, is designed to provide empirical data to plan sponsors struggling to determine what target date fund asset allocation strategy is best suited to improve their plan participants' retirement outcomes.

"Plan sponsors run the risk of falling short in best positioning participants to achieve retirement security if they aren't assessing whether their target date portfolio design stands up to the stresses of real-life saving and investing," said Anne Lester, Managing Director, J.P. Morgan Asset Management Global Multi-Asset Group.

Participant Behavior Patterns

A key finding is that the fund industry's modeling of participant behavior patterns is often unrealistic. Consistent with previous years, participants contributed less and borrowed and withdrew more than prevalent industry expectations informing asset allocation models. Whereas convention wisdom generally assumes participants start contributing at 6% and reach 10% of salary by age 35, in actuality, as of the end of 2011, average participants start contributing at 5% and increase slowly, not reaching 10% until age 59. Contribution rates for auto-enrolled participants are even lower. Meanwhile, large numbers of participants continue to take sizable account loans and pre-retirement hardship withdrawals are on the rise. These suboptimal behaviors directly translate into a wider range of projected participant outcomes.

Another key finding is that most participants withdraw their entire account balances shortly after they stop working. As of 2011, 83% of participants have withdrawn their entire account balance within just three years of retirement. This has significant implication for the "to" versus "through" glidepath debate in the target date fund industry, as it relates to contention over the appropriate level of equity risk at the point of retirement. These withdrawal figures suggest that maintaining outsized equity allocations in years leading up to retirement subjects participants to unnecessary and dangerous risks just as they are most prone to withdraw their assets.

"It's risky for target date funds to rely heavily on equities, but at the same time they can't curtail long-term return potential by being too conservative. We think the solution is to increase risk efficiency through broader asset class diversification, such as incorporating high yield, direct real estate, emerging market equity and debt and other asset classes to lower expected volatility without sacrificing return potential," said Daniel Oldroyd, Portfolio Manager of JPMorgan SmartRetirement target date strategies, J.P. Morgan Asset Management Global Multi-Asset Group. "A stronger risk-adjusted return profile can also help mitigate the long-term impact of these negative participant behaviors, such as loans and contribution shortfalls, that we see occurring increasingly among savers."

Comparing Target Date Fund Designs, Combating Suboptimal Behaviors

Having a well-designed target date fund offers the greatest chance of retirement security for the vast majority of participants. However, it's hard to compare target date funds on an "apples to apples" basis and short-term performance can be misleading when evaluating strategies. Plan sponsors have to look at long-term return potential, embedded volatility, asset allocation and how these nuances interplay with real-life participant behaviors. J.P. Morgan Asset Management's Target Date Compass tool objectively maps competing fund strategies across quadrants based on portfolio composition and risk levels to give sponsors and advisors a comparative view. Regardless of how they choose to assess fund choices, plan sponsors should carefully consider the type of strategy that will best meet their particular plan's needs and goals.

Plan Sponsors need Proactive Plan Design, Higher Auto-Enrollment and Auto-Escalation

Despite the increasing adoption of automatic plan design features such as automatic enrollment and automatic escalation, J.P. Morgan findings show that overall contribution rates are generally in decline. On average, new plan entrants are contributing less overall and growing their contributions more slowly. The average auto-enrolled participant contribution rate was 4%, almost half the average contribution rate of 7.7% for non-auto-enrolled participants. Plan sponsors have a unique opportunity to help participants save more by setting rates higher, and even more importantly setting escalation programs to rise more quickly to reach 10%. Otherwise, they may find that participants are forced into the difficult game of "retirement catch up" in their 40s, 50s and 60s or risk underfunding their retirement needs.

"When it comes to getting as many participants over the retirement finish line as safely as possible, proactive plan design can be equally as important as investing and asset allocation," said Mr. Oldroyd. "Defined contribution plans are ultimately a partnership between participants and companies, but the reality is that sponsor decisions have a tremendous impact on retirement outcomes."

Methodology

J.P. Morgan Asset Management conducted rigorous, quantitative examination of real-world participant savings and spending patterns over 10 years based on a group of 280 defined contribution plans with 1.5 million participants administered by J.P. Morgan Retirement Plan Services.

About J.P. Morgan Asset Management – Retirement

J.P. Morgan Asset Management is a leading comprehensive retirement solutions provider dedicated to improving individual retirement outcomes. J.P. Morgan Retirement Plan Services provides bundled defined contribution services to more than 650 clients and 1.8 million plan-level participants, representing more than $125 billion in retirement plan assets as of September 30, 2012. J.P. Morgan Defined Contribution Investment Solutions manages more than $69.7 billion in defined contribution assets as of September 30, 2012.

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TARGET DATE FUNDS: Target date funds are funds with the target date being the approximate date when investors plan to start withdrawing their money. Generally, the asset allocation of each fund will change on an annual basis with the asset allocation becoming more conservative as the fund nears the target retirement date. The principal value of the fund(s) is not guaranteed at any time, including at the target date.

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