INVESTMENT COMPANY INSTITUTE

**MEMO# 28139**

May 23, 2014

# ICI Draft Comment Letter in Response to SEC's Latest Target Date Funds Release; Comments Requested by June 2

[28139]

May 23, 2014

TO: ADVERTISING COMPLIANCE ADVISORY COMMITTEE No. 11-14
PENSION COMMITTEE No. 13-14
PENSION OPERATIONS ADVISORY COMMITTEE No. 11-14
SEC RULES COMMITTEE No. 22-14
SMALL FUNDS COMMITTEE No. 10-14 RE: ICI DRAFT COMMENT LETTER IN RESPONSE TO SEC'S LATEST TARGET DATE FUNDS RELEASE; COMMENTS REQUESTED BY JUNE 2

As previously reported, [1] in its April 3, 2014 release, [2] the Securities and Exchange Commission (SEC) has reopened the comment period on amendments to its advertising rules to enhance the information provided to target date fund investors first proposed in 2010 (the "2010 Proposal"). [3] The majority of the Release is dedicated to soliciting comments on whether the SEC should develop a glide path illustration for target date funds that is based on a standardized measure of risk as either a replacement for, or supplement to, the asset allocation glide path proposed in 2010.

Attached is ICI's draft comment letter that we intend to submit in response to the Release. In our letter, we argue that the adoption of a risk-based glide path would run counter to the SEC's goal in proposing the rule amendments of providing enhanced information to investors concerning target date retirement funds and reducing the potential for investors to be confused or misled. We urge the SEC not to adopt rule amendments that stipulate the use of a glide path illustration for target date funds that is based on a standardized measure of fund risk. Rather, we urge the SEC to continue with its approach to the glide path set forth in the 2010 Proposal.

More specifically, our comments in response to the Release include the following:

- There is no single measure of risk that the industry has coalesced around, particularly with respect to target date funds, due to the complexity and multi-faceted nature of risk and the inherent limitations of any single measure.
- Risk metrics can be helpful tools for assessing the potential return volatility risk of an

investment portfolio, but a simplistic use of such measures can lead to misleading conclusions. Widely identified weaknesses include the limitations of historical data on which they are based (including the inability of data to sufficiently account for market events with no historical precedent).

- Adoption of a mandatory risk measure, either alone or in connection with the construction of a risk-based glide path illustration, presents several unique challenges when applied to target date funds, including the following:
    - A risk-based glide path focused solely on return volatility risk would not capture all forms of risk to which target date funds are subject, because there is no single statistical measure that captures the many facets of risk encountered by individuals investing for retirement, including return volatility risk, inflation risk, and longevity risk;
    - Conventional approaches to measuring risk (e.g., standard deviation of returns)— which use time-weighted metrics over specified time periods—do not work for target date funds with changing asset allocations; and
    - The limitations associated with the use of historical data are more pronounced for target date funds, which are composed of multiple asset and sub-asset classes whose weightings and representative investments change over the funds' investment horizons; interpreting from data how and at what level of precision these various assets correlate and in what direction presents difficult challenges.
- Investors would have difficulty understanding, and would be vulnerable to being misled by, a risk-based glide path illustration, because such an illustration:
    - may not be comprehensible to investors not familiar with the statistical concepts underpinning the glide path's construction, such as standard deviation, beta, or whatever other alternative may be chosen;
    - would suggest that future levels of risk in a fund are reasonably predictable, but return volatility risk measures are probabilistic in nature, not exact, and investors may place too much confidence on the measure as predictive of future performance, or even regard it as promissory in nature;
    - would not accurately reflect how most target date funds are managed; and
    - would make investors susceptible to de-valuing other important investment considerations, such as longevity and inflation risks and return potential, thereby potentially jeopardizing the realization of their retirement goals.
- A few foreign jurisdictions require or permit funds to disclose "risk rating" information. The use of risk ratings for funds and their underlying methodologies suffers from many of the same flaws that plague the risk-based glide path and its potential underlying methodologies.
- An asset allocation glide path is not only a good proxy for return volatility risk, it shows actual intended asset allocations, allowing for better glide path comparability among target date funds. In contrast, a risk-based glide path can be based only on predictive measures of return volatility risk in future years, over which portfolio managers have far less control.
- The asset allocation glide path illustration and other disclosure requirements contemplated in the 2010 Proposal, together with all of the information that target date fund investors and plan administrators have at their disposal, would provide a comprehensive and multi-faceted picture of fund risk.
- We continue to support the SEC's flexible approach in the 2010 Proposal in not prescribing the asset classes to be shown in the proposed asset allocation glide path.
- The SEC has requested comment on a complex topic with no new specific rule amendments and very limited analysis. In the event that the SEC chooses to pursue

some type of risk-based glide path, the SEC should formally propose new specific rule amendments accompanied by careful analysis (including a detailed regulatory impact analysis), to which the public would have the opportunity to provide more specific comments.

If members have any comments on the draft letter, please contact me at matt.thornton@ici.org or 202-371-5406 no later than Monday, June 2 (close of business). Please pay particular attention to those bracketed questions/comments directed to members that are embedded in the draft. The deadline for submitting this comment letter is Monday, June 9.

Matthew Thornton
Assistant Counsel

Attachment

**endnotes**

[1] See Institute Memorandum No. 28016, dated April 7, 2014, for a summary of the SEC's latest release on target date funds.

[2] "Investment Company Advertising: Target Date Retirement Fund Names and Marketing," Release Nos. 33-9570; 34-71861; IC-31004 (April 3, 2014) (the "Release"), available at: http://www.sec.gov/rules/proposed/2014/33-9570.pdf.

[3] See Institute Memorandum No. 24389, dated June 25, 2010 (describing the 2010 Proposal). The Institute filed a letter with the SEC strongly supporting the spirit and core of the Commission's 2010 Proposal and making several recommendations. See Institute Memorandum No. 24508, dated August 23, 2010 (summarizing the comment letter).

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