

Statement on Target-Date Funds

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Chairman Shapiro, Deputy Secretary Harris. Thank you for this opportunity to testify on behalf of the Vanguard Group on the subject of target-date funds (TDFs) and their effectiveness as a retirement savings vehicle.

My name is John Ameriks. I am an economist and a Principal at the Vanguard Group. Vanguard is a client-owned investment management company with over \$1 trillion in assets under management, the majority of which are devoted in some fashion to retirement. We manage more than \$35 billion in our Target Retirement Portfolios, making us one of the top three providers in the business.

Given the short amount of time I have today, I will focus my remarks on three major points about target-date funds:

- 1) The diversification that target-date funds offer is critical in helping investors manage the array of financial and economic risks they face throughout their lives.
- 2) While financial markets have been historically poor in the last year, target-date funds have weathered this storm, and have achieved the objective of improving diversification and mitigating risk for their investors.
- 3) Going forward, we see opportunities to further simplify and improve disclosure and communications with respect to target-date funds, which could make these funds an even more effective tool for investors and plan participants.

I'll address each point in turn.

The Value of Diversification

At their most basic, target-date funds are a diversified investment portfolio designed to be appropriate for individuals accumulating assets for retirement. TDFs 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 a TDF is to provide investors a diversified, prudently managed, appropriate exposure to investment risk. 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 to continue to bear investment risk, 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 for this age group.

In order to provide potential returns to offset these costs, retired investors should retain a meaningful exposure to the stock market. In Vanguard's case, at the point of retirement, our target-date funds contain a 50% allocation to equities. The equity allocation continues to decline over the seven years following retirement, until it reaches 30% of the portfolio.

Target-date funds have achieved their goals in a challenging environment

When evaluating the performance of target-date funds, it is important to acknowledge the extreme severity of the financial meltdown we have just experienced. Virtually all types of investment portfolios—defined benefit plans, endowments, and even the general accounts of commercial insurers—have suffered significant losses.

While target-date funds were no exception in suffering poor results, in our view, they performed as designed. In particular, in the vast majority of cases, older investors were exposed to far less risk than younger investors, and consequently suffered less dramatic losses. In addition, even in the worst cases, the broad diversification of these funds helped to diminish the impact of specific financial failures on investors. It is also critical to note that in cases in which there was poor performance, it was not necessarily as 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 is valuable to note and understand the reasons why target-date funds performed well or poorly in crisis. However, 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.

As of the end of May, all of the Vanguard Target Retirement Funds with at least a 5-year track record generated positive returns over that 5-year period. And over a far longer horizon, which is appropriate even for retired investors, we expect our funds to produce a significant positive return, on average.

While the general principles of diversification and declining risk exposure with age are a part of all TDFs, a vigorous debate continues over the ideal design of these funds. There are several specific 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 7 underlying mutual funds. These include our Total Stock Market Index Fund, our Total Bond Market Index Fund, three international stock index funds representing the global equity market, our

Treasury Inflation Protected Securities fund, and our Prime Money Market fund. Our glidepath features a clearly specified, passive allocation to these funds, with equity allocations for those under 40 at 90%, declining to 50% at age 65, and falling to 30% by age 72. Our funds have expense ratios of 19 basis points (less than 1/5th of 1%) or less.

We believe the transparency, simplicity, broad diversification, and low cost of this structure represents an ideal approach to TDFs, with many advantages for plan sponsors and investors.

However we recognize that investment professionals, investors and plan sponsors may see significant value in alternative approaches. While we are 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 freedom to choose a specific design that best meets their specific needs. The TDF market is and should remain highly competitive. And in the case of DC plans, the strong fiduciary regulations currently in place with regard to a plan sponsor's responsibility in selecting TDFs provide the strongest incentive for them to make a choice based solely on what they see as best for their participants.

For all of these reasons, we strongly oppose any efforts to regulate the glidepaths or other aspects of the investment design or construction of target-date funds.

Disclosure and investor communications recommendations

TDFs 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.

Vanguard has been a leader in this area. In addition to our prospectus disclosure, which we believe has one of the most straightforward designs in the industry, we have tried to use collateral materials to help plan sponsors, participants, and all investors understand these products.

In general, we favor proposals such as the ones outlined by the Investment Company Institute which attempt to present important information on target-date funds, in a simple, straightforward manner. Well-designed TDFs with simple, usable disclosures can clearly meet the needs of investors who read such materials, and who conclude that they prefer a "hands off" investment solution as part of their retirement portfolio.

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 of any kind.

Plan fiduciaries play a key role in selecting and monitoring fund options. We support efforts to ensure that plan sponsors know what key factors to look at when evaluating and selecting target-date funds.

Final thoughts

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

At this point I would be happy to take any questions.