No. 12-2056

IN THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

RONALD C. TUSSEY, et al.,

Plaintiffs-Appellees,

– against –

ABB, INC., et al.,

Defendants-Appellants.

On Appeal from the United States District Court
for the Western District of Missouri

BRIEF FOR THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF DEFENDANTS-APPELLANTS AND IN SUPPORT OF REVERSAL

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RULE 26.1 CORPORATE DISCLOSURE STATEMENT

Amicus curiae certifies that it has no parent corporation and no publicly held corporation owns ten percent or more of its stock.

STATEMENT OF COMPLIANCE WITH RULE 29

All parties have consented to the filing of this brief. *Amicus curiae* certifies that no party's counsel authored this brief in whole or in part, no party or party's counsel contributed money that was intended to fund preparing or submitting the brief, and no person, other than *amicus curiae*, its members, or its counsel, contributed money that was intended to fund preparing or submitting the brief.

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STATEMENT OF IDENTITY AND INTEREST OF AMICUS CURIAE

The Securities Industry and Financial Markets Association ("SIFMA") brings together the shared interests of hundreds of securities firms, banks, and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation, and economic growth, while building trust and confidence in the financial markets. SIFMA is the U.S. regional member of the Global Financial Markets Association.

As the leading voice for the U.S. securities industry, SIFMA has a strong interest in promoting complete and accurate information about the nature of securities products, including target-date funds like the funds involved in this case. SIFMA submits this brief in support of Defendants-Appellants to address several misunderstandings about target-date funds that are reflected in the District Court's opinion, to clarify how target-date funds work, and to explain how the Department of Labor treats target-date funds.

SUMMARY OF ARGUMENT

The District Court failed to recognize the following key characteristics of "target-date" or "target-dated" funds ("TDFs"):

First, TDFs automatically shift their investment mix over time to reduce the portion of the fund allocated to growth-oriented equity investments and increase the portion allocated to more conservative fixed-income investments. Thus, they are fundamentally distinct from traditional balanced funds, where the asset allocation does not automatically become more conservative over time.

Second, TDFs are designed to make it easier for people to invest for retirement. An investor farther from retirement typically has a comparatively higher risk capacity and thus the TDF's investment mix contains riskier, more growth-oriented investments; as the investor approaches retirement, her risk capacity decreases, and the TDF's investment mix will shift to a more conservative profile according to a predetermined schedule. The Department of Labor (the "Department" or "Labor Department") has endorsed TDFs as appropriate investment options for retirement plans.

Third, each TDF has its own "glide path," which defines the manner and timing according to which the asset allocation shifts from more aggressive to more conservative investments. Indeed, the glide path is a defining characteristic of any particular TDF. As such, glide paths are a central consideration of retirement plan fiduciaries when determining which TDFs to make available as investment options to plan participants.

Fourth, TDFs are a relatively new investment option, having first been introduced in the 1990s. In 2000, for instance, there were few TDFs on the market. Thus, in 2000, a retirement plan fiduciary who wanted to add a TDF to the plan necessarily did not have many options from which to choose.

Accordingly, the Court should take into account these features of TDFs in considering whether the retirement plan fiduciaries in this appeal violated their fiduciary duties when they replaced a traditional balanced fund with a TDF as an investment option for the plans.

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ARGUMENT

ABB, Inc. maintained two retirement plans (the "Plans") subject to the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). The Plans were "participant-directed plans" because they allowed participants to decide how to invest their account balances in various investment alternatives. The fiduciaries of the Plans (the "ABB Fiduciaries") determined the "menus" of investment alternatives from which the participants would choose. Until 2000, one of the Plans' investment alternatives was the Vanguard Wellington Fund, a traditional "balanced" fund. In 2000, the ABB Fiduciaries removed the Vanguard Wellington Fund as an investment alternative and replaced it with a suite of several TDFs called the "Fidelity Freedom Funds."

Plaintiffs-Appellees brought a lawsuit under ERISA challenging, among other things, the ABB Fiduciaries' selection of the Plans' investment alternatives. After a bench trial, the District Court concluded that the ABB Fiduciaries violated their fiduciary duties to the Plans when they removed the Vanguard Wellington Fund from the Plans' investment menus and replaced it with the Fidelity TDFs. *See* Mem. Op. at 5, 32. Specifically, the District Court concluded that the

ABB Fiduciaries failed to comply with the Plans' Investment Policy Statement by not engaging in a deliberative assessment of the merits and by not considering additional investment options when determining which investment option to choose. *See* Mem. Op. at 43-44. Throughout its opinion on this point, the District Court repeatedly compared the performance of the Vanguard Wellington Fund to the Fidelity TDFs. *See, e.g.*, Mem. Op. at 32-48.

But the District Court's analysis reflects a misunderstanding of the fundamental differences between a traditional balanced fund and a TDF. Furthermore, the District Court repeatedly misconstrued the nature of TDFs and their role as investment alternatives in retirement plans. Accordingly, Section I of this brief shows how traditional balanced funds and TDFs are fundamentally different from each other. Section II discusses why TDFs are appropriate for inclusion in the investment menus of participant-directed plans. Section III explains that "glide paths" are material and critical components of TDFs, vary greatly among TDFs, and, therefore, are an appropriate basis for distinguishing between TDFs. Finally, Section IV demonstrates that there were few TDFs available in 2000, and thus a plan fiduciary

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should not be faulted for not considering more than a handful of TDF investment options at that time.

I. THE DISTRICT COURT FAILED TO RECOGNIZE THE ESSENTIAL DIFFERENCES BETWEEN TARGET-DATE FUNDS AND TRADITIONAL BALANCED FUNDS.

Although both the Fidelity Freedom Funds and the Vanguard Wellington Fund invest in a mix of stocks and bonds, they are fundamentally different investment options. The Fidelity Freedom Funds are TDFs—dynamically managed to diversify a plan participant's portfolio across different asset classes, the mix of which is adjusted according to a "glide path" over time to become more conservative as the participant nears retirement. In contrast, the Vanguard Wellington Fund is a traditional balanced fund, in that it normally invests about two-thirds of its assets in stocks, and about one-third of its assets in high-quality fixed-income securities. Vanguard Wellington Fund, Registration Statement (Form N-1A), at 5-6 (Mar. 24, 2000). Unlike a TDF, whose investments become more conservative over time, a traditional balanced fund such as the Vanguard Wellington Fund has a more static mix of equity and bond investments, and does not move on a "glide path" towards more conservative investments over

time. The District Court does not seem appropriately to have recognized the critical differences between TDFs and balanced funds. *See, e.g.*, Mem. Op. at 32-48.

A. The Mix of Investments in Target-Date Funds Shifts over Time.

The Labor Department, which has general administrative authority regarding the relevant provisions of ERISA, has stated:

> [TDFs are] designed to be simple, long-term investment vehicles for individuals with particular target retirement dates in mind. They operate by investing in a diversified mix of investments and automatically shifting that mix away from riskier investments to more conservative investments . . . as the target date approaches. That shift is referred to as a fund's glide path.

U.S. Sec. and Exch. Comm'n and U.S. Dep't of Labor, *Pub. Hearing on Target Date Funds and Other Similar Inv. Options* at 10 (June 18, 2009), *available at* http://www.sec.gov/spotlight/targetdatefunds/targetdatefunds061809.pdf ("Pub. Hearing on Target Date Funds and Other Similar Inv. Options") (statement of Seth Harris, Deputy Sec'y, Dep't of Labor). Many investments can be grouped into two asset classes: equity (such as stock) and fixed income (such as bonds). Equity investments are typically viewed as riskier investments, while fixed-income investments are considered to be more conservative

investments. *See, e.g.*, Staff of S. Special Comm. on Aging, 111th Cong., *Target Date Retirement Funds: Lack of Clarity Among Structures and Fees Raises Concerns* at 11 (Oct. 2009) (summary of committee research prepared by Majority Staff) (referring to "higher risk investments, such as stocks," and "lower-risk investments, such as bonds and cash equivalents").

A TDF's strategy is based on a particular time horizon and the level of risk that is considered appropriate for that timeframe. Over time, the TDF automatically adjusts its risk to reduce the investment in equity and growth-oriented assets and to increase investments that focus on capital preservation. Industry practice is to label TDFs in five- or ten-year increments, with the year representing the retirement date. Thus, a TDF with a contemplated target retirement date of 2050 would be expected to have a significant amount of assets invested in equities and other growth-oriented investments today, since an investor contemplating retirement in 2050 would generally be expected to take on more risk in search of capital appreciation. In 30 years' time, however, the invested assets of that same 2050 TDF can be expected to shift to more conservative investment options, such as investment grade

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bond funds and debt securities, since an investor in the fund at that time presumably will be more risk adverse as retirement approaches. *See, e.g.*, U.S. Dep't of Labor, *Investor Bulletin: Target Date Retirement Funds* (May 6, 2010), *available at* http://www.dol.gov/ebsa/pdf/TDFinvestorbulletin.pdf ("Investor Bulletin"); Michael Hess, John Ameriks & Scott J. Donaldson, Vanguard Investment Counseling & Research, *Evaluating and Implementing Target-Date Portfolios: Four Key Considerations* at 5 (2008).

Because the performance of an investment vehicle depends, in part, upon the types of assets in which the vehicle invests and the vehicle's ratio of equity to fixed-income assets, constructing a meaningful comparison of investment vehicles and their respective managers requires, at a minimum, that the asset allocations of the vehicles be similar over time. If, instead, the asset allocations of the vehicles are not similar, performance comparisons will reflect differences that are significantly attributable to differing asset allocations, rather than differences such as the skill and efficiency of the vehicle's investment manager. *See, e.g.*, Maneesh Sharma, Thomas Totten & John Cierzniak, Soc. of Actuaries Pension Section, *Back*

Testing of Investment Performance by Asset Class (Jan. 2013) (studying the relative performance over time of hypothetical portfolios with various asset allocations and finding differing performance results based on the particular asset allocation).

For example, a TDF near its target retirement date that is heavily invested in relatively conservative fixed-income securities or underlying funds will likely have a performance that differs substantially from that of a mutual fund that invests principally in equity securities. In a rising stock market, a TDF near its retirement date may have comparatively lower returns than a mutual fund invested more heavily in equities. In a declining stock market, on the other hand, the same TDF is likely to produce comparatively higher returns than the same mutual fund, because of the greater proportion of its assets allocated to fixed income and cash. Thus, in the scenarios described, a significant portion of the difference in performance is attributable to the differing asset allocations, rather than solely to differing levels of manager quality. *See, e.g.*, William F. Sharpe, *Asset Allocation: Management Style and Performance Measurement*, 18 J. Portfolio Mgmt. 7 (Winter 1992) ("It is widely agreed that asset allocation accounts for a large part

of the variability in the return on a typical investor's portfolio.").
Accordingly, because the asset allocation of a TDF varies materially over time, meaningfully comparing a TDF and its investment manager with another type of investment vehicle and its investment manager would be difficult.

Traditional balanced funds differ in kind from TDFs. While a balanced fund will tend, like a TDF, to invest simultaneously in multiple asset classes, a balanced fund "does not . . . adjust its balance of fixed-income and equity exposures to take into account a target level of risk." *See, e.g.*, Default Investment Alternatives Under Participant Directed Individual Account Plans, 72 Fed. Reg. 60,452, 60,462 (Oct. 24, 2007). In effect, an investor in a balanced fund is expecting to obtain a static balanced exposure to both equity and fixed-income investments, but does not rely on the manager to alter the fundamental characteristics of the investment mix over time. *Id.* Thus, while at certain times the ultimate asset allocation of a balanced fund may be similar to that of a TDF, meaningful comparisons between a balanced fund and a TDF are difficult because the TDF's asset allocation will become more conservative over time, while a balanced fund will

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continue to invest in the same defined percentage of equity and fixed-income securities.

By way of example, one would expect a traditional balanced fund to be invested more heavily in fixed-income securities than the hypothetical 2050 TDF discussed above, since, in the year 2013, a 2050 TDF would be targeting most of its investments in equity investments. At the same time, a traditional balanced fund would be invested more heavily in equity securities than a hypothetical TDF with a target retirement date of 2015, since a 2015 TDF would be targeting most of its investments in fixed-income investments. *See, e.g.*, Investor Bulletin at 1 ("Typically, [target date] funds shift over time from a mix with a lot of stock investments in the beginning to a mix weighted more toward bonds.").

B. The Labor Department's Treatment of Target-Date Funds Supports the Conclusion that Target-Date Funds are Fundamentally Different from Traditional Balanced Funds.

The distinct characteristics of TDFs, in contrast to the characteristics of traditional balanced funds, are illustrated by the Labor Department's separate treatment of TDFs in connection with its regulatory initiatives regarding participant-level disclosure. By way of

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background, under a participant-directed plan, a fiduciary may include in the investment menu classes and types of funds that the fiduciary believes are appropriate for inclusion in the menu. *See, e.g.*, 29 C.F.R. § 2550.404c-1(b)(3)(B)(*2*) (requiring as a condition to relief under the so-called "404(c) rules" that there be a broad range of investment alternatives "each of which has materially different risk and return characteristics").

In October 2010, the Department finalized regulations governing participant-level disclosure covering a wide range of requirements. *See* Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans, 75 Fed. Reg. 64,910 (Oct. 20, 2010); 29 C.F.R. § 2550.404a-5. The Department reserved for later consideration the inclusion of provisions specifically directed to TDFs. *See* 75 Fed. Reg. at 64,926; 29 C.F.R. § 2550.404a-5(i)(4).

On November 30, 2010, the Labor Department proposed regulations (the "Proposed TDF Regulations") that would specifically cover TDFs. 75 Fed. Reg. 73,987 (Nov. 30, 2010). In the preamble to that proposal, the Department stated that "[t]he growing popularity of [TDFs] led to a focus in recent years on issues relating to the design,

operation, and selection of TDFs for 401(k) plans, both as investment alternatives for plans generally and as qualified default investment alternatives for participants that do not provide investment direction." 75 Fed. Reg. at 73,988.[1] The Department's identification of TDFs as a separate focus of regulation is significant because it illustrates the distinct status of these funds.

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[1] Focus on TDFs in the disclosure context is particularly significant given the role of disclosure requirements in the Department's general regulatory efforts. The Department's disclosure proposals involve a multi-pronged initiative, including participant-level disclosure and revamped annual-reporting requirements for plan administrators involving the "Form 5500." *See* 72 Fed. Reg. at 64,709; *see also* 29 C.F.R. § 2550.408b-2(c)(1) (regulations setting forth exemption for the provision of services to a plan from the prohibited-transaction provisions of Section 406(a) of ERISA). The Labor Department regards the regulation of plan-related disclosure as critical to its regulatory efforts. *See, e.g.*, 75 Fed. Reg. at 64,910 ("The Department believes that all participants and beneficiaries with the right to direct the investment of assets held in their individual plan accounts should have access to basic plan and investment information.");*Testimony of Phyllis C. Borzi, Assistant Secretary of Labor, Employee Benefits Security Administration, Before the Special Committee on Aging, United States Senate* (Mar. 7, 2012), *available at* http://www.dol.gov/ebsa/pdf/ty030712.pdf at 8-9 ("The Department has a number of ongoing initiatives designed to improve the transparency and adequacy of retirement savings plans, in particular focusing on 401(k) plans where a number of investment and other risks have been shifted onto the shoulders of workers. Our goal is to make sure that employers and workers have good retirement savings options and the information to make the best choices about retirement savings.").

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II. THE DISTRICT COURT'S RULING FAILED TO GIVE WEIGHT TO THE VALUE OF TARGET-DATE FUNDS IN PARTICIPANT-DIRECTED PLANS.

The District Court's analysis of the ABB Fiduciaries' actions did not sufficiently consider the nature of TDFs. TDFs are appropriate options for inclusion in a menu of investment alternatives for participant-directed plans. Further, the Department's guidance and regulatory scheme recognizes their important role in defined contribution plans.

A. Target-Date Funds Are Qualified Default Investment Alternatives.

The evolution of the rules governing "qualified default investment alternatives" ("QDIAs") demonstrates that the Department takes the position that TDFs may qualify as an appropriate investment option for a participant-directed plan and, further, may be an appropriate default choice for participants who have not provided investment direction. As described more fully below, a plan sponsor will receive certain protections from breach of fiduciary duty claims for investing a participant's balance without direction in a QDIA. A TDF may be used as a QDIA, but many types of investment funds do not satisfy the regulatory definition of QDIA.

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In 2006, Congress enacted the Pension Protection Act (the "PPA"), Pub. L. No. 109–280, 120 Stat. 780 (Aug. 17, 2006), which addressed a wide range of issues under ERISA. One of the PPA's new protections related to investments under participant-directed plans. In particular, the QDIA rules added pursuant to Section 624(a) of the PPA, codified at Section 404(c)(5) of ERISA, 29 U.S.C. § 1104(c)(5) (2006),[2] govern the substantial amount of investments made under participant-directed plans where the plan fiduciary receives no investment directions from the participant or beneficiary:

> Part of the retirement savings problem is attributable to employees who, for a wide variety of reasons, do not take advantage of the opportunity to participate in their employer's defined contribution pension plan (such as a 401(k) plan). The retirement savings problem is also exacerbated by those employees who enroll in their employer's plan, but do not assume responsibility for

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[2] "For purposes of paragraph (1), a participant or beneficiary in an individual account plan meeting the notice requirements of subparagraph (B) shall be treated as exercising control over the assets in the account with respect to the amount of contributions and earnings which, in the absence of an investment election by the participant or beneficiary, are invested by the plan in accordance with regulations prescribed by the Secretary. The regulations under this subparagraph shall provide guidance on the appropriateness of designating default investments that include a mix of asset classes consistent with capital preservation or long-term capital appreciation, or a blend of both." 29 U.S.C. § 1104(c)(5)(A).

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> investment of their contributions, leaving their accounts to be invested in a conservative default investment that over the career of the employee is not likely to generate sufficient savings for a secure retirement.

Default Investment Alternatives Under Participant-Directed Individual Account Plans, 71 Fed. Reg. at 56,806 (Sept. 27, 2006).

The QDIA rules provide a safe harbor for plan fiduciaries. Section 624(a) of the PPA directed that regulations be issued that provide "guidance on the appropriateness of designating default investments that include a mix of asset classes consistent with capital conservation or long-term capital appreciation, or a blend of both." A QDIA is an investment that the Labor Department has determined is appropriate for plan fiduciaries to use as a default investment in cases where there has been no direction from the plan participant.

When the Department first issued proposed QDIA regulations, it identified only three categories of investment alternatives as QDIAs: (i) TDFs, (ii) traditional balanced funds, and (iii) managed accounts. *See* 71 Fed. Reg. at 56,810. In contrast, "stable value" and other fixed-income investments, long considered market-standard conservative investments, *see, e.g.*, 72 Fed. Reg. at 60,462-63, were not approved as QDIAs. Thus, from the outset, the Labor Department accorded TDFs a

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special status as an appropriate plan investment option – indeed, an investment option suitable for use as a default plan investment, consistent with the needs of the average plan participant.

TDFs are listed as a permissible QDIA in the regulations, both as proposed and finalized.[3] The final QDIA regulations describe TDFs as follows:

> an investment fund product or model portfolio that applies generally accepted investment theories, is diversified so as to minimize the risk of large losses and that is designed to provide varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures based on the participant's age, target retirement date (such as normal retirement age under the plan) or life expectancy. Such products and portfolios change their asset allocations and associated risk levels over time with the objective of becoming more conservative (i.e., decreasing risk of losses) with increasing age. For purposes of this paragraph (e)(4)(i), asset allocation decisions for such products and portfolios are not required to take into account risk tolerances, investments or other preferences of an individual participant. An example of such a fund or portfolio may be a "life-cycle" or "targeted-retirement-date" fund or account.

29 C.F.R. § 2550.404c-5(e)(4)(i).

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[3] Under the final QDIA regulations, balanced funds (e.g., the Vanguard Wellington Fund at issue in this case) and managed accounts that include a mix of equity and fixed-income securities intended to provide long-term appreciation and capital preservation may also qualify as QDIAs. 29 C.F.R. § 2550.404c-5(c)(4)(ii), (iii).

In the initial proposal and in the final QDIA regulations, the Department rejected the inclusion of a capital-preservation alternative as a QDIA.[4] In the preamble to the final QDIA regulations, the Department explained the reason for its rejection:

> Lastly, the Department is concerned that [including a capital-preservation alternative], without limitation, may be perceived by participants and beneficiaries as an endorsement by the government, by virtue of its inclusion in the regulation, or as an endorsement by the employer, by virtue of its selection as the qualified default investment alternative, as an appropriate investment for long-term retirement savings. Although the Department recognizes that such perceptions . . . might be addressed with investment education and investment advice, the Department nonetheless is concerned that, overall, the potentially adverse effect on long-term retirement savings may be significant.

72 Fed. Reg. at 60,463.

Accordingly, by categorizing TDFs as QDIAs, the Department necessarily determined that including such an investment option as a QDIA should *not* have a "potentially adverse effect on retirement

[4] Following the receipt of comments received after the publication of the proposed regulations, the Department did include in the final regulations some limited relief for fixed-capital investments made before the effective date of the final regulations or made during a limited time period following a participant's first elective contribution. *See* 72 Fed Reg. at 60,462-60,464; 29 C.F.R. § 2550.404c-5(e)(4)(iv), (v).

savings [that] may be significant." *Id.* This determination does not mean that a fiduciary necessarily should choose a TDF as a QDIA or otherwise include TDFs as investment alternatives under participant-directed plans. Rather, the fact that TDFs are included within the small universe of investment options selected by the Department for important treatment as QDIAs is worth recognizing because it indicates the appropriateness of TDFs for inclusion in the investment menu.

B. The Labor Department's Rulemaking Efforts Further Support the Conclusion that Target-Date Funds are Appropriate Investment Alternatives.

In 2008, the Labor Department's ERISA Advisory Council studied several aspects of TDFs as 401(k) plan investment alternatives and recommended that the Department provide additional guidance to both plan fiduciaries and participants to enhance their understanding of TDFs. *See* 75 Fed. Reg. at 73,988. Following this recommendation, the Labor Department and the Securities and Exchange Commission (the "SEC") held a joint public hearing in 2009 to address questions including whether variations in the glide paths of TDFs could put plan participants' retirement assets at risk. Pub. Hearing on Target Date Funds and Other Similar Inv. Options at 11 (statement of Seth Harris,

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Deputy Sec'y, Dep't of Labor) ("Recent concerns have been raised about variation in the glide paths of target date funds offered by different providers and how that variation may result in plan participants and investors unknowingly placing their retirement assets at risk . . . .").
The hearing was designed to determine what additional guidance would be helpful to alleviate such concerns. *See id.* The hearing also generally included discussions about how TDFs are managed at the institutional level, how they are selected by plan fiduciaries and by investors, and how information about them is disclosed to plan participants. *Id.*

The purpose and the content of the hearing confirm the Department's general approval of TDFs as appropriate investment options for plan participants. In particular, the Deputy Secretary of Labor expressly acknowledged TDFs' popularity and appropriateness.[5]
He stated:

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[5] TDFs have continued to be a very popular investment option for participant-directed plans. *See, e.g.*, Employee Benefit Research Institute, *Target Date Fund Use in 401(k) Plans and the Persistence of Their Use, 2007-2009, Issue Brief No. 361* (Aug. 2011) ("In this database in 2007, 67.3 percent of plans offered target date funds as an investment option."); Josh Charlson and Laura Pavlenko Lutton,
(footnote continued)

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> [TDFs'] increasing popularity, I think it's fair to say, is also due in part to the Department's identification of target date type funds as appropriate investments for plan sponsors when they're investing 401(k) plan contributions on behalf of participants who don't give specific investment instructions. *They're appropriate, we have said that they are appropriate default investments for employees in their 401(k) plans.*

Id. at 10-11 (emphasis added).

Following this hearing, the Department and the SEC jointly issued an Investor Bulletin to provide general information to investors about the operation and risk profiles of TDFs. *See* Investor Bulletin.

In addition, the Department recently issued additional "Tips for ERISA Plan Fiduciaries" on investments in TDFs. U.S. Dep't of Labor, *Target Date Retirement Funds – Tips for ERISA Plan Fiduciaries* (Feb. 28, 2013) ("Tips for ERISA Plan Fiduciaries"), *available at* http://www.dol.gov/ebsa/pdf/fsTDF.pdf. Again confirming the

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(footnote continued)
Morningstar Fund Research, *Target-Date Series Research Paper: 2012 Industry Survey* at 3 (May 2012) ("Target-date funds are fast becoming a fixed feature of the defined-contribution landscape. . . . In its most recent study, Vanguard reported that 82% of its retirement plans offered target-date funds, and nearly one fourth of participants invested only in a target-date fund. The consultant Casey Quirk estimates that target-date funds will consume more than half of all defined-contribution assets by 2020.").

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Department's focus on the TDF as a viable retirement investment alternative, the Department expressly referred to TDFs as "increasingly popular" and stated that they "can be attractive investment options for employees." *Id.* at 1; *cf.* 29 C.F.R. § 2550.404c-1(b)(3)(B)(*3*) (requiring as a condition to relief under the so-called "404(c)" rules that there be a broad range of investment alternatives "which in the aggregate enable the participant or beneficiary by choosing among them to achieve a portfolio with aggregate risk and return characteristics at any point within the range normally appropriate for the participant or beneficiary").

In sum, the Department's guidance underscores the Department's continued belief that TDFs are appropriate investment options for participant-directed plans.

III. THE "GLIDE PATH" OF EACH TARGET-DATE FUND IS AN IMPORTANT DISTINGUISHING CHARACTERISTIC OF THE FUND.

The schedule for adjusting a TDF's asset allocation from higher-risk to lower-risk asset classes is commonly referred to as the TDF's "glide path." In its decision, the District Court fundamentally

misunderstood the nature of a TDF's glide path. Specifically, the court stated:

> [T]he only reason provided to the Court as to why the Group preferred the Fidelity Freedom Funds over other target-dated investment options was the Freedom Funds' "glide path"—the changes to allocation over time as a participant nears retirement. However, such allocation changes are not unique to Freedom Funds, but rather is a characteristic embodied by lifestyle funds generally.

Mem. Op. at 38. But, as discussed below, while all TDFs have glide paths, each TDF's glide path generally is distinct, and a particular fund's glide path is a primary basis for distinguishing it from other TDFs.

A. Each Target-Date Fund Is Defined by a Particular "Glide Path."

Generally speaking, a TDF's glide path reflects a reduction in a TDF's exposure to equity investments until the fund reaches a "landing point," at which time the fund's asset allocation does not change. The SEC has recognized that some investors "may mistakenly assume that [TDFs] that all have the same date in their name are managed according to a uniform asset allocation strategy," and so the SEC has proposed disclosure rules concerning TDF glide paths and asset allocations to "help counterbalance any misimpression that . . . all

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[TDFs] with the same target date are similarly managed." Investment Company Advertising: Target Date Retirement Fund Names and Marketing, 75 Fed. Reg. 35,920, 35,922, 35,925 (June 23, 2010).

In fact, retirement fund administrators, and financial advisors more generally, carefully consider different glide paths in connection with decisions to invest in particular TDFs. They do so because "there are many different approaches or glide paths for managing the shift from higher to lower risk allocations." Pub. Hearing on Target Date Funds and Other Similar Inv. Options at 38 (statement of Jeffrey Knight, Managing Director and Head of Global Asset Allocation, Putnam Investments). Indeed, "the allocation of assets among stocks, bonds, [and] cash-equivalents [has been found to vary] greatly among target date funds with the same target retirement date." Staff of S. Special Comm. on Aging, *Target Date Retirement Funds: Lack of Clarity Among Structures and Fees Raises Concerns* at 8 (summary of committee research prepared by Majority Staff). Some managers design TDFs such that the "landing point" is reached at the target retirement date, at which time asset allocation becomes static, while other managers design TDFs such that asset allocations continue to

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shift after the target retirement date. *See, e.g.*, Charlson, et al., at 9-10; 75 Fed. Reg. at 35,921 ("For some target date funds, the landing point occurs at or near the target date, but for other funds, the landing point is reached a significant number of years—as many as 30—after the target date."). The SEC has observed that "opinions differ on what an optimal glide path should be," noting:

> An optimal glide path for one investor may not be optimal for another investor with the same retirement date, with the optimal glide path depending, among other things, on an investor's appetite for certain types of risk, other investments, retirement and labor income, expected longevity, and savings rate.

75 Fed.Reg. at 35,922.

Thus, the glide path is a key defining characteristic of a TDF. Indeed, "[w]hile the variations in returns among target date funds with the same target date can be explained by a number of factors, one key factor is the use of different asset allocation models by different funds . . . ." *Id.* As such, it would not be at all surprising for glide paths to be a significant factor in a plan fiduciary's selection of TDFs as plan investment options. *See, e.g.*, Pub. Hearing on Target Date Funds and Other Similar Inv. Options at 192–97 (statement of Josh Cohen, Russell Investments) (discussing his firm's views on appropriate glide path

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characteristics in the selection of TDFs); *id.* at 197–202 (statement of Lori Lucas, Defined Contribution Practice Leader, Callan Associates, Inc.) (discussing her firm's proprietary tool for measuring the efficacy of various glide paths); *id.* at 202–09 (statement of Chip Castille, Barclays Global Investors) (discussing his firm's detailed, technical procedures for constructing glide paths and the associated retirement investment portfolios).

B. The Labor Department's Proposed Target-Date Funds Disclosure Regulations Support the Conclusion that a Target-Date Fund's "Glide Path" Is a Key Characteristic of the Fund.

The Labor Department's rulemaking regarding participant-level disclosures confirms both the significance of a TDF's glide path generally and the importance of the details surrounding the particular glide path applicable to any given TDF. In its Proposed TDF Regulations, the Department would specifically require disclosure of "an explanation of the asset allocation, how the asset allocation will change over time, and the point in time when the investment will reach its most conservative asset allocation, including a chart, table, or other graphical representation that illustrates such change in asset allocation over time and that does not obscure or impede a participant's or

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beneficiary's understanding of the information explained pursuant to this requirement." 75 Fed Reg. at 73,989. The Department further noted that, while many providers already use such graphical representations, "the Department is persuaded that any additional burden associated with preparation of a compliant illustration will prove highly beneficial to enhance participants' and beneficiaries' understanding of a TDF's asset allocation and how it will change over time." *Id.* The Department and the SEC's Investor Bulletin on TDFs also emphasizes the importance of understanding how a fund's investment mix changes over time. *See* Investor Bulletin. Similarly, the Department's recent Tips for ERISA Plan Fiduciaries states that glide paths "can significantly affect the way a TDF performs" and advises that fiduciaries "[m]ake sure you understand the fund's glide path." Tips for ERISA Plan Fiduciaries at 1-2.

Accordingly, it is reasonable and appropriate for a plan fiduciary to base a decision to select one TDF over another based in part on the TDF's particular "glide path."

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IV. WHEN THE ABB FIDUCIARIES REPLACED THE VANGUARD WELLINGTON FUND WITH THE FIDELITY TARGET-DATE FUNDS, THEY NECESSARILY ACTED ON THE BASIS OF INFORMATION THEN AVAILABLE.

A. ERISA Fiduciaries Are Expected to Act on the Basis of Information Available at the Time They Make Their Decisions.

As the District Court recognized, "[t]he Eighth Circuit has held that '[t]he . . . prudent person standard is an objective standard . . . that focuses on the fiduciary's conduct preceding the challenged decision.'" Mem. Op. at 11 (brackets and ellipsis in original) (quoting *Braden v. Wal-Mart Stores, Inc.*, 588 F.3d 585, 595 (8th Cir. 2009)). Thus, the determination of whether an ERISA fiduciary has met the prudent person standard focuses on whether the fiduciary took the necessary measures and examined the merits of options that are present at the time a decision is made, not at any time afterwards. *See Harley v. Minn. Mining & Mfg. Co.*, 42 F. Supp. 2d 898, 906 (D. Minn. 1999), *aff'd*, 284 F.3d 901 (8th Cir. 2002), *cert. denied*, 537 U.S. 1106 (2003). *See also* ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B) (2006) (describing the duty of prudence as involving the exercise of care, skill, and diligence "under the circumstances then prevailing"). It is axiomatic

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that hindsight is an inappropriate basis on which to evaluate the conduct of ERISA fiduciaries.

Notwithstanding the foregoing, however, the District Court seems to have judged the ABB Fiduciaries on precisely that basis, stating "[a]dditionally, between 2000 and 2008, the Wellington Funds outperformed the Freedom Funds. Such behavior underscores the Court's finding that [one of the ABB Fiduciaries] did not recommend the removal of the [Vanguard] Wellington Fund and the addition of the [Fidelity TDFs] solely based on the merits of the investments and the requirements of the [applicable investment policy statement]." Mem. Op. at 42-43. The District Court appears to have judged the ABB Fiduciaries' decisions based upon hindsight, as the ABB Fiduciaries would not have had information about the future performance of the funds at the time they made their decision to replace the Vanguard Wellington Fund with the Fidelity TDFs.

B. At the Time the Vanguard Wellington Fund Was Replaced, There Were Very Few True Target-Date Funds from Which to Choose.

The ABB Fiduciaries considered three funds when they decided to include the Fidelity TDFs in the Plans' investment menus. *See* Mem.

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Op. at 35. The District Court suggested that the ABB Fiduciaries should have considered additional funds when they made this decision. *See id.* (concluding that the ABB Fiduciaries "did not employ a 'winnowing process'").

If the District Court was suggesting that the ABB Fiduciaries should have considered additional *traditional balanced* funds, this suggestion disregards the fundamental differences between traditional balanced funds and TDFs, as discussed above. If, on the other hand, the District Court was suggesting that the ABB Fiduciaries should have considered additional *TDFs*, then the District Court did not grasp the fact that there simply were not many TDF alternatives available in 2000. Although the District Court recognized that "[i]n 2000, there were not many lifecycle funds, or target-dated funds, in the market," *see* Mem. Op. at 35, it appears to have failed to understand just how few TDFs were available for the ABB Fiduciaries to consider.

TDFs were still a relatively new investment product in the year 2000, with very few sponsors. In fact, at the end of 2000, when the ABB

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Fiduciaries selected the Fidelity Freedom Funds, there were only four sponsors of target-date mutual funds. *See* Hess, et al., at 2 (Figure 1).[6]

Furthermore, the District Court assumed that TDFs may be grouped together with so-called "lifestyle" funds. *See* Mem. Op. at 33 (stating that TDFs are also referred to as "lifestyle" or "lifecycle" funds). In reality, however, there are important distinctions between "lifestyle" funds (also known as "target risk funds"), on the one hand, and TDFs (and "lifecycle" funds), on the other. Whereas a TDF or lifecycle fund may be viewed as "follow[ing] a predetermined reallocation of assets over time based on a specified target date," a lifestyle fund generally "maintains a predetermined risk level" and does not change its asset allocation over time. Investment Company Institute, 2012 Investment Company Fact Book: A Review of Trends and Activity in the U.S. Investment Company Industry 127 (52d ed.); *see also* Investment Company Institute, *Frequently Asked Questions about Target Date or Lifecycle Funds* (June 2009), at http://www.ici.org/faqs/faq/

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[6] Those four TDF sponsors managed collectively only 24 mutual fund TDFs. *See* Investment Company Institute, 2012 Investment Company Fact Book: A Review of Trends and Activity in the U.S. Investment Company Industry 186 (52d ed.) (Table 53).

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faqs_target_date ("Lifestyle funds do not change their asset allocations over time. Target date funds, by contrast, . . . adjust their asset allocation over time to become more conservative.").

The District Court's failure to comprehend the differences between TDFs and lifestyle funds may have led the court to the erroneous conclusion that the ABB Fiduciaries could have and should have considered additional funds offering the same features and qualities as TDFs. *See* Mem. Op. at 35-36. While there were more lifestyle funds available at the end of 2000 than TDFs, *see* Investment Company Institute, 2012 Investment Company Fact Book at 186 (Table 53), for the reasons given above, it was entirely reasonable for the ABB Fiduciaries to choose TDFs, as distinguished from lifestyle funds, as a menu option for the Plans and to confine their consideration to a review of the few true TDFs then available to investors.

Considering the limited number of sponsors making TDFs available at the time, it would appear that the ABB Fiduciaries evaluated a reasonable and appropriate range of TDF sponsors under the circumstances then present.

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CONCLUSION

For the foregoing reasons, this Court should reverse the judgment below.

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Dated: March 4, 2013

CERTIFICATE OF COMPLIANCE

I certify that:

(1) this brief complies with Fed. R. App. P. 32(a)(7) because it contains 6,497 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii);

(2) this brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because it has been prepared in 14-point Century font;

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Dated: March 4, 2013

s/ Alexander R. Bilus
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CERTIFICATE OF SERVICE

I certify that on March 4, 2013, I electronically filed the foregoing brief via the Court's CM/ECF system. I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the CM/ECF system on the following counsel:

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