Participant Preferences in Target Date Funds: An Update

Examining Perceptions and Expectations Among Target Date Investors and Non-Investors

White Paper | February 2014

A research study by Voya Investment Management and Voya *Retirement Research Institute*®

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Executive Summary

Voya Investment Management conducted an online survey in September 2013 with 1,017 employer-sponsored retirement plan participants to see if attitudes toward target date funds and preferences among target date fund features have changed since our 2011 study. Among the findings:

- Target date fund investors remain significantly more confident about investing and meeting their retirement goals than non-target date fund investors, exhibiting more indicators of investment success, such as higher contribution percentages.
- Despite the rise in the equity markets since the last survey, participants still prefer wealth preservation over growth, especially at or near retirement.
- Target date fund investors expect broad diversification in their target date funds, with that preference extending to multiple investment managers.
- Those who invest in target date funds do so for the ease of use and built-in diversification that adjusts over time. Those who don't invest in a target date fund might consider it if they had more communication about the benefits of the products.

Have Participants' Target Date Fund Preferences Changed in the Past Two Years?

In September 2011, Voya Investment Management, in collaboration with the Voya *Retirement Research Institute®*, conducted a comprehensive survey to determine the preferences of defined contribution plan participants — as opposed to those of sponsors and consultants — on the various investment features of target date funds (TDFs).[1] The goal was to support plan sponsors in the target date fund selection process by helping them align their choice with the preferences and attitudes of their plan populations.

Findings from 2011

The 2011 survey revealed:

- Participants who use target date funds are significantly more confident in their ability to reach retirement goals than those who don't.
- The overwhelming preference of both target date fund investors and non-investors was to preserve their wealth, rather than grow it, especially at or near retirement.
- Both TDF investors and non-TDF investors showed a strong preference for target date funds that incorporate a broad number of asset classes and investment managers.
- Despite stated and unstated needs for more TDF education, the survey found strong support from participants for TDFs as a qualified default investment vehicle (QDIA).

Any follow-up survey should try to determine if these one-time findings persist over time and thus continue a trend. That's especially true for our 2011 survey, which was taken not so long after the Great Recession — and while TDFs were still somewhat enigmatic to many plan participants. The preference for wealth preservation, for example, was to be expected given the tumultuous financial markets of 2008–10. But do participants still feel that way two years into a strong bull market? These and other questions were addressed in this current survey.

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Methodology for Follow-Up

Voya Investment Management conducted an online survey of 1,017 employer-sponsored retirement plan participants between September 16, 2013, and September 20, 2013. Of the respondents, 500 invested in a TDF within their plan while 517 did not. All respondents to the survey were currently contributing to an employer-sponsored defined contribution plan, were age 25 or older, and were the primary/joint financial decision maker for their account.

The survey included plans of all employer sizes. The data has been weighted by household income, age and gender, among other variables, to more closely represent the demographics of the general retirement plan population.[2] To prevent bias, Voya Investment Management was not identified as the sponsor of this research.

[1] The original research is available at voyainvestments.com.

[2] At 90% confidence, the margin of error in the study was +/- 3.5%.

Target Date Funds Increased Investors' Confidence Levels

The 2013 Employee Benefits Research Institute (EBRI) retirement confidence survey found that the percentage of workers confident about having enough money for a comfortable retirement is essentially unchanged from the record lows observed in 2011. Only 13% of workers felt very confident that they are doing a good job of preparing financially for retirement, and more than 49% felt either "not at all confident" or "not too confident" they would have enough money for a comfortable retirement.[3]

It's probably not surprising that two years of favorable markets have not budged these perceptions, given the continuing low retirement savings of DC retirement plan participants. Our survey provides some reassurance that things may change — at least in the sense that target date fund investors remain significantly more confident about investing and meeting their retirement goals than non-target date fund investors, and exhibit more indicators of investment success, such as higher contribution percentages.

Target date fund investors remain significantly more confident about investing and meeting their retirement goals than non-target date fund investors.

TDF investors feel more comfortable with the tasks associated with retirement plan investing…

Strongly Agree / Agree / Disagree

	TDF Investors (%)				Non-TDF Investors (%)			
	Total	Strongly Agree	Agree	Disagree	Total	Strongly Agree	Agree	Disagree
I am comfortable deciding how much to invest in each investment option in my 401(k), 403(b) or 457 plan.	67	22	45	13	52	13	39	18
It's easy to get enough information about my investment options to make informed decisions.	66	17	49	8	49	10	39	15
I have the time that is required to keep an eye on my investments and to make changes as market conditions change.	57	17	40	21	40	11	29	32
And this contributes directly to confidence that they will reach their retirement goals:								
I am confident I will reach my retirement goals.	56	17	39	16	41	8	33	24
I have a plan to turn my 401(k), 403(b) or 457 plan savings into an income stream once I retire.	64	22	42	13	43	9	34	21

[3] EBRI Issue Brief #384, March 2013

The survey provides some clues as to why TDF investors are more confident:	TDF Investors %	Non-TDF Investors %
I feel investing in a Target Date Fund would alleviate the stress of retirement planning.	70% Agree or Strongly Agree	39% Agree or Strongly Agree
A Target Date Fund will increase my confidence that I am making good investment decisions.	68% Agree or Strongly Agree	37% Agree or Strongly Agree
A Target Date Fund will increase my confidence that I will have a successful retirement.	68% Agree or Strongly Agree	34% Agree or Strongly Agree

Almost 50% of TDF investors report contributing over 10% of income to their plans.

Higher Confidence Leads to Higher Contribution Percentages

The gap in confidence levels between TDF investors and non-TDF investors suggests that TDFs are doing what they are supposed to be doing: providing a diversified investment option for plan participants that reallocates over time to make investment planning easier to execute — and retirement goals easier to reach. This not only translates into general employee satisfaction but also into tangible results. TDF investors report contributing a full 2% more of their pay to their retirement plans than non-TDF investors. In fact, 42% of TDF investors report contributing over 10% of their income (vs. 23% of non-TDF investors).

Participants Favor Wealth Preservation over Growth, Especially Near Retirement

In 2008, the S&P 500 Index dropped 37% and equity fund flows into defined contribution plans dropped by $229 billion. In the five years since then, the S&P 500 has gained an average of 15% per year; net equity flows have continued to decline, however, by a total of $306 billion as of the end of 2012.[4] From a behavioral finance standpoint, one could argue that investors still suffer from the "snake-bite effect" of 2008. Target date funds can help insulate participants from such dangerous investment behaviors; by design, they help protect against unexpected volatility at or near retirement — the very point at which participants are most sensitive to fluctuations in value.

Stronger Protection Against Loss in the Years Leading up to Retirement

If asked to choose between strong protection from investment loss and potential for investment growth in the years leading up to retirement, 64% of participants expressed a preference for protection from loss. When asked specifically about a target date investment, 92% of TDF investors (70% of non-TDF investors) expressed interest in a TDF that "provided stronger protection against investment losses near and in retirement."

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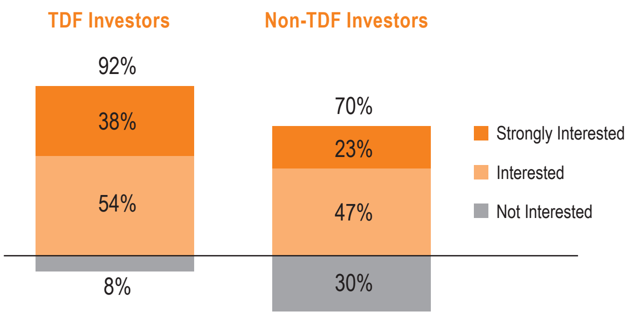


[4] Source: Investment Company Institute, Voya Investment Management. Flows include both 401(k) and IRA plans.

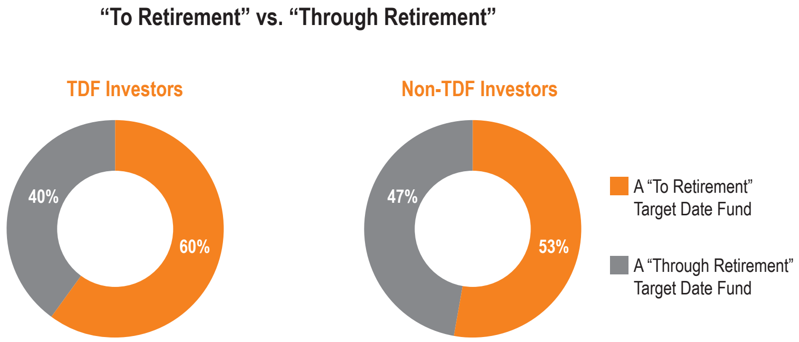
A Preference for a "To" versus a "Through" Glide Path

Both surveys — one taken during the cautious 2011 recovery and the other amidst the robust 2013 bull market — show that the majority of participants don't want their accumulated savings subjected to significant capital market losses either in the years leading up to retirement or after retirement.

How does this finding inform the debate among TDF observers on the relative merits of "to" versus "through" investment approaches? The industry is fairly evenly split between those whose target date glide path continues to adjust its equity/income mix "through" retirement age (i.e., well past the target date) and those that reach their most conservative allocation at the retirement target date (the "to" retirement approach), when participants are most vulnerable to market shocks.

The 2011 survey indicated an unspoken preference for a "to" glide path approach, so we decided to explicitly ask the question in the 2013 survey.[5] The preference — at least among TDF investors — was fairly clear: 60% prefer a "to" retirement glide path, something that plan sponsors — especially those with an older demographic — should keep in mind as they assess a target date fund provider's philosophy and approach.

Participants were asked:
Based on these descriptions, which type of target date fund would you prefer?



60% of TDF investors prefer a "to" retirement glide path, something that plan sponsors — especially those with an older demographic — should keep in mind.

[5] To and through were defined for survey participants as follows: Target Date Funds managing "to" retirement are generally less aggressively invested in the final years prior to retirement to help protect investors from market losses during that period (while limiting their potential for gains during that time). "To" managers reach their most conservative asset allocation at the target date.

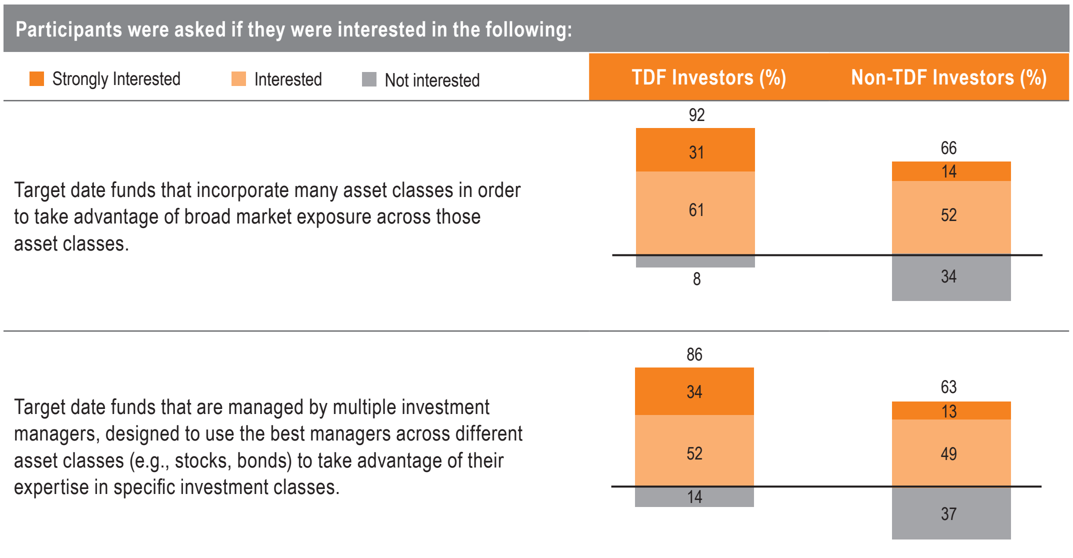
Target Date Funds managing "through" retirement are generally more aggressively allocated near and at retirement (meaning they have less protection from market losses during that time), while they will continue to change their asset allocation past the retirement date. "Through" managers reach their most conservative asset allocation between 10 to 30 years after the retirement date.

Broad Diversification of Asset Classes and Investment Managers

Target date fund managers not only differ in asset allocation design, they also differ in their use of underlying investment managers, allocations to various asset classes, and the inclusion of active and passive investment sleeves. When asked specifically about target date funds, participants showed a strong interest in diversification not only by asset class but also by investment manager.

Diversification Interest Level

Participants prefer and expect broad diversification across asset managers and asset classes.



Participants were asked: "Would you prefer to have a target date fund that allocates to multiple asset managers to gain exposure to best-in-class managers across different asset classes (e.g., stock, bonds), or a single asset manager with experience in all asset classes?" Among those who stated a preference, TDF investors chose a multi-manager approach by a 5 to 1 ratio, while non-TDF investors preferred multiple investment managers by a 2.5 to 1 margin.

The Importance of Diversification

Given this participant emphasis on diversification, it's important for plan sponsors to determine that their target date fund, which is designed to be a comprehensive, single-portfolio solution, actually provides adequate diversification. Most target date fund providers offer broad diversification among asset classes, but they may not provide coverage for key sub-classes or for alternative investments. Additionally, very few target date fund providers offer broad diversification among investment managers, as many invest only in proprietary funds. This survey reiterates the finding of the earlier one that participants prefer and expect broad diversification across asset managers and asset classes.

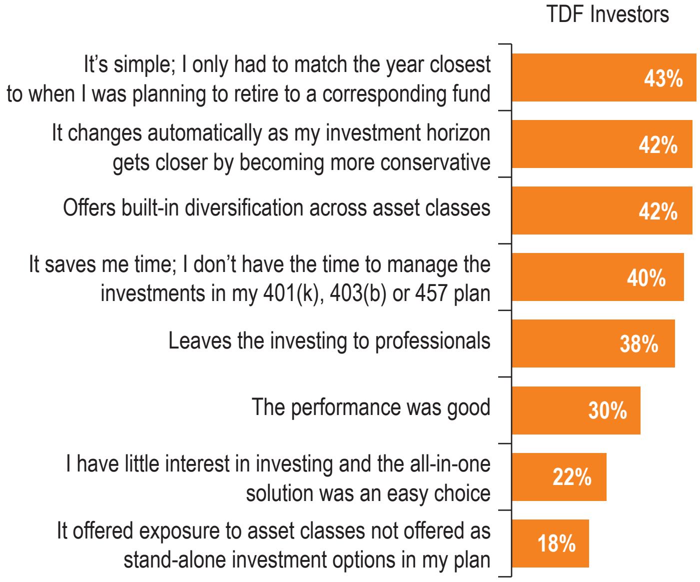
Investors' Perceived Benefits of Target Date Funds

Our 2011 survey revealed broad acceptance of target date funds. For example, 75% of TDF investors surveyed embraced a TDF as a default investment option (as did over 50% of non-TDF investors). For this survey, we wanted to gain a more specific understanding of what was attractive and unattractive about target date funds to TDF investors and non-TDF investors.

In 2013, TDF investors reported they made the decision to invest in target date funds based on the simplicity of choosing a target date, automatic adjustments to asset allocation along the glide path, and all-in-one diversification. Investment performance was a less significant factor.

TDF investors stressed time savings, simplicity, automatic reallocations and built-in diversification far more than performance as factors in choosing TDFs.

TDF Investors were asked:
Please select the factors as to why you choose to invest in a target date fund.



Non-Target Date Fund Investors' Perception of Target Date Funds

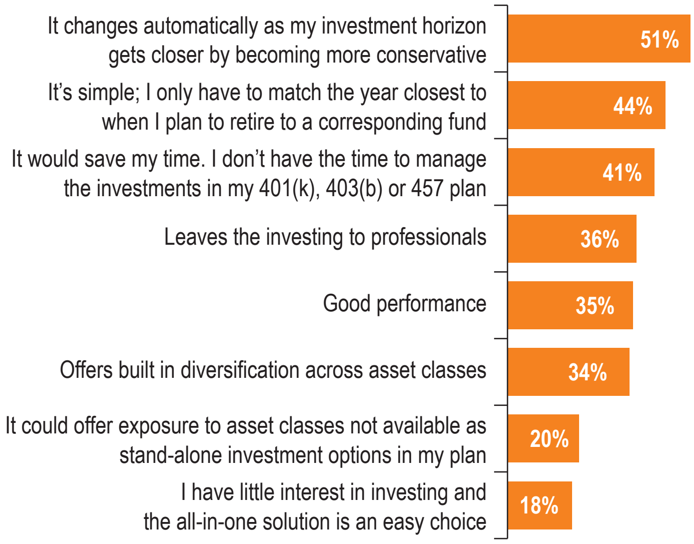
If simplicity was the prime draw for TDF investors, the main drawback for those who chose not to invest in a TDF was the wish to select and monitor their investments themselves. A commanding 54% of non-TDF investors chose that as the reason for not investing.

For those participants without a plan TDF option, we asked if they would invest some of their 401(k) money in a target date fund (knowing that over 50% of this population by their own admission "did not understand" target date funds). Of the 46% who said they would consider one, we asked what factors would lead them to actually invest in a TDF. Here's how they responded:

Non-TDF investors were asked:

Please select the factors that would lead you to invest in a Target Date fund.

Simplicity and convenience trump investment considerations such as performance for interested non-TDF investors



As with those who already decided to invest in TDFs, simplicity and convenience trump investment considerations such as performance for interested non-TDF investors.

Finally, we asked of those who would consider a TDF what percentage they would consider investing in one. Here, the lack of communication about TDF benefits is readily apparent, as only 6% of this sub-group say over 80% of their plan assets. The median contribution percentage is 31%, roughly equivalent to the allocation of other investments in a retirement portfolio.

The “Mainstreaming” of Target Date Funds

Our original survey identified how participants understand TDFs and what specific features they prefer. Target date funds have since come to dominate investment menus even more than was foreseen at that time. According to Callan Research, 72% of defined contribution plans now utilize TDFs as the default investment option.[6] Our update makes it clear that target date funds are now accepted and supported by those who invest in them.

This confirms that TDFs have moved from the periphery of retirement plan menus to the center, having grown in acceptance because of their simplicity and ease. Our latest survey, by and large, reinforced the appeal of TDFs identified in the first survey, in that:

- TDF investors remain more confident about investing and meeting their retirement goals than non-TDF investors.
- TDF investors contributed at a higher percentage than non-TDF investors.
- Participants continue to favor a conservative TDF investment posture, especially at or near retirement.
- Participants strongly prefer diversification and multiple investment managers in TDFs.
- Participants have become much more comfortable with, and supportive of, automatic features.
- Support of target date funds centers around ease, diversification and understanding of TDF design.

Target date funds can play an essential role in ensuring retirement readiness for plan participants.

The key takeaway from this research is that target date funds can play an essential role in ensuring retirement readiness for plan participants. Target date investors understand and support auto-enrollment (71%) and auto-escalation (69%), which can help plan sponsors get participants into a TDF. Investors also support TDFs as QDIAs, with 74% of target date fund investors agreeing that “having a target date fund as the default option in my 401(k), 403(b) or 457 plan would be helpful for many participants.”

Using a TDF as a QDIA, backed with auto-enrollment and auto-escalation features, can be an effective solution to today’s retirement savings problem — provided that sponsors also align plans with the investment preferences of participants, which center around conservative glide paths and multiple investment providers.

[6] Callan 2014 Defined Contribution Trends Survey, p. 21

Voya Investment Management has additional materials that provide a framework for assessing the investment approaches of different TDF providers and better help individual plans meet their fiduciary duties in the selection of a Target Date provider. Contact your Voya Representative or visit www.voyainvestments.com today to learn more.

Voya Investment Management

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[1] As of December 31, 2014 Voya IM assets of $204 billion include proprietary insurance general account assets of approximately $83 billion calculated on a market value basis. Voya IM assets, as reported in Voya SEC filings, include general account assets valued on a statutory book value basis and total approximately $199 billion. Both totals include $7 billion in Private Equity assets managed by Pomona Capital, approximately $7 billion in Real Estate and $3 billion in other assets. The $34 billion in DC assets excludes approximately $27 billion in assets under administration.

Important Information

There are no guarantees a diversified portfolio will outperform a non-diversified portfolio.

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