Russell Investments

DOL/SEC Hearing on Target Date Funds and Similar Investment Options

Russell Investments' Testimony – Josh Cohen Presenting

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Thank you for the opportunity to allow Russell Investments to present today. Russell provides strategic advice, performance benchmarks and a range of institutional-quality investment products to clients globally. I am a Senior Consultant with a particular focus on defined contribution plans.

Russell advises plan sponsors on the selection of target date funds. We also implement target date solutions through either customized approaches or commingled and mutual funds. Russell has spent many years working with clients to come up with better target date fund solutions. We've done a lot of research with respect to target date funds: how they are constructed; how they are used by participants; how their performance can be measured; and how to deal with some of their challenges.

Many investors were surprised at the magnitude of losses that many target date funds, particularly those with a "near term" retirement date, have suffered. These losses are primarily due to the high level of equity exposure of some funds as they near the target retirement date. Interestingly, we have found there is a correlation between the length of time that the glide path continues to slope down after retirement and the level of equity exposure at retirement.

Opinions differ as to what is the right "shape" of a target date fund glide path. I'd like to share with you our opinion -- based on our work with clients, our research and our analysis.

Two basic points: First, Russell believes that investment risk should be more limited at retirement. In fact, Russell's standard glide path has a 32% allocation to equities at retirement. Second, in retirement, the glide path should be flat rather than "slope".

We reach these conclusions because of a fundamental understanding of what the objective of retirement savings is and the nature of contribution patterns in to plans.

We believe target date funds should be created with a certain objective in mind and rigorously engineered to meet that objective. Further, we believe target date funds should be viewed as a component of an overall retirement program

The objective of retirement savings should be to create greater certainty of meeting an income replacement goal in retirement. Given this objective, risk should be measured in terms of not meeting that goal. This is different than some arbitrary point-in-time risk measure like standard deviation of returns or level of equities, which really doesn't tell you anything about the ultimate risk of falling short of an income replacement goal.

Now let's discuss *the nature of contributions*. The wealth for young participants with a long investment horizon consists primarily of future payroll contributions and they can therefore afford more risk in their asset portfolio**.** At retirement, participants stop putting money into their plan and start taking it out. As a result, large losses -- say a negative 40 percent return -- have much more impact just before retirement than at any other time because account balances are at their highest and the ability to respond to the setback and rebuild assets is small. We would call this risk of experiencing poor investment performance at the wrong time, sequential risk.

So, if your objective is to reach a retirement income goal, while reducing as much as possible the risk that you will fall significantly short of it; and if your maximum exposure to catastrophic loss is highest as you near retirement, we believe fund risk should be limited during that period.

Now to our second point -- why a flat glide path post retirement?

We believe that a participant is financially most "at risk" the day he or she retires. That's because he or she has, at that point, the longest time to live and therefore the greatest amount of time for which he or she needs to fund retirement income. Thus, it does not make sense to us to use a "sloping" glide path that maximizes investment risk on the day of retirement and reduces it thereafter.

I would, in closing, like to discuss two additional issues.

The first is target date performance measurement. We believe a *simple measurement of the effectiveness of a glide path to generate wealth using actual fund performance and contributions should be adopted.*

I want to stress that there is not one performance number that will tell a plan sponsor whether a target date fund is good or not. Fiduciaries need to use prudent investor standards to determine the appropriateness of a solution. That being said, Russell has developed a performance measurement tool (Target Date Performance Measure*) that attempts to answer the question of how well a target date fund family has done at its task – specifically how well did it do in building retirement wealth over time versus other alternatives. The key attributes to this approach are: (1) It evaluates a target date family of funds as a whole instead of evaluating each individual fund in the series. And (2) it uses a dollar weighted approach -- which gives considerably more weight to the returns of those funds that are near their target date than those that are far away from their target dates.

More information about this approach will be released soon.

Finally, in regards to *manager selection*, most target date funds tend to be manufactured entirely out of proprietary funds from a single investment shop. While this won't necessarily lead to inferior results, these approaches do face headwinds, as it's hard to make the case that a single investment management firm is best-in-class in all asset classes.

A customized approach in which a plan sponsor creates their own target date fund is a possible solution, yet for many plan sponsors there are significant challenges doing this correctly and cost-effectively. Russell's target date commingled and mutual funds are put together using multi-manager asset class funds based on extensive research and the utilization of over 50 external investment managers.

Thanks for your time today and I look forward to further discussion.

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*Patent Pending

Disclosures

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Target date fund investing involves risk, principal loss is possible. Target Date funds are not a complete investment program.

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