



The Profit Sharing and 401(k) Advocate • Sharing the Commitment since 1947

Statement of Ian S. Kopelman

On Behalf of the Profit Sharing / 401k Council of America

Department of Labor and the Securities and Exchange Commission Hearing on Issues  
Related to Investments in Target Date Funds and Similar Investment Options by 401(k)  
Participants and Other Investors

June 18, 2009

Thank you for this opportunity to testify about the use of target date funds in profit sharing, 401(k) and other defined contribution plans. I am a partner with DLA Piper where I chair the firm's Employee Benefits and Executive Compensation practice group. I am presenting the views of the Profit Sharing / 401k Council of America (PSCA), a sixty-year-old non-profit association representing companies that sponsor profit sharing and 401(k) plans. PSCA speaks for over 1,200 companies who employ approximately five million plan participants throughout the United States. PSCA's members range in size from very small firms to conglomerates with hundreds of thousands of employees. All regard their profit sharing or 401(k) plans as vital factors in their business success. I have been PSCA's Legal Counsel for seven years and have been involved with PSCA since 1978.

Employers sponsor 401(k) and other defined contribution retirement plans to help attract, retain and motivate high quality workers. It is critical in today's competitive environment that the interests of employers and their employees be as closely aligned as possible. One way to reinforce that alignment is to deliver the very best defined contribution program possible.

More and more employers are deciding that target date funds are a beneficial investment offering and are rapidly adding them to their 401(k) plans. Preliminary analysis of PSCA data for 2008 finds that fifty-eight percent of private employer defined contribution plans offer target date funds; up from twenty-five percent in 2005 and virtually none in 2000. Over half of plans with automatic enrollment have a target date fund as the default investment.

Mutual fund products continue to be the product of choice for qualified plans. It is imperative that this factor be considered at this hearing. Our research indicates that seventy-eight percent of plan target date investments are mutual fund products.

In April 2009, PSCA and Casey, Quirk & Associates, a management consultancy focused on the global fund management industry, conducted a survey of target date fund practices in employer sponsored defined contribution plans. More than four hundred companies of various sizes participated. Twenty-one percent have fewer than 200 hundred participants and twenty-seven percent have 5,000 or more participants. Eighty-seven percent use a packaged target date fund program. Thirteen percent of the programs are custom designed.

Most plan sponsors in the survey are satisfied with their target date investment options, despite weak performance during the recent market crisis. Only thirteen percent of sponsors are dissatisfied and only one percent is very dissatisfied. Such support, however, reflects neither apathy nor blind approval. Nearly two-thirds (sixty-four percent) of the sponsors are considering changes to their target date investments. The focus on improvements to target-date funds under consideration is concentrated in two key areas – diversifying the assets in the investment and selecting top quality investment managers to oversee investments. Only thirteen percent are considering consider making changes to the glide path.

As with other aspects of their defined contribution programs, plan sponsors are driving innovation and improvement in their target date funds. The resulting evolution of target date retirement funds will significantly affect how America’s defined contribution plan assets are managed in the future.

Financial investment experts, by an overwhelming majority, recommend three basic principles for long-term capital appreciation, the method used to accumulate retirement assets. First, diversification among bonds, equities, and cash-like investments provides the maximum balance between risk and return. Second, once an investment allocation is determined, periodic rebalancing is necessary to preserve the allocation ratio. Finally, the asset allocation ratio should be altered as an investment horizon shortens to favor risk aversion over returns. These three principles are the bedrock that defines a prudent overall investment policy for a defined contribution plan. Target date funds embrace these principles and apply them automatically to individual plan participants based on the participant’s age and assumed retirement date. We hope that this hearing results in a reaffirmation of these principles and 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. The responsible plan fiduciary must act with the “care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character with like aims.” When selecting and monitoring plan investments, we believe that a prudent process is required. Fees related to the investment, if paid with plan assets, must be reasonable. The selection must be made solely for the benefit of plan participants. Once an investment is selected, the fiduciary

must monitor it to ensure that it remains a suitable plan investment. What absolutely is not required is to ensure that a plan investment always results in positive returns. Even prudent investors can suffer an investment loss! We are confident that both agencies support this proposition, despite the intense publicity surrounding the recent market events. Plan investments are for long-term investing, and questioning their propriety based on short-term performance will create havoc for the employer provided retirement plan system.

All target date funds have different “glide paths,” the ratio of the three asset classes for each age cohort. A glide path automatically implements the three investing principles previously discussed – diversification, rebalancing, and reallocation. Glide path variations reflect the preferences of the individual investment manager. A plan fiduciary must be familiar with the glide paths of plan target date investments and determine that they are prudent. How is this achieved? Some plans, usually larger plans, will hire an expert to assist them. Others will conduct a survey of the glide paths of several target date funds. Benchmarks may be utilized to assist in this process. A plan fiduciary, absent any evidence to the contrary, should be able to consider that a particular fund’s glide path being within a general range of similar funds is an indication that the glide path is a reasonable. In fact, ignoring this data may require documented justification. The fiduciary must also consider the performance and fees of the target date fund. Again, this is achieved by comparing similar products. It is important to note that the fiduciary process is generally limited to the universe of existing financial products. Only the most sophisticated plans have the ability or resources to invent their own products in a cost-effective manner. Ninety-five percent of the 694,550 plans reporting under the 2006 Form 5500 Abstract have assets of \$10 million or less. These plans are maintained by small and mid-size businesses.

The current controversy about target date funds centers on the appropriate glide path as a participant reaches the assumed retirement age, usually age 65. For the most part, there is little debate whether a 65-year old retiree should hold equities in their retirement account. The question is “how much?” That brings us back to the fiduciary process. The overwhelming body of financial advice indicates that a new retiree should hold a substantial percentage of equities in their retirement account, in the general area of fifty percent. This position is not influenced by a short-term value fluctuation at retirement. It is based on the twenty to twenty-five year investment horizon for a recent retiree. A plan fiduciary is, to a large degree, bound by this body of expert knowledge and ignores it at considerable risk.

The impacts of social security and other retirement assets are often overlooked when analyzing glide paths. An individual receiving half of their retirement income from social security, a common scenario, and half from their retirement account invested fifty percent in equities can be viewed as having an overall portfolio containing twenty-five percent equities. Another important factor is whether the employer also provides a defined benefit plan to the same participants, resulting in further dilution of the ratio of

equities in the participant's overall retirement assets. We suggest that a prudent plan fiduciary should be able to make general assumptions about social security income and other retirement plans offered by the employer when assessing a target date fund glide path. The preamble to the final rule on qualified default investment arrangements (QDIA) embraces this interpretation. A target date fund is not required to be the optimal investment for each individual participant; it must be a prudent plan investment for the participant population in whole.

Another debate regarding target date funds is whether the glide path should be frozen at the target retirement age. We believe that it should extend throughout the life of the participant or beneficiary if the plan permits retired participants, terminated employees, or beneficiaries to remain in the plan beyond the normal retirement age. A case in point is that a retiree may remain in a target date fund plan investment long after retirement. The investment must be prudent for this individual and freezing a glide path at retirement age may violate this principle.

Some, including Chairman Kohl, are concerned that the Department of Labor has not issued requirements regarding the composition of target date funds and an appropriate glide path in the QDIA regulations. We respectfully disagree. The Department's rule specifically states that 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 from a failure to satisfy these rules." The rule describes the target date fund default investment as one that "applies generally accepted 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 the participant's age, target retirement date (such as normal retirement age under the plan) or life expectancy." These are firm requirements, and we have described the process used to meet them.

Some have suggested that the Department of Labor and the Securities and Exchange Commission set actual glide path parameters. In effect, this approach would require these agencies to set numerical limits on glide path allocations. Their judgment will replace the body of expert knowledge. Should this approach be pursued, plan fiduciaries must be relieved of any responsibility regarding selection and monitoring of a glide path in a target date fund. On one level, this has certain appeal – plan sponsors will be relieved of liability for this decision. However, we do not recommend this course of action. It will substitute government agency preferences, which are inherently political, for generally accepted investment theories. It will also result in a one-size-fits-all product that precludes the ability to select a target date fund that recognizes the unique situation of a particular plan's participants.

While we urge that this hearing not result in any prescriptive actions regarding glide paths, an examination of target date funds can be productive and informative. We look forward to the hearing's findings. While we believe our comments on the fiduciary



The Profit Sharing and 401(k) Advocate • Sharing the Commitment since 1947

considerations regarding the selection and monitoring of a target date fund reflect the Department of Labor's views, verification or further explanation by the Department will be valuable to plan sponsors. Some participants will remain in a target date fund plan investment alternative after retirement. For this reason, the target date fund's glide path should extend beyond a target retirement date. Arguably, the general fiduciary requirements regarding plan investments require this feature. However, the Department of Labor's final QDIA rule does not require that the glide path extend beyond expected retirement age. The Department should consider specifying that the glide path of a target date fund plan investment must extend beyond a target retirement date if the plan permits retired participants, terminated employees, or beneficiaries to remain in the plan beyond the normal retirement age. The Securities and Exchange Commission should consider this issue for all target date funds.