MEMORANDUM

November 19, 2013

TO: File No. S7-12-10

FROM: Aidan O'Connor
Division of Investment Management

RE: Investment Company Advertising: Target Date Retirement Fund Names and Marketing – Release No. IC-29301

On August 8, 2013, David Grim, Deputy Director, Diane Blizzard, Associate Director, Hunter Jones, Assistant Director, Michael Pawluk, Branch Chief, and Aidan O'Connor, Senior Counsel, of the Division of Investment Management met with Karrie McMillan, Brian Reid, Dorothy Donohue, and Anna Driggs of the Investment Company Institute.

The purpose of the meeting was to discuss certain issues raised in the Recommendation of the Investment Advisory Committee, Target Date Mutual Funds (Adopted April 11, 2013). The Investment Company Institute participants provided the materials attached to this memorandum and the report available at http://www.ici.org/pdf/per19-04.pdf.

Attachments

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TARGET DATE FUND FEE DISCLOSURE

Investor Advisory Committee Recommendation:

The SEC's Investor Advisory Committee has recommended that the Commission consider amending the fee disclosure requirements for target date funds "to provide better information about the likely impact of fund fees on total accumulations over the lifetime of the investment." In the Committee's view, "the fee table currently provided in the fund summary and fund prospectus does not adequately illustrate the significant impact that seemingly small differences in fees can have on long-term accumulations." As possible ways to improve this disclosure, the Committee suggests that "[w]here a fund is designed for a retirement date many years in the future, for example, the impact of fees could be measured based on that expected retirement date. Similarly, the calculation could be based on average or 'typical' annual investment amounts in the fund."

Investment Company Institute Response:

- What problem is the Committee trying to solve? It is unclear on what basis the Committee has concluded that current fee table disclosure, including the hypothetical example showing fund expenses over 1, 3, 5, and 10-year periods, is inadequate—particularly given trends in mutual fund fees.
    - Across each of the major asset categories, average expenses paid by mutual fund investors have dropped significantly, on an asset-weighted basis, since the early 1990s. For example, in 1993, investors incurred expenses of 1.07 percent (or $1.07 for every $100 in assets) to invest in equity funds, on average. By contrast, expenses averaged 0.77 percent for equity fund investors in 2012—nearly 30 percent lower than in 1993.
    - On average, 401(k) plan participants pay lower fees—and, like fees throughout the rest of the mutual fund industry, those fees have trended down for the last 15 years. For example, retirement savers in 401(k) plans, on average, incurred expenses of 0.63 percent on equity funds—down 15 percent from 1998 and well below the 0.77 percent for all equity fund investors in 2012.
    - The fact that assets in 401(k) plans are concentrated in lower cost funds strongly suggests that existing fee disclosure is working/target date fund investors are already sensitive to fees.
- The current disclosure clearly illustrates the trajectory of fund expenses and allows investors and/or retirement plan consultants to make comparisons among funds.
- Measuring fund expenses based on the "expected retirement date" and/or the "average" or "typical" annual investment amount could be misleading.

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- First because it requires a number of assumptions that may not hold true over longer periods (indeed, they may not hold true over shorter periods but the impact of the assumption will grow over time):
    - Projected or hypothetical annual investment return
    - Static fees (*i.e.,* the fund will not raise or lower its fees measurably over the time period in question)[1]
- Although we do not have data on average holding periods for target date funds, it is our sense that they (1) likely are more closely tied to job tenure than to the target date; and (2) might not differ substantially from average holding periods for funds in general.

- Focusing on fund fees in isolation obscures the fact that what matters most is performance after fees.
- The SEC has repeatedly considered amendments to the fee table as part of improvements to Form N-1A, including most recently in 2009, and has not deemed these changes necessary.
- For all of the foregoing reasons, we urge the Commission to refrain from pursuing the Committee's recommendation regarding target date fund fee disclosure.

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[1] When the SEC adopted the existing hypothetical example in 1988, it exempted new funds from including the 5 and 10 year expense projections precisely because "their current expenses are much higher than their future expenses will be" and "the validity of the estimate may diminish in later years."

Developments in Target Date Funds

August 2013

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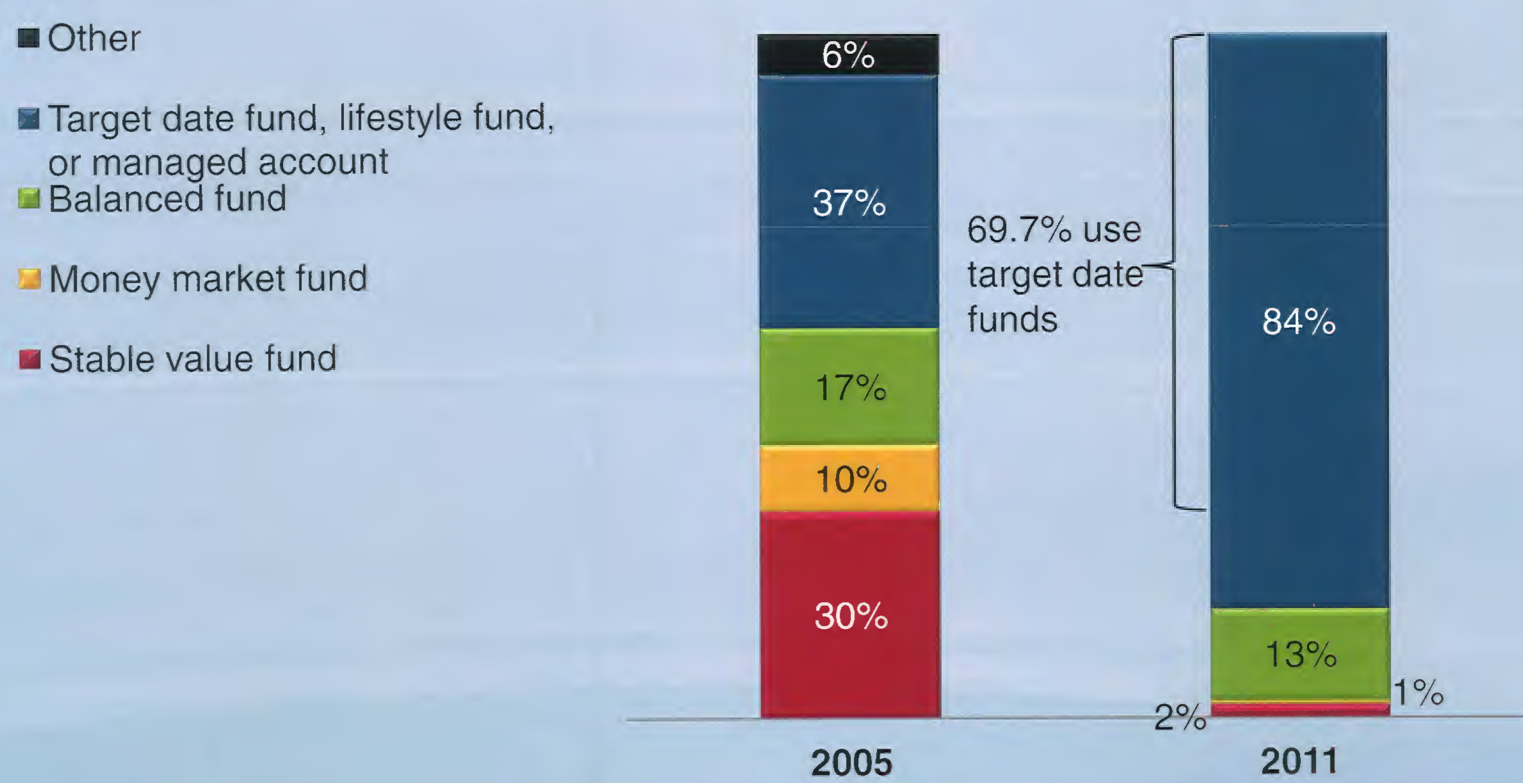
Overview

- Target date funds are diversified and rebalance to be more focused on income over time.
- In 2013:Q1, 71% of target date mutual fund assets was held in defined contribution (DC) retirement plans and 19% was held in individual retirement accounts (IRAs).
- Target date funds represent a rising share of 401(k) plan assets; 13% at year-end 2011.

Default Investment Options Increase Focus on Growth and Diversification

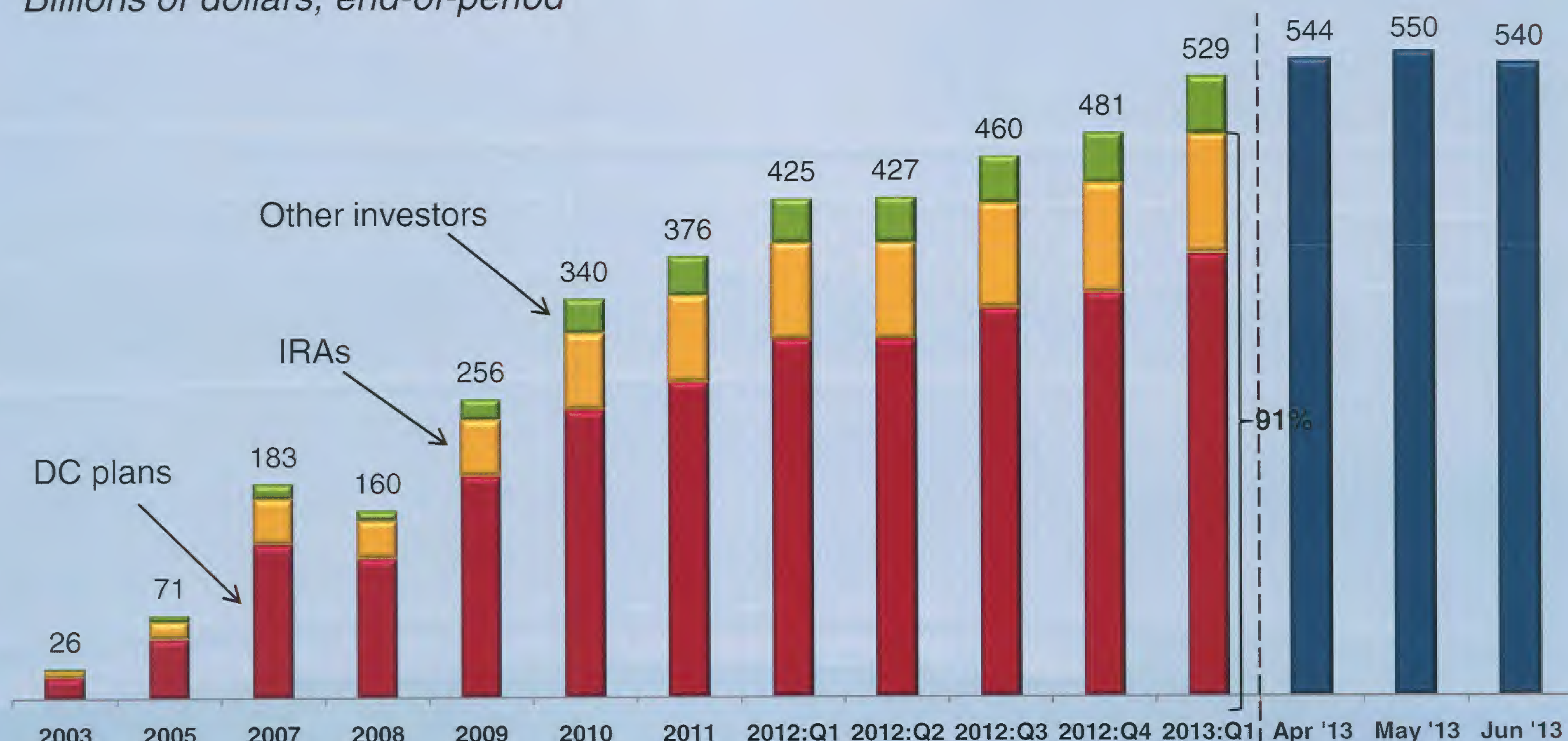
Default investment options among plans with automatic enrollment; percentage of plans



Note: "Fund" includes mutual funds, collective investment trusts, and other pooled investments.
Source: Plan Sponsor Council of America; see annual PSCA member surveys

Target Date Mutual Fund Assets

Billions of dollars, end-of-period

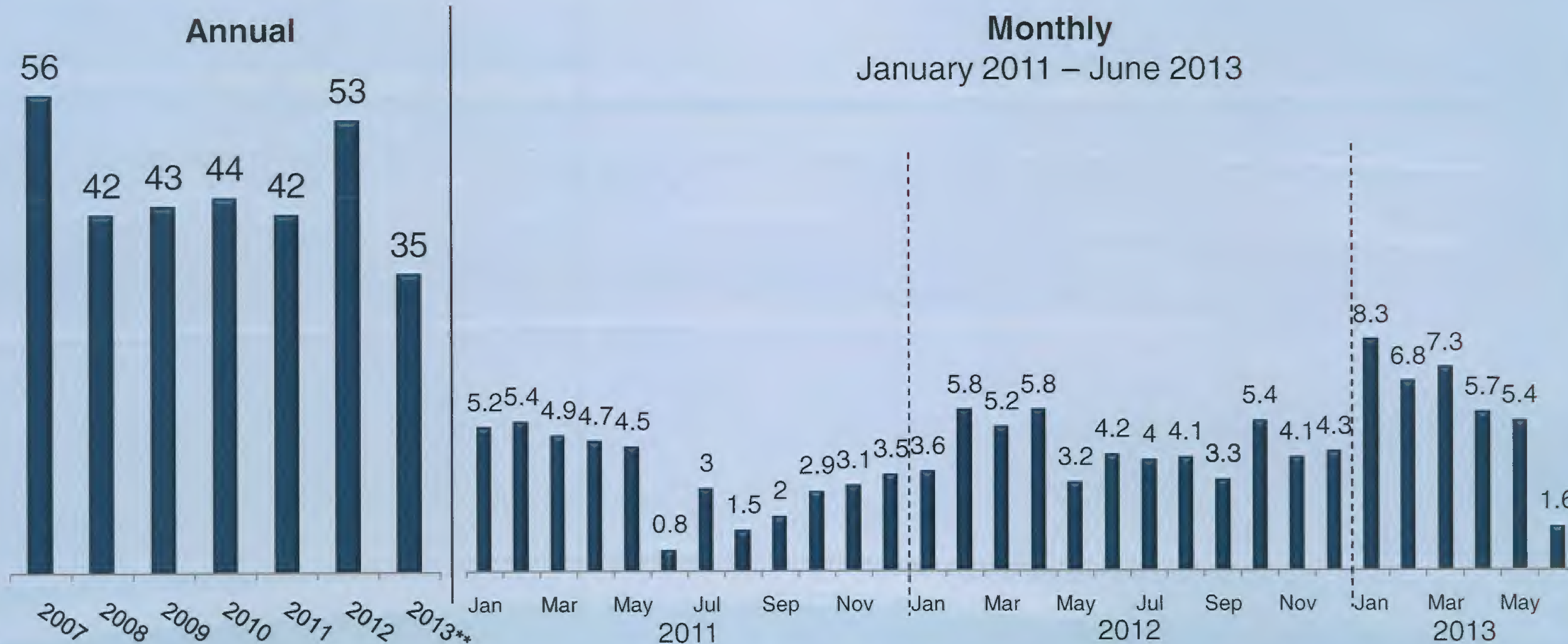


* A target date (lifecycle) fund typically rebalances its portfolio to become less focused on growth and more focused on income as it approaches and passes the target date of the fund, which is usually included in the fund's name.

Source: Investment Company Institute

Target Date Mutual Funds Draw New Cash

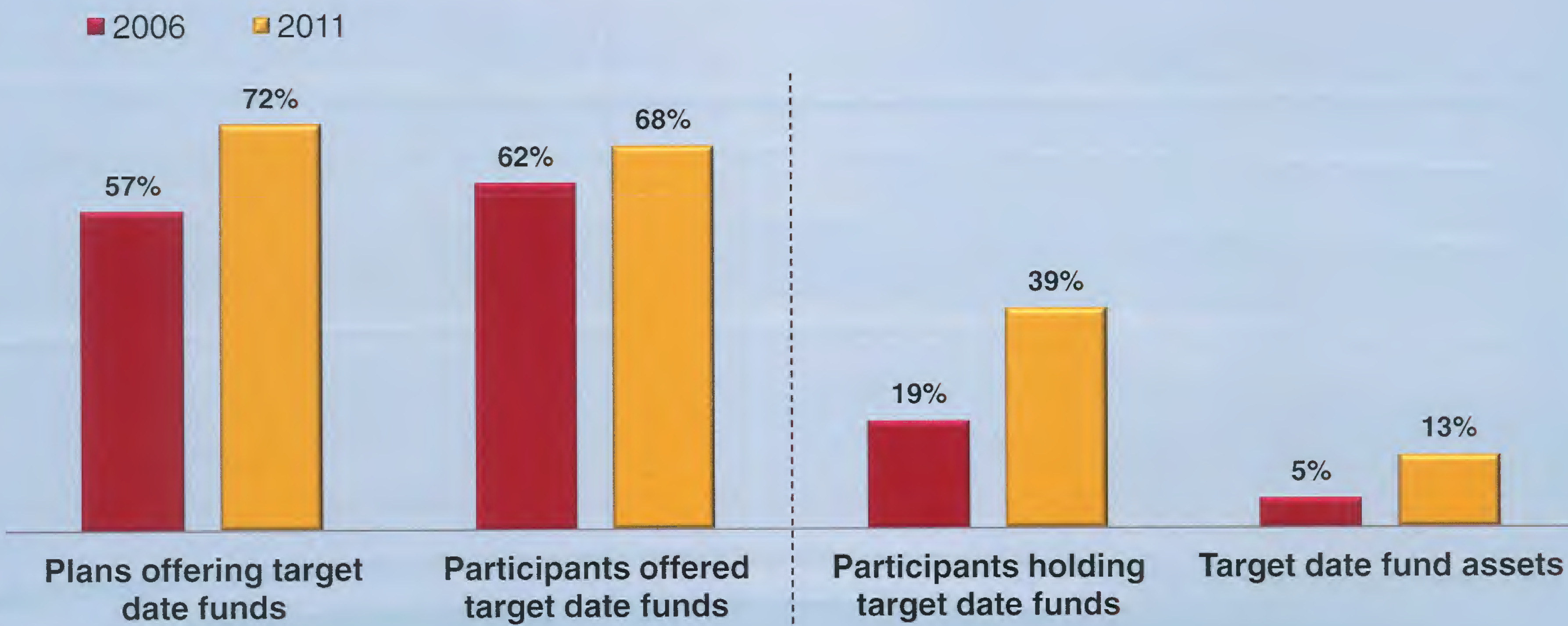
Net new cash flow, billions of dollars*



*Net new cash flow is the dollar value of new sales minus redemptions, combined with net exchanges. Does not count reinvested dividends or reinvested capital gains.
**2013 data are year-to-date through June 30, 2013.
Source: Investment Company Institute

Target Date Funds Claim a Growing Share of 401(k) Market

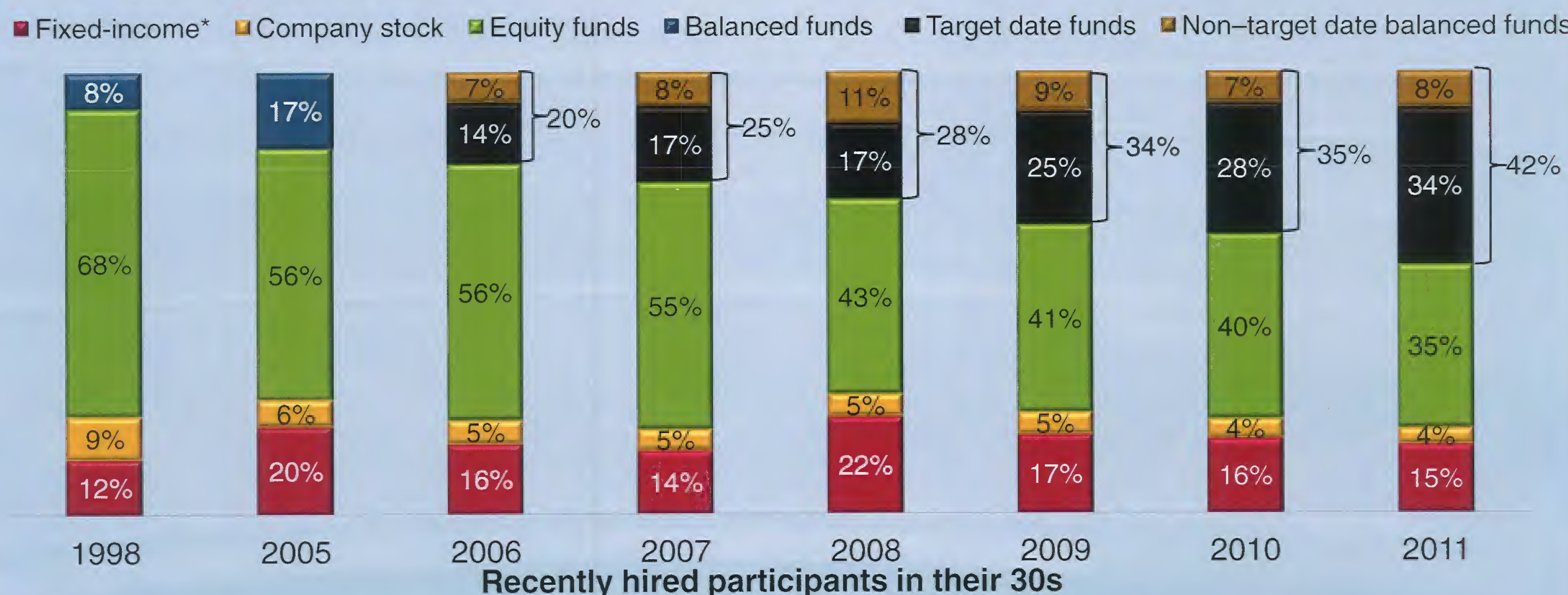
Percentage of totals, year-end, 2006 and 2011



Note: "Funds" include mutual funds, bank collective trusts, life insurance separate accounts, and any pooled investment product primarily invested in the security indicated.
Source: EBRI/ICI Participant-Directed Retirement Plan Data Collection Project; see Holden, VanDerhei, Alonso, and Bass "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2011," *ICI Research Perspective* and *EBRI Issue Brief* (December 2012)

Recently Hired Participants in Their Thirties Hold More Target Date and Balanced Funds

401(k) plan average asset allocation among 401(k) participants with two or fewer years of tenure, percent of total



*Fixed-income investments include bond funds, guaranteed investment contracts (GICs) and other stable value funds, and money funds.
Note: "Funds" include mutual funds, bank collective trusts, life insurance separate accounts, and any pooled investment product primarily invested in the security indicated. Percentages are dollar-weighted averages.
Source: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project; see Holden, VanDerhei, Alonso, and Bass, "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2011," *ICI Research Perspective* (December 2012)

Target Date Mutual Fund Fees

Total expense ratios of target date mutual funds, basis points, 2008–2012

	Asset-weighted average	Simple average	Median
2008	67	123	118
2009	67	120	114
2010	65	114	111
2011	61	111	109
2012	58	107	104

Sources: Investment Company Institute and Lipper; see Gallagher, "Trends in the Expenses and Fees of Mutual Funds, 2012," *ICI Research Perspective* (April 2013)

References

Gallagher, Emily. 2013. "Trends in the Expenses and Fees of Mutual Funds, 2012." *ICI Research Perspecitve* 19, no 3 (April). www.ici.org/pdf/per19-03.pdf

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