IDC
INDEPENDENT DIRECTORS COUNCIL

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June 9, 2014

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

Re: Investment Company Advertising: Target Date Retirement Fund Names and Marketing; File No. S7-12-10

Dear Mr. O'Neill:

The Independent Directors Council[1] appreciates the opportunity to respond to the Securities and Exchange Commission's request for comments on the recommendation of the Commission's Investor Advisory Committee ("Committee") relating to target date retirement funds ("target date funds").[2] Fund directors—whose primary responsibility is to promote and protect the interests of their funds' shareholders—have a keen interest in policy issues affecting fund investors.

The Commission had previously proposed rule amendments that would, among other things, require marketing materials for target date funds to include a table, chart, or graph depicting the fund's asset allocation over time, *i.e.*, an illustration of the fund's so-called "asset allocation glide path."[3]

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[1] IDC serves the U.S.-registered fund independent director community by advancing the education, communication, and policy positions of fund independent directors, and promoting public understanding of their role. IDC's activities are led by a Governing Council of independent directors of Investment Company Institute member funds. ICI is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds, and unit investment trusts. Members of ICI manage total assets of $16.8 trillion and serve more than 90 million shareholders, and there are approximately 1,900 independent directors of ICI-member funds. The views expressed by IDC in this letter do not purport to reflect the views of all fund independent directors.

[2] *See Investment Company Advertising: Target Date Retirement Fund Names and Marketing*, SEC Release Nos. 33-9570; 34-71861; IC-31004 (April 3, 2014).

[3] *See Investment Company Advertising: Target Date Retirement Fund Names and Marketing*, SEC Release Nos. 33-9126; 34-62300; IC-29301 (June 16, 2010) (the "2010 Proposal").

Subsequently, the Committee recommended that the Commission develop a glide path illustration for target date funds that is based on a standardized measure of fund risk as a replacement for, or supplement to, the proposed asset allocation glide path illustration.[4] The Commission has reopened the comment period for its 2010 Proposal to seek public comment on the Committee's recommendation.

The Commission's 2010 Proposal Satisfies Its Articulated Policy Goals

IDC is supportive of disclosure initiatives that help investors make informed decisions about their investments. The market for target date funds consists largely of investors saving through retirement plans or retail investors investing through IRAs.[5] Both employers selecting target date funds for 401(k) plan menus, as well as 401(k) plan participants and IRA investors selecting target date funds for their retirement investments, need concise and understandable information about the key features of the target date funds. To that end, IDC is supportive of the Commission's goal, as stated in the 2010 Proposal, "to provide enhanced information to investors concerning target date retirement funds and reduce the potential for investors to be confused or misled" regarding these funds.[6]

Indeed, boards and advisers have been sharply focused on enhancing the risk disclosures provided to target date fund investors, particularly since 2008. For instance, in June 2009, the Investment Company Institute published *Principles to Enhance Understanding of Target Date Funds*, which highlights how target date funds used for retirement savings can convey effective disclosure.[7] Among the key pieces of information it identifies that could enhance the public's understanding of target date funds is an asset allocation glide path illustration accompanied by narrative disclosure, and many target date funds now include such illustrations in their disclosures.

We believe that an asset allocation glide path illustration in target date fund marketing materials, as the Commission proposed in 2010, would satisfy its policy goal and would help address concerns that arose following the market downturn in 2008 about investor understanding of target

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

[5] *See* Investment Company Institute, "Retirement Assets Total $23.0 Trillion in Fourth Quarter 2013" (March 26, 2014), available at http://www.ici.org/research/stats/retirement/ret_13_q4. As of December 31, 2013, target date mutual fund assets totaled $618 billion. Retirement accounts held the bulk of target date mutual fund assets: 90 percent of target date mutual fund assets were held through defined contribution plans and IRAs.

[6] *See* 2010 Proposal, *supra* n. 3.

[7] The *Principles* are available at www.ici.org/pdf/ppr_09_principles.pdf. The document reflects the results of an ICI Target Date Fund Disclosure Working Group project. The Working Group reviewed the then existing disclosures applicable to target date funds and determined that five key pieces of information displayed prominently can help enhance understanding of these funds.

date fund investment strategies. The key feature of any target date fund is its asset allocation glide path. A glide path illustration would provide investors, at a glance, with both a short-term and long-term view of the fund's investment strategy. It would alert the investor that the asset allocation is not static throughout the life of the fund but will change over time, including near—and often after—the target retirement date, until the landing point is reached. In particular, the illustration would reinforce an understanding of the target date fund's allocation to equities at the target date and whether that allocation would continue to change after the target date.

IDC Questions the Feasibility and Advisability of a Risk-Based Glide Path

We question, however, the feasibility of a standardized risk-based glide path to convey useful—and not confusing or misleading—information to investors about target date funds. The Commission does not propose a specific standardized risk measure to support a risk-based glide path, nor did the Committee suggest one in its recommendation. This suggests that there is not a single risk measure that would be an obvious choice for this purpose. Indeed, we are not aware of a risk measure that the industry (or academia) has embraced as a standard for target date funds.

It is not surprising that a viable standardized risk measure has not been identified, given that investment risk is multi-faceted and has different meanings for different investors. In fact, different concepts of risk cannot be captured in a single risk measure. We note that the Commission issued a concept release in 1995 exploring ways to enhance mutual fund risk disclosure.[8] The Commission aptly concluded not to require a fund to disclose information designed to quantify its expected risk levels, citing, among other things, the lack of a broad consensus as to what measure of risk would best serve fund investors.[9] That lack of broad consensus persists today.

The Committee suggested that the Commission focus on factors such as volatility of returns or maximum exposure to loss and noted that these factors are directly related to the primary concerns of those approaching retirement. This focus on volatility raises a number of concerns. For one, it ignores other important facets of risk, including inflation risk (*i.e.,* the risk that the purchasing power of one's assets will erode over time), longevity risk (*i.e.,* the risk of outliving one's assets), and income replacement risk (*i.e.,* the risk that the income provided for in retirement will not be sufficient). These other risks are important considerations for younger, long-term investors who are looking to accumulate sufficient assets to support their future retirements.

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[8] *See Improving Descriptions of Risk by Mutual Funds and Other Investment Companies,* SEC Release Nos. 33-7153; 34-35546; IC-20974 (Mar. 29, 1995).

[9] *See Registration Form Used by Open-End Management Companies,* SEC Release Nos. 33-7512; 34-39748; IC-23064 (Mar. 13, 1998).

Volatility risk (which may be measured by standard deviation) may not be meaningful for those investing for the long term; a measure of short-term volatility does not necessarily correspond to the risk of longer-term underperformance. A risk-based glide path built around a volatility measure could lead some investors to overvalue volatility risk at the expense of other important factors (*e.g.*, return potential, longevity risk, and inflation risk). Those investors may choose lower volatility funds that may not be appropriate to meet their long-term investment goals.

A mandated risk-based glide path also raises concerns about investor understanding of such technical information. Many investors may not understand the basic concepts and limitations of standard deviation or other risk metrics, and some target date fund investors, such as those investing through a retirement plan default option, may be even less sophisticated than others when it comes to investment concepts. For instance, investors may not appreciate that risk measures use historical data to make assumptions about future risk, and that history may not be a reliable predictor of future markets nor sufficiently account for market events with no historical precedent. Nor might they appreciate the level of uncertainty in a risk-based glide path illustration. Most target date funds are not managed to a targeted risk metric, but rather, a targeted asset allocation. While, for those funds, the glide path would be based on an asset allocation under the adviser's control, a risk-based glide path would be based on predictive measures of risk over which the adviser has less control. Investors may place too much reliance on a risk-based glide path and view it as predictive of future levels of risk and performance. As a result, investors may not understand that a fund could in practice behave very differently as a result of market conditions, changes in underlying portfolio holdings and the correlations in returns of those holdings. Indeed, for example, the market events of 2008, which saw the short-term phenomenon of generally non-correlated assets tending to move together, demonstrate that even logically sound risk constructs (relied on by even sophisticated investors) may be of limited value.

Given these limitations, we are concerned that a risk-based glide path would confuse and possibly mislead investors, rather than help them understand the potential risks of the target date fund. Rather than help investors make informed investment decisions, a requirement that target date fund marketing materials focus on a particular risk may hinder investors' ability to do so.

Moreover, any risk-based glide path would likely require substantial additional, narrative explanation, which, even if it were comprehensible to the average retail investor, would diminish the value of a glide path illustration to convey useful information at a glance. An asset based glide path illustration, as the Commission originally proposed, offers a cleaner and clearer method for providing useful information to investors.

The Commission Should Proceed Cautiously With Respect to Any Risk-Based Disclosure Requirements

As noted above, IDC shares the Commission's goal of continuing to help investors understand the potential risks associated with target date fund investments. Although a glide path based on a standardized risk metric may not be feasible, there may be other ways to provide investors with information to help them understand the different investment risks associated with target date funds. For example, some have suggested providing more detail about the target asset allocations, such as the sub-classes within an asset class.

To the extent the Commission continues to consider requiring additional risk-based disclosures with respect to target date funds, we urge the Commission to keep the following in mind:

- Any disclosure requirement should be helpful and appropriate to both longer-term investors and those approaching retirement. Otherwise, such disclosure could cause investors to inappropriately focus on the wrong risks for them.

- Similarly, any disclosure requirement should help investors focus on the range of risks, and not a particular risk. Simplified disclosure (such as illustrations, graphics or other non-narrative disclosure) that focuses on a particular risk might lead investors to place undue reliance on that metric.

- Any disclosure requirement should be clear and informative, and not misleading. While reducing complex information into an illustration can be helpful, it also presents the risk of being confusing and/or misleading, without substantial additional narrative, which then diminishes the value of a clear-cut illustration.

To the extent the Commission is considering disclosure requirements beyond marketing materials (*i.e.*, registration statements), we urge it to proceed very cautiously. The current fund disclosure requirements are the result of lengthy study and thoughtful consideration of how best to present complex information in a balanced and understandable format. For example, the performance bar charts in fund prospectuses[10] and summary prospectuses and the performance line graphs in annual reports are useful and intuitive graphic measures of risk that investors receive. The bar chart requirement is intended to illustrate graphically the variability of a fund's returns and thus provide investors with some idea of its risk. For similar reasons, the Commission should be extremely cautious about extending to other types of mutual funds any requirement to include standardized risk measures in marketing materials or registration statements.

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[10] *See* Item 4(b)(2) of Form N-1A under the Investment Company Act of 1940.

The Commission Should Propose Any Risk-Based Disclosure Requirement Before Adopting It

Finally, we note that the Commission's release lacks detail regarding any proposed methodology for a risk-based glide path. If the Commission determines to pursue this enhanced disclosure, it is critical that it first seek comment on a specific proposal before adopting it.

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If you have any questions about our comments, please contact me at ([redacted]

Sincerely,

Amy Lancellotta

Amy B.R. Lancellotta
Managing Director
Independent Directors Council

cc: The Honorable Mary Jo White
The Honorable Luis A. Aguilar
The Honorable Daniel M. Gallagher
The Honorable Kara M. Stein
The Honorable Michael S. Piwowar

Norm Champ, Director
Division of Investment Management