Participant Preferences in Target Date Funds: Fresh Insights

Findings, Insights and Opportunities

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Research by Voya Investment Management

INVESTMENT MANAGEMENT
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Executive Summary

In our third survey of participant preferences in target date funds, Voya Investment Management tracked how views of target date funds (TDFs) have evolved as these funds have become more mainstream investment vehicles for defined-contribution plans. The survey, conducted online in September 2015 with 1,005 employer-sponsored retirement plan participants, confirms **key trends established** in our 2013 and 2011 surveys:

- TDF users are more confident than non-users that they will reach their retirement goals, and feel greater comfort with investment decision making.
- TDF users report contributing more to their accounts than non-users – a median of 2% more of income.
- Acceptance of TDFs has steadily progressed as more participants come to understand their benefits, convenience and features.
- Most participants prefer multi-manager TDFs, with a mix of proprietary and nonproprietary funds. Yet many do not fully understand the diversification benefits of TDFs.
- Nearly two-thirds of users prefer TDFs with a “to retirement” asset allocation glide path over a “through retirement” glide path.
- The majority of participants puts a high priority on wealth protection, especially near retirement.

In addition, **new insights** have emerged:

- Certain employee cohorts are less confident of reaching their retirement goals than older or male participants.
- Across all survey respondents who express a preference, nearly two out of three prefer TDFs with a mix of active and passive managers. Fewer than one in four prefer all active and fewer than one in seven prefer all passive.
- Interest in TDFs is linked to generations: Millennials show the highest level of interest, followed by Gen-Xers and then Baby Boomers.

Finally, our study’s results point to several **opportunities** for plan sponsors to improve participation rates and potentially enhance outcomes for retirement savers:

- Implement automatic enrollment into a TDF as the plan’s qualified default investment alternative (QDIA)
- Implement automatic escalation of contributions to increase savings
- Increase use of targeted communications to, and engage with, specific employee cohorts to increase awareness of the benefits of TDFs

New Findings and Insights

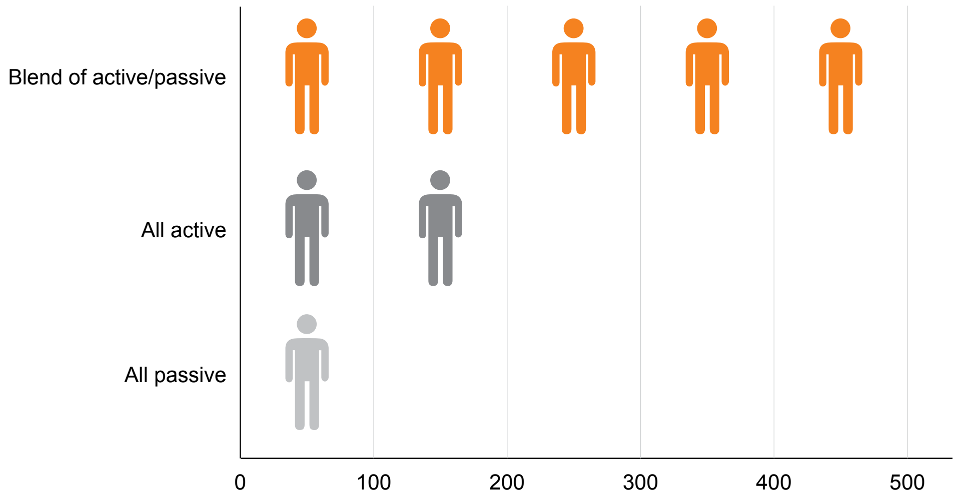
Global economic uncertainty has prevailed since our initial survey in 2011, and so it is not surprising that we find it's had an impact on investor confidence. Self-described, less-experienced investors — more often reported by female and younger participants — seem generally less confident of reaching their retirement goals than older and male counterparts. Among participants age 25-49, 44% agreed with the statement, "I'm confident that I will reach my retirement goals," whereas 54% of those over age 50 said they were confident. Across all age groups, men expressed higher confidence than women. This finding suggests that it may be beneficial for educational programs about target date fund benefits to focus on younger participants and women.

Millennials show greater interest in target date funds (TDFs) than do Gen-Xers or Baby Boomers, likely because they have been introduced to them from the very beginning of their careers. Use of TDFs is likely to increase as Millennials come to represent a greater portion of plan participants, and the use of auto-features continues to gain traction. Millennials also show keen awareness of the need to save for their retirement, even though significant numbers of them have postponed doing so.[1]

Among respondents who express a preference, 61% want funds that contain a mix of active and passive investment strategies (Figure 1). Only 24% prefer all-active funds, and 14% prefer all-passive.

Figure 1. Survey Respondents Prefer a Blend of Active and Passive Investment Strategies

Respondents Who Expressed a Preference (N=804)



Source: Voya Investment Management

Participants want TDFs with a mix of active and passive components.

[1] Source: Voya Retirement Research Institute (2015), "Millennials: Back to the Future," p. 2.

Earlier Findings Reaffirmed and Trends Established

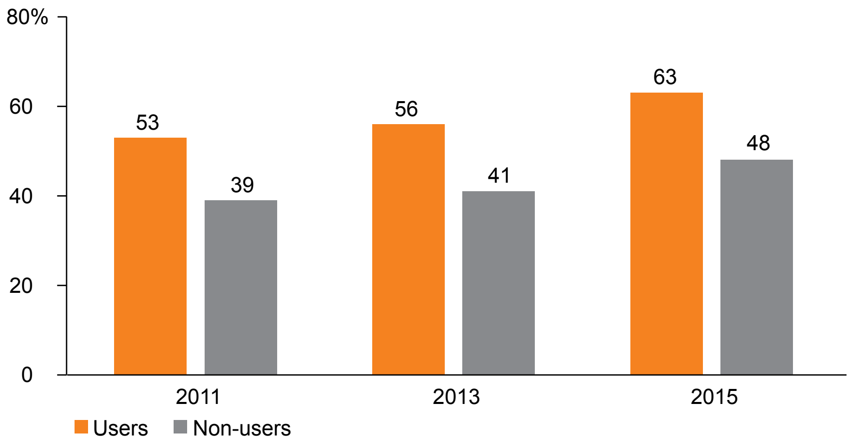
TDF Users Remain More Confident Than Non-Users

Now that TDFs have been in use for some time, users steadily have grown more confident that they will reach their retirement goals. Non-users have grown more confident too, but at lower levels than users (Figure 2).

TDF users feel greater comfort with investment decision-making and exhibit stronger indicators of future success, such as higher contribution levels. More than 75% of users feel that TDFs alleviate the stress of retirement planning, 75% report increased confidence that they are making good investment decisions and 72% say TDFs help them feel more assured they will have a successful retirement. By contrast, 37% of non-users say a TDF would alleviate the stress of retirement planning, only 34% report increased confidence that they are making good investment decisions and 35% say a TDF would help them feel more assured they will have a successful retirement— less than half the rate of TDF users.

TDFs promote successful investing behavior.

Figure 2. Participant Confidence: Percentages of Respondents Who Say They Are Confident They Will Reach Their Retirement Goals



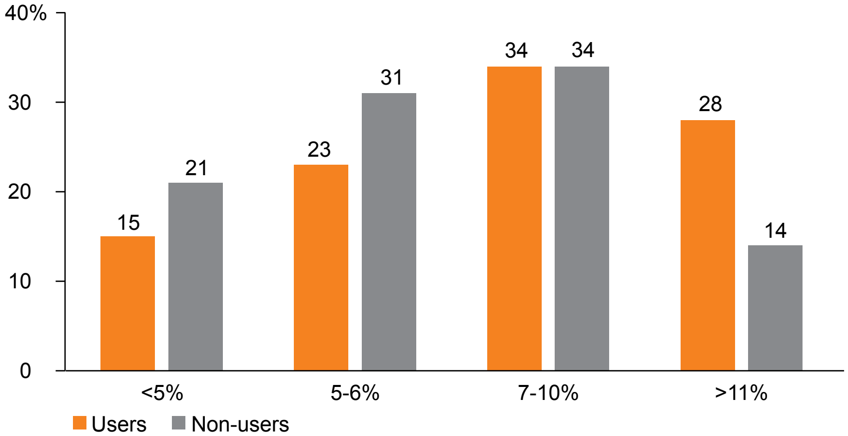
Source: Voya Investment Management

Greater Confidence Leads To Higher Contributions

The confidence gap between TDF users and non-users suggests that TDFs are doing their job: providing a choice that simplifies retirement investing and making participant goals easier to reach. This increases employee satisfaction with the retirement plan and also increases the contribution level (Figure 3). According to the most recent survey results, TDF users report contributing more to their accounts than non-users – a median of 2% more of income. The median contribution for TDF users was 8% of income, whereas the median contribution for non-users was 6%. Both figures have increased since the 2013 survey.

Figure 3. TDF Users Report Contributing More Than Non-Users To Their Retirement Plans

Percent Income Contributed to Plan



Source: Voya Investment Management

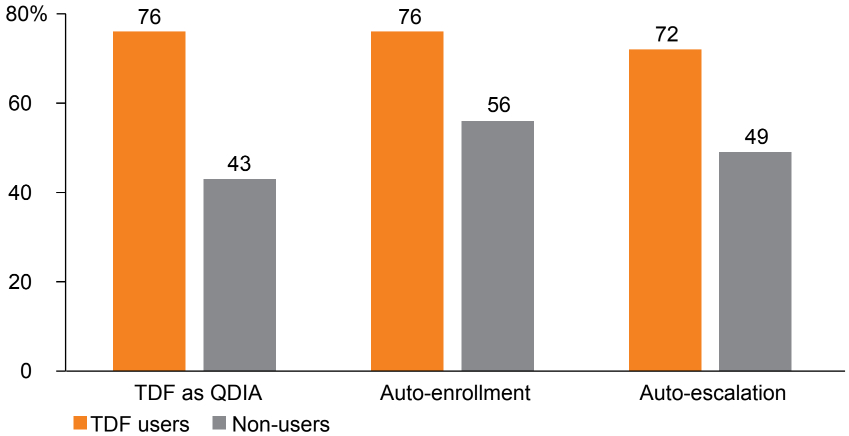
This greater degree of confidence extends to outcomes as well: 67% of users say that they have a plan to turn their savings into an income stream at retirement, vs. 46% of non-users. As noted in the new findings, however, younger participants lack confidence about investment outcomes. This suggests that offering a TDF as an investment option or targeting educational efforts to younger participants about the benefits of TDFs could improve participation rates among this group.

Acceptance of TDFs Has Steadily Progressed

Acceptance of TDFs has steadily progressed as more participants come to understand their benefits, convenience and features. Simplicity and convenience remain more important for participants than performance. Plan participants also have become more accepting of automatic enrollment and escalation, and think that such features will help them realize their goals (Figure 4). The survey results indicate strong interest in auto-features, particularly among TDF users: 76% feel that auto-enrollment into the employer's retirement plan would be helpful for many employees, and 72% feel that automatic increases of contributions would be helpful. Non-users also agree strongly that auto-enrollment and automatic increases of contributions would be helpful to many employees.

Figure 4. Most Respondents Agree That TDF Automatic Features Are Helpful

Agreement Rates Among Respondents



Source: Voya Investment Management

Other findings lend support to the potential benefits of auto features. Interest among non-users for TDFs with such features tends to be higher among those who are female, those under age 50 and those with less than $50,000 in their employee-sponsored retirement plan (ESRP) savings. These groups are broadly congruent with self-described, less-experienced investors, who generally report relying on friends and family and auto-enrollment to get started with retirement saving. Compared to 35–49 year olds, Millennials stand out in terms of heavier reliance on friends and family (54% vs. 34%). What's more, about four in ten have put off saving for retirement.[2] Taken together these findings suggest that auto-enrollment into a TDF, and subsequent auto-escalation of contributions, could significantly increase Millennials' participation rates.

Forty-nine percent of non-users would invest in a TDF if it were offered by their plan. Likelihood to invest was highest among Millennials. Nearly half of non-users are unsure if their employer-sponsored retirement plan offers a TDF option. Only one-quarter of non-users report they have the option, but don't use it. These findings were consistent with those from 2013.

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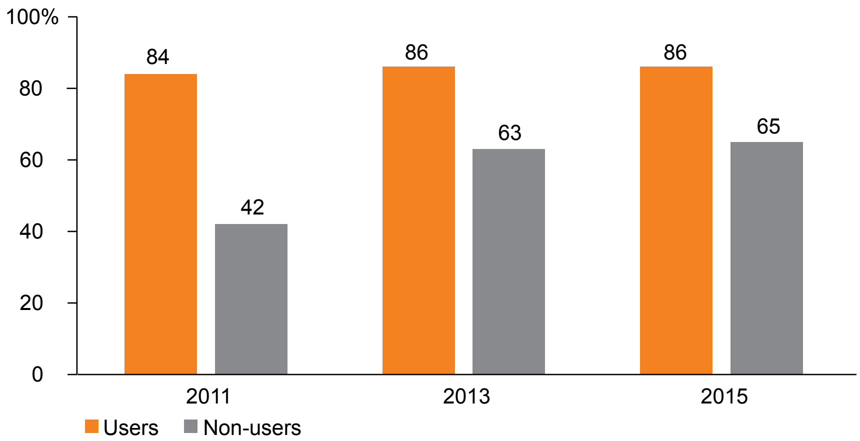
[2] Ibid, p. 4.

Preference for Multi-Manager and Multi-Asset TDFs

TDF users and non-users both strongly prefer multi-manager funds designed to use best-in-class managers (Figure 5). What's more, they prefer a mix of active and passive managers by almost two to one (Figure 6). Among non-users, 65% of Millennials preferred multiple investment managers and 73% preferred multiple asset classes to take advantage of broad market exposures.

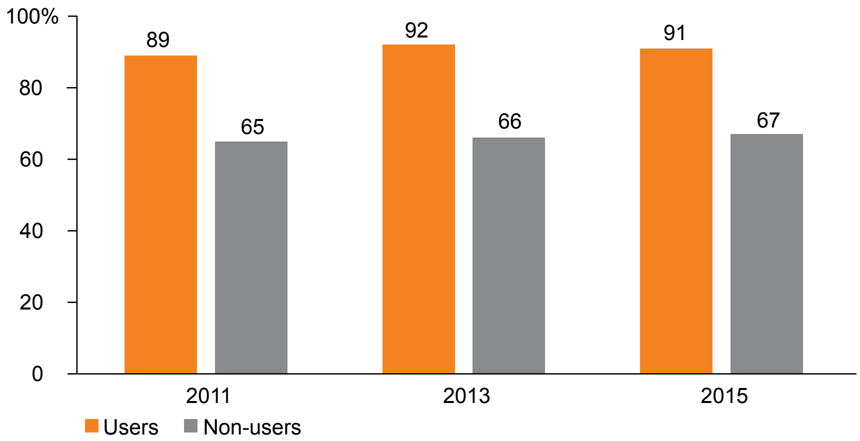
Broad support for automatic features and high diversification.

Figure 5. Preferences for TDF Allocation: Interest in Multiple Investment Managers



Source: Voya Investment Management

Figure 6. Preferences for TDF Allocation: Interest in Multiple Asset Classes

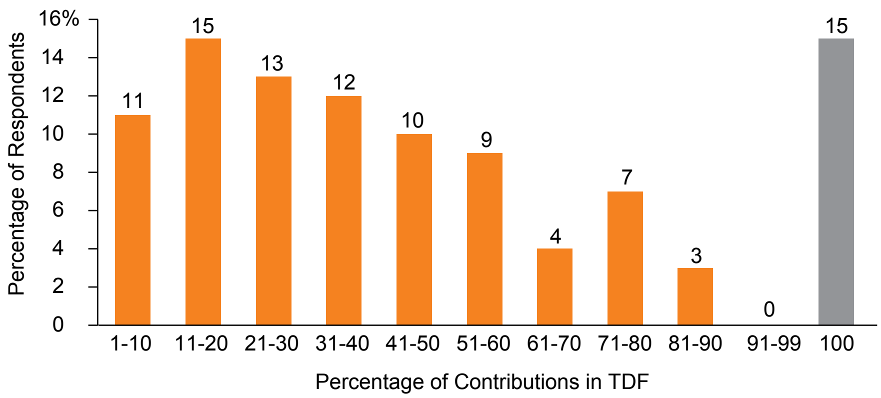


Source: Voya Investment Management

Diversification Benefits Misunderstood

Even knowledgeable users, however, seem not to fully understand the diversification benefits of TDFs: significant numbers of them use other funds to diversify away from the TDF, though in most cases that is not necessary. Less than one-sixth of survey respondents said they put 100% of their contributions into the plan's TDF; the mean value was 47% of contributions (Figure 7). Participants may have learned not to put all their eggs into one basket, but don't realize that TDFs were designed to offer a well-diversified portfolio in a single allocation.

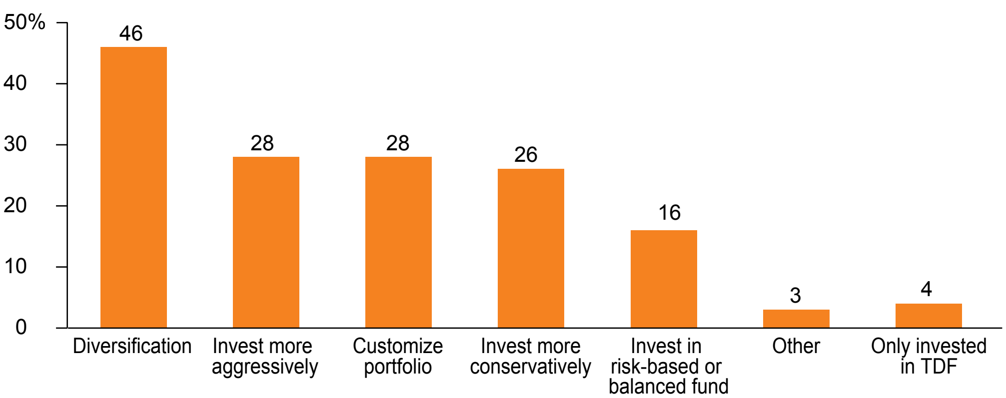
Figure 7. Few Plan Participants are Using TDFs as They Were Intended



Source: Voya Investment Management

Out of 502 respondents surveyed in 2015 who used TDFs, 425 also reported using other investment options, primarily to achieve additional diversification but also to modify their investment approach (Figure 8).

Figure 8. Reasons for Using Investment Options in Addition to TDFs



Source: Voya Investment Management

Such so-called "partial" TDF usage has been associated with greater levels of risk and poorer outcomes for participants.[3] In contrast, partial target-date fund participants had significantly lower returns than participants in all age ranges who invested at least 95% of their savings in TDFs, exhibiting an average difference of 2.44%, net of fees.[4] Deeper education about TDF diversification could prompt participants to reduce the number of their non-TDF investments and perhaps help deliver better investment outcomes.

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[3] Source: "Help in Defined Contribution Plans, 2006 through 2012," May 2014, Financial Engines and Aon/Hewitt.

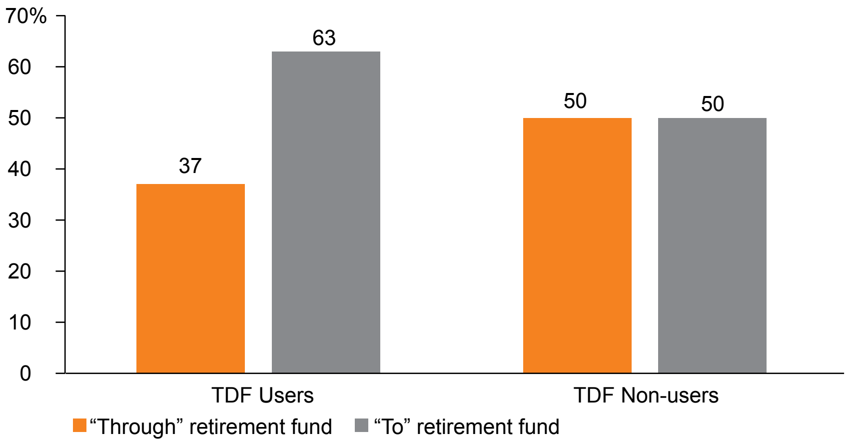
[4] http://corp.financialengines.com/employers/FinancialEngines-2014-Help-Report.pdf, page 39.

Preference for "To" vs. "Through" TDF Glide Path

Nearly two-thirds of TDF users prefer funds with a "to retirement" asset allocation glide path over a "through retirement" glide path (Figure 9). By contrast, non-users are evenly divided in their preferences for "to retirement" vs. "through retirement" TDFs. These results are consistent with the 2013 findings.

High demand for features that support wealth protection.

Figure 9. TDF Users Prefer "To Retirement" Funds; Non-Users Are Evenly Divided



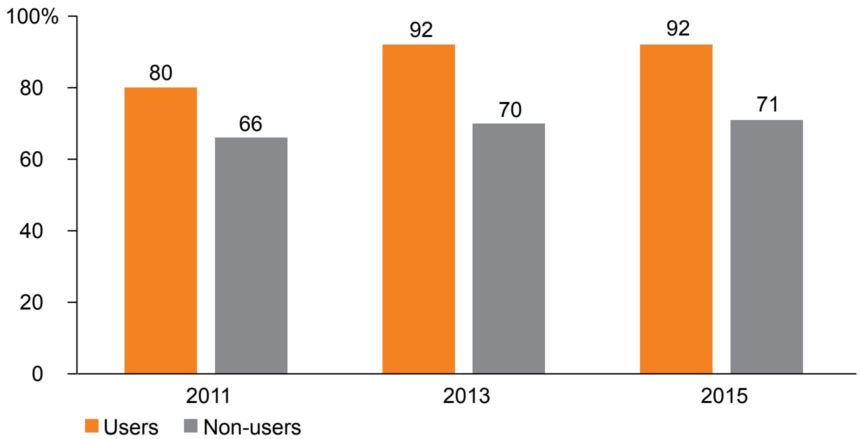
Source: Voya Investment Management

Wealth Protection Remains a Top Priority

All participants – regardless of whether they use TDFs – place a high priority on wealth protection, especially as retirement nears (Figure 10). The importance of avoiding losses is probably a response to persistent economic uncertainty during the study period. Since the underlying conditions aren't likely to change in the future, this preference should persist. The results of the 2015 survey are consistent with those of 2011 and 2013, though among non-users the percentage who made wealth protection a top priority dropped slightly.

Figure 10. Respondents Want to Protect their Wealth

Want More Protection Against Market Losses Near Retirement



Source: Voya Investment Management

While wealth protection is the top priority across generations, Millennials say it is more important than growth potential by nearly two to one, a higher rate than both Gen-Xers and Baby Boomers. Interestingly, this is almost the same prioritization as ranked by self-described, inexperienced investors (Figure 11).

Figure 11. Importance of Investment Loss vs. Investment Growth

Feature	Millennials (%)	Not experienced (%)
Protection from loss	63	62
Potential for growth	37	38
Totals	**100**	**100**

Source: Voya Investment Management

A corollary of the importance attached to wealth protection is that investors may have become too risk-averse for their own good. Since the Great Recession, mutual fund investors in aggregate have reduced their investment in equities and increased their exposure to fixed income. While this might have given them greater peace of mind during the market turmoil of recent years, investors may have bought that peace at the expense of future savings growth. TDFs, with their built-in, dynamic, asset allocation features, offer savers a potentially more effective way to balance the need for growth with the desire for wealth preservation.

Conclusions and Opportunities

The 2015 survey confirms earlier findings and highlights emerging insights, underscoring the point that certain plan designs may not align with participant priorities or the objective of optimal outcomes. For example, our research shows clearly that participants want easy-to-understand investment choices, choices which reduce the stress of decision-making and bolster confidence that they are making the best decisions they can. TDF benefits and features align squarely with these priorities. Figure 12 presents findings from 2011 updated for 2015. It still points to important discrepancies between participant preferences and plan features, and serves as a guide for choosing TDFs that may better align with both plan sponsors' and participants' needs.

Figure 12. Disconnect Between Participant Preferences and Industry Practices

TDF Feature	Survey Findings	TDF Industry Practice
Glide path allocation at retirement	81% of survey respondents want stronger protection against market losses near retirement.	Of the 25 largest TDF managers, only eight use "to" rather than "through" glide paths.
Investment architecture	75% of respondents want multiple investment managers.	Six of the 25 largest target-date managers allocate meaningfully to non-proprietary, active funds.
Asset class diversification	79% of respondents want broad market exposure through multiple asset classes.	The level of diversification among asset classes varies widely: from 5-7 for many passive TDF providers, to 15-20 for some blend and active TDF providers.

Source: Voya Investment Management

The survey shows that plan participants generally understand and accept the concept of TDFs, and widely desire them as investment options. A majority of respondents prefers TDFs with "to retirement" glide paths over funds with "through retirement" glide paths. While emphasis on "to" funds may limit the number of vehicles for consideration, plan sponsors should keep this result in mind when evaluating a TDF to serve as the QDIA.

The preferences for open architecture and multiple assets classes are even more compelling: nearly eight out of ten respondents favor multiple investment managers and multiple asset classes. This "more is better" stance would suggest that sponsors could enhance plan satisfaction by emphasizing actively managed TDFs, which tend to offer wider ranges of asset classes. While there are few choices for open-architecture TDFs, it may be possible to identify competitive candidates that meet sponsors' criteria and enhance participant satisfaction.

Millennials are critical to the future of retirement saving. They recognize the need to participate in their plans but hold back — perhaps because of competing priorities. Automatic enrollment and contribution escalation will be important features to keep Millennials on track with their savings. Increasing the use of TDFs as qualified default investment alternatives (QDIAs) should bolster Millennials' confidence and lead to higher satisfaction with their plans. Millennials also indicate a marked preference for an investment that can be converted into an income stream upon retirement. While the survey did not ask participants about longevity risk, the desire for such products may suggest some awareness of the risk of outliving their savings.

Our findings point to several opportunities for plan sponsors:

- Increase plan participation by implementing a TDF as the QDIA
- Implement automatic enrollment and automatic escalation of contributions at healthy levels to increase savings
- Communicate to, and engage with, younger participants and women, to increase awareness of the benefits of TDFs

Survey Methodology

The survey conducted in 2015 represents the third sampling of participant data.

- Voya conducted an online survey about target date funds for use in developing promotional and marketing materials and during discussions with plan sponsors and advisors. The study was previously conducted in September of 2011 and September of 2013.
- 1,005 consumers responded to the survey.
- All respondents are currently contributing to an employer-sponsored retirement plan (ESRP), age 25+ and are a primary/joint financial decision-maker for their ESRP.
- 502 have target date funds within their ESRP; 503 do not.
- Quotas were set for target date fund users and non-users. Data are weighted on household income, household size, gender, age, employment, marital status, region and users/non-users within the total sample.
- The study was conducted from September 23, 2015 through September 29, 2015.

General Investment Risks:

All investing involves risks of fluctuating prices and the uncertainties of rates of return and yield inherent in investing. The “target date” is the approximate date when an investor plans to start withdrawing their money. There is no guarantee that any investment option will achieve its stated objective. Principal value fluctuates and there is no guarantee of value at any time, including the target date.

Stocks are more volatile than bonds, and portfolios with a higher concentration of stocks are more likely to experience greater fluctuations in value than portfolios with a higher concentration in bonds. Foreign stocks and small- and mid-cap stocks may be more volatile than large-cap stocks. Investing in bonds also entails credit risk and interest rate risk. Generally, investors with longer timeframes can consider assuming more risk in their investment portfolio.

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