From: Leonard_Glynn@putnam.com [mailto:Leonard_Glynn@putnam.com]
Sent: Friday, June 05, 2009 10:23 AM
To: EBSA, E-ORI - EBSA
Subject: Request to Testify from Putnam investments -- File Number 4-582 Target Date Joint Fund hearing June 18, 2009

To: The Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, NW.,Washington, D.C. 20210

From: Leonard M. Glynn, Managing Director, Policy,
Putnam Investments, 1 Post Office Square, Boston, Ma.
617-760-1074

In re: Target Date Fund Joint Hearing – File Number 4-582

Dear Sir or Madam:

I am writing to advise you that Jeffrey Knight, Managing Director and head of Global Asset Allocation of Putnam Investments wishes to testify and would be willing to take questions at the joint hearing hosted by the Department of Labor and the Securities and Exchange Commission this June 18 at the DOL in Washington.

Our understanding is that the hearing will discuss issues surrounding the oversight and regulation of target-date or 'Lifecycle" funds used in retirement and workplace savings plans. We would be pleased to address these issues and to answer any questions that may be raised.

As you know, Putnam Investments is a Boston-based asset management firm with more than $100 billion under management. We are an active participant in America's workplace savings industry and our Chairman and CEO, Robert Reynolds, has long been an advocate of efforts to strengthen workplace savings in the interests of participants.

I have attached a detailed outline of our proposed testimony – which would take approximately ten minutes to enter orally.

Please let me know what more we need do. Please also let me know if Mr. Knight will have a speaking role on June 18th so that we can plan on traveling to Washington.

All the best,
Leonard Glynn

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Putnam Investments
Outline of Testimony on Lifecycle Fund Issues
Joint DOL/SEC Hearing
File Number 4-582 Target Date Fund Join Hearing
June 18, 2009 – Page 1 of 2

Background: The Rise of Lifecycle Investing

The severe market downturn in 2008 and the resulting loss of value in many retirement portfolios has drawn high scrutiny to lifecycle investment strategies, which have been among the fastest-growing elements of workplace savings. Their growth has largely been due to the de facto endorsement that lifecycle funds received when they were cited as a qualified default investment alternative for 401(k) plans in the Pension Protection Act (PPA) of 2006. The rapid adoption of lifecycle strategies since then has been one of the most striking examples of positive policy uptake – ever – in part because the theory at the heart of lifecycle investing is so intuitively appealing.

It makes sense, after all, for young investors to commit the bulk of their savings to higher-risk, higher-returning stocks since they have little to lose and many years to make up for any downturns. Over time, as their wealth grows, it equally makes sense for middle-aged investors to hedge their bets by shifting steadily – as lifecycle strategies do – to lower-returning, but less volatile assets like bonds. The closer one approaches retirement and the larger one's assets grow, the stronger grows the case for yet more conservative allocation since there is more money at risk, less toleration for volatility and less time to make up for any losses.

This pattern seemed to be validated quite well in the first real-life stress test of lifecycle strategies, namely when the dot.com bubble burst and stocks crashed from 2000 to 2003. Lifecycle funds intended for people planning to retire in the years 2000 or 2005 generally held up very well through that trauma -- even registering gains in many cases – because even while the cumulative return of the S&P 500 fell 37.61% over those years, the Barclays Aggregate Bond Index rallied 33.47%. Those "non-correlated" returns provided a very powerful offset just as diversified investment theory suggested they would.

But over the next few years, lifecycle fund managers faced a combination of pressures – from rising stock markets, to the surge in adoption of lifecycle strategies following the PPA to the fund industry's all-too-typical focus on short-term performance rankings – even in funds intended for lifetime income. This unbounded intra-industry competition tilted the lifecycle universe towards higher and higher levels of equity allocations in many funds.

The Impact of the 2008 Downturn

By early 2008, as a recent report to the Senate Committee on Aging showed, many lifecycle fund providers had lifted their equity allocations to levels of 50% or more – even in target date funds for 2010, that is in portfolios intended for people planning to retire within two years. That allocation shift proved exceptionally risky when the Crash of 2008, a true "100-year flood," inundated both stock and bond markets.

While the S&P equity index dropped 39% in 2008, many fixed-income assets commonly used in lifecycle funds, such as corporate and mortgage-backed bonds, also fell sharply in a rare and very damaging correlation. Apart from U.S. Treasuries and cash itself, in fact, virtually every major asset class dropped in sync.

For investors in or very close to retirement who had committed the bulk of their assets to lifecycle strategies heavily weighted to equities, the timing was awful. Many lifecycle funds fell by 25% to 30% or even more -- at precisely the time that some of these investors needed to begin drawing current income from these shrinking portfolios. For those in that situation the impact was severe. Younger investors in lifecycle funds have more time before retirement. They may well recoup all of last year's losses long before they have to draw down their savings. For them, the stock market drop represents a chance to buy low, accumulating long-term equity at fire-sale prices. Still, it is perfectly legitimate to judge a risk-dampening strategy at the margin, under stress. And by that standard, too many lifecycle funds did fall short last year – and badly so.

But to dismiss the lifecycle concept now, right at a possible market bottom – or to return to such options as stable value funds in our retirement policy planning – would be a gross mistake. Long-term policy should not be based on momentary market snapshots, but on longer-term patterns that at least provide some historical perspective. The impact of market declines last year, for example, was not uniformly damaging to all lifecylce investors. For young investors' 2008's "reset" of equity risk premia might well increase their lifetime expected returns particularly on contributions not yet made to their accounts. It is dangerous to make policy level decisions based on episodic damage to a selected sub-group of participants. Rather than discarding the lifecycle template, this suggests we would do better to refine and improve it, taking recent experience into account.

Financial providers, policy makers and plan sponsors can – and should -- find ways to shore up the stability of lifecycle offerings and enhance their ability to reliably provide retirement security. The bad news is that a theory that had seemed nearly bullet-proof proved to have real vulnerabilities in practice. The good news is that we can – and should – fix them all.

Three Steps to Strengthen Lifecycle Funds

Here are three steps that we at Putnam believe the mutual fund industry itself can take – in collaboration with regulators and legislators -- towards a more robust model for the next generation of lifecycle funds.

Consider limits on the total equity shares in the "mature" phase of qualified defaults. Recognizing that long periods of market gains can spur an unhealthy race to increase equity allocations in lifecycle funds and thereby lift performance, regulators and providers should discuss and then agree on a ceiling for pure equity allocations in the "mature" phase of lifecycle glidepaths – i.e. the ten years prior to a target retirement date and beyond. A cap of 50% -- perhaps even lower – for funds meant for investors aged 55 and over seems prudent -- at least for those lifecycle funds used as the "defaults" in workplace savings plans. But even a 50% cap on pure equity holdings might not be robust enough to protect investors struck by another financial "Katrina" like 2008. So we believe the next generation of lifecycle funds should be buttressed even more.

Integrate absolute return strategies. One way to do that would be to direct a significant share of lifecycle portfolios to the newly emerging category of absolute return funds. Such strategies – which can employ hedging and short-selling to seek positive returns even in down markets -- have long been a central element in wealth preservation strategies for high-net worth and institutional investors. Since they have at least the potential of gains even amid severe securities market slumps, absolute strategies offer valuable diversification from "relative" return funds, which almost always, by definition, suffer severely when all securities markets slump in unison. Directing a quarter, a third – or more – of a qualified default lifecycle portfolio into absolute return strategies at the "mature" phase of its roll-down – i.e. post age 55 – could be a prudent way to curb volatility at a time of investors' maximum vulnerability.

Offer a protected income option to further curb risk. One last step in a "belt-and-suspenders" approach to buttressing lifecycle investing would be to offer a clearly-disclosed annuity or other assured income option to lifecycle investors – again, in the mature, post-55 stage of a lifecycle roll-down. By opting to commit a quarter, a third or more of their assets to purchase a fixed annuity, mature lifecycle investors could potentially further diminish the risk that any possible replay of 2008 would severely damage their retirement income prospects. In considering this option as an element of future qualified default offerings, regulators would be well advised to define a core annuity offering as a template. The goal would be to provide a simple, understandable, scaleable model -- and also to curb potentially irrational competition among insurance providers, who have repeatedly been tempted to make offers that they later fail to deliver on.

All three of these enhancements to lifecycle fund design are permissible for providers to offer and for plans to adopt under current law. Indeed, as we revitalize our defined contribution savings business at Putnam, we either offer or are working on all of them. These changes will go far towards making the next generation of lifecycle offerings a more robust, more reliable source of retirement income for future generations – even through severe financial storms.

But while we at Putnam can – and will work to develop and implement these changes, we believe that Congress, the Department of Labor and the Securities and Exchange Commission could help a great deal, as they did with the Pension Protection Act three years ago. Explicit endorsement of prudent changes through law and regulation has a powerful impact. We believe that the evolution of lifecycle investing and its application in workplace savings could benefit from further legal protections for employers who do the right thing – and move to adopt the ideas we've suggested. The time for positive change is now.

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