Five surprising facts about target date funds (TDFs)

1. **People who use TDFs contribute less than people who don't use them.** Even when accounting for factors like age and automatic enrollment, people who fully invest in TDFs tend to save less than others.
2. **People don't stay invested in TDFs for very long.** Half of people who were fully invested in them ended up switching out of them within 10 years.
3. **TDF use is impacted by what other investment funds are available.** When companies offer more funds outside of target date funds, people are less likely to use target date funds as intended.
4. **When people stop using TDFs, many make extreme changes to their asset allocation.** Among those who stopped using TDFs altogether, 46% invested their entire portfolio in equities, while 14% went all-in on fixed income.
5. **Investing in multiple TDFs is common.** One out of every 10 TDF investors uses more than one vintage. Among partial TDF users, the percentage more than doubles.

Alight studied behavior for approximately 2.5 million target date fund investors. All information is as of January 1, 2019, unless otherwise indicated.

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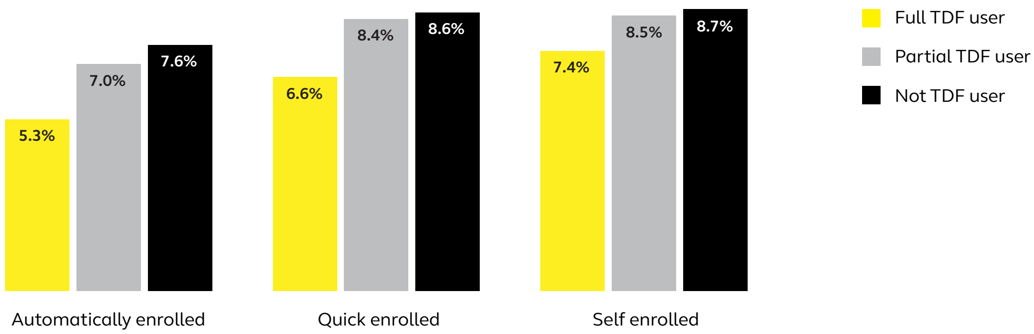
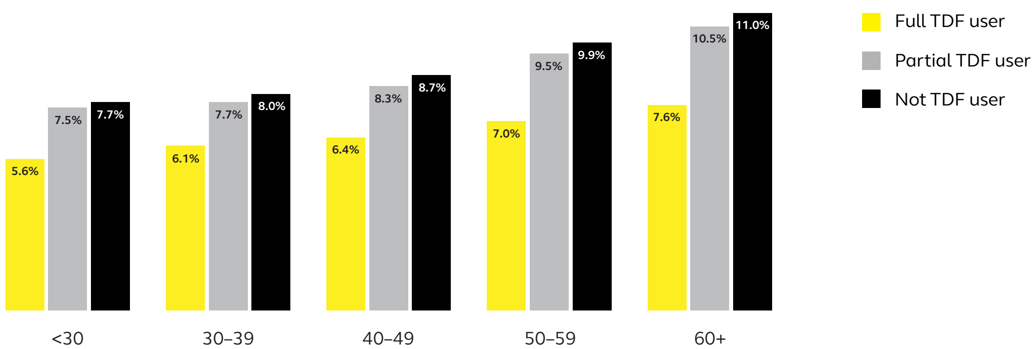
People who use TDFs contribute less than people who don't use them.

On average, full TDF investors contribute 6.2%, compared to 8.4% for other investors.[1] Even when controlling for how people enrolled in the plan, people who fully invest in TDFs contribute less than others. Full TDF investors also contribute less on average even when accounting for age.

Average contribution rate, by enrollment type and investor type[1]

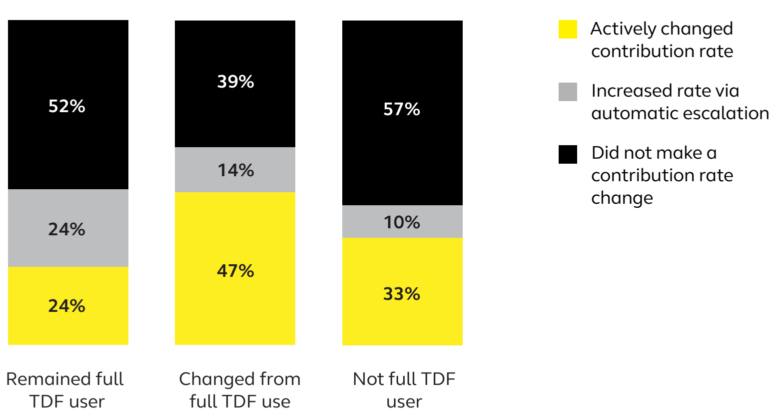


Average contribution rate, by age and investor type[1]



When people changed from full TDF use, approximately half (47%) actively changed their contribution rate, 14% changed their contribution rate via automatic escalation and the rest kept their contribution rate the same. Among those who remained full TDF investors, only 24% actively made a contribution rate change, while another 24% increased their rate via automatic escalation.

Percentage with a contribution rate change among those active/eligible during 2018, by change type



1 Contribution rate data is among people hired within the last ten years, since TDFs have largely become the default investment in 401(k) plans over the last decade.

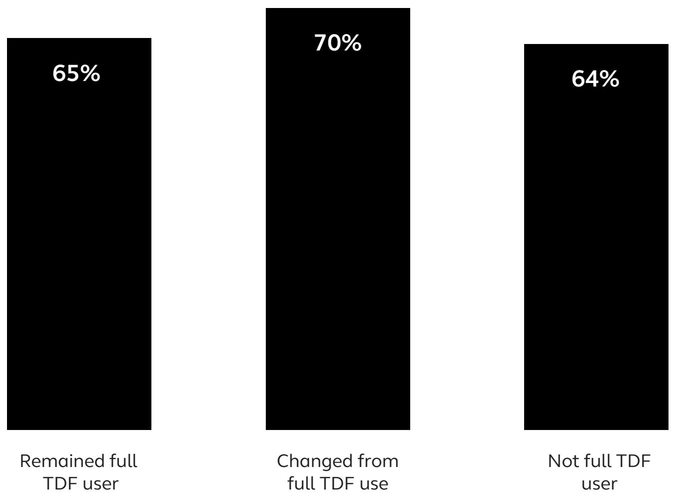
People in managed accounts contribute more than full TDF investors, and are more likely to continuously save.

- People enrolled in a managed account contribute 2.4% more on average than full TDF investors.
- Over a three year period, 84% of those consistently enrolled in a managed account made contributions throughout the period, compared to 69% of those consistently invested in TDFs.

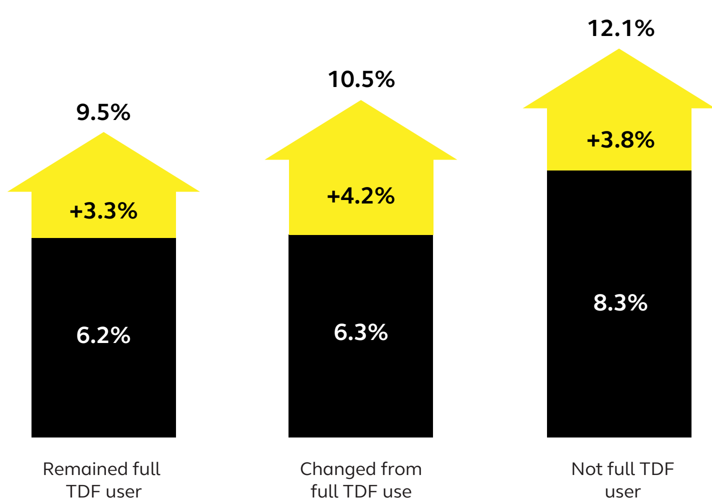
Source: Professional Investment Assistance in Defined Contribution Plans, 2008-2017, Alight Solutions

Usually, when people changed their contribution rate, they increased it. Those who changed from full TDF use increased their contribution rate to an average of 10.5%—one percentage point higher than the average for people who remained full TDF users and increased their rate.

Percentage who increased contribution rate, among those who actively changed their contribution rate



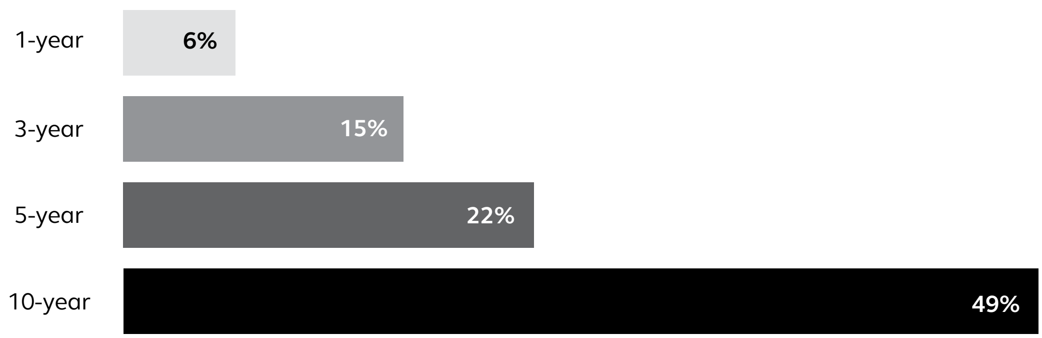
Average contribution rate increase, among those increasing contribution rate from previous year (excluding automatic escalation)



People don't stay invested in TDFs for very long.

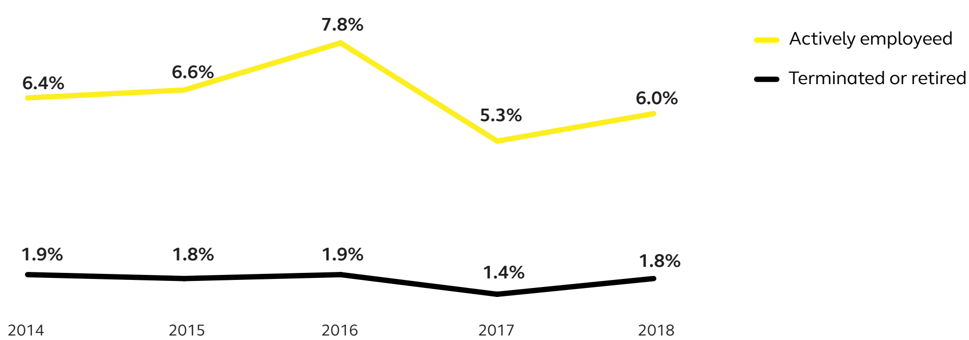
Even though many plans label TDFs with descriptions like "lifecycle funds," people are not staying invested in them throughout their working lives. In fact, half of people (49%) who were fully invested in them ended up moving out of them within ten years.

TDF lapse rates by time horizon



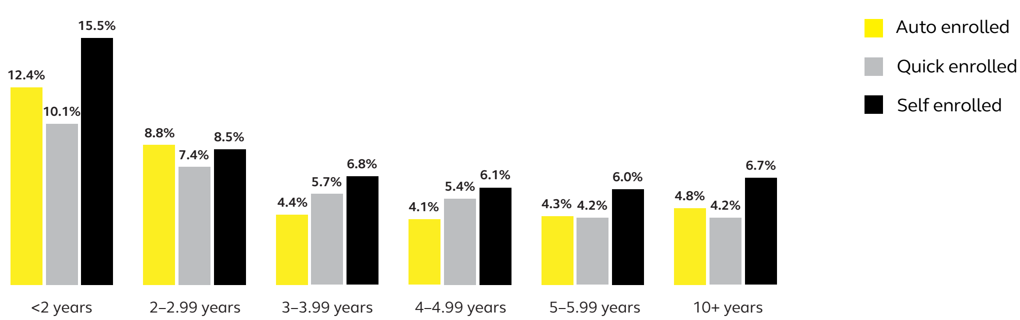
People who are actively employed are much more likely to change their investment from being fully invested in a TDF. Over the past five years, annual lapse rates[2] from full TDF use have remained relatively steady.

Lapse rate from full TDF, by year and status



People who enrolled on their own were more likely to move out of TDFs than people who were automatically enrolled or joined the plan through quick enrollment.[3] Those who were hired more recently were also significantly more likely to stop fully investing in a TDF compared to others.

2018 lapse rate from full TDF, by tenure and enrollment method, among actively employed

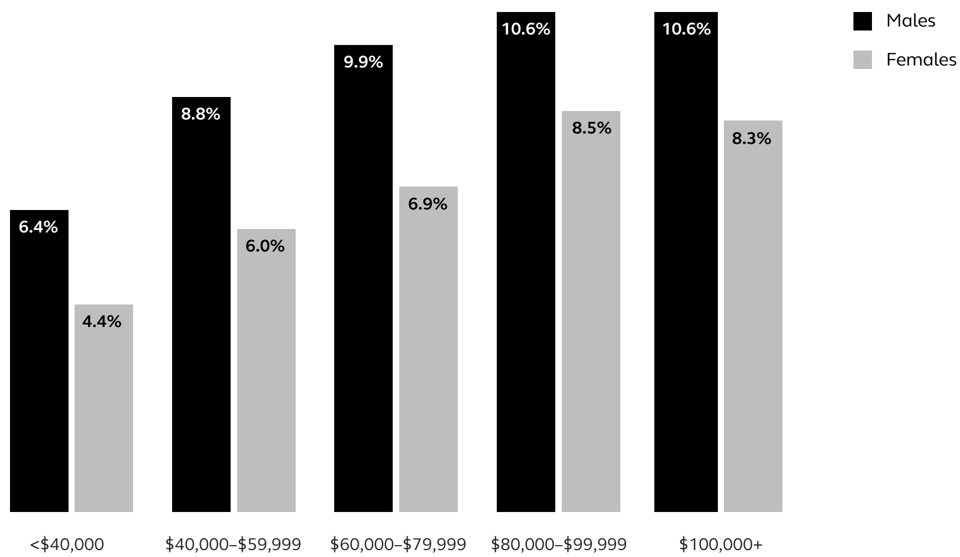


2 Lapse rate indicates the percentage of participants who went from full TDF use at the beginning of the year to something other than full TDF use by the end of the year.

3 Automatic enrollment occurs when a plan requires an individual to take action to opt out of the plan. If no action is taken, the individual becomes a participant in the plan. Under quick enrollment, a person makes a quick election online or by mail among a preselected savings rate and investment portfolio.

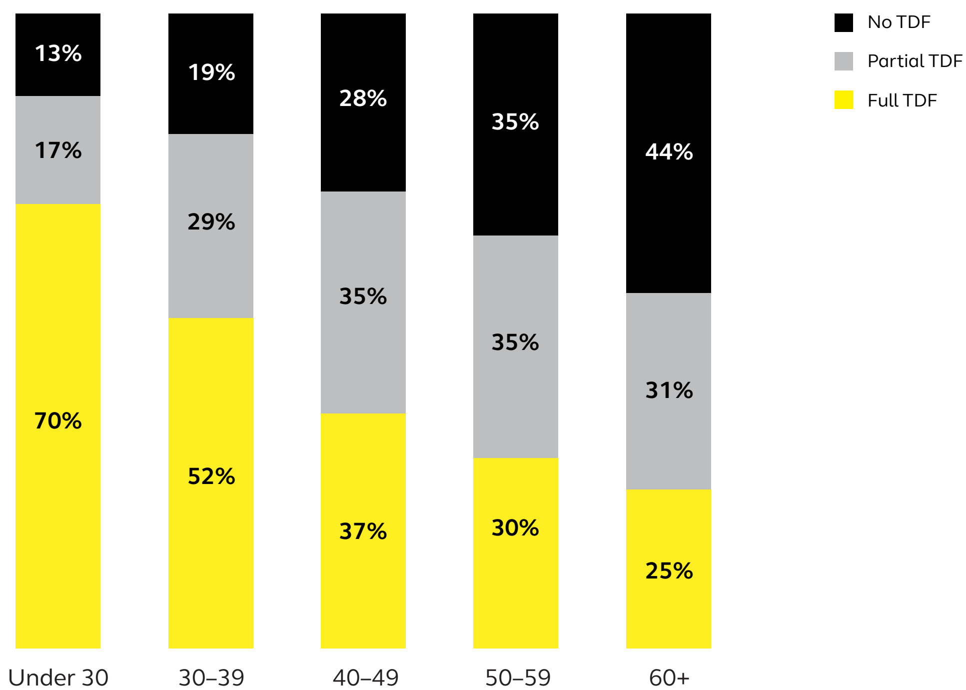
Males were more likely than females to move away from a full TDF portfolio. Also, higher-paid workers had higher lapse rates than lower-paid ones.

2018 lapse rate from full TDF, by pay and gender, among actively employed



Older participants are least likely to have their entire balance invested in a TDF. Among those close to retirement (age 60 or older), just 25% had their entire balance in a TDF.

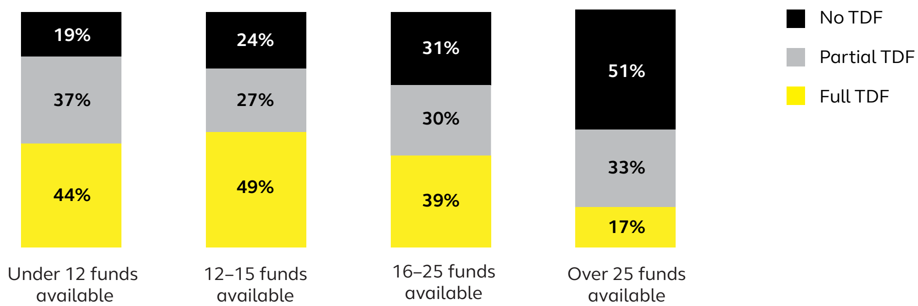
TDF use type, by age



TDF use is impacted by what other investment funds are available.

Three-quarters of plans communicate investment tiers to their people, with the vast majority using the TDFs as a tier.[4] Despite this, TDF usage depends on what other investment funds are available. Specifically, when there are more funds available, people are less likely to be invested in TDFs.

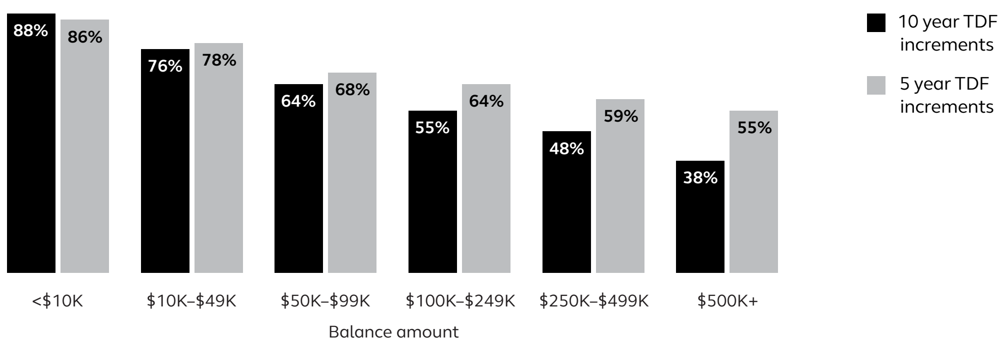
TDF usage by the number of funds available (excluding TDFs)



On average, plans have 14 investment funds outside of TDFs.[4]

People are more likely to use TDFs when vintages are offered in increments of 5 years rather than 10 years. Among those with balances under $50,000, there is a negligible difference in TDF utilization, but as balances became bigger than $50,000, TDF use became greater and greater among employers with 5-year vintages.

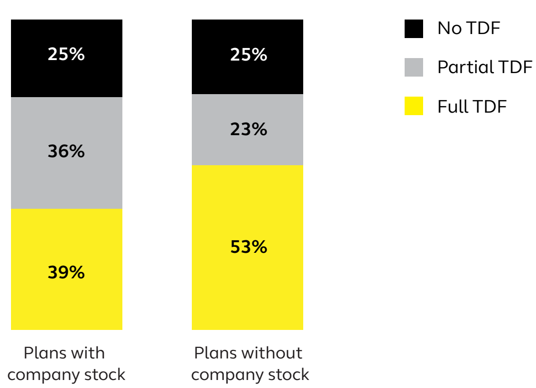
Percentage investing in TDFs, when vintages offered in 5-year or 10-year increments



33% of employers have company stock as an investment option.[4]

There is virtually no difference in the percentage of people who invest in TDFs when company stock is available as an investment option in the 401(k) versus when it is isn't available. However, partial TDF use is higher in plans with company stock, often with people supplementing their TDF investments with company stock.

TDF usage by company stock availability

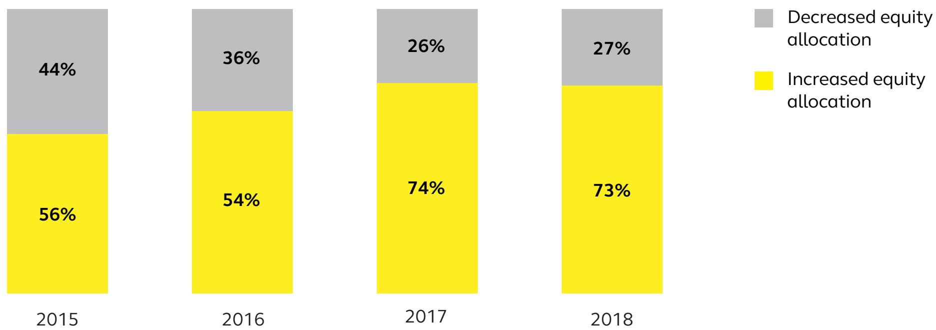


4 Trends & Experience in Defined Contributions Plans, 2019, Alight Solutions

When people stop using TDFs, many make extreme changes to their asset allocation.

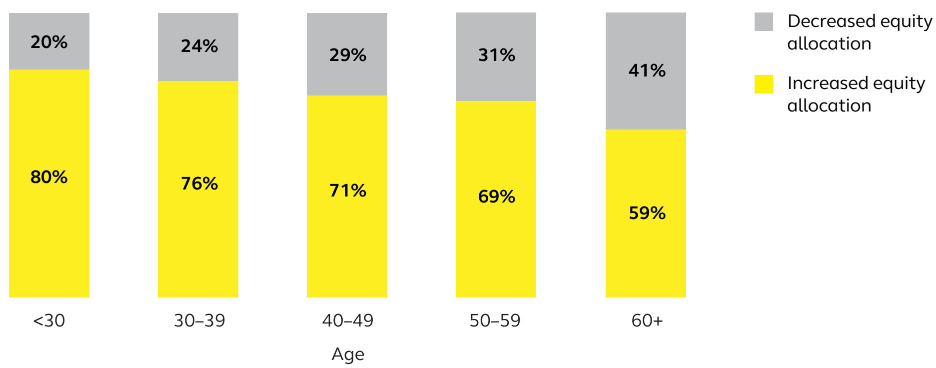
Most people increased their overall portfolio allocation to equities when moving out of TDFs.

Percentage who increased/decreased portfolio equity allocation when changing from full TDF, by year



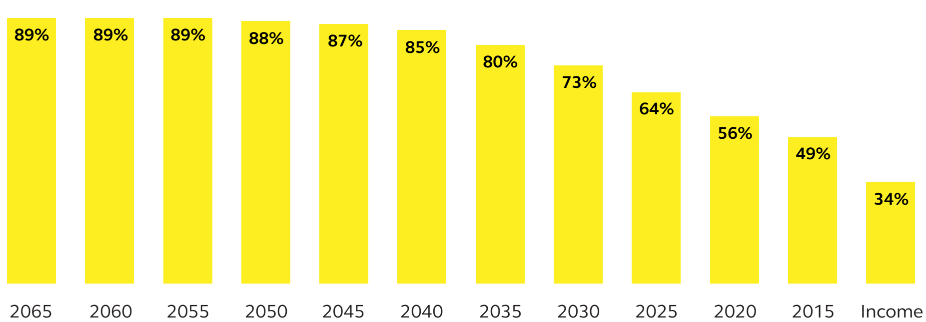
TDFs are designed to reflect the appropriate level of equity allocation based on a person's age, with younger people taking on more risk than those closer to retirement. Despite TDFs having an average allocation of 89% for 2050+ vintages, the younger people who left them generally increased equity exposure. Among older age cohorts, a higher percentage decreased their equity allocation. There could be at least two explanations for this behavior: 1) individual factors and preferences for a different risk exposure or 2) a fundamental lack of understanding of TDFs.

Percentage who increased/decreased portfolio equity allocation when changing from full TDF, by age



Among those who changed from full TDF during 2018

Average TDF equity allocation, by vintage

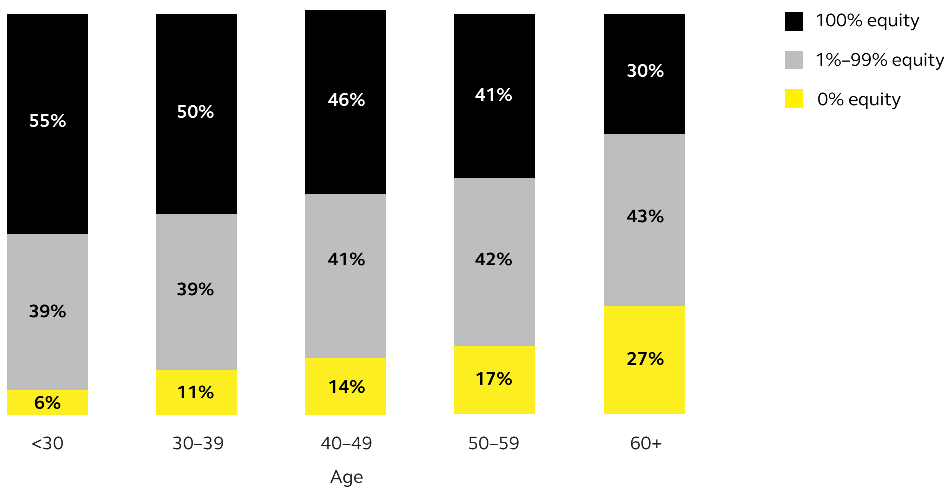


Averages based on TDFs offered by various asset managers as of 1/1/2019

When people switched from full TDF usage in 2018, three in four (75%) kept at least some money in TDFs. Those who moved fully away from TDFs were most likely to be close to retirement age. More than one-third (36%) of people age 60 or older who changed from full TDF use chose not to use TDFs at all.

When investors moved all of their money out of TDFs, they tended to make extreme portfolio allocations. Almost half (46%) invested their entire balance in equities, while 14% invested solely in fixed income. 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. Nevertheless, 30% of investors age 60 or older chose a 100% equity allocation after changing from full TDF use.

Percentage of people, among those changing from full TDF use to no TDF use



Most people do not understand TDFs.

When people were asked to select true statements regarding TDFs, **59%** indicated they didn't know anything about target date funds.

Additionally,

14% Just 14% correctly indicated that a TDF rebalances over time

11% Just 11% correctly indicated that a TDF is designed so that people need to invest in only one fund instead of several

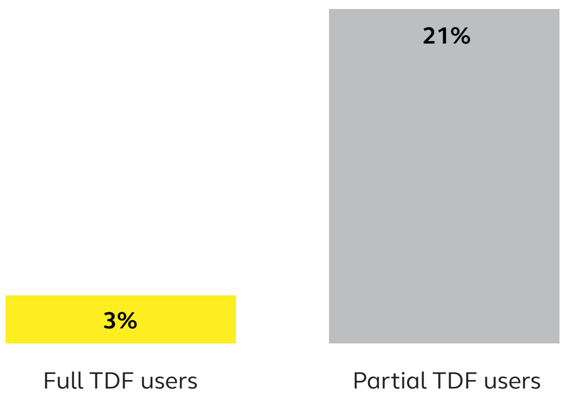
Source: Health & Financial Wellbeing Mindset Study, 2019, Alight Solutions

Investing in multiple TDFs is common.

One out of every 10 people who use TDFs are invested in more than one vintage. One out of every five partial TDF users is invested in more than one TDF.

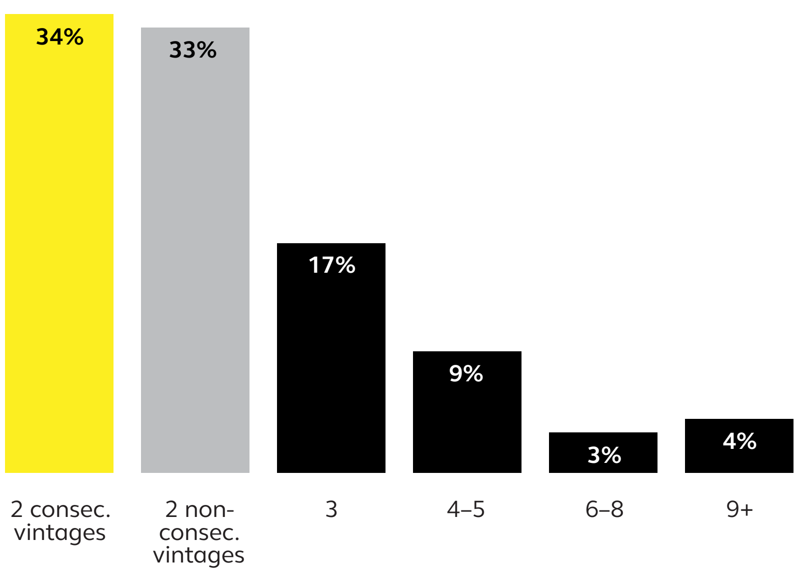
People with larger balances are more likely to invest in more than one vintage. Among full TDF investors with a balance of at least $100,000, 9% used more than one TDF vintage.

Percentage of TDF investors investing in more than one vintage



Of people investing in multiple TDFs, one in three (33%) are invested in more than two vintages. However, only 34% of those investing in multiple vintages use two vintages that are "consecutive," meaning the associated target retirement years are within 5 years of each other (10 years if TDFs are only offered in vintages of 10-year increments).[5]

Percentage of TDF investors investing in number of vintages, among those investing in multiple vintages



5 People using the income vintage in addition to another vintage were considered to be consecutively investing in two vintages if the other vintage was a 2020 vintage or earlier.

Furthermore, among people invested in multiple TDFs, a significant portion of dollars are not in seemingly age-appropriate vintages. Across all such investors, 30% of TDF assets among these investor types fall outside of +/-5 years of one's typical retirement vintage.

Percentage of TDF assets in vintages, by age cohort, among multiple TDF users

Among participants 25 and younger who are invested in multiple TDF vintages, 28.7% of assets reside within a 2060 vintage or higher.

Among participants 66 and older who are invested in multiple TDF vintages, 32.1% of assets reside in vintages more than 5 years outside of that which typically correspond with this age group.

Vintage	25 and younger	26–30	31–35	36–40	41–45	46–50	51–55	56–60	61–65	66 and older
2060+	28.7%	5.8%	3.2%	1.9%	1.8%	1.6%	1.1%	0.8%	0.8%	0.7%
2055	25.7%	37.2%	9.5%	4.0%	2.5%	1.8%	1.4%	1.1%	0.9%	1.2%
2050	17.3%	31.6%	40.4%	13.9%	7.1%	5.0%	4.3%	3.3%	3.0%	2.4%
2045	4.6%	7.1%	17.6%	35.5%	11.2%	4.4%	2.9%	1.9%	1.5%	1.4%
2040	5.3%	5.4%	13.1%	22.8%	39.5%	16.1%	7.8%	5.4%	4.4%	4.2%
2035	2.4%	1.9%	3.6%	7.9%	15.7%	35.0%	12.3%	5.8%	4.2%	3.5%
2030	2.8%	1.9%	2.9%	4.5%	10.2%	20.0%	37.6%	17.6%	10.3%	6.9%
2025	2.5%	1.4%	1.6%	1.7%	3.3%	6.4%	16.3%	34.5%	20.0%	11.9%
2020 and below	2.7%	1.5%	1.8%	2.1%	2.9%	3.9%	9.5%	19.5%	36.3%	25.9%
Income	8.0%	6.3%	6.3%	5.6%	5.8%	5.7%	6.9%	10.1%	18.8%	42.0%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Portion outside range	45.6%	25.4%	32.5%	27.8%	33.6%	28.9%	33.8%	28.4%	25.0%	32.1%

What are some questions for plan sponsors to consider?

- People may not understand how TDFs are intended to be used. How can employers better educate their workers?
- Target date users may need to be reminded of the importance of saving for retirement. How can employers nudge them in this direction?
- Are there better investment options than the current suite of TDFs?
- Most people increase equity exposure when changing their investment from a TDF. How can sponsors help workers determine the right amount of risk for their situation?

About Alight Solutions

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