

## Testimony to Joint DOL/SEC Hearing on Target-Date Funds

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Thank you 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 don't agree that the purpose of target-date funds should be, in Senator Kohl's words, "**to minimize the risk and volatility for those nearing retirement.**"

The express objective of our US target-date funds was—and is—**to minimize the risk that participants will run out of money in retirement.**

To achieve this objective, we designed our target-date funds to maximize savings in the working years and prolong spending in retirement. Our research and 40 years of experience in investment planning suggest 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. Sufficient exposure to well-diversified equities can provide a bumpy path to adequate retirement income.

Let me explain. There are several risks to retirement income. One key risk is market volatility, which hurt so much in 2008. Stocks certainly are more volatile than cash or bonds. But the risks to retirees from inflation (eroding purchasing power) and longevity (needing income for longer than average) are equally serious. Over time, we believe, cash and bonds expose investors to much greater inflation risk and longevity risk than stocks.

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

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 US stocks, bonds and cash, we compared the results of a 60/40 stock/bond strategy with holding cash and bonds. Assuming retirees withdrew 5% of their initial savings each year, we looked at

how often each strategy funded 30 years of retirement spending. We focused on 30 years because some 25% of today's 65-year olds will live at least that long.

The results were stunning. A portfolio with 60% in stocks NEVER ran out of money—not once in all the 30-year periods we studied—not even in 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 30-year period, and the bond strategy ran out of money in 85% of the periods. We also looked at a mix of 30% stocks and 70% bonds, which ran out of money in 59% of the 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 submitted for the record) confirms our earlier research that, in most cases, a 60/40 stock/bond mix is appropriate for participants at retirement.

You are hearing many points of view today. Perhaps the only common ground is that there is no consensus on the best glide path design. Thus, there is no such thing as a passive target-date fund, because the key decision – glide path design – is always an active choice. And under ERISA, fiduciaries must evaluate whether the target-date glide path is prudent and is likely to help plan participants meet their retirement goals. 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 equity allocation might be prudent. By contrast, where a sponsor makes large contributions of company stock to the DC plan, a LOWER equity allocation might be prudent. Such factors influence how we customize target-date glide paths for large DC plans. There is a differential of over 20 percentage points in the equity exposures of the 2010 target date portfolios we manage. Why consider rules that could preclude plan sponsors from adopting the glide path best suited to their particular circumstances?

In addition, we are 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 equity exposure in target-date glide paths. Why implement rules that could stifle such innovation?

Now, let's turn to the underlying investments in target-date funds. We also think that fiduciaries should evaluate whether the underlying investments are appropriate, well-run, and cost-effective. Because most target-date assets are currently in proprietary mutual funds, such fiduciary reviews can be challenging.

In proprietary offerings, a mutual fund firm designs the glide path and manages ALL the underlying investments. Frequently (and not coincidentally), the fund company also provides recordkeeping. If a plan sponsor is unhappy with the management of one or more underlying investments, there is nothing it can do—short of moving to a different target-date provider, and perhaps another record keeper. This logistical challenge tends to keep plans locked-in to proprietary target-date providers.

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, best-in-class managers for each underlying investment, and its preferred record keeper. The plan sponsor continually monitors the performance and costs of each underlying investment provider, and is free to replace unsatisfactory providers. In short, DC plan sponsors (and their consultants) can oversee custom target-date funds as they would a DB plan.

We believe the custom target-date structure provides much better governance. It can also significantly lower costs for larger DC plans.

Recent advancements have made it easier for larger plans to implement custom target-date portfolios. But at this point, proprietary target-date mutual funds remain the most cost-effective option for smaller plans. We therefore believe 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.

In sum, we would like to stress two key points:

- First, target-date glide paths will generally require substantial allocations to equity at age 65 for participants’ money to last through retirement, and the precise glide path will vary for different DC plans.
- Secondly, there is a growing trend for larger DC plans to move from proprietary target-date mutual funds to customized target date portfolios, which have better governance and lower cost.

Thank you for your consideration.