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Target-Date Funds versus a Managed Account Approach

*Turbulent financial markets reinforce the need for a
comprehensive managed account solution for
retirement plan participants*

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Introduction

For the past several years, retirement plan providers have performed extensive market research to help them learn more about retirement plan participants and their attitudes toward saving and investing. In the process, providers have discovered that many participants fall into a category commonly known as the “Do it For Me” investor.

This group of retirement plan participants can be convinced that saving and retirement planning are important and necessary. However, they lack the knowledge, time and/or discipline to manage the process themselves. These participants typically desire an investment advice service or professional management of their retirement account. Based on our plan experience at The Standard, this group makes up just over 45 percent of the employee population.¹

Target-date mutual funds have become one of the most prevalent retirement planning solutions currently available to “Do it For Me” retirement plan participants. Although target-date funds are not technically considered an investment advice solution, they have been marketed as a simple and low maintenance solution – in essence a “set it and forget it” or “autopilot” approach to retirement planning. Participants simply choose a fund that generally corresponds to their planned year of retirement. The fund is allocated more heavily toward equity investments in the earlier working years, and automatically adjusts its asset mix to more conservative investments as retirement approaches.

Sounds simple, right? Unfortunately, that simplicity may not be serving the best interests of retirement plan participants – especially during the daily (and unprecedented) turbulence currently being experienced by the financial markets.

Target Date Funds under Scrutiny

From the mutual fund industry’s perspective, target-date funds were not just designed to provide potential growth and automatic asset re-allocations during a participant’s working years. They were also designed to continue providing potential growth throughout their retirement as well – a period that can last twenty or more years, depending on a number of factors. A typical target-date fund may maintain a significant portion of its asset allocation in more aggressive equity investments both before and

¹ Based on The Standard’s Managed Account Service Update Report (MASU) as of September 30, 2008.

during a participant's retirement. In fact, depending on the fund's management approach, many target-date funds do not adjust to their most conservative allocations until participants are five to ten years into their retirement.

Although this investment objective and approach are described within the target-date fund prospectuses, it is the "set it and forget it" marketing message that investors and plan fiduciaries have bought into. As a result, the current significant downturn of the financial markets is generating extreme surprise and confusion among plan participants who have invested in target-date funds -- specifically those who are nearing retirement. These investors believed that the "autopilot" approach marketed by the target-date funds was designed to protect them appropriately as they approached retirement -- *especially* during a market downturn. Given the current performance of many target-date funds (and their significant exposure to equities), participants in target-date funds are well-justified in their confusion.

In particular, consider the current situation facing investors who plan to retire in the year 2010 (and are invested in 2010 target-date funds). The average 2010 fund lost 27.3 percent of its value from January 1, 2008 through November 30th, 2008. Some of the most aggressive 2010 funds lost as much as 43 percent through this time period. Investment firms with the most aggressive 2010 funds invested about two thirds of their money in stocks. ²

The Managed Account Approach: Getting Personal

A target-date fund approach does not take into account an individual investor's tolerance for risk, outside assets, or savings rate. The only factor considered is the participant's projected retirement date. Although an impersonal approach such as this may be sufficient during rising markets, it may expose investors to unnecessary risk during market downturns.

The Standard believes a managed account program is the most comprehensive and appropriate solution for plan sponsors and plan advisors looking to address the long-term retirement income needs of plan participants. During both good times and bad, participants in our Mainspring Managed program can be confident that their saving and

² Source: Lipper, as cited in a 12/7/08 *Boston Globe* online article entitled "Risky Targets", authored by Steven Syre.

investment strategy fully addresses their most current investor profile, including their tolerance for risk, personal savings goals, timeline to retirement, projected income needs during retirement and any outside assets they may have.

Mainspring Managed: Retirement Income Adequacy is the Objective

The Standard's managed account service, known as Mainspring Managed, goes beyond the traditional managed account/advice solution that is prevalent in the industry today. It is not just an investment plan. Mainspring Managed is a formal, goal-based Savings and Investment Plan which is implemented and actively managed by The Standard. Above all, Mainspring Managed addresses the personal needs of individual participants.

The process of building a customized plan for a participant begins with an initial Savings and Investment Plan Snapshot (which is included in the enrollment booklet). The Snapshot serves as a personalized retirement income gap analysis and is based on the participant's actual current salary. Factoring in the participant's current account balance, a retirement income scenario is illustrated based on assumptions concerning annual increases in pay, current savings rate, inflation, investment rate of return, expected Social Security income and other factors. Reviewing the retirement income gap analysis is often an eye-opening experience and has served as a strong motivator for participants to overcome inertia and take action.

The initial gap analysis serves as a catalyst for a more in-depth discussion of the participant's current situation, retirement resources and goals for the future. Additional data is collected, including information on any other outside retirement assets as well as spouse/partner retirement assets. Once this process is completed, a formal Savings and Investment Plan that focuses on achieving the participant's projected retirement income needs is created. The savings rate recommendation is then implemented, along with a schedule of future increases. Assets are invested among a series of broadly diversified, institutionally-priced portfolios.

Once a participant's Savings and Investment Plan is implemented, the account is reviewed on a quarterly basis. The Plan is actively managed and investment rebalancing is performed as necessary. Participants receive a progress report each quarter which illustrates progress made toward reaching their goals. In the case of a

projected retirement income shortfall, tactical solutions are implemented (such as increasing the savings rate or revising the asset allocation strategy).

The Savings and Investment Plan remains actively managed, and assumes that a participant's personal situation will change and evolve over time. As changes occur, the participant can call an investment advisor representative and have their Savings and Investment Plan updated immediately. For example, a change in marital status usually requires an immediate update of the plan. Changes in a participant's tolerance for risk over time can be incorporated into the plan as well. This planning flexibility can be an advantage over a target-date fund approach, which does not allow for changes to an individual's situation over time.

Finding the Right Balance of Investment Risk and Savings Rate Level

The Mainspring Managed approach is designed to find the most conservative portfolio allocation that will meet the participant's stated retirement income goal. A participant often finds this methodology provides a more conservative allocation than expected. While the retirement industry has typically focused on increasing risk to achieve higher returns, we utilize a more conservative approach to help achieve a balance between increasing risk and enhancing savings levels. In other words, we focus on helping the participant meet the retirement income goal in the most affordable manner (minimal contribution increases) and with the lowest portfolio risk.

The planning methodology first determines if the participant can meet the retirement income goal, with the most conservative savings and investment strategy – that is, with no contribution increase and the most conservative equity allocation for each time period. If this strategy is adequate to meet the income goal then these results will translate into a personalized Savings and Investment Plan. If it is not adequate, the methodology will evaluate the effect of increasing the equity allocation within certain maximum ranges in order to meet the goal. If the goal is still not met, the Mainspring Managed methodology will begin to evaluate the effect of increasing the contribution rate.

What About Mainspring Managed Participants Retiring in 2010?

Mainspring Managed portfolios have also had negative returns during this current market downturn; however, the negative returns have been mitigated by utilizing this more conservative and practical approach. For example, a participant in Mainspring

Managed planning to retire in 2010 who has a medium risk tolerance would have a maximum acceptable range of equity allocations of 20% - 40% (meaning that between 20% and 40% of that participant's account would be held in equity-based investments). This approach is illustrated in the shaded cells below.

MAINSRING MANAGED EQUITY ALLOCATION RANGES, AS A PERCENTAGE OF THE TOTAL PORTFOLIO, BASED ON YEARS TO RETIREMENT AND RISK TOLERANCE LEVEL. *

Time Horizon (years to retirement)	Low Risk Tolerance	Medium Risk Tolerance	High Risk Tolerance
15 or More	20% - 50%	60% - 80%	80% - 100%
10 – 14	20% - 30%	40% - 70%	80% - 100%
5 – 9	10% - 20%	30% - 60%	60% - 80%
Less than 5	0% - 20%	20% - 40%	40% - 70%

* Equity allocation is defined as the sum of U.S. equity holdings and non-U.S. equity holdings. The Mainspring Managed allocation parameters are incorporated into the planning methodology and are used to develop the specific investment strategy. The planning methodology will always seek the most conservative investment strategy that, when combined with the savings strategy, will eliminate the projected income gap.

Let's specifically compare the Mainspring Managed equity allocation range for a participant with less than 5 years to retirement (**20 - 40%** noted in the shaded cells above) to the equity allocation of the four largest 2010 target-date funds (which collectively hold about 90% of all the assets invested in 2010 funds). The four largest target-date funds include: Fidelity Freedom 2010, T. Rowe Price Retirement 2010, Vanguard Target Retirement 2010 and Principal Life-Time 2010. The average equity allocation of these four largest 2010 target-date funds was **52.2%** as of September 30, 2008 ³. Compared to this, one can see that the Mainspring Managed equity allocation is significantly more conservative.

Conclusion

At The Standard, we believe the current market downturn contains a silver lining. It offers an excellent opportunity for plan sponsors, plan advisors and plan providers to take stock of the retirement planning solutions currently being offered to retirement plan participants. Market downturns test whether or not we have delivered the right products

³ Source: "2010, A Fund Odyssey" published 11/1/08 on Financial Planning.com (authored by Craig L. Israelsen).

and services to help participants effectively manage investment risk, save adequately for the future and successfully fund their retirement income needs.

During both good times and bad, we believe that a managed account approach is the most appropriate and prudent approach for the “Do it For Me” investor. Participants can be confident that their savings and investment strategies fully address their needs and wishes, and have the flexibility to adapt to change. Mainspring Managed is a truly participant-centric approach, created to stand the test of time.

Plan sponsors and participants should carefully consider the investment objectives, risks, charges and expenses of the investment options offered under the retirement plan before investing. The prospectuses for the individual mutual funds and The Standard's Group Variable Annuity Contract and each underlying investment option in both the group variable annuity and group annuity contain this and other important information. Prospectuses may be obtained by calling 877.805.1127. Please read the prospectus carefully before investing. Investments are subject to market risk and fluctuate in value.

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