

MEMO# 24389

June 25, 2010

SEC Proposal for Target Date Fund Names and Marketing Materials; July 14th Conference Call

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TO: PENSION COMMITTEE No. 16-10
PENSION OPERATIONS ADVISORY COMMITTEE No. 14-10
SEC RULES COMMITTEE No. 27-10
SMALL FUNDS COMMITTEE No. 8-10
ADVERTISING COMPLIANCE ADVISORY COMMITTEE No. 2-10
529 PLAN ADVISORY COMMITTEE No. 1-10 RE: SEC PROPOSAL FOR TARGET DATE FUND NAMES AND MARKETING MATERIALS; JULY 14TH CONFERENCE CALL

The Securities and Exchange Commission has proposed amendments to its advertising rules to clarify the meaning of a date in a target date fund's name and enhance the information provided to investors to address potential misunderstanding of these funds. [\[1\]](#) We are pleased to report that many of the elements of the Institute's "Principles to Enhance Understanding of Target Date Funds" are incorporated into the SEC's Proposal. [\[2\]](#) The Proposal is summarized below.

Comments on the Proposal are due to the SEC no later than August 23, 2010. We will hold a conference call on Wednesday, July 14, at 3:30 p.m. EDT to discuss the Proposal and ICI's comments. The dial in number for the call is 1-800-475-0222 and the pass code is 52929. Please email Brenda Turner at bturner@ici.org if you plan to participate on the call. If you are unable to participate, please provide any comments to Anna Driggs (202-218-3573 or adriggs@ici.org) or Dorothy Donohue (202-218-3563 or ddonohue@ici.org) before the call.

General Overview

The Proposal has two primary components:

1. Content requirements for target date fund marketing materials. The Proposal would amend the advertising rules, Rule 482 under the Securities Act of 1933 and Rule 34b-1 under the Investment Company Act of 1940, to require:

- a. A target date fund that includes the target date in its name to disclose the fund's asset allocation at the target date immediately adjacent to the first use of the fund's name in marketing materials;
 - b. Marketing materials for target date funds to include a table, chart, or graph depicting the fund's asset allocation over time, along with a statement highlighting the fund's final asset allocation; and
 - c. A statement in marketing materials to the effect that a target date fund should not be selected based solely on age or retirement date, that the fund is not a guaranteed investment, and the stated asset allocations may be subject to change without a shareholder vote.
2. Antifraud guidance affecting all mutual funds. The Proposal would also amend Rule 156 under the Securities Act to identify two circumstances when a statement in marketing materials relating to target date funds or any other investment company could be misleading. These two circumstances are when a statement:
 - a. Emphasizes a single factor, such as an investor's age or tax bracket, as the basis for determining that an investment is appropriate; or
 - b. Suggests that investing in the securities is a simple investment plan or that it requires little or no monitoring by the investor.

While the Proposal would not amend the prospectus disclosure requirements, the SEC requests comments on prospectus and summary prospectus disclosure requirements as those may apply to target date funds.

I. Content Requirements for Target Date Fund Marketing Materials

(Amendments to Rule 482 and Rule 34b-1 [\[3\]](#))

Scope of Proposal

More Than Insubstantial Focus. The Proposal would only apply to advertisements and supplemental sales literature that place "a more than insubstantial focus" on one or more target date funds. The more than insubstantial focus determination would be based on the particular facts and circumstances. Under the Proposal, materials that relate exclusively to one or more target date funds would be covered. Also, materials that cover a broad range of funds, such as a bound volume of fact sheets that include target date funds or a Web site that includes Web pages for target date funds, would be covered. However, materials that may not be primarily focused on marketing target date funds to investors (e.g., a complete list of each fund within a fund complex, together with its performance) are not intended to be covered.

Target Date Fund Definition. The Proposal would apply only to target date funds. Proposed Rule 482(b)(5)(i)(A) would define a "Target Date Fund" as "an investment company that has an investment objective or strategy of providing varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures that changes over time based on an investor's age, target retirement date, or life expectancy." The Proposal states that "[t]his definition is intended to encompass target date funds that are marketed as retirement savings vehicles and that have given rise to the concerns described in this release."

Use of Target Dates in Fund Names

Target Date Tag Line Asset Allocation Disclosure. Proposed Rule 482(b)(5)(iii) would

require a target date fund that includes a “target date” in its name to disclose, immediately adjacent to the first use of the fund’s name, the intended percentage allocations of the fund among types of investments (e.g., equity securities, fixed income securities, and cash and cash equivalents) at the target date (or, for periods on and after the target date, a fund’s actual asset allocation as of the most recent calendar quarter). The purpose of the tag line target date asset allocation disclosure is “to alert investors to the existence of investment risk associated with the fund at and after the target date” in an effort to reduce investor misunderstanding or confusion with respect to the fund’s name and to increase comparability between target date funds. The SEC requests comment on whether this disclosure should appear in a different location.

Manner of Disclosure. The tag line asset allocation disclosure would be required to be presented in a manner reasonably calculated to draw investor attention to the information. The Proposal notes that the SEC does “not believe that the presentation requirements set forth in current rule 482(b)(5) for certain legends required in print advertisement and supplemental sales literature (e.g., type size and style) would be appropriate for the proposed target date asset allocation disclosure.” The SEC gives an example of when the existing rule would permit the name of a target date fund to be presented in a very large type size but the major portion of the advertisement to be presented in significantly smaller type size. The SEC does not believe the latter to be sufficient to attract investor attention. The SEC asks whether it should prescribe the specific format for the target date asset allocation disclosure, including through a table, chart or graph.

Asset Classes and Types of Investments. The Proposal does not prescribe the asset classes to be used in disclosing a target date fund’s asset allocation or the methodology for calculating the percentage allocations. The Proposal states, however, that “the current target date fund prospectuses typically use asset classes such as ‘equity,’ ‘fixed income,’ and ‘cash and cash equivalents. If the rule is adopted as proposed, [the SEC] would expect that many target date funds would use these asset classes in making the required disclosure.” The Proposal requests comments on whether the SEC should prescribe the methodology for calculating the percentage allocations in the final rule and, if so, what it should be.

The Proposal clarifies that, by “types of investments,” the SEC means the underlying asset classes in which the target date fund invests, whether directly or through other funds. For example, the fund would be required to disclose its percentage allocation to equity securities, rather than to equity funds.

The Proposal asks for comment on how various disclosure methods compare in their effectiveness for conveying investment risk information without confusing or misleading investors and specifically asks:

- Would the Proposal’s approach cause investors to rely excessively on information about their asset allocation at target date?
- Should this disclosure be accompanied by a cross-reference to the disclosure of risk and considerations?
- Should the disclosure include all types of investments or just some (e.g., equity allocation)?
- Are there allocations for other categories or sub-categories of investments (e.g., domestic, foreign and emerging market securities) that should be required to be disclosed in target date fund marketing materials?
- How should the use of alternative investment strategies (e.g., hedging strategies) be

reflected in the particular categories of investments for which allocations must be shown?

Disclosing Other Risks. The Proposal asks about the extent to which the special emphasis on asset allocation at the target date might cause investors to prioritize investment risk at a particular moment in time over longevity risk, inflation risk, or other risks. Given this concern, the SEC asks whether additional disclosure should be required to focus attention on inflation and longevity risks.

Disclosing Ranges. The Proposal notes that the proposed rule would permit disclosure of a range of potential percentages. However, it cautions against the use of broad ranges of percentage allocations or against replacing the specific percentage allocations disclosed in the prospectus with ranges. It further notes that “it would be inconsistent with the rule and potentially misleading for a fund to include a range, with the intent of investing only at one end of the range. In addition, representations about ranges of potential percentage allocations may be misleading if funds deviate materially from the stated ranges.” The SEC asks whether there should be limitations on the size of the range and whether a range should be permitted.

Alternatives and Additions to the Target Date Tag Line Asset Allocation Disclosure. The Proposal asks for comments on alternative approaches. For example --

- **Landing Point Disclosure.** Proposed Rule 482(b)(5)(i)(C) defines landing point as “the first date ... at which the asset allocation of a Target Date Fund reaches its final asset allocation among types of investments.” The Proposal asks whether the rule should require that target date fund names, or disclosures immediately adjacent to those names, provide more information to investors regarding the fund’s landing point and/or asset allocations at the landing point. The SEC specifically requests comment on the following:
 - Whether marketing materials should be required to include the asset allocation as of the landing point in close proximity to the fund name, either in lieu of, or in addition to, the asset allocation as of the target date;
 - Whether the rule should require that any date used in the name of a target date fund be the landing point rather than the target date except in cases where the landing point and the target date are the same; and
 - whether there should be additional disclosure immediately adjacent to a target date fund name indicating whether the glide path extends to the target date or through the life expectancy of the investor. Alternatively, whether the narrative disclosure should be required to accompany a target date fund name that indicates whether or not the fund reaches its most conservative allocation at the target date and, if not, when that point is reached.
- **Risk Rating.** The SEC asks whether target date fund marketing materials should be required to disclose a risk rating based on a scale or index that could be compared to other target date funds. If so, how would such a scale or index be designed? Should the scale or index reflect only investment risk, or should it also take into account longevity and/or inflation risks?
- **Changes to Fund Name Rule (Rule 35d-1 under the Investment Company Act).** The SEC requests comments on the following:
 - Whether the SEC should require that the target date asset allocation be included as part of the fund’s name, so that it would appear every time the name is used;
 - Whether it should require the target date asset allocations to appear adjacent to

- a fund's name in its statutory prospectus, summary prospectus, shareholder reports, or other required filings as well as marketing materials;
- Whether Rule 35d-1 should be amended to prohibit the use of a date in target date fund names; and
- Whether Rule 35d-1 should permit target date funds to use the landing point date in its name, rather than the target date.

Asset Allocation Table, Chart, or Graph for Print and E-Media Ads; Statements for TV and Radio Ads

Table, Chart, or Graph. Proposed Rule 482(b)(5)(iv) would require that a print advertisement or an advertisement delivered through an electronic medium include a prominent table, chart, or graph clearly depicting the percentage allocations of the fund among types of investments (e.g., equity securities, fixed income securities, and cash and cash equivalents) over the entire life of the fund at identified periods that are not longer than five years and at the fund's inception, the target date, the landing point, and, in the case of an advertisement for a single target date fund, as of the most recent calendar quarter ended prior to the submission of the advertisement for publication. This requirement would apply to all target date funds, including those that do not have dates in their names.

For marketing materials relating to a single target date fund, the Proposal would require depiction of actual percentage allocations among types of investments and use of specific dates, rather than the number of years before or after retirement.

For marketing materials relating to multiple target date funds that share a common glide path, the Proposal would require either a separate presentation for each fund or a single table, chart or graph that clearly depicts the intended percentage allocations of the funds and identifies the periodic intervals and other required points using numbers of years before and after the target date.

Accompanying Legend. Proposed Rule 482(b)(5)(iv) would require that the table, chart, or graph be immediately preceded by a statement that helps explain the table, chart, or graph to investors. This statement requirement would apply to advertisements and supplemental sales literature for multiple target date funds with different target dates that all have the same pattern of asset allocations or for a single target date fund materials that are submitted for publication prior to the fund's landing point. The statement would include the following information:

- A. The asset allocation changes over time;
- B. The landing point (for multiple target date funds - the number of years after the target date at which the landing point will be reached); that the asset allocation becomes fixed at the landing point; and the intended percentage allocations among types of investments; and
- C. Whether, and the extent to which, the intended percentage allocations among types of investments may be modified without a shareholder vote.

The SEC has not proposed presentation requirements for the legend statement, other than indicating that it must immediately precede the table, chart or graph.

Radio or TV Ads. Proposed Rule 482(b)(5)(v) would require that a radio or TV advertisement that is submitted prior to a fund's landing point must disclose:

- A. The landing point;
- B. An explanation that the asset allocations becomes fixed at the landing point; and
- C. The intended percentage allocations of the fund among types of investments.

The emphasis of this statement would have to be equal to that used in the major portion of the advertisement.

Disclosure of Risks and Considerations Relating to Target Date Funds

Proposed Rule 482(b)(5)(ii) would require marketing materials for all target date funds to include a statement that:

- A. Advises an investor to consider, in addition to age or retirement date, other factors, including the investor's risk tolerance, personal circumstances, and complete financial situation;
- B. Advises an investor that an investment in the target date funds is not guaranteed and that it is possible to lose money by investing in the funds, including at and after the target date; and
- C. Whether, and to what extent, the intended percentage allocations among the types of investments may be modified without a shareholder vote.

II. Antifraud Amendments to Rule 156 under the Securities Act

Proposed Rule 156(b)(4) would be revised to provide that a statement suggesting securities of an investment company are an appropriate investment could be misleading because of:

- 1. The emphasis it places on a single factor (such as an investor's age or tax bracket) as the basis for determining that the investment is appropriate; or
- 2. Representations, whether express or implied, that investing in the securities is a simple investment plan or requires little or no monitoring by the investor.

Scope. The proposed rule would apply to all investment companies, including target date funds, lifestyle funds, and other funds. For example, the reference to the "tax bracket" is included because of tax-exempt funds or variable annuity issuers and not because it has been emphasized by target date funds.

III. Compliance Date

The amendments to Rules 482 and 34b-1 would be effective 90 days after the effective date of the amendments. The Proposal requests comment on whether this compliance date should be based on the date that the marketing materials are used, the date that they are submitted for publication, or some other basis.

The amendments to Rule 156 would be effective immediately upon the effective date of the amendments.

IV. Request for Comments on Prospectus Disclosure Requirements

The Proposal states that the staff has examined the prospectus disclosures made by a number of target date funds and found that they generally disclose: a description of the glide path (which is often presented graphically); the significance of specific points along the glide path (target date, landing point) and any flexibility retained by the investment adviser to deviate from the glide path; and the specific risks attendant to an investment in target date funds (e.g., risk of loss up to and after the target date and the risk of loss due to

the absence of guarantees associated with the investment).

While not proposing amendments to the prospectus disclosure requirements, the SEC requests comments on whether the requirements should be amended to address issues specifically related to target date funds, including whether Form N-1A should be amended to provide specific requirements for target date funds.

The Proposal asks:

- Whether target date fund prospectuses and/or statements of additional information (“SAI”) should be expressly required to disclose --
 - The fund’s landing point and whether the fund is managed “to” the stated target date or “through” that date;
 - The fund manager’s underlying assumptions in selecting the fund’s glide path (e.g., assumptions about life expectancy, inflation, savings rate, other investments, retirement and labor income, withdrawal rates);
 - The flexibility retained by the fund manager to change the glide path in the future;
 - The number of times the fund manager has previously changed the fund’s glide path and reasons for those changes;
 - The latitude the fund manager has to deviate from its stated glide path, the circumstances for that, and the reasons for any past deviations;
 - The use of commodities, derivatives, or other alternative investments by the fund; and
 - Effect of leverage on a fund’s asset allocation, whether attributable to borrowing, derivative investments or other sources.
- If the SEC requires new line item disclosures specific to target date funds, whether these should be included in the prospectus (or summary prospectus) or SAI.

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endnotes

[1] See Investment Company Advertising: Target Date Retirement Fund Names and Marketing, SEC Release Nos. 33-9126; 34-62300; IC-29301 (June 16, 2010) (“Proposal”), available at <http://www.sec.gov/rules/proposed/2010/33-9126.pdf>. The Federal Register version, 75 Fed. Reg. 35920 (June 23, 2010), is available at <http://edocket.access.gpo.gov/2010/pdf/2010-15012.pdf>.

[2] A copy of the Principles is available at http://www.ici.org/pdf/ppr_09_principles.pdf.

[3] The Proposal would make identical changes to Rule 482 and Rule 34b-1. For simplicity, this Memorandum references only Rule 482 when discussing the proposed changes, unless otherwise noted.

abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.