Default Options and Market Power: Evidence from Target-Date Fund

Abstract

We study how default options generate market power in the U.S. retirement savings market. Focusing on target-date funds (TDFs), the predominant default in 401(k) plans, we show that TDFs charge substantially higher fees than their underlying funds, by 22 basis points or over 100% as of 2019. We argue that TDF managers exercise market power and price discriminate against fee-insensitive default investors. We then estimate a structural model of demand and fee-setting in TDF and non-TDF markets. Eliminating price discrimination between TDFs and non-TDFs increases TDF investors' welfare by $1.2 billion per year with a modest reduction in managers' profits.

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