

June 9, 2014

Mr. Kevin M. O'Neill  
Deputy Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549-1090

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Re: *Investment Company Advertising: Target Date Retirement Fund Names and Marketing*  
(File Number S7-12-10)

Dear Mr. O'Neill:

T. Rowe Price Associates, Inc., T. Rowe Price Investment Services, Inc., and T. Rowe Price Retirement Plan Services, Inc. (collectively, "**T. Rowe Price**") appreciate the opportunity to submit comments in light of the reopening of the comment period on the SEC's 2010 proposal (the "**Proposal**") to require certain disclosures in target date retirement fund marketing materials ("**TDF Marketing Materials**").

#### I. Introduction and Background

T. Rowe Price Associates, Inc. is the principal investment adviser to the T. Rowe Price family of over 150 funds ("**Price Funds**") and is registered under the Investment Advisers Act of 1940. T. Rowe Price Investment Services, Inc. is a registered broker-dealer under the Securities Exchange Act of 1934, FINRA member firm, and acts as principal underwriter to the Price Funds. T. Rowe Price Retirement Plan Services, Inc. provides retirement plan recordkeeping services to over 3,400 plans serving almost 2 million participants as of March 31, 2014. As of March 31, 2014, T. Rowe Price Associates, Inc. and its affiliated investment advisers reported total assets under management of approximately \$711.4 billion for more than 9 million individual and institutional accounts.

The T. Rowe Price Retirement Funds ("Retirement Funds") were launched in 2002 and the T. Rowe Price Target Retirement Funds ("Target Retirement Funds") were launched in 2013. As of March 31, 2014, these funds (collectively the "Target Date Funds") held assets of \$111.6 billion and represent 17.5% of the target date mutual fund universe.<sup>1</sup> T. Rowe Price is the third largest provider of target date mutual funds in the industry.<sup>2</sup>

The Target Date Funds are made available to individual retail investors on a direct basis, through retirement plan recordkeepers or through certain intermediaries using a share class with 12b-1 fees, and in all cases carry no front-end or deferred sales loads. In addition, target date investments (including mutual funds and common trusts managed by T. Rowe Price and other providers) are used as investment options in over 90% of the defined contribution retirement plans for which T. Rowe Price Retirement Plan Services serves as the record keeper and over

<sup>1</sup> Source: Strategic Insight Simfund MF.

<sup>2</sup> Ibid.

35% of assets held in these plans are invested in these target date investments. Accordingly, T. Rowe Price has a keen interest in marketing rules that allow clear and concise information about these funds to be conveyed to investors.

## II. Summary of T. Rowe Price's Position and Commentary

We support the comments of the Investment Company Institute in their comment letter dated June 9, 2014. In addition, we would like to offer our own comments about the Proposal, as well as some additional information that we think will be helpful to the Commission in its further evaluation of the Proposal.

T. Rowe Price is an active participant in the dialogue about the appropriate disclosure standards for target date funds<sup>3</sup>, and we support the Commission's ongoing efforts to help investors understand these investments. We share the interest of regulators and commentators in helping investors become well informed about the characteristics of their investments. The issue is how best to accomplish this goal, and in particular, whether it would be helpful or counterproductive to provide more information—especially relatively abstract statistical data—to an audience composed largely of individual investors who have limited investment experience. In our experience, more information is not always better, particularly if it will confuse or potentially overwhelm the investor. This is especially important given that most target date fund investors are saving for retirement.

The complexity of target date funds requires clear explanation of their investment strategies, changing asset allocations, and risks. Nonetheless, we do not believe that the use of a risk-based glide path illustration as either a replacement for or supplement to an asset allocation glide path illustration (a chart that shows how a target date fund's asset allocation changes over time) will enhance investor understanding of target date funds. On the contrary, a risk-based glide path illustration may actually impede investor understanding of these products. Our research, discussed in more detail below, demonstrates that an asset allocation glide path illustration provides a substantial amount of information about a target date fund's current and future risks, and that introducing either a risk-based glide path or a more detailed asset allocation glide path illustration that shows sub-asset classes does not communicate a meaningful amount of additional information.

The following is a summary of our comments in response to the Release, all of which are discussed in greater detail below.

- **Most target date funds are managed to a specific asset allocation rather than a specific target risk level;** Risk-managed target date funds comprise a very small percentage of the total target date fund market;
- **Target date funds are designed to address multiple investment risks,** primary among these being (1) *longevity risk*, or the risk of an investor outliving his retirement assets;

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<sup>3</sup> Richard T. Whitney, Vice President and Head of Asset Allocation at T. Rowe Price Associates, Inc., who leads the team responsible for managing the T. Rowe Price Retirement Funds and Target Retirement Funds, testified before the DOL/SEC Target Date Fund Hearing on June 18, 2009.

(2) *inflation risk*, or the risk that the purchasing power of those assets will be eroded by a rising cost of living; and (3) *market risk*, or the risk of loss resulting from price movements in capital markets. Elevating one of these risks (for example, by mandating the inclusion of a risk measure based on risk of loss) could minimize the importance of the other risks to investors and possibly lead them to focus on one risk to the exclusion of others. This creates the potential for unintended consequences to their investing behavior, to the detriment of retirement savings adequacy;

- **A balanced discussion of the risks of target date funds necessarily requires that all three primary investment risks be addressed, not just market risk.** This may be particularly important for those investors with longer time horizons, for whom longevity risk may be of greater concern than shorter-term market risk;
- **An asset allocation glide path illustration provides a substantial amount of information about a target date fund's current and future risks.** We believe, based on our research described below, that introducing a risk measure or risk-based glide path illustration does not communicate a meaningful level of additional risk information; and
- **A robust glide path illustration that provides detailed information about a target date fund's exposure to sub-asset classes** (such as high-yield bonds or international securities) **does not provide substantially more information about the fund's risks than a simple asset allocation glide path illustration** showing only stocks, bonds, and cash.
- **Mandating disclosure of a risk metric or more detailed asset allocation glide path illustration will not increase the average investor's understanding of target date funds.** These funds are generally used by individual investors who have relatively limited investment experience, the majority of whom come to target date funds through employer-sponsored retirement plans, retirement plan recordkeepers, and other intermediaries.

### III. T. Rowe Price Target Date Funds

T. Rowe Price currently offers two sets of target date funds: the Retirement Funds and the Target Retirement Funds. The primary difference between these sets of funds is the amount of equity exposure in the glide path. The Retirement Funds feature a greater allocation to equities and seek to provide lifetime income over an extended post-retirement withdrawal horizon. The Target Retirement Funds have a lower allocation to equities and are designed to support income over a moderate post-retirement withdrawal horizon.

Both sets of T. Rowe Price Target Date Funds offer investors an array of diversified investment portfolios with the goal of simplifying the retirement investment process by delivering a complete, professionally managed investment program. We have found that retirement plan participants and other investors can benefit from the broad diversification and periodic rebalancing built into these funds, avoiding inappropriate concentration of assets in equities or fixed income investments, which is a common pitfall of investors.

Our Target Date Funds invest in a number of underlying T. Rowe Price mutual funds representing various asset classes and sectors. Each fund is managed to a specific retirement year (target date) included in its name and each has a strategic asset allocation strategy that changes over time according to a predetermined glide path.

Our Target Date Funds are allocated among two broad asset classes: equities and fixed income. For both sets of funds, the highest equity allocation (90%) is maintained in the funds with the longest time horizons. At the target retirement date, the funds maintain a substantial exposure to equities (a neutral position of 55.0% for the Retirement Funds vs. 42.5% for the Target Retirement Funds). Both sets of Target Date Funds reach their most conservative planned allocation to equities (20%) 30 years after their stated retirement year, at which point the allocation to equities remains static, with the remainder in fixed income instruments and cash. (See Appendix A for the asset allocation glide paths of the Retirement Funds and the Target Retirement Funds.)

#### IV. Support for an Asset Allocation Glide Path Illustration

In general, we favor the approach taken by the Commission in the Proposal to communicate key features of target date funds in TDF Marketing Materials through the use of an illustration that conveys the changing asset allocation of the target date fund over its entire life cycle, including at the target date and the point where the fund arrives at its final asset allocation (the "asset allocation glide path illustration"). We believe that such asset allocation glide path illustrations are effective in conveying to investors the relationship between different asset classes throughout the fund's approach to and through its target date.

However, we do not believe that layering an additional risk-based glide path illustration will meaningfully enhance an investor's ability to make an informed investment choice. Presenting investors with information that confuses them may lead to an inappropriate choice of fund or, worse, investing paralysis that results in inadequate retirement savings. Our experience suggests that many people who invest in target date funds do not possess the time, interest, or investment knowledge required to adequately understand standard measurements of investment risk, such as standard deviation and beta.

At the same time, most investors do know when they want to retire and can use this information to select an appropriate target date fund from a given lineup. Requiring investors to evaluate additional criteria such as a risk metric will not necessarily lead to a better outcome. Our experience shows that many investors have difficulty accurately judging their own risk tolerance. As a result, we believe many target date investors would have difficulty matching a potentially inaccurate assessment of their individual risk tolerance to an appropriate target date fund. We are also concerned that a greater focus on the risks of target date funds rather than on the risks of other investment options, evidenced by a requirement to include a risk metric only in TDF Marketing Materials, could navigate investors away from target date funds.

In our opinion, the asset allocation glide path illustration provides the most relevant and practical information necessary for investors to make informed decisions about target date funds. This information includes a fund's present and future asset allocation, including at the target

retirement and terminal dates, as well as how the allocation changes over time. We believe that asset allocation (at the broad asset class level) is an excellent proxy for risk and is more likely to be understood by the average investor than risk measures like standard deviation or beta. We would argue that any risk-based measure that is ultimately chosen does not provide enough of an incremental benefit to warrant the potential for a counterproductive increase in complexity and risk of overwhelming investors.

V. Concerns with a Risk-Based Glide Path Illustration

A. Most target date funds are not managed to meet a target risk level.

We have substantial concerns about a requirement to display a risk-based glide path illustration in TDF Marketing Materials. One of the primary reasons for our concern is that a risk-based glide path illustration is inconsistent with the manner in which the vast majority of target date funds are managed. The typical target date fund follows an asset allocation-based glide path, adjusting asset class weights over time. For example, the T. Rowe Price glide paths described above automatically adjust their asset class weights over time, and we manage our target date funds to the specific asset allocation as indicated by the glide path. If, at five years before the target date, the glide path indicates that the funds' asset allocation is 65% stocks and 35% bonds, then we will maintain that exposure independent of the resulting level of portfolio volatility. In this case, risk metrics that depend on asset allocation, such as market volatility, are the residual of the asset allocation decision.

A risk-managed target date fund—one in which a specific risk measure is defined and tracked along a glide path—is a reasonable investment approach. However, there are very few target date funds that use this approach. In fact, we can clearly identify only two mutual fund families that follow a risk-managed approach, and they represent less than 3% of total assets in the target date fund industry. Risk-focused fund managers typically target a specific parameter, for example, 10% volatility at the expected retirement age, and then actively rebalance the portfolio to meet that target. In such a strategy, the fund's asset allocation results from changes made to meet the volatility target. In our experience, target date funds can be managed either to an asset allocation-based glide path or a risk target, but they cannot be managed to both. As a result, we believe that the most appropriate glide path illustration for a particular target date fund is one that represents that fund's specific construction methodology.

B. Focusing on market risk could minimize attention given to other equally important risks that target date funds are designed to address.

Because they integrate an element of financial planning with an investment program, target date funds differ significantly from many other mutual funds. Target date funds are designed to help individuals accumulate, manage, and then draw down retirement savings over time. This, in our opinion, is a more complex financial challenge than the typical narrowly focused mutual fund is designed to address. As a result, the success or failure of a target date fund in meeting its objective cannot be measured accurately at one specific point in time with one particular statistic. Rather, a target date fund's impact should be evaluated through its ability to provide a sufficient outcome over a long time period. In our opinion, the dual nature of a

target date fund – combining investment management with financial planning – explains much of the adoption of target date funds as a default investment for retirement investors.

Just as the design and objective of target date funds differ from a typical mutual fund, so too do their risks. Investors saving for retirement face a number of risks, primary among which are (1) *longevity risk*, or the risk of an investor outliving his retirement assets; (2) *inflation risk*, or the risk that the purchasing power of those assets will be eroded by a rising cost of living; and (3) *market risk*, or the risk of loss resulting from price fluctuations in capital markets.

If a target date fund's objective is to support lifetime income over a potentially lengthy period, for example, it will typically place greater emphasis on offsetting longevity and inflation risks through a higher allocation to equities due to their long-term growth potential. At the same time, however, greater exposure to equities can increase a fund's exposure to market risk, which can result in increased variability in account balances over shorter time periods. On the other hand, a target date fund that is more focused on safeguarding an investor's account balance at retirement or on a withdrawal horizon that is relatively shorter may focus more on offsetting market risk, and thus, have greater exposure to less volatile fixed income instruments. Since it is impossible to eliminate all risks, target date funds must strike an appropriate balance between these competing risks, placing more or less emphasis on addressing each risk depending on a fund's particular investment objective.

We are also concerned that highlighting one particular risk will place undue emphasis on that measure and may cause investors to inappropriately prioritize that risk above all others that are equally important. Most quantitative risk metrics (including those suggested by the Commission) are focused on some measure of market volatility, which is more easily observed (if not quite so easily measured) by the average investor than other risks like longevity and inflation. However, these other risks can have as equal or greater impact on investor outcomes as market risk. If TDF Marketing Materials focus on market volatility, investors may conclude that the mitigation of market risk is of primary importance, and that other types of risk are relatively less important. All else being equal, investors may gravitate toward target date funds with lower anticipated market risk, which may not be appropriate for their individual investment objectives and time horizon.

C. What is appropriate for one category of investors may not be appropriate for others.

In our view, it is not appropriate to develop a disclosure principle, such as maximum exposure to loss or volatility of returns, that is focused primarily on a single category of investor (those "approaching retirement") as suggested by the Investor Advisory Committee ("**Committee**").<sup>3</sup> Those approaching retirement are only one category of investors who might consider target date funds as suitable investments. Approximately 50% of the investors in the T. Rowe Price Retirement Funds are 49 years old or younger, and 29% are younger than 40. These investors are still in the accumulation phase of their retirement planning and may have 15, 20, 30 years or more remaining before they reach the Target Date Fund's assumed retirement age of 65.

Simply put, a 30-year-old investor who plans to retire when she is 65 may be more concerned with accumulating assets than protecting them against short-term market losses. A

single metric about risk of loss or even a risk-based glide path illustration will provide little insight into the more important dimension – a target date fund’s return potential. By their nature, risk metrics are backward-looking, and focusing solely on risk leaves half of the story untold. The reason investors take on risk is for the potential for higher returns; a risk-based glide path illustration will depict an unbalanced view of target date funds if it does not also show information about the funds’ potential returns.

D. A target date fund’s equity allocation is more instructive than any risk measure.

T. Rowe Price agrees with the Committee’s statement that “much of the differences in risk among target date funds can be explained by differences in asset allocation models and glide paths.”<sup>4</sup> Our research indicates that an asset allocation glide path illustration provides a substantial amount of information about a target date fund’s future risks. However, we also find that additional detail in the form of a risk-based disclosure or a more granular glide path illustration provides relatively limited benefit over a simpler asset allocation glide path illustration.

As a result, we disagree with the Committee’s conclusion that “a glide path illustration based on an appropriate, standardized measure of fund risk would be more accurate than an illustration based on asset allocation alone.”<sup>5</sup> We also differ with the Committee’s assertion that “asset allocation may mask significant differences in the risk levels of funds with apparently similar or even identical asset allocation glide paths, particularly when the asset classes are defined broadly.”<sup>6</sup>

If the Commission’s stated objective is to “reduce the potential for investors to be confused or misled regarding these [target date] funds,” we believe it is most important to present or describe target date funds using attributes that will lead to materially different outcomes.<sup>7</sup> Investors in target date funds often have limited investment expertise. As a result, disclosure that focuses on small differences in design or outcome will be of limited value. Illustrations of different target date fund designs should focus on the attribute that will lead to the greatest variability in outcomes – asset allocation – rather than identifying the subtle differences between target date funds. We believe that requiring disclosure of (1) a standardized risk measure, particularly one of the volatility-oriented metrics such as those proposed, or (2) a more detailed asset allocation disclosure, is unlikely to tell investors significantly more about the potential future risks of a target date fund than does its overall asset allocation strategy.

In reaching these conclusions, T. Rowe Price analyzed the effectiveness of asset allocation in differentiating the risk levels of target date funds. We considered whether future volatility of a fund was better explained by historical volatility or by asset allocation. We also considered the relationship between asset allocation and projected volatility under a standardized model. In both cases, asset allocation, as measured by the equity allocation of the fund, largely

<sup>4</sup> Recommendation of the Investor Advisory Committee: Target Date Mutual Funds (Apr. 11, 2013), available at <http://www.sec.gov/spotlight/investor-advisory-committee-2012/iac-recommendation-target-date-fund.pdf>.

<sup>5</sup> *Ibid.*

<sup>6</sup> *Ibid.*

<sup>7</sup> Investment Company Advertising: Target Date Retirement Fund Names and Marketing, Securities Act Release No. 9126 (June 16, 2010) [75 FR 35920 (June 23, 2010)] (“Proposing Release”).

explains any differences in risk among target date funds, and the addition of a risk measure does not tell us substantially more about future risks.

We looked at the relationship between a target date fund's past risk and future risk and compared this to the relationship between the fund's equity exposure and its future risk for each calendar year between 2006 and 2013. Our analysis utilized the universe of target date mutual funds available in Morningstar Direct with reported equity weights and risk statistics. For each period, we compared the relationship between a target date fund's volatility of daily returns in a calendar year against those of the previous calendar year. We also compared the relationship between a target date fund's reported average equity exposure over the calendar year and its volatility of daily returns over the following calendar year. (See Appendix B.)

T. Rowe Price's findings do not support a conclusion that the use of a risk metric is substantially more accurate than the use of a fund's equity exposure in predicting future volatility. Both metrics (past volatility and equity exposure) have a strong positive relationship with future volatility. We conclude that both a risk metric and an asset allocation glide path provide very similar information, and neither provides superior information over the other about the future risks of a target date fund.

Our analysis recognizes that disclosure of previous-period risk may help explain risk for the period immediately following. However, we question whether such disclosure provides meaningful information about risks further into the future. For example, for an investor in a 2040 target date fund, the fund's risk profile over a defined previous period may provide helpful insight into the relative risks over the immediately following period, but it does little to help investors understand the fund's risk profile at a target retirement date that is decades in the future.

T. Rowe Price also analyzed the relationship between equity allocation and the projected risk of a fund. To determine projected risk, we utilized a standardized model that can be applied across a full range of target date funds. Our model of projected risk quantified each fund's holdings according to more detailed asset allocation profiles that included sub-asset class categories such as, U.S. equity, non-U.S. developed markets equity, non-U.S. emerging markets equity, investment-grade bonds, and high yield bonds. Using these more granular profiles, we estimated the risks and correlations of these sectors based on the prior three years of commonly used index returns.

This analysis focused on a target date fund peer group of 2015-dated funds, representing a peer universe of funds that are close to their target retirement date. Based on the asset allocation for each fund in the peer group as reported by Morningstar, we compared the relationship between a ranking of a fund's equity exposure to that of a ranking of the predicted volatility using asset class risks and correlations based on three-year historical returns. The rankings are nearly identical, which indicates that estimating a target date fund's risks according to a more granular asset allocation profile does not provide materially more information than estimations based on broader asset class categories. (See Appendix C.)

We confirmed that this relationship holds true in more extreme market environments. To do this, we used asset class risks and correlations from a period of high market volatility as well as a period of low market volatility. These periods were determined by selecting the three-year periods that resulted in the highest and lowest equity volatility, respectively, over the last ten years. Both of these market environments confirmed what we have seen using current data: the differences in projected risk for these funds are largely identical to differences in equity exposure.

In conclusion, our research supports the assertion that an asset allocation glide path illustration is an appropriate means of communicating information about a target date fund's risks and demonstrates that a more detailed glide path is not substantially more accurate in predicting future volatility than a fund's broader equity exposure. We find that a fund's overall equity exposure explains the vast majority of a fund's predicted volatility, independent of the volatility environment or of the granularity of asset allocation used to forecast future volatility. We also find that use of a more granular asset allocation profile does not significantly alter the volatility rankings of funds within a peer group relative to use of equity exposure alone.

While choices of asset classes used within a glide path can alter the risk profile of a target date fund, our analysis indicates that the impact of such differences on portfolio risk is generally modest relative to the impact of the overall equity allocation. Our analysis does indicate that additional asset allocation detail may help differentiate among funds of substantially similar risk levels, but does not provide additional insight in differentiating among funds with materially different risk profiles.

This is intuitively evident as most target date funds have relatively modest allocations to investments that would substantially increase the risk profile of a broader stock-bond-cash mix. For example, the average 2020 target date fund has only 2.6% allocated to high-yield fixed income investments and 2.4% allocated to emerging markets equities.<sup>8</sup> Since the allocation to such asset classes is relatively small, the addition of this information to the glide path may marginally change the perception of target date funds with similar overall equity exposure and risk profiles, but will not change the relative relationship of funds that have very different stock/bond/cash profiles given that equity exposure is the primary driver of glide path risk.

#### VI. Mandating Disclosure of a Risk Metric or a More Granular Asset Allocation Glide Path Illustration Will Not Increase the Average Investor's Understanding of Target Date Funds.

Target date funds are typically designed for and used by individual investors who have relatively limited investment experience, the majority of whom come to target date funds through employer-sponsored retirement plans, retirement plan recordkeepers, and other intermediaries. Assessing the impact of additional asset classes within a glide path requires an understanding of each investment's overall risk relative to other investments in the portfolio, as well as an understanding of the interaction of those investments relative to each other (correlation). Many investors understand the basic principle that equity exposure is more volatile than fixed income exposure. However, most investors do not understand the nuances of the risk levels of more

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<sup>8</sup> Source: S&P Target Date Indexes, 2013.

granularly defined asset classes. We do not believe that the typical target date fund investor would fully understand these nuances and be able to evaluate their impact on risk levels of different target date funds, particularly if such information were presented in TDF Marketing Materials without accompanying narrative disclosures.

Most target date investors benefit from a fiduciary working on their behalf. The vast majority of investors in target date funds arrive at their investment through a defined contribution plan where the investment menu is determined by plan sponsor fiduciaries (often assisted by financial professionals). (As of March 31, 2014, over 80% of the assets in our target date products originate from defined contribution plans.) Plan sponsor fiduciaries operate under legal principles that require them to exercise skill, care, diligence, and prudence in selecting investment options. They have a fiduciary duty to understand the details of the investment choice, and therefore, they require more details about the construction and design of target date funds in order to make a well-informed decision as to the appropriate design to be used within their plan.

Contrary to the claims made in the Committee's recommendation, in our experience, these fiduciaries (or the advisers and consultants they employ) are deeply familiar with the details of the funds they select, as well as the competitive choices available in the marketplace. (Over 65% of private defined contribution plan assets are serviced by advisors and consultants.<sup>9</sup>) Certain risk metrics and sub-asset class allocations are available to these more sophisticated financial professionals, who also bring their own expertise to bear on the wealth of public information available about target date funds. We believe this differentiation is appropriate and should be considered in any proposed rulemaking with a goal of tailoring the appropriate level of information to each unique audience involved in the investment decision-making process.

Importantly, a participant's age is the primary factor used by retirement plan sponsors when selecting default target date funds as a qualified default investment option for their participants, a fact that is communicated to the participants in plan enrollment materials. If the participant is allowed to choose the fund in which their contributions will be invested, the participant's proposed retirement age is often the means by which he or she determines in which fund to invest. Using age helps the participant choose a target date fund that appropriately balances longevity, inflation, and market risks given their time horizon until retirement.

While risk metrics and sub-asset class allocation data, in addition to historical returns, can serve to assist clients in their decision making process, they should continue to be offered to clients who seek them out, either through self-service website functionality or interactions with T. Rowe Price shareholder service associates. For example, more granular asset allocation details and accompanying narrative disclosures explaining the performance and positioning of the asset classes within the funds are available to interested investors as well as institutional buyers through annual and semiannual shareholder reports that are available on our website.

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<sup>9</sup> Source: Cerulli Quantitative Update – Retirement Markets 2013.

## VII. Conclusion

In conclusion, we urge the Commission to be extremely careful not to single out target date funds for additional disclosure that could unintentionally create negative comparisons with other investment choices, and thus, undermine confidence in target date funds, and more generally threaten retirement savings overall. In keeping with the objective of this Proposal, which is to provide mutual fund investors with key information about target date funds in an easily understood format so they can make well-informed investment decisions, we strongly urge the Commission not to require additional information that does not add to an investor's understanding of these products and, in fact, may cause greater confusion.

We appreciate the opportunity to provide comments on this Proposal. If you have any questions or need additional information, please contact any of the undersigned at the phone numbers listed below.

Sincerely,



Danielle Nicholson Smith

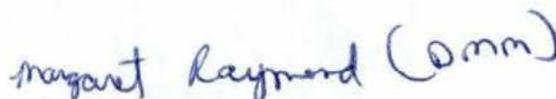
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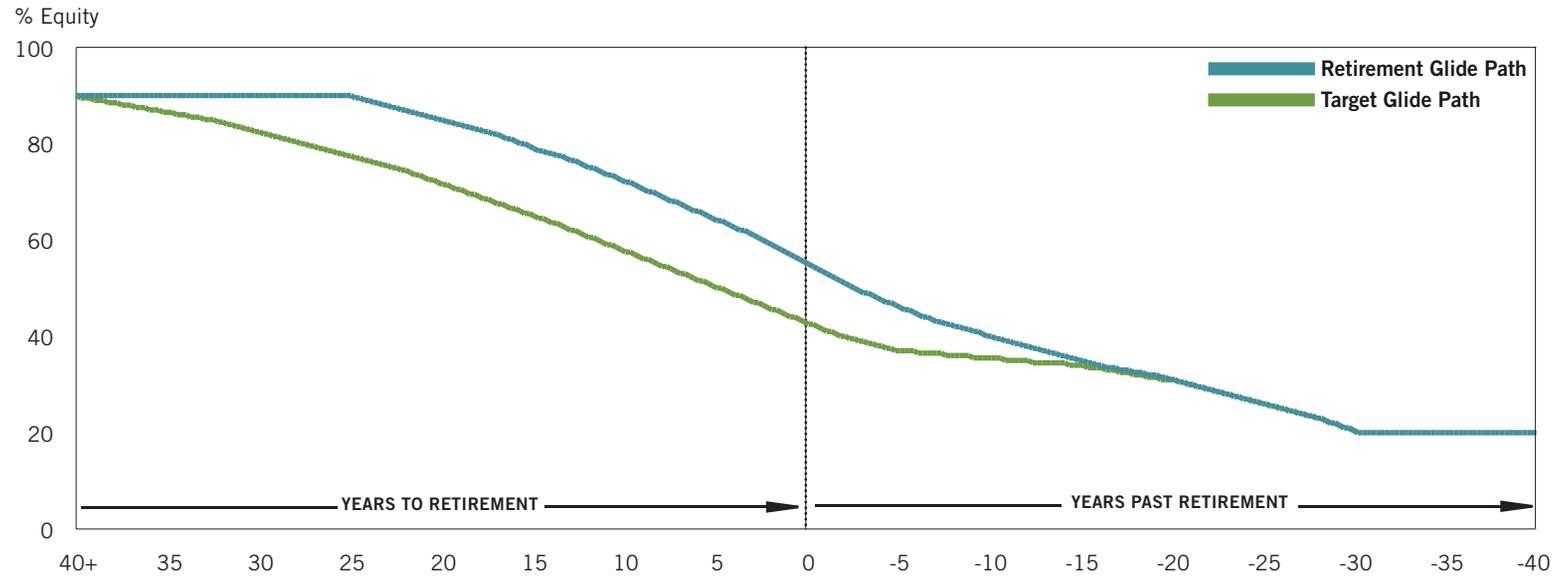
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(Encls.)

## T. Rowe Price Target Date Solutions



Retirement	<b>90.0</b>	90.0	90.0	<b>90.0</b>	85.0	79.0	72.0	64.0	<b>55.0</b>	46.0	40.0	35.0	<b>31.0</b>	26.0	<b>20.0</b>	20.0	20.0
Target	<b>90.0</b>	86.5	82.5	<b>77.5</b>	71.5	65.0	57.5	50.0	<b>42.5</b>	37.0	35.5	34.0	<b>31.0</b>	26.0	<b>20.0</b>	20.0	20.0
Difference	<b>0.0</b>	3.5	7.5	<b>12.5</b>	13.5	14.0	14.5	14.0	<b>12.5</b>	9.0	4.5	1.0	<b>0.0</b>	0.0	<b>0.0</b>	0.0	0.0

**APPENDIX B:**  
**Analysis of the Effectiveness of Asset Allocation in Differentiating Risk Levels of Target Date Funds**

**Objective**

- Examine the effectiveness of asset allocation (as measured by equity exposure) in differentiating the risk levels of target date funds.
- Determine whether a fund's future risk was better explained by historical risk or by asset allocation (equity exposure)

**Methodology**

- Universe: the oldest share class of all target date mutual funds available in the Morningstar Direct database with reported equity weights and risk statistics (i.e., funds that reported an equity weight for at least one month out of the year; standard deviation for the calendar years covered in the analysis)
  - o Excluded funds that appear to achieve a significant portion of their equity exposure with derivatives as this means the equity exposure reported by Morningstar was not a reliable measure of the fund's effective equity exposure. As a result, the following fund families were excluded: PIMCO, INVESCO, Putnam, Allianz, State Farm, BlackRock, and Harbor.
- Time period: analysis performed on calendar years 2006 through 2013 (incorporating data from 2005-2013)
- Asset allocation is defined as the fund's average equity exposure over that calendar year (Equity exposure defined as Morningstar's Asset Allocation Equity % - Long Rescaled. This method of calculating a fund's equity exposure is calculated by Morningstar by measuring the percentage of the fund's assets in stocks and is rescaled to ensure that the sum of the asset allocation breakdown equals 100%).
- Risk is defined as a fund's standard deviation of daily returns for each calendar year, as calculated and reported by Morningstar.
- For each calendar year, we fit a linear regression model to explain each fund's standard deviation based on its equity exposure ("Equity Regression Model").
- We also fit a linear regression model that explained each fund's standard deviation based on its standard deviation in the previous year ("Previous Risk Regression Model").
- $R^2$  of the regression determines how much of the variation in the fund's standard deviation was explained by the variable we regressed on (either equity allocation or previous calendar year's standard deviation) and was used to evaluate the appropriateness of the model and compare the two approaches.
- A high  $R^2$  indicates that there is a very strong relationship between the two variables, i.e., between either equity exposure and current risk or past risk and current risk.

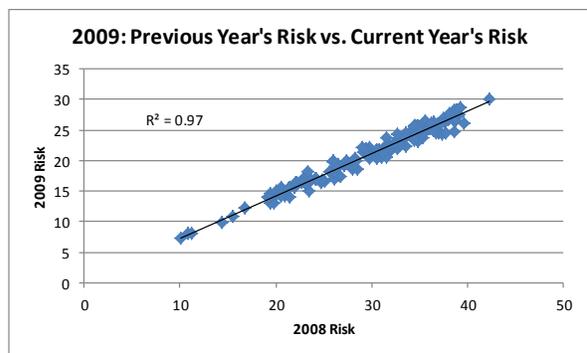
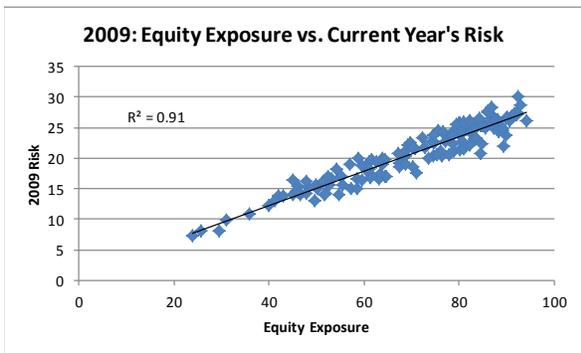
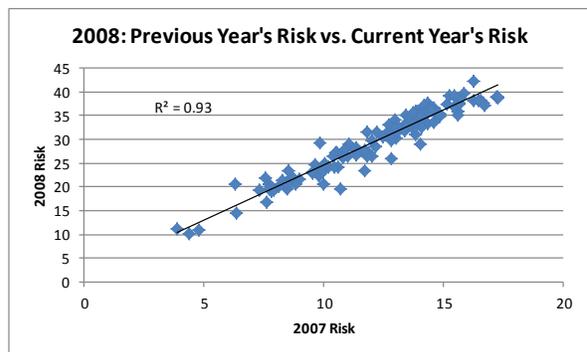
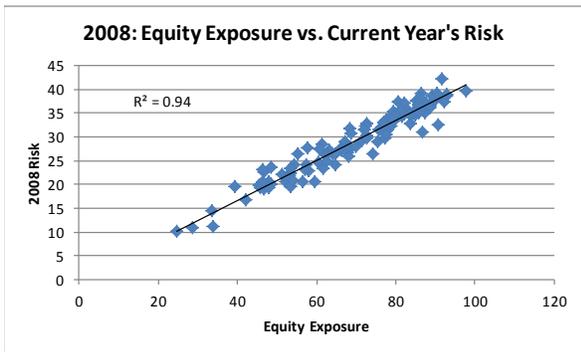
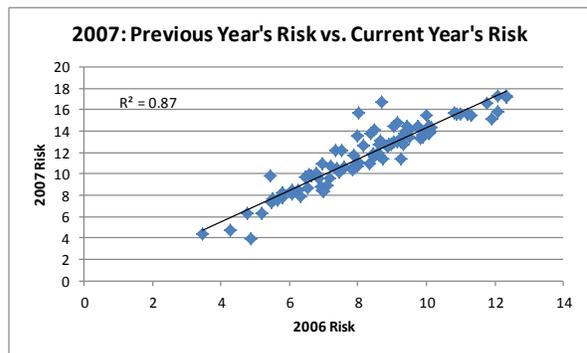
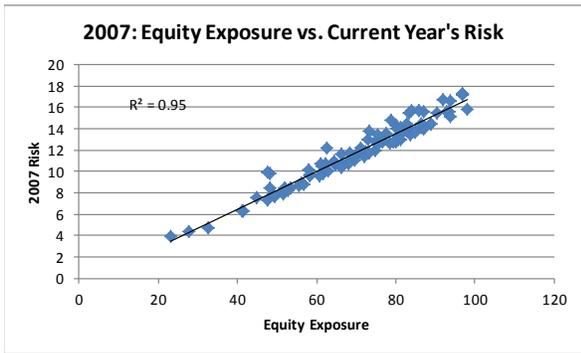
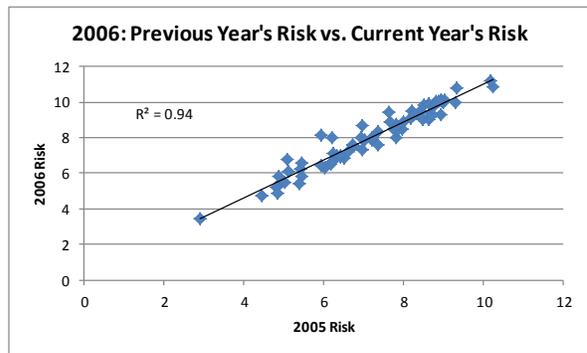
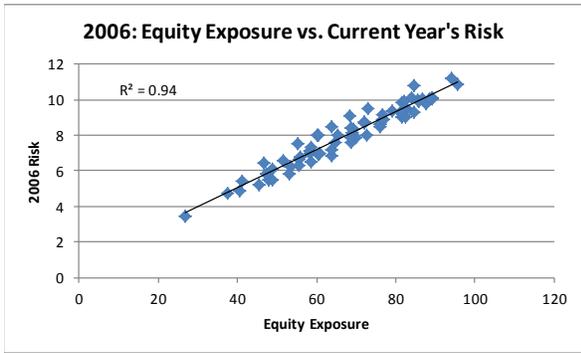
**Findings**

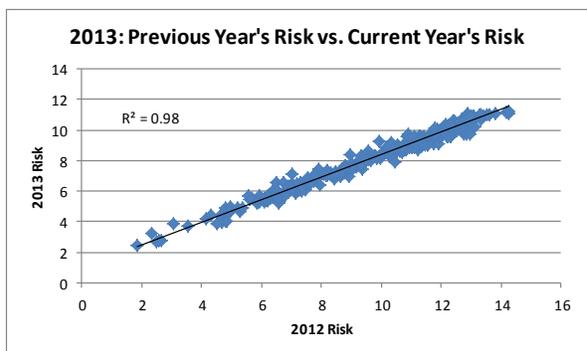
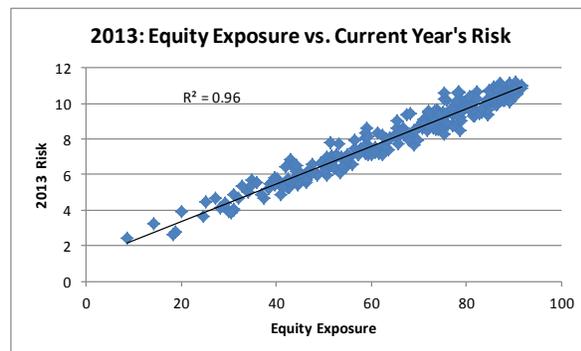
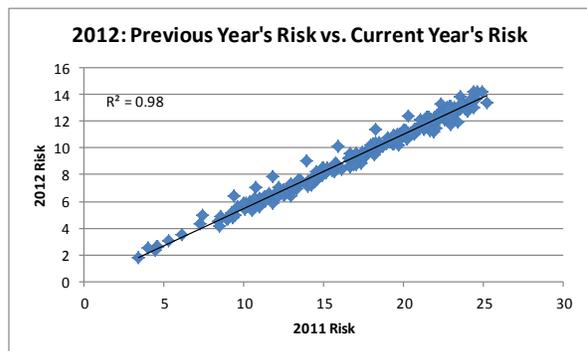
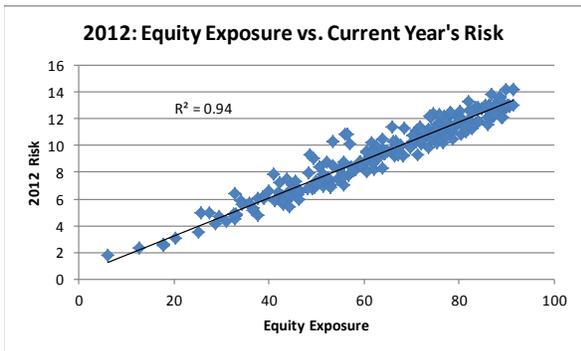
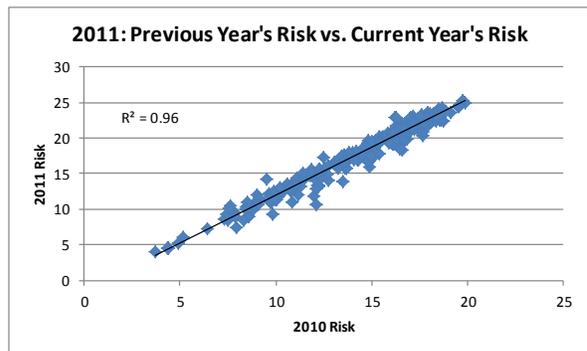
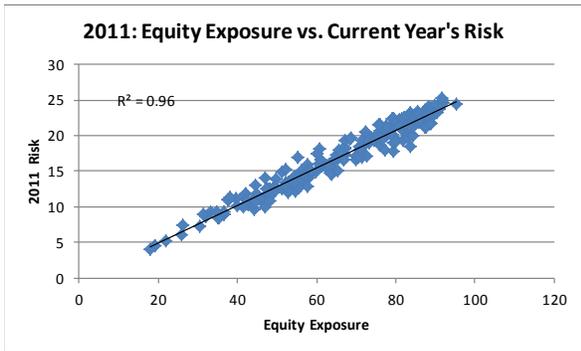
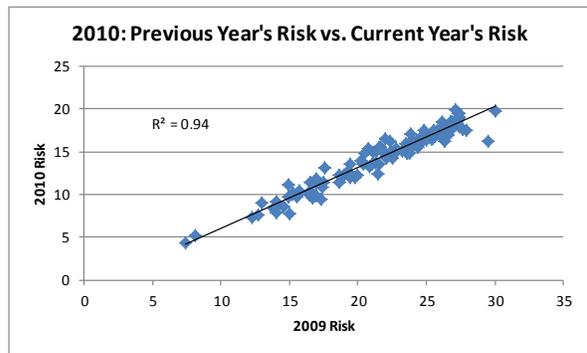
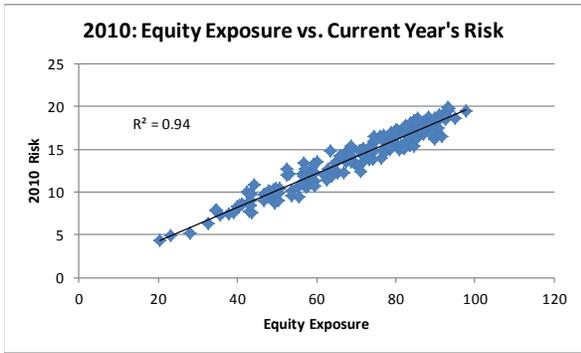
- Past risk and equity exposure both have strong positive relationships with future risk.
- In each year, the  $R^2$  from each regression is at least 0.91 for the model using equity allocation and at least 0.87 for the model using the previous year's risk.
- Each model worked better in some of the years, but on average they both had high average  $R^2$ 's of 0.94 and 0.95.

	# of Funds	R <sup>2</sup> of EQ Regression Model	R <sup>2</sup> of Previous Risk Regression Model
2006	69	0.94	0.94
2007	95	0.95	0.87
2008	128	0.94	0.93
2009	165	0.91	0.97
2010	211	0.94	0.94
2011	262	0.96	0.96
2012	281	0.94	0.98
2013	315	0.96	0.98
<b>Avg.</b>	-	<b>0.94</b>	<b>0.95</b>

### Conclusion

- Both a risk metric and an asset allocation glide path illustration provide very similar information and neither provides superior information over the other about the future risks of a target date fund.





## **APPENDIX C:**

### **Analysis of the Relationship between Equity Allocation and Target Date Fund Projected Risk**

#### **Objective**

- Examine the relationship between equity allocation and the projected risk of a fund to identify whether more detailed asset allocation information demonstrates the projected risk of a fund better than a fund's equity allocation.

#### **Methodology**

- Universe: The oldest share classes of the 42 funds in the Morningstar 2015 target date fund universe that disclosed their allocations according to the classification criteria described below.
- Allocation data used was as of 3/31/2014, if available; 12/31/2013 if not.
- Using data available from Morningstar, we categorized each fund's holdings utilizing two different classification criteria:
  - o Criteria 1: Equity grouped by *region* - results in the following asset allocation groupings
    - US Equity
    - Non-US Developed Equity
    - Non-US Emerging Equity
    - Investment Grade Bonds (includes US and Non-US)
    - High Yield Bonds (includes US and Non-US)
    - Cash
  - o Criteria 2: Equity grouped by *market-cap* - results in the following asset allocation groupings
    - Large Cap Equity
    - Mid Cap Equity
    - Small Cap Equity
    - Investment Grade Bonds (includes US and Non-US)
    - High Yield Bonds (includes US and Non-US)
    - Cash
- In order to standardize portfolio holdings, we excluded the "Other" asset allocation category in Morningstar and normalized portfolio weights to sum to 100%.
- Projected risk was determined by assuming each asset allocation grouping had the risk and correlation characteristics as determined by the most recent three years of data (as of 4/30/2014) for the following major indices:
  - o US Equity: Russell 3000 Index
  - o Non-US Developed Equity: MSCI EAFE Index
  - o Non-US Emerging Equity: MSCI Emerging Market Index
  - o Large Cap Equity: MSCI USA Large Cap Index
  - o Mid Cap Equity: MSCI USA Mid Cap Index
  - o Small Cap Equity: MSCI USA Small cap Index
  - o Investment Grade Bonds: Barclays Aggregate Index
  - o High Yield Bonds: Barclays High Yield Index
  - o Cash: Citigroup 90-Day T-Bill
- Target date funds were ranked by projected risk. Additionally, we ranked the funds by equity allocation.
- We then fit a linear regression model, regressing the rank-order of the risk projections on the rank-order of equity allocations.
- We then viewed the  $R^2$  of the analysis.  $R^2$  of the regression determines how much of the variation in the fund's projected risk rank was explained by the fund's equity rank.
- A high  $R^2$  indicates that there is a very strong relationship between the two variables, i.e., an  $R^2$  close to 1 would indicate that the two ranks are nearly equivalent.

- This relationship was additionally tested for robustness in various market environments by using the risk and correlations from more extreme market environments, determined by the highest and lowest volatility periods of equity over the past 10 years:
  - o High Volatility Environment: 3 years ending 12/31/2010
  - o Low Volatility Environment: 3 years ending 5/31/2007

**Findings**

- There is a very strong relationship between equity allocation and projected risk.
- This strong relationship holds for all three environments (current, high volatility, and low volatility), and for both equity classification criteria.

	R <sup>2</sup> of regression		
	Current	High Volatility	Low Volatility
AA Criteria 1: Equity region	0.97	0.98	0.97
AA Criteria 2: Equity market capitalization	0.98	0.98	0.96

**Conclusion**

- Choices of asset classes used within a glide path can alter the risk profile of a target date fund, but our analysis indicates that the impact of such differences on portfolio risk is generally modest relative to the impact of the overall equity allocation.
- Additional asset allocation detail may help differentiate among funds of substantially similar risk levels, but does not provide additional insight in differentiating among funds with materially different risk profiles.

