TARGET DATE RETIREMENT FUNDS – PRELIMINARY FINDINGS.

Over the past two decades, 401(k) plans have grown to be the most widespread private sector-employer retirement plan in the United States. The Employee Benefit Research Institute estimates that in 2007 over 48 million American workers were active 401(k) participants with plan assets totaling roughly $3 trillion.[1] At the end of 2007, 14.7 million participants, 37 percent of all 401(k) participants, had some or all of their retirement savings invested in "target date" or "lifecycle" retirement funds —relatively new investment vehicles designed to automatically adjust to more conservative investments as one approaches retirement.[2] Because employers can now automatically enroll their workers in these funds, it is estimated that 35 percent of all plan assets will be invested in target date funds by 2015.[3] In response to concerns about their financial risk, the Committee recently initiated an investigation into the composition and marketing of certain firms' 401(k) target date retirement funds.

The Committee requested information from select firms that manage target date retirement funds to better understand the design of these selected target date funds. Specifically, the committee requested information on select funds' (1) current asset allocations, (2) oversight mechanisms, and (3) promotional and educational materials representing these funds. The firms were selected based on the size of the assets under their management and the performance of their funds in 2008.

The Committee's preliminary findings indicate:

(1) that the equity holdings of 2010 target date funds vary significantly—ranging from 24 to 68 percent,

(2) that the date in the name of the target date fund is not significant to the design of the fund, and

(3) the ERISA Advisory Council made specific recommendations in 2008 to the Department of Labor related to target date retirement funds that have yet to be implemented.

While Target Funds Are Advertised as Wealth Preservation Tool, Funds May Over Expose Retirees to Financial Risk

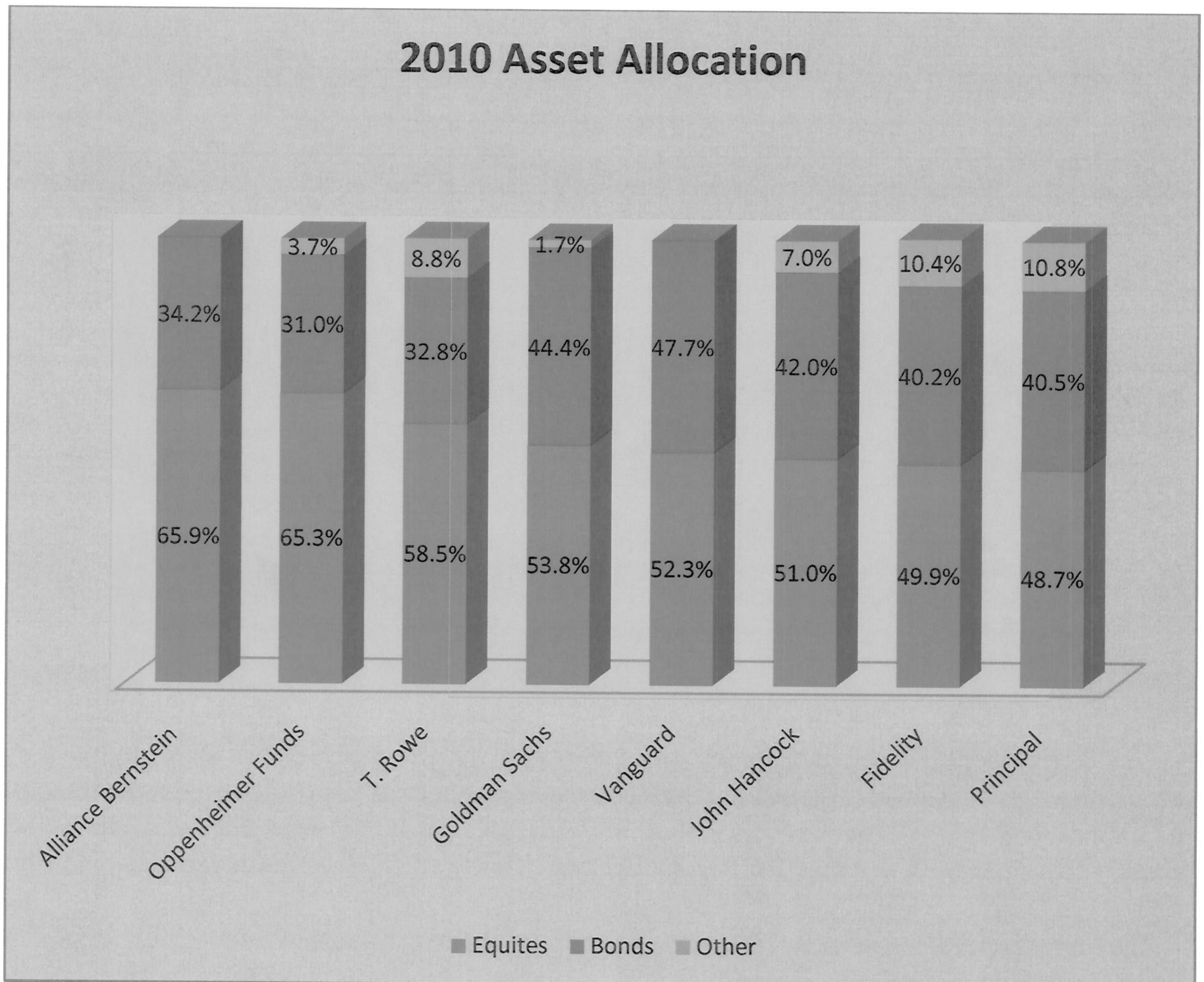
While many investment firms advertise target date retirement funds as wealth preservation tools, many target date funds have high equity holdings, which may over expose retirees to financial risk at the time of retirement. The Committee's investigation found that there are significant differences in the asset allocation of target date retirement funds, with firms' 2010 target date funds' equity holdings ranging anywhere from 24 to 68 percent. As a comparison, the Dow

---

[1] Employee Benefit Research Institute. *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2007,* EBRI Issue Brief No. 324, December 2008.
[2] EBRI Issue Brief No. 324, December 2008.
[3] Employee Benefit Research Institute. *EBRI Policy Forum: Defined Contribution Plans in a Post-PPA Environment, EBRI Notes, July 2008, Vol. 29, No. 7 – Statement made by* Nancy Szmolyan, senior practice expert at McKinsey & Co.

Jones Target Portfolio Indexes suggest that a firm's asset class allocation for 2010 target date funds contain around 27 percent in equities. Likewise, the Federal Thrift Savings Plan's target asset allocation for its 2010 lifecycle fund was 35 percent in equities.[4] However, the Committee's review of select 2010 target date funds found that many funds had equities exposure around or well over 50 percent, as shown in table 1.

Table 1: Asset Allocation Ranges of Select Companies



Source: U.S. Senate Special Committee on Aging.

In addition, the Committee staff found that of the selected companies reviewed, the date in the name of the fund (e.g., ***2010*** target date retirement fund) did not appear to be significant to the design of the fund. The date of significance is the end point (or the target date) to which the assets are intended to last for the investor, which is known as the glide path.[5] However, there

---

[4] The Thrift Savings Plan's target asset allocation was as of January 1, 2008.

[5] The glide path is the asset allocation mix of a target date fund, based on the number of years to the target date. The glide path creates an asset allocation that becomes more conservative (i.e., includes more fixed-income assets and fewer equities) the closer a fund gets to the target date.

are varying opinions on when that glide path should end, and thus, when to reallocate assets to more conservative investments.

The major fund families increased their equities holdings in recent years across the glide path in an effort to secure better short term performance and extended the glide path from the target date out to an assumed date based on life expectancy, in some cases, as much as thirty years beyond the target date. Documentation provided to the Committee by select firms indicates that many of these funds are designed to take into account and mitigate (1) market risk, (2) longevity risk, and (3) inflation risk.[6] Many of the advertisement documents the Committee staff reviewed suggested that these funds were not intended for a participant to cash out their retirement savings at the projected retirement date. Instead, the funds were designed to provide income for the years during retirement as well. While the Committee recognizes the need to mitigate these risks, it was estimated in 2008 that about half of retired households between the ages of 55 to 75 tapped into their long-term accounts, typically as a large, one-time withdrawal to mostly address living expenses in the past year. Only two out of ten households spent down their accounts on some type of systematic or regular income payment program.[7]

Because such labeling may be misleading, some believe that investment firms should be required to re-label their funds for increased transparency. For example, a target date fund labeled as 2010 should have a target date of 2010 and have an asset allocation that reflects that date. However, there is currently no industry agreement on the rate at which these funds should changed their asset allocation over time or related to an "appropriate" asset allocation when a participant reaches the anticipated "target date," usually assumed to be age 65.[8]

DOL Has Yet to Take Action on Target Date Fund Recommendations

In late 2008, the ERISA Advisory Council studied the issues related to target date retirement funds and concluded that the Department of Labor should provide more specific guidance as to the complex nature of target date retirement funds and the methodology necessary for plan fiduciaries who are responsible for selecting and monitoring these funds as prudent investment alternative in a defined contribution plan. The Council also recommended that DOL should develop participant education materials and illustrations to enhance awareness of the value and the risks associated with these funds. As of February 23, 2009, DOL had not taken actions to implement these recommendations.

---

[6] Market risk is the risk of adverse market movements. Longevity risk is the risk of outliving one's savings. Inflation risk is the risk that inflation can eat away at the purchasing power of accumulated savings possibly very rapidly.
[7] Vanguard Center for Retirement Research, *Spending the Nest Egg: Retirement Income decisions among older investors,* Volume 35, October 2008. The results in this report are based on a national online panel survey of older Americans, age 55-75, with $50,000 or more of accumulated financial assets. A total of 1,478 respondents participated in the survey, which was conducted in May 2008.
[8] According to *The Journal of Performance Management*, the best glide path strives for high returns in the early years, when the investor should be less risk adverse, because there is still time to recover if necessary and asset balances are low. Surz, Ronald J. and Israelsen, Craig: *Evaluating Target Date Lifecycle Funds.* The Journal of Performance Management. Winter 2007/2008.