TIAA-CREF Testimony for the DOL/SEC Joint Hearing on Target Date Funds and Similar Investment Options – June 18, 2009
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Background

TIAA-CREF is a not-for-profit provider of defined contribution pension plans and one of the world's largest retirement systems, with $363 billion in combined assets under management. We also are one of the largest sources of retirement income products in the United States, paying out $10 billion in retirement income each year to over 500,000 retirees. As a defined contribution retirement plan provider for over 90 years, TIAA-CREF has a unique perspective on pension plan design and target date funds. We have invested a substantial amount of time and attention to determining the appropriate asset allocation necessary to provide our clients with lifetime financial security.

In our testimony, we would like to address a few key points on target date funds. First, we will address the role that clear, concise disclosure plays in ensuring that individuals make appropriate investment decisions. Secondly, we will discuss the important role target date funds have taken on in many defined contribution plans. Next, we will look at how a target date fund's portfolio changes as investors approach retirement, often referred to as the glide path. Finally, we will review steps individuals can take to smoothly transition into retirement once they have reached a target date.

Disclosure

The recent economic downturn, in which 401(k) participants have seen an average decline of between 30-40% in their portfolios, has caused policy makers, investors and the financial services industry to reexamine defined contribution plan products and reconsider their place in pension plan design. During this process, the issues of risk disclosure and portfolio composition have gained prominence. Target date funds quickly have become essential building blocks of defined contribution plans, providing plan participants with an effective tool not only for accumulating retirement savings, but also for managing retirement income. In light of the proliferation of target date funds and the market downturn, it is appropriate to examine how investment managers disclose their risks.

TIAA-CREF supports clear, concise, and meaningful disclosure of key investment information, regardless of the type of investment. With regard to target date funds in particular, investors should understand that the primary goal of such a fund is to maintain a diversified portfolio over time that offsets many of the risks associated with overexposure to any particular asset class.

To ensure that investors have complete information regarding target date funds, TIAA-CREF believes that the funds **must**: (1) provide a detailed description of how the portfolio will change regarding each asset class in the fund, perhaps in graphic form so that the glide path can be easily discerned; (2) clearly state the allocation for each asset class in the fund; (3) provide a listing of the funds that comprise each asset class; and (4) provide a brief description of the risks associated with each asset class. The prospectus also should include a clear description of the sum of all the fees participants pay. We also believe it is important to ensure investors receive adequate education regarding what these funds can and cannot do.

As a provider of both defined contribution retirement plans and retirement income products for over 90 years, TIAA-CREF has researched extensively the appropriate asset allocation to provide our clients with lifetime financial security. Based on our research, the two most important elements in defined contribution plan design are the length of participation and amount of contributions made to the plan. The greatest protection against market risk is contributing throughout your working years at a sufficient rate. While asset allocation is important, no allocation scheme can make up for deficiencies in participation duration or contribution rate. Given these findings, we encourage and applaud efforts to allow employers to institute automatic enrollment programs that encourage employees to save for retirement.

Portfolio Composition

Our research has proven time and time again that a balanced portfolio of multiple asset classes is essential to creating wealth and preserving financial security. We promote the prudent use of traditional assets, such as stocks and bonds, to provide diversification and enhance risk-adjusted returns. But we believe that other asset classes such as real estate, guaranteed interest annuities, stable value funds, and TIPS also provide diversification benefits to savers and can serve as suitable default investment options. Nevertheless, issues around daily liquidity have kept some of these asset classes out of certain target date funds, in particular those funds that are required to be made up of registered securities (e.g., target date and lifecycle funds in the 403(b) marketplace), while other types of plans under different Internal Revenue Code sections (e.g., 401k plans) have no such restriction. We believe that the benefits that these asset classes would provide to the average investor in these plans merit a review on behalf of the DOL and the SEC. We encourage both agencies to consider revising these regulations, especially for the 403(b) marketplace, to provide consistency and to allow for the inclusion of these non-traditional asset classes in all target date portfolios.

While equity prices fluctuate, we agree with research that demonstrates equity investors earn a premium over time for taking on additional risk.[1] This has led us to conclude that equities are an essential part of an investment portfolio in both the accumulation and retirement income phases. The recent poor returns of the publicly traded equity markets have sparked a debate about this point, especially concerning how these returns have affected individuals at or near retirement. But it is important to focus on the long term nature of investing not only up to retirement, but through retirement as well. Many if not most people will live 20, 25, 30 years or more in retirement. As a result, we believe it is important not to limit or constrain a retiree's opportunity to benefit from this asset class. Appropriately risk mitigated growth is as important during the income phase as it is during the accumulation phase as it can help reduce some of the risks to retirement income, such as the potential for outliving savings and high health care expenses.

[1] Market Results for Stocks, Bonds, Bills, and Inflation 1926-2008, Ibbotson SBBI 2009 Classic Yearbook, http://corporate.morningstar.com/ib/documents/MarketingOneSheets/DataPublication/SBBI_ClassicTOC.pdf.

Glide Path

The glide path, or how a target date fund adjusts its portfolio over time, is an essential element of target date funds and an important feature for investors to understand. Recent studies have discovered that the portfolio composition of near term target date funds varies widely among investment providers. Some funds were found to be overly aggressive based on the investor's time horizon and suffered significant losses during the recent market decline. Others were very conservative and, while they missed much of the market decline, they now leave investors exposed to a long-term risk of inflationary erosion.

TIAA-CREF has 10 Lifecycle Funds[2], starting with an initial allocation of 90% equity and 10% fixed-income. At 25 years before the fund's maturity date, the equity allocation decreases at a rate of approximately 1.6% each year until the fund ultimately reaches an allocation of 40% equity and 60% fixed income 10 years beyond the target date. This deliberate approach helps our Lifecycle Funds maintain an appropriate level of risk while still providing the growth potential necessary for building assets.

The specific allocation of the equity portion of the Lifecycle Funds is 75% domestic equity and 25% foreign exposure. Investments are diversified among styles (growth, value and blend), approach (enhanced indexing and active management) and

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[2] TIAA-CREF Lifecycle Funds are designed to provide a single diversified portfolio managed with a target retirement date in mind. As of 3/31/09, TIAA-CREF Lifecycle Funds assets total more than $1.9 billion. More information about these funds can be found in the fund prospectus.

capitalization (small-, mid- and large-cap). This broad diversification helps the funds succeed in various market cycles.

We recognize that, due to the cyclical nature of asset class returns and individual risk preferences, there is no single "right" or "perfect" answer to the glide path question. There are multiple, appropriate paths to achieving the desired portfolio composition and, as experience with new asset classes grows, improvements to glide path design are likely to emerge. We urge the DOL and the SEC to issue guidelines that ensure full and clear disclosures regarding both the composition of target date funds and the structure of the glide path so that plan sponsors can make fully informed decisions. At the same time, however, fund managers need to be able use their own research and experience to determine both the glide paths and the underlying investments that comprise target date funds.

Target date and beyond

Target date funds are designed to be a "one-stop" solution that enables investors to set a course for their retirement through automatic asset rebalancing and continuous diversification based on a retirement goal. How a fund's allocation changes, and what the particular glide path is once an investor reaches the target date varies among investment firms. Many firms continue to use the glide path beyond the target date until a time when the allocation becomes fixed. For example, at TIAA-CREF the allocation in our Lifecycle Funds becomes static 10 years beyond the target date at which time we convert investors into our Retirement Income Fund, which is allocated 40% to equities and 60% to fixed income. But given the increased longevity of individuals, we are considering substantially extending that time horizon. Funds should be required to explain to investors how long the glide path will remain active and how the fund's allocation will be handled once the target date is reached. It is also important for investors to know that once they reach the target date and/or when they need to use the funds as income, they need to take additional steps to protect their retirement income.

A common question asked by many retirees is how the assets that they have accumulated over a lifetime of work will be distributed in retirement. TIAA-CREF supports the same asset allocation tenets in the distribution phase of a retirement plan as we do in the accumulation phase, which include maintaining a well-diversified portfolio and using multiple asset classes to attain lifetime financial security. We also strongly believe that guaranteed lifetime income is essential to ensure a financially secure retirement. Target date mutual funds cannot provide for this essential need. For this reason, we feel that it is important for retirees to be encouraged, or perhaps required, to place all or a portion of their retirement savings into a lifetime annuity that offers the same broad based asset classes as in the accumulation phase.

We recognize that there is no "one size fits all" approach to retirement income management. Each individual will have divergent investment and income needs that can be met only through a flexible set of income options ranging from guaranteed lifetime income (annuities) and systematic withdrawals to occasional partial cash distributions.

Conclusion

We support the use of target date funds in retirement plans. Properly constructed target date funds with clearly defined investment goals and parameters provide investors ready access to a professionally managed, broadly diversified portfolio, which is essential to building a successful defined contribution retirement plan. We look forward to working with the DOL and the SEC on this issue and thank you for the opportunity to voice our views on this essential investment option.