Deep Dive: References, Sources and Additional Resources for the "Zombie Investors" Article on Problems with 401(k)s and Target Date Funds

1. *Officially, neither the U.S. government nor the retirement planning industry keeps count of how many American employees entrust others to decide for them how and where to invest their hard-earned retirement savings.*

    - **Vanguard** email (9/15/10) from Rebecca Katz, Public Relations: "Bad news!! We don't have such data. We have not been able to track default behavior at the participant level…. We're looking at ways to track this in the future, but alas, we can't help now."

    - **Department of Labor** email (9/14/10) from Gloria Della, Director, Public Affairs: "The research office of the Employee Benefits Security Administration does not have data on participants that do not make investment choices. He also indicated that it is hard to determine, even at the plan level, whether an individual elected via silence to participate in a QDIA fund.

      He did not have any definitive external research source, but recommended contact the Employee Benefits Research Institute in Washington…"

    - **Employee Benefits Research Institute** email (9/13/10) from Stephen Blakely, editor and communications director: "We do not have that number."

    - **Profit Sharing/401K Council of America** emails (9/13/10) from David Wray, press contact: "Excellent question but one we have not asked." – "Do not know enough to [make an educated] guess."

2. *Nonetheless, there is evidence that the number of these so-called 'zombie investors' – those who shuffle forward without using their brains – may already exceed 15 million individuals and is on a sharp upward trajectory.*

    - Figures from the **Employee Benefit Research Institute** and **Investment Company Institute** indicate that by the end of 2008, 15.4 million people held at least some of their 401 (k) funds in Target Date Funds.

      Both the number of investors and the total pool of TDF funds are growing rapidly. Between 2003 and 2009, according to the

Investment Company Institute, the funds held in TDFs grew almost tenfold.

While TDFs are not the only 401 (k) QDIA funds likely to overcharge savers for fees and expenses, they are the most prevalent of the three qualified default investment alternative funds.

The industry-wide average asset-weighted total expense ratio in stock market funds used for 401(k) plans is 0.74% according to the **Investment Company Institute**.

Vanguard Mutual Fund Group founder **John Bogle** and others estimate that the annual costs charged to investors in TDFs "can reach almost two percentage points."

3. *Effective management of a retirement portfolio can be a challenging task, requiring significant knowledge and commitment of time," cautions the Securities and Exchange Commission.*

- Background, Page 5, Investment Company Advertising: Target Date Retirement Fund Names and Marketing, 17 CFR Parts 230 and 270. . June 16, 2010.

4. *Such full-faith reliance on administrators and funds managers is propagating gargantuan portfolio losses that will billow to hundreds of billions of dollars during the lifetimes of the current generation of U.S. workers.*

- **Fidelity Investments**, which is the nation's leading provider of workplace retirement savings plans, reports that as of June 30, 2010, the average 401 (k) account balance was $61,800.

- The **Investment Company Institute**, the national association of U.S. investment companies, reports that the 401(k) plan retirement system now holds $2.8 trillion in assets on behalf of more than 50 million active participants and millions of former employees and retirees.

- About 10 percent of all 401 (k) plans, or $270 billion, are now invested in Target Date Funds, according to the **Securities and Exchange Commission** and **Morningstar Direct**. Fee and expenses for TDFs can range widely.

- The **Department of Labor** reports that a 100 basis points difference in fees and expenses – 1.5% versus 0.5% -- for a fixed sum 401 (k) of $25,000 held for 35 years and producing an annual return on investment of 7 percent will deprive the investor of $64,000 in realized savings.

- If all $270 billion currently invested in TDFs were to 'overpay' 100 basis points in fees and follow the same 35-year course with an annual return of 7 percent, the total amount lost in potentially realized savings would be $691.2 billion.

Our estimate assumes the average 401 (k), with a current account balance of $61,800 will continue to grow during the lifetimes of the current generation of U.S. workers and is already much larger than the SEC's example of a fixed $25,000 portfolio.

Certainly not all investors holding TDFs will overpay 100 basis points on fees and expenses for the lifetime of their 401 (k) plan. That will be even more true as word spreads about how punitive such fees are when compounded.

But it does not require a refined calculation to understand that if a single basic portfolio of just $25,000 is diminished over 35 years by $64,000 in unnecessary fees, aggregate 401 (k) portfolios currently in the $270 billion range – and rapidly rising – could forego hundreds of billions of dollars during the lifetimes of their owners.

5. *Consider the financial fate of an unawares 30-year-old worker who has relegated the choice of which 401(k) plan should be selected for his or her present-day retirement balance of $25,000.*

   - Calculations based upon **U.S. Department of Labor**'s, *A Look at 401 (k) Plan Fees*, available at http://www.dol.gov/ebsa/publications/401k_employee.html

6. *Or because there are no prescribed standards for who is permitted to make these judgments, employees may be entrusting the most important financial decision of their lifetime to their boss's dunderhead brother-in-law.*

   - The **Employment Retirement Income Security Act** (ERISA) sets standards for 401 (k) plan administrators for private-sector retirement plans. ERISA does not apply to public-sector plans or those sponsored by churches.

     ERISA sets standards for the behavior of plan administrators but not their specific qualifications or training.

     "The duty to act prudently is one of a fiduciary's central responsibilities under ERISA. It requires expertise in a variety of areas, such as investments," according to *Meeting Your Fiduciary Responsibilities*, a **U.S. Department of Labor** guide published in October 2008.

> "Lacking that expertise, a fiduciary will want to hire someone with that professional knowledge to carry out the investment and other functions," the guide notes.
>
> On the specific topic of fees, the Labor Department says: "While the law does not specify a permissible level of fees, it does require that fees charged to a plan be "reasonable." The guide does not expand upon DOL's definition of "reasonable."

7. *"In 2006, as part of the Pension Protection Act, Congress approved legislation that shields companies and their 401 (k) administrators – including the employer's idiot brother-in-law – from liability…"*

- **Securities and Exchange Commission**. Background, Page 8, Investment Company Advertising: Target Date Retirement Fund Names and Marketing, 17 CFR Parts 230 and 270. . June 16, 2010.

8. *According to Towers Watson, a global risk and financial management consultancy, 90% of all new hires and 80% of those doing a reenrollment of investment elections let their 401 (k) plan administrator choose for them where their money will be staked.*

- **Towers Watson** email reply (9/13/10) from Whitney Kuhn, media relations.

9. *Of those who opt for the no-brainer – i.e. "zombie" – method of retirement planning, roughly 70% end up invested in so-called Target Date Funds…*

- Testimony of Andrew J. Donohue, Director of Investment Management, U.S. Securities and Exchange Commission, October 28, 2009, citing a Mercer, Inc. study of more than 1,500 companies.

10. Since their inception in 1993, TDFs have grown exponentially and now account for about $270 billion, or roughly 10%, of all 401(k) assets. The funds attracted $43 billion in net new cash flow in 2009 alone and by some estimates may reach the $1 trillion level by 2014.

- "*Industry's First Target-Date Fund Celebrates 15 Years Since Groundbreaking Launch*" – news release (11/7/08), **Barclays Global Investors**.

- The **Securities and Exchange Commission** and **Morningstar Direct**. See Background, Pages 7&8, Investment Company Advertising: Target Date Retirement Fund Names and Marketing, 17 CFR Parts 230 and 270. June 16, 2010.

- $1 trillion estimate is from **Cerulli Associates**, as cited in **Fortune** magazine, June 2, 2010, "*The senator who wants to save your retirement*," by Katie Benner.

11. *TDFs proved highly unreliable in 2008, when funds with a fast approaching target date of 2020 suffered losses averaging almost 25%. At least on of 31 theoretically "safe" 2010 target date funds plunged 41%.*

- Testimony of **Mary L. Schapiro**, Chairman, **Securities and Exchange Commission**, June 18, 2009, page 14. Public Hearing on Target Date Funds and Other Similar Investment Options – Washington D.C.

- **Oppenheimer's Transition 2010** target-date fund lost 41% in 2008 and was ranked the worst such investment by **Morningstar**, according to **Fortune** magazine, June 2, 2010, "*The senator who wants to save your retirement*."

12. *The fact that TDFs failed to prevent the portfolios of expectant retirees from evaporating so rapidly caused the SEC, Department of Labor and Congress to make quite a fuss, holding hearings and earlier this year proposing new SEC rules aimed at providing investors a better understanding of the risks associated with TDFs.*

- "Target Date Funds Get Senate Scrutiny" – **Wall Street Journal**, October 30, 2009, By Daisy Maxey

- "SEC Proposes New Measures to Help Investors in Target Date Funds" – Securities and Exchange Commission news release – June 16, 2010

13. *And astonishingly, no government body is promulgating new rules aimed at capping the wide-ranging fees charged by administrators and fund managers – fees that actually are the most risk-laden aspect of TDFs and all 401(k) funds.*

- In February 2009, **Senator Tom Harkin** of Iowa and **Senator Herb Kohl** of Wisconsin sponsored the *Defined Contribution Fee Disclosure Act of 2009*, which would require all 401 (k) plan providers to disclose all fees to those saving for retirement. The bill was read twice and then referred to the Committee on Health, Education, Labor, and Pensions. It has not been heard from since.

Fortune magazine reported in June 2010, "*The senator who wants to save your retirement*", that Senator Kohl is drafting legislation that would deem target-date companies to be fiduciaries under the Employee Retirement Income Security Act (ERISA). In theory, such legislation could regulate both fees and who is permitted to act as a TDF fiduciary. Senator Kohl has yet to actually introduce such a bill.

14. *TDFs might well have to deliver average annual returns of as much as 8% to 10% - or more - just to break even.*

- Authors' estimate.

15. *TDFs, it turns out, are the elite of the zombie 401(k) guard…*

- **Brightscope**, a research firm, says target-date fees are 10% to 25% higher than those of other 401 (k) options, as cited in **Fortune** magazine, June 2, 2010, "*The senator who wants to save your retirement*."

16. *Because of compounding, keeping fees in check will likely have greater influence on how much money individuals have to spend in retirement than the underlying performance of the funds they invested in…*

- "Fees are the single biggest factor in predicting the performance of target-date funds…," **Anne Tergesen**, *How to Pick a Target-Date Fund*, **The Wall Street Journal**, July 24, 2010. Ms. Tergesen bases her statement on data recently released by investment-research firm, **Morningstar Inc**.