# Testimony before the U.S. Department of Labor and the Securities and Exchange Commission

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I want to thank the Department of Labor and the Securities and Exchange Commission for the opportunity to provide J.P. Morgan Asset Management's views on Target Date Funds.

The testimony I am giving today draws upon the extensive work that my colleagues and I have done in developing and managing J.P. Morgan's Target Date strategy. We will be submitting written testimony which will cover the points I will make in much greater detail, but what I will do now is summarize what we believe are the key considerations for fiduciaries – whether they are asset managers or plan sponsors – in developing, managing, and monitoring Target Date strategy.

In building our Target Date strategy, we really took a Defined Benefit approach to the problem. That means three things. First, it means defining a desired outcome for investors in the funds – a definition of success. Second, it means defining a time horizon for the investment. And third, it means understanding what cash flows will be coming into – and out of – the funds.

All three steps are extremely important, but in hundreds of conversations with plan sponsors over the past 5 years on Target Date investing, we think that the first step – defining an outcome and a definition of success – is the most critical.

What do we mean by this? Simply stated, we mean articulating what you want the Target Date strategy to achieve. At the extreme, there are two different outcomes a manager or sponsor can pursue – maximizing the upside, or minimizing the downside. Another way of looking at it – are you building a strategy that will earn more when markets are strong, or are you building a strategy that will lose less when markets are weak?

The outcome we are aiming for is the following: maximizing the number participants who reach a minimum level of income replacement. We aren't trying to generate the highest expected balance, because we know that in seeking higher returns, we're also adding volatility – and the chance of greater failure if markets don't cooperate.

Now, not all plan sponsors will seek the same outcome. And the broad range of Target Date Funds allows plan sponsors to match the outcome they seek to that of the provider. But if neither the plan sponsor nor the fund manager understands what their desired outcome is, finding the best match is pretty tough. And that's why I said that this step of the process is the most important.

Second – time horizon. There has been a lot of discussion around "to" retirement or "through" retirement – and we'd like to think that the white papers that we've published over the years – and which we are submitting for the written record – have contributed to that dialogue. Our bottom line: as a fiduciary, I know that I can understand with some degree of certainty how participants will behave as savers – up to the point of retirement. But I have no ability to predict how individuals will behave after retirement. But again, I do think that reasonable people can disagree about the importance of "to" or "through" – which is why understanding the outcome you are trying to achieve, and then allowing plan sponsors or advisors to choose the fund that best matches their plan's needs, is critical.

And this brings me to the third point – cash flows. At J.P. Morgan, we are big believers in defining what we know – and what we don't. And in developing our target date strategy, we thought it was important to factor in observed cash flows – how participants put money into and take it out of their 401(k) plans – instead of making assumptions about how people behave – or worse, managing money based on how we thought participants should behave. It turns out that participants save a lot less than most people assume, and they take out a whole lot more in loans and distributions than they should.

Our final step in building a glide path is optimizing an asset allocation – and evaluating our outcome based on our definition of success. Using forward-looking assumptions, as well as various historical time periods, we evaluated how well our glide path does in achieving the outcome we seek. We pay particular attention to minimizing shortfall at the point of retirement, since behavioral finance tells us that being short $50,000 is two and a half times more painful than having an extra $50,000 is good.

I'd like to conclude my remarks by commenting on something that we don't spend enough time discussing – and that is the rate of savings. How much people save is by far the most important factor in determining success in accumulating assets for retirement. And there isn't enough discussion on the relationship between how much people are willing to save on the one hand, and the certainty of outcomes on the other. Put another way – the "safest" retirement strategy is one that has the highest probability of "getting over the finish line" – not the strategy that isn't going to lose money in a bear-market.

We will be submitting for the written record an analysis we did comparing hypothetical results of someone in our 2010 glide path for 25 years – whose portfolio would have lost over 20% of their assets in 2008 – with someone invested in the "safe" alternative – a money market fund. The hypothetical glide path portfolio generated almost double the assets, even after a 20% loss in 2008 and ten years of essentially no returns from the US equity market. Put another way, the person in the money market fund would have had to save more than twice as much to end up in the same place. Unmet expectations are always a risk when there is a default option – no matter what the market environment, which is why understanding a Target Date strategy's desired outcome is so critical. As Yogi Berra said, "You've got to be very careful if you don't know where you are going because you might not get there."

I look forward to answering any questions that you might have.