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PUBLIC HEARING ON

TARGET DATE FUNDS

AND OTHER SIMILAR INVESTMENT OPTIONS

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MR. DOYLE: Welcome to our joint hearing on Target Date Funds and Similar Investments. It is a joint undertaking by the Department of Labor and the Securities and Exchange Commission, a first, and I would also note it's a first in terms of at least the Department of Labor's webcasting of one of its hearings, so in terms of at least the Department of Labor's webcasting one of its hearings, so an exciting day I think all around for us certainly, and a day to learn a lot about target date funds and some of the issues that have been surrounding those types of investments of late.

Prior to opening remarks from Seth Harris, Deputy Secretary of Labor, and Mary Schapiro, Chairman of the Securities and Exchange Commission, I just want to thank both the SEC staff and the Department of Labor staff for all the work that went into organizing this morning's hearing.

I think what we will begin with is opening remarks, and then I'll cover, following those remarks, some of the technical aspects, the administrative aspects of this morning's hearing, but we will be going on a panel-by-panel basis. There are subjects that have been associated with the various panels. We tried to do the best in doing some
informal categorization, but the panelists will not necessarily be limited to those particular topics.

So with that, we will officially begin our hearing today, and I will introduce Seth Harris.

MR. HARRIS: Thank you very much.

Good morning, everyone, and welcome to the Labor Department on behalf of Secretary Solis and the Employee Benefits Security Agency and all of us here at the Labor Department. We're delighted to have you here and to be embarking on this unique and hopefully not unique for long partnership with our friends and partners at the Securities and Exchange Commission.

We are delighted to welcome Chairman Mary Schapiro and Commissioners Walter and Paredes here today to review the issues related to the use and the offering of target date funds by participants in 401(k) plans and by individual investors.

And of course I'd like to thank Senator Kohl, who chairs the Senate Special Committee on Aging, for his interest and the work of his committee and his committee staff on some of the challenges that are faced by today's investors as they save for retirement.

I'm especially delighted to be able to participate today because I am myself an investor in a couple of target
date funds, so I'm looking forward to learning what I've
gotten myself into.

As most of the people in this room know already,
target date and lifecycle funds are designed to be simple,
long-term investment vehicles for individuals with particular
target retirement dates in mind. They operate by investing
in a diversified mix of investments and automatically
shifting that mix away from riskier investments to more
conservative investments, perhaps lower yield but more
reliable investments, as the target date approaches. That
shift is referred to as a fund's glide path.

These investments funds have become increasingly
popular with investors including participants in 401(k) plans
because of those built-in features. An investor can choose
an appropriate target retirement date and let the fund
managers do the rest because investments will automatically,
or at least by the design of the manager, become more
conservative as the retirement date approaches.

Their increasing popularity, I think it's fair to
say, is also due in part to the Department's identification
of target date type funds as appropriate investments for plan
sponsors when they're investing 401(k) plan contributions on
behalf of participants who don't give specific investment
instructions. They're appropriate, we have said that they
are appropriate default investments for employees in their 401(k) plans.

Recent concerns have been raised about variation in the glide paths of target date funds offered by different providers and how that variation may result in plan participants and investors unknowingly placing their retirement assets at risk, or at least not knowing exactly what risks they are bearing with respect to their particular investment, making choices without the full information that we would like them perhaps to have. We are here today to explore precisely those concerns.

We're going to hear about how target date fund managers make decisions about their funds' glide paths and underlying fund investments, what information is disclosed to plan sponsors, plan participants and individual investors and how investors such as 401(k) plan participants are using these funds.

The public record established as part of today's hearing will help us determine whether regulatory or other guidance will be helpful to alleviate those concerns, and we're hoping to learn more about all of that from those of you in the room today and others.

Let me thank the members of our panel including representatives from both the Labor Department's EBSA and the
SEC, and I want to thank all of the witnesses who are going
to be testifying throughout the day about these important
topics. We are delighted that you are willing to come here,
share information, help us to figure out this emerging and
growing field of retirement planning and retirement investing
in our society. Of course our goal is safeguard investors'
funds and to assure a secure retirement for every American.

Now, it's my great pleasure, let me just say, the
reason I say that, while this meeting is unique, we hope it's
not going to be unique in a few years is we hope that this is
a beginning of a longstanding, soon-to-be-longstanding
partnership or a long-lasting perhaps I should say
partnership with our colleagues at the SEC.

It's, frankly, unclear to me why this hasn't been a
partnership that's been in existence for years and years and
years since we have responsibilities that don't just overlap
but that should be closely integrated and I think common
interests between the two organizations.

So we're delighted to be able to welcome three
members of the SEC today, and particularly it's my great
pleasure to be able to both welcome and introduce the Chair
of the SEC.

Prior to becoming the SEC Chairwoman, Mary L.
Schapiro was the CEO of the Financial Industry Regulatory
Authority, or, to the cognoscenti in this field, FINRA. That's the largest nongovernmental regulator for all securities firms doing business with U.S. public, and she had previously served as a Commissioner of the SEC as well as the chair of the Commodities Futures Trading Commission. On January 20, 2009, she was appointed the 29th chair of the Securities and Exchange Commission by President Barrack Obama, and it's my great pleasure, and I hope you'll join me, in welcoming Mary Schapiro.

(Applause.)

CHAIRMAN SCHAPIRO: Thank you very much, Seth. It's really a thrill for me to be here and for us to begin what I also hope will be a very long and successful partnership with the Department of Labor. Our interests are very much aligned as we all work to protect investors and retirees in our country.

I also want to thank Secretary Hilda Solis and the very dedicated staff of the Department of Labor for hosting this event and working with the staff at the SEC to get it organized.

I'd also like to echo Deputy Secretary Harris' thanks to Senator Kohl for his focus on target date funds. I think that was an important impetus for all of us to really pay attention to this space.
As you've heard, target date funds have become an increasingly popular investment option for Americans investing for retirement and educational needs. These funds and other similar investment options are financial products that allocate their investments among various asset classes. These funds automatically shift that allocation to more conservative investments as a target date approaches, and this shifting allocation is frequently referred to as the funds' glide path.

The set-it-and-forget-it approach of target date funds can be very appealing to investors. Target date funds were expected to make investing easier for the typical American and avoid the need for investors to constantly monitor market movements and realign their personal investment allocations.

But the reality of target date funds was quite surprising to many investors last year. It has been reported that the average loss in 2008 among 31 funds with a 2010 target date was almost 25 percent, but perhaps even more surprising were their widely varying performance results. Returns of 2010 target date funds in 2008 range from minus 3.6 percent to minus 41 percent.

These varying results should cause all of us to pause and consider whether regulatory changes, industry
reforms or other revisions are needed with respect to target date funds, and this is what I hope today's joint hearing will help us assess.

I'm really looking forward to an in-depth discussion of target date funds, their construction, their role in retirement investing, their allocation to various investment classes and the understanding or perhaps misunderstanding of target date funds by some retail investors.

I'm of course particularly interested in how SEC regulations, including our disclosure requirements, impact target date funds. For example, do our regulations foster investor understanding of target date funds, their risk characteristics, their fees and the meaning of a particular target date that's actually used in the fund's name.

And of course I'm interested in whether it's necessary to improve SEC regulations to address any deficiencies with respect to target date funds. Of all of the issues that the SEC is examining at the moment, our review of target date funds is one that may most directly affect everyday Americans seeking access to our securities markets to help build a better life and a greater sense of financial security for themselves and for their families.

We owe these workers and other investors our
commitment to addressing target date funds' issues for their benefit. I believe that today's hearing, which features a number of respected experts and impassioned thought leaders, will help advance the understanding of these funds and help crystalize our thoughts on the role of target date funds in a retail investor's retirement portfolio.

As you know, the administration is in the midst of overhauling the entire regulatory landscape with the goal of better protecting investors and restoring confidence in the markets, and we are doing our share within each of our own agencies to achieve these goals as well, and I think today's hearing is an example of just that.

So I also want to thank all of today's joint hearing participants for volunteering to share their views and insights with us. I look forward to hearing from you and to engaging in a meaningful dialogue on target date funds. And finally I'd also like to thank the staff members of the SEC who worked with the Department of Labor to bring this event about, primarily Buddy Donohue and Tara Buckley. Thank you all very much for being here.

(Mr. Doyle: The panels will be called in the order in which they are listed in the agenda. We ask that each panel member in advance of their testimony identify
themselves, who they are affiliated with, who they're
testifying on behalf of, and perhaps a short indication of
the nature of the organization they're representing, unless
it's otherwise obvious from the description.

It's important that, again, we try to stay within
the allocated time limits. There will be an opportunity to
supplement the record. We will keep the official record open
for 30 days so those testifying that want to supplement their
remarks will certainly have an adequate opportunity to do so.

We would also invite those who have not had an
opportunity to testify today that may have views on the
issues or some of the comments or testimony they hear today
to submit their views.

As I indicated, this proceeding is being webcast,
and the webcast will be archived and available on both our
website and through the SEC website. We will also have a
transcript of the proceeding as the official record, and
those will be available in both agencies' public disclosure
rooms.

I suppose I should introduce the panel. Going from
my right to left, we have Commissioner Troy A. Paredes;
Elissa B. Walter, Commissioner, SEC; of course Chairman
Schapiro; Alan D. Lebowitz, Deputy Assistant Secretary for
the Employee Benefits Security Administration; Joe
Piacentini, to my immediate right, who is EBSA's Chief Economist and Director of Policy and Research.

With that, I think we'll call the first panel.

MS. McMILLAN: Good morning, Chairman Schapiro and distinguished members of the panel. I'm Karrie McMillan, the general counsel of the Investment Company Institute. We're the National Association of Registered Investment Company Industry, and I'm very pleased to testify here today on behalf of ICI and its members on the subject of target date funds.

This hearing was inspired in large part by the market turmoil of the last two years, a bear market that is wider, deeper and more unsettling than any in generations, and that turmoil has taken a significant toll on retirement plans of all types.

We're very mindful of the declining balances that workers have seen and that those declines are particularly hard on workers that are nearing retirement. Because this downturn has hit a wide range of asset classes, diversified investments such as Target Date Funds have not been immune, so we welcome this examination of how Target Date Funds are constructed, used and understood.

Target Date Funds are one of the most important recent innovations in retirement savings. They provide a
convenient way for an investor to purchase a mix of asset
classes within a single fund that will re-balance the asset
allocation and become more conservative as the investor ages.

Research shows that asset allocation is one of the
most important factors in portfolio performance, and just as
important, Target Date Fund investors avoid extreme asset
allocations that we often observe in retirement savings, a
25-year-old that holds only cash or a 60-year-old that is
fully invested in equities alone.

Just like growth funds or value funds, Target Date
Funds are not all the same. Some providers design their
Target Date Funds to reach the most conservative asset mix at
or shortly after the target date. These funds place a higher
priority on producing immediate income and preserving assets
at retirement age.

Many other providers design their Target Date Funds
to reach their most conservative asset allocation ten or
twenty years or even longer after the target date, and these
funds emphasize the need to earn higher returns at and after
the retirement age in order to increase assets and generate
income later into retirement.

Clearly it is vital that employers, 401(k) plan
participants and IRA investors understand these and other key
features of any Target Date Funds that they're considering.
While Target Date Mutual Funds currently do a good job of describing their objectives, risks and glide paths, we do see gaps in the public understanding of Target Date Funds generally, so ICI formed a working group of members to propose ways to enhance understanding.

After several months of work, the group identified five key pieces of information that employers and investors should consider about any Target Date Fund and drafted principles to insure that this information is prominently and clearly displayed.

So what are those five key pieces of information? First, the relevance of the target date used in the fund's name including what happens at the target date. A fund should explain that the target date represents the assumed retirement date and when the investors expect it to stop making further investments.

Second, the fund's assumptions about the investor's withdrawal intentions. A fund should explain whether it is designed for an investor who expects to spend all or most of his or her money at retirement or is designed for an investor that plans to withdraw money over a longer period of time.

Third, the age group for which the fund is intended, and, fourth, an illustration of the glide path that the Target Date Fund follows to become more conservative over
time. The illustration should highlight the asset allocation both at the target date and at the date that the fund reaches its most conservative allocation.

We also think there should be a simple narrative describing the same information, and, if an asset manager has the discretion to deviate from the glide path, the parameters of that should also be described.

And finally, a statement that the risks associated with a Target Date Fund include the risk of loss near, at or after the target date, and that there is no guarantee that the fund will provide adequate income at or through the investor's retirement.

We believe that these principles can be applied to any Target Date Fund product used for retirement savings no matter who offers it. The principles are not meant to replace the disclosures already in place by the federal securities laws, ERISA or other statutes, but, rather to highlight how disclosures can be made effectively within these standards. My written statement includes a copy of the disclosure principles, sample language and an illustrative fund information sheet showing how the disclosures can be implemented.

Our working group also considered whether we could enhance investor understanding of Target Date Funds by
changing the names of these funds. As detailed in my written
statement, the group considered changing the current
convention of linking the name of the fund to the target
date's assumed retirement date, it considered dropping any
mention of target dates from fund names, and it considered
adding descriptors to fund's names. In each case, the
working group concluded the changes could increase investor
confusion, still without providing all of the information
that an investor needs to know about these particular funds.
In the end, we are firmly convinced that investor
understanding of Target Date Funds should be enhanced through
disclosure and education, and we stand ready to work with
regulators and others in the retirement industry to improve
understanding of the Target Date Funds.

Thank you.

MR. WHITNEY: Good morning. My name is Richard
Whitney, and I'm the Director of Asset Allocation of T. Rowe
Price and lead the team responsible for the T. Rowe Price
retirement funds. Thank you for this opportunity to present
our views regarding the important topic of Target Date Funds
and your efforts to determine if additional guidance is
needed.

The T. Rowe Price retirement funds are designed to
make investing easier and more successful for participants,
both during the accumulation stage when they're saving for retirement and during the post-retirement stage when they're managing their savings to last through their lifetimes.

Our design is based on the concept of a single fund focused on the expected retirement date of an individual can be a suitable investment for life for a broad population of investors who choose to delegate their investment decisions to professionals. It is not intended to require an investor to switch to an alternative strategy at retirement.

We'd like to make several points this morning from our written testimony. First, investing for retirement involves facing a variety of risks including market, inflation and longevity and managing the tradeoffs between them.

Focusing solely on short-term market volatility will leave investors vulnerable to other risks. There's no single strategy that's optimal for all these risks at the same time, but Target Date Funds attempt to strike a balance between them.

The second point is satisfactory outcomes will only come through sound financial advice provided through investment vehicles that simplify actions required by participants. Target Date Funds were designed to be easy to use and require little maintenance.
And our third point is that plan participants should understand their investments, and we support industry efforts to adopt model disclosure principles.

We're of course now focused on market risks, and, while the recent experience has understandably led many of us to overemphasize the short-term volatility of equity markets versus their long-term benefits, it also tempts us to underemphasize the longer-term challenges participants face in funding their retirement years. However, those risks remain substantial.

The erosion of purchasing power by inflation continues to be a serious long-term threat. Assuming a relatively conservative 3 percent inflation rate, the real value of retirement assets will be cut in half in just over 20 years. An income stream of $40,000 a year must grow to $80,000 a year to maintain the same level of purchasing power.

Rising life expectancy means the duration of income needed from retirement savings is increasing. Average life expectancy at age 65 is approaching 20 years. Today the chance that one member of a couple in their sixties will live beyond 90 is more than 50 percent, and there is almost a 25 percent chance that one spouse will live to 95.

In short, many should expect to spend 30 or more
years in retirement, and because the elderly are most -- the
most elderly are most likely to need expensive custodial care
or other support services, retirees generally are likely to
need greater financial resources in the later years of their
retirement, not less.

After considering all these factors in conjunction
with extensive simulation and financial modeling tested
against historical data, it's clear to us that an appropriate
asset allocation strategy must balance short-term volatility
against long-term earnings potential.

When considering the typical rates of savings and
withdrawals, the need for equity becomes even stronger. At
the same time, we understand that investors' tolerance and
capacity to bear risks varies as they age, and so we manage
the degree of market risks through the use of a glide path.
This glide path tends to match portfolio volatility to the
decurring risk tolerances typically exhibited by investors as
they age.

Our second point is that participant behavior can
significantly influence their financial success. Our funds
were developed in response to the fact that many individuals
have neither the time nor expertise to construct an
investment strategy to see them through retirement.

Target Date Funds were designed to address these
difficulties through a comprehensive, diversified asset allocation portfolio that minimizes the decisions needed from an investor, and while 2008, was a test of strategies, it's also a test of the behaviorally friendly design that Target Date Funds are intended to offer.

The results so far show that participants appear to have stayed the course and have stuck with their investments to a much greater extent than would have been expected by many observers.

To be sure, it's likely this outcome is driven by inertia working in investors' favor here, but there are also indications that target date investors have been so far even less likely to make changes to their strategy than investors with more of a do-it-themselves approach.

The last point is that target date investors should understand their investments and how they fit into an overall plan for retirement. In most cases, consultants or advisors assist plan sponsors in selecting Target Date Funds that are appropriate to the needs of their plan.

From our experience, consultants and sponsors are very engaged in reviewing our products' glide path, underlying investments, related risks and compare such factors against those of other products in evaluating Target Date Funds for their plans.
While we believe sponsors fully understand the theory and practice of Target Date Funds, we also know that a key to success for individuals is a suitable level of confidence and knowledge to stay with their strategy during challenging times.

Thank you.

MR. AMERIKS: Good morning. My name is John Ameriks. I'm an economist and a principal at the Vanguard Group. Thank you all very much for this opportunity this morning to testify on behalf of the Vanguard Group on the subject of Target Date Funds and their effectiveness as a retirement savings vehicle.

Given the short amount of time that I have today, I want to focus my remarks on three major points about Target Date Funds. First, the diversification that Target Date Funds offer is critical in helping investors manage the array of financial and economic risks that they face throughout their lives.

Second, while the financial markets have been historically poor in the last year, Target Date Funds have, in general, weathered this storm and have achieved the objective of improving diversification and mitigating risks for their investors.

And third, going forward, we see opportunities to
further simplify and improve disclosure and communications
with respect to Target Date Funds which could make these
funds even more effective for investors and plan
participants. So I'll address each of these points in turn.

First, diversification. At their most basic,
Target Date Funds are a diversified investment portfolio
designed to be appropriate for individuals accumulating
assets for retirement.

Target Date Funds are not designed to be riskless
or to provide a guaranteed amount of retirement income which
continues to be the crucial role of social security as well
as defined benefit pensions.

In contrast, the fundamental purpose of Target Date
Funds is to provide investors a diversified,
prudently-managed, appropriate exposure to investment risks.

Both financial theory and hundreds of years of financial
markets' experience suggest that broadly-diversified
investment risk is a compensated risk. By bearing these
risks, one can expect, on average, to earn a return well
above that of less-volatile investments.

The need to remain diversified and continue to bear
investment risks is not limited to younger investors.
Investors approaching or in retirement still have long
horizons. They need diversification and significant growth
potential to protect against inflation, longevity risk, rising health care and other costs that are uniquely important to this age group.

Second, on the current environment, when evaluating the performance of Target Date Funds, it's important to acknowledge the extreme severity of the financial meltdown we have just experienced. Virtually all types of investment portfolios, defined benefit plans, endowments, even the general accounts of commercial insurers have suffered significant losses.

Target Date Funds were no exception, but in our view they performed as designed. In particular, in the vast majority of cases, older investors were exposed to far less risks than younger investors and consequently suffered less dramatic losses. In addition, even in the worse cases, the broad diversification of these funds helped to diminish the impact of specific financial failures on investors.

It's also critical to note that in cases where there was poor performance, it was not necessarily a result of exposure to the stock market. In fact, underperformance in certain sectors of the bond market was a major cause of negative results in some funds.

We agree it's valuable to note and understand the reasons why Target Date Funds perform well or poorly in
crisis, but it's just as critical to assess the value of these funds over longer periods of time, and there the news is not as dire.

In particular, at the end of May, all the Vanguard target retirement funds with at least a five-year track record generated positive returns over that five-year period and over a far longer horizon, which is appropriate for even retired investors, we expect our funds to provide a significant positive return on average.

While general principles of diversification and declining risk exposure with age are a part of all Target Date Funds, a vigorous debate continues over the ideal design of these funds. There are several design principles that Vanguard adheres to which we believe are key factors in the optimal design of TDFs.

Our Target Date Funds are comprised of different combinations of seven underlying mutual funds. They include our total stock market fund, total bond market index fund, three international stock index funds representing the global equity market, our TIPS fund and our prime money market fund.

Our glide path features a clearly specified, passive allocation of these funds with equity allocations for those under 40 at 90 percent declining to 50 percent at age 65 and falling to 30 percent by age 72, assuming retirement
at 65. Our funds have expense ratios of under 19 basis points, less than one-fifth of 1 percent.

We believe that transparency, simplicity, broad diversification and the low cost of this structure represent an ideal approach to TDFs with many advantages for plan sponsors and investors, but we recognize that investment professionals, investors and plan sponsors may see significant value in alternative approaches.

While we're convinced of the merits of our design, we strongly believe that innovation and further improvement of these funds can only occur if sponsors and investors have the freedom to choose a specific design that best meets their specific needs. The Target Date Fund market is and should remain highly competitive. For all of these reasons, we strongly oppose any efforts to regulate the glide paths or other aspects of the investment design or construction of Target Date Funds.

On disclosure, Target Date Funds are built on a strong foundation; however, we recognize the challenges that exist with regard to full and clear communication and disclosure about various aspects of these funds.

The industry and the regulatory community can do more to simplify and standardize information for plan sponsors, participants and other investors. In general, we
favor proposals such as the ones outlined by the Investment Company Institute which attempt to present information on Target Date Funds in a simple, straightforward manner.

That said, we do want to emphasize the challenges that exist in getting disengaged participants to read and fully digest any information provided to them. In fact, Target Date Funds were specifically designed to provide an appropriate, broadly diversified, professionally managed investment portfolio for exactly those participants who are unlikely to pay sufficient attention to required disclosures or communications.

Target Date Fund investing is one of the most significant and promising innovations in the retirement savings marketplace in years. These funds offer diversified, low-cost, professional investment management to a wide variety of plan participants and other retirement investors. We strongly support both private and public efforts to foster innovation growth and further adoption of these funds.

Thank you.

MR. YOUNG: Thank you for the opportunity to present today. My name is Derrick Young, and I am the Chief Investment Officer of the Fidelity Global Asset Allocation Group. This is the investment team responsible for Fidelity's Target Date Funds known as Freedom Funds.
Now since the advent of defined contribution plans in the 1980s, Fidelity has been a leader in providing comprehensive investment solutions, analytical tools and administrative services to plan sponsors and participants. The Freedom Funds were launched in 1996, and Fidelity was one of the first mutual fund firms to offer Target Date Funds specifically designed to meet investors' retirement needs.

The Freedom Funds are constructed to provide individuals with a well-diversified investment portfolio that is professionally managed and automatically re-balanced over time, gradually shifting from asset types with greater risks to those with lower risks. We take a long-term, strategic approach to asset allocation decisions and employ a rigorous process for selecting the underlying funds in the portfolios.

For a lifecycle fund to meet its objectives, three elements are required: First, adequate and consistent contributions; second, a disciplined investment strategy that meets performance expectations; and, third, time.

While no asset allocation approach will be successful if individuals do not contribute enough toward retirement savings, we believe the best-suited strategy for reaching a retirement goal is one that balances the tradeoffs among required contributions, investment volatility and time. Target Date Funds provide this balance and offer powerful,
sophisticated, long-term asset allocation strategies in a simple, straightforward investment vehicle.

The Fidelity Freedom Funds are constructed with the assumption that an individual's defined contribution investments in combination with social security will represent the bulk of his or her retirement income resources. Based on this assumption, the savings objective for an individual's defined contribution plan can be expressed in the form of a salary multiple such as a retirement account balance of ten times ending salary at target date.

While future investment returns are unknown, we can evaluate strategies using historical risks and returns of various market indices for stocks, bonds and cash equivalents. Using these assumptions, we can solve for the required contribution rates among different investment strategies.

To illustrate the benefits of the target date approach, it is useful to consider two extreme cases. If we consider an all-cash portfolio over the last 30 years, 29 percent of a participant's salary must be contributed each year to reach the savings objective. While this approach poses no market risk of losing money, the contribution rate would be prohibitively high for the majority of investors.

If we assume an all-stock portfolio over the same
period, the contribution rate is reduced to approximately 14 percent of annual salary, a more obtainable level. However, an all-stock portfolio exposes investors to substantial volatility as the experience of 2008 demonstrates. A remedy for excessive volatility is to reduce stock exposures as the target date approaches.

Now when we evaluate a general lifecycle strategy over the prior 30 years, our analysis showed the required contribution rate to reach the objective is just over 12 percent of annual salary, lower than either the all-cash or the all-stock strategy. While the next 30 years may not resemble the last, these relationships are maintained over most time horizons of similar length; therefore, an investment in a Target Date Fund has the potential to reduce volatility compared to an all-stock portfolio but provide a more realistic chance for achieving the retirement goal than an all-cash portfolio.

The target date is the point at which the accumulation phase and the distribution phase meet. For the typical investor, the distribution of income phase will extend for 20 years beyond retirement and could reach 30 years or longer for some retirees.

The asset allocation for the Freedom Funds at the target date and in the retirement years recognizes several
risks that can be grouped into four broad categories:
Longevity risk, market risk, withdrawal-rate risk and inflation.

The Fidelity Freedom Funds currently have an allocation of about 50 percent to equities at the target date, and this gradually declines until reaching 20 percent equities about 15 years after the target date.

We believe that the Freedom Funds glide path prudently balances the risk of retirees outliving their savings, exposure to capital market declines, higher-than-expected spending rates in retirement and the damaging effects of inflation.

The challenging market environment in 2008 has raised concerns about the viability of long-term investment strategies such as those used by Target Date Funds. After the worst year for the stock market since 1931, it is understandable that investors have strong emotions in reaction to short-term market events. In this type of environment, many individuals take dramatic action with their investment portfolios, often selling at depressed levels only to buy back at higher priced levels.

To avoid these pitfalls, we believe that it is important for investors to stay committed to a retirement savings plan. Target Date Funds are designed to help
participants maintain this discipline.

Fidelity appreciates your concerns regarding the portfolio construction and performance of Target Date Funds. As America's retirement leader, Fidelity is committed to helping solve the retirement savings challenge. We believe that the investment principles used by Target Date Funds provide a critical foundation for individuals' savings for retirement and are an effective solution for participants who lack the time and inclination to apply lifecycle principles to their own retirement portfolios.

Thank you for the opportunity to discuss this important topic today.

MR. KNIGHT: Good morning. My name is Jeff Knight. I am managing director and head of global asset allocation at Putnam Investments in Boston, Massachusetts. In this role, I helped to design our lifecycle offerings in 2003 and am presently lead manager on both our retirement-ready and retirement-advantage lifecycle strategies.

I first want to commend the Department of Labor and the Securities Exchange Commission for convening today's hearing on Target Date Funds, arguably the single, most useful investment innovation of the past generation with particular value in workplace savings such as 401(k) plans, 403(b)s and 457s.
Congress, in our view, took a major step forward with the Pension Protection Act of 2006 to recognizing the emerging role of workplace savings as the primary source of future retirees' lifelong incomes.

The PPA's explicit recognition of lifecycle or Target Date Funds as qualified default alternatives appropriately called attention to an investment strategy that helps investors solve a complex, lifelong challenge with a single strategy that provides diversification, risk adjustment and re-balancing over a lifetime. Since many participants in a workplace savings program rarely, if ever, change their investment elections, mutual funds that adjust over time are especially valuable.

Within the overall lifecycle pattern, there are many different approaches or glide paths for managing the shift from higher to lower risk allocations. All lifecycle fund managers must balance the objectives of growing investors' wealth and protecting investors' wealth in the face of market risk and longevity risk.

At Putnam, we have prioritized wealth conservation in our glide path design as evidenced by our low allocation of 25 percent to equities at our funds' designated target date. Our research concludes that such conservatism minimizes the risk of asset depletion or severe financial
stress in late old age.

Last year the stress across financial markets was unusual and severe. Stocks, as measured by the S&P 500 Index fell by 37 percent, its third worst year since 1900. In addition, many categories of fixed income securities including corporate bonds and mortgage-backed bonds fell in price almost as dramatically as equities did as forced selling into frozen credit markets drove unprecedented pricing volatility in those areas. Diversification therefore across asset classes or across geographies provided only weak defense against these market losses.

Not every investor in lifecycle funds, though, was hurt by these events. Younger investors in lifecycle funds still have plenty of time before retirement. They may well recoup all of last year's losses long before they have to draw down their savings, and for them the stock market drop represents a chance perhaps to buy low, accumulating long-term equity in bonds at reduced prices.

But for investors in or very close to retirement, the timing was awful. Many 2010 lifecycle funds, including ours, fell by 25 to 30 percent or even more. For those who needed to draw current income from these shrinking portfolios, the impact was severe. Under stress, existing risk-dampening strategies fell short last year.
In fairness, this episode is not over, and securities prices have recovered substantially in 2009. Our own 2010 fund, for example, has gained over 10 percent at NAV through June 15th.

A calm reckoning, though, of last year's events suggest that we indeed have work to do to improve the resilience of lifecycle strategies, but to dismiss the lifecycle concept now in the wake of a market trauma or to return to stable-value funds, for example, as qualified default options in our retirement policy planning would be a gross mistake. A more sensible course is for providers to identify and repair the vulnerabilities that were exposed by the market stress of 2008.

The good news is that we can and should evolve and improve these funds. Among the steps that we are taking at Putnam to improve the resiliency of our lifecycle funds is evaluating the role that absolute return strategies can play in the glide path as well as evaluating methods to incorporate customized insurance against longevity risk into our product offerings.

And make no mistake: Target Date Funds face strong market discipline and competitive pressures. There may at times be a disconnect between the lifelong investment horizons that lifecycle managers aim for, 30 years or more,
and the far shorter windows that some rating agencies use to judge lifecycle funds' investment performance, often three years or less; therefore, we would not oppose regulatory guidelines to limit these pressures while fostering strong competition.

On behalf of Putnam Investments, thank you very much for this opportunity to share our views.

MR. DOYLE: Thank you very much.

Now we'll begin with the questioning. We'll start with Chairman Schapiro.

CHAIRMAN SCHAPIRO: Thank you very much, and thank you all so much. Thank you all so much for your presentations. They're enormously helpful.

One of the things I'm trying to understand is the extent to which, if it is at all a problem, that investors have one set of expectations about the date in the Target Date Fund, and you all have a different set of expectations about what that date means, so for the fund groups, I guess particularly, sorry, Karrie, I'd love to know if there's consistency even among all of you about what the date means in the name of the fund.

MR. WHITNEY: Well, I can start. I think there is at least one degree of consistency. I think that all of us would agree that the date in the fund name means the date at
which we expect investors to stop contributing to the fund,
so I think that's pretty standard across the industry.

And I think it's also relatively standard, although there will be some more variation around this in terms of the duration of time in which the fund is expected to generate an income stream, there are some that have a much longer duration than others.

MR. YOUNG: But I think there's a -- we have to make a value judgment at that date as to what the priorities are, and I think there is some difference of opinion in good faith across that decision, whether or not we should treat equally the risks of shortfall versus the value of happy surprises, and I think that does allow for some fairly substantial differences in the strategies that we champion at that point.

MR. AMERIKS: Yeah, I think that's right. For all of us, the target date is used as the anchor for the design of the asset allocations that we do. It's the point of retirement around which we build the rest of the portfolio allocation.

The reality is is that retirees do a lot of different things with the money in these plans at the point of retirement, and so there is some debate around exactly how the money is going to be used. Many folks don't draw on this money until the required minimum distributions kick in at 70
and a half, which may be well after when they've retired. Others may want to roll that money out and choose an annuity or other payout mechanism, so it's very difficult to come up with a sort of specific answer that solves the problem for everybody.

What we're trying to do is come up with, I think, a prudent approach that tries to balance all of these needs, and, you know, part of that is a judgment about how much risk needs to be there. There's not a wrong answer there. It really is a preference of where on an efficient frontier, if you will, you want to be, and that's a fiduciary call.

MR. YOUNG: We tried -- I was going to say when we launched the Freedom Funds back in 1996, and this is before this industry had taken off like it has now, we were going through and trying to determine what is the appropriate name to have on a fund, and we went through a lot of debate about, you know, should you use a birth date, should you use a projected death date?

You know, if you go through and you look at those alternatives, I mean you can see very quickly that all of a sudden you're forced into thinking, now what is the most logical date to use?

So as far as how it actually happened for us, we did go through and we'd say, you know, the retirement date is
a very important date for people to think about their
investment savings. We want it to be a threshold. We want
that date to be important.

I mean, at Fidelity, we have retirement income
planning, and we encourage all of our participants to go
through that retirement income planning process as part of
that target date, so that target date really highlights that
whole need of at that point in time it's a critical juncture,
you are going, you're from the accumulation phase to the
withdrawal phase, and you need to make sure that you're
planning for that.

MR. WHITNEY: If I could just add one last point.
I think, at least in the 401(k) space, most Target Date Funds
are selected through the use of a consultant or an advisor,
and the plan sponsor obviously has a very big role. They
know their employees, they know the demographics across their
employee base, and in conjunction with that consultant,
they'll examine a wide variety of different strategies and
pick the one that they think best matches what their
employees need.

COMMISSIONER PAREDES: Is this on? Can you hear
me? All right.

Jeff, you mentioned the need to evolve and improve
the fund, and so I'm just curious to hear a little more from
you and from the others. What lessons have been learned in terms of asset allocation and diversification based on the recent events and performance of the funds to improve and evolve on a going-forward basis?

MR. KNIGHT: Well, I mean, I think it would have been difficult to foresee just how widespread and dramatic the declines would be across everything last year. It was surprising I think to even professional investors how weak diversification turned out to be, and so I think the two directions where we need to evolve the strategies, number one, is to redouble our efforts to think about ways to diversify.

And typically the historical play book has involved diversifying by asset class, by geography, by style, by market cap, all of the things that are generally fully invested in market tracking, and I think other mechanisms to diversify exist but haven't been explored, incorporating investments that respond to a different philosophy, not buy and hold track the index but rather something that's built more for stability and an all-weather pattern of returns.

Now, that's a challenge in and of itself, but I think one aspect is just the investment engineering of expanding the playing field for diversification.

The second, though, is, because, as unusual as last
year is and hopefully it will never happen again, I think it's nevertheless unacceptable, particularly for the close to retirement years and for somebody whose savings themselves are kind of borderline, aren't quite -- they're cutting it close. And I think for those investors we need to do a careful job of thinking about insurance-driven solutions that offer some kind of minimum income guarantee throughout a lifetime, however long that lifetime is. And those are really the two engineering directions that we're taking.

COMMISSIONER WALTER: I'd like to follow up a little bit on Chairman Schapiro's original question. You said that different allocations among different classes of holdings and different glide paths may be appropriate for different retirees, but, unless I'm wrong, generally speaking, people will offer a series of Target Date Funds just from one sponsor or one investment company complex, and that doesn't really take into account, I mean it's one thing to say a sponsor knows the demographics of his employee population, but that population is going to differ and have different needs.

Does that suggest to you that actually there ought to be a series of 2010 funds offered that have different balances between the upside and the downside post-retirement, because I think the way it's been done to date sort of
assures that there's going to be a mismatch with a substantial number of people.

MR. AMERIKS: If could take that, I'll respond to that one, and then I want to go back to the other question quickly if I could.

I think -- I've seen that proposal before. It's one of the favorites out of the academic community in terms of the different -- the conservative version of the target date, the moderate, the aggressive. I think the challenge there is what I alluded to in my testimony is that you've got to get people to engage. A plan sponsor can't look at a participant and put them in a fund that, you know, they don't have "risk tolerance" stamped on their foreheads, so we don't know whether someone's conservative or aggressive or moderate.

And so I think what you have to do, I mean, the power of these funds is their ability to be suitable for a broad spectrum of investors. And it's not perfect, but it is suitable, and it's based on one piece of information, you know, at the point at which they want to retire and an assumption on the part of the plan sponsor about when that retirement date's going to occur. That's really the innovation here.

There are other types of funds. In Vanguard's case,
the life strategy funds, that have exactly that structure:
Moderate, aggressive, conservative. And if someone is
willing to take the five minutes to fill out a risk-tolerance
questionnaire, you could target a better portfolio, but the
strength of these is that you can help people who aren't
going to engage and make that kind of decision and provide
that type of information.

On the other issue in terms of what have we learned
from the markets last year, I'm not so much that we learn --
I don't think we've learned a lot new. We relearned some old
lessons, I think, about the power of diversification and what
ture diversification means.

You had to have exposure to all parts of the
investment markets last year. Government bonds performed
incredibly well last year in general and did provide the
diversification benefits that people talk about, but you had
to have exposure to those, and now that's why, you know, I
think we emphasize broad-based exposure at market
capitalizations through index funds to try to make the most
of the diversification that does exist.

It's never going to be perfect. Diversification is
not insurance. But it did help us to do much better than the
average last year in our funds.

MS. McMILLAN: If I can jump in on the question
that you asked, Commissioner Walter, you know, I think the average number of plans -- funds that are offered in a plan are 19, so if you start doubling that to add on a whole another array of Target Date Funds, you really risk, I think, confusing investors.

And what investors do have the ability to do if they engage is to take a look and say, you know, the 2020 fund is too conservative for me based on when I think I'm going to retire, my risk-type preference, I'm going to adjust by five years, I'm going to invest in a different target date. You're not required to invest in the one that matches up with your presumed retirement date.

So again, and this is the question, how do you get them engaged? And so that's what we were trying to focus on is how can you give them the fact sheet that they get, you know, as they're looking at this and make it something that's graphically available to them to understand what this really means, so we think you're going to retire at 65, maybe you're going to retire at 60 or 70, and you have to look at that in your own circumstance and then decide what that means for you, both for your retirement date and the level of conservativeness or not that you're going to hit at that date.

And we think that's probably a less confusing way
of getting to the same question than throwing a lot more choices at them that are just going to vary a little bit amongst their glide paths. I mean, there are some significant deviations, but not more that could be adjusted for than by switching your date of retirement.

COMMISSIONER WALTER: Now, Karrie, if I can stick with that for a second. I guess what brings the question to mind, and I'm certainly no academic and not knowledgeable enough to really suggest a solution, but if you look at the 2010 funds where people were hit very hard, and I know people myself who kind of looked around and said once they were hit that hard, gee, my Target Date Fund has an allocation of, you know, X in equity; if I had a Y's Target Date Fund, it would have been less.

I don't think there's a real appreciation, I mean there's a decision being made, and maybe it's a question of disclosure, although we all know lots of people don't read disclosures, so I hesitate to have that be the only answer. But there were wide variations for people in terms of what, you know, what their allocations were, so obviously you guys are making somewhat significantly divergent expert decisions, and I don't think people understand that.

MS. McMILLAN: I think it's fair that they don't understand it. I guess the hope is that this is a wakeup
call for everybody and people will pay more attention. And it's also a wakeup call for the industry to do a better job of educating investors about what it means.

I mean, there are ways that plan sponsors provide education to their employees. There are ways that fund groups get better information out there. And I think we all, this is a challenge and sort of a call for all of us to step up our jobs and do a better job at that.

I don't -- I would hesitate for it to be a government rule of mandating a particular asset allocation, though. First of all, it's not something that the government has typically done as to go in and put parameters on investment. I'm sitting here with some really smart people, and they don't agree, so, you know, I think it'll be a challenge for anybody to come up with one one size fits all answer.

And I think, very importantly, if you were to have been looking at this and coming up with a mandated asset allocation ten years ago based upon the market at that time in your experience, it probably would be a very different answer than it would if you're regulating right now with these experiences.

And ten years from now, you may look back and go, wow, that was really conservative, our investor just missed
this huge bull market, so I think that, you know, being able
to have the flexibility of the professional management is
very important.

MR. AMERIKS: I think that set of circumstances
that you described probably applies in most cases to a plan
participant who maybe was defaulted and really wasn't engaged
and saw the performance and noticed for the first time that
they were in these funds and started asking questions.

So I think it's also an opportunity for the plan
sponsor to talk about the process that they went through to
select the Target Date Fund, to explain why they chose the
particular fund that they did.

And in my experience in dealing with plan sponsors,
they are very diligent about the process of selecting funds,
and they have good arguments for either increasing the risk
exposure or decreasing the risk exposure relative to what we
offer, and they try to make that decision with the best
interests of the plan participant in mind. And it's
certainly fair to ask questions, I think, about that process,
but in most cases I think the plan sponsors have very good
answers.

MR. WHITNEY: It's also, I think, a lesson from
behavior finance that we've learned, is that you can't
underestimate how much more difficult you make a decision for
an uninformed participant when you ask them to think about
different dimensions.

MR. LEBOWITZ: And maybe I could interrupt there,
and just ask, how do you intend to inform them? You've all
said in one degree or another that your investors, in large
part plan participants, were uninformed about the
consequences -- about what was behind these funds and why
they performed the way they did during the market last year,
and you seem to have -- there seems to be a consensus among
you that you all need to do a better job of explaining these
things, I guess, the dynamics of these funds, to
participants, but there doesn't -- am I right?

Mr. Knight, you seem to -- you seem to be
suggesting maybe there's a role for government in defining
the parameters of the asset allocation, but I gather the ICI
doesn't see that as being a productive way to go, and I don't
know how the other organizations feel.

MR. KNIGHT: I mean, first of all, honestly, I
think the biggest surprise last year had to do with the
markets and not the funds, particularly at the trustee level.
I think there is a great deal of due diligence, and they
would, given the set of facts that the markets delivered last
year, would probably conclude that they would have seen
losses on the order of magnitude that they did, so I don't --
I don't think the emphasis necessarily is that we under-disclosed or that there was confusion about what to expect under those circumstances. I think the surprise was the circumstances themselves.

And to the other point, I think there just -- part of what would make a lifecycle offering effective is that it reinforces the correct behaviors. A number of my colleagues pointed out how important it is to the overall retirement equation when it's self-directed for participants to start early, to invest adequately and to stay the course.

And our view is that if there is a confusion based around the sort of proliferation of solutions that undermines that behavior, then it's worth having a dialogue as to how we can address that. And that's about as far as I care to go on that, on that subject. I'm not arguing for any specific legislation, just that we want to have the best solution for the national retirement problem.

MR. AMERIKS: I want to jump in on this, too. I mean, I think we're all highlighting and very concerned about those investors that are not informed, but I don't want to -- we certainly don't want to leave the impression that we think our investors are uninformed. There are an awful lot of them that are very well-informed, and in our case, we're very proud of the materials that we provide and give to them to
help them understand their investments.

There are lots of people that use Target Date Funds as just a part of their portfolio, that actually pick a Target Date Fund for say half of their assets and then make other elections around that, and, in our experience, they do that in an informed way, but definitely our concern is with those people who don't feel like they had enough information and how can we do things even better to help them.

And so I think the types of things that we have in mind are simple, clear descriptions that emphasize graphics. People like pictures rather than words. These pictures of a glide path I think are incredibly useful for people and make it easy for them to see what these funds do and what they are.

And the second thing just on this is, you know, I think, if this is the problem, the lack of information, the lack of understanding, I'm not so sure that a government regulation would address that. I think you're still going to end up with that problem. Even if Target Date Funds all have the same glide path, they're going to be a class of investors who didn't understand that, didn't expect what happens, and how do we help them.

And I think what we're all saying is we can get better at that, we can continue to improve the way that we do
that, but, you know, let's remember it's a small set of the investors that are having these issues around misunderstanding them. There's even a larger set that like these funds an awful lot and use them very effectively.

MR. YOUNG: I would also just point out that, when you look at the market that we had in 2008, I mean, as we know, we haven't had an equity market that far down since 1931, so it truly is, it is a test, and it's a valid test, a real, live stress test to go through and see what happens with certain allocations, so it's important for investors to understand this is the impact of that risk profile, but also, as you look forward and think about what happens over the long term, you have to go through it and think about the impact, not only of the down markets, but also the up markets that could potentially be there.

If I go through and look more specifically at a fund like our 2010 fund, because I know there's been a lot of discussion about the 2010 funds, our 2010 fund was down 25 percent 2008; however, remember we launched the Fidelity Freedom Funds back in 1996.

So for an investor who put $100,000 into the Fidelity 2010 Fund back in 1996 when we launched would in essence, after having declined 25 percent in 2008, would now have $197,000 in the Fidelity 2010 Fund, because what
happened is, if you go back the past ten years, for example, only three of those years were down years.

You had a couple of years in there where you had high-teens type returns, 19 percent back in '99. You had 17 percent for the fund in 2003. So in essence, what happened is, as you go through, and I'll tell you, when 2008 happened, I felt the pain personally, right. I mean losing money is never fun. I mean we know that. I mean that's the normal reaction. I had the same reaction.

But you have to go through and think about it: If the market takes something from you, what has the market given you in the past? Do you feel like, net net, you're whole, or do you feel like looking forward, net net, you're going to be whole?

And so for us, we keep trying to reinforce that message with our shareholders about what happens over the long term. It's one of the most important parts of this whole exercise because what we know is that investors are very emotional.

What they do, and I mentioned it in my testimony, what they do, and we see it over and over again and it just pains us to no end, right, because what happens is the market falls, everybody sells because of the panic, and then what do they do? They wait until they're confident that the market's
back again, and they buy back in high. And that's the part of the strategy that we're really trying to think about with Target Date Funds. Can we somehow avoid that emotional reaction? That's what we're trying to accomplish.

MR. PIACENTINI: I guess let me jump in. I heard several of you talk about the fact that there are multiple risks to keep in mind, right. It's not just short-term volatility. You also have to think about, for example, longevity risk, and that in choosing how to design a Target Date Fund, the way you would manage each of those risks is not identical, so you have to reach some kind of a balance.

I guess my question is, how large is that tradeoff and, as a result, how much -- what is the magnitude of this risk that's tolerated?

Mr. Young said at one point that you could contribute 12 percent rather than much more if you had a good glide path, and then you'd hit your goal, but I'd presume that means with some small chance of failing to hit your goal, so what is that chance and how much is acceptable?

MR. YOUNG: Yeah, if you go through and look, and let's just talk more about the glide paths, one of the important things to think about is these are all based on models, and, as you know, the models are only as good as the assumptions that go into the models.
So what happens is, there's a couple of different stages here, so we can think about wealth accumulation and we can think about, in essence, the distribution phase, so there's two different pieces to the model. In essence, it's the same thing. It's like whether you're putting cashflows into the process or are you taking cashflows out.

So when you're looking up front and you're trying to think about what is the goal that one should set, you're trying to think about the behavior of those contributions, so you have to give yourself a range of expectations. While you have an optimal point you'd like to see, you have to think about that range of possible contributions that could be there. You also have to go through and think about the assumptions associated with investments, so a couple of different inputs there. So you're going to have the inputs of how much are you contributing and you're going to have the input of what are the market assumptions that you're putting into your model.

Then for us we build actually a target of ten times the ending salary. Now, once you get to the stage of distribution, there are other assumptions that go into our model, so we're looking at the withdrawals, so withdrawal rates matter as we know. You'd prefer to see a withdrawal rate around 4 percent. The history will tell you, in terms
of the research, that a 4 percent withdrawal rate will actually give you 30 years of protection off of your investments.

If you look at it, we have to consider the withdrawal rates. We consider longevity, so life expectancy risk. We consider inflation. And we also consider the market risk again at that stage.

So there are all these different inputs that are going into models, and I think that's the reason why you see a lot of difference between the providers is because any one of these assumptions, dramatic changes in any of these assumptions can dramatically change what the allocations are.

MR. PIACENTINI: So in the end for any particular investor, they are facing some risk. They are facing a risk that they will outlive their assets. They're facing a risk that, because of a market downturn close to their target date, that they will undershoot their goal from the start.

You all have estimates of what you think those risks are, but, in fact, the size of those risks is unknown.

MR. YOUNG: Yeah.

MR. PIACENTINI: Is that all accurate?

So but, going back to the 12 percent to hit the goal, how big is the risk there that you won't, what is the risk that's tolerated?
MR. YOUNG: Yeah, it's interesting, because what we see is that most plan sponsors -- or, excuse me -- plan participants actually contribute around 7 percent, and then, if you assume there's a matching component on top of that of three to 5 percent, it gets you close to that 12 percent rage, so the history, in terms of our data, is indicating that fairly close to that, to that type of a number, but, again, that assumption matters just like all the other assumptions, but our individual data indicates a 7 percent contribution rate is what we've seen historically from our participants and then a matching on top of that.

MR. WHITNEY: I could be maybe a little bit more specific. In terms of when we look the duration of an income stream generated in distribution from a retiree's assets, our glide path is designed to provide a 90 percent chance of success, so our estimate is that nine times out of ten, given market environments that are recently typical, that nine times out of ten we will see assets last for at least 30 years as retirees draw income from that asset base.

MR. PIACENTINI: Okay.

MR. YOUNG: And then I would say we do the same kind of thing, but to go back to your further point, I mean, these are all estimates of risk.

MR. PIACENTINI: I understand.
MR. YOUNG: It's not as if this risk is knowable and we can quantify it, so we do the same kinds of estimates, and we use a number more on the order of 85 percent at a 30-year horizon, but then you've got 85 percent of the money lasting that long a period, but you -- for an individual, you've got a five or 10 percent of the individual lasting that long of a period, so it's a much higher standard than it sounds from 85 or 90 percent.

MR. PIACENTINI: So just the last little bit of the question, when you have numbers like that, there's a 10 percent chance that you'll fail to achieve something. Is that part of what is communicated, and, if not, is that something it should be?

MR. AMERIKS: I mean, just in the discussion that we're having here, you can see how hard it is to talk about these structures, and, you know, we all have the backgrounds to do this kind of a thing.

I think what we need to disclose is that there is a risk. This is not a guaranteed, insured product. We are trying to balance longevity risk and market risk and inflation risk in designing the portfolios, so the risk exist. It's not zero. And I think we've tried to be prudent about managing that, but I just don't know, other than taking everyone to graduate school and giving them an economics
degree, how we're going to get more precise information into their hands.

MR. WHITNEY: And we do -- we do certainly communicate that information in great detail with plan sponsors and consultants and through white papers and research, so the design of our glide paths are well-known and well-communicated, but, as John said, you know, distilling that down to, you know, a few sound bullets that make sense is very difficult to do.

COMMISSIONER WALTER: But it seems to me it might be helpful to be more specific with respect to the variables that are under the particular person's control, how much I take out a year, how much I put in. You could more generally describe the kinds of things that went into the balance about the structure, but, if I know that I should be taking out 4 percent if I want it last 30 years and if I take out 8 percent that's not going to happen that's something that would be quite useful.

MR. WHITNEY: Right. We agree completely, and, in fact, we have a retirement calculator that's available on our website to anybody where they can go through those simulations and model their exact experience and their own patterns to really get a good handle on what those numbers would be.
MS. Mc MILLAN: It's also important to remember, though, that this probably isn't the only asset that's going to support an investor's retirement, and so, when you do these calculators, you need to really tailor it for your own circumstances.

You probably have social security which is going to provide a good foundation point for you, and then you may have your own, outside of your 401(k) or outside of your target date plan, so these assumptions of taking out 4 percent or 8 percent are based really just on the fund, not so much what else is going on, and so I think we'd have to make sure that investors understand that caveat as well.

MR. DOYLE: Do we have any further questions? Well, thank you very much.

MR. YOUNG: Thank you.

MS. Mc MILLAN: Thank you.

(Applause.)

MR. DOYLE: So if we could have Panel Two. And I'm hoping you know who you are. I don't know whether you have a preferred order, but I'll defer to the panel.

MS. CAPELLI-DIMITROFF: I'll go first if you'd like.

MR. DOYLE: Ladies first.

MS. CAPELLI-DIMITROFF: Good morning. I'm Marilyn
Capelli-Dimitroff, and I'm chair of the Certified Financial Planner Board of Standards and president of a financial planning firm in the Detroit, Michigan, area. I appreciate the opportunity to testify today at this hearing.

CFP Board's mission is to benefit the public by granting CFP certification and upholding it as the recognized standard of excellence in personal financial planning. CFP Board currently regulates nearly 60,000 CFP professionals who voluntarily agree to comply with our standards of ethics, which includes a fiduciary standard, and with our competency standards.

Financial planning professionals help their clients meet their goals through proper management of financial resources and cover a broad range of subject areas including investments, employee benefits and retirement planning.

CFP Board appreciates the opportunity to address the use of Target Date Funds in participant-directed retirement plans.

Target Date Funds, appropriately managed, can be beneficial to investors. However, we have serious concerns that these funds are fundamentally misleading to investors because they're allowed to be managed in ways that are inconsistent with reasonable expectations that are created by the titles and the use of the names.
The use of a date in a fund's name carries with it a generally understood message to investors. For example, the name, "Target Date 2010," says to the investor this fund will invest in an appropriate mix of investments for someone retiring around 2010.

However, you heard SEC Chairman Mary Schapiro recognize the widely varying strategies used among fund managers as evidenced by the 2008 performance of the Target Date 2010 funds ranging from minus 3.6 percent to minus 41 percent.

Now, put yourself in the place of a person who's retiring in seven months who is invested in a 2010 fund expecting low volatility and then experiencing a 41 percent loss in 2008. It's devastating.

Let me underscore an important point. It can be perfectly appropriate for investors approaching retirement to employ an aggressive strategy with their 401(k) funds, particularly when they have other resources, but Target Date Funds, which are marketed as being on autopilot, investments for those who do not have the time, desire or expertise to monitor their investments, are not the appropriate vehicles for implementing aggressive retirement investment strategies for those nearing retirement.

It is not an answer to say that misleading fund
names can be cured by effective disclosures. Appropriate disclosures are required and must be provided, but, in reality, disclosures are seldom read or understood fully despite our ongoing education of our clients. For example, many of our clients continue to ask us how they can shut off receiving prospectuses, and, if they get them by mail, they say to me, I just throw them away and it's waste of trees. If they get them electronically, they say it's a nuisance because they have to hit delete, delete, delete.

For these reasons, we recommend that the SEC amend its misleading names rule to provide that a Target Date Funds' name is materially deceptive and misleading unless the fund's investments fall within an acceptable range of asset allocations consistent with its name.

Appropriate ranges of asset allocations for target dates based on reasonably accepted industry practices can and should be established. Such ranges can be developed by a panel of experts from the financial service industry that could include experts in ERISA, investment advisors, CFP professionals. The establishment of acceptable ranges will allow for continued competition among funds while at the same time aligning risks with investors' expectations.

Establishing asset allocation standards for Target Date Funds is especially important given that Target Date
Funds are designated as qualified default investment alternatives under the Pension Protection Act of 2006.

The designation as a QDIA sends two important messages. First it conveys to employers that the government believes that the allocations in Target Date Funds are appropriate for individuals based on their expected date of retirement. Second, it conveys to employees that the government is making an appropriate investment decision on their behalf.

That's why it's particularly important for the Department of Labor to work with the SEC to encourage the development of accepted industry standards. Should the SEC fail to move toward needed investor protections in the management of Target Date Funds, we believe that the Department should proceed on its own to regulate these funds, or, alternatively, should rescind such funds' eligibility as qualified default investment alternatives.

Let me close by saying CFP Board stands ready and willing to facilitate the participation of CFP professionals who are experts in retirement planning to assist in the development of needed industry standards for Target Date Funds.

Thank you.

MR. BARE: Good morning, ladies and gentlemen.
Thank you for this opportunity to present our views on how to improve the investor experience relative to Target Date Funds. My name is Rod Bare and I'm the Director of Asset Allocation Strategies at Morningstar in Chicago.

Now, to set the context, we believe there are five major risks investors face. We've heard a bit about them this morning as investors face these over their lifetime as they work on funding a retirement.

The first and most important risk in our minds is the savings risk, the risk a person doesn't contribute enough money to give the strategy a reasonable chance of success. The second is mortality risk, the risk the investor dies before the financial security of loved ones is secure. The third is market risk via suboptimal asset allocation or poor security selection. The fourth is inflation risk which has been a longstanding concern for retirees facing fixed income streams, and finally, longevity risk, the risk the investor outlives their retirement income.

Now the first two risks, savings and mortality, are very important early in an investor's life. Savings is always important but especially early on. Auto enrollment, financial education and life insurance helps control these risks.

As an investor matures, market risk, inflation risk
and longevity risk rise in importance. A properly constructed target date portfolio can do much to tame these three risks. Like most new products, today's first generation Target Date Funds have helped highlight what to improve in the next generation.

Morningstar and our subsidiary, Ibbotson Associates, has spent the past year and a half packing a combined 60 years of asset allocation and security selection research into a set of retirement portfolio indexes. These benchmarks are helping us analyze the current target date marketplace to understand what could be improved.

In our opinion, there are three enhancements to consider adding to a default target date series: Risk profile choice; expanded asset class diversity; and low-cost passive security selection.

First is risk profile choice. Everyone agrees that investors have a diverse set of financial situations, retirement objectives, risk appetites and lifetime income possibilities. Because this investor diversity is unavoidable we say glide path choice is essential so investors can better synchronize their risk profiles with their retirement portfolios.

We have three glide paths in our target date benchmark family to address three common risk profiles,
conservative, moderate and aggressive to help fiduciaries and
asset managers select benchmark and construct Target Date
Funds. Offering risk profile choice in a target date solution
also creates a natural opportunity for an advisor or online
tool to engage the investor in valuable reviews of retirement
resources, long-term objectives and outcome expectations.

The second enhancement is expanded asset class
diversity. There are Target Date Funds on the market today
that aren't taking advantage of the benefits of meaningful
diversification into asset classes such as emerging markets
equities, international bonds, TIPS and commodities.

Fifty years of research starting with Harry
Markowitz' modern portfolio theory have established that
portfolios with a broad set of asset classes can deliver
better risk return experiences for investors than portfolios
with narrower ranges of asset class exposures. Adding
guaranteed income as an asset class will also be beneficial
for investors for reasons that will most likely be discussed
in later panels.

There is a relationship here that should be
considered. Increasing a Target Date Funds' asset class
diversity can, in some cases, strengthen the case for passive
security selection. This third enhancement is the trickiest
to discuss with this audience, but one that should really be
the most intuitive to understand given the performance history of thousands of funds across several countries over many years.

In general, we know actively managed funds have a difficult time beating their benchmarks and can be more expensive. Of course there are exemplary portfolio managers who add value to the security selection process, but they are rare, especially in clusters.

The difficulty then is that a Target Date Fund with adequate asset class diversity typically doesn't have access to the leading portfolio managers for every asset class. There are ways to construct custom Target Date Funds using hand-picked managers. That additional effort in manager selection and monitoring has a cost which is sometimes offset by the cost of the underlying investment, but the odds of outperformance still remain uncertain.

Today's Target Date Funds therefore may have the cart before the horse. Instead of starting with Target Date Funds filled with active portfolio managers who can't all be above average, let's be honest, it should make sense for Target Date Funds to start with a foundation of passive index funds and perhaps substitute in value-adding managers over time. The benefits of lower costs in terms of extra retirement income after 30 years of accumulation are another
big plus for this approach.

In conclusion, investors deserve the best target date investment experience we can give them. Industry research suggests risk profile choice, expanded asset class diversity including guarantee income and low-cost, transparent security selection are three enhancements that can improve target date investor outcomes going forward.

The uniqueness of today's format and the joint effort involved in understanding the issues highlight the depth and complexity of this topic. Morningstar has a number of free resources and research devoted to target date investing at indexes.morningstar.com, and the performance data, summary allocations and research papers there are tools that we hope folks will utilize as they work through the issues presented today.

Thank you.

MR. NAGENGAST: Good morning, Joe Nagengast, Target Date Analytics, an independent RIA dedicated to the analysis and indexing of Target Date Funds. Thank you for receiving our comments, and let me tell you a story, the origin of Target Date Funds and where some of them went wrong.

TDFs were designed in response to a persistent problem plaguing the 401(k) industry; that is, with the investment responsibility now in the hands of each
participant, it was clear that the challenge was greater than the average skill or inclination.

In response, Wells Fargo and BGI introduced the first TDFs in March 1994, 15 years ago. It was a stroke of genius. Aggregate all participants by years to retirement and use a glide path to attenuate risks over the accumulation period. Objective: Do it for them. Invest their retirement savings. Get them safely to the target date, then fold the assets into the income or preservation fund.

When plan sponsors and participants started adopting TDFs in big meaningful numbers starting in 2002, the race was on for performance numbers, and this is where the train went off the track.

The way to win the short-term performance horse race and resulting market share was through higher equity allocations. Each of the major fund families found justifications for, one, increasing the equity allocations across the glide path, and, two, extending the glide path beyond the target date, beyond the period that can be managed with a glide path.

These two changes correspond to the two biggest contributors to risk in TDFs, one, the amount of equity in the fund, and, two, the design of the glide path. There is some theoretical rationale for employing a glide path through
the accumulation phase. No credible rationale has ever been proffered for using a glide path in the distribution phase. This is what caused the unacceptably large losses in 2010 funds in 2008. Both of these flaws stem from misunderstanding or misappropriating the purpose of Target Date Funds, and these excessive losses weren't necessary. Our 2010 index lost less than 5 percent in 2008 because it stuck to its core objective while the average 2010 fund lost 23 percent.

Recommendations: We favor target date investing, and there are legitimate areas for improvement that may not be affected by market forces alone. You can help. The name of each fund must bear some relationship to the way the fund is managed; that is, its glide path. If a fund labeled 2010 is really targeted to land at 2040, it should be relabeled as a 2040 fund. Disclosing that the 2010 fund isn't actually designed for safety at 2010 will not work. It must be properly named.

In turn, glide path -- the glide path should be designed to provide for a predominance of asset preservation as the target date nears and arrives. This is, after all, nothing more than implied by the date in the name of the fund and is what participants expect.

For benchmarking purposes, the Commission and the
Department should encourage the adoption by plan sponsors and
their consultants of indexes based on the core objectives of
target date investing; that is, indexes which end their glide
paths at the target date. Indexes which are derived from
current flawed practices will only reflect the performance of
those flawed practices and will not hold the funds to any
standard.

Prospectuses, especially for the SEC, prospectuses
should be clear about the objectives of the funds. Language
describing the objective of a fund as dependent on its
allocation should not be permitted. We support NAIRPA’s
proposal to eliminate the mutual fund exemption of fiduciary
responsibility borne by any QDIA manager.

And I add some cautions about regulating. I urge
you to keep your eye on the ball. Required disclosure about
a fund's glide path will not be read. The solution is to
require proper naming of a Target Date Fund. Again, there is
no credible rationale for doing otherwise. And then you
won't have to mandate allocation percentages.

Beware of red herrings. Issues that cannot be
addressed by glide-path-based allocation models, longevity
risk, inadequate savings, inflation risk, those are not the
domain of glide path-based investing. That is properly the
accumulation phase.
Addressing the inherent conflict of interests in fund managers using their own funds as the underlying assets is sensible, but, if you address the underlying assets and not the allocation, you've addressed only 10 percent of the variability of returns leaving 90 percent on the table. I'd be happy to discuss how you can effectively regulate TDFs without getting into the messy business of mandating allocation percentages.

Thank you.

MR. CERTNER: Members of the panel, my name is David Certner. I'm Legislative Counselor and Legislative Policy Director at AARP. We appreciate the opportunity to discuss the important issues surrounding Target Date Funds.

Over the past 20 years, America has seen a shift from DB plans and DC plans, and TDFs have become an increasingly an important investment vehicle for participants in DC plans. It is estimated that roughly 200 billion was invested in TDFs in 2008, and the percentage and the amount of funds in TDFs are expected to continue to grow dramatically.

TDFs are designed particularly for a simpler mechanism to address the needs of the very large numbers of people who really don't want to manage their funds. These funds allow participants to simply choose their retirement
date and have a TDF allocate funds accordingly. So TDFs hold out the promise of professional asset management in an individual account context.

TDFs, however, are not a perfect solution. Numerous questions have been raised about TDFs ranging from fund make-up to fee structure to asset allocation and underlying glide path assumptions, and the answers to these questions can have a profound affect on an individual's retirement savings.

Because plan fiduciaries must determine whether to select TDFs and what kind of TDFs as investment options for their 401(k) plans, it presents an opportunity to better manage expectations and improve disclosure around TDFs. Plan fiduciaries must assess whether TDFs are prudent for their plans, and there's an important opportunity to improve the role of the fiduciary. This is particularly important because almost by definition participants who choose TDFs do not want to exercise ongoing management and oversight of their investment choices.

So AARP suggests that the DOL develop a selection and monitoring target date tool similar to other compliance assistance the Department has issued in order to assist fiduciaries to better meet their duties in selecting Target Date Funds.
The tool should provide suggested areas of inquiry for evaluation including, but not limited to, asset classes allocation, numbering quality of underlying funds, glide paths and fees and expense ratios for both the fund itself and any of the other mutual funds in which the Target Date Fund invests. We have prepared a more detailed list of potential areas of inquiry, which we will submit for the record.

The DOL may also wish to issue compliance assistance for fiduciaries on best practices and eventually more specific regulatory guidance on fiduciary responsibilities.

We also agree with the DOL’s ERISA Advisory Counsel that participant education and materials are a good start to better inform participant investors of how their TDFs work, the underlying assumptions and the risks involved.

More explicit and better disclosures concerning risk, glide paths and fund allocations would be helpful, and AARP suggests that DOL and SEC work together to determine the specific types of disclosure necessary including fund names and issue guidance or regulations.

However, because the underlying principle behind TDFs is to simplify investment choices, especially for those investments who are less financially literate, participant
education and disclosure will not be enough. The real issue surrounding TDFs is how to make them work better to meet the objectives of providing an adequate and secure retirement, so we believe that more specific regulations on disclosure and consistency in terminology will be needed.

Terminology is important. For example, Morningstar reported that the percentage of equities in private 2010 funds range from less than 30 percent to 65 percent. The Federal Thrift Savings Plan holds 30 percent in its 2010 fund.

This difference results, in part, from the meaning and purpose of the Target Date Fund. Is it a fund with the assumption that money will be drawn immediately or is it one where funds will be drawn until death? Both purposes are legitimate, but the expectation of the investor may not at all coincide with the either the title or purpose of the fund.

AARP also recommends additional research on the issue of appropriate benchmarks on TDFs. Benchmarks have only recently been established and are inconsistent. Consistency on the underlying purpose of the TDF may yield the appropriate benchmark which would provide welcome guidance.

Some commentators have suggested there should be
limitations on the amount of equities held in Target Date Funds especially for funds within a five- to ten-year window of a participant's retirement date.

AARP is aware that there is a dearth of research and inconsistencies, as we've heard, concerning the methodology currently used to determine the amount of equities held in a Target Date Fund. As noted earlier, this has led to wide variation in the amount of equities held in TDFs.

This is particularly critical as an individual approaches retirement. We suggest that DOL and SEC collect further information and work with interested parties to determine best practices and whether the parameters are needed.

In addition, added disclosure to participants may be necessary to help them better understand the level of risk. Although, again, we note that these plans are designed for those who desire to avoid such decisions. However, in our view, it is likely that many close to age 65 would be surprised to learn the level of risks they are assuming under some TDF allocations.

Of additional concern to AARP is the lack of transparency for individual funds that make up Target Date Funds, the fees for those funds, the overall fee level for
TDF and their affect on overall returns.

While asset allocation is critical, plan fees compound over time, and the larger the fees, the bigger the reduction. Comprehensive information on plan fees and expenses will enable both fiduciaries and participants and other investors to insure that fees and expenses are reasonable. Consequently, TDFs should disclose, not only the fees they are charging, but also the underlying fees -- underlying funds or other investments that comprise the TDF.

In conclusion, we thank you for this hearing and we look forward to continuing to work to help both the fiduciaries and investors to make proper decisions.

MR. DOYLE: Thank you very much.
CHAIRMAN SCHAPIRO: Thank you. Thank you all very much.

I have a question that perhaps I should have asked the last panel, but maybe Morningstar can help with it. I'd be curious about whether the same target -- the same funds underlie Target Date Funds as underlie 529 plans where there's an expectation of a, you know, 2015 retirement date and 2015 a child's going off to college, and, if so, is that appropriate?

MR. BARE: I wish I could answer that. I don't have that info. I can get that to you, though, but I don't
work in that particular --

MS. SCHAPIRO: Okay.

MR. BARE: -- group that analyzes the 529 plans.

MS. SCHAPIRO: Does anyone else have any idea about whether there's a one size fits all approach in between 529s and Target Date Funds?

MR. CERTNER: I don't know the answer to that question, but you would think that the distribution phase and for the 529 plans would be over a shorter amount of time, so it may be different because of that.

MS. SCHAPIRO: Okay. I'll probably get --

MS. CAPELLI-DIMITROFF: Yeah, I believe that it is shorter but the allocation is different because of the time frame.

MS. SCHAPIRO: Okay.

MR. BARE: Yeah, the allocation is different, but the underlying funds, are they the same? I'll get you that information.

MS. SCHAPIRO: That would be great. Thank you.

MR. DOYLE: Joe, any questions?

MR. LEBOWITZ: David, you talked about fees and the need for more transparency, I guess, more disclosure or better disclosure with respect to fees. How are the fees -- in the typical Target Date Fund, which is made up of a number
of funds, a fund of funds, they're fees at the individual
fund level and then presumably at the Target Date Fund level.
Are they all aggregated and disclosed to investors or how
does that work?

MR. CERTNER: I think here what's probably more
important is how they're disclosed to their fiduciaries,
because I think, by definition, in these kinds of funds we're
not going to have individuals paying as close attention.
That's not to say we shouldn't be providing some of this
information to individuals who want to go and look at it, but
I'm not sure that giving them tons of information is going to
be completely helpful as is giving them the broadest number
that's available in funds but then allowing them to go
someplace else for those who want to have more information
because, as we've discussed, people in these funds tend not
to be the ones who want to oversee and manage these funds in
the first place.

So the issue is really for the fiduciary. Are they
going to have access to all the fee information they need,
not just in the aggregate, but in the underlying funds?
And part of the concern here is when you have a
fund of funds, it may become a lot easier to, for example,
hide under-performing funds in Target Date Funds, hide higher
fee funds in a Target Date Fund that may not be completely
appropriate, and so having the investigation not of just the
total cost but of the cost and the adequacy of each of the
underlying funds, I think, is going to be a very important
for the fiduciary as a first line of defense.

MR. PAREDES: In terms of the possibility of
enhanced disclosure, it's still important, ultimately, for
the investors to actually be engaged with whatever
information is disclosed, so in terms of strategies to
actually prompt investors to be more engaged with respect to,
again, whatever the disclosures happen to be, what are your
thoughts on that aspect of the challenge?

MS. CAPELLI-DIMITROFF: When I hear the word
"engaged," it says to me financial planning. And again, when
we look at the whole issue that we're talking about today,
with the funds, and we talk about investments in general,
it's always something that's in order to. Investing is in
order to meet the goals that you have.

And engaging folks is often a matter of getting
them to look at a bigger picture to see where this fits into
the whole analysis of their financial well-being, and so we
find that working from that point often is a prod to get
people to take a look at that.

Most people are afraid of looking at these issues
and just are quick to turn them off, so it is important to
find a reason to lure them into exploring all of these
issues.

MR. BARE: I think from our perspective, you know, we've designed three glide paths that, you know, we think can be used with advisors and other tools, at key points in an investor's, you know, lifetime so that they can take the time to assess where they are financially and what their objectives are and then select something that's appropriate for them.

We went with three glide paths. I understand you could, as an alternative, move up and down on the glide path. You know, we felt that, you know, the date that you, you know, stop receiving a salary is an important date. And it's easier to kind of understand the retirement time frame and then what's my relative risk appetite, you know, in that time frame rather than should I, instead of the 2010 fund, move into the 2005 or 2015 fund?

Our algorithms, you know, produce glide paths that are distinct, and there is a difference in equity exposure moving from moderate to conservative. For example, our 2010 moderate has 45 percent equity exposure; our 2010 conservative has 29 percent equity exposure. That same 2010, if we just went to -- if we moved to 2005 to try to get more aggressive, you know, our moderate has 39 percent equity
exposure. So it's still higher than what we think is conservative. Again, this is just according to our math and research.

MR. CERTNER: This is -- you're sort of dealing with the basic conundrum here, which is that these Target Date Funds are designed for people who really don't want to pay attention, don't want to manage, don't want to read the information. And so how do you get information to people who really aren't that interested in information?

Well, and then, really, you're talking about information at a very basic simplified level, which is, I think, why, as some have expressed here, you know, the names of these funds and how they're labeled is going to be very important.

We have not done specific research among our membership on this issue, but my guess is that people who are looking at 2010 Target Date Funds are thinking something much more conservative than maybe the theoretical notions of what the payouts are going to be over a longer lifetime period.

That may have some theoretical basis, but I don't think a lot of people are actually thinking about it that way. Trying to get them to think about it that way would be useful. I'm not sure how successful we can be at that for a large number of people. So trying to at least originally
name something correctly is going to be helpful. I mean, we do know, for example, from previous issues in debates we've dealt with that, you know, the older population tends to be more risk adverse. We saw that, for example, in the social security debate where it was very clear that individuals preferred security over risk-related gains that they could potentially have by overwhelming numbers.

So when you're talking about a 2010 fund where people certainly who are in retirement, I think they value security much more than they do potential upside returns that they could get, and so I think it's going to be important to think about that in this context particularly for those who are at or near retirement.

You know, glide paths may have some theoretical basis, but I'm not sure if, you know, the theoretical glide path basis is really matching the way real people really think.

MR. NAGENGAST: If I could address that issue, I think we -- you look at what made Target Date Funds work at all, and that's the aggregation glue, the stroke of genius if you will, that allowed us to say everybody with the same length of time to the liquidity date can more or less be lumped into one allocation, and we'll adjust that, fund
managers will adjust that over time.

As you -- so a 20-year-old with a $2,000 account balance suffering a 50 percent market loss isn't really hurt too much if you consider all the possibilities for making it up by contributions, market returns. A 55-year-old maybe with a $500,000 account balance suffering a 50 percent loss is devastated.

And so I think for -- to get back to your question, I think you need to segment the group. Don't try to train every 20-year-old to become their own CIO. That's why we have Target Date Funds. But focus the efforts on people in this transition phase. As you move from the accumulation phase to the Target Date Fund where that aggregation glue, if you will, is melting, we're no longer able to put everybody in the same bucket. Then you have some options.

Now a participant with a $500,000 account balance can afford some financial planning, some personal assistance. Or they may be better served by an annuity product. Or maybe the fund company themselves can manage a portfolio -- the income portfolio. It's no longer a single path at this point. It's a transition area, and that's where I think your targeting communication could be most effective.

MR. BARE: And can I add, if I may, there aren't many safety nets left for the individual retirement --
retiree. This is a huge responsibility for an individual to
take on, and we don't want to cut too many corners here. One
solution is elegant, I agree, but having two or three options
that can work with a financial planning session to help, you
know, better fit an investor to a solution should be, you
know, better than having 15 options on the menu, which is
what we currently have today in a number of 401(k)s.

MS. SCHAPIRO: Could I -- just a small question.

To what extent are target funds marketed as the solution for
somebody's retirement security or marketed as just a
component of other investments or obviously social security
or other options? Are they really pushed as the be-all-and-
the-end-all in your experience?

MR. NAGENGAST: In my experience, if you read the
material -- if you read the brochures, you'll see one
message, which is, relax, pick the date, we'll take care of
the rest of it for you.

If you read the disclosure, the prospectus, it
disclaims everything that the brochures say. We have no
responsibility. This is on you. Make sure you're picking
the right thing. These can lose money. Be careful.

MS. CAPELLI-DIMITROFF: Mary, also I believe it
depends often on a workplace by workplace environment. A lot
of things take place where there are meetings for employees
and things are explained. And I don't know how to answer how
that occurs on an individual workplace situation. We think
that's where a lot of the communication does take place.

MR. CERTNER: I think particularly in the workplace
in the context of a retirement plan, I think it is
essentially -- I mean market is probably not the right term,
but the education you're getting from your employer from the
context of the plan is that, you know, for those who do not
want to take responsibility for allocating their money, here
we have these Target Date Funds that allow you to put your
money directly into something that's appropriate for your
retirement date.

And of course, now, with automatic enrollment, you
may not even have anything. It's just automatically
happening and people are automatically being put into these
Target Date Funds, which may be very appropriate, but,
particularly as people get close to retirement, I think it
gets a lot more complicated as we've all been discussing
about what your time lines are for taking the money and what
may make the most sense there.

But I think the way it is, when you're taking about
in a plan design, it is interestingly talked about: Well, if
you don't want to have to take control of investing your
money, pick a Target Date Fund.
But interestingly I think the experience in a lot of plans is that these are not necessarily seen that way by participants. Participants, I think, very often look at these as just another fund choice, and so they are allocating their monies among funds including, you know, potentially their appropriate Target Date Fund, so even in the plan context, I'm not sure it's working the way it's even being talked about in the plan context.

MR. BARE: We would certainly agree these should be marketed as the primary fund, you know, for retirement investing if you're going to participate in the target date structure. It doesn't make any sense to split your money across three other Target Date Funds or use it as a core and then dabble in tech funds and, you know, other things like that.

The message should be clear that these are carefully designed, that there are a lot of smart folks here have put a lot of work into designing these to be efficient, and the power of that efficiency is pretty easily destroyed if you -- if you don't put 100 percent in.

MR. PIACENTINI: I have a question for -- I'm sorry if I pronounce this -- Mr. Nagengast. I'm pretty sure I heard you say that glide paths don't belong after a target date.
MR. NAGENGAST: Yes.

MR. PIACENTINI: And that glide paths are not a good tool for managing longevity risk. And I think I heard some people on the last panel say the opposite, that longevity risk is one of the things that they try to balance when they design a Target Date Fund, and I think the implication was that continuing the glide path after the target date is a piece of that.

So could you elaborate a little bit on why you hold this strong view?

MR. NAGENGAST: Certainly. As I pointed out at the beginning, target date investing was developed to answer a specific need, and that is participants in participant-directed defined contribution plans are now being charged with their own asset allocation responsibility, which they never had before. And we tried for years to educate them and that didn't work.

And it's not that participants are ignorant or stupid or anything like that, it's just that they have other things to do. I don't know how to tune my car up anymore, and I shouldn't be expected to. Nor should a participant know everything about how their fund mechanics work. They should have somebody to whom they can say, please do it for me, that's what I'm turning to you for.
So the glide path was developed to manage time-based asset allocation over the accumulation phase only. The first funds were immediately rolled into the receiver fund, the income or asset preservation fund. Wells Fargo's Lifepath 2000 was folded into their Today fund in 2000. And that's how it worked fine until the assets started to get so attractive that a performance horse race ensued.

And the way to win that, as I said, was through higher equity allocations. I would say that the solution to a number of problems, longevity risk, inflation risk, under savings for goodness sake, guaranteed income, the solution to all those is going to turn out to be more equity. So the answer is there before the problem is presented. The problems are mere justifications for the higher equity allocation, and that's why I say what I say.

If -- a glide path -- if you are an investor at age 65 now with a pool of money starting your distribution phase, your point of highest risk is at that first day, so why would you have a glide path that starts out with high risk and tends to lower risk at your actuarial projected death date for some example. Your highest risk is at the beginning. You could turn a glide path on its head.

But we really think that people need individual, more individual opportunities as they enter that transition
phase, maybe different aggregations, not turning that
completely back on every individual.

MR. PIACENTINI: Thank you.

MR. CERTNER: If I could add to that. I mean, I
think what we've heard is that these funds are really based
on a moderate risk, long-term investor. And certainly, while
choosing moderate risk may, you know, make sense, as on
average, it's -- you know, we're talking about one size fits
all plans, this is where it becomes problematic, particularly
for longer-term investors.

I mean, you may have -- with high turnover among
workers, long-term investors may or may not make sense,
particularly when you're getting to closer to retirement.
Many people may be planning on leaving the money in the plan
and not taking it out until minimum distribution is
necessary. Others may need money more immediately for health
or long-term care needs. So the long-term horizon doesn't
necessarily fit very well, particularly as one's getting
close to retirement.

MR. NAGENGAST: If I could just add one key thing
that I forgot, and that is the glide path serves its core
function, investing through the accumulation phase. If you
put it into service for other purposes, ameliorating
longevity risk, making up for inadequate savings, you disable
its ability to perform its core function, and that's what

MR. BARE: If I could just add another counterpoint
quickly. My philosophy is at the other end of the range than
Joe's, and we agree to disagree, but actually it's really
relative to the objective. Our glide paths continue well
past the target date and into retirement because there's
still a lot of life to live. You still need to keep the
money working as hard as it can. If you're in a -- and
that's for a self-annuitization model where folks have talked
about, you know, withdrawal rates of four to 5 percent and
how that can last.

Now, if you're in a situation where you're going to
buy an annuity product on retirement date, then it does make
sense to force yourself into a more conservative stance at
that date. If I was looking at the U.K. in designing a glide
path for that where there's mandatory annuitization, then I
would adjust the allocation. This is tuned for a U.S.
investor that's presumed to be self-annuitizing.

MS. CAPELLI-DIMITROFF: And I think this discussion
points out very clearly that the issues that are here and
understanding, first of all, what it means to have a 2020
fund. It is defined a little differently if we're looking at
that's the point of retirement and then withdrawals start,
and we have a set of circumstances in place. It may be defined differently if we're looking at this is something that's going to be designed to last 30 years.

So I think there are -- it's clear that there are best practices that need to be developed so that the consumer is not confused. When the consumer hears that this is a Target Date Fund with a given year, the consumer has a clear idea of what that means and then can use that to design the rest of their actions around financial decisions.

MR. PIACENTINI: Thank you.

MR. DOYLE: Thank you. Thank you very much.

(Applause.)

MR. DOYLE: And I think with the conclusion of that panel, we're going to take a short 15-minute break. We will be reconvening exactly at 11:20, so if the next panel could be up and ready to go at that time, that would be terrific.

(A brief recess was taken.)

MR. DOYLE: Thank you very much. Just to call your attention, we've had some substitutions representing the Agency, Andrew Donohue, Director of the Division of Investment Management at the SEC, has joined us, and Fred Wong of the Office of Regulations and Interpretations with EBSA has joined us. So with that I will turn it over to the panel.
MR. MOSLANDER: Good morning. I'm Ed Moslander, SVP for Institutional Business Development at TIAA-CREF, and I'd like to thank you for giving us the opportunity to share our views on Target Date Funds.

TIAA-CREF is a not-for-profit provider of defined contribution pension plans and one of the world's largest retirement systems with $363 billion in assets under management almost all dedicated to retirement. We also pay out more than $10 billion a year in lifetime retirement and -- lifetime retirement income to over 300,000 annuitants.

As a provider of defined contribution retirement plans for over 90 years, TIAA-CREF has a unique perspective on both Target Date Funds and pension plan design. We've invested a substantial amount of time and attention in determining the appropriate asset allocation to provide our clients with lifetime financial security.

Today I will discuss disclosure, the glide path and retirement income management. TIAA-CREF supports clear, concise and meaningful disclosure of investment information to retirement plan sponsors and their plan participants. Plan sponsors and investors need to understand that the primary goal of Target Date Funds is to maintain a diversified portfolio over time that offsets risks from overexposure to one particular asset class.
To insure the plan sponsors and their participants have complete information, TIAA-CREF believes that Target Date Funds must provide a detailed description of how the portfolio will change over time, perhaps graphically, to make it really clear what the glide path is, clearly state the asset allocation for each asset class in the fund, provide a listing of the investments that comprise each asset class and provide a brief description of the risks associated with each. The prospectus should also include a clear description of the parts and the sum of all the fees participants pay.

Target Date Funds are designed to be a one-stop solution that enable plan participants to set a specific course for their retirement through automatic asset re-balancing and continuous diversification over time. The glide path is an essential element of the funds.

Our research has shown that a balanced portfolio of multiple asset classes, diversification, is essential to creating retirement savings and preserving financial security. We promote the prudent use of traditional assets, such as stocks and bonds, provide diversification and enhance risk adjusted returns, but we also believe that other asset classes, such as real estate, guaranteed interest products and stable-value funds also provide diversification benefits.

While equity prices fluctuate, we agree with
research that demonstrates equity investors earn a premium over time for taking on additional risks. This has led us to conclude that equities are an essential part of an investment portfolio in both the accumulation stage and the retirement income phase.

Recent poor returns of the publicly traded equity markets has sparked a debate about this point, especially concerning how these returns have affected individuals at or near retirement, but it's important to focus on the long-term nature of investing, not only to retirement, but through retirement.

Many participants are going to live 20, 25, 30 years or more in retirement. As a result we believe it's important not to limit or constrain a retiree's opportunity to benefit from this asset class, from the equity asset class with its potential for growth.

Risk-mitigated growth is as important in the income phase as during the accumulation phase because there are multiple risks to retirement security that the potential for growth helps to mitigate such as, for example, the potential for outliving savings and health care expenses.

TIAA-CREF has 10 lifecycle funds starting with an initial allocation of 90 percent equity, 10 percent fixed income. At 25 years before the funds' maturity date, the
equity allocation decreases at a rate of approximately 1.6 percent per year until the fund ultimately reaches an allocation of 40 percent equity, 60 percent fixed income 10 years beyond the target date. This deliberate approach helps our lifecycle funds maintain an appropriate level of risk while still providing the growth potential necessary for building assets.

There is no right or perfect glide path. There are multiple appropriate paths to achieve a desired portfolio composition and, as experience with new asset classes grows, improvement to glide path design will emerge.

We urge the DOL and the SEC to issue guidelines that insure full and clear disclosures regarding the composition of Target Date Funds so plan sponsors can make fully informed decisions. However, fund managers do need to be able to determine, based on their own research and experience, both the glide paths and the underlying investments that comprise the Target Date Funds.

TIAA-CREF supports the same asset allocation tenets in the retirement income management phase as in the accumulation phase, which means maintaining a well-diversified portfolio that uses equity, fixed income and other asset classes to attain lifetime financial security.

The ongoing allocation of equities during
retirement is designed to strike a balance between the need for both current income and continued portfolio growth through retirement. We also strongly believe that guaranteed lifetime income is essential to insure a financially secure retirement for most people.

But Target Date Funds as mutual funds cannot guarantee lifetime income. As a result we feel that it's important for retirees to be encouraged or incented or perhaps even required to place a portion of their tax-favored retirement savings into an annuity that guarantees lifetime income and perhaps even into an annuity that guarantees a minimum level of lifetime income.

We support the use of Target Date Funds within retirement plans. Properly constructed Target Date Funds with clearly defined and clearly disclosed investment goals and characteristics provide investors ready access to a professionally managed, broadly diversified portfolio that's an important component of a successful defined contribution retirement plan.

We look forward to working with the DOL and the SEC on this issue, and thank you very much for the opportunity to express our views.

MR. MASTERS: Good morning. I'm Seth Masters, the Chief Investment Officer for Blend Strategies and Defined
Contribution at AllianceBernstein. And thank you very much
to the DOL and the SEC for the opportunity to testify at this
hearing.

We at AllianceBernstein agree that Target Date Funds should help DC participants achieve good outcomes and
must be properly designed, managed, monitored and
communicated. We also agree that most Target Date Funds,
including our own, delivered very disappointing results in
2008. But we do not agree that the purpose of Target Date Funds should be, as Senator Kohl recently stated, to minimize
the risk and volatility for those nearing retirement.

The express objective of our Target Date Funds in
the U.S. is and was to minimize the risk that participants
will run out of money in retirement, and, to achieve this
objective, we designed our Target Date Funds to maximize
savings in the working years and prolonged spending in
retirement. Our research and 40 years of experience in
investment planning suggests that even after retirement, most
participants need the growth that equities can provide.

When saving for retirement, over-reliance on cash
and bonds will likely be a smooth road to ruin whereas
sufficient exposure to well diversified equities can provide
a bumpy path to adequate retirement income. So let me
explain.
As a few other speakers have mentioned, there are several risks in retirement income. One key risk is market volatility which hurt so much last year. And stocks are certainly more volatile than cash or bonds. But the risks to retirees from inflation, which erodes purchasing power and longevity, which is the need for income that's longer than on average, are equally serious. And over time we believe cash and bonds expose investors to far greater inflation risk and longevity risk than do stocks.

The challenge to appropriate glide path design is to strike the right balance for each phase in participants' lives, and we took that approach when we designed our standard glide path with a 60/40 stock bond mix at retirement, I've explained in a research report we published in 2005 and I've submitted for the record.

Now, after last year's financial crisis, we took another look at retiree asset allocation by modeling investment results for people who retired in every year since 1926. Using index data for U.S. stocks, bonds and cash, we compared the results of a 60/40 stock bond strategy with holding cash and bonds.

Assuming that retirees withdrew 5 percent of their initial savings every year, we then looked at how often each strategy funded 30 years of retirement spending, and we
focused on 30 years because some 25 percent of today's 65-year-olds will live at least that long. So if this hits home, I'd like everyone here to think about the fact that some material number of people here today will live to at least age 100.

Well, the results of our study were pretty stunning to me, too. A portfolio with 60 percent in stocks never ran out of money, not once in all the 30-year periods that we studied and not even in those periods that included the Great Depression.

The cash strategy, by contrast, ran out of money in half of the 30-year periods. And when we adjusted withdrawals for inflation, the cash strategy ran out of money in every single 30-year period, and the bond strategy ran out of money in 85 percent of the 30-year periods.

By contrast, after inflation, the 60/40 strategy only ran out of money in a quarter of the periods. So this study, which we have also submitted for the record, confirms our earlier research that in most cases a 60/40 stock bond mix is appropriate for participants at retirement.

Now, today you're hearing many points of view. Perhaps the only common ground is that there's absolutely no consensus on the best glide path design. And that means there's no such thing as a passive Target Date Fund because
the key decision, the glide path design, is always an active choice. And under ERISA, fiduciaries must evaluate whether the glide path is prudent and likely to help plan participants to meet their retirement goals. So why pass rules which could weaken this layer of fiduciary oversight? In fact, we do not think that a 60/40 strategy at retirement is suitable for all plans. For example, when DC plan participants are also enrolled in a DB plan, an even higher level of equity allocation might be prudent. By contrast, where a plan sponsor makes large contributions of company stock into a DC plan, then a lower equity allocation would probably be prudent.

Such factors influence how we customize target date glide paths for large DC plans. And there is a differential of over 20 percentage points in the equity exposures of the 2010 target date portfolios that we manage. So why consider rules that could preclude plan sponsors from adopting the glide path best suited for their particular circumstances? In addition, we're close to launching a target date platform with embedded income guarantees backed by multiple insurers. This could reduce the impact of market risk on participants and could therefore warrant increasing the equity exposure in target date glide paths especially after retirement. So why implement rules that could stifle such
Now, let's turn to the underlying investments in Target Date Funds. We also think the fiduciary should evaluate whether the underlying investments are appropriate, well-run and cost-effective. But because most target date assets are currently in proprietary mutual funds, such fiduciary reviews can be very challenging.

In proprietary mutual funds, a mutual fund firm designs the glide path and manages all the underlying components. Frequently, and not coincidentally, the fund company also happens to provide the recordkeeping.

Now, if a plan sponsor is unhappy with the management of one or more of the underlying investments, there is really nothing it can do short of moving to a different target date provider and perhaps another recordkeeper. The logistical challenge of changing target date providers tends to keep plans therefore locked in to proprietary offerings.

Now, recently an increasing number of large DC plans have begun to adopt custom Target Date Funds which liberate them from proprietary offerings. In a custom target date structure, the plan sponsor selects a glide path manager and best-in-class managers for each underlying investment and its preferred recordkeeper. The plan sponsor then
continually monitors the performance and costs of each of
those underlying providers and is free to replace any of
them.

In short, DC plan sponsors and their consultants
can oversee custom Target Date Funds exactly as they would a
DB plan. We believe the custom target date structure provides
much better governance and it can also significantly lower
costs for larger DC plans.

Now, recent advancements have made it easier for
larger plans to implement custom target date portfolios. I
should also mention that at this point proprietary target
date mutual funds do remain the most cost-effective option
for smaller DC plans.

So we believe that any rules covering Target Date
Funds need to be broad enough to encompass both the legacy
proprietary mutual funds and the emerging custom target date
programs.

So I just have a couple key points just to
summarize. The first, glide paths require flexible and
substantial equity at retirement in most cases, so any
guidance that the SEC or DOL provide has to keep that in
mind. And secondly, custom Target Date Funds are growing and
they will permit better governance and lower costs for quite
a few larger plans in years ahead.
So thank you very much for your consideration, and I look forward to your questions and comments.

MS. LESTER: Thank you. My name is Anne Lester, and I am Senior Portfolio Manager at J.P. Morgan Asset Management and responsible for J.P. Morgan's target date strategies. I want to thank the panel for the opportunity to present our views on Target Date Funds today.

The testimony that I'm giving draws upon the very extensive work that my colleagues have done in developing and managing our Target Date Funds, and we will be submitting for the record written testimony that will cover what I am going to summarize here in much greater detail as well as a number of white papers that we've written.

But what I'd like to really focus on are what we believe is the key considerations for fiduciaries are in developing, managing and monitoring target date strategies.

In building our target date strategy, we really took a defined benefit approach to the problem. That means three things.

First, it means defining a desired outcome for investors in the funds, a definition of success. Second, it means defining a time horizon for the investment. And third, it means understanding what cashflows will be coming into and going out of the funds.
All three steps are extremely important, but in hundreds of conversations with plan sponsors over the past five years on target date investing, we think that the first step, defining an outcome and a definition of success, is the most critical.

What do we mean by this? Simply stated, we mean articulating what you want the target date strategy to achieve. At the extreme we think there are two different outcomes that a manager or a sponsor can pursue, and I suspect you're seeing those extremes at this table right now, maximizing the upside or minimizing the downside. Another way of looking at it, are you building a strategy that will earn more when the markets are strong or are you building a strategy that will lose less when markets are weak?

The outcome that we are aiming for at J.P. Morgan is the following: Maximizing the number of participants who reach a minimum level of income replacement at the point of retirement. That's how we are defining success for Target Date Funds from the view of the plan sponsor.

We aren't trying to generate the highest expected balance at the point of retirement or even trying to articulate what it means not to run out of money before death because we know that in seeking higher returns, we're also adding volatility and the chance of greater failure if the
markets don't cooperate.

Now, not all plan sponsors will, in fact, want that same outcome that we have articulated, and the broad range of Target Date Funds allows plan sponsors to match the outcome that they were seeking to that of the provider they have selected.

But if neither the plan sponsor nor the fund manager understands what that desired outcome is, finding that best match is pretty tough, and that's why we think this is, in fact, the most part of the process regarding Target Date Fund evaluation.

Second, time horizon. There has been a lot of discussion around to-retirement or through-retirement. Our bottom line is as a fiduciary, I know that I can understand with some degree of certainty how participants will behave as savers up to the point of retirement. But I have very little ability to predict what happens to participants' cash at that point of retirement.

Some people leave all of their money in the plan and don't touch it till their 70 and a half. Some people take all of their money out before they retire after the age of 59 and a half and everything in between. So again, as the fiduciary responsible for saying what the right answer is, we feel it's very hard to do.
And that brings me to this third point, cashflows. We are very, very focused on defining and articulating what we know and what we don't. And so we have developed our target date philosophy around observed cashflows, how participants put money into and take it out of 401(k) plans instead of making assumptions about how people behave or, worse, managing money based on what we think they should be doing.

It turns out the participants save a lot less than most people assume, and they take a whole lot more out in loans and distributions than we think they should.

I'd like to conclude my remarks by commenting on something that we don't spend enough time discussing, and that is the rate of savings. How much people save is by far the most important factor in determining success in accumulating assets for retirement, and there isn't enough discussion on the relationship between how much people are willing to save, on the one hand, and the certainty of outcomes on the other.

Put another way, the safest retirement strategy, we believe, is the one that has the highest probability of getting over the finish line safely, not the strategy that is going to lose money in a bear market. If people want a more certain outcome, they have to save more to get to that same
finish line.

We will be submitting for the written record an analysis that we did comparing hypothetical results of someone in our 2010 glide path over the past 25 years whose portfolio would have lost approximately 20 percent in 2008 with someone invested in the safe alternative, a money market fund. The hypothetical glide path generated almost double the assets, even after a 20 percent loss in 2008, in ten years of essentially no returns in the U.S. equity market. The person in the money market fund would have had to save more than twice as much to end up in the same place.

Unmet expectations are always a risk when there is a default option no matter what the market environment, which is why understanding a target date strategy's desired outcome is so critical. As Yogi Berra said, "You've got to be very careful if you don't know where you're going because you might not get there."

I look forward to answering any questions that you might have. Thank you.

MR. SMITH: Good morning. My name is Michael Case Smith, and I am a Target Date Manager in Avatar Associates. Avatar is tactical asset allocator founded in 1970. We run a series of collective trusts that rotate balances above and below the set glide path based on indicative data and risk
return tradeoffs identified by analysis in over 150 economic
and behavioral, factors. As an example, our 2010 fund has a
20 percent allocation of equities.

In March of this year, we tactically overweighed it
to 25 percent to capture some of the rebound in the market.
In the fall of last year, we under-weighted it to 13 percent,
rotated away from credit and treasuries in the spring and
avoided a lot of financial stocks internationally, and the
result for our 2010 fund was a loss of 2.6 percent.

You're going to hear a lot today about insurance
and modern portfolio theory and absolute return and different
things and different tools in the market. Here's the dirty
little secret about our business. One's standard of living
and retirement is about the glide path. You get that right
and all the other things are mathematically pretty
irrelevant. I want to talk about how we compose ours and how
we got to that 20 percent.

The consensus methodology is based on modern
portfolio theory, and this assumes that if you have the
dollar today, you can minimize the variability of its future
value given the mean of its future value. For an investor
with a financial investment or commitment to fund at
retirement, the challenge is the exact opposite.

Future values, the retirement commitment, is known,
and the challenge is to determine how much to invest and allocate at the present. Our glide path begins with a risk aversion sequence. This is the path of probabilities of meeting the retirement funding goal or falling short.

To solve for the glide path mathematically, the one that serves the investor's best interest, defined as providing the highest level of income, replacement ratio, that can be achieved for a given level of contribution and risk aversion path, we use Nash equilibrium calculations. If you remember the movie "A Beautiful Mind," you recall that equilibrium is met when every asset allocation along the glide path is the best response to all other asset allocation decisions.

So here's how it works. Imagine yourself as a clone of yourself over 40 years. You at 25 versus you at 65. Nash equilibrium theory is going to go through a series of trade-offs to fund that commitment. Modern portfolio theory begins at the portfolio and has a series of unrelated portfolios going forward. We begin backwards and go to the current day.

So at 65 -- or at 64 you know you need to fund the commitment in a year, and you have less tolerance to the kind of risk we saw in 2008 because three things happen. You stop contributing, your employer stops matching and you drawing
down. So it's not just another day as far as the commitment and the human aspect.

So your risk aversion is going to be higher. That's something that's sort of unique in glide path design.

And when the Nash equilibrium trade-off, the 64-year-old then turns and hands the portfolio to you at 63, who in the trade-off selects the portfolio that minimizes the mean and standard deviation for the year. And we have white papers available on this to go into more detail.

This equilibrium game is repeated again to deliver the glide path that mathematically serves the employer's best interest and the employee's best interest, again, defined as the highest income replacement ratio given the contribution and given the probability of success and shortfall.

Now, in 2009 with a year to go, as I said, this Nash equilibrium based glide path resulted in a solution -- mathematical solution, not a theory, of a 20 percent of allocation of equities. Now, I would note that our 2040 and 2050 in 2008, we're closer to the 90 percent, and we were good at tactically avoiding some risk, but, again, it's about the glide path. So those funds got crushed.

But our clients -- our clients know and understand the process, and they take solace in knowing there's a mathematical optimization solution that's prudent, unbiased
and effective.

I'd like to use my remaining time to address the selection of the funds that populate the glide path. Principles of our firm were involved in the creation of the TCW exemption and the Sun America Advisory business methods that allowed parties and interests to create portfolios, give advice, take discretion so long as the conflicts of interests were removed.

So fiduciary interests are very serious to us. A number of our clients ask us to be fiduciaries to the plan. We have 338 ERISA managers. We put it in writing. And as such, it's imprudent for us to expose them to prohibitive transactions and construct our glide paths with funds from which we receive an economic interest.

So the first criterion we have when we construct the glide path is to make sure there's no economic interest in the underlying funds. We construct the Nash equilibrium glide path that I've described with exchange traded funds, typically 20 to 35 ETFs.

The ETFs are much more close to the tracking of the asset classes we're trying to track. We're a beta manager. They're very transparent, very low fee. And again, since there's no economic interest, it removes the ability for us as a party of interest, an ERISA fiduciary to self-deal.
Thank you.

MR. DOYLE: Thank you.

COMMISSIONER WALTER: I'd like to come back to the "to or through" point. And I think we've heard a fair amount of support this morning for a "through" point of view. I'm wondering -- and don't take this as a point of view because I'm learning a lot here so I really don't have a position -- whether we would be wiser to accommodate both by encouraging or perhaps forcing a "to" decision with plan sponsors then being required to offer a set of options at the -- at the "through" point of view, at the retirement point of view.

And I wondered what your reaction to that would be, which essentially would allow more flexibility if people didn't necessarily feel that the same mix of assets or, you know, an evolving mix of assets, same sorts of decisions, are appropriate during the accumulation phase and following that.

MR. MASTERS: Okay. Let me perhaps take a stab at that. I think the question really revolves around what people do with the money. And let me echo something that was mentioned on an earlier panel. In the U.K. in DC plans, there is mandatory annuitization by age 75 in their case, and our glide path in the U.K. is, therefore, a "to" retirement glide path and would look like some of the ones that have been described earlier with a far, far lower equity
allocation at the retirement phase, because if you know for sure that you're going to be taking the money and spending it, in this case on an annuity, you want to be essentially minimizing the variance of the risk of making that purchase decision at retirement.

The problem is, though, that quite a lot of plan participants, especially the ones who are likely to end up in a target date default option, may very well stay there for the rest of their lives and at that point to have managed their glide path as if they were going to spend the money at age 65 when, in fact, they're going to be drawing that money down over the next 25, 35 years perhaps would actually produce a very, very unfavorable outcome for them.

So our belief is that, given the way that things work today in the U.S., we should be designing a glide path that goes through retirement because that is what the default would indicate. And to the extent that there is a plan sponsor that has a different point of view and wants to actually get participants annuitized, we would, in fact, work with them to design the appropriate glide path for that plan sponsor.

MS. LESTER: I think it all goes back to assumptions. And as someone on one of the earlier panel says, the differences in all of our glide paths really go
back to those assumptions. And one of the things that I find
most difficult as a fiduciary for the assets that we manage
is to make a best determination about what we think is going
to happen.

And I think the level of uncertainty around what
participants actually do at that point of retirement is so
large that we have taken, I think, a different view, that
given that level of uncertainty that we observe and given
very, very lumpy cash distributions that we typically see, we
did a very detailed analysis and saw that starting at the age
59 and a half, one quarter of the population that we're a
recordkeeper for takes out about 20 percent of their assets
in a lump sum every year.

So very large sums of money leave. But of course,
not everybody does. Not everybody -- you know, and so given
that level of uncertainty, we decided as fiduciaries the most
prudent thing to do would be to minimize the risk of down --
shortfall, if you will, at the point of retirement and
negative returns, but at the same time being cognizant that
most people leave some money in.

You don't actually want to go, we don't believe, to
a hundred percent cash portfolio, which, again, if there were
certainty around, for instance, annuitizing, right, you would
really want to minimize volatility at that point. But
there's no certainty at all, so a portfolio manager is left
to the set of assumptions they're going to make about what
happens to the money.

We're assuming that most of it's going to leave. Others assume most of its going to stay. There's very little
data right now that's terribly clear because, of course,
there are very few people, historically speaking, who have
entered retirement with a defined contribution program as one
of their main sources as retirement income. So that that
uncertainty makes it very, very tricky to know how to behave.

But that goes back to my point about disclosure in
dialogue with the plan sponsor or the advisor as they are
helping someone pick the Target Date Fund, and trying to
articulate that precise point is, I think, one of the biggest
elements of getting this right.

MR. MOSLANDER: We are one of the places, we've had
a defined contribution plan for 90 years for the institutions
of higher education, so we do actually have a lot of
experience with people approaching retirement. And for the
-- people don't -- they may be defaulted into any sort of
fund, whatever it might be. They don't default out of it.
People generally, in our experience, always have
extensive consultation either with us or with an independent
financial advisor who's working with them when it coming to
constructing a retirement income management stream.

I think to your point, a lot of people do take money out in lump sums, probably not always wisely, but there is that option. But people don't default out. They default in. So there is a little bit of that -- there is a "to" and then there is a "through," and they are two differently managed experiences from the individual's perspective.

MR. MASTERS: Could I also make maybe one further point, which is I believe that the -- Anne Lester's point about we don't really have great data yet on the way DC plans will behave. It's a very important one because literally no one yet has really, since 401(k) plans were created in 1981, no one yet has retired whose retirement plan was based on a 401(k).

And in fact, the evolving regulatory environment has drastically changed the way the plan sponsors think about their 401(k)s. PPA really does change everything. Auto enrollment and auto-escalation has transformed the landscape. And especially in the default option I think what we're going to find is there is a new population of Americans who are growing up now with, in general, Target Date Funds as their primary savings pool of money. And my guess is because they were defaulted into it and because they were auto-enrolled and auto-escalated, they're going to
increasingly think that that automation is a good thing. And I do believe that the Target Date Funds, as currently designed, have the potential to serve them very, very well, and as we continue to innovate around this vehicle, I think we will enable retirement success even greater.

But think about what that means. When they retire, they will probably have grown quite comfortable with the fact that they're in that Target Date Fund. Their behavior may be very different in the future than in the past, and we do have to envision the probability that many of them will want to stay there especially because it's not obvious to me that individuals buying at retail will ever be able to replicate the quality of investments that they can get from a plan sponsor who spent a lot of time and effort choosing the best thing he can find for them.

MR. DONOHUE: When you've gone through a lot of your research in order to determine an appropriate glide path for a -- either a plan or a fund that's being put together, I suspect that the information that you use is historical index information as opposed to actual actively managed fund information, and, yet, then when it's implemented there's the additional risk I would think, where I've only heard of one that uses -- and, Michael, you'd indicated that, I think,
when you do it that you try and avoid tracking error, but that, you know, in terms of using ETF set that would track the indices.

How do you -- you know, to the extent that you've come up with a really good mousetrap for a glide path that's based on indices, then go to actively managed?

MS. LESTER: I'll start. I think what we viewed, and, again, I didn't touch on this in my summary, is that it's incumbent upon the fund manager to articulate a process by which they select underlying managers.

And if they choose to believe, as we do, that active management will add value over time, one of the jobs that's absolutely incumbent upon that manager is articulating on a prospective basis why they believe the managers that they've selected will, in fact, add value, and then as you move through time, basically make those hiring and firing decisions to make sure that that continues to be true.

I will point out that there are a number of asset classes that we use that are not easily indexable so that, while you use a historical analysis to understand how an index might have, you know, behaved over time, when we, in fact, build our glide paths, we're using a forward-looking return in risk expectations, and we test them to understand what might have happened using historical data, but we don't,
in fact, use history to sort of rear-view mirror drive where we're going in the future. So we don't, in fact, use those historical returns to build a glide path.

But it is very important to have a process by which you select funds. And I guess in response to some comments that have been made, if the fund manager can't articulate and demonstrate that process as fiduciaries by which they hire underlying managers and remove them when necessary, I think that that's a very key part of the hiring process the plan sponsor and individual has to go through, and we need to be transparent about that process.

But there are a number of asset classes that you cannot cheaply or effectively index. And in some instances the active management fee is lower than it would be in ETF. And so I don't necessarily think you can just say that that's always the best way to implement it.

MR. DONOHUE: And I didn't mean to imply --

MS. LESTER: No, I didn't --

MR. MASTERS: If I could further those comments by saying I think this is one of the reasons why custom Target Date Funds are so interesting and are really beginning to take off, because this is an element of the success or failure of any target date program. And although the glide path is going to drive the vast bulk of the return, any
active management can either contribute or detract from that success.

And so what we are finding, in fact, is that many plan sponsors are increasingly viewing this decision exactly the same way they would view active versus passive inside a DB program. And by having a custom target date structure where essentially all of the underlying components can be either active or passive and can change from time to time as perhaps asset classes that used to not be available in passive form suddenly do become available or perhaps an asset class that used to be managed passively, now you've found a great active manager that you like, you can put them in, that to us makes an awful lot of sense.

And I should just mention that some of the target date clients of ours who are doing this are all passive. Some of them are all active, and most, increasingly, are somewhere in between, which reminds me an awful lot of what they're doing in DB.

MR. SMITH: I used to work for Harry Markowitz, and he tells the story of he was getting his graduate degree at the University of Chicago, waited to meet with his advisor. And in the waiting room was the guy's stockbroker. He said, what are you doing here? He said, well, I got to go figure out what I'm going to do my thesis on. And the guy says,
well, why don't you do it on the stock market. And Harry said, okay. And it was that serendipitous.

And a number of times today people have said there's a lot of smart people in the room, but it all goes back to that chance meeting in that room in Hyde Park, Chicago.

The point is that linear math that he had applied became modern portfolio theory, the two values of risk and reward, was based on natural occurrences, you know, how neutrons pop off each other, cloud vectors, things like that. The limited data we have thrown in with the human behavior, I think makes that modern portfolio theory what it is, just a theory. Okay?

For what it's worth, you asked a question. I'll give you an answer. We forecast nothing. Okay? We infer value from the actions of different market participants. Insiders are usually right. Mutual fund buyers are usually wrong.

But based on that, we have just a different sort of approach that, again, optimizes for an answer rather than theorizes what could happen and creates a bell curve and you have events that happen like 2008, which are six standard deviation events. That's nine with 21 nines after it, but it happened. So we got to focus on that. So we avoid
MR. PIACENTINI: I have just two questions. I'll try to keep them both narrow and short if I can.

The first, a couple of the panelists talked about the merit of building a Target Date Fund out of underlying funds in which the builder has no financial interest. I guess the implication there is that the opposite is true where the underlying funds are proprietary funds are signs that there's a problem. Was that meant to be implied and can you elaborate just a little?

MR. MASTERS: Well, since we do both, maybe I should comment. We do not think that there is necessarily any problem and there's not a necessary conflict between the target date manager also managing some or all of the sleeves. That is a fiduciary decision, a choice, that the plan sponsor should be making.

But our view is, it is a choice. And the problem perhaps in a lot of target date mutual funds is that because mutual funds by definition are pre-baked, many of the plan sponsors may not realize that they're implicitly making a choice to have the same investor manage the glide path and all the pieces.

MR. PIACENTINI: So if there is a financial interest of the person building the Target Date Fund, what's forecasting.
the nature of the financial incentives they face when they
choose the underlying funds?

MR. SMITH: One might argue that taking discretion
over participant assets, which is a highly, a highly
regulated act under ERISA, allows them to skew allocations to
underlying funds of variable fees, so now I've taken
participant -- taken discretion and I can skew the glide path
or that point-in-time allocation to the funds that deliver
more fees. One could make that argument.

To eliminate that happening, you know, we choose to
construct portfolios with ETFs. The argument one might make
is, well, in 1974 the framers of ERISA said mutual fund share
is a plan asset but the underlying stuff isn't, so we apply
that today to these tiered-funded funds to say we're not
part -- we're not fiduciaries; therefore, this isn't a
prohibited transaction; therefore, we're free to do that.

I think it's a question that should be asked. And
in fact, we've submitted a question in exactly that tone to
the Department of Labor on March 3rd asking to clarify that.

MS. LESTER: Yeah. And I think as a manager who
typically manages assets in either commingled trust funds or
in mutual funds as well as some separately managed accounts
for clients, I think that the very clear way to avoid any
potential conflict of interests, which I'm not entirely sure
I agree with to begin with, but theoretically speaking, is to just state what your fee is irrespective of what the underlying asset or fund choices will be so that there's no incentive to move those underlying funds around. And I think that's very straightforward.

So I do not, in fact, think there is any conflict there at all. But the key to that is, again, articulating clearly what you're doing and articulating clearly what the fee is for that.

MR. MASTERS: Let me just agree that we, again, we do not believe either that there is a conflict. We do think, though, that it can be attractive for plan sponsors to have the choice.

MR. PIACENTINI: But is the fee of the underlying fund the only possible source of a financial interest?

MR. SMITH: In increasing the glide path, the Wall Street Journal two years ago did a story called what was once a safe investment has become exotic. It wasn't exactly. And it notes that the glide paths have increased their equity allocation as the Pension Protection Act of 624 -- Section 624 came on. And it just sort of questioned why.

You know, again, where everybody's looking at the same math, but the solution before the Pension Protection Act was to end the glide path at I think it was 30 percent
equity, and all of a sudden the industry average is 45. So there are two ways that one could question its increase in the glide path exposure to equities, which generate higher fees, and then within that point in time skewing the allocation to higher fee equities.

COMMISSIONER WALTER: One brief question about sponsor options in terms of customizing for your particular plan. Do you think it calls for some governmental intervention to require that that be permitted, because there are some people who are kind of tied in, as I understand it, to a series of choices depending on who's administering their plan?

MS. LESTER: We actually did an in-depth study of about 45 different plan sponsors looking at different participant behaviors, different demographic bases and different benefit structures. And depending on the definition of success that a plan sponsor chooses to apply, we don't believe that in most cases a different glide path gives a better outcome; that is, getting more individual participants to a level of a minimum income replacement at the point of retirement.

There are circumstances that are typically -- devolve around plan design like minimum -- excuse me, a required age of retirement at the age of 60 and you must take
your balance out in cash, right. If your 401(k) happens to be structured that way, that's a very unique plan design.

So our view is that it is not terribly frequently that we do see plan sponsors who would benefit from a different asset allocation in their glide path. But I think, again, that helping a plan sponsor understand how to think about aligning their goals in the glide path that they choose would be constructive.

MR. MASTERS: May I make sure I understood the question? Were you asking is there a need to facilitate or pass regulations or facilitate moving away from proprietary target date mutual funds to custom Target Date Funds because of some problem that the plan sponsors have getting from A to B?

COMMISSIONER WALTER: Uh-hmm.

MR. MASTERS: Because if that's the case, I believe that a speaker on the forthcoming panel has done a survey, and somewhere between 25 to 35 percent of large plan sponsors have already customized their Target Date Funds, and quite a few more are planning to do it.

The main impediment in our experience to customizing is plan size. The economics of building a custom Target Date Fund are simply not attractive if you have too little in assets in the Target Date Fund.
COMMISSIONER WALTER: Does that problem go away as you create numbers of customized plans, which, in fact, may match those smaller companies as well so that they, in effect, become another commodity option?

MR. MASTERS: No, I don't think so, because the whole point of a customized plan is it actually belongs to the plan sponsor, not to the fund company.

COMMISSIONER WALTER: I see.

MR. MASTERS: And therefore -- well, I can tell you that we're doing everything we can to bring that threshold level down as far as we can go. But there will always be a threshold because there are some significant fixed costs at the plan level to setting up a customized structure.

MS. LESTER: I would also add that there are a number of issues and risks that arise as you start creating daily valued funds with daily liquidity that are operational in nature. And again, the costs, the fixed costs, associated with having a robust solution are quite high. And again, I would state that I do believe that it's very easy to underestimate the risks in running typically ten daily valued funds with liquidity moving that money around between managers. And creating a very robust solution to that is not inexpensive in terms of money or time.

MR. MASTERS: Well, actually, since we as a firm
happen to run over $5 billion in such asset structures for
quite a variety of plans, and have been doing so for a number
of years, I would invite, by the way, anyone who's interested
to approach us, we actually can document that the risks are
quite manageable. They are exactly the same risks
incidentally as exist inside a target date mutual fund, which
has to do exactly the same thing every night.

And furthermore, as far as we can tell -- in fact,
on the operational side there are some advantages from a risk
standpoint and there are definitely, if you're large enough,
very, very significant cost savings.

MR. SMITH: If I can answer, your question
specifically said, do we need to think about a statutory
relief to talk about customized QDIAs. Section 624 of the
Pension Protection Act 2006 as promulgated by the Department
of Labor and the Qualified Default Investment Alternatives
said, you can construct a customized glide path so long as
there's a fiduciary somewhere that signs off on it.

You can have your consult do it, and you as the
plan sponsor signs off on it, that you're on the hook for the
glide path, and you've monitored what they're doing. Or you
can bring in an ERISA 338 manager and have them do it. So
there's clarity in the statute to facilitate that.

What we do see is plan sponsors saying, hey, I want
a fiduciary to do this because with the QDIA I've taken
someone's terminal wealth at retirement and previously here's
a fund roster, kind of go off in the woods and shoot
yourself. As long as they're diversified in 404(C), I'm off
the hook.

When you buy a Target Date Fund, someone's wealth
at retirement, standard of living at retirement, is 100
percent dependent on picking the Bernstein fund versus the
J.P. Morgan. It's a significantly high fiduciary hurdle. So
to do a customized approach, bring in a 338 manager. A lot
of plan sponsors say, hey, that's my job to pick the high
yield fund, not the fund company's job, I need to switch them
out, so we like that business model a lot.

COMMISSIONER WALTER: Thank you.

MR. DOYLE: No further questions. I'll thank the
panel.

(Applause.)

MR. DOYLE: So if we could have Panel Four.

MR. KOPELMAN: Well, good afternoon. Thank you for
the opportunity to speak. My name is Ian Kopelman, and I am
a partner with the law firm of DLA Piper where I chaired the
firm's Employee Benefits and Executive Compensation Practice
Group.

I am here representing the views of the Profit
Sharing/401(k) Counsel of America, which is a 60-year-old association representing companies that sponsor profit sharing and 401(k) plans. I've been PSCA's legal counsel for seven years, and I've been actively involved with PSCA since 1978.

Target Date Funds have rapidly become the investment option of choice for defined contribution plans. Where virtually no defined contribution plans offered a Target Date Fund in 2000, PSCA research indicates that 25 percent of such plans offered a Target Date Fund in 2005 and over 58 percent of such plans offered Target Date Funds in 2008. In addition, half of such plans with automatic enrollment have a Target Date Fund as their default investment.

It's also of the utmost importance to keep in mind that mutual fund products continue to be the product of choice for most qualified plans. Our research indicates that 78 percent of target date investments are, in fact, mutual fund products.

There are three widely accepted principles for long-term capital appreciation. First, diversification among asset classes provides the maximum balance between risk and return. Second, periodic re-balancing is necessary to preserve the allocation ratio; and, finally, the asset
The allocation ratio should be altered as an investment horizon shortens in favor of risk aversion over returns.

Target Date Funds embrace these principles and apply them automatically to individual plan participants, and we hope that this hearing results in a reaffirmation of these principles and a recognition of the efficacy of Target Date Funds in achieving these investment goals.

The selection and monitoring of an investment fund offered within a plan is subject to the fiduciary requirements of ERISA and a prudent process is required. However, what is absolutely not required is to insure that a plan investment always results in positive returns over all possible time horizons. Even prudent investors can suffer an investment loss over a particular period of time, and it must be understood that the plan investments are for the long -- are for long-term investing and questioning their propriety based on short-term performance will create havoc for the retirement system.

A plan fiduciary must determine that the glide path offered by a particular Target Date Fund is prudent. How is this achieved? Some plans will hire an expert to assist them while others will conduct a survey of the glide paths of several Target Date Funds under consideration. Benchmarks may be utilized to assist in this process.
And we believe that a plan fiduciary should be able
to consider that a particular fund's glide path being within
the general range of similar funds is an indication of the
glide path being reasonable.

It must be remembered that 95 percent of the almost
700,000 plans reporting under the 2006 Form 5500 Abstract
have assets of $10 million or less. These plans are
maintained by small and mid-sized businesses, and the
application of particular fiduciary requirements to them must
be effective in insuring a sufficiently high standard of
performance, but there must also be a recognition that it
must be reasonable for plan fiduciaries of small and
medium-sized plans to comply with the requirements.

There is little debate whether a 65-year-old
retiree should hold equities in his or her retirement
account. The question is how much. The consensus among
investment managers is in the general area of 40 to 50
percent, based on the 20- to 25-year investment horizon for a
recent retiree.

We believe that it is imperative that the glide
path should extend throughout the life of the participant or
beneficiary following retirement if the plan permits these
parties to remain in the plan beyond the normal retirement
age.
We disagree with those who claim that there's no regulation of Target Date Funds. For example, the QDIA rule specifically states that, quote, "It does not provide any relief from the general fiduciary rules applicable to the selection and monitoring of a particular qualified default investment or from any liability that results in a failure to satisfy these rules," close quote.

The rule describes a Target Date Fund default investment as one that, quote, "applies generally accepted accounting investment theories, is diversified so as to minimize the risk of large losses and that is designed to provide varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposure based on a participant's age, target retirement date such as the normal retirement date under the plan or life expectancy," close quote. These are firm requirements, and we have described the process used to meet them.

Some advocate that regulations set glide path parameters. Should this approach be pursued, plan fiduciaries must be relieved of any fiduciary responsibility regarding selection and monitoring of a glide path in a Target Date Fund; however, we do not recommend that this course of action be taken.

It will substitute government agency preferences,
which are inherently political and oftentimes static for generally accepted investment theories that may be dynamic based on changing market conditions and new and more efficient investment products. It will also result in a one size fit all product that precludes the flexibility to select a Target Date Fund that recognizes the unique situations of a particular plan.

Thank you for this opportunity to share the views of the PSCA, and I look forward to your questions.

MS. FLORES: Hi. My name is Jessica Flores, and I am the Managing Partner of Fiduciary Compliance Center or FCC. FCC is a boutique consulting firm that collaborates the efforts of other industry leading subject matter experts to address the needs of both plan sponsors and the legal communities.

My testimony today was formed in response to the issues I've identified while performing complex product reviews for large-plan fiduciaries and as a result of my experience as a litigation consulting expert.

While I believe the asset allocation should be more consistent from product to product to make it possible for investors to properly compare performance and other attributes when deciphering which 2030 or 2050 fund to use, I also think there are other issues that the regulatory
Fiduciaries are responsible for selecting and monitoring the fund of funds product. Yet, in most cases they have no control over the selection of the underlying fund options. Financial experts craft and manage these investments, making decisions with regards to what underlying investment vehicles will be represented; yet, they're still a question as to the extent of their liability for the suitability of the underlying participants invested in these products.

One of the concerns that I see as a key issue, and I know it's been brought up in previous panels, is feeding the family. While offering a turnkey allocated portfolio makes sense for most participants who have better things to do than to become investment experts, the manufacturing of these products also creates enormous opportunities for the investment complexes.

The PPA ignited an explosion in the development and the adoption of these products. Most investment complexes have taken advantage of this market opportunity to feed their family of fund managers. According to the financial research corporation 2008 study of lifecycle funds, as of 2007, 71 percent of firms offering target date products only invested in their own underlying funds.
I've yet to find an investment complex that is stellar in every asset category. In fact, most became significant market players because over the years they offered a few management strategies that were notably better than most competitors. This has not and is not likely to change because you just can't be great at everything.

Each complex offers a suite of investment products that represent the varying asset classes, some of which they are really competitive at managing and some of which they are terrible at managing and then there's everything in between. These products represent an asset allocation into the investment complex's varying investment options, the asset classes they are good at managing and the asset classes they are not.

Many times the underlying investments can rarely be sold on the street because they possess insufficient assets under management and/or their performance isn't competitive. Holding these funds in a fund of funds approach enables the complex to beef up the assets under management regardless of the performance and whether or not it's quality.

There are inconsistencies with the oversight process imposed on fiduciaries. Feeding the family creates serious issues for decision-making fiduciaries responsible for monitoring these investment selections. It is not
uncommon that funds that will not pass the criteria set forth in the investment policy statement and therefore would not be permitted for direct investment through the plan would be the very funds that these prepackaged products will invest.

If the funds do not qualify for direct investment, they should not be hidden beneath the layers of other fund of funds approaches; yet, few fiduciaries, if any, have peeled back the onion and examined the funds held in these products imposing significant liability for inconsistently applying their own investment policies.

Looking at the product performance on the surface is irrelevant. As we have already established in this debate, none of these products are equal. How can you determine you are achieving sound performance if you don't examine the underlying investments, and even if you do, in most instances, what can you do about it if the fiduciaries cannot control what these funds invest in?

The sales pitch for these products is all about the efficient frontier, not management selection. Most vendors discredit the need for quality managers with strong, consistent performance histories by quoting modern portfolio theory. If that's the case, then why aren't we all just going passive versus active? I've asked this question to the best managers in the past. They make arguments as to why
active is better; yet, at the same time they deny that
manager selection is a key driver.

You pay a great deal more in costs in managing
active portfolios, much more than any investor realizes, as
currently only a small percentage of true underlying costs
are required to be disclosed. For example, in active
strategies annual transaction costs for the trading of
securities held in the underlying funds are commonly as high
as 3 percent roundtrip costs. This figure is not disclosed
anywhere to fiduciaries unless they are very, very large
fiduciaries and have a way of getting that information.

We do not enforce the usage of only top quality active
managers. We will accept mediocrity; yet, we will also pay
for the premium managers.

When sitting back and watching this great debate
over appropriate asset allocation and listening to all of the
strategic economic arguments as to why each complex has the
best capture of the appropriate allocation, I kind of have to
laugh. One must understand why so many complexes want to be
aggressive in their mix. The answer is very simple:
Performance.

Fiduciaries are only comparing products on their
surface and complexes are bearing poor performing funds
inside these products. They have to be aggressive in the
allocation to make certain their product performs well in comparison to the other products labeled with the same targeted retirement date. This debate in many ways is nothing more than a distraction from reality. You should be responsible for the underlying funds that you invest in these products.

There's been a great deterrence over the years with benchmarking, a lot of questions over whether or not you can effectively benchmark these. I know a lot of those solutions have been created now. The tools have improved. We were told this was not easy, that you couldn't do it, which never made any sense to me because you could blend the benchmarks just as easy as you can blend the portfolios.

Looking into the investments this way, if you were to offer a tool that both benchmarked the underlying investment, the allocation itself, and then went a step further and rank the underlying funds by peer group, it would expose the usage of these poor performing fund managers that are buried in most of these products. So as an industry, we've made this very simple solution overly complicated, denied that it was really that easy all along.

Another area where I've seen abuse of practices that just make me cringe is when the asset allocation funds are combined with online investment advice systems. Most
investment advice providers with the help of the sales
efforts of the investment complex and recordkeepers managing
the plan encourage automatic enrollment to their products for
participants and forcing them to take action to get out of
these investment advice products. This causes participants
paying extra layers of fees to be enrolled in these products.

Then the investment advice system they are paying
additional fees to use will recommend that they invest in
2030 or 2050 fund, which also imposes a layer of fees over
top of the underlying investments.

This is a ridiculous solution for participants and
a gravy train for providers and a trend is growing, given all
the pressure to better disclose fees, which will in turn
empower fiduciaries to negotiate fee reductions. They have
to make it up some way, and this crafty strategy is a good
place to start; yet, this is overkill and unnecessary for the
participants. It only increases cost and not performance,
and it should not be permitted to go on.

The asset allocation theories used to develop these
products as well as the processes applied or not applied when
selecting the underlying investment options can be very
self-serving for many investment complexes. There's no
requirement for fiduciary status with the suitability of the
products for the participants and no requirement of
independence.

As in most aspects of the industry, the failure to demand, regulate and enforce independence will continue to prove costly for all participants as well as fiduciaries, because they're going to pay the price in litigation.

MR. DOYLE: Thank you.

MS. KLAUSNER: My name is Allison Klausner, and I'm the Assistant General Counsel of Benefits for Honeywell International, Inc. I appreciate having the opportunity to testify at this hearing.

I'm here today on behalf of the American Benefits Council, a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees.

Honeywell's primary defined contribution plan permits participants to make contributions and to direct the investment of their contributions among numerous asset classes, including relatively low funds, such as bond funds, fixed income funds and stable value funds, four equity based funds, three special funds, the company's stock fund and, of course, the Target Date Funds.

Currently the Target Date Funds are a series of ten funds which invest in several asset classes, are targeted to
specific retirement dates and automatically reduce the
exposure to equities and risks as the targeted retirement
date approaches. Honeywell 401(k) plan participants can
choose to invest in one or more Target Date Funds. And for
those participants who do not make an investment direction,
their plan assets are defaulted to the eight appropriate
Target Date Funds.

After Honeywell made the decision to include Target
Date Funds as an asset class available for investment of the
plan's assets, the Honeywell Savings Plan Investment
Committee, a fiduciary committee, made numerous decisions
consistent with its investment policy including whether to
offer Target Date Funds that are custom designed or off the
shelf, actively or passively managed in five- or ten-year
increments. The committee analyzed glide paths, asset
allocations and retirement and, of course, fees and expenses
relating to the potential funds.

With my counsel, the committee understood that
satisfaction of their fiduciary duties depended on the
process itself. I note this today as it is critical that any
guidance issued with regard to the selection and monitoring
of Target Date Funds should be on the decision-makers'
prudent process.

The focus should be on whether the process employed
by the fiduciaries is designed to identify Target Date Funds that are appropriate as an investment within a menu of investment funds and as a default for those who do not affirmatively choose the investment funds to which their plan assets will be allocated.

I urge the Agencies to draft regulations which do not mandate the features and characteristics of Target Date Funds. Any regulations promulgated should permit plan fiduciaries to make prudent decisions appropriate for its body of plan participants. We ask the Agencies to respect that one size and one style will not be best for all plans.

After Honeywell decided to include Target Date Funds in their 401(k) plan, the focus turned on disclosure and communication. I counseled our Honeywell team and worked with our communications, investments and administration teams to develop and implement communications describing the pros and cons of Target Date Funds including the value these funds offer to investors who are interested in a more hands-off approach to investing.

We described the differences between Target Date Funds with glide paths on the one hand and prepackaged funds which were static and non-dynamic on the other hand. Participant education was deemed critical as the implementation of the Target Date Funds was followed shortly
thereafter with the closing of the prepackaged funds. Thus, in addition to providing the SMM, pop-up messaging was added to our website, meaningful brochures were distributed and a fund fact sheet was created. This document noted the Target Date Funds' objectives, investment strategies, expense ratio, historical performance and, very importantly, the asset allocation in each of the Target Date Funds.

Although Honeywell made great efforts to disclose and communicate the Target Date Funds to Honeywell's 401(k) participants, I urge the Agencies to recognize the special disclosure rules for Target Date Funds are not necessary. Rather, plan sponsors should be encouraged to comply with the current disclosure rules that are applicable to all DC plan contribution investment choices.

With regard to glide paths and the underlying investments in Target Date Funds, plan fiduciaries, again, generally do not support government mandates. Plan fiduciaries will support regulations that respect the well-established rule that fiduciary decisions will be satisfied by fiduciaries, who, in fact, engage in thoughtful, developed processes which are documented and provide evidence of diligence, prudence and care. It is not apparent to me why this standard would need to be modified or lose its
flexibility in the context of Target Date Funds.

If Target Date Funds must comply with mandated
glide paths and rules regarding the underlying investments,
the Agencies must provide protections for plan fiduciaries
that use appropriate processes in adding and maintaining
Target Date Funds. Plan fiduciaries that have a reasonable
process in place to gather and analyze information should
have their decisions regarding the Target Date Fund glide
paths respected in the absence of a showing that their
judgment was adversely impacted by bad faith, gross
negligence, or willful misconduct.

If regulations mandate the glide path for Target
Date Funds, it is critical that any such regulations insulate
plan fiduciaries from liability with regard to any negative
outcome which is based in whole or in part on the mandated
glide path.

Finally, like with glide paths, any regulations
regarding whether Target Date Funds are custom or off the
shelf should be flexible so fiduciaries can determine the
appropriate offering to its plan participants based on the
information it gathers from its due diligence. As such, we
specifically request that the Agencies not draft regulations
which include an inflexible rule or to include a presumption
for or against any one type of Target Date Fund.
Thank you for holding this hearing and providing
the American Benefits Council to testify today. I anticipate
that our comments and the comments you will receive from
others at the hearing will be helpful in guiding you to your
next steps. I am happy to answer any questions you have.

MR. WAYNE: Good afternoon. My name is Mark Wayne.
I am the President of Freedom One Investment Advisors. For
over 20 years, Freedom One has been an investment consultant
and a plan fiduciary to hundreds of 401(k) plan sponsors, and
our firm has been evaluating and recommending various target
date alternatives for over ten years.

I am here on behalf of the National Association of
Independent Retirement Plan Advisors. NAIRPA is a national
organization of firms which provide independent investment
advice to retirement plans and their participants.

I'd like to share my experiences on how TDF asset
allocation strategies and the associated risks communicated
to plan sponsors and their participants and ways that this
process could be improved, and I'll close with the proposal
to improve the use of TDFs as a qualified domestic investment
alternative.

My written testimony also gives you a detailed
description of a review Freedom One conducted on a particular
plan's target date offerings and the sponsors lack of
understanding of their TDFs.

In my work, I meet with plan sponsors on a daily basis, and TDFs, although relatively new, are very popular and gaining in popularity. NAIRPA strongly agrees with the concept and theory behind offering TDFs as 401(k) plan investment option. For most participants it's the most easily accessed mechanism to insure that a participant has an appropriate mix of investments and that their portfolio is re-balanced on an ongoing basis.

However, my experience has shown that there are significant problems with how TDFs are presently marketed. In particular, what is lacking is clear and understandable information on the investment strategy and potential risks associated with that strategy.

The experience of our members is that TDF prospectuses for major mutual fund families generally describe the funds' investment objectives to simply be, quote, "provide capital appreciation and current income consistent with its current asset allocation," end quote.

This wording comes from a Vanguard prospectus and is used to describe the investment objective for Vanguard's entire family of TDFs. However, these -- similar language can be found in prospectuses from ING, Schwab, AllianceBernstein and others.
Plan fiduciaries and unsophisticated plan participants need a clear and more understandable way to understand how the fund invests and the investment risk that are associated with that strategy, and only then would it be possible for participants to clearly understand the different asset allocations and be able to compare different TDFs providers.

We suggest the communications could be greatly improved with kind of a truth-in-lending approach. Merely providing the prospectus information required under current securities laws is not enough as I demonstrated already, and there's a widespread confusion as to what the word "target date" really means. And we believe there must be a consistent standard although we don't believe there should be a mandated mix of a particular investment or types of investments; however, plan managers should disclose in plain English what the landing point will be for their TDF's glide path.

In other words what will the point be that the fund no longer needs to be re-balanced because it's reached the appropriate mix of stocks, bonds and cash? Now, with this information plan sponsors will be in a better position to make an apples-to-apples comparison between providers.

I'd like to close with a recommendation on how to
improve the use of TDFs in the context of a 401(k) plans
default investment menu. Under the QDIA regulation, an
investment fund can qualify as a QDIA only if it's managed by
ERISA 338 investment manager or a named fiduciary of the
plan. However, mutual funds are exempted from this
requirement.

As a result, a mutual fund is not required to
assume any fiduciary responsibility for the investment
decisions made regarding the funds' asset allocation or the
underlying investments used in its allocation or glide path.

We believe that the TDF regulations must be
changed; that, in the absence of an ERISA 338 investment
manager, the manager of a mutual fund TDF must also agree to
assume fiduciary responsibility with respect to the plan's
investments in the TDF and the asset allocations made with
respect to the TDF so that the entity making the decisions is
actually on the hook for those decisions.

This is consistent with the sentiment expressed in
the preamble to the QDIA regulation that those responsible
for investment allocation decisions must be fiduciaries who
acknowledge the responsibility, and, although the preamble is
in reference to the required fiduciary status of a non-mutual
fund TDF, treating a mutual fund TDF and a non-mutual fund
TDF differently in this context, we -- was not the case of
We believe this fiduciary requirement will greatly assist plan sponsors and participants by providing that all Target Date Fund managers stand behind the investment decisions they make.

Interestingly, applying this fiduciary standard is also consistent with President Obama's proposal just yesterday to establish a fiduciary duty and to kind of, you know, harmonize regulations between different types of organizations that offer the same types of services.

Thank you, and we appreciate the opportunity to express our views.

MR. DOYLE: Thank you.

COMMISSIONER WALTER: I'd like to actually go back to a fairly basic point, and there's been a lot of talk so far today about one size doesn't fit all, and I'd like to talk about that in a slightly different context.

Obviously the approval of Target Date Funds as a default show that we do believe, to a certain extent at least, in one size fits most, and in reaching a default decision, you're really actually balancing the needs of your collective employee population as opposed to the needs of your individual employee population.

And I wondered if you have any thoughts about
whether that decision, that decision really needs to be
re-balanced? Do we need to encourage -- and I want to stay
away from what the government should do or not do and really
talk more about the policy in terms of what direction we
should head in in terms of whether there are things that we
can do either from the private sector or the government
encouraging or perhaps mandating a little bit more weight on
the individual side of the spectrum; for example, if a plan
sponsor were required to take into account certain
demographics of individual employees in deciding what Target
Date Fund to default someone into, not necessarily the one
that has the particular date that one would otherwise assume
or any other variation on that theme?

MS. KLAUSNER: Well, I'll try and take a stab at
answering that answer -- that question. In terms of having a
plan sponsor or more likely the plan fiduciaries consider
other elements of their broad-base population in determining
how to present Target Date Funds to their plan and to their
participants, we do believe that it should be a very broad
discussion.

So for example, at Honeywell and many of the plan
sponsors who have defined benefit plans, we do consider that
some of our participants will be having the opportunity to
draw down on retirement funds from our employer-sponsored
defined benefit plan, recognizing, of course, that, as
there's been a great shift from defined benefit plans and
defined contribution plans, number one, not all companies
have defined benefit plans; and, two, not all companies who
have defined benefit plans have them continuing to accrue
benefits; and, number three, not all employees within that
company have actually opportunity for a DB plan.

But recognizing that there are other elements in
the organization that need to be considered to understand
your population is important, not just recognizing the
individual's age and populating them into a Target Date Fund
that way.

MR. KOPELMAN: Yeah, if I could add, I'm worried
that two very different concepts are being thrown into this
mix, and we're getting into an apples-and-oranges discussion.
I mean, the concept of whether a Target Date Fund as a class
does or should fit the concept of what a default option
should be is very different than which of the various
offerings of Target Date Funds are appropriate for a
particular plan at a particular time.

For the former, you know, under those regulations,
I personally agree with them. I think the Target Date Funds
clearly satisfy and should continue to satisfy the rules of a
qualified default investment option, if that's what you were
But whether a particular fiduciary, you know, how a particular fiduciary chooses what a -- which Target Date Fund he will or she will select as an option in a fund or even as a default option in a fund. That is, you know, that's very different. That's going to depend on the particular fund. It's going to depend, quite bluntly, on the resources. You know, the process will determine the resource -- on the resources that the fiduciary has available to them.

And with all respect, the fiduciaries of a very large plan are a lot greater than the resources of one of the -- you know, the 90 percent of the 700,000 plans that we talked about that have assets of $10 million or less. You do the best you can with what you've got.

COMMISSIONER WALTER: My question certainly goes more to the latter than to the former. And I guess my question was really, as a matter of policy, whether you believe that tailoring -- I mean, let's assume you have Target Date Funds as your default option, whether it is a good idea to encourage plan sponsors to try to tailor the choice of fund to the individual employee as opposed to making an across-the-board decision. And that was sort of irrespective -- I recognize resources are going to determine, in part, whether that's practical, but is that a good idea?
MR. WAYNE: I think it would definitely be a difficult option to try and make that kind of customization at the employee level individually. Employers have trouble figuring out what those demographic issues are, although we firmly believe that offering, you know, Target Date Funds as a default alternative makes a lot of sense to the question of resources.

That's why we believe if the exemption was taken off of the mutual funds and more treated similarly between independent advisors in the mutual fund industry to be able to have the same fiduciary standing, then you'd have many more people who would be watching over that mix, and, as a result would be helping that employer to better prepare those employees for their retirement.

MS. KLAUSNER: I'd just like to add that I think your issue can be better addressed by the Department of Labor looking at financial advice and, you know, how we frame what financial advice should be provided or can be provided to our plan participants and how that can be provided in a framework; whereby, if a process is followed by the plan sponsor or the plan fiduciary or outside consultants that are brought in that there is, you know, a minimization of the liability that could flow with providing that financial education.
So that if you look at Target Date Funds and try and customize them on an employee level or even have, as someone had suggested earlier, multiple different types of Target Date Funds within a specific plan, I don't mean 2010, 2020, 2030, I mean one that has a landing point at different places or a glide path that does or doesn't continue to or through retirement, I think you start to get to the point where there's too much complexity, too many opportunities, disclosures we've described that may or may not be read or useful, but instead start to change our focus.

We want to get to the employee level, on, again, financial education and how that financial education can be best provided through the employer or the sponsor or its consultants with the safety that, if they do it through an appropriate process, they don't have liability.

MR. KOPELMAN: Although, for example, were I a fiduciary of a plan that required people to take distribution at normal retirement age, I might choose a Target Date Fund with a different glide path than if I were a fiduciary of a plan where employees typically permitted -- typically continue to keep their money in the plan past normal retirement date for five or ten years, and I knew -- and I had the information to know that that situation is occurring.

MS. FLORES: I think also another answer to that is
we have indeed created a system to do custom retirement planning already with the investment advice regulations. You could easily answer that solution if someone decided that they wanted to be custom for each employee and they didn't think a 2050 was a one size fit all for everyone retiring in 2050, you could default everyone into an investment advice model that took the funds that were selected as the options within the plan and would create those models and monitor them ongoing.

So I think we've already got a solution to that. You either have the pre-packaged or you have an investment advice model that customizes by employee, and every employer can choose how they combine those two options.

But I think we have the two solutions that answer that question. Now, which one we enforce or if we don't enforce either one of them is, you know, obviously a debate, but I think that there's already something created for that.

MR. DOYLE: So I mean, what I'm hearing from this particular panel and we've heard it from other panels that you don't see a real benefit to some standardization, some pre-defined regulatory criteria for what constitutes a lifecycle fund, Target Date Fund type investment option whether, independent of whether it's a default option or not, or does it make any difference if it is a default.
MS. KLAUSNER: I think that's correct. You know, all of our other funds, there really aren't government-mandated parameters, so, if we decide to offer a small cap fund, you know, we can include some mid cap as long as in our disclosure we say it's a small cap fund with mid cap companies, you know, up to a certain percentage or, if we have an international fund, it's called an international fund, but we could choose with our investment managers to have domestic companies within that international fund so long as there are appropriate disclosures and we recognize it.

So with the Target Date Fund, as long as there's a certain minimum disclosure that describes that it goes from, you know, an equity-based, a primarily equity-based investment fund down to something with a lower exposure to bond funds or, you know, some form of a fixed income fund, I think the general description of it starting with one level of risk down to another is the parameter in and of itself.

MR. WAYNE: And I would suggest that certain standardizations, certain standardization is necessary, because today you have funds that hold to or through scenarios. Just think about that. That's a 30-year difference between those two numbers.

And if a fund is labeled 2020 and one is a
to-retirement and one is a through-retirement, unless that's really, really clear somehow, the participant won't know it, and really the plan sponsor won't know either.

MR. DOYLE: Well, that's my, kind of my other question, is there a distinction between what plan sponsors understand about the investments they're choosing and what participants understand about the nature of these investments?

MR. WAYNE: Surprisingly, usually the plan sponsor is the participant, you know, they invest in their own plans. And unfortunately, and disappointingly, there is not a lot of difference in the understanding.

And the larger plans that have been represented here, they have incredible resources to figure those things out, and they do very, very well. I mean, 80 percent of the plans that have, you know, a million and two million or ten million dollars in them, you know, there's quite a statistic there in their percentage, you know, they have a very difficult time figuring out what's in a Target Date Fund, how do they evaluate it, what is a glide path and whether or not to even ask the question whether it's a to or a through. That is something that, in our experience, nine out of ten plan sponsors would not ask and do not know how to ask.
MR. KOPELMAN: But I would suggest that the resolution would be in the area of disclosure rather than in required parameters for the funds. That's within the province of the fiduciary to determine.

MR. DOYLE: Any other questions? Thank you very much.

And with this panel, we will adjourn for a short lunch. We will try to convene at 1:30 or shortly thereafter.

(Whereupon, a luncheon recess was taken.)

AFTERNOON SESSION

MR. DOYLE: We will reconvene our hearing. Thank you again for all being here. Thank you, Panel Four, for being so timely.

We have some new members of the panel, Douglas Scheidt, Associate Director and Chief Counsel, Division of Investment Management, Securities and Exchange Commission; Gene Gohlke, Associate Director, Office of Compliance Inspection and Examinations with the Securities and Exchange Commission.

And with that we'll turn it over to our next panel.

MR. VanDERHEI: Members of the panel, thank you for your invitation to testify today on this important topic. I'm Jack VanDerhei, Research Director of the Employee Benefit Research Institute. EBRI is a nonpartisan research institute
that has been focusing on retirement and health benefits for
the past 30 years. EBRI does not take policy positions and
does not lobby.

Last year, as part of EBRI's analysis on the likely
impact of the PPA's safe harbor automatic enrollment and
automatic escalation provisions, we developed a stochastic
simulation model to project future 401(k) balances as a
function of various plan design variables as well as
assumptions with respect to various employee behavior
responses.

Today I will report results I obtained using the
EBRI simulation model to determine how TDFs would likely
impact 401(k) participants assumed to be automatically
enrolled. I realize that TDF use in 401(k) plans is not
limited to those automatically enrolled, and our March 2009
"Issue Brief" by Craig Copeland provides significant details
on the differences.

However, based on our simulation results, it
appears that this will represent the majority of TDF use in
the future, and, hence, I will concentrate my comments today
on those results.

I have passed out copies of my figures to each of
you, and I apologize for those of you in the audience, but we
will have those posted on EBRI.org by the end of tomorrow.
The simulation model starts with all workers, whether or not they are currently enrolled in a 401(k) plan, and tracks them through age 65 by stochastically assigning job change, whether the new employer sponsors a 401(k) plan, cashout behavior, and financial market performance. In addition, we use the EBRI/ICI 401(k) database to statistically impute asset allocation under participant directed baseline scenarios.

And again, this is a database that has more than 21 million individual participants from more than 56,000 401(k) plans dating back to 1996. It represents more than 50 percent of the 401(k) assets in the universe as of year end 2007.

Now, although this model produces several output metrics, the one of most interest for today's discussion is the ratio of what we refer to as "401(k) accumulations" divided by wage at the time of retirement, or, for purposes of cashout behavior discussed later, the time of job change. Most of the analysis presented today will focus on the percentage increase or decrease of those balances moving from participant-directed investments to TDFs.

Given my time constraints, I will limit my comments today to the comparison of the so-called "average" TDFs in terms of equity allocation, but I have included sensitivity
analysis in the appendix for both the most aggressive and the
most conservative TDFs as well.

Now, as you can see from the table of contents on
page 2 of the handout, I am bifurcating all my results today
into those dealing with account balances at retirement and
those dealing with account balances at job change for those
who cash out. Although the results for these seven figures
all assume a baseline rate of return assumptions, which are
detailed on the last page of the handout, results for
alternative return assumptions are also provided in the
appendix for your consideration.

Moving to Figure 1, I show the interquartile range
for the percentage increase in balances moving from
participant direction to Target Date Funds. As you can see
from the medians in the middle column for each cohort, the
average impact appears to be truly de minimis, less than 1
percent. However, this can be very deceiving.

The 25th and 75th percentiles show that this can
make a huge difference, especially those exposed to TDFs at a
relatively young age. For those 25 to 29, the top 25 percent
will have at least an 8 percent gain in account balances by
moving to TDFs, but the bottom 25 percent would have at least
a 5.9 percent loss.

But given the incredible heterogeneity of asset
allocations under participant direction, it should not be surprising that the adoption of TDFs has a large range of different outcomes.

If you turn to Figure 2, it shows the same type of analysis as the previous figure, although this time the relative gains are displayed as a function of the participant's initial equity allocation. Obviously, the primary advantage of TDFs when viewed in this context is the expected gains for those with an initial equity allocation of less than 40 percent.

Although the median gains are still relatively small, less than 5 percent for all groups other than those with zero equity exposure, the 75th percentile is in the range of a 14 to 25 percent gain for those under a 30 percent equity allocation while the 25th percentile is only about a 2 to 6 percent loss.

While some financial advisors may argue that less than a 30 percent equity allocation may be optimal for those very close to retirement age, it is likely that that will not be the case for younger participants. In fact, much of the EBRI/ICI analysis we've done since 1996 has shown that about a third of the individuals in the 20s and 30s have absolutely no equity allocation whatsoever in their 401(k) plans.

To show the potential value of TDFs for these young
employees, I bifurcate the analysis in Figure 2; for those under age 45, in Figure 3; in those 45 or over, in Figure 4.

As you can see in Figure 3, the positive results of TDFs in the lower equity allocation ranges are much more pronounced with the 75th percentile for those with a less than 30 percent allocation in the positive 25 to 37 percent range while the losses associated with the 25th percentile is always less than 6 percent. Moreover, even the median gains in this range are in excess of 5 percent for all groups.

Figure 4 shows exactly the same analysis, only for those over 45. Obviously, results were much more muted given the compressed investment horizons.

Now, while the previous figures illustrate that the TDFs can indeed make a substantial difference in balances at retirement for some participants, another concern that has often been expressed after the proposed QDIA regs were released dealt with the potential impact on participants who were likely to cash out instead.

So if you look at Figure 5, it shows the expected impact on these individuals of moving from participant directed investments to TDFs, as a function of how long the employee had been with the employer before they cashed out. The median impact is extremely small, 1 percent or less; however, the interquartile range increases with duration, as
expected, and the 75th percentile for those with 11 or more
years with the employer exceeds 6 percent.

Now, another related issue during the discussion
period for the proposed QDIA regs dealt with the potential
utility of including a stable-value alternative. If you turn
to Figure 6, it shows the results of an average TDF versus a
stable-value fund on those who cash out. And there's two
interesting, but very conflicting, messages in here.

First, the median increase from TDFs is positive,
reaching a value just in excess of 5 percent for those in the
highest tenure category. However, the probability that a
participant who cashes out would have had a larger balance in
stable value as opposed to average TDF consistently remains
in the 40 percent range.

And then finally on Figure 7, I show exactly the
same analysis but instead of using a stable-value fund this
time, I used a money market fund. The medians in this case
are substantial, ranging from approximately 5 percent for the
lowest tenure range to approximately one-third for those with
11 or more years in the plan.

Moreover, the probability that the TDF balance
exceeds the money market account for this group is
monotonically increasing from 71 percent for the lowest
tenure group to 85 percent for those in the highest tenure
I also have an appendix on page 10 for you of the handout that shows some of the sensitivity analysis that we run, and we're also doing additional work that we plan to do within the 30-day period for written testimony looking at counter-factual experiments that will track people who have been with the same employer from 1999 through 2008, look at what they actually ended up with for account balances on the participant direction and go back and compute what they would have ended up with had they been in the average Target Date Fund, the most conservative Target Date Fund, the most aggressive Target Date Fund and a stable-value alternative.

Thank you very much for this hearing, and we look forward to working with you in the future on this important topic.

MR. WARSHAWSKY: I appreciate the opportunity to offer some comments on the risk characteristics of Target Date Funds, both when used as an accumulation vehicle in retirement accounts and when used for retirement distributions.

My name is Mark Warshawsky. I'm Director of Retirement Research at Watson Wyatt Worldwide. And I base these comments on a conference of analysis we have conducted recently in the Research and Innovation Center at Watson.
And I will attach, for the record, a copy of our working paper containing this analysis. We would be glad to answer any questions that the Department or Commission may have on the data assumptions, methodologies and results in our paper.

It is difficult to say what is the optimal, overall asset allocation in retirement accounts because individual workers have different extensive pension and social security coverage, career and employer risks, tax situations and personal characteristics such as health and marital status and family responsibilities.

Nonetheless, our empirical evidence suggests that asset allocations by workers in their retirement accounts seem to be less than optimal with many, regardless of age, investing entirely in equities or entirely in fixed income instruments. Indeed, one-fifth of workers approaching retirement in 2007 had their entire balances invested in equities.

Against this background, Target Date Funds offer a better and easier approach to retirement investing for individuals because the asset mix shifts automatically away from equities towards fixed income instruments as the worker ages.

Our empirical evidence also shows that there is a wide range of initial allocations, glide paths and exit
positions among Target Date Funds of varying maturities and
the respective fund family's income distribution funds. This
range presents to us the need for deeper consideration and
analysis. Because Target Date Funds are so new, insight is
better gained through stochastic simulations rather than
actual performance.

Our particular stochastic model is quite
comprehensive in considering annuity pricing, fund expense
charges, mortality and cross correlations of returns, both
short and long run, among the three asset classes, equity
bonds and cash, bond yields and inflation. So what I'm going
to talk about now is based on the stochastic analysis which
we've conducted.

For typical workers of various ages contributing
consistently to a 401(k) across their career, they first
evaluate Target Date Funds in terms of the amount of terminal
wealth accrued upon retirement and the intendant levels of
risk.

For younger workers two findings are of note. The
differentials in final balances among the five Target Date
Funds that we have selected range from highest to lowest
initial equity allocations. They're actually relatively
small across stochastic outcomes, mainly because of multiple
crossovers of allocations over the life cycle in the fund
families. For example, they may start out higher and end up
with lower equity allocations.

And the second finding of note is the investment
risk remain substantial regardless of which Target Date Fund
family is used. Poor investment outcomes will be
disappointing to all 401(k) participants using any of these
families compared to, say, a lifelong participation in a
defined benefit plan.

For mid-career workers who start their Target Date
Fund investing at age 50, we begin to see more consistent
differentiation in outcomes among the fund families. Those
investing in funds with high equity allocations can see
significantly larger balances if equity markets perform well
whereas those investing in funds with higher bond and cash
allocations are better protected on the downside. Note,
however, again, that the initial allocations do not indicate
the whole picture because even at later ages some funds cross
over.

For workers approaching retirement, that is, first
investing their considerable balances at age 60, the return
differences among funds within the observed wide range of
equity allocations are quite large. A high equity fund may
outperform a low equity fund by about 27 percent in good
times, but may under perform the latter by 16 percent in a
down market. The sharp ratios, that is the risk adjusted returns, are higher for low equity funds.

For some participants, plan sponsors and policymakers, the analysis ends here, and it might be thought that the need for regulation begins, but that would leave out a significant, additional aspect of the problem: What is the best asset allocation and distribution strategy to cover comfortably a long retirement?

When that aspect is considered, playing it safe, in other words lower equity, may not always be the best answer. When a plan participant or an IRA holder holds a -- pursues a fixed percentage or fixed dollar withdrawal strategy in retirement, our simulations find that the fund families with the highest allocations to equities at and during retirement perform the best and represent the lower-risk alternatives against the chance of falling below certain minimum income amounts in inflation-adjusted terms or of outliving one's retirement plan resources. Only if complete annuitization is chosen do the lower equity allocations before and at retirement represent lower risk.

Note also that a higher bond rather than cash allocation before and at retirement makes more sense in this latter strategy because the bond holdings in the funds represent better hedges than cash against the interest rate
induced volatility in annuity pricing, and the annuitization strategy, on average, produces a higher income stream at the cost, however, of loss of liquidity and of bequest potential.

This concludes my summary of our research results, and I'm glad to answer your questions.

MS. DiCENZO: Good afternoon. My name is Jodi DiCenzo. I'm going to switch gears here a little bit. My colleague, Michael Liersch, and I represent Behavioral Research Associates. We're an applied behavioral research firm, and we specialize in studying saving and investing decisions. We are pleased to have the opportunity to speak with you today, and we're primarily going to cover three things.

First of all, worker misperceptions about Target Date Funds. We'll offer some potential psychological explanations for what might be causing those misperceptions. And finally we'll discuss the importance of these misperceptions, particularly in light of automatic enrollment plans. And we suggest that behavioral research continue to inform your regulatory efforts should there be any.

First of all, the misperceptions. In March of this year, we conducted an online survey of 250 American workers. Our respondent group is representative of the U.S. population, and our methodology employed standard research
Prior to asking respondents or survey subjects particular questions about Target Date Funds, we showed them a composite description of the funds that we compiled from the actual marketing materials from the top three Target Date Fund providers. You have a copy of what we provided to the survey subjects.

Here are some of the results that we found. 61 percent of people say that Target Date Funds make some sort of promise. At a 95 percent confidence level, that's a statistical majority. Of these people we asked them to describe the promise that Target Date Funds make. Nearly 70 percent of these people perceive a promise that does not, in fact, exist.

Here are some of what respondents think that Target Date Funds promise: Funds at the time of retirement; secure investment with minimal risks; it's like a guaranteed return on investment even when the market bottoms out; a comfortable retirement.

Alarmingly, over 60 percent of employees say that investing in a Target Date Fund means that they will be able to retire on the target date. 38 percent believe that Target Date Funds offer a guaranteed return, and 30 percent of workers think that they can save less money and still meet
their retirement goals if they invest in a Target Date Fund. Worse yet, when workers were asked to rank five tasks in terms of their overall importance to their retirement planning success, selecting a savings rate, which arguably is the most critical determinant of retirement planning success, was rated number one by the fewest number of people. Only 8 percent of American workers selected it as the most important factor in their overall retirement planning success.

And what about the risk of Target Date Funds and how workers perceive that? Over 23 percent of workers think that there's little to no chance that they can lose money either before or after the target date. 41 percent think that there's little to no chance that they will lose money in any one-year period. 70 percent think that they're equally or less likely to lose money in a Target Date Fund as they are in a money market fund.

What might explain these findings? Although more research is necessary to really uncover what might be at work here, we'll offer three potential psychological explanations. And I encourage you to ask Michael more about each of them during the Q&A.

First of all, excessive optimism probably explains some of these responses. Humans tend to be tirelessly
optimistic. It explains why more than a majority of us think
that we will be better than typical.

Secondly, framing effects and how these funds are
framed may fit into a particular schema or mental framework
of investors. The framing may set expectations that the fund
will somehow solve general retirement planning issues rather
than just asset allocation issues. These frameworks may be
so powerful that people remember what they expect, not what
they are told.

Finally, attention salience and focusing illusions
may explain some of these results. The focus on the
investment simplicity of Target Date Funds and the target
date itself may cause people to misperceive them as a
superior retirement investment solution along many
dimensions, not just asset allocation.

What does the future hold if this problem is not
addressed? When do working Americans learn that Target Date
Funds do not promise retirement readiness; when they retire?
How can we drive the message home that how much you save is
of critical importance?

Until we can answer these questions, American
workers are investing in false hope. And absent change, we
are knowingly accepting that a significant percentage of
American workers believe in some sort of Target Date Fund
magic. They believe the funds offer retirement readiness on the target date and a guaranteed return. These beliefs are not just naive and harmless, they are detrimental to the financial well-being of thousands of Americans.

How can it be addressed? Regulation offers at least two alternatives, disclosure and product restrictions. Let me be clear that we are not recommending one over the other or even either for that matter. We are merely suggesting that, as you move forward, continued behavioral research will offer valuable insight on what may be effective.

Understanding perceptions is just the first step of this work. Empirical research must illuminate effective methods to improve understanding and behavior. We can hear smart people weigh in all day long on what might work, but until we empirically test these ideas to evaluate the behavioral impact, it's all just conjecture. Our actions here must be based on rigorous empirical evidence.

As you consider ways to address this issue, and a number of people have mentioned this already, but we need to keep this in mind, that many Target Date Fund investors are not actively engaged. They do not actively make the decision to invest in them. They've been automatically enrolled in them.
Many workers believe in Target Date Fund magic, and we have a growing number of passive Target Date Fund investors. As you move forward, consider the research finding that people view default choices as implicit advice, and in every decision context there's a default choice.

What implicit advice will you provide the American worker and what behavioral evidence will it be based on?

Thank you.

MR. DOYLE: Thank you. I just have two quick questions. One, when was this survey conducted?

MS. DiCENZO: March of this year.

MR. DOYLE: So these are presumably some workers who actually had some firsthand experience with the current market turmoil?

MS. DiCENZO: Only 9 percent of our respondents actually self-reported that they invested in Target Date Funds. The only other behavioral study that we're aware of that looked at workers' perceptions of Target Date Funds was one conducted by Janis, and in their work they only surveyed people who self-reported that they invested in Target Date Funds, and still, in their respondent group, 19 percent of the people said that they thought that Target Date Funds provided some sort of a guaranteed level of income at retirement.
MR. DOYLE: So that actually was my other question about the Target Date Fund magic. What was the basis for this conclusion that there was magic? Was it the way these funds were described? Was it the title? What aspect of the material that was available or considered did the investors or the surveyed individuals reach their conclusions?

MS. DiCENZO: So the retirement date or the Target Date Fund magic, those are my words, and that's to make salient the notion that workers think that investing in Target Date Funds means that they'll be able to retire on the target date and that a significant percentage believe that they offer a guaranteed return when they, in fact, do not.

MR. DOYLE: But I guess what I'm asking is, did they have particular material that defined what a Target Date Fund was, and then, based on that material, they reached that conclusion?

MS. DiCENZO: Right. And the description that we provided to them, we dropped some copies off for each of you, we compiled that description from the marketing materials of the top three Target Date Fund providers.

MR. PIACENTINI: I have a couple of questions that I think are probably mainly for Jack or Mark or both. We've heard this morning and now this afternoon several conclusions that are drawn from modeling that people do when they think
about Target Date Fund designs. They run stochastic scenarios, different investment returns that people might experience, and then you look at, well, what are the probabilities of different outcomes, right, so many researchers are doing similar things along those lines.

So I guess the questions I want to ask, one is, is it the case, I think it is, that the probabilities in fact are not -- how do I want to explain this -- that there's concentration in cohorts, so if there's a small chance of a bad outcome or of a very nice surprise, that in fact, as it plays out in reality, that those small probabilities, when they do come to pass, come to pass for an entire group of people who are about the same age, is that right, so that when I look, for example, at Jack's diagrams, the people at the different percentiles, that really a whole cohort will find themselves being located in one of those places or another most the time?

MR. VanDERHEI: Well, the way, there are several different ways of conducting those stochastic simulations. The way I conducted this one, what you said is correct.

MR. WARSHAWSKY: Yeah, I'm not quite sure that's correct in terms of the way we've done the stochastic simulations because, although it's based on historical
evidence, it is based on -- typically a stochastic analysis is a projection, and it's not necessarily for any particular cohort.

In other words, you -- certainly there are outcomes. The simulation is done over a very long period of time, and there are outcomes that are extremely positive, and there are outcomes that are extremely negative, but I wouldn't characterize it as an cohort analysis.

MR. PIACENTINI: But I guess what I mean is, if you see an outcome that's predicted to occur with a 2 percent probability, that doesn't mean that if you look at a particular cohort, you'd find that 2 percent of them had that experience. It's more the case that 2 percent of cohorts will have an experience something like that.

MR. WARSHAWSKY: That's right, because, I mean, we're talking about markets, and these are very broad trends, and it would be extremely unlikely that, if they're investing according to the glide paths of the Target Date Funds, that different people find different outcomes.

In fact, you know, as I stated in the testimony, one of the conclusions is the investment risk is very real, and, you know, compared to other, for example, benefit plans, there is risk here.

MR. PIACENTINI: My second question I guess goes to
the distribution of possible outcomes, so I know some people use historical data, sometimes they mix up the historical years, sometimes they just use historical years as they actually consecutively happened. Sometimes they generate hypothetical returns.

And Jack, looking at your material, it looks like you chose an expected level of return and some amount of deviation around that. Are you assuming the returns are normally distributed according to those statistics?

MR. VanDERHEI: What we're generating, we've generated three different scenarios. The baseline scenario there's a log number distribution. And for the second alternative scenario, which was in the appendix, it's nothing I had time to talk about today, basically what we did was radically reduce the expected equity premium going forwards.

The third one was truncated much more because we wanted to have the stable-value alternative, and we were only able to take our time series back 20 years for that, so the equity, US or non-US equities are all logged normally, distributed in that particular example, but there are different time spans from which these data are being derived.

MR. PIACENTINI: So one of the areas of uncertainty that I think these exercises have to deal with is, what is the probability of the extremes? How likely is a very large
deviation from the average, either positive or negative, and
so if that -- I mean, we all expect those probabilities are
small, but then, you know, there's small and there's small,
and I'm assuming that some of the results, in terms of what
turns out better could be different?

MR. VanDERHEI: Without a doubt. This is not
contained in what I've done here under the Target Date Funds,
but in one of the first simulation models that was built
dealing with EBRI/ICI data, I did with Sarah Holden from ICI
back in 2002.

In those situations we basically went back to test
how bad bad could be. We would override stochastic
simulations both at the beginning and in the middle and at
the very end of a worker's career just to show the overall
impact.

That basically is the only way, at least the way we
have the simulation model constructed now, to basically focus
in on what that kind of a shock could be over an retirement
income. That would be extraordinarily easy to add into what
I've done for today if that's something you'd like to see.

MR. WARSHAWSKY: In responding to your question for
the model which we used, we used an vector auto-regression
model basically patterning it after a model that was first
introduced a few years ago by John Campbell at Harvard
University.

So it is based on historical data, but it is a model so that it includes cross correlations both in the short run and the long run among different asset classes, equity, bond and cash, as well as the random inflation rates and bond yields, so we feel as if it's a pretty sophisticated model and comprehensive of the relevant risks for this type of analysis.

And it doesn't -- in the paper which you will see, we emphasize the outliers, so the 1 percentile outcomes as well, which I think is -- will give you some indication of how bad or good things could be.

MR. SCHEIDT: I have a question for all three or all four panelists. It's based on your research and your findings. What points would you -- do you believe that plan sponsors and plan participants should take, what points arise from your research, what points should they take into consideration when considering, including Target Date Funds and the options available, in either choosing a Target Date Fund as a plan participants or in being defaulted into and living with the consequences?

MR. WARSHAWSKY: Okay, I'll take it first. Maybe we'll say five points. Number one is Target Date Funds are an improvement over the status quo. For many participants
they're a good thing, and therefore for a plan sponsor
they've a good idea.

With that being said, they are risky, and I think
the findings, which indicate that there may be some
misunderstanding of that, is a significant finding because
the reality is that they do represent risk.

The third item is that the different strategies
that are out there are all possibly reasonable. Both the
initial equity allocations, the glide paths, the termination
allocations, they're all reasonable, but it very much depends
on, and this is the fourth point, on the strategy that the
participant is -- and I guess to some extent this is
determined by plan design, but I think more importantly the
participant plans to make of their investment.

Are they going to cash the plan out or are they
going to hold it till retirement or are they going to hold it
past retirement and actually use it for either a purchase of
an annuity or getting income from the retirement plan during
retirement? The answers for asset allocations, the optimal
strategy, really depends on how they're actually used.

And that may be not be understood, but I think
that's an important point, certainly from both the plan
sponsor and the participant.

MR. VanDERHEI: Let me add one other potential
stakeholder and that is the government in considering the appropriate public policy route. As has been discussed many times this morning, PPA basically changed the rules with respect to employers considering the future adoption of automatic enrollment and automatic escalation.

I think from the standpoint of what's likely to happen in terms of more and more employees being brought into these in a default basis going forward, whether or not the overall distribution results tends to look better for Target Date Funds or for participant direction, and that's what I tried to focus on, but certainly it would appear that there are a relatively large percentage of participants not currently in Target Date Funds making choices that just do not seem rational.

We don't have the whole household portfolio in front of us, but in many cases, again a very large percentage of people in their 20s and 30s have absolutely no equities whatsoever. In testimony I did for Congress in October last year showed that as many as 42 percent of people between 55 and 65 had over 70 percent on their portfolios in equities. Over one in five had over 90 percent.

Getting people away from those extremes, again given them the opportunity to opt out if they'd like, but, at least in the default for those people who are not providing
serious consideration to this, I think is, from a public
policy standpoint, quite admirable.

With respect to the employer objective, I think the
presentation this morning from J.P. Morgan was excellent. I
think the type of thing you want to focus on is what is the
employer's objective in terms of making sure at least a
minimum percentage of your work force has a standard of
living, when combined with social security, that's going to
be acceptable.

What type of Target Date Fund or if indeed Target
Date Funds are going to help maximize that percentage, I
think is the thing to look at. From the standpoint of the
employees, I think what you really want to really to try and
focus on, and this is something I think Jodi was touching on,
is what type of research do we need to look at to see what
employees are doing when they're given the choice, not the
ones who are defaulted into this through automatic
enrollment, but when they're being provided those choices by
their employers, what are they doing with it and what's going
on with the rest of their portfolio?

MR. LIERSCH: I think from my perspective, coming
from a psychology background, is really that participant
behavior isn't rational, and I think we all need to
understand that, although we assume we give people proper
information, make the appropriate disclosures, that people aren't rational actors and that there are behavioral biases that will drive what people do.

And we need to consider that when informing or making our future decisions about what to do with Target Date Funds and what not to do with Target Date Funds. And as people pointed out, Target Date Funds have made a vast improvement upon what existed previously, but we also still need to consider the behavioral aspect.

MS. DiCENZO: I'd like to just add my, and I accepted the most difficult role by going last, but for participants, two things: One, there is no magic in Target Date Fund investing. You cannot invest your way to a secure retirement. You must save.

The other thing is that there is risk associated with Target Date Funds, and for plan sponsors, an awareness of some of these misperceptions and then also to support what Michael said: We really need to engage in behavioral research as we try to identify effective ways to improve retirement outcomes in America.

MR. DOYLE: Thank you very much.

MR. COHEN: Hi, I am Josh Cohen from Russell Investments. Thank you for the opportunity to allow Russell Investments to present today. Russell provides strategic
advice, performance benchmarks and a range of institutional quality investment products to clients globally. I am a Senior Consultant with a particular focus on defined contribution plans.

Russell advises plan sponsors on the selection of Target Date Funds. We also implement Target Date Funds solutions through either customized approaches or commingled to mutual funds.

Russell spent many years working with clients to come up with better Target Date Fund solutions. We've done a lot of research with respect to Target Date Funds, how they are constructed, how they are used by participants, how their performance can be measured and how to deal with some of their challenges.

Many investors were surprised at the magnitude of losses that many Target Date Funds, particularly those with a near-term retirement date have suffered. Those losses are primarily due to the high equity allocation exposure of some funds near the retirement date.

Interestingly, we have found that there is a strong correlation between the length of time that the glide path continues to slope down after retirement and the level of equity exposure at retirement.

Now, opinions will differ as to the right shape of
the Target Date Fund glide path. I would like to share with you our opinion based on our work with clients, our research and our analysis.

Two basic points: First, Russell believes that investment risk should be more limited at retirement. In fact, Russell's standard glide path has a 32 percent allocation to equities at retirement. Second, in retirement, the glide path should be flat rather than sloped.

We reached these conclusions because of a fundamental understanding of what the objective of retirement savings is and the nature of contribution patterns into plans. We believe Target Date Funds should be created with a certain objective in mind and rigorously engineered to meet that objective. Further, we believe Target Date Funds should be viewed as a component of an overall retirement savings program.

The objective of retirement savings should be to create greater certainty of meeting an income replacement goal in retirement. Given this objective, risks should be measured in terms of not meeting that goal. This is different than some arbitrary point in time risk measure like standard deviation returns or level of equities which really doesn't tell you anything about the ultimate risk of falling short of an income replacement goal.
So now let's discuss the nature of contributions. The wealth of young participants with a long investment horizon consists primarily of future payroll contributions, and those participants can therefore afford more risk in their asset portfolio.

At retirement, participants stop putting money into their plan and start taking it out. As a result, large losses, say a negative 40 percent return, have much more impact just before retirement than any other time before because account balances are at their highest and the ability to respond to the setback and rebuild assets is small.

We would call this risk of experiencing poor investment performance at the wrong time a sequential risk, so if your objective is to reach your retirement income goal while reducing as much as possible the risk that you will fall significantly short of it and if your maximum exposure to catastrophic loss is highest as you near retirement, we believe fund risks should be more limited at that period.

Now to our second point, why a flat glide path in retirement? We believe that a participant is financially most at risk the day that he or she retires. That's because he or she has, at that point, the longest time to live and therefore the greatest amount of time for which he or she needs to fund retirement income.
Therefore, it does not make sense to us to use a sloping glide path that maximizes investment risk on the day of retirement and reduces it thereafter regardless of what that right allocation is.

I would like in closing to discuss two additional issues. The first is target date performance measurement. We believe a simple measurement of the effectiveness of a glide path to generate wealth using actual fund performance and contributions should be adopted.

I want to stress that there is not one good performance number that will tell a plan sponsor whether a Target Date Fund is good or not. Fiduciaries need to use prudent investor standards to determine the appropriateness of a solution.

That being said, Russell has developed a performance measurement tool that attempts to answer the question of how well a Target Date Fund family has done at its task; specifically, how well did it do in building retirement wealth over time versus other alternatives.

The key attributes to this approach are, one, it evaluates the Target Date Fund family as a whole instead of the individual funds in the series, and, two, it uses a dollar weighted approach which gives considerably more weight to the returns of those funds that are near their target date.
than those that are farther away. More information about this approach will be released soon.

Finally, in regards to manager selection, most Target Date Funds tend to be manufactured entirely out of proprietary funds from a single investment shop. While this won't necessarily lead to inferior results, these approaches do face head winds as it's hard to make the case that a single investment management firm is best in class in all asset classes.

A customized approach in which a plan sponsor creates their own Target Date Funds is a possible solution; yet, for many plan sponsors there are significant challenges doing this correctly and cost-effectively. Russell's target date commingled and mutual funds are put together using multi-manager asset class funds based on extensive research and the utilization of over 50 external investment managers.

Thanks for your time today, and I look forward to further discussion.

MS. LUCAS: Good afternoon and thank you for the opportunity to testify at this important hearing on Target Date Funds. My name is Lori Lucas, and I am the defined contribution practice leader at Callan Associates, one of the largest independently-owned investment management consulting firms in the country.
Our client services include strategic planning, plan implementation, monitoring and evaluation and education and research for institutional investors such as sponsors of pension and DC plans. We do focus mainly on large plan sponsors, those with 100 million in assets or above.

My comments are based on more than 20 years of experience as a DC and investment consultant, and I would like to address plan sponsors need to appropriately monitor and evaluate Target Date Funds.

The introduction of Target Date Funds to DC plans represents an important advancement for long-term retirement income potential within these plans; however, during the market collapse of 2008, Target Date Fund performance, particularly the performance of 2010 funds, ranged widely due to the highly varied approaches of Target Date Funds across the industry.

First is the fact that there is no standard approach to Target Date Fund investing, good or bad. We know that this is consistent with the wide range of investment approaches sponsors of DB pension plans take. Asset allocations for DB plans can vary substantially depending on the unique circumstances, investment goals and risk tolerance of each DB plan sponsor, and to a large extent, the same factors apply to DC plans. Demographic differences, the
presence of a DB plan, observed risk preferences all can
justifiably result in different target date asset
allocations.

However, a wide range of target date solutions
makes the evaluation process complex. Currently Target Date
Fund performance analysis is very basic, however. A Callan
survey found that 85 percent of Target Date Fund managers
used proprietary benchmarks in evaluating the performance of
their Target Date Funds.

Such benchmarking offers very limited insight into
the drivers of Target Date Fund performance since the focus
is on measuring excess return, the return relative to the
target asset allocation, and not the appropriateness of the
asset allocation itself. This is a significant drawback in
that it is asset allocation that ultimately is a key
determinant of long-term performance.

The first step in evaluating Target Date Funds
should be to select an appropriate objective index or
benchmark. Since as of today no standard third-party target
date index has emerged, Callan has developed its own target
date index, the Callan Target Date Index, in order to measure
the efficacy of various competing Target Date Fund glide
paths.

Callan's approach is straightforward. We base our
index on the glide paths of all of the available Target Date Funds on the market. A consensus glide path index reflects the range of Target Date Funds available to the plan sponsor. By comparing the Target Date Fund to the consensus glide path, the plan sponsor can make a knowledgeable determination as to whether any differences away from the consensus are acceptable or desirable.

This knowledge should help minimize surprises when the performance of a sponsor's chosen Target Date Fund vary significantly from competing target date offerings due to differences in glide path.

Employing the right benchmark, however, is just the first step. Other important factors to analyze include the level of participants' pre-retirement income that the Target Date Fund glide path is expected to replace with a reasonable probability of success. After all, the true role of Target Date Funds is to help participants maintain their standard of living in retirement.

The interim risk is another risk that should be examined. This is the risk to which participants are being exposed on a near-term basis, and it is especially important for individuals near retirement. Longevity risk or the risk of investors in the Target Date Fund outliving their wealth during retirement due to factors such as inflation, this is
also very important.

The quality of the implementation of the Target Date Fund, this is where we get at the value of active over passive management of the underlying funds in the Target Date Fund.

And finally, Target Date Fund fees, and I would submit that it is important that Target Date Fund fee analysis take into account the potential value added of both the asset classes included in the glide path and the underlying managers.

The analysis described here is admittedly multifaceted, but that reflects the complexity of Target Date Fund products and their critical role in DC plans. Many in the industry predict that Target Date Funds will ultimately hold the majority of DC assets. These funds have a lot of moving pieces and can offer surprises, as we saw last year, if the plan sponsor does not understand how the pieces fit together.

Finally in closing, I would like to offer that Target Date Fund communication at the participant level has been overly simplistic as well. Specifically, many Target Date Funds are not targeted for retirement but for the participant's lifetime, and that seems to have gone missing in much of the existing target date communication.
Target Date Funds that continue to have equity allocations that glide down during retirement with substantial equity positions near or past age 65 should be positioned as lifetime funds. This would clarify that investment in these funds isn't intended to terminate at retirement but to continue years after, thus necessitating some continued risk-taking in order to combat the potential damaging effect of inflation during retirement.

The same measures used by plan sponsors to evaluate Target Date Funds should be simplified and adapted for participants to explain risk return tradeoffs and communication.

We have come far as an industry with Target Date Funds, but it is time for such areas as benchmarking and communication to catch up with the advancements we have made on the investment side.

Thank you for the opportunity to share Callan's views on this important topic.

MR. CASTILLE: Good afternoon. Barclays Global Investors welcomes the opportunity to share our views and experience regarding Target Date Funds with the Department of Labor and the Securities and Exchange Commission.

BGI has been managing assets for defined contribution investors for over 20 years. Today we're the
fourth largest manager of DC assets in the United States and
the largest investment-only DC provider. I'm the head of
product development for BGI's DC business and I'm closely
related in our Target Date Fund products.

Given the time available, I would like to focus our
testimony on three things: First, BGI's approach to asset
allocation with our Target Date Funds, i.e., the glide path;
the importance of providing flexibility around the
construction of the glide path; and, finally, the ways to
communicate with plan participants about Target Date Funds
that is simple for them to understand and allows them to make
informed decisions.

We have submitted testimony for the record that
contains numerous charts including an analysis of the
comparative performance of 2010 funds and their respective
allocations to equities. I am happy to answer questions on
any of the information in that submission.

Our focus on BGI's Target Date Fund strategy is
twofold. The first is to illustrate the discipline and
scientific rigor that underlie the construction of a
lifecycle fund, and second is to illustrate how the objective
of a fund series itself; for instance, are you trying to
replace income or are you trying to provide a stable
consumption stream, how that investment objective can impact
the desired equity allocation in retirement.

BGI's been incorporating asset class forecasts into our investment products since the early 1970s, and we invented the Target Date Fund category in 1993 and received a patent on our methodology as a natural extension of our multi-asset class research but with a very different and specific objective in mind, and that was to design a fund that would allow DC investors to achieve well-diversified returns on par with those achieved in defined benefit plans.

We use historical data in our own proprietary modeling capabilities to construct asset class, risk and return forecasts, and importantly one of those reference point we utilize is the average asset allocation of the top corporate defined benefit plans in the United States, and thereby we incorporate the consensus view of some of the largest and most sophisticated investors in the world.

Once we develop risk and return forecasts for all of the asset classes in our target date portfolios, we then use a mean variance optimization to create a series of highly efficient and investable portfolios. And we define efficiency as maximizing expected return for a given level of expected risk and we call the set of those efficient portfolios the "Efficient Frontier."

Now, in order to construct a glide path, one needs
to know the appropriate risk level for each portfolio at a
given point in time and as well as to determine how that risk
could change throughout time as a participant nears
retirement, and so at BGI we start that process of creating
the glide path by focusing on the retirement portfolio.
And our retirement portfolio has a very specific
investment objective. That objective is to minimize the risk
to less than a one-in-ten chance that a retiree is forced to
significantly alter their consumption pattern in retirement,
and that alteration comes from either due to market
dislocation or because of a higher than average life span.

Now, we determine the asset allocation consistent
with this particular investment objective which we call the
stable consumption objective. We do that through extensive
Monte Carlo simulations, and that leads us to a current
allocation to equities and equity like instruments today of
38 and a half percent in our retirement portfolio, and that
equates to an annualized expected volatility of about six and
a half percent.

Now, once we've determined the risk level of the
retirement portfolio and located data on the Efficient
Frontier, we place the rest of the target date series on that
same frontier along that risk return continuum so that the
relationship between time until retirement and the level of
risk remains constant throughout the entire glide path.

Now, this stable consumption approach anchors the glide path in the retirement portfolio itself, and the retirement portfolio is that stock/bond mix that best balances two risks, longevity risk, the risk of outliving one's savings; and market risk, the risk of needing to alter consumption because of a loss in account value similar to what we experienced in 2008.

Now, there are other providers I'm sure you've heard today that have a much higher allocation to equities at retirement, and those providers are most likely focusing more heavily on what is termed "income replacement" itself. So the goal in these funds is to determine the retirement portfolio most likely to yield the highest amount of expected annual income for the participant.

And I think a simplistic way to understand the differences in these two approaches is that the stable consumption approach, the BGI approach, focuses on minimizing the effect of the extreme event whereas the income replacement approach focuses on increasing the mean or maximizing the income in normal market conditions. So I think it recognizes the cohort effect that you were talking about earlier.

BGI strongly believes that it is important to
continue to permit managers and plan sponsors some
flexibility concerning the construction of the glide path,
and a good example of that is the creation of customized
Target Date Funds. Now, when we created the first Target
Date Fund, we understood at that time that we'd only know the
participant's expected retirement date, but today, working
with a particular plan sponsor, we can capture much more
information.

So for instance, about a particular plan population
we may be able to learn the expected defined benefit payment,
the average retirement age, the average allocation in the
company stock. And taking this information, we will in
certain cases create a customized glide path which can differ
materially from our standard product.

Although we use the same asset class forecast and
we use the same basic process, the solution differs when we
take this additional information into consideration. And an
example of that would be, all else being equal, a lower
retirement age would prudently suggest a more aggressive
asset allocation at retirement because there's more longevity
risk.

Because of our history in offering Target Date
Funds, BGI is well versed on the challenges that plan
sponsors face in communicating with participants, and our
experience indicates that communications about Target Date Funds need to be simple and focus on the benefits rather than diving immediately into the investment details.

We believe that it is important that the agencies consider the potentially negative effects of complicating the Target Date Fund message. The simplicity of Target Date Funds is what makes them such effective investment vehicles.

Forcing sponsors to add risk-traunched target date series would not only add significantly to plan costs, but would also confuse participants, and, when confused, our experience tell us that participants will either make an election not to participate at all in the plan or to utilize common and suboptimal heuristics.

BGI has been managing Target Date Funds since the strategy's debut over 15 years ago, and we believe that incorporating them into DC plans in a more meaningful way is a very important step towards advancing these plans into becoming credible self-funded pensions.

We do believe, however, that the current focus on the returns of these funds needs to be considered in context because Target Date Funds are very long-term investment strategies designed for participants with an investment horizon that often exceeds 40 years, and it is important therefore to evaluate their efficacy over multiple years.
rather than focusing on one extraordinarily negative quarter.

In closing, we would like to underscore the fact that plan sponsors themselves are very knowledgeable on glide path construction and take great care when selecting a target date provider. BGI alone has had hundreds of discussions with sponsors and the investment consultants who often advise them on Target Date Fund construction, and in each of these discussions, plan sponsors acting as fiduciaries have endeavored to make the decision most appropriate for their participants.

Again, I appreciate the opportunity to be here today and would be pleased to answer any questions.

MR. RICHARD MICHAUD: Hello. My name is Richard Michaud, and I'm from New Frontier Advisors in Boston. And Robert Michaud is with me, my associate, and he will be answering some questions.

The Swedish social security system found that roughly 70 percent of participants either do not know or do not want to know -- make investment decisions about their long-term investments. Many individuals do not understand portfolio risk or have access to reliable investment advice. Qualified default investment alternatives are regulated to provide safe, diversified investments for such individuals.

Target Date Funds claim to fulfill this QDIA role.
These age-based rules define risk as a stock/bond ratio that declines in value as retirement approaches. TDFs are extremely simple solutions to a very complex problem of choosing an appropriate investment; however, TDFs have critical limitations as QDIAs that include the inappropriateness of age-based rules for defining risk and have unregulated management and risk control policies.

Some background in risk is useful. Risk level or the stock/bond ratio asset allocation is widely acknowledged as the single most important investment decision for long-term investment, but effectively choosing the appropriate risk level is a highly complex and often very costly kind of process.

Age-based risk is a myth that is unreliable, ineffective, misleading and often very perverse. An unemployed 25-year-old may be rightly far more conservative than a wealthy octogenarian. No formal, credible financial theory exists or can exist that rationalizes age-based risk for long-term investing. Such rules ignore wealth level, income volatility, risk aversion, the health of an individual at a point in time, marital status that changes over time, and legacies for the future.

Financial economists have devoted much of their careers to the study of defining investment risk. Serious
studies for defining long-term risk are very intensive. Even empirically, age is on average unrelated to risk. That's a new result. Age-based rules are basically artifacts that facilitate fund sales. Age-based choice simplifies sales while encouraging investors to stay in the same fund until retirement.

TDFs are largely unregulated through a wide variation of stock/bond ratios with the same target date it highlights as fact. Many managers engage in stock market and market timing of the stock/bond ratio, increasing the risk of meeting long-term objectives.

Target risk funds are a more appropriate alternative. Target risk funds are well-defined, diversified asset allocations indexed by the stock/bond ratio. Usually a spectrum of TRFs are made available to investors from 20 percent to 100 percent in stocks. Many sophisticated investment platforms for wealthier individuals have this kind of platform.

Now, a 60/40 or balanced TRF may usefully represent a market-neutral investment. In aggregate, investors hold claims to the economic productivity of the economy. Mathematically, the average portfolio is roughly equal to a 60/40 risk target portfolio of capitalization-weighted ETFs or index funds. Deviating from this portfolio represents
under-weighting of one segment of the economy over another. The market portfolio is a good candidate for a default-qualified QDIA. A TRF framework is transparent and does not encourage either recklessness for the young or excessive conservatism for the elderly and does not lock investors into a fund over time when things change. Marital status changes, wealth changes and many other things changes. TRFs can be mandated not to engage in market timing and more explicitly follow their long-term objectives. TRFs that require professional advice are no simpler and much less transparent than TRFs. Asset allocations are often optimized with a 50-year-old procedure that has proven performance limitations. In other cases managers often ignore risk management principles. Fund fees are a very important additional consideration. New technology can be improved in risk management and is often being ignored.

To summarize, no formal credible financial theory exists or can exist that rationalizes an age-based reduction in stock/bond risk for retirement investing. TDF age-based decision rules are unreliable and very often perverse for defining risk suitable for QDIA investing. TRF QDIAs are an alternative that is more transparent and may more properly meet retirement objectives, a wide range of them. A balanced TRF can be used as a
default QDIA.

So our recommendations carefully limit the use of TDFs as QDIAs. Use TRFs as an alternative to QDIA investing. I have no idea why nobody here has mentioned TRFs before, but they are being used widely in many other contexts. Propose a balanced TRF as a qualified QDIA perhaps with ETFs to reduce costs. Limit active management in QDIAs. Limit ineffective risk management technologies and encourage more effective risk management.

MR. DOYLE: Thank you very much.

MR. MICHAUD: Did you want to say anything, Bobby?

MR. ROBERT MICHAUD: If I could have about 90 seconds. So just to make some comments about today, most people here are representing management companies that are all claiming to have investment value, but what we really want to do is gather the most assets and get paid for it. Managers are either boasting about their 2008 performance or excusing it, but this misses the point here. We're talking about investment for the people, and this should not be subjective. A person's financial future shouldn't depend on a lucky and insufficiently-informed decision about which fund to pick. Being informed isn't easy and, for you, neither is regulation. Even with specific stock/bond constraints, competing managers seeking
performance and the assets that will come with it will allocate to increasingly reckless asset selections. When they fail, they'll dismiss it as an six-sigma event, but it's hard to discourage speculative investments into commodities, junk bonds or undeveloped markets.

Some solutions have been suggested today. I'm not sure that a wider variety of Target Date Funds are the answer. They require as much professional guidance as target risk funds but with less transparency and more complexity. However, passively allocated index funds make sense as the default risk investment. I'm thinking about the concept of a market portfolio.

The default risk-less investment is more interesting. Cash is one option, but annuities are another. And just to say sort of a crazy portfolio -- proposal, you could allow people to buy at a fair market price into the greatest annuity there is out there, which is the social security.

The only open question left is what percentage of wealth an individual can afford to risk, which part to have risk-less, which part to have in a passive market portfolio. Unfortunately there's no one size fits all answer to this.

MR. DOYLE: Thank you. I actually have lots of question, but to start with Mr. Michaud, the target risk
fund, I guess in my mind when you think about it in the context of a qualified default, it presupposes information about the risk tolerance of a particular participant, and I think the assumption was that that's not information that is objectively available from participants who have essentially opted not to affirmatively participate in the system.

So I'm just curious. Who's going to make that determination about the appropriate level of risk for a particular participant?

MR. RICHARD MICHAUD: What we have proposed then, and perhaps it's something new here, I don't know, it's as much Robert's idea as mine, but it has to do with a 60/40 TRF. And the economic balance between the stocks and bonds in any economy is a reflection of the risks in the economy.

And so, did you want to explain that a little bit?

MR. DOYLE: I mean, is that essentially a balanced-fund type approach?

MR. RICHARD MICHAUD: That is --

MR. DOYLE: We have that as an option under our regulations, one of three, but it is an option.

MR. RICHARD MICHAUD: And that's if it's done well, if it's not actively managed, if it's done with perhaps ETFs, it is a very good default fund. And as I was saying earlier, the Swedish social security system found that 70 percent of
their participants would prefer to be in such a fund, okay. For someone who is informed or has advice and so on, then they can find alternatives that are appropriate for their long-term investing and so on.

What you've heard today again and again is that TDFs are okay, but they're not quite okay because maybe we should add this or maybe we should add that or maybe we should have multiple glide paths, and then we have to ask that question. The point is that you're going to have to deal with this issue anyway. And what you have heard today is nothing more than this argument resurfacing in many, many guises.

MR. DOYLE: And I -- just one more question then I'll share.

The Barclay's representative talked about income replacement versus stable consumption. Is there confusion over those concepts and how do you communicate those in a way that both employers and participants understand the strategy?

MR. CASTILLE: And maybe the earlier comments touched on that.

The Target Date Fund universe has grown to represent a large variety of investment styles, and I think, if you look at them closely, I think they're all trying to satisfy a different particular investment outcome. And some
of them are focusing on being able to maximize the amount of
income that can be replaced as a percentage of what final
salary is and others are saying what is -- our approach has
been more to say what do participants want in retirement.

We think they want a more stable, the ability to
have some confidence so they can draw upon their savings in a
stable fashion and do that.

So I don't think that there's the recognition yet
in the Target Date Fund space that the funds themselves are
actually pursuing different investment objectives that are
going to lead to different outcomes, and, until you get to
the big event that illustrates that, wow, you know, there's a
big dispersion in these funds here.

MR. DOYLE: Maybe what I ask the panel generally is
one strategic philosophy in the context of a default
investment better than another?

MS. LUCAS: And I would say no. I think the beauty
of the Target Date Fund industry today is that it's got a
wide variety of glide paths that are available. A few years
ago, there were a few, and it was very limited. Now we've
got a wide variety.

And again, we know that there are a wide variety of
needs out there. We work closely with plan sponsors to
determine, you know, if they've got a DB plan, perhaps they
need a different glide path. If they have -- if they are aware that people are taking their money out of the plan and, in fact, it's their intention that that's what happens, they're not encouraging people to necessarily keep their money in the plan, they need a different glide path than if they are actively encouraging people to keep their money in the plan.

So we would, at Callan, believe that this is a virtue of the industry, this wide variety that we have today.

MR. COHEN: Yeah, I would actually -- I've looked at a lot of Target Date Funds, and some of them have published a lot about their research, and we think that all Target Date Funds should so people understand their methodology.

See, I think this whole idea that's been going around that some want retirement income, others want growth, others don't want to run out of money, I think it's all the same thing to me. It's all we're trying to fund people's income needs and their holding a standard of living in retirement.

And I think a lot of it, if you really read the methodologies, comes down to two different things. One is different assumptions, so different assumptions on what you assume for, for example, the withdrawal rate in retirement
and the savings rate and things like that, those who kind of
tend to assume that people are going to take out more than
they should or not save enough.

Those tend to be sometimes more aggressive because they need to make the assets work, where there's others that use more of a kind of a baseline-type approach tend to be more conservative. So I think it's all trying to answer the same question.

And then I think the other reason is because they all -- there's a different definition of risk sometimes. Some of it's sort of a shortfall risk that, you know, you're just going to -- how far are you going to fall short below your target. Others are more at kind of an all-or-nothing risk whereas either you make it or you don't. And when you do those different types of risk, you can come out with different results, but I think in the end everyone's trying to do the same thing.

MR. RICHARD MICHAUD: But again, I think that, going back to the issues we raised, there are just so many things besides age that should be related to long-term investing, okay, the stock/bond ratio. I mean I've been involved in many studies for defined benefit plans, defined contribution plans, wealthy individuals, many, many different kinds. Some of my earliest work was widely copied by some of
the people who may be here even in some of the master trust
departments.

The issue of how to think about risk for investing
is not age-based, okay. That is a myth. And so what you have
is basically a convenient way to sell funds, okay. And what
you are doing is ignoring the way that really needs to be
addressed. And it may not be a simple solution.

But misinformation is much worse than no
information, much worse than no information. You've got
people who are changing their lifestyles, okay, over time
getting married, getting divorced, a reduction in health,
changes in wealth level, all of these things. And you're
going to put them on a glide path? Does this make any
investment sense?

MR. COHEN: Maybe I think an important point is
glide paths don't slope down because of time horizons. They
slope down because of the nature of contributions into a
401(k) plan. And this is sort of the human capital argument.
So it's not that young people can take more risk because
they don't care as much and older people, they get more risk
averse or that they have a longer time horizon to make up for
losses.

Really, if you got all your money that you were
ever going to contribute at 25 and invested it, then you
should probably have a single-risk profile the whole time, because then it doesn't matter. If you're never making contributions or distributions, then it never matters what the order of those returns are.

But because of the way that, really like I said before, for young people most of their wealth is actually in the form of future contributions, which is really, for most people, bond-like. It's, you know, those who are going to get kind of steady contributions into the plan, so in order to offset that, you can take higher risk in your asset allocation, in your asset portfolio, younger on, but as you go and deplete your human capital, now most of your wealth becomes financial wealth. That's why you need to start de-risk as you get closer to retirement because now, in order really to mean a similar risk profile across the entire glide path.

MR. DONOHUE: Could I ask a question? One of the things I've been thinking about as I've listened to many of the panelists talk today, it seems that there's very heavy equity allocations very early on, for the younger, but it really doesn't mean anything because there's very little money there, and so there's taking a lot of risk with a little bit of money because it doesn't matter.

What is the difference in the outcome or expected
outcome if there isn't as heavy an equity allocation in the very beginning as you run your studies? Is it really helpful or is it harmful to have that heavy equity allocation and the volatility that comes with it?

MS. LUCAS: Yeah, we -- we actually looked at this just recently, and we looked at the average Target Date Fund glide path, and we found that it is actually vastly superior to a glide path that rolls down to zero percent, so one that is much less heavily equity-oriented than the average.

And what we found that is, if you look at historical simulations going back all the way to 1926, and we've heard a little bit about this earlier today as well, that, in fact, this glide path that is more heavily equity allocated is superior in every simulation including one ending in 2008 over a 30- or 40-year period.

So what we find is that it's superior to having a 100 percent cash because what's happening is people are able to accumulate over that period of time, you know, a very substantial amount of money relative to their worth in cash.

MR. DONOHUE: I think my question was in the very beginning, it's the slope of it; in other words, 100 percent equity versus 70, does it matter that much in the early age, in the early part of a fund?

MR. COHEN: Yes. I mean, I think it's a risk worth
taking, and certainly, you know, you're going to have negative periods, but that's the time that you, you know, you're always going to have to take risk in order to have appreciation, and that's the time to take risk.

We actually -- we've done work where we say let's look at a negative two standard deviation event. Now, granted, we just went through a negative six standard deviation event, but a negative two standard deviation event, again, because you're at 90 percent equities for a 30-year-old, it's going to be a large account balance decrease for that year, but the impact on ending wealth is something like two or 3 percent of their portfolio whereas a negative two standard deviation event for someone at retirement, even though they're only going to have 30 some percent in equities, is actually going to even have a much greater impact. So that's the time to take risk. It is the worthwhile time to do it, we think.

MR. CASTILLE: We have similar findings, that small changes in the initial equity allocation leads to small outcomes and changes in outcome, and obviously on the order of what you're talking about, 30 percent, that would be pretty substantial.

MR. DONOHUE: And take the other end of somebody reaches retirement. There's a benefit, at least as I always
understood it, that one gets from periodically investing in
that, I mean, if you have volatile assets you're buying more
when they're cheap and less when they're rich.

On the distribution side, you have the opposite
effect. If you want to take out a periodic payment from an
investment, you wind up selling more when it's low and
selling less when it's high. And if you have a constant
allocation in volatile assets, how does that work out? Is
that a wise choice?

MR. RICHARD MICHAUD: I was going to say -- I was
going to say for that type of question, and I've heard that
question before earlier, retirement distribution investing is
different. I do not see this as any kind of glide path at
all solution. It really needs to be thought through. And
again, the retirement distribution idea is not as an open
question in financial theory currently. It is not well
understood.

One of the interesting reasons about that is that
really qualified, highly qualified academics have not paid
attention to this study, this kind of issue. So -- and to
some extent, we, as practitioners, are a little bit on our
own in terms of how to solve this problem. But in my own --
well, our work and in my own view of understanding of the
problem, it's a very different answer, and it has to be done
differently. It is not a glide path.

Did you have something to say about either the other question, Bob?

MR. ROBERT MICHAUD: I had sort of two comments. One is clearly we didn't experience a six-sigma event. What happened last year is a lot more likely than that. I mean, when people talk about six-sigma events, they're assuming some sort of modeling. Clearly the model they were assuming was wrong.

As far as sort of your last two questions go, I'm not sure I can answer the question, but I can answer the intuition behind the questions, which is, I think, does it matter, you know, when someone is only investing $10 a month whether they're 100 percent equities or leaving it under a mattress? And the answer for them is, probably not so much.

But fund managers aren't rewarded on how much of your money did they -- how much money did they make for you. They're more managed and more measured on what was the total performance of the fund. And so by sticking people without much money into highly aggressive portfolios, then over the lifetime of the fund you have this really great, you know, hopefully, a really great return at the beginning that's going to keep you above water relative to your peers for a long time. I'm just thinking sort of from a, you know, game
theory perspective of how someone might rationalize this.

MS. LUCAS: And I would just add that I would agree, that's a very important consideration and one that I mentioned in my testimony is you need to look at the longevity risk and you need to look at what is the probability that these assets will last through retirement until age 70, 80, 90, and then evaluate the risk of running out of money. And that's a huge consideration taking into account a certain level of draw down.

MR. DOYLE: Any other questions?

MR. SCHEIDT: I have one follow-up question. Has anyone done any research to see whether high equity allocations for younger workers is actually a deterrent to investing in the Target Date Fund? I can imagine that some workers that don't have a lot of money for retirement don't want to risk losing a big portion of that small amount that they have, that they would rather invest more conservatively at the outset until they have a bigger pot to take a risk with.

MS. LUCAS: I would agree with you that this is the behavior we see, and it's actually pretty counterproductive. When people are in their 20s and they're investing on their own, they are as conservative as people in their 60s according to the data I've seen from participant databases.
And that's an issue because, you know, as Josh said, they should be taking more risks. That's when they're in the ultimate position to be taking that level of risk is when they're younger.

But the good news is that when we look at the behavior last year of participants across ages and Target Date Funds, even during the worst of the downturn, money was going into these Target Date Funds on a net basis, not coming out. People who are defaulted into Target Date Funds have shown very little sensitivity to the volatility of these funds.

MR. CASTILLE: I think the gentleman from EBRI has a lot of that data that you were asking about as how different age groups, when you segment them, how they responded in the course of this crisis.

And the other thing to consider is they'll make that -- they'll get back even more quickly because their contributions as a percentage of their account balance is greater. So if they continue to contribute, they'll get back faster.

MR. COHEN: And I just saw a study, I think it was Vanguard, so correct me if I'm wrong and I misquote it, but, again, those who got defaulted in tended to really stay with the options, but the interesting -- the biggest change in
behavior was for someone who signed up for the first time in 2008 for example. They look at all the options, and they tend to go more conservative just because they look at the rate of returns. And you would look back if someone had -- you know, for example, in 2003 when the market recovered, the people who signed up that day or that year tend to have the higher returns.

So it shows (a) that defaulting people is very powerful because inertia is powerful, and (b) getting them the right decision at the beginning of time of enrollment is really important too because that's really going to impact their future contributions.

MR. RICHARD MICHAUD: And while both sides of this issue -- I mean, there are younger people taking a lot of risk fairly recklessly in many cases, if they do not have much money and they're not likely to have a whole lot of money in their lifetime.

On the other hand, wealthy people really want to keep up with their lifestyle and just putting all of their money in a fixed rate type of annuity is not going to maintain their lifestyle over time. So there are just all kinds of situations for which these things really don't work.

And the interesting thing is even empirically, I mean unless everybody thinks that everybody's crazy, and I
don't feel that way at all, the way it works is that on
average young people don't put much money in equities, and
then it sort of grows over time as you increase your level of
wealth and you're into your career, and then finally it does
start to decline. But interestingly, that's also, if you
condition it with respect to education level, it's pretty
much flat.

So it's the whole issue here of misinformation is
worse than no information, in my view at least, and giving
people explicit, transparent kinds of investments as opposed
to the multiplicity of these TDFs, it's going to happen if
they're not regulated and continue to be regulated as QDIAs.

MR. SCHEIDT: Okay, I just have one more question.
This is for Lori Lucas. You talked about through-funds and
to-funds. What is the key information that a plan sponsor
needs to know in deciding between the two types of funds?

MS. LUCAS: I think the key that they need to
understand is, what is the expected behavior of participants
in retirement? What do they see happening and do they
anticipate that people will be using these funds through
retirement or are they, in fact, going to at age 55 go into
an annuity, which, by the way, only 3 percent of participants
do that, roll their money out into maybe a similar Target
Date Fund?
You know, there's ways of observing it. It's also somewhat difficult to observe if they do roll their money out, you're not sure what they're rolling it into. But most plan sponsors, when we talked to them, have a pretty good idea of their own policy, whether they're trying to encourage people to stay in the plan or not, and they have a good idea of, you know, what they've seen in terms of participant behavior.

And I think those are very -- at least those two are very valuable, a very valuable beginning to understand, you know, to what degree are we comfortable with equities through retirement.

MR. DOYLE: Thank you. And I'd like to thank the panel as with all the panels today. This has been fascinating. We'll take a short ten-minute break.

(A brief recess was taken.)

MR. DOYLE: And we shall now begin the last session of the day, not last panel. We will have no more breaks between now and the end.

(Laughter.)

MR. DOYLE: So if you missed the break, I don't know what to tell you. And we shall now begin.

MR. LAUDER: First of all, thank you to the DOL and the SEC for setting up this forum. It's been very valuable,
I think, for all of us today. I've been both baffled and
dazzled all at the same time with some of the things we've
heard, but thank you very much for setting this up.

My name is Jim Lauder. I'm the CEO of Global Index
Advisors. We are a registered investment advisor. While our
main business is managing target date assets for our partners
at Wells Fargo Bank and State Street Global Advisors, our
firm was also a pioneer in the space of target date index
development. We designed the first, and until very, very
recently the only target date indexes in the industry back

I was invited here today to speak on three topics.
First, understanding Target Date Funds, selecting Target
Date Funds and then monitoring Target Date Funds. And I
intend to honor that structure with a little bit of added
brutal honesty based on some of the things, the questions
that we've heard today that I think maybe the answers didn't
come out fully. And I hope you appreciate my brutal honesty
more than my wife does.

First of all, understanding Target Date Funds,
we've heard several great definitions of Target Date Funds,
and there's really nothing more complicated to it. So I'm
not going to waste your time with giving you my version of
reducing risk over time, yada, yada, yada. But I thought I
would make a couple of points about what Target Date Funds are not. I think we've heard it a few times with other panelists, but I think it's important to reiterate that, number one, what they aren't. They are not a substitute for disciplined, practical savings habits by participants. You cannot solve the savings problem that we've had over the last several years with any type of investment product. It's just not going to happen.

More than ever before the responsibility for target -- or for retirement success rests on the shoulders of participants. We've seen over the last several years what many people have referred to as the demise of the DB plan. And now, even in this environment, we're seeing contributions or matching contributions from the defined contribution providers starting to be removed because of the burden that that places on these companies.

So I think more than ever the responsibility for our success as savers and retirement savers rests on the individuals. And for us as providers, product providers and fiduciaries, we need to be aware of that and be sensitive to those needs.

They are not a replacement for education and communication. You know, I think that was one of the reasons why people said that we came up with this idea of Target Date
Funds was because it was so difficult to educate and communicate the participants and get them to do the right things. It's not a substitute. What it does do is it changes the nature of that education and communication. Instead of trying to make expert investors out of all the participants in the plan, now we're free to focus on, look, Participant Sue, Joe, what do you need to retire, to have to be at a state of retirement readiness? Is it 70 percent of your income or what you project to be your income at retirement? Is it ten times or 12 times your ending salary?

Those are the kinds of things that we need to focus our education and our communications on now. And we have a very fiducially -- what I believe is still a fiducially sound product foundation for doing that kind of education. They do not, and I think we've heard this, they do not in most cases offer investors contractual guarantees as to the return of their principal or to any kind of lifetime income. And I think it's very sad from some of the information that we heard earlier from the behavioral group that was up here that that has been the belief of some of these people that have bought into Target Date Funds. So what are some of the other characteristics of Target Date Funds and the nature of their use that need to be
discussed? I think the sources of performance or portfolio behavior is very important, addressing various types of retirement risks, the dangers of designing financial products for the average participant. I think those are three areas that with worth discussing today.

First and foremost, glide path. We have all talked about glide paths today. That does basically result in 90 percent of the behavior of any portfolio. That's not just an average number, but that's based on years and years of study that your average mixed asset class portfolio, about 90 to 92 percent of the returns of the behavior is based on the asset allocation, not security selection.

There's no magic optimizer out there or exciting new asset class that can offset the impact of a provider's glide path, period. For a bit of that brutal honesty that I mentioned earlier, let me just tell you that in the face of financial catastrophe or severe market meltdowns like we've had, asset classes have a nasty little habit of becoming very, very correlated with one another. And that's what we've seen over the last two years.

So nobody can talk about their exposure to commodities or to REITs or anything else. Saving them from a poorly designed or a mismatched view of risk for a set of participants, it's not just there.
Second, providers are making some significant
decisions and setting expectations on how well they manage --
or how they manage two primary types of investment risk,
participant longevity risk and volatility risk. The nature
of those risks are quite different. Longevity risk is fairly
predictable. It discriminates mostly against people that
don't save enough for retirement.

Volatility risk on the other hand, discriminates --
it does not discriminate actually. It's very random, and
it's based on the sequencing of returns and the time value
fluctuations that those differences in returns actually cause
to participants that are close to retirement.

To skip ahead, selecting Target Date Funds, I think
some of the most important things here in this area would be
to help plan sponsors get their minds straight on what it
takes to select an appropriate Target Date Fund or a QDIA.
And it's not so much about understanding Target Date Funds as
it is about understanding themselves, their roles as a
fiduciary and their participant base.

I think, first of all, they have to understand
their participant base may not be the same as them as far as
their risk tolerance. You usually have people that are on an
investment committee. You've got CFOs. They might be a lot
more sensitive to risk than you are sitting in that chair as
a fiduciary.

Secondly, I think it's very important to know that participants care about the magnitude of potential outcomes much more than they do about the probability of those outcomes. And I believe we've had several questions on that today.

Let me give you an example. New Orleans, 2005. On August the 28th, there was only a 29 percent chance that that hurricane was going to hit New Orleans. Those levees were designed to withstand an average median Category 3 hurricane. Those people had a pretty good chance of surviving and not being displaced. Things should have been okay. In actuality 99.9976 percent of the U.S. population was unaffected by Hurricane Katrina.

So what we are talking about as far as this modeling and Monte Carlo simulations and our view of, gosh, we're trying to get, you know, nine out of ten people okay? The problem with that is where do you think the impact, the magnitude of that event before that .0003 percent of the population was? Pretty darn significant. Is that okay?

And I think we have to ask ourselves as fiduciaries and as providers what level of collateral damage, what I call "participant collateral damage," is okay when you're running these models? They really don't care. Numbers don't have
souls. They're tools. And you have to remember that. Those people in the tales are real people.

And I think there was another question earlier about how does the meltdown like we've had recently affect those people in the tales, and it does affect all of them. So it's not just affecting 5 percent of your population over time. Every single participant that is age 55 up has been devastated or a great many of them have been devastated by Target Date Funds here recently. So I think it's very important to keep that in mind.

Let me make just one real quick point, if I can, about some of the things we think would be important for potential fixes for this space. First, let me say that our target 2010, our Wells Fargo 2010 fund had a return of about minus 10 percent last year. Our Today fund had a minus 3 percent return compared to the 25 percent return for the industry for 2010s and I think 20 percent for today's.

So we're basically target date heroes right now. We're rock stars. But you know -- and if you guys regulated this industry and brought people more in line with the way we run things, it would be a boon for me personally. It would be a huge financial boon for me for you to regulate and say, gosh, you were right and everybody else was wrong. Do I believe that's the answer? No.
Contrary to what we heard on the last panel that we're all greedy and that's all we care about, I don't think that's the right answer. I think that the answer might lie in better communications to plan sponsors as they're choosing QDIAs. I've submitted in my written testimony to the panel some ideas on a target date fact sheet that could be used by plan sponsors that they would have to sign off on that have things like what are the maximum draw downs? If this is the glide path, what are the -- what's the worst case scenario for these participants during the retirement red zone or, you know, five years before retirement, five years after?

It could be down 20 percent. It could be down 30 percent. You need to initial it as a fiduciary for that plan and say I understand that this is the worse case scenario, and I agree that this is an acceptable level of risk for my participant base, those kinds of things.

I think we also, lastly, we have to make sure that we eliminate the opportunities for the gamesmanship and the returns and jacking up the equity exposures to play peer group games to be a top quartile performer next quarter. And I think you can also do that through communication by making product providers, in advance of any kind of change to their glide path, communicate with that same type documentation that says, look, I'm changing my glide path, I'm increasing
the equity and this is the new worse case scenario. And you
as a fiduciary that has selected me already as a QDIA need to
initial on this dotted line that you still understand that,
and you still feel that this is predictable and has a --

MR. DOYLE: Thank you.

MR. LAUDER: Thank you very much.

MR. MORTON: My name is Chip Morton and I'm with
the Corporate Advisors Group, and I'm an independent
retirement planning consultant. We offer advisory services
through Raymond James, and as they like me to say, these are
my views and not necessarily the views of the firm as a
whole.

As you three gentlemen that heard me at the advice
hearing know, that I speak from the heart and not from the
wallet. I'm here on my own dime, and I speak for the
participants. I was named one of the top five retirement
plan advisors this year by Plan Sponsor Institute, so I'm
good at what I do. But I do think that the participants
often, in this academic environment in these hearings, get
forgotten, and I'd like to sort of be the color guy and add a
little bit of down homeyness, if you will, to the testimony
to let you know a few things.

A few things that I did pick up in just listening
throughout the day, first, Pension Protection Act. I
applauded it back in October. Great job. We acknowledge that advice is necessary, that participant direction just doesn't work. They haven't done a good job for 30 years.

And the pilot doesn't come in the back of the plane and ask you to fly the plane, so nor should we ask participants to make, you know, decisions. It doesn't matter if they're a neurosurgeon or a janitor. Everybody has a different lot in life and a different area of expertise. So I don't want to give up.

We have to realize that Target Date Funds -- we're all here to try to find a solution to rendering advice in a mass basis without being able to economically sit down one-on-one. So to that degree, target dates are a solution.

Several years ago there was a big move to eliminate proprietary funds by recordkeepers by saying, oh, well, this is XYZ Fund Company's 401(k), and we need to have 60 percent of the funds be ours and then you can go outside. Well, obviously, that helped their profitability, and we spoke against that several years ago.

It's interesting to me that here we sit, and many of the funds that are here testifying they're a single family of funds, so it's almost like we've gone kind of back-doored the policies that were made five or six years ago to prohibit a proprietary environment because one of the premises of a
Target Date Fund is it assumes that you will put all of your money into that Target Date Fund, you know, not half of it in the target date and then mix it up over here. It needs to be able to be -- if it has a glide slope methodology, it needs to be able to hit that glide slope, and it can't be done if you don't have all the money. So it seems that there's a great commercial reason why a lot of people are very interested in pushing Target Date Funds. But speaking for the participants, I really don't care how profitable they are to some of the large mutual fund complexes.

So I wanted to throw that in as well as we talked a lot about QDIAs. Do you know how much money really goes into a QDIA in the true sense of a QDIA where somebody doesn't fill out a form and there's a deferral made on the participant's behalf? Hardly any money goes in under that scenario. It's very rare that a human resources department doesn't track down somebody and get them to fill out the form.

So what we're really talking about here is not QDIA in the sense that if they don't make a positive election, then money's thrown in for them. And actually with a lot of matches being stopped lately, it even limits, so let's not get hung up on QDIA.

What I think we need to talk about is opting into
professionally managed solutions whether it be Target Date Funds or what I'm going to talk about in just a moment. The bottom line is we do need to do something to opt them in at the plan level. But a QDIA by default -- it's not really a default. It's a positive consulted -- consultive approach that I would go to a plan sponsor, and have with many of mine, and said let's default them into a better solution.

And also, I don't know that we would really be here if we didn't have the perfect storm two years after PPA started using QDIAs. I hate to use a catastrophic analogy, but it comes to mind, the flight from Brazil to France was struck by lightening. I don't think the pilot did anything wrong. I don't think the glide slope that the plane was on was incorrect. Probably no malfunction of any systems.

But just like our economy and the mortgages and the greed and everything that caused this, I think that we have to look at the situation that we might be over-thinking this whole thing. I think if we had Target Date Funds for the last 30 years, nobody would be complaining, and the average account balance instead of being $40,000 and the average participant is 42 years old, not nearly enough to strike any kind of retirement, even 20 years out, would probably be three and four times that had there been some disciplined approach rather than participant direction.
So in my last 30 seconds, I would offer that as I spoke of before, I believe managed accounts are a far superior solution to Target Date Funds. An independent consultant like myself does a very good job, we all do, of looking at all the funds available at any given vendor and screening with our screens those funds and picking a great platform. This fund is large value, mid value, large growth, et cetera, and building out a platform.

We called that 404(c) for years, but it didn't do any good because as good of a platform as we built, guess what? Nobody really knew how to do it. The average participant has what? Three funds. Why? Because they either put everything in the guaranteed because they don't get it, or they chase returns and pick the two best returns in the statement that's already 6, 8, 12 weeks old, and they chase the return, and that's not a good investment policy either.

So we know there's a problem there. So -- I'm already over, but managing accounts is the solution where we still build the platform, but we pick an independent glide slope, whether it be a Wilshire or an Ibbotson or a Morningstar or Avatar, and I can't name them all, sorry. But you pick a glide slope and we consult based on the demographics the same way we pick funds for the platform, and
you marry the two together.

But again, mutual fund complexes don't really push for that because they don't make as much money because why? They don't get all the pieces of the pie. But they have healthy competition. That's capitalism. They want to get as many pieces of the pie as possible so they compete through our screening, and if they make three or four slots, great. But again, it's not as commercial for them as getting all the pieces in a Target Date Fund.

And the other limitation is a lot of recordkeeping systems can't handle a third-party glide slope producer, if you will, or manager, to plug into the system, so therefore a lot of record keepers want to push for Target Date Funds because they're easier for the recordkeeping system, and you don't have to spend millions of dollars with Sungard or internally to build the platform out.

But again, I don't really care how expensive it is if the right solution for the participant is a managed accounts. And it is possible, then I think that that's a solution that we really need a hearing on that as well, you know. But it doesn't get as much play, again, because it's not got so much commercial value.

So I would leave you saying that managed accounts, I think, is a solution that needs to be mentioned today
because it really creates the effect of Target Date Funds.
And sure, we have to figure out what's the glide slope and
what not.

But I will say this, with an average payroll
bridge -- now, listen. It reads birthday, okay. Same as the
Target Date Fund. It reads gender. There are studies that
say males and females have different risk tolerances. State
of residence, salary, deferral as it relates as a percentage
to the salary.

All that gives it a little bit more information for
the computer to build a model. Far better than just the
birth date, just like the gentleman earlier said. But again,
it's not something we had a hearing on, but it's a far better
solution. But again, it doesn't have the big commercial
backing, but it should, because we're all here in America at
the Department of Labor doing these testimonies, and we don't
want to forget capitalism, because, frankly, a Target Date
Fund is a bit socialist, if you look at it. And particularly
as it pertains to all the funds being proprietary and rammed
down somebody's throat. So with that there's my color, and I
will close.

MR. DOYLE: Thank you.

MR. DUNNE: Hard to follow that.

MR. LAUDER: Actually there's no time for you two
because he and I took all of it between the two of us.

MR. DUNNE: What you forget is that I'm Irish.

MR. MORTON: You do have a cool accent.

MR. DUNNE: We can talk till the cows come home.

Thank you very much. My name is Richard Dunne. I'm the founder of QDIA.com. It's a service to help 401(k) plan sponsors increase retirement security, reduce fiduciary risk and eliminate excessive costs using ERISA Qualified Default Investment Alternatives. I previously submitted fairly extensive written material for the panel's consideration.

And in the time available today, and very much in the light of the earlier testimony we've heard, I've actually decided to focus on just one of the areas covered in that testimony. So on the off chance that anyone wants to hear my views on improving fiduciary transparency, improving performance and risk monitoring, particularly as it relates to glide path disclosure and index construction, I'd ask you to please refer to the written comments while I focus on improving decision-making processes.

Retirement plan fiduciaries are routinely expected to make complicated decisions involving competing and sometimes conflicting demands, multiple options, limited resources and uncertain outcomes. The way in which decisions are made critically affects the quality of the results
achieved.

Now, ERISA wisely reflects this by focusing on the quality of decision-making processes when determining whether a fiduciary has acted prudently. However, based on my experience over particularly the last ten years, I find that the decision-making procedures used by many fiduciaries have not evolved to keep pace with the increasing complexity of the choices they are required to make.

So conceptually Target Date Funds are designed and management is quite simple. We've heard that today. But every testament we've heard today talks about the complexity of these things. They raise complicated issues, and, therefore, they result in a very wide variety of different product offerings all to achieve the same basic simple, supposedly simple objective. So no single product can simultaneously be best on every single selection or decision criteria, and therefore inevitably plan sponsors have to make a series of tradeoffs.

Most decision-making methods used by plan sponsors and their advisors today focus on a single measurement at a time, and they do a very poor job of balancing multiple selection criteria. Very often decision-makers use some combination of simplified screening or scoring methods to reduce the number of decision variables to a level where they
can intuitively identify their preferred choices. Such methods suffer from severe deficiencies. Screening fails to reflect the relative importance of different criteria and fails to take into account the degree of performance difference on each criterion. The value of many scoring systems is severely limited because of the way in which the scores are assigned. Using a flawed methodology might actually be more dangerous than helpful because it creates a superficial impression of being systematic when in reality it fails to meet minimum requirements for validity and effectiveness.

Unfortunately most fiduciaries are so busy dealing with day-to-day operational issues, they rarely have time to consider the effectiveness of their decision-making processes. Furthermore, while the pension industry is overflowing with investment and legal experts, it severely lacks expertise in decision process management. Perhaps, therefore, it's not surprising that on the rare occasions that pension governors do review decision-making procedures, the focus is usually on meeting legal and regulatory requirements rather than improving the quality of the decisions they are making.

Many plan sponsors, consultants and fund managers continue using traditional methods despite their known
weaknesses because they think the only alternative is to embrace unfamiliar solutions that might prove even more dangerous, so even when the logic recommends itself, the logic of a new approach, the potential unknowns places it too far outside their comfort zones.

Fortunately, there is a viable solution to this impasse. The challenges of deciding complex issues involving multiple quantitative and qualitative decision-making criteria are not unique to the investment industry. A discipline called Multiple Criteria Decision-Making and their methods have been the subject academic research and used successfully for decades in a myriad of challenging solutions.

So by looking beyond our own industry's borders, we can actually draw on a wealth of global standards, proven methods and practical experience to help us tailor an effective solution to all these complicated issues we've been debating today and hearing about. But most of the leading decision-making management methods are unknown to pension fiduciaries and fund managers even though each has at least a 30-year global pedigree.

Furthermore, techniques such as Analytical Hierarchy Process, Adoptive Conjoint Analysis, Rasch Measurement Scales, maximum difference, they may sound very
daunting, particularly to a newcomer. I mentioned them
earlier to someone with a Ph.D., and he said, that goes over
my head. But actually these methods are conceptually
extremely easy to understand, and they've each been
implemented in software programs that have been designed to
be intuitively easy to use by non-experts.

Moreover, they're not theories. They are practical
operational tools that have been extensively proven in
real-world use including the commitment of multiple billions
of dollars in capital investment programs both in the private
and the public sector.

It takes a rare combination of integrity, insight
and initiative for a plan sponsor to independently seek out
and implement better solutions. Fortunately, such leaders do
exist, which is how the system slowly evolves towards better
outcomes. I believe, however, that solving fundamental
problems of poor decision-making is sufficiently important
and urgent that it needs the kind of catalytic effect that
can best be achieved through direct support from the
regulatory agencies.

I therefore recommend that the Department and maybe
the SEC also initiate a program specifically to help plan
fiduciaries improve the quality of their decision-making
processes. This program might start by encouraging voluntary
disclosure by plan sponsors of a written investment policy
statement for Target Date Funds and other Qualified Default
Investment Alternatives combined with guidance from the
agencies in the form of model decision-making processes that
could be adopted and incorporated into such a statement.

The goal would be to eventually have all plan
assets managed using decision-making processes that meet
three essential standards that I set out in my written
testimony and to which I would refer you since I'm also
running over time.

The benefits of successfully implementing such a
program would be, A, to provide an impetus for the entire
retirement industry to upgrade its decision-making methods
and tools, to reduce individual fiduciary risk and to help
both individual decision-makers and the industry as a whole
more easily repeat past success and identify opportunities
for further improvement.

Regulators play a crucial role, and you're already
providing strong leadership in relation to Target Date Funds.
But plan sponsors, their advisors and fund managers, all of
us in this industry, we all have to make the effort necessary
to deliver investment products that will help, not hinder,
plan participants in achieving the retirement income security
they deserve.
Thank you.

MR. DOYLE: Thank you.

MR. HARVEY: Thanks again, and thank you all for permitting this testimony. I'd like to say that my approach is perhaps a little bit different from what you're heard today, which is really more of a diagnostic one, looking at the problem of Target Date Funds as defined by losses, by complaints, and so forth and so on. My presentation is supported by the written materials I've distributed, so I'm not going to go through all of those details.

In the way of background, where we're coming from is a perspective of expertise in both the ERISA side of the world as well as the investment company side of the world and being a plan sponsor of what could be one of the first automatic enrollment plans in the -- universe. So we have some hands-on experience in that regard.

We found basically two root causes for the problems associated with Target Date Funds today. The first of the root causes I would describe as non-compliance with federal regulations. Non-compliance may sound strong, but I think you'll get the point later on. Ineffective enforcement has permitted several aspects of both ERISA and investment company regulation to be ignored.

The second root cause is faulty investment
practices that are, in fact, permitted. These faulty
investment practices come under the category within the QDIA
and the PPA language of generally accepted investment
theories. We have sort of an open window in terms of what
is, in fact, a generally accepted investment theory.
Surprisingly, in our work we have found virtually no problems
with asset allocations in Target Date Funds. And I will
touch on that momentarily.

Let's talk about the non-compliance issues first.
One of the things that we have been doing over the last
several years is literally evaluating whether or not Target
Date Funds and QDIAs in general comply with the associated
regulations across the board, whether they be securities
regulations or labor type regulations.

I have four examples to give you here. One is
discrepancies that exist between the presentations made in
fund prospectuses and the QDIA regulations. To quote out of
the QDIA regulations, "they must be designed to provide
varying degrees of long-term appreciation and capital
preservation." Sounds simple, but you try to find a fund
prospectus, interpret a fund prospectus to determine whether
or not that standard is met. To say it's difficult is an
understatement. It literally doesn't exist. So the process
of selection of a proper QDIA, if, in fact, you're using the
regulations and the prospectus, is extremely difficult.

The second point has to do with self-dealing among Target Date Funds. I think a couple panels earlier talked a bit about the idea of self-dealing in that universe.

The third one is something that I have not heard discussed today, and that is the participant notices. The idea that you're going to default a participant into an investment implies that that participant is not familiar with investing and is not going to be trained and provided with the education. However, as an industry what we've done is we've not met that standard that says it's calculated to be understood by that particular defaulter. So we literally write communication for a sophisticated investor and give that to these folks who are -- who don't meet that standard.

The fourth point is fund prospectuses permit providers to charge exit fees within 90 days of QDIA regulations even though that is, in fact, explicitly prohibited in the regulations. I would have to say the number of prospectuses that permit that is daunting.

The conclusion we draw from that is that we need some level of oversight, and the notion that plan sponsor oversight will take care of it, I think, is both impractical and ineffective. Maybe in the case of large plans, the 10 percent of plans that have the kind of capability, it works,
but in 90 percent of plans where you've got a human resource
manager, you know, trying to get their daily work done,
they're not going to be addressing issues of whether or not,
you know, the prospectus of a QDIA is in line with the
regulations.

The second point, and I'll try to run through this
quickly, has to do with faulty investment practices. While
asset allocation is very widely used in the industry among
Target Date Funds, we generally found them to be consistent
with the stated investment theory and policy. So it's not
that firms are going off the reservation, they're working
within the structure that exists there.

The question I have for you there is, how much
difference would it make in a portfolio that had General
Motors stock if instead they had General Motors bonds to
provide the higher fixed income component?

The answer is in 2008 it probably would not have
made very much difference. The point here is the asset
allocation schemes, the asset allocation procedures that we
have seen seem to be consistent, and they're doing that which
they are supposed to do.

So what are the flaws? What are the problems? We
have identified and we're going to mention -- I'm going to
mention five of them here. One is the dependence on asset
classes being uncorrelated.

The whole theory that asset classes are uncorrelated is an issue, and we do not have an answer for the case where they do become correlated as they did back in 2008. There is no answer. We have not heard anybody address the issue of what do you do when the stocks and the bonds both go down? How is that working?

The second is there's no provision to limit losses. And this is really coming not from investment perspective as much as it is from a consumer perspective or I should have said participant perspective. The participant is really interested in finding out how their QDIA can limit their losses, and we have not heard that discussion. I think it's an important thing that we ought to consider within the context of QDIAs.

The third has to do with leverage and margins. We have all kinds of constraints with investment companies as far as how much margin risk they can take, and so forth. But to the best of my knowledge, there is absolutely no restriction on how much leverage is permitted within the assets in the portfolio. So we prevent excessive leverage in the portfolio itself, visibly, but the underlying assets can have as much leverage as needed. I think there is some need to address that.
The fourth, I think we've heard discussed in the earlier panel, and that's the notion of using a single criterion, age, to solve a multi-dimensional problem, retirement investment. The idea that by simply looking at age, you can project exactly what somebody's investment should be for the rest of their life I think is to say that it's false is an understatement.

Finally, we have labels that imply things that are not really true. When you have a 2030 retirement fund, most people would interpret that, as we've heard discussed before, as a fund that you would use if you're going to retire in 2030. The fact of the matter is no fund fits all people's circumstance.

So the fact that we're promoting these kinds of theories, these kinds of things that go beyond just the name, but it's also included in the material -- the fact that you give the impression that this is the solution for everybody. If you're going to retire in 2030, by golly, the only question you have is which 2030 fund you want to use, which is patently false. I think there are more important decisions.

MR. DOYLE: I think I'm actually going to have to cut you off so we can have a little time for questions and stay reasonably on schedule. So with that I will turn to my
fellow panelists.

MR. SCHEIDT: I just wanted to highlight one aspect of Mr. Lauder's written testimony. I think, and maybe you can elaborate a bit, you talked about an effective communication strategy would be to develop a universal target date index, and then have some graphic illustration about how the particular Target Date Fund's glide path differs from the benchmark, and then a narrative description of how the manager of the Target Date Fund can -- has discretion to go beyond the glide path percentages. And if you would just elaborate on that, that we be helpful.

MR. LAUDER: Absolutely. And I think your last point first, it's one thing to put a glide path in a prospectus. It's an entirely different thing to live by that glide path when you see your competing fund managers change theirs in order to jockey for position. So that's a good point, and I think people need to address that.

Your first thing as far as our ideas for a standardized what I call kind of a fiduciary target date fact sheet would indeed have a universal benchmark not to judge the absolute performance of the universe of Target Date Funds. There will never be a single index benchmark that fits the bill because of the difference in philosophies, but just to help people understand the difference between some
standards, they have some benchmark.

You know, I think the other key to that, that fiduciary fact sheet for Target Date Funds, to help plan sponsors understand what they are buying into, is to put these things in terms that are really from the participant's perspective, so as opposed to just saying, oh, this index could return a minus 10 percent in this kind of environment, change it to where you talk about, you know, potential dollar amounts. You know, put it in terms of a participant to say, yeah, this could be a maximum draw down, because that's really what participants experience. They don't care about rolling 12 months. They care about maximum draw downs.

To put it in terms of, gosh, how many years' worth of contributions did they just lose? And I think when you do that exercise on the numbers that we've tossed out all day about the average return for a 2010 fund, it's even more frightening if you take that 25 percent, convert that to a number of years worth of contributions that those people just lost. It's about 25 years worth of contributions that just went away, gone.

So I think that's the key to do an effective communications piece, a standardized communication piece, is to put it in terms that people can understand, and say, gosh, this is the way my participants experience. We're not
talking about statistics here, we're talking about real
people that have been on the work line or the call center for
30 years. If we subject them to this kind of risk, they
could lose 30 years worth of contributions. It could take
them 20 years to recover. Whatever it is, recovery time.

So I think it's very important, again, that the
benchmark would not be for the purposes of judging fund
providers' performance, absolute performance, but just to
give people a benchmark and what that would mean for -- at
the participant level.

MR. MORTON: I'd like to add something again. The
problem with any of the disclosures, we've already
acknowledged they don't know how to pick their own funds. Do
you really think they're going to understand the correlation
between glide slopes and benchmarks? That's the problem.
Look at my coal miner clients. Many of them don't read and
write.

The problem is they need professional management.
You don't go to your defined benefit manager and ask them to
explain all their methodology. You know, I was at a defined
contribution summit last week, and somebody, a frustrated
plan sponsor spoke up, and said, what's the answer? And he
said, well, the only real answer is to go back to the defined
benefit plans. And everybody laughed.
But the point being is you're not going to get them to understand all this methodology. We've already acknowledged with the PPA that they're got going to know how to mix up their own funds. For God's sake, they're not going to understand all the smart people stuff we've heard today.

MR. SCHEIDT: My point in raising this was there are different ways to communicate information to people. There may be plan fiduciaries that will understand a graphic presentation. There are others who will understand narrative descriptions. There are financial planners who will be able to use this information if it is made available to them. And I thought your ideas were worthwhile.

MR. LAUDER: Thank you. And again, just to make sure that everybody understands, that was intended to be a fact sheet for fiduciaries, not for the individuals. I agree wholeheartedly that if I went and I tried to explain my methodology, below mean variance, Markowitz-based optimization, they wouldn't get it. I mean, this is purely for helping people select a prudent QDIA for their participants.

MR. DUNNE: If I may add a comment on that, please. I agree with what you're saying that the communication level have to match the ability of the recipient to understand it. But in relation to the indexes, I think we have to be very
careful in what index is used if it's going to be a single
index. And I think two comments.

One is if it becomes -- well, it obviously can't
become a single commercial company's index because that's
just not -- that's not fair in a sense commercially, so it
becomes some kind of a regulated -- a regulatory decision as
to what it should be, that is the danger of creating a super
index, which essentially kills innovation around that because
everybody would just want to conform to it no matter what you
say.

What I haven't heard today is reference to
liability indexes. Essentially, although by the time someone
comes to retirement what they actually do after it, we've
heard, there's great variety in what they're going to do.
But I take your point. Come up with some way of expressing
it that people -- they can relate to it.

And I do think a way to relate to it is to say that
essentially at the end we want to fund a lifetime annuity.
Whether you buy it or not is your own choice beyond that.
But as an absolute basic to live, there should be some flow
of income coming in.

And so there is a price on that. There is a market
price. There are providers. The insurance industry will
provide that and others can calculate it.
So what I would recommend -- I agree with the idea of having an index, but I would ask you please to look at, if you're going to do an official one, a liability-based index. And so what you're really looking at is when you're looking at the performance of the funds as you go forward, it's the return on the fund on your asset side versus the changes in the present cost of buying a given annuity, lifetime annuity stream in the future. And so people can see what I have today is worth this to me if I want it down the road as an annuity. I don't have to buy it. And as the returns change, like you're saying, you'll see this in the reduction in the annuity.

So instead of telling someone even you've lost -- you've have to work for five more years, which may or may not be true depending on the model, you can tell them precisely today, given what you've just lost in 2008, the annuity income stream you can now buy with your pension has gone down from, you know, whatever, a couple of thousand a month to a couple of hundred a month for the rest of your life when you retire. I think that would get people's attention.

MR. GOHLKE: Let me just follow up on something Lou mentioned. Among the reasons for TDF problems you mentioned faulty investment practices?

MR. HARVEY: Yes.
MR. GOHLKE: Is that in the context of the investment manager not following guidelines in either the TDF portfolio construction or the underlying funds if it's a fund or funds?

MR. HARVEY: More of the former than the latter, frankly. Let me just quickly just sort of go over it. One of the principles in Target Date Funds is the lack of correlation among asset classes. Right? Now, that's a generally accepted principle up until 2008 that there is -- their asset classes are uncorrelated and we can take advantage of that.

So that to me is a fault. Is it a fault of the investment manager that he didn't know anything better? No. I think it's perhaps more a realization today that that assumption is in fact a faulty one. You take other things like provisions to limit losses is another area I talked about. We've heard more discussions these days about absolute return funds, which is in response to that. It's a realization that participants are, you know, very concerned that an investment will limit losses. I think that should be part of, if you will, the promise of a QDIA.

You see, if I'm making my own investment choices, I can adapt for those things. I can say I want a portion of my portfolio in a stable-value fund, and I'm going to limit the
losses there. If I'm in a QDIA, that concept, which is a very important human behavioral concept, is lost. So the point is not so much who did something wrong but what is structurally wrong with the theories that we're using.

MR. GOHLKE: Thank you.

MR. DOYLE: Okay. Thank you very much. We appreciate your contribution to today's hearing.

MR. DOYLE: If you want to start, go for it.

MS. TUTTLE: Certainly, I'm Anne Tuttle. I'm the General Counsel of Financial Engines. Thank you for the opportunity to testify today.

Financial Engines is an independent investment advisor founded by Bill Sharpe, who was awarded the Nobel Prize in economics in 1990, and Joe Grundfest, a former SEC Commissioner.

We offer investment services to plan participants through leading employers including 112 of the Fortune 500 reaching more than 7.4 million participants. We provide both discretionary investment management through our managed accounts program and non-discretionary investment advice through our online advice services, in each case as a plan fiduciary and fiduciary to the plan participants.

We also provide access to investment advisor representatives via the phone and retirement evaluations.
which provide an assessment for the participant of their forecasted retirement income taking into consideration their 401(k) balance, any defined benefit plan balance and other assets. This helps participants to understand where they stand. We offer this advice on an individualized basis. Our portfolios are unique. More than 73 percent of our portfolios are unique.

To talk about not just disclosure but engaging the participant, let me tell you the story of Sally. Sally is an actual plan participant who called our investment advisor representatives to receive a retirement checkup, which is a 20 minute process. She's 58, a long-haul dispatcher and recently divorced.

She told us she wanted 30 thousand dollars in retirement income, and that was about 70 percent of her pre-retirement income so that matched kind of general rules of thumb.

But her Social Security and 401(k) gave her a protected retirement forecast at a median of only $20,000. Well, it turns out Sally was a good saver and she had other assets. And when we took those into consideration, her median forecast was $27,000.

Our representative discussed working longer. Well, she would have none of that, not even one year longer, but
she was willing to change her savings rate. And she increased her savings rate from 10 percent to 17 percent. She also told us that she did have a pension benefit from a former spouse. Taken altogether her median retirement income forecast reached $32,000.

She told us she had a fear of working until she was 85, but now she had better information and she had increased her savings. She didn't hold Target Date Funds, but we believe that a best practice plan design can include both Target Date Funds and managed accounts. In fact we see this in practice. 73 percent of our plan sponsors use both Target Date Funds and managed accounts.

Why is this? Well, we have heard a lot today about different participants having different preferences. We analyzed 429,000 participant portfolios before management began, and we saw that the range of risk preferences is demonstrated by their actual equity holdings were dramatically different for younger employees and employees who were closer to retirement.

At age 25 the range of equity holdings was between 80 percent and 92 percent, a spread of 12 percentage points. At age 60, the range was 25 percent in equity to 71 percent in equity, now a range of 46 percentage points.

We've also done a case study with a large Fortune
500 company, which rolled out managed accounts and Target 
Date Funds at the same time. Three years later we saw that 
the average age of the participants using Target Date Funds 
was 35 versus the average age of the participants using 
managed accounts was 45. This is consistent with the recent 
EBRI study as well, finding greater usage of Target Date 
Funds among younger participants.

Participants have different approaches to their 
401(k). These differences mean that the disclosure is needed 
both for sponsors and participants to get the right fit. The 
sponsors need better visibility into the underlying holdings 
and the glide path. The industry can do a better job of 
disclosure for participants around expenses, risks and, 
again, their fit.

And we can go beyond disclosure to participant 
engagement. We need to engage participants to actually show 
them in the context of their own circumstances, whether they 
are holding Target Date Funds or other assets, where they 
stand today, the probabilities of reaching a retirement goal 
and how to improve their situation.

When we've done retirement checkups as a pilot by 
phone, we have a hundred participants where we have before 
and after data. And what we've seen is less than 25 percent 
had an even likelihood of meeting their retirement income
goal at the beginning of the process, but close to 60 percent
to bring their forecasted income up toward their
goal by increasing savings or delaying their retirement,
making a change to risk preference or making other updates to
their retirement plan.

We should allow participants to make decisions
about the relative amounts of equity in their defined
contribution account in the context of these savings
preferences, desired retirement ages and when they will need
the income from their 401(k).

Thank you.

MR. MOORE: Thank you for the opportunity to add
information to this discussion. My name is Ed Moore, and I'm
president of Edelman Financial Services based in Fairfax,
Virginia.

Our firm provides financial advice to thousands of
individuals and families, and we currently manage more than
three and a half billion in assets. Unlike other firms that
primarily service high net worth investors, our firm caters
to the middle class.

Our hands-on experience advising clients allows me
to give you an in-the-trenches perspective on how Target Date
Funds are actually being used by ordinary consumers.

Our experience has taught us that Target Date Funds
pose specific dangers to investors, and I would like to
describe these problems and offer two simple solutions that
can help protect investors.

    Obviously, American workers are responsible for
making their own investment decisions regarding retirement
plans at work. Yet, in a 2006 survey by John Hancock, 69
percent of workers admitted they lack investment knowledge.
67 percent said they fear -- their fear of market volatility
prevented them from managing their 401(k) properly.

    So Target Date Funds would seem to solve this
problem, the theory that a Target Date Fund would allocate a
person's assets based on a projected retirement date.
Someone planning to retire in 20 years would choose a 2030
fund. The person requiring sooner might choose a 2020 or
2015 or 2010 fund.

    But in concept, this doesn't work. In practice
this doesn't work. No two Target Date Funds are alike. They
don't have the same asset allocation, investment holdings,
turnover rate or glide path. The result is that investors
are gambling that the Target Date Fund offered by their plan
is right for them.

    Morningstar lists 153 Target Date Funds that have a
date of 2010; total assets in January, 22 billion. Yet,
there's little consistency in the funds' holdings. According
to the review we conducted, 14 of the 150 funds hold more than 60 percent of their assets in stocks, 15 percent hold less than 30 percent, and one had only 19 percent in stocks. The ordinary investor in a retirement plan would not know the difference between these or the implications of these allocation changes.

The 2008 returns for these funds were just as broad. According to Morningstar, 6 of the 150 2010 funds lost more than 40 percent of their value last year while four lost only 10 percent. Again, a huge disparity.

A final problem is that many workers don't know that Target Date Funds are comprised of other funds. As a result, most of those who use Target Date Funds use them incorrectly. If you use a Target Date Fund, you're supposed to put all your assets into that single fund allowing the fund to provide you with the asset allocation and glide path that's appropriate.

But a 2009 white paper by Janis Capital Group found that most of the people who owned Target Date Funds in their 401(k) plan own six funds including both Target Date Funds and other mutual funds. Nearly two-thirds incorrectly believe that Target Date Funds need to be combined with other funds to create a diversified portfolio.

According to the Thrift Savings Board, which
oversees a retirement plan used by employees of the federal government, 55 percent of plan participants who use the plan's L funds, the lifecycle funds, also have money in other funds offered by the plan. 16 percent, in fact, have money in every fund in the Thrift Savings Plan.

It's even worse in private sector plans. According to Vanguard, which offers its own version of lifecycle funds, 63 percent of plan participants use L funds in addition to other funds.

So the problem occurs for two reasons. First, each fund is permitted to create its own allocation, investment holdings and glide path without any constraint, and they're permitted to change their asset allocation at will. Secondly, workers are being given access to these investments without the understanding they need in order to make informed investment decisions.

Edelman Financial Services offers two simple, easily implemented solutions to help solve these problems. First, prohibit the use of the funds -- of dates in the funds' name. Allowing funds to refer themselves solely by year is highly misleading, especially since there are no industry standards regarding portfolio construction or management.

Second, require these funds to disclose their asset
allocation and glide paths and require them to adhere to them. By showing investors how funds are constructed and how they'll evolve over time, investors will be able to better determine if the funds are suitable.

This methodology is commonly used by Section 529 plans very effectively, and there's no reason the approach can't be used here. These two simple improvements will dramatically help investors make better informed and effective decisions.

We're pleased the SEC and Department of Labor is taking on the task of investigating Target Date Funds. Thank you for the opportunity to appear today.

MR. DOYLE: Thank you.

MR. McGATHEY: Good afternoon. Thank you for the opportunity to be here today. My name is Randal McGathey. I'm an independent professional in the financial services industry, having spent 26 years with a firm that provides products and services to institutional investors. The last two years with that firm were spent doing operational product development work related to Target Date Funds.

I believe the Target Date Funds are valuable retirement investment products. That notwithstanding, the current practice of using the target date as the sole product descriptor is insufficient and potentially misleading. The
target date, per se, does not convey important characteristics of each product's particular nature. These products need to be more specifically labeled in order for one to be differentiable from others with the same target date but significantly different risk return profiles, i.e., the glide paths. Without the ready disclosure of this information, there remains a significant risk of misunderstanding the product's essential nature, resulting in mistaken product selection and erroneous expectations by participants and undesired outcomes even though those outcomes may well have been expected based on the product's design.

Therefore, I suggest a framework is needed by which to organize Target Date Funds, and then more transparently and consistently describe and disclose their differentiating characteristics. This organizational and descriptive framework should also enable more meaningful comparative analysis of risk and performance.

The framework should first be concerned with the time horizon of Target Date Funds, specifically the point in time on the glide path relative to the target date that the funds reach its lowest risk profile. There is significant variability in this factor among funds with the same target date, as we've heard a lot about today.
While the variability of this factor from one fund to the next is typically viewed as a single continuum ranging from before the target date to well after, I believe that it's instructive and valuable to sort funds into two types based on this factor, those that reach their respective lowest risk point before the target date versus those that do so after.

Those that reach their minimum risk level by or before the target date, I refer here as accumulation type. These allow or even expect that the investor will make a separate decision at the retirement date as to how to redeploy the assets in a separate retirement income and investment program.

This type defers to the premise that the time just prior to and following the target date is the period during which an investment loss has the greatest negative impact. The counterpoint to this reduced risk is the commensurate reduced investment return.

The funds that reach their minimum risk level after the target date, I refer to as lifecycle type, these expect that the investor will remain in the same Target Date Fund throughout the entire retirement savings lifecycle, incorporating both the asset accumulation and the retirement income components into one product. Most Target Date Funds
are, in fact, this type.

The objective for pushing the minimum risk point later into the cycle in these funds is to increase investment return supported by the rationale that the funds have a longer investment horizon, as we have heard eloquently today. The counterpoint is the increase risk of loss later in the retirement savings lifecycle including the time adjacent to the retirement date.

Either type may be a good selection if done so knowingly and properly in the context of other retirement savings. However, either could deliver undesired outcomes if expectations were for the other type. Therefore, it is important to know which is which.

Target Date Funds do not typically describe and obviously disclose this characteristic, the point at which they reach the minimum risk level, in a way that easily supports its consideration in comparison to other funds. The negative consequence to that fact is the products that are dissimilar in this regard may be compared to each other, in which case some products will appear to be more aggressive as measured by equity allocation than others and to an extent that may raise concern.

I suggest, however, that the investment horizon should be considered before two funds are compared to each
other. As described some Target Date Funds will, by their essential design, have greater equity allocation later in the cycle, but I suggest that is not greater aggression but, rather, a different product type, such as suggested by accumulation versus full lifecycle distinction.

Therefore, products should first be sorted by type or at least graded by the position of their minimum risk level relative to the target date before undertaking comparative analysis. Only after organizing the products this way can one come to meaningful conclusions about relative aggressiveness.

Again, if the distinction is not made and one is compared to another that is dissimilar, the exaggerated perception of their difference in aggression might result in unfavorable and perhaps even very unfavorable conclusions and understandable but greater than do broad-based remediation for Target Date Funds in general.

All this is said in support of Target Date Funds. The use and debate about frameworks can advance our better understanding and disclosure and better use of Target Date Funds. It is my view that a well-disclosed and properly selected Target Date Fund can deliver more and more consistent positive outcomes than leaving the formulation and execution of the investment strategies to those individuals
themselves.

Thank you.

MR. KRASNOW: Good afternoon, gentlemen. Excuse me. My name is David Krasnow. I am the founder and president of a company called Pension Advisors in Cleveland, Ohio. I'm honored to be here today.

While many people testifying in both on this panel and previous panels are executives and have been involved in the creation of Target Date Funds, I believe I bring a unique perspective, in that I spend a high amount of my time actually in front of plan participants as well as plan sponsors. The common denominator that I have not heard a lot of today is what is going on at the plan participant level.

While the specific problem of the day is Target Date Funds and the perfect storm that we have fallen in as a result of 2008, the real problem goes to the education or their lack of education on the plan participant level. I also read the John Hancock study, which in essence said that 69 percent of all plan participants are, in essence, financially illiterate.

From my firsthand experience, I find that this number is probably 15 to 20 percent higher than that. And this is a problem that's not going to go away, and it needs to be addressed.
The hearings that are taking place today on Target Date Funds probably should have taken place five years ago before it was let out of the barn, but now we're trying to kind of fix the problems that have taken place.

The creation of Target Date Funds was the latest and greatest financial tool to help the financially literate be able to participate effectively in retirement plans. The concept is a great concept. I'm not going to go into the detail that I've heard before here today, but it's a great concept. In essence, the idea is it ages with you.

But before it was properly researched, it was put out to the masses. For that, there are many in the industry and beyond who share in the responsibility and the blame.

The problem in a nutshell is that unlike most funds there are no categories differentiating Target Date Funds. What we have is a free for all or what I like to refer as the wild, wild, west.

J.P. Morgan did a report breaking down Target Date Funds, and they broke them into different categorizations. They broke it down and could be looked at in one of two ways or one of four ways.

What I've heard here today and what I like to look at them is two distinct and different ways. The first is going to be based on retirement. So let's call that target
for retirement, which when a person gets into it the idea is they're getting in thinking when is my retirement year. And the idea is this will age with them. It will have more in bonds and less in equity as they get to retirement.

The second, which, frankly, I'm not sure, having dealt with participants firsthand, has a real place inside of retirement funds, is the lifetime where this is the methodology where fund companies are looking out for the benefit of participants saying you need retirement benefits well beyond retirement, and this is something that has not been disclosed adequately to plan participants.

Very often the mutual fund explanation to everything in regard to investments is it's in the prospectus. Asking somebody who's financially illiterate to read a prospectus is not realistic.

An example that I did is while there are 153 different 2010 Target Date Funds, there is 32 in the A share, which is the lowest expense ratio of the institutional. I went through the 32 myself yesterday. And what I was looking at is I was looking at from highs to lows.

The best performing fund in 2008 was minus 3.5 percent. The worst performing fund was in excess of minus 41 percent. The best performing fund had 90 percent bonds, which, in my opinion, is proper for somebody who's going to
be retiring in the year 2010.

The worst performing fund had 31 percent bonds or in excess of 69 percent of the assets in equity. To me, this is complete system failure for the financially illiterate participant inside of retirement plans.

What has made this situation exponentially worse is that as part of the Pension Protection Act of 2006, the Department of Labor, again, as we've discussed, has approved three different types of funds with target dates being one of those funds. This coupled with automatic enrollment has been like pouring fuel on a fire.

The solution I recommend is this. There needs to be clear categorization of the Target Date Funds. Call them target date retirement. Have another category called target date lifetime. They need to be clearly categorized and rated as such.

There needs to be mandatory suitability questions provided by vendors to plan sponsors. People need to know what they're buying and ultimately providing to their plan participants.

There needs to be real information to plan participants. As somebody who does both group and individual meetings, I have had people walk in and look me in the face when they have lost 30 to 40 percent, and these are people
that understand. Many people in Target Date Funds just got run over by a truck and don't know why.

In conclusion, participants have been misled. I agree with Senator Kohl's comments that inadequate oversight could jeopardize American's retirement security. And I will take that one step further and say inadequate oversight has jeopardized many Americans' retirement security.

Many Americans who know that they're far from being financial experts bought into the target date concept, trusting that what they had bought had been investigated and was all it appeared to be. Many of these people, people I see every single day, may never be able to retire.

This morning, my wife and I, we were having a conversation about this panel today, and she asked me if a person could convert their lifetime target funds to retirement target funds. I said that -- could it convert their -- that's correct, their lifetime to target. While the answer's a simple yes, they would be locking in a loss that they would never recover from. Their only hope at this point is to remain in the unsuitable aggressive investments and to hope that this volatile market can recover in time for them.

People have worked too hard for too long for their nest eggs, but because of carelessness, they're not going to be able to retire. They expect better, deserve better, and
as everybody involved with these, we need to do better.
Thank you.

MR. DOYLE: Thank you.

Questions? Okay. Just to kind of follow-up on your last point about the failure, and I guess more specifically where you see the failure arising. Is this a communication issue that when one looks at the description of these funds it's not clearly articulated? Is it the investment strategy? The asset allocation? Glide path?

What is it that one would do?

Because I guess at a superficial level, and as we've thought about it in the kind of QDIA context, as a default with respect to participants who have potentially opted not to actively participate themselves and make investment decisions on their own behalf, but having a mechanism, not necessarily a particular product, but a mechanism that undertakes on their behalf a gradual decrease in the kind of the mix from equity to more conservative investment made sense.

What did we do wrong here? What -- or what can we do better?

MR. KRASNOW: In my opinion, I think what's gone wrong is that there was a great concept put out there of Target Date Funds. The concept is great. For the
uneducated, you know that when you're 25 years old, you
should be aggressive, and when you're 55 years old, you
should be conservative. It's remote control investing that's
going to age with you.

But what was not put on to -- was any sort of
requirements or regulations on the investment companies
themselves. Every different company, and I've sat here for
the last couple to three hours and heard everyone's own
commercial and own methodology, there needs to be uniform
methodology or restrictions put on the Target Date Funds. If
you categorize a Target Date Fund that is based on your --
the year you're going to retire, then the bond and equity
component would hold in place.

But part of the J.P. Morgan study illustrates that
there's four different boxes where, frankly, every company
has been allowed to put their own stamp on that. As a result
of that, it has been a free for all, and the company that
finished worst in performance in 2008 was near the top in
They were cheating to get higher percentage rankings, which
gets more equity, which gets more -- again, and I mean no
disrespect. It's an absolute free for all.

And so it needs to be regulated. It needs to have
simply like an investment policy statement on the retirement
years that will track it. We can't be in a situation, if we
have another 2008, with the amount of equity that people are
going to retire in 2010 are losing between 35 and 40 percent
of their retirement overnight.

MR. DOYLE: But do you accept the proposition that,
in defining the glide path, so to speak, it would be
reasonable to take into account if their defined benefit plan
or other benefit so that there would be variations in how the
glide paths are determined from plan to plan?

MR. KRASNOW: And I do believe there should be
variations. There is no one right answer for everything
across the board, but it needs to be disclosed.

MR. DOYLE: Well, that's what I'm getting at. So
is this an issue where the plan sponsor -- let's just start
with the plan sponsor. They're kind of the first line of
defense, so to speak, for the participant. They're actually
choosing the fund or funds to make available. Are they not
understanding how these funds operate?

MR. MOORE: In some cases there are Target Date
Funds and there are 30 or 50 or 100 other funds as well, so
it's -- they're offering a smorgasbord of choices for
investment for participants.

The issue is matching up the risk tolerance with
the investment. And as long as the participant understands
that the -- that there is a risk or recognizes what the risk
is for a particular investment and feels comfortable with
that, and it goes down 30 percent or 40 percent, then that's
okay.

But those that got blindsided because they didn't
recognize -- they thought they were buying something
different than what they were actually buying, that's the
issue.

At our firm as registered investment advisors, we
have an investment program and we have 70 different
portfolios from super conservative to super aggressive. We
actually have something that we call a guide to portfolio
selection where someone goes in and they answer a series of
questions and they come to a particular portfolio. By doing
that, then there's a match.

So if they're aggressive, they're conservative,
they want to invest for the long-haul or if they want to pull
all their money out in two or three years, their investments
will be dramatically -- tailored dramatically differently.
And I think that's what's lacking, is the understanding by
the participants of what they own.

MR. KRASNOW: And my simple answer is no, I do not
think the plan sponsors often understand. I think they rely
heavily on the advisor, the vendor, and then top down also in
regulating bodies such as the SEC and Department of Labor to patrol them.

One of the things that we provide for all of our clients on a quarterly basis is we do a review of all funds, and we break them into specific categories. We're going to benchmark every large cap value fund versus every other large cap value fund. In comparing the two 2010 Target Date Funds, it's like comparing an elephant versus a zebra because they're both animals. They're different animals, and they need to be differentiated, but that's what we're doing.

Everything has been lumped into one thing. And so the disclosure is not there, and I think it starts with differentiating between classes, and then it needs to be disclosure from a top down level, from the government to the different vendors, from the vendors to the plan sponsors, plan sponsors to plan participants.

MR. DOYLE: Okay. Thank you very much.

MR. DONOHUE: When you're looking at Target Date Funds and trying to make some selection or some means of selecting, typically for funds one can look at past performance at least in terms of how a fund has behaved, get a sense of what was maybe the worst period that they had. But here you have funds that, by their nature, are changing their allocations over time, which makes that, I would think,
information less useful unless you have attribution in terms of where returns were coming from so that you could get a sense of whether -- if it was really -- most of their performance was, their positive performance was coming from equities and they weren't doing a really good job with bonds. But the noise from the equity outweighs what was going on in the bonds, but if it's moving heavily into bonds, one would then anticipate, at least with respect to possible outcomes, that this fund will not perform quite as well as it has in the past relative.

How would you address that? Or how do you address it?

MR. KRASNOW: How do I address it. The first thing is that, and I'm going to say that people who step into retirement plans as advisors but don't do it on a daily basis, they do it as maybe you're a stockbroker who's doing it for a friend, they're often guilty of chasing performance, which is a dangerous game. You're chasing the return after it's been done.

What we do is we dig into the statistical information and the analytics of the fund. And so we saw the storm arising several years ago with the lifetime funds, and we have steered our clients clear of the lifetime target date theory. We have stuck to the retirement. While we very much
counsel our participants that retirement doesn't end the day you retire and get your gold watch and walk out the door, you need to make sure you've got income sustaining for the rest of your life.

We don't feel like it's the proper due diligence of our plan sponsors to make the decision for you today at age 55 that's on a glide path going until 90. We want it to be until your retirement, age 65. So we dig into the statistics and the analytics, and we disclose, and our clients are aware of the two different types of Target Date Funds.

And frankly, I read the article about this and was so passionate about it that I responded and, again, very pleased to be here today to kind of state my opinions because I think everyone has got their heads and hearts in the right place, but it's not being delivered with the way that it could or should be. And unfortunately you don't realize that until we have a year like 2008 to kind of slap us all in the face a little bit.

Did I answer your question, sir?

MR. DONOHUE: (Nodding.)

MR. KRASNOW: Okay. If not, just -- I'll come up for air at some point, so.

MR. PIACENTINI: Let me ask a different question.

So you're saying that you favor the approach where you have a
very low concentration of equity at the retirement date.

Other witnesses in earlier panels have said that with that
strategy you actually end up with a higher possibility of
running out of money or if you live a long time or if you
live in a high inflation environment, you're trying to have a
steady income stream you're taking out, you actually need the
stock. Without it you'll have a higher possibility of
running out of money.

Do you think that analysis is just wrong, the
conclusion is wrong or, if not, then why do you still hold --

MR. KRASNOW: I'm not going to say that that is
wrong. I'm going to tell you my opinion from meeting with
individuals who work in manufacturing facilities in
Cleveland, Ohio, is that these people are looking at the
finish line, which is retirement. And we want to educate
them on what's going to take place post retirement and how
they need to, whether it's annuities or Social Security or
other form of income or pension plans, they need to make sure
they've got that income in place for the next 25 to 30 years.

In my opinion to have people who have got more than
five years in more than probably 30 percent equity, in my
opinion, and that's all it is, in my opinion, that's
irresponsible. I understand that you have to have different
investments to keep the income sustained, but with a
five-year duration or shorter, you're taking on a lot of risk and not giving yourself the opportune time to recover.

MR. MOORE: And I would just respond by saying that as long as an individual knows that I'm either going towards the finish line at age 62 or 65 or I'm going to be invested for a lifetime. The problem with doing it at age 65 is when that person retires and they're 90 percent in bonds, then they're going to have to then pack their bags and go to some other form of investment, be it their bank or with an investment advisor or some other vehicle because that's probably not an appropriate allocation for them for the next 25 or 30 years of their life.

MS. TUTTLE: We have actually as well published research looking at ways to handle longevity risk, and in some cases that is a use of annuities. By setting aside a relatively small amount of the portfolio at retirement, an annuity can be purchased, which will begin to pay out at age 85. Now you're able to maximize the use of that portfolio around a finite time frame, which is actually able to raise the amount of income that the participant could experience.

MR. McGATHEY: I think, likewise, it's important to differentiate between the full lifecycle versus the accumulation fund, because by making that distinction and offering people the choice, you begin to help them understand
the two different approaches to Target Date Funds. So by differentiating whether that's -- there needs
to be something in the name so that not all funds that carry
the same date are perceived as being the same by offering
them the choice. One being different from the other, they'll
begin to understand the two approaches to Target Date Funds.
And I think it's not necessary necessarily for us to decide
or certainly for me to decide which is better. Participants
will decide which they want.

The important thing is for them to understand the
difference. And one of the ways that you help people to
understand the difference, I believe, is by naming those
differences and making that distinction sort of public and
up-front, easy for them to find as opposed to being somewhere
else by comparing glide paths on prospectuses or fund sheets,
make it something that's obvious, discernable, easily
differentiable one from the other.

MR. DOYLE: One more question.

MR. SCHEIDT: Is there any information that is not
contained in the fund prospectuses that would be helpful to
you as investment advisors in advising your clients about
Target Date Funds or is there a better way of presenting that
information that is already in there to make your jobs
easier?
MR. KRASNOW: The first part of your question, is there additional information, there are many -- and there's a lot of people that don't know this. There's a lot of prospectuses that also have a supplemental prospectus, the second piece of that.

Frankly, I think what you ought to do is we ought to provide almost like a summary plan description of the prospectus which breaks down the highlights and details of it in something that your average 22-year-old could read and understand.

And so we've had some super intelligent people up here today, but would the average person understand what they were saying or the methodology of what they're meaning? The answer is probably not. And so to the best of my knowledge it's all covered in the combination of prospectus and supplement prospectus, but by throwing a dictionary at them isn't solving it.

And somebody said it before, sometimes too much information isn't the right answer. Sometimes less is more. Almost a summary plan description of the prospectus in a couple of pages telling them the expenses, the objectives, the asset allocation. At the end of the day, participants are financially illiterate, and, again, 70 percent plus, and a lot of them are still not going to do it. But I think we
have an even better chance to reach them by doing something more simplified.

MR. SCHEIDT: Help is on the way. The SEC just adopted rules requiring funds to provide that sort of information in short form.

MR. KRASNOW: So that wasn't my idea? Okay.

(Laughter.)

MR. SCHEIDT: It's a good idea.

MR. MOORE: Just one other quick point on the prospectus, when it says that equity exposure could be 20 to 90 percent, that's what a -- that's what you'll read in a prospectus, and that's just not definitive enough for an investment advisor to select that fund, so we look more at actual, what they're actually doing as opposed to what they state in the prospectus.

MR. DOYLE: Okay. Thank you gentlemen.

Our utmost appreciation for the patience of our last panel. It's been a long but incredibly informative day at this point. We appreciate your hanging in there.

MR. DREW: Well, good afternoon, and thank you very much for the opportunity to testify before this committee on the subject of Target Date Funds. My name is Mike Drew. I'm a professor of finance at the Griffith Business School.

I have to disclose this afternoon that I'm also a
member of the Investment Committee of QSuper, the pension fund for public servants in the State of Queensland in Australia, so therefore the views I express today are mine and do not necessarily reflect the views of the QSuper Board of Trustees.

Colleagues, given the detailed discussion we've had today about the glide path, I'd like to open with an aviation analogy. As is very well known and well-documented, the majority of general aviation accidents occur during take off and landing. The setting of the glide path is, that is the aircraft's line of descent to land, is a deceptively complex problem.

While principles exist, for instance, a conventional aircraft let down to a runway is typically along a glide path of three degrees, the experience of the pilot, advanced instrumentation and ground-based equipment must work in concert to mitigate under- or overshooting. This analogy lies at the heart of my testimony today.

Target Date Funds employ pre-determined age-base rules that switch the asset allocation through time, and typically it's a unidirectional approach to the problem. However, airplanes, like Target Date Funds, do not operate in a vacuum. Issues like the GFC and the changing correlations of portfolio components within these funds require careful
management. Accident prevention programs train pilots to deal with the effect of wind shears on the glide path to insure a safe landing, so we could, for the sake of argument this afternoon, think of the GFC as an extreme form of wind shear.

Why, then, in the current design of Target Date Funds, do we not incorporate downside volatility events like the GFC as a feedback mechanism to evaluate the glide path of lifecycle funds?

With my colleague, Dr. Anup Basu from QUT, we've undertaken research that considers the various wealth outcomes under conventional lifecycle asset allocation rules. These findings are available in the current edition of the Journal of Portfolio Management and have been submitted for the record.

Our evidence suggests that the general increase in portfolio size as one approaches retirement is significant from an asset allocation perspective. It is our conjecture that the key issue for the design of Target Date Funds is to decide when you expose the largest amount of money to growth asset classes such as equities.

To operationalize these ideas, we examined the case of a hypothetical retirement plan participant with an investment horizon of four decades. We consider hypothetical
strategies, which we term contrarian strategies, which invest none or much less in volatile -- in less volatile assets like bonds and cash when participants are younger and then switch to stocks as they get older; that is, we test the mirror or reverse direction of conventional TDFs. We then look at the final wealth outcomes and evaluate them against traditional or conventional lifecycle products.

Using stochastic simulation techniques, we find that the contrarian strategies defy conventional wisdom. Switching to risky stocks from conservative assets over time produce far superior wealth outcomes in all but the most extreme cases; that is, the 5 percent worst outcome or beyond.

Importantly for the design of these default products, the outcomes are not symmetrical. For the worst outcomes the difference between the conventional and the contrarian is only about 8 percent. We're talking tens of thousands of dollars at retirement, relatively immaterial. However safe the 90th percentile, the difference is around 55 percent and is around a million U.S. dollars in terms of the contrarian outperforming the conventional.

This demonstrates that the size of the portfolio at different stages of the lifecycle exerts substantial influence on the investment outcomes and therefore should be
carefully considered when making asset allocation decisions.
It is very important to stress that we are not advocating that contrarian approaches to lifecycle funds are the most appropriate way forward. What our research has confirmed is that from a risk/reward perspective, by investing conservatively during such a crucial phase, lifecycle strategies recommended by many advisors may sacrifice significant growth opportunities and can be counterproductive to the participant's wealth objective.

More importantly, this does not seem to be compensated adequately in terms of the risk of potentially adverse outcomes. In short, conventional Target Date Funds seem to provide very limited downside protection while materially capping the upside potential. Is there a solution?

In our current working paper with Dr. Alistair Burn from the Edinburgh Business School, we explore what we call the next generation of Target Date Funds that take a dynamic approach to the asset allocation problem. Dynamic TDFs have at their core a performance feedback loop that keeps risk on the table when investors are below the target balance and provides de-risking of the fund when investors are ahead of their savings goal.

The research findings are encouraging in that the
dynamic lifecycle funds considered in the paper have favorable risk/reward characteristics against conventional Target Date Funds. They seem to fall in a superior manner even against static asset allocation balance funds. And the thing that's most encouraging about the research is that up to certain accumulation targets, they dominate a 100 percent stock portfolio.

In summary, the idea of lifecycle or Target Date Funds where risk is reduced on the basis of age is a very, very elegant concept indeed. However, as our aeronautical colleagues have taught us, the glide path is a deceptively complex problem, and it is much more than a simple, predetermined rule.

I would like to formally acknowledge and thank the Vice Chancellor of Griffith University, Professor Ian I. Conner, the Pro Vice Chancellor of Business, Professor Michael Powell and our Department Chair, Professor Christine Smith, for supporting my travel to attend the hearing today. Thank you again for the opportunity to testify, and I sincerely look forward to your questions.

MR. DOYLE: Thank you.

MR. TOBE: Thank you for letting me appear here today. My name is Chris Tobe. I am a senior consultant for B Cap, an institutional pension consulting firm in
Louisville, Kentucky, and also a trustee for a large public pension plan. I've been a state regulator and was a major, I guess, critic of this, of Target Date Funds in the 2007 letters as a member of the stable-value industry. So I was kind of there from the beginning and have always thought that the target date industry has kind of been flawed because, again, we, you know, what's happened in reality is an oligopoly has come out to dominate market share, and, of course, it's very high fees for a handful of firms.

And however, I think there are specific actions that DOL and SEC can take to make diversified portfolios, including Target Date Funds, work better for investors. And I'll get to that.

So the target date industry is really, when we take a look at it from a big picture, is an oligopoly of four or five providers dominating the market. And once a plan chooses from one of the oligopolies, then they lose pretty much control of the selection of the underlying managers for their risk return and underlying fees, and these providers have, in my opinion, no effective independent oversight as a few mutual fund trustees may oversee 150 or more plans for that same large firm making their oversight, in my opinion, ineffective.
Now, DOL's QDIA mandate has, in my opinion, kind of forced defaulted investors, some of the most vulnerable people out there, from low risk/low fee, kind of what we call stable-value products, into higher risk, higher fee and, in this particular case, negative return target date products, at least for the time being.

So you know, again, all government employees, including those with the SEC and DOL, participate in the Thrift Savings Plan. The Thrift Savings Plan, to 2002, outperformed, an example, Fidelity, which is probably pretty average of the higher equity ones, by nearly 15 percent in 2008, or 1500 basis points. Well, you know, reasonable -- well, equity allocations had a major part of that. Another difference was that the TSP was allowed and was able to invest in a stable-value-like fund called the G fund that, again, helped its return.

Wharton Professor David Babble has stated that target date mutual funds because they exclude stable value are not on the efficient frontier making them inferior to plans like the TSP who can use non-mutual funds. Again, some of this goes back to the 2004 SEC decision to not allow low risk/low fee stable-value mutual funds, which has effectively prevented a lot of the current Target Date Funds from providing some of the best risk return and outcomes for
Ten basic recommendations, and a lot of these are really to do not only with Target Date Funds but the entire industry which I think will be underlying things that can be done by the DOL and SEC. I think the DOL should broaden fee disclosure for all bundle options, but even try to work into the bundle insurance companies -- I know that's getting a little out of jurisdiction -- where there are many of these plans that I call roach motel plans where you can check in but cannot check out without paying a huge penalty. And I'd like to see the DOL broaden themselves to some of these insurance products.

I think that the DOL should redesign its compliance structure around size of plans. This is a -- there's a $4 trillion DC market out there. The top 1,500 plans make up half of the assets. So two trillion is spread over 1,500 plans and the other two trillion is spread over 650,000 plans.

Some kind of tiered regulation where you would have people looking at all the plans under one million, the plans from one to 20 million and 20 million plus, I think, would lead to better oversight. There's such a difference in fee structures between these types of plans that I think that some kind of tiering there would create more effective
Again, I have a theory that I think that, you know, if you do tier it, plans over $20 million should have an independent investment consultant to help select options. Again, a lot of this is part of, you know, DOL and SEC putting resources where the dollars are. If 80 percent of DC assets are in four or five providers, you should maybe consider more oversight for those particular providers.

One question is, I think, the SEC, and I alluded to this before, should limit the number of mutual fund boards independent trustees sit on to five since, I just took an example, Fidelity, but there would be other ones that are like it. Target funds, the trustees in Fidelity target funds oversee 161 funds. And again, I think again SEC should look to get the majority of fund directors to be qualified. The independent ones would also be varied to get more specifications on how qualified they are.

I think that the DOL should reinstate stable value as the fourth QDIA option so that people will have -- the plans will have the ability to use that if they want to instead of target date and other funds.

And of course, I think SEC should lift its ban on stable-value mutual funds and re-look at that and that the DOL should broaden its reach to both nonprofit 403(b) and 457...
plans so they cover all Target Date Funds, not just the ones in 401(k).

So that's all I have today, thank you.

MR. DOYLE: Okay. Thank you.

MR. FOLEY: Well, thank you for the opportunity to testify and thank you for your fortitude in taking in all of this information over the course of the day.

My name is Mark Foley, and I'm here representing Prudential, which is a leading investment manager, recordkeeper and guarantee provider for 401(k)s and other qualified plans.

In defining default investment alternatives for DC plans, the Department of Labor stated that one of its objectives was to insure that, quote, "The regulation is sufficiently flexible to accommodate future innovations and developments in retirement products," unquote. My testimony will focus on exactly the kind of innovations and developments anticipated in the regulation as this first generation, as a prior commenter said, most folks have got their hearts in the right place but this first generation of Target Date Funds is not finishing the job of providing retirement security.

Participants remain vulnerable to critical risks that threaten their ability to retire when planned. That
vulnerability was demonstrated in dramatic fashion during 2008 when even Target Date Funds designed for participants, as mentioned earlier, retiring as soon as 2010 lost as much as 41 percent of their value.

A secure retirement requires more than just a well diversified portfolio. DC participants need to generate retirement income and protect that future income stream. A worker's ability to retire should not be dependent on the current state of the financial markets. Target Date Funds enhanced with income guarantees are part of the solution.

Here participants keep investing in the Target Date Fund as they currently do. However, as the fund approaches its target date and the participants approach retirement, an income guarantee is activated. The specifics may vary, but the guarantee will have five key features.

First, it generates an income base at the time of activation, likely five to ten years before retirement. The income base is used to determine a participant's guaranteed level of retirement income. It initially equals the participant's market value and can never be less than that amount plus additional contributions.

Second, the income base may increase in the years before retirement depending on market performance, but it can not decline.
Third, after retiring the participant will receive a guaranteed level of annual income for life set at a percentage such as 5 percent of the income base at retirement. In this example, a $300,000 income base translates into $15,000 a year in lifetime income.

Fourth, during retirement the income base will never decline as long as withdrawals don't exceed the guaranteed level of annual income. It may even increase depending on market performance.

Finally, both before and after retirement, the participant retains full control of his or her assets and is able to withdraw varying amounts of those assets. Withdrawals before retirement will lower the income base proportionately as will withdrawals after retirement that exceed the guaranteed level of income.

It's important to note that these innovations were anticipated in the regulation defining QDIAs which explicitly allows Target Date Funds with benefit guarantees to qualify as a QDIA.

With respect to fees, once the guarantee is activated, a guarantee fee is charged and not before. It is visible, transparent and fully disclosed to both plan fiduciaries and plan participants. The asset allocation of a Target Date Fund with an income guarantee safely enables
greater equity participation than a typical Target Date Fund in the years both immediately before and after retirement and hence potentially greater opportunity for growth.

This combination also provides critical flexibility for the participant if, for example, unexpected health care costs arise. This flexibility is particularly important because many retirees are likely to find themselves in just that position with major medical expenses at some point.

Finally, any assets remaining at the time of death would be available as a bequest to heirs. This could be a significant amount particularly if the markets had appreciated during retirement or if the participant had a short lifespan in retirement.

Combining Target Date Funds with income guarantees adds additional levels of oversight and protection to participants. Since the guarantees come in the form of insurance contracts, they are subject to the rules and requirements of multiple state departments of insurance. These regulations include specific valuation and reserving requirements to insure that the insurers can meet the obligations of the guarantees.

Combining Target Date Funds with income guarantees offers four unique benefits to retirement plan participants. First, it provides a simple, automatic source of guaranteed
retirement income from the DC plan. Second, it provides a straightforward way for participants to begin thinking about their DC plan as a stream of retirement income rather than just a pile of cash.

Third, it offers flexibility to meet unforeseen emergencies because participants can always take out more or less than their guaranteed amount. Paradoxically, the mere presence of this flexibility may help more people feel comfortable sticking to their plans and preserving their source of retirement income rather than taking a lump sum.

Finally, it provides an incentive for participants to keep their dollars in the qualified plan after retirement. This keeps them under the watchful eyes of plan fiduciaries and lets them enjoy the additional oversight afforded to qualified plans by the Department of Labor and other appropriate regulatory bodies.

At Prudential we know these kinds of solutions are more than theoretical. As of March 31st over 120 plan sponsor and several thousand of their participants have enjoyed the flexibility, control and peace of mind afforded by Prudential products with the kind of guarantees I just discussed.

As the Department and the Commission consider how to enhance the protections for plan participants, we would
ask that you keep in mind the space for innovations and
developments in retirement products including income
guarantees which can be part of the solution.

Thank you, and I look forward to your questions.

MR. DOYLE: Thank you, very much.

MR. BREMEN: I guess you saved the best for last.

Good afternoon and thank you for your time today. My name is
Ross Bremen. I'm a partner at NEPC in The Defined
Contribution Consulting Group. Sitting to my left is Steve
Charlton, who's head of all consulting at NEPC.

By way of background, NEPC is one of the largest
investment consulting firms in the country. Our investment
advice and recommendations are unbiased and without conflict.
We do not manage investment products. We accept our role as
a fiduciary and serve the singular interest of both plan
sponsor and the participants they represent.

Our firm consults to over 275 clients with assets
of nearly 300 billion, including over a hundred defined
contribution plans with total assets in excess of 70 billion
representing accumulated assets of a million participants.
NEPC has over a decade of experience working with Target Date
Funds, and virtually all of our clients have TDFs.
We're here today to represent the defined
contribution plan sponsors we work with and to share with you
the fact that over the last many years these sponsors have
spent a tremendous amount of time selecting and monitoring
their Target Date Funds. The potential outcomes of these
hearings that may result are of great interest to these plan
sponsors. They have concerns that proposed regulations could
undo important decisions that they've made with regard to
their plans.

Turning our attention to the facts at hand, 2008
was a sobering experience for market participants. The year
will be known for many things when historians do their post
mortems. It will likely be remembered predominately as the
year in which fundamentals were cast to the sidelines and
diversification did not work. Virtually every risk-bearing
asset class lost ground, some historically by wide amounts.
Active management recorded one of its worst years ever.

For years, NEPC has recommended reducing equity
exposures and maintaining returns through increased
diversification and use of alternative investments. Our
clients have done that, which is the reason why they have now
collectively outperformed national averages for 20 of the
23 years that we've been in existence.

Last year the median institutional portfolio was
down 24 percent. Data from J.P. Morgan indicates that
workers close to retirement were down 32 percent on average.
These numbers don't surprise us. They're consistent with every other study that we've seen that institutional investors outperform retail investors.

It's our belief that in absence of good, diversifying alternative investments, equities need to be held in high weights in Target Date Funds to meet income replacement needs and to manage longevity risk. However, high equity is NEPC's second best idea.

We tell clients that in a portfolio of 60 percent equities, the equity content accounts for 90 percent of the risk. Encouraging greater adoption of alternative investments within Target Date Funds will reduce risk and provide the returns participants need from these investments. It will make Target Date Funds more defined-benefit like in design.

Regulators should consider clarifying safe harbor rules for custom target date solutions as these programs are at the forefront of introducing alternative assets and have produced, in many cases, better results than the packaged products. Regulators should also consider whether daily valuation is necessary or whether Target Date Funds would benefit from a move away from daily valuation.

One of our main concerns is that regulation will reduce the options available to plan sponsors as opposed to
increasing the options. We worry that additional restrictions could guarantee the outcomes that they're intending to thwart.

Now, let's turn our attention to another point. Target Date Funds are the best of the three qualified default investment alternatives. The market recognized it. Participants bought into it, and the regulators supported it. Any effort to unwind the QDIA regulations would be a significant step backwards in our view.

On the matter of whether investors understand Target Date Fund risk, we must recognize the limits of what we can realistically achieve with education and communication. We cannot make the average investor, the average American, an investment expert. Two equity funds are difficult to tell apart from one another. Why would two Target Date Funds be any different?

Products with similar names, 2010 for example, can have very different equity contents, and that's okay. Today plan sponsors make the decision on which target date series to offer in their programs. And in our experience they make very informed and considered decisions, decisions that are right for their populations. Regulations that make Target Date Funds more uniform are not needed and placing limits around innovation and choice is generally not a good idea.
Along the lines of innovation, participants could benefit from greater use of guaranteed income solutions to offset the real concern of longevity risk. Clarification around the use of insurance products in Target Date Funds and as the QDIA could be a tremendous catalyst for progress. The current regulations do not give sponsors comfort and they are rightfully hesitant to partner with an insurance company for what might be a 60-year commitment without some sort of support or protection.

In conclusion, the unfortunate truth is that the dominant retirement savings system in the U.S. requires the average American to be an investment expert. TDFs represent the best efforts to date to de-mystify retirement investing for the average American and the best way we believe for most defined contribution programs to meet their ultimate goal.

Regulators should encourage the continued development and evolution of TDFs. Any efforts to mandate or legislate the equity content in Target Date Funds would be bad for the industry and bad for Americans, particularly if the regulation leads managers to shift more assets to cash and bonds than to diversifying alternative assets.

On a final note, we would also add that if regulations mandated early participation in higher savings rates, all of this would be a very different conversation.
We'd like to thank you for the opportunity to speak with you today. NEPC recognizes the critical importance of defined contribution plans for American workers and is committed to working on their behalf to increase their retirement security.

MR. DOYLE: Thank you.

MR. DONOHUE: A question for the panel excluding Michael. Michael is the sole voice that has talked about an alternative that seems to have outcomes that one would embrace, but it seems to be different than the construction that has happened for most. And I guess it's a shame, Michael, we put you at the end because it could have been interesting dialogue for some of the others.

But what's your reaction to Michael's research?

MR. DREW: Just say "good."

MR. TOBE: Yeah, good, good.

(Laughter.)

MR. TOBE: This is a difficult -- you know, this is a difficult area. You know, there were so many good ideas today, you know, and there's so many different ways of doing this that you all have such a tough job of just trying to figure out. But you know, I agree with a lot of the things that Ross was saying. I mean, you really cannot -- you know, right, you got to let innovation go in this market. There's
no way to regulate that. And I think that's the real theme
that I would -- that you can't really -- you can't put too
much regulation on innovation.

There's a lot of different ways to skin this cat, and we got kind of -- as a regulator, I mean, you know, there's -- you have very limited things you can do, and I think limiting that would be a mistake.

MR. DREW: I concur with that.

MR. BREMEN: Yeah, I would agree. If a plan sponsor took a look at a product that had an interesting and clear methodology and it seemed to work and they felt that it would be appropriate for their participants, then a plan sponsor should have the ability to include that option for their plan.

MR. TOBE: But I've always been a freedom of choice proponent. Again, when I wrote the 2007 letter, one of the issues that some participants wanted to keep a -- they had a very -- a work force that may have had a DB plan or had -- was only -- the average worker only worked three or four years for them, so a stable-value was still an appropriate QDIA for them. So you know, as flexibility for the plan sponsor has been something, you know, in support of, you know, Target Date Funds and other options need to be held out so that they can do that.
MR. PIACENTINI: I have a question for Mr. Foley. When you were talking about the income guarantee product, you gave an example of a 5 percent withdrawal rate. Was that intended to be a realistic number or is that just illustrative? Is that actually the amount in a product like that that can be taken out every year, and if so, beginning at what age?

MR. FOLEY: What we typically see in the institutional marketplace is 5 percent would be a realistic amount. It will vary depending on the solution, but that's typically starting at age 65, but that would be a viable percentage.

MR. PIACENTINI: Okay. And just -- I don't know if you have an answer for this, but in rough order of magnitude, the example you gave was a $300,000 balance that would then be drawn down at this 5 percent rate -- I guess not actually not drawn down, the balance would be retained.

MR. FOLEY: No, the source of income in this solution is taking withdrawals from the Target Date Fund and the promise is that, if the withdrawals in the investment performance exhaust the Target Date Fund, then the insurer would be making payments. So the critical thing that it avoids is the irrevocable annuitization decision that otherwise accompanies more traditional forms of annuity.
That's where you get the flexibility and the control for the participant.

MR. PIACENTINI: Okay. That's all right. Now I understand. And to make this work, you said there is a fee, a guarantee fee.

MR. FOLEY: That's correct.

MR. PIACENTINI: And the order of magnitude of that relative to the numbers you gave?

MR. FOLEY: In the institutional marketplace, again, it's going to vary. A reasonable proxy would be 1 percent or 100 basis points.

One thing I would note is that when you look at that fee combined with a Target Date Fund's investment management fee, which for round numbers would be anywhere from 50 basis points to a hundred basis points, if you compare that solution on an all end cost of roughly 150 to, say, 175 basis points, to get a comparable solution, because such solutions are available in the retail market, they will typically run, based on the latest NAV Morningstar data, in the order of 3.25 to 3.5 percent in total.

So these solutions really do have the ability to deliver institutional pricing and some of the benefits I mentioned relative to the involvement of the plan fiduciary and their execution of their fiduciary responsibility in
evaluating these.

MR. DONOHUE: Mark, a follow-up question on that. Do you impose, then, restrictions on the portfolio in terms of -- if it starts -- loses half its value that it has to go more into bonds? Are there any requirements?

MR. FOLEY: In the solutions that we offer in the institutional market, we need to evaluate and underwrite the investment guidelines and the glide path before we bring the fund on board. Once we bring the fund on board, as long as it's following those guidelines, we do not require any changes to that. That's part of the risk that we're accepting as an insurer.

MR. BREMEN: If I could just add a few comments relating to just insurance products in general. It's clearly one of these areas where innovation needs to be allowed to continue unless the government and regulators wanted to push it along. Insurance products are very interesting, right? They provide a guarantee, to combat longevity risk, that participants always have an income stream.

But there are challenges with income solution products. For example, if you look at what the regulations say today -- and we're speaking about this. These are the conversations that we have with plan sponsors, is they evaluate these products. If you look at what the regs say
insurance products, annuities are not precluded from being a QDIA. So the word is precluded, so the implication is that annuities may be okay, but are they truly recommended?

If you look at what the final annuity regs say from a selection perspective, one of the requirements is that a sponsor has to be able to evaluate the ability of the insurance provider to meet its obligations, which is, as we said, you certainly could be -- you could have a relationship with the investment for 60 years, and as we've seen in more recent periods, especially most recently, insurance companies can certainly have troubles of their own.

As it relates to the characteristics of the funds specifically, we've already talked about fees in response to a question, but there are also issues around portability. A lot of these products are set up with certain plan recordkeepers and not others, and so if a plan sponsor moved from one recordkeeper to another, they might have to give up the benefit that participants have been paying for for years. Also, if participants were in the income solution and then they move out and then they move back in, they've given up the annuity benefit that they've accumulated.

So we've already also talked about the best in class question. Are these the best in class investments or are they proprietary in nature?
So this is clearly one of those areas where if regulators start to put restrictions around products, you might not see what might be one of the best products for participants come to fruition, unless, of course, the government wanted to take the position that these things are excellent, and by the way we recognize that there are some issues with the insurance industry and we're going to provide a backstop of last resort to make everyone feel comfortable.

MR. PIACENTINI: I have one last question for Professor Drew. So if I understood, you were talking about a possible product design where de-risking, as you called it, would be tied to approaching or reaching your target rather than to age. And I guess my question is when you say "de-risking," is that potentially compatible with moving into what we've just talked about as an income guarantee type of product?

MR. DREW: Yes, thank you very much for the question. If I could respond with sort of a paraphrase from the chairman of Berkshire Hathaway, when it comes to playing bridge, he says, it pays to look at the cards. And that's essentially the analogy I'm giving today is that we see a lot of Target Date Fund design as investment managers fighting essentially with one arm tied behind their back because they're heading toward some nebulous goal of a large amount
of money in accumulated balance. This tends to throw all sorts of risk management strategies out.

So we find a great deal of difficulty in the efficacy of age-based or simply switching on the basis of age we can't find empirical support for it. Even when you look at the worst outcomes -- and as some previous panels have said, like investment classes correlate to plus 1 and they all go down. So whether you're in a conservative, aggressive, 100 percent equities, when you look at the economics of the balance in the worst sort of, you know, 5, 10 percent outcomes, the annuity stream you can purchase is very poor indeed. It doesn't matter what you're in.

But by going through a system where you are taking this risk off the table without looking at the target, you're actually capping the -- distribution which is the big problem with the -- we argue, which is the problem with this sort of fund design. So we even could foresee a day where in the sort of innovations we're presenting in the next generation, the de-risking process, as you said, could be thought of as even banking returns and buying longevity products and things like that with those kind of returns.

But the anchor is always there. The feedback loop -- why would you today post the GFC for a 45-year-old crystallize losses today because the glide path is sort of on
You know, if you think about distribution of returns, you know it's highly skewed and highly peaked. And you've got to get all of these sort of small positive returns to get yourself out of the draw down. And all you're actually doing by following this sort of blind glide path is you're removing the -- distribution to get you out of the hole.

So that's the idea is that, respectfully, what we're doing is we're anchoring one corner of the triangle in the next generation of Target Date Funds. Richard before said it could risk-based. It could be 10 to 12 times your accumulated, you know, pre-retirement salary. It could be an income. That's irrelevant. We can lock the triangle in and have the discipline of the feedback loop continuing through time and absolutely part of annuity purchases, part of longevity risk type products built in can be a standard part of the design in the next generation.

MR. DOYLE: Thank you.

MR. CHARLTON: If I could just add to that. I thought this was a great session, a great talk. And you know, de-risking a portfolio comes in a lot of different ways. We like to talk about it like a defined benefit type portfolio where you can start to incorporate insurance and
guarantee that income stream over time. And you know, to
de-risk a portfolio, I think you could systematically take
pieces out of a portfolio and put it into an insurance-type
product to guarantee that income to do effectively what's
been described.

The problem is the hurdles that are in today's
system wouldn't allow you to do that as Ross was talking
about primarily because it's single insurer, you don't have a
multiple pool of insurance products, you don't have a final
backstop. In addition to that, fees, even at 1 percent, are
relatively high.

I think most in the institutional world would hope
that that number comes down and hope that the government
steps in and tries to force that number lower. You know, 1
percent plus the management fee, I think, is still too high.

So there are many factors at play here, and
probably the most important, that I think some of the other
panelists have mentioned is that most plans, defined
contribution plans, are designed to have a lump sum at the
day people retire or near thereafter so you effectively kill
exactly what we're talking about doing here today.

So you know, think about how that works. You
designed this program at the employer level. People invest
in this program and then you allow them to take all their
money out and put it somewhere else. You're effectively
taking out the best in all plan designs and allowing people
go and do whatever they want with it.

MR. DOYLE: Okay. Thank you very much. Now for
closing remarks.

MR. DONOHUE: On behalf of the Securities and
Exchange Commission, I would like to thank each of the
witnesses for your participation in today's joint hearing.
Your written submissions and most particularly your
participation directly with us today will greatly inform our
deliberations going forward. We have a lot to think about
and a lot to contemplate in this area as we determine what
actions might be appropriate.

I also want to take a moment to thank the staff of
the Department of Labor, most especially Robert Doyle, who
championed the idea of this joint hearing, but also Fred Wong
and Kristen Zarenko. You all made this possible and I thank
you for that.

Additionally I want to thank Jennifer McHugh,
counsel to the Chairman, and Tara Buckley of my staff for
their leadership in helping us to develop this joint hearing.
I thank my colleagues as well, and now I'll turn the
microphone over to Bob Doyle to officially close today's
instructive hearing.
MR. DOYLE: Thank you very much. And I, of course, join you in thanking them. We are very blessed to have wonderful staff that work so hard to make all this work so smoothly.

Just kind of on a technical note to remind everyone, we are going to keep the record open for 30 days to allow those who testified today to supplement the record. We will also accept any submissions on behalf of other interested parties who did not have an opportunity to testify today, and we will make every effort to get those, whatever the submissions are, up on our websites as soon as we possibly can.

And with that, again, we thank everyone for their participation and we will formally close this hearing.

(Applause.)

(Whereupon, at approximately 5:30 p.m., the hearing was concluded.)