INVESTMENT COMPANY INSTITUTE

MEMO# 28229

June 25, 2014

ICI Draft Comment Letter in Response to DOL Request for Comments on Its Target Date Fund Disclosure Proposal; Comments Requested by June 30

[28229]

June 25, 2014

TO: ADVERTISING COMPLIANCE ADVISORY COMMITTEE No. 16-14
PENSION COMMITTEE No. 14-14
PENSION OPERATIONS ADVISORY COMMITTEE No. 13-14
SEC RULES COMMITTEE No. 28-14
SMALL FUNDS COMMITTEE No. 17-14 RE: ICI DRAFT COMMENT LETTER IN RESPONSE TO DOL'S REQUEST FOR COMMENTS ON ITS TARGET DATE FUND DISCLOSURE PROPOSAL; COMMENTS REQUESTED BY JUNE 30

As expected, in response to the Securities and Exchange Commission's reopening of the comment period on proposed amendments to its advertising rules to enhance the information provided to target date fund investors, [1] the Department of Labor (DOL, and together with the Commission, the "Agencies") has decided to seek public comment in connection with its own 2010 proposal, which would enhance disclosures about target date funds by amending its qualified default investment alternative regulation (29 CFR § 2550.404c-5) and participant-level disclosure regulation (29 CFR § 2550.404a-5)(collectively, the "Regulations"). [2] The reopening of the respective comment periods by the Agencies was in response to the recommendation by the Commission's Investor Advisory Committee that the Commission 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 illustration that was part of the rule proposal issued by the Commission in 2010.

Attached is ICI's draft comment letter that we intend to submit in response to the DOL's request for comments. It makes arguments substantially similar to those made in our comment letter in response to the SEC Release. [3] In our letter, we urge that the DOL not adopt amendments to the Regulations that stipulate the use of a risk-based glide path illustration for target date funds. Rather, we urge the DOL to continue with its approach to the asset allocation glide path set forth in its 2010 proposal.

More specifically, our comments include the following:

- 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 in the construction of a risk-based glide path will harm, rather than help, plan participants. 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.
- Commentators have criticized the use of risk ratings in the few foreign jurisdictions in which they are used.
- Plan participants may be confused and misled by a risk-based glide path illustration, because such an illustration:
  - may not be comprehensible to plan participants not familiar with the statistical concepts underpinning the glide path's construction (e.g., standard deviation or beta);
  - would erroneously suggest that future levels of risk in a fund are reasonably predictable;
  - likely would cause plan participants to view the illustration as predictive of future performance;
  - would not accurately reflect how most target date funds are managed; and
  - would cause plan participants 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 an effective proxy for return volatility risk and shows actual intended asset allocations, facilitating comparisons 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 plan participants and plan fiduciaries currently have available, provide an effective and comprehensive picture of fund risk.
- If the DOL chooses to pursue some type of risk-based glide path as part of its amendments to the Regulations, it is critical that it first seek comment on a specific proposal and its associated regulatory impact analysis before adopting it.

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 30 (close of business). The deadline for submitting this comment letter is Thursday, July 3.

Matthew Thornton
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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] See 75 FR 73987 (Nov. 30, 2010). For the DOL's announcement regarding reopening of the comment period, see 79 FR 31893 (June 3, 2014) (the "DOL Release"), available at www.gpo.gov/fdsys/pkg/FR-2014-06-03/pdf/2014-12667.pdf. The proposed amendments to the Regulations regarding target date fund disclosures would apply to all target date funds and arrangements, regardless if they are offered as mutual funds or other types of investment products.

[3] Available at http://www.sec.gov/comments/s7-12-10/s71210-114.pdf.
