fi360 Annual Conference May 5-7, 2010

It's All About the Beneficiaries

Fiduciary Best Practices in Target Date Funds

Ron Surz, President Target Date Solutions
Ron@TargetDateSolutions.com
(949)488-8339

TDS Target Date Solutions

Our Message

Fiduciaries have a responsibility to choose GOOD Target Date Funds (TDFs). Status as a Qualified Default Investment Alternative does not mean that any TDF will suffice.

Fiduciaries, not fund companies, need to establish objectives:

Safety or Growth

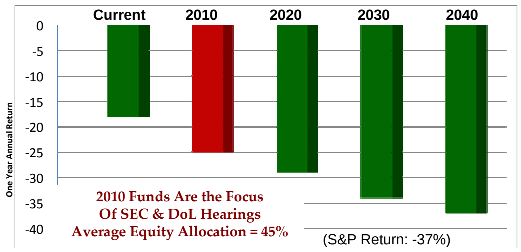
TDS Target Date Solutions

Agenda

- SEC and DOL June 18, 2009 Hearings
- The Prudence and Wisdom of "TO" Funds
- Safe Landing Glide Path™**:** A standard for TO Funds
- Risks and Rewards of "TO" and "THROUGH" Funds
- Fiduciary Imperative

TDS Target Date Solutions

2008 Has Been a Safety Test
Should Investors be Better Protected?



Fund companies assure all is OK

The June 18, 2009
SEC and DOL Hearings

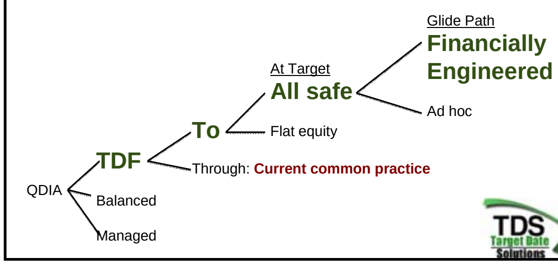
- Mutual funds are NOT Fiduciaries to the retirement plan. Collective Trusts are.
- Plan sponsors have the responsibility of selecting and monitoring TDFs. Plan recordkeepers might not be the best choice.
- Most TDFs are "Through" funds, designed to last to death, so the target date is meaningless.
- Fiduciaries, not beneficiaries, must be better informed & educated.

THE Key Decision

Growth

Safety

Fiduciary Checklist for Safety First



Agenda

- The Sec and DOL June 18, 2009 Hearings
- **The Prudence and Wisdom of "TO" Funds**
- The Safe Landing Glide Path™
- Risks and Rewards of "TO" and "THROUGH" Funds
- Fiduciary Imperative

Fred Reish, ERISA Attorney, says…

"*It is critical that* ***fiduciaries understand*** *the competing philosophies of target-date managers… and identify high-quality target-date funds that are structured accordingly… target-date funds come in two "flavors": those that anticipate being cashed out at the plan's retirement age and those that do not. However, it seems to me that* ***401(k) plans mainly have one flavor: those that cash out at retirement…*** **" (i.e. "TO" Funds)**

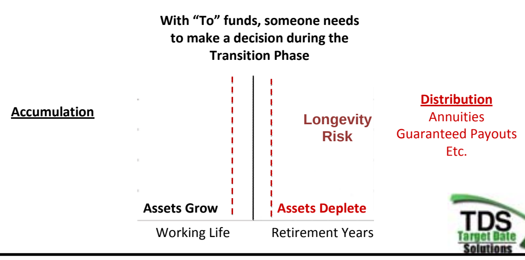
"Targeted Flavors", July 30, 2009, ***Plan Sponsor*** magazine

Real “To” Funds Address the Problems with “Through” Funds

- Participants withdraw accounts at target date
- Target is Death, not Retirement
- No glide path can manage Longevity Risk (except “The Hemlock Fund ”)
- Transition period is in Jeopardy. Sacrifices Safety for Growth.
- Designed for Profit, not Safety: Proprietary funds, high fees, emphasis on equities near target (high fees), hope to retain assets beyond target

The Transition from Accumulation to Distribution is Critical

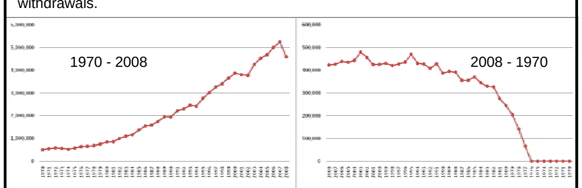
Qualified Default Investment Alternatives (QDIAs) should protect as retirement approaches since savings are especially dear then.



Proof that the Transition Period is Critical

Growth of a 40/60 Stock/Bond Well-diversified Portfolio over past 39 Years, in Actual Sequence, then Reversed.

Someone retiring in 1970 with $500,000, and spending 5% per year, increasing by 4% per year, would have $4.5 Million today. But if the market gods “Benjamin Buttoned” the return sequence, experiencing 2008 1st, the investor would have gone broke 7 years ago. Note that ending wealth would be identical if there were no withdrawals.

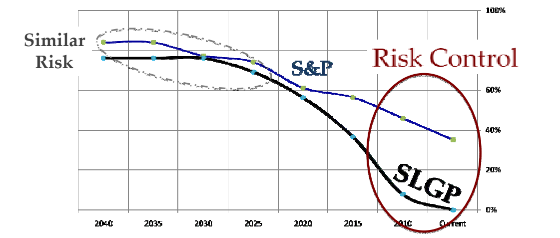


Dr. Craig Israelsen, Brigham Young University

Also see video of Prof. Moshe Milevski, York University, at Return sequence risk

Glide Paths: Equity Allocations of "TO" versus "THROUGH"

Objective transitions from growth to preservation, with BIG difference near target date



S&P Target date index is an industry average of all target date funds.
SLGP is our Safe Landing Glide Path™ – a "TO" Fund

Agenda

- The Sec and DOL June 18, 2009 Hearings
- The Prudence and Wisdom of "TO" Funds
- **The Safe Landing Glide Path™**
- Risks and Rewards of "TO" and "THROUGH" Funds
- Fiduciary Imperative

Objectives and Policies

Hippocratic Oath for Target Date Funds: ***First, lose no money***

Objectives

1. **Safety**

   Preserving value is primary goal

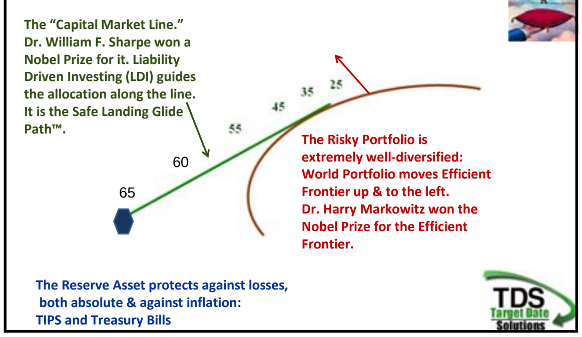
2. **Growth**

   Increasing value is secondary goal

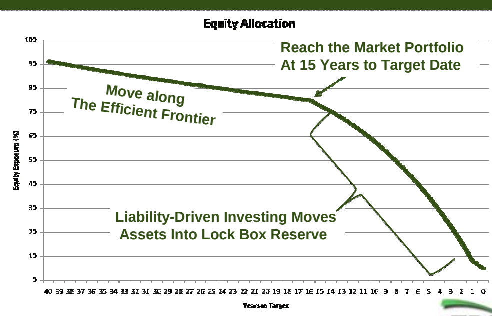
Policies

- ✓ Diversification
- ✓ Risk Control
- ✓ Sound Theory
- ✓ Low cost

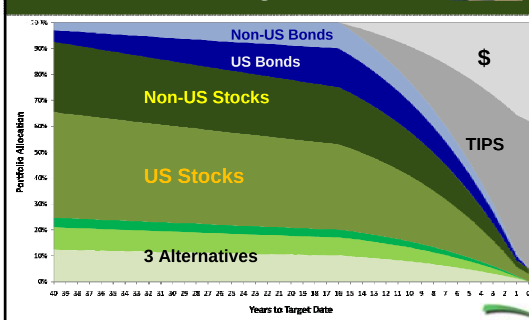
Recordkeepers Keep Records. Financial Engineers Design Safe Glide Paths.



The Safe Landing Glide Path™



A closer look at The Safe Landing Glide Path™



Open Architecture, Mostly Passive

Benefits of The Best Glide Path

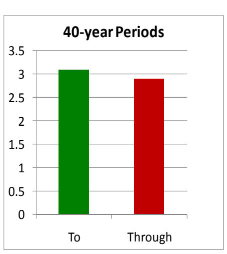
Diversification
\+ Risk Control
\+ Sound Theory
\+ Low Fees

= Safe Landing Glide Path™

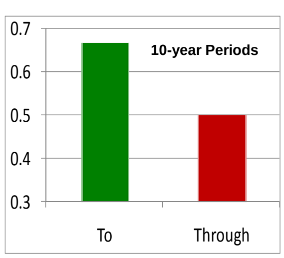
Agenda

- The Sec and DOL June 18, 2009 Hearings
- The Prudence and Wisdom of "TO" Funds
- The Safe Landing Glide Path™
- **Risks and Rewards of "TO" and "THROUGH" Funds**
- Fiduciary Imperative

Reward-to-Risk Ratios 1926-2008



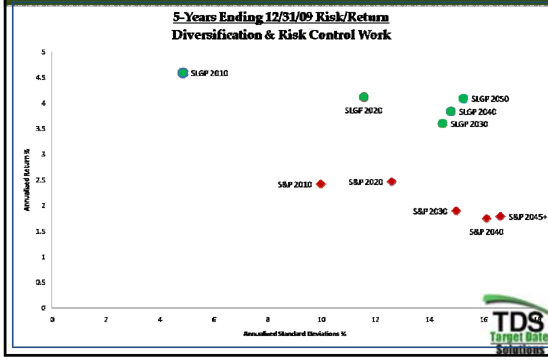
To is 7% Higher



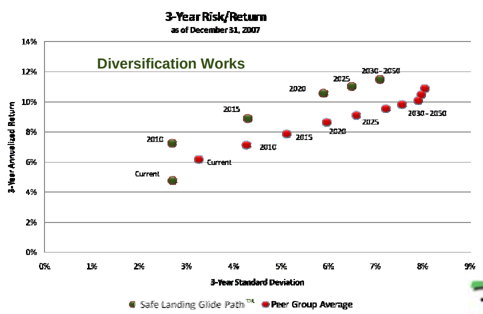
To is 34% Higher

Please see "Measuring the Risks and Rewards of Target Date Funds"
In Jan/Feb 2010 *Investment and Wealth Monitor*

The Proof of the Pudding



Looking Back to Better Times: 3 Years Ending 12/31/2007



Agenda

- The Sec and DOL June 18, 2009 Hearings
- The Prudence and Wisdom of "TO" Funds
- The Safe Landing Glide Path™
- Risks and Rewards of "TO" and "THROUGH" Funds
- **Fiduciary Imperative**

Fiduciary Considerations

- Current common practice: “Through” funds
  - Procedural prudence
  - 35% Equity at target date is OK?
- Safety First: “To” Funds
  - Substantive prudence
  - Duty of Care: Participant expectations
  - 35% at target date is probably too much

TDS Target Date Solutions

Summary

1. **The key decision is “To” or “Through” target date: Safety or Growth**
2. **Investment managers are mostly providing “Through” products. Profits are a probable reason.**
3. **Plan sponsors are responsible for selecting & monitoring. Convenience and familiarity with the plan’s recordkeeper are not suitable criteria.**
4. **The Safe Landing Glide Path™ exemplifies a good target date fund glide path.**

TDS Target Date Solutions

Target Date Fund Choices for Consultants: Fiduciary or Salesman

(1) Best or Worst practices
(2) Paid by investment firm (Fee or No Fee)

Objectives

Best	Worst
1) Safety First to Target Date	Growth to Death (Longevity risk)
2) Growth	

Policies

Best	Worst
Liability-driven investing	Growth focused using closed architecture
Broad diversification	US-centric mostly stocks
Low costs	High fees and sales commissions
Financially engineered glide path	Ad hoc rules, like “some # minus age”

Salesman/Suitability

Advisor/Fiduciary

TDS Target Date Solutions

A Key Decision: Choosing a GOOD Target Date Fund

Plan sponsors have a fiduciary duty to select and monitor GOOD target date funds.

It's All About the Beneficiaries: What are Their Objectives?

Recordkeepers might not be the best choice.

TDS Target Date Solutions

Best Practices in Target Date Fund Investing

presented by

FRED REISH, ESQ.

REISH & REICHER

❖

May 7, 2010

The Fiduciary Breach

"The Committee's investigation found that there are significant differences in the asset allocation of target date retirement funds, . . . one 2010 target date retirement fund . . . lost over 40 percent in 2008. A loss of this magnitude simply should not occur in a financial product that was designed and is specifically advertised to limit risk and volatility as one nears retirement."

Letter from Senator Kohl to Chairman of the SEC, February 24, 2009.

2

Target Date Investments

Senator Kohl, Chair of the Senate's Special committee on Aging, held hearings earlier this year . . . then urged the SEC and DOL to follow up.

On June 18th, the DOL and SEC held a joint hearing, focusing on the following questions:

- How TDF managers determine asset allocations and changes to asset allocations (including glide paths) over the course of a TDF's operation;
- How they select and monitor underlying investments;
- How the foregoing, and related risks, are disclosed to investors; and
- The approaches or factors for comparing and evaluating TDFs.

3

Legal Issues and Practical Consequences

The preamble to the QDIA regulation says:

"The selection of a particular qualified default investment alternative (*i.e.*, a specific product, portfolio or service) is a fiduciary act and, therefore, ERISA obligates fiduciaries to act prudently and solely in the interest of the plan's participants and beneficiaries.

A fiduciary must engage in an objective, thorough, and analytical process that involves consideration of the quality of competing providers and investment products, as appropriate."

The Fiduciary Process

The fiduciary process for selecting target date investments involves:

- The qualitative and quantitative analysis generally used for investments, including reasonableness of expenses.
- An analysis of asset allocation.
- An analysis of the glide path ("to" and "through").
- An analysis of its manager and its abilities and limitations.
- An analysis of the needs of the plan and the needs and abilities of the participants.

Note: Benchmarking issues
Open architecture.

Focus on Older Participants

Asset Allocation and Glide Path:

"It is in the glide path where we see the most fundamental differences between fund families. For instance, do the managers believe their job is to boost retirement account balances through aggressive growth strategies, or do they believe their job is more accurately stated by the Hippocratic paraphrase, 'First, lose no money?' "

--Popping the Hood II, An Analysis of Target Date Fund Families, by Turnstone Advisory Group LLC.

Note: Focus on final 10 years.

Needs of Plan and Participants

The courts have embraced the need for fiduciaries to assess the needs of a plan in making decisions regarding plan investments:

> “Failure to investigate *the needs of a plan* or to ascertain the particular requirements or restrictions of a plan, and failure to invest in accordance with the best interest of plan participants . . . constitutes a breach of fiduciary duties imposed by ERISA.”

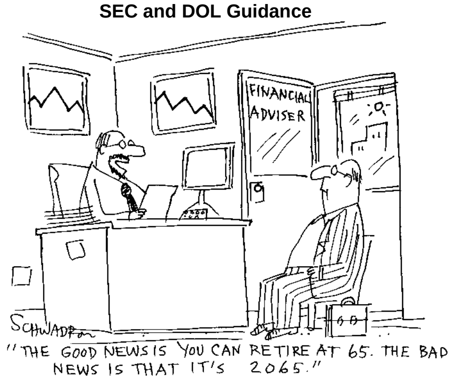
7

TDF Distinctions

- Aggressive versus conservative
- Focus on last 10 years
- Asset classes

8

SEC and DOL Guidance



Consequences

- Better information for plan sponsors, as fiduciaries
- Prudent process and informed decisions by fiduciaries
- Better communication with participants—reasons and risks
- Alternative choices from providers

Note re Kohl proposal for legislation on fiduciary status.

10

REISH & REICHER

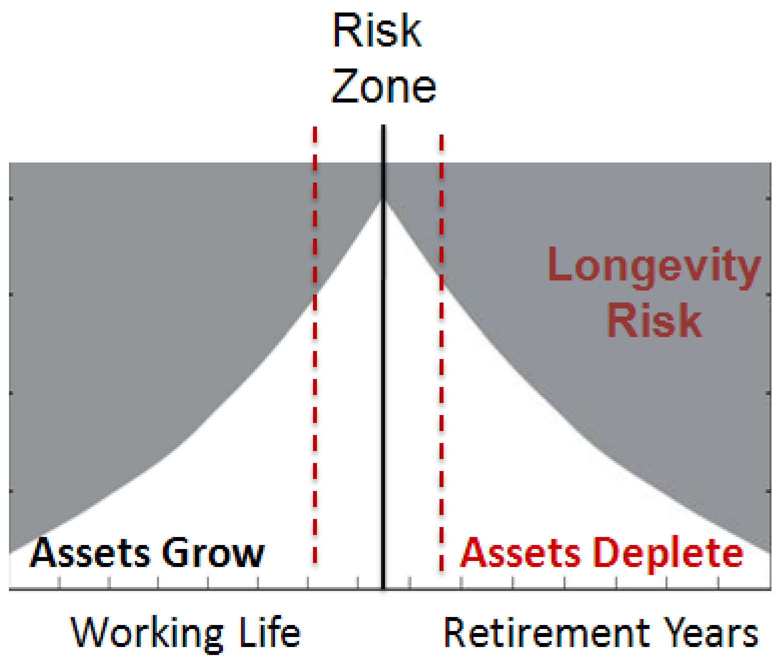
A PROFESSIONAL CORPORATION ATTORNEYS AT LAW

FRED REISH, ESQ.
11755 Wilshire Boulevard, 10th Floor ❖ Los Angeles, CA 90025-1539
(310) 478-5656 ❖ (310) 478-5831 [fax] ❖ (310) 776-7822 [direct fax]
FredReish@Reish.com • www.linkedin.com/in/fredreish
www.reish.com/practice_areas/empbenefits.cfm

Narrowing the Target Date Fund Choice to the Risk Zone of Retirement Savings

Ron Surz President Target Date Solutions
Ron@TargetDateSolutions.com 949/488-8339

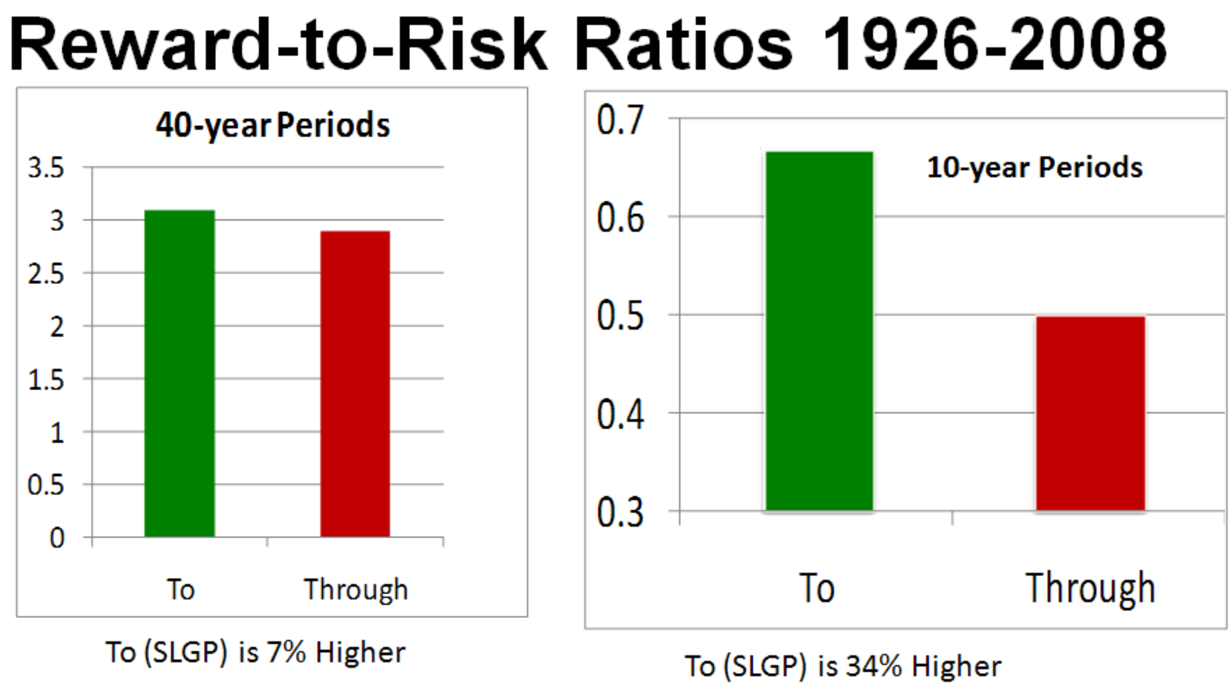
Most are aware of the sensitivity of life style in retirement to the "risk zone", which is roughly the 5 years before retirement and the five years after retirement. Losses during this critical time period inflict a double whammy on retirees: (1) dollar losses are at their highest level because account balances are their largest (see graph at right), and (2) retirees can only respond with a reduced standard of living since re-entry into the workforce is limited.



We need to be especially protective during the risk zone. But how do we measure and evaluate safety in this critical period, especially as it relates to the popular target date fund (TDF)? One way is to define risk as a dollar loss rather percentage loss. Losing 10% of a one dollar portfolio is significantly less painful than losing 10% of a million dollar savings account. Life style in retirement relies on money, not percentages. I have measured risk in this fashion and published my findings in the Jan/Feb issue of the ***Investment & Wealth Monitor***, a publication of the Investment Management Consultants Association (IMCA). The article contrasts the reward (dollar growth) and risk (of dollar loss) of the Safe Landing Glide Path™ (SLGP) target date fund to that of the typical TDF. The SLGP™ ends the target date glide path almost entirely in safe assets, whereas the typical TDF ends at 35% in equities because it is a "through" fund designed to continue beyond the retirement date, so it is substantially riskier in the risk zone. See graph and reference below.

As comes as no surprise, the SLGP™ delivers superior reward-to-risk in the risk zone, defined as the last 10 years before retirement. Somewhat surprising, reward-to-risk is about the same for the entire 40 years prior to retirement, primarily because the glide paths of the two approaches are very similar at 15 years or more away from the target date, so 25 of the 40 years are in synch.

Enlightened fiduciaries should focus on the risk zone in their target date fund selection. Most TDFs provide similar asset allocations prior to the risk zone, and then they become widely disparate in their equity exposures during the risk zone. Most TDFs view the target date as a speed bump in the highway of life, ignoring the risk zone altogether. It is during this critical period that TDFs demonstrate their mettle, protecting or not. Safety first is the right choice as the target date nears because life styles are at stake.



Please see "Measuring the Risks and Rewards of Target Date Funds"
In Jan/Feb 2010 *Investment and Wealth Monitor*

Also see video of Prof. Moshe Milevski, York University, at [Return sequence risk]