

JOINT HEARING OF
THE DEPARTMENT OF LABOR
AND
THE SECURITIES AND EXCHANGE
COMMISSION
ON TARGET DATE FUNDS

TESTIMONY OF
BARCLAYS GLOBAL INVESTORS

JUNE 18, 2009



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Barclays Global Investors ("BGI") welcomes the opportunity to share our views and experience regarding target funds to the Department of Labor and the Securities and Exchange Commission (the "Agencies"). BGI, a subsidiary of Barclays Bank PLC, is one of the largest investment managers in the world and the largest provider of structured investment strategies such as indexing, tactical asset allocation and quantitative active strategies.

BGI has been managing assets for defined contribution ("DC") investors for over twenty years. We are currently the fourth largest manager of DC assets in the United States and the largest investment-only DC provider. Importantly for today's hearing, BGI was the original architect of target date funds (also referred to as lifecycle funds) and has one of the longest track records in the industry in lifecycle asset management.

It is our understanding that the Agencies are evaluating the performance of target funds in the wake of the significant market dislocation in the fourth quarter of 2008 with a potential eye toward either specifying asset allocation ranges or recommending changes in the disclosures provided to participants (particularly those at or near retirement).

In this light, we would like to focus our testimony primarily on:

1. BGI's approach to asset allocation with our target date funds (the "glidepath")
2. A comparative analysis of target date fund performance in 2008
3. Commentary on the importance of providing flexibility around the construction of the glidepath
4. Commentary on communicating to plan participants in ways that are simple for them to understand and allow them to make informed investment decisions

The purpose behind our providing an in-depth discussion in this testimony of BGI's target date fund investment strategy is to twofold: 1) to illustrate the discipline and scientific rigor that underlie the construction of lifecycle funds 2) to illustrate how the objective of a fund series (e.g., income replacement or stable consumption) can impact the desired equity allocation in retirement.

1. BGI's Approach to Asset Allocation

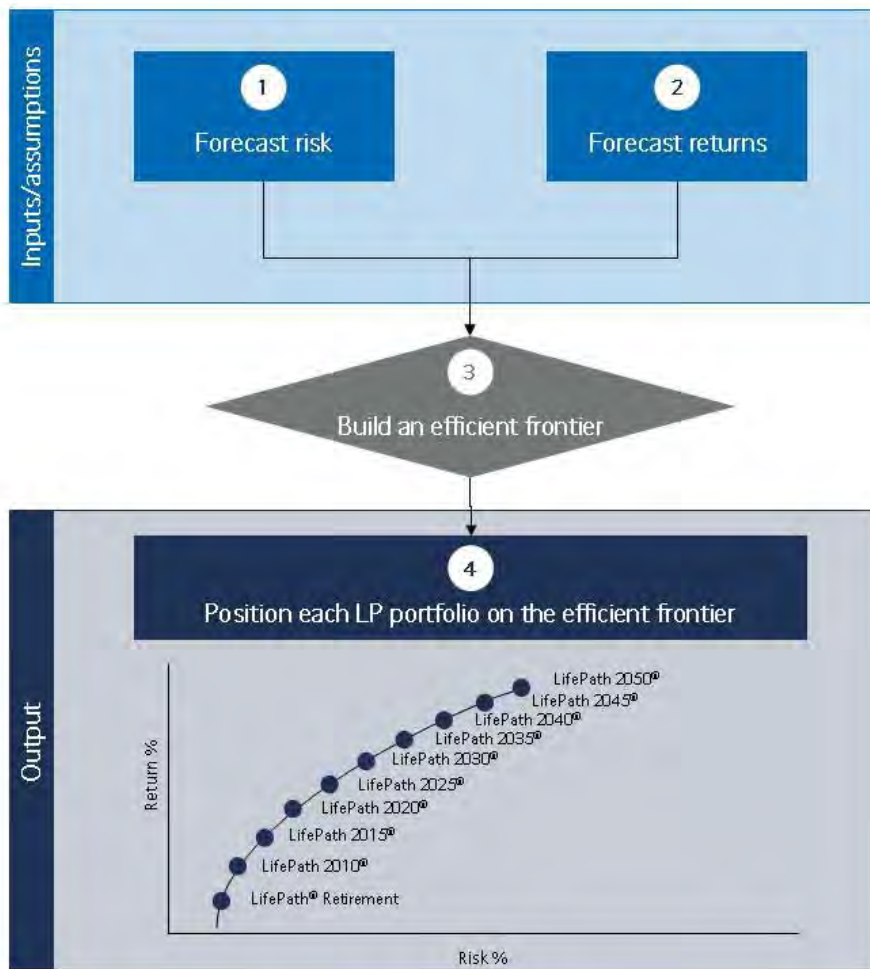
BGI has been incorporating asset class forecasts into our investment products since the early 1970s. We created target date funds in 1993 (and received a patent on our methodology) as a natural extension of our multi-asset class research, but with a very specific goal in mind: designing a fund that would allow DC investors to achieve well diversified returns on par with those achieved in defined benefit plans.

Defined contribution plans have typically underperformed defined benefit plans by between 1.5% and 4% per annum primarily due to extreme asset allocations and fees.¹ The creation of institutionally managed lifecycle funds seeks to address this issue by giving participants an easy way to invest in efficient, auto-rebalancing portfolios that look to provide age appropriate levels of risk and return.

¹ Waring, M. Barton, Laurence B. Siegel, and Timothy Kohn. 2004. "Mind the Gap! Why DC Plans Underperform DB Plans and How to Fix them." Investment Insights 7, no. 1 (January), San Francisco: Barclays Global Investors

BGI's target date funds employ the sophisticated investment processes that are commonly utilized in the defined benefit market. We consider both investor risk tolerance and investment horizon into the portfolio construction process. (See Figure 1 for a high-level overview of the BGI investment process for LifePath.) As described in more detail below, BGI's lifecycle funds incorporate a range of different asset classes, are constructed using the tools provided by Modern Portfolio Theory², such as mean variance optimization³, and evolve systematically along a risk frontier as a constant function of time.

Figure 1: BGI LifePath Investment



² Modern Portfolio Theory is an investment theory that emphasizes the rigorous analysis of risk and return as the basis for investment decisions and also emphasizes three elements that are crucial to building portfolios, including asset allocation; optimization of the risk/return tradeoff; and performance attribution.

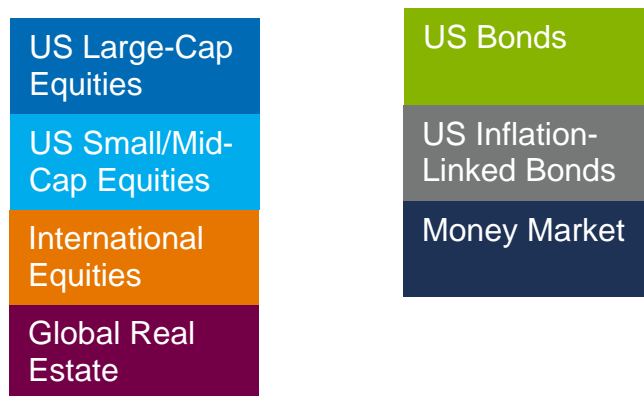
³ The ratio of the mean expected excess return on an element of investment to the variance of return. The conditions for optimization of a portfolio across several investment opportunities take the form that mean/variance ratios be equal, or strongly related.

Asset Class Incorporation

BGI's target date funds, "LifePath",⁴ provide participants with exposure to a range of different asset classes in order to maximize diversification. BGI currently includes seven asset classes within our target date funds (see Figure 2). Each of these asset classes is incorporated into the suite of funds we offer in order to raise the expected return for each unit of risk taken.

As part of BGI's continual evolution of the lifecycle, we reevaluate the asset classes included in the funds on an annual basis. As new asset classes become available we assess whether or not the new asset class is appropriate for inclusion, taking into consideration investability and cost. Over the last few years we have made several important asset class additions to our funds: Treasury Inflation Protection Securities (TIPS) in 2006, emerging markets in 2007, Global Real Estate Investment Trusts (REITS) and international small cap in 2008. The asset classes included in BGI's current target date fund series are illustrated in Figure 2.⁵

Figure 2: Seven Asset Classes



Mean Variance Optimization

BGI believes that the most appropriate method for constructing an efficient multi-asset class portfolio is to utilize mean variance optimization (the process by which different asset classes are combined in such a way to achieve high risk adjusted returns). In order to employ an optimized approach, BGI draws on our extensive experience in asset class risk and return forecasting.

We use both historical data as well as our own proprietary modeling capabilities in order to construct our asset class risk and return forecasts. Importantly, one of the reference points we utilize is the average asset allocation of the top private defined benefit plans in the United States, thereby incorporating the consensus views of some of the largest and most sophisticated investors in the world. Once we develop a consistent set of risk and return forecasts for all the asset classes included in our lifecycle portfolios, we are able to create a series of highly efficient,

⁴ BGI's lifecycle funds are marketed under the name Lifepath©. LifePath target date funds are offered by BGI both as mutual funds (registered investment companies--RICs) and as bank collective investment funds. LifePath® is a registered trademarks of Barclays Global Investors, N.A. The LifePath products are covered by U.S. patents 5,812,987 and 6,336,102

⁵ BGI offers both mutual fund as well as commingled trust fund ("CTF") versions of LifePath. While both fund structures are fund-of-funds and employ the same glidepath construction methodology and asset classes, there are differences with regard to the use of underlying funds. The mutual fund version invests in risk-controlled active mutual funds as well as iShares ETF funds. The CTF versions invest only in underlying CTF vehicles.

investible portfolios. We define efficiency as maximizing return for a given level of risk and the set of these efficient portfolios is referred to as the efficient frontier.

LifePath® Glidepath Methodology and Rationale

In order to construct a glidepath, you need to identify the appropriate risk level for each portfolio at a given point in time, as well as determine how that risk should change throughout time as a participant nears retirement. BGI begins this process by setting the risk level for the target date retirement portfolio⁶.

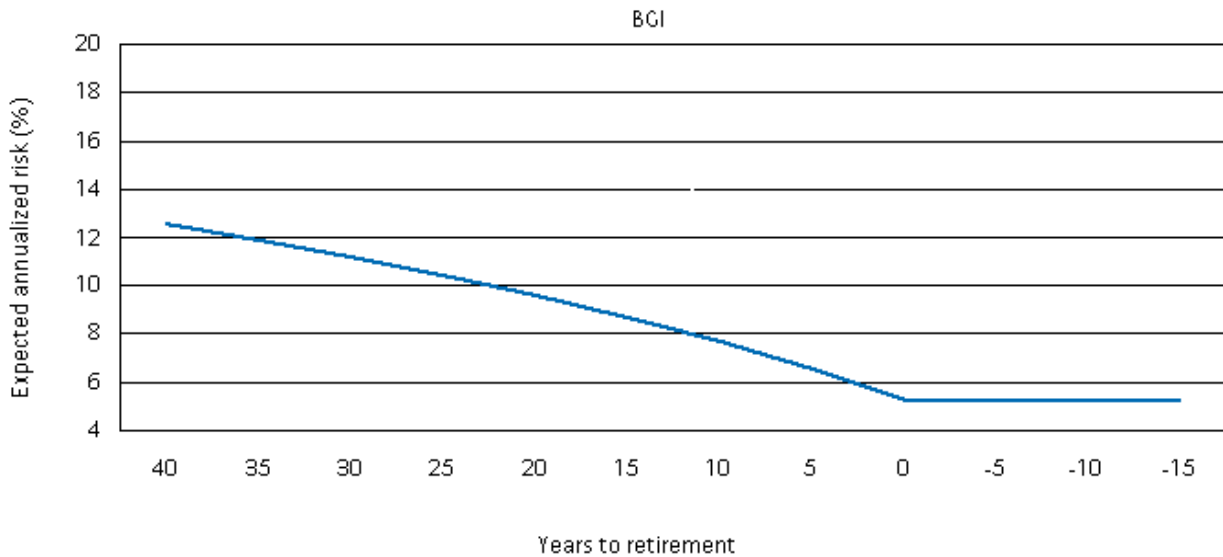
At retirement, there are a number of investment and lifestyle considerations that interact including how a retiree might need to adjust consumption in the event of a market downturn and the longevity effect or more simply, the risk of outliving one's assets. BGI's LifePath Retirement Portfolio has the objective of minimizing the risk that a retiree is forced to significantly alter her consumption patterns, either because of market dislocation or because of a higher than average lifespan, to less than a 1 in 10 chance. We determine the asset allocation consistent with this objective through Monte Carlo simulations.

Our simulation process incorporates a range of different expected asset class returns, volatilities and covariances, as well as current data on the level and variability of average participant drawdowns. This approach which focuses on the ability of the fund to support consistent drawdowns across different market environments is designed to offer the retiree confidence that she can meet her monthly spending needs. BGI's current allocation to equity and equity like instruments is 38.5% in the Retirement Portfolio which equates to an annualized expected volatility of 6.47%.

Having determined the risk level within the retirement portfolio and located it on the efficient frontier, we then place each of the remaining portfolios on the risk/return continuum, spacing them evenly across the efficient frontier so that the relationship between the time until retirement and the level of risk remains constant across the entire glidepath. Implicit in our location of portfolios across the efficient frontier is the notion that younger investors with very long horizons to retirement are well positioned to bear investment risk.

⁶ The LifePath portfolios (offered at five and ten year increments, i.e., 2010, 2015, 2020, up to 2050) "fold in" to the LifePath Retirement portfolio at maturity. At the point where the year in the name of the LifePath portfolio is reached, the asset allocation of the fund will be identical to that of the Retirement Portfolio. For example, the LifePath 2020 asset allocation will have the same target allocations as the LifePath Retirement portfolio on 12/31/2019. At that time, all assets are merged into the Retirement fund. There is no action required of participants.

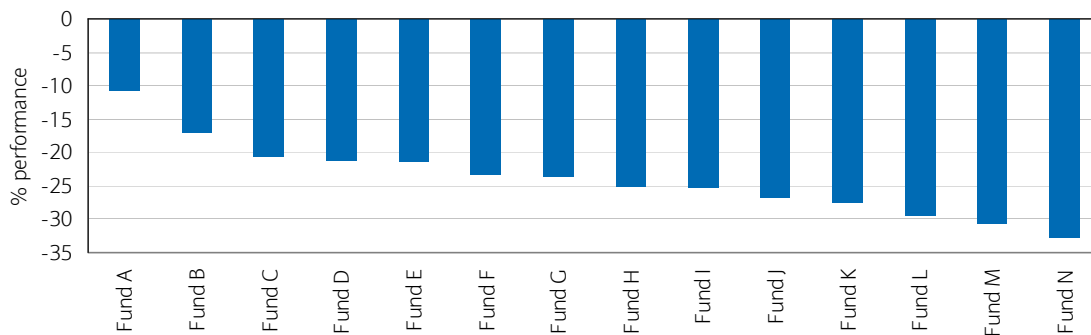
Figure 3: BGI Glidepath



2. A comparative analysis of target date fund performance in 2008

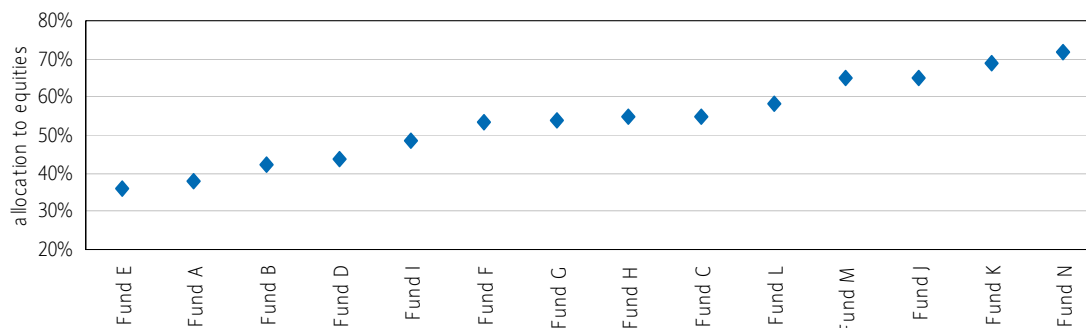
The performance of target date funds, particularly those funds geared for participants at or near retirement (ie. The “2010 portfolio”), has received a great deal of attention over the last several months. As illustrated in the graphic below there was a very wide range in performance among target date funds across the industry with some portfolios declining as much as 30%+ in 2008.

Figure 4: 2010 Target date Fund Performance (2008 Full Year)



These stark differences in return among target date fund retirement portfolios reflect very different allocations to equity (ranging from 35% to 75%) in the retirement portfolios, which in turn belie very different approaches to glidepath construction. As highlighted earlier, BGI's stable consumption approach anchors the glidepath in the retirement portfolio. The equity allocation for the retirement portfolio is the stock/bond mix that best balances two risks: longevity risk (the risk of outliving one's savings) and market risk (the risk of needing to alter consumption because of loss in account value similar to the experience of 2008).

Figure 5: 2010 Target date Fund Allocations to Equity and Equity-like Asset Classes



Providers who allocate a much higher percentage of the portfolio to equity in the latter years are likely focusing more heavily on what is often termed “income replacement.” The goal in these funds is to determine the retirement portfolio most likely to yield the highest amount of expected annual income for the participant. A very simplistic way to understand the differences in these two approaches is that a stable consumption approach will focus on minimizing the effect of the extreme event (i.e., 2008), whereas an income replacement approach will focus on increasing the mean or maximizing expected replacement income in normal market conditions.

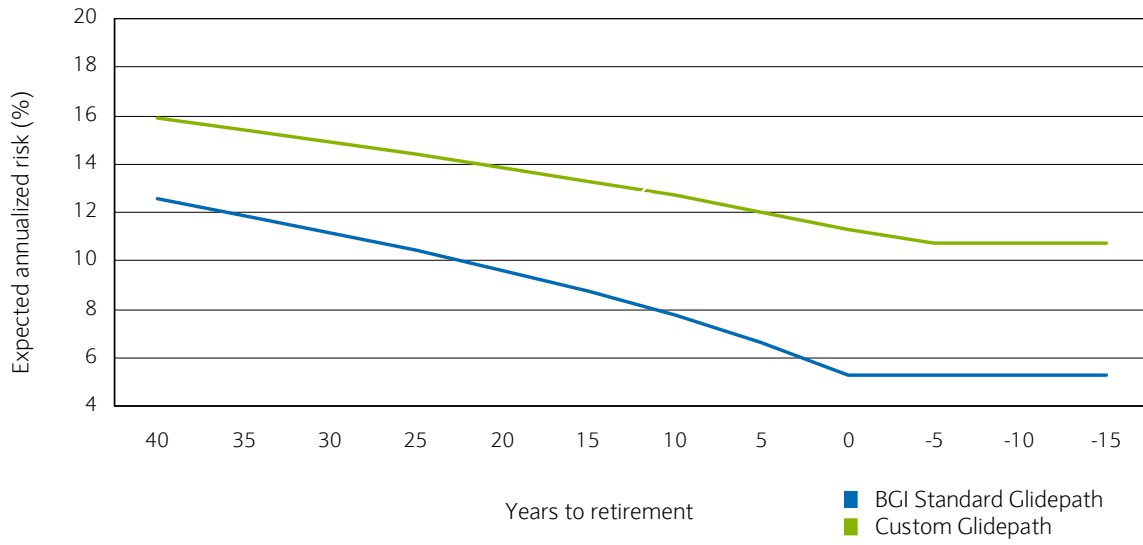
It is important to highlight that neither of these approaches is incorrect; however, they are different. When making a decision between providers, plan sponsors will (and do) consider the merits of each approach.

3. Commentary on the importance of providing flexibility around the construction of the glidepath

When BGI initially created the target date fund in 1993, we did so with the understanding that we would know only one thing about the participant—her expected retirement date. That is the more generalized data point around target date funds. However, BGI works closely with plan sponsors to several more pieces of information about their particular participant population at a macro level including 1) expected defined benefit payment 2) average retirement age and 3) average allocation to company stock. Using this information, BGI will in certain cases create a customized glidepath which can differ materially from our standard product.

Although we use the same asset class forecasts and process, the solution differs when additional inputs are taken into consideration. For example, all else being equal a lower retirement age would suggest a more aggressive asset allocation at retirement (because of longevity risk). Below we illustrate a comparison between the BGI LifePath standard glidepath and a custom glidepath (Figure 6). This customized glidepath was created for a client whose DC population has both an open defined benefit plan and a low average retirement age. These factors can significantly influence glidepath construction and this example emphasizes the need to allow for customization of the glidepath. We also incorporate this information to illustrate that a plan sponsor making a prudent decision may elect a glidepath with a very high equity allocation at retirement.

Figure 6: Custom Glidepath Example

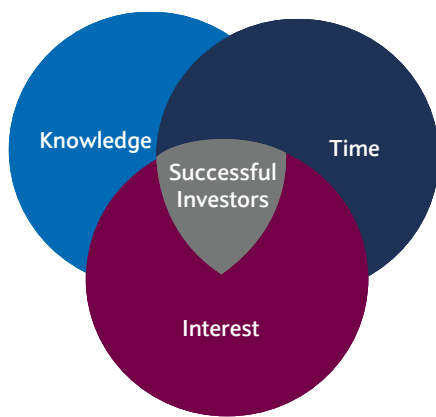


4. Commentary on communicating to plan participants in ways that are simple for them to understand and allow them to make informed investment decisions

Because of our history in offering target date funds, BGI is well versed on the challenges of plan sponsors' efforts in communicating with participants. In the early years of target date funds, we consistently found that these funds were not fully understood by participants. They either tended to think of the target date as a laddering exercise (e.g. a participant would allocate a little to each fund) or they didn't recognize the simplicity of the fund doing all the work for them.

We therefore began investing in research on participant behavior to identify which participants would benefit the most from a total investment solution and find a message that would resonate with them. Through both primary and secondary research, we found that participant populations can typically be segmented into three groups on the basis of their knowledge, interest and time to invest (see figure 7 below). These groups are what we call the "lobbyists", the "special interest group" and the "silent majority." We built our target date funds to service the silent majority – the corpus of any DC plan that typically lacks the time, interest or knowledge to successfully invest their own retirement accounts. For this group, communications about investing need to be simple and focus on the benefits (pre-mixed portfolio, automatic diversification and rebalancing, etc.) rather than diving immediately into the investment details.

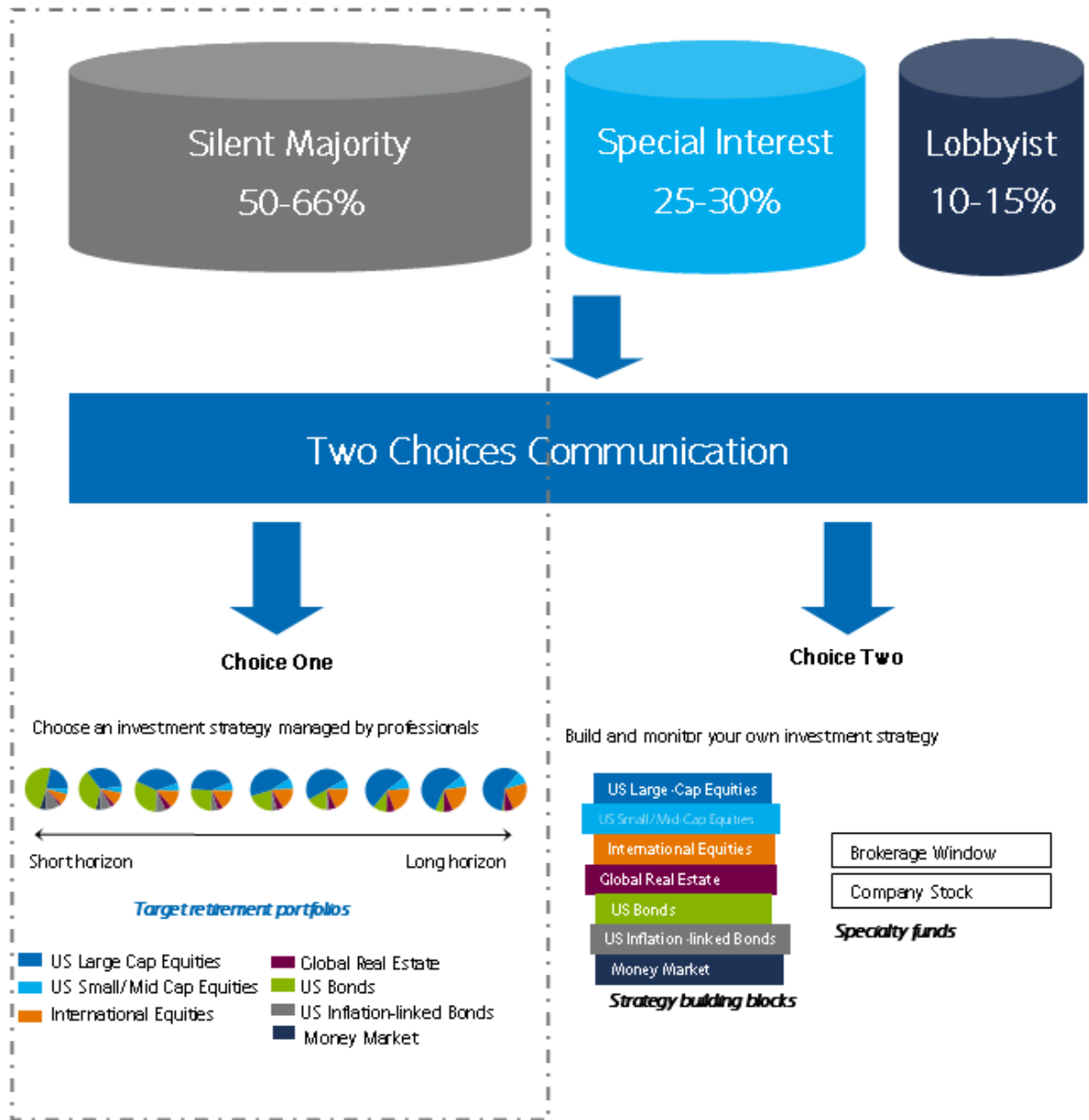
Figure 7: Segmented Participant Audiences



The Two Choices communication approach is now commonplace within most DC plans, particularly those who have implemented QDIA plan changes. By taking a segmented, tiered approach to communication, sponsors can direct their participants toward the choices that best suit their knowledge and engagement levels.

At BGI, we encourage plan sponsors to employ the Two Choices communication approach in a way that allows participants to self segment themselves by answering a very simple question: "Do you want to build and monitor your own investment portfolio or would you prefer to have a professional do it for you?" In Appendix 1 to this testimony, we have included a sample communication which illustrates how plan sponsors utilize a Two Choices campaign to help make investing easier for plan participants.

Figure 8: Two Choices Communication Approach



We believe it is important that the Agencies consider the potentially negative effects of complicating the target date fund message. The simplicity of target dates funds is what makes them such effective investment vehicles for the participant who often lacks the expertise or time to effectively manage a retirement portfolio. Forcing sponsors to add multiple target date series (conservative, moderate and aggressive) or labeling funds would not only add significantly to plan costs but would also confuse participants. A provider might for example be relatively aggressive with their 2050 fund and conservative with their 2010 fund. When confused, participants will either make an election not to participate or utilize common (and sub-optimal) heuristics such as 1/n. (Please see Appendix 2 for more information on 1/n phenomenon).

If the Agencies determine that more disclosure is required, we would propose that a “risk ribbon” be considered where different plan options are placed along a risk continuum. See Figure 9 below for an example.

Figure 9: Risk Ribbon



It is also important to note that most target date funds investments are made through 401(k) and similar participant directed plans. According to Hewitt, about 77% of plans offer target date funds, and these funds are increasingly collective investment funds, not RICs. According to Greenwich Associates, 39% of large DC plans used CIFs in 2007. In considering disclosure regimes, the Agencies must consider that the plan fiduciary plays a critical role in selecting and monitoring investment options under the plan, and be careful not to impose a participant disclosure standard designed for individual retail investors who do not have the benefit of a fiduciary making the initial selection of investment options.

Conclusion

BGI has been managing target date funds since the strategy's debut over 15 years ago. We believe that incorporating them into defined contribution plans in a more meaningful way is an important step towards advancing DC plans into becoming credible, self-funded pensions.

We have shared in this testimony our disciplined approach to asset allocation, as well as some explanation for the range in returns across the industry. We do believe however that these returns need to be considered in context. Target date funds are very long-term investment strategies designed for participants with an investment horizon that often exceeds 40 years. It is important therefore to evaluate their efficacy over multiple years rather than focusing on one extraordinarily negative quarter.

When considering the participant, in the words of Harvard Behavioral Economist David Laibson, it is important to “help make good decisions easy and bad decisions difficult.” Complicating investment choice for participants could conceivably be more detrimental than a single shock to the stock market. If participants don't save and aren't able to make good decisions, we will continue to see the DC system struggle to mature and develop into a truly sound retirement system.

In closing, we would also like to underscore that fact that plan sponsors are very knowledgeable on glidepath construction and take great care when selecting a target date provider. BGI alone has had hundreds of discussions with sponsors and the investment consultants who often advise them on target date funds construction. In each of these discussions, plan sponsors, acting as fiduciaries, have endeavored to make the decision most appropriate for their participants.

Appendix 1

TESTIMONY OF BARCLAYS GLOBAL INVESTORS

JUNE 18, 2009



Connect With Your Benefits

PIP Investment Changes



PIP Investment Changes



February 2006

The Personal Investment Plan (PIP), Mattel's 401(k) plan is enhancing investment options/alternatives effective April 1, 2006.

Please take the time to read this brochure to learn about:



- LifePath® Portfolios: A new investment choice managed by professionals at Barclays Global Investors;
- Changes in investment funds offered;
- How existing account balances and investment elections in certain funds will automatically convert or “map” to the new investment options; and
- What actions you can take to change your current investment direction.



The new menu of investment funds continues to provide options in all the major asset classes, and now enables participants to choose a professionally managed investment solution (BGI's LifePath® Portfolios).

If you have any questions about the changes or the Personal Investment Plan (PIP), you may contact the Mattel Benefits Service Center at 1-877-841-8395 or log onto *Your Benefits Resources*™ website at www.resources.hewitt.com/mattel.

For more information about the Personal Investment Plan (PIP), please read the Summary Plan Description enclosed with this brochure.

NOTE REGARDING MATTEL STOCK FUND:

Effective April 1, 2006, the maximum amount you may contribute to the Mattel Stock Fund investment option is 25%. If you are currently contributing more than 25% to the Mattel Stock Fund, the amount in excess of the 25% maximum will be defaulted to the Stable Asset Fund.

Mattel is changing the way you look at retirement investing.



1



CHOICE ONE

Choose an investment portfolio managed by professionals or . . .

The BGI LifePath® Portfolios from Barclays Global Investors, N.A. will be added to the Personal Investment Plan (PIP) starting April 1, 2006.

- The LifePath® Portfolios are designed as complete investment solutions for participants in the PIP.
- Each LifePath® Portfolio is a broadly diversified portfolio, based on a projected retirement date.
- With the LifePath® Portfolios, owning just one fund will provide you with a diversified, professionally managed retirement strategy!

How do they work?

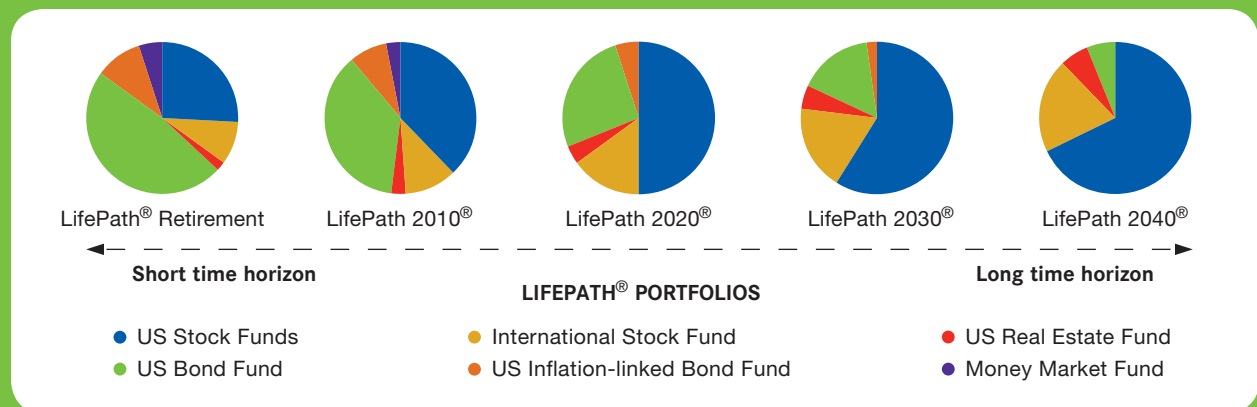
As time passes, a team of investment managers at Barclays Global Investors gradually shifts the investment mix from a greater concentration of higher-risk investments (namely stock funds) to a greater concentration of lower-risk investments (bond funds and money market instruments).

Each portfolio option—as in the LifePath 2020®—represents the approximate year when you plan to start withdrawing your money.

As you get closer to this year, the investment managers gradually adjust the portfolio's mix to try to maximize your return for the level of risk that is appropriate for each stage of your life. For example, the LifePath 2040® Portfolio option is designed for participants at the beginning of their careers while the LifePath® Retirement Portfolio option is designed for participants who are already at or near retirement.

Choose your target year

Your target year is when you plan to start withdrawing money from your account. To find your target year, simply add the number of years until you need the money to the current year. For example, if the current year is 2006 and you plan to retire in 24 years, your target year is 2030. You'd choose the LifePath 2030® Portfolio for your investment. If your target year falls between two portfolios, you may invest in the portfolio that most closely matches your target date or you can invest in both portfolios. For example, if your target year is 2035 you can invest in both the LifePath 2030® and LifePath 2040® Portfolio.



Participants now have two choices.



2

CHOICE TWO

Build and monitor your own investment portfolio

The Personal Investment Plan (PIP) also offers all the essential building blocks to create your own investment portfolio. To build your portfolio, you need to have a strategy that takes into consideration how much time you have to save, and your comfort level with risk.

Diversification is a technique designed to reduce your overall risk. By owning more than one fund, you minimize the impact of one fund's negative performance on your overall portfolio value. Remember, when creating

your own portfolio, it is important to understand each fund, diversify your assets and regularly review your asset allocation.

Use individual funds to create and monitor your own strategy

The following funds are available for participants' investments. You can mix and match any of these funds to create your own portfolio. For more details about these options, please refer to the additional investment fund information enclosed in this mailing.

The New PIP Investment Choices

Major Asset Category	Corresponding PIP Fund Option	Risk/Return
Stable Value Fund	Stable Asset Fund	Low
US Bond Market	Intermediate Bond Index Fund	Low
	Long-Term Bond Fund	Low/Moderate
US Large Cap Equity Market	Large Cap Equity Fund	Moderate/High
	S&P 500 Equity Index Fund	Moderate/High
US Small/Mid Cap Equity Market	US Small/Mid Cap Equity Fund NEW!	Moderate/High
	Wilshire 4500 Equity Index Fund NEW!	Moderate/High
International Equity	International Equity Index Fund NEW!	High
	International Equity Fund NEW!	High
Company Stock	Mattel Stock Fund (Limited to 25% Contribution)	High

It is now easier to understand and select a program that is right for you.

BUILD
YOUR
FINANCIAL
FUTURE

FUND CHANGES

If you are currently invested in any of the existing funds below, your holdings and future contributions will be mapped to the corresponding new fund, effective April 1, 2006. These existing funds will be closed and no longer offered after March 31. If you are satisfied with how your investments will be mapped **there is no action necessary**. Of course, you may reallocate your account balance among the investment options at any time.

Existing PIP Funds

New PIP Funds

Large Cap Growth—Wells Fargo



Large Cap Equity Fund—ICAP

Wilshire 5000—Barclays



Equity Index Fund—Barclays

Small Cap Growth—Wasatch



US Small/Mid Cap Equity Fund—AXA Rosenberg

Small Cap Value—Royce



US Small/Mid Cap Equity Fund—AXA Rosenberg

Russell 2000 Equity—Barclays



4500 Equity Index Fund—Wilshire

International Equity—Artisan



International Equity Index Fund—Northern Trust

Global—New Perspectives



International Equity Fund—The Boston Co.

TO TAKE ACTION

To change your investment election options, invest in the LifePath® Portfolios or change your contribution rate, contact the Mattel Benefits Service Center at:

1-877-841-8395

or

log on to www.resources.hewitt.com/mattel

Connect With Your Benefits




Appendix 2

TESTIMONY OF BARCLAYS GLOBAL INVESTORS

JUNE 18, 2009

The importance of election form design

A photograph of a white computer mouse on a wooden surface. The mouse is positioned on the left side of the frame, with its cord extending towards the top left. The background is a warm-toned wood grain.

Is your graphic designer helping your participants make the wrong investment decisions?

by Shlomo Benartzi

The number of funds an investor selects within their 401(k) plan is often an arbitrary decision with potentially devastating nest egg consequences. Although modern portfolio theory suggests that participants should consider risk and return profiles of any investment selection as well as their own risk tolerance, research shows that too many participants are making the wrong decisions. How can administrators combat this trend, and can better election form design make a difference?

Two academic studies reveal several alarming trends about participants' decision-making patterns. In 2001, Benartzi and Thaler found that plan participants had difficulty selecting among the dizzying list of funds available to them, and many divided their money evenly among the available investment funds, regardless of the funds' risk and return profiles.¹ In other words, when offered four equity funds and one bond fund, participants put 80% in equities, and when offered one equity fund and four bond funds, they invested 20% in equities.

Benartzi and Thaler tested the “number of lines” hypothesis to see whether participants tend to select as many funds as the number of lines provided on the form.² The researchers conducted a survey on *Morningstar.com* in which two groups of survey participants were presented with eight investment funds and were asked to allocate their retirement contributions. In both conditions, subjects could pick from one to eight funds, but half the participants were given a form with four fields and an option to click if they wanted

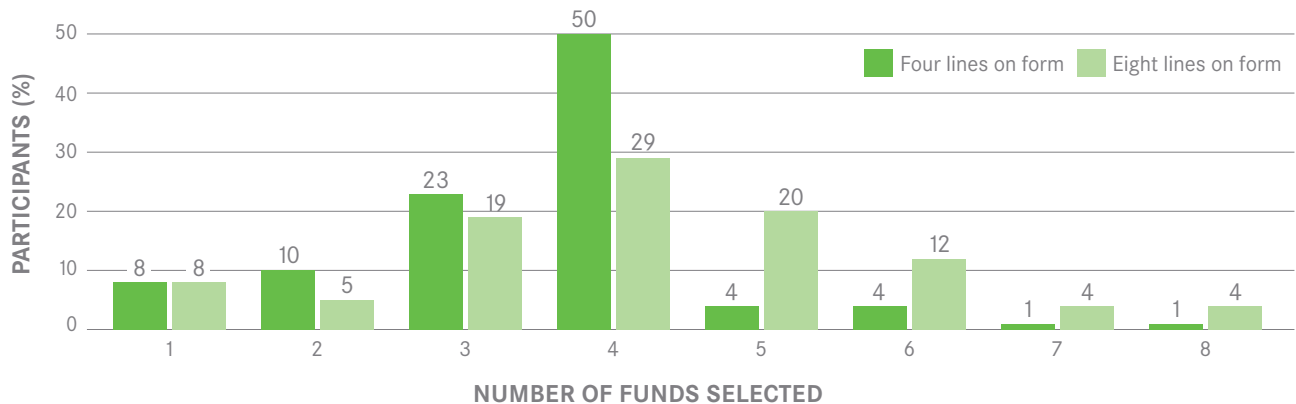
to select more than four funds and the other half were given a form with eight fields.

Despite the ease of selecting more than four funds by using the highlighted link, only 10% of the subjects in the first group actually did so. In contrast, 40% of those viewing the election form with eight lines chose more than four funds.

These findings suggest that the number of lines on the investment selection form has the unintended consequence of determining the number of funds participants choose. One frightening corollary is that participants' portfolio choices are inadvertently affected by the aesthetic decisions made by the graphic designers who set the lines and their placement on the investment election forms.

To avoid such unintended consequences, plan administrators should carefully consider election form design and avoid offering investors too many lines for investment options. Watch for more information about this topic in future issues of *DCfocus*. **DC**

DON'T GIVE PARTICIPANTS TOO MANY OPTIONS—THEY MAY TAKE THEM ALL



1 Shlomo Benartzi and Richard Thaler, “Naive Diversification Strategies in Retirement Savings Plans,” *American Economic Review*, March 2001 (vol 91.1).

2 Shlomo Benartzi and Richard Thaler, “Heuristics and Biases in Retirement Savings Behavior,” *Journal of Economic Perspectives*, forthcoming.

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