

MEMO# 28323

August 19, 2014

ICI Submits Comment Letter in Response to SEC's Latest Target Date Funds Release

[28323]

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TO: BANK, TRUST AND RETIREMENT ADVISORY COMMITTEE No. 37-14
BROKER/DEALER ADVISORY COMMITTEE No. 42-14
OPERATIONS COMMITTEE No. 38-14
TRANSFER AGENT ADVISORY COMMITTEE No. 54-14 RE: ICI SUBMITS COMMENT LETTER IN RESPONSE TO SEC'S LATEST TARGET DATE FUNDS RELEASE

Attached is the comment letter that ICI submitted on June 9 in response to the April 3, 2014 release (the "Release") [\[1\]](#) issued by the Securities and Exchange Commission (SEC). The Release reopened the comment period on amendments to SEC advertising rules to enhance the information provided to target date fund investors first proposed in 2010 (the "2010 Proposal"). [\[2\]](#) As previously reported, [\[3\]](#) the Release solicited 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.

In our letter, we urge that the SEC not adopt rule amendments that mandate the use of a risk-based glide path illustration for target date funds. Rather, we urge the SEC to continue with its approach to the glide path set forth in the 2010 Proposal. More specifically, our comment letter includes the following points, all of which are discussed in greater detail in the letter.

- There is no single measure of risk on which the industry has settled. This is due to the complexity and multi-faceted nature of risk and the inherent limitations of any single measure.
- Managers of target date funds attempt to address a variety of risks faced by individuals investing for retirement. In addition to return volatility risk, target date fund managers also consider longevity or shortfall risk (i.e., the risk of outliving one's assets), inflation risk (i.e., the risk that the purchasing power of one's assets will erode over time), and income replacement risk (i.e., the risk that the income provided for in retirement will not be sufficient).

- Risk metrics can be helpful tools for assessing one of these risks, i.e., the potential return volatility risk of an investment portfolio, but a simplistic use of such measures, alone or in the construction of a risk-based glide path, will harm, rather than help, investors. Widely identified weaknesses include the limitations of historical data on which they are based, the challenges associated with adapting such data to a particular portfolio, and the inability of data to account sufficiently for market events with no historical precedent.
- While a few foreign jurisdictions require or permit funds to disclose “risk rating” information, the use of such ratings and their underlying methodologies have been criticized for these and other limitations that affect risk-based metrics generally.
- 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 cannot capture all forms of risk to which target date funds are subject, such as inflation risk and longevity risk;
 - As a fund’s asset allocation changes, its risk profile also changes, and therefore it is not possible to take a risk statistic such as standard deviation and extrapolate the same risk metric out over the life of a target date fund; 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 varying assets correlate presents difficult challenges.
- Investors may be confused, and may be 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 (e.g., standard deviation or beta);
 - 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 likely will view the illustration 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 cause investors to de-value other important investment considerations, such as longevity and inflation risks and return potential, which will make it more difficult for them to realize their retirement goals.
- An asset allocation glide path is not only an effective proxy for return volatility risk, it also shows actual intended asset allocations, allowing for better glide path comparability among target date funds.
- 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 currently have available, provide an effective and comprehensive picture of fund risk.
- 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 formally should propose specific new rule amendments accompanied by careful analysis (including a detailed regulatory impact analysis).
- In the event that the SEC chooses to pursue some type of risk-based glide path, the U.S. Department of Labor should impose similar rules on non-mutual fund target date funds and arrangements to assure that all retirement investors receive the same basic

information about these important retirement savings vehicles.

We will continue to keep you informed of developments in this area.

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[Attachment](#)

endnotes

[1] “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>.

[2] 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).

[3] See Institute [Memorandum](#) No. 28016, dated April 7, 2014, for a summary of the Release.

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