June 5, 2014

Ms. Elizabeth Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

rule-comments@sec.gov

Subject: File No. S7-12-10
Investment Company Advertising: Target Date Retirement Fund Names and Marketing

Dear Ms. Murphy;

DALBAR, Inc. and Target Date Analytics LLC welcome the opportunity to jointly respond to the request for additional comments regarding the proposed rule. This response reflects the extensive experience of both firms in analyzing target date funds, the professionals who create, manage and use them and most importantly, the investors who rely on target date funds to produce retirement income.

About DALBAR

DALBAR, Inc. is the financial community's leading independent expert for evaluating, auditing and rating business practices, customer performance, product quality and service.

Launched in 1976, DALBAR has earned the recognition for consistent and unbiased evaluations of investment companies, registered investment advisers, insurance companies, broker/dealers, retirement plan providers and financial professionals.

DALBAR awards are recognized as marks of excellence in the financial community.

About Target Date Analytics

Serving investors, plan sponsors, advisors and portfolio managers, Target Date Analytics LLC is the leading independent provider of analysis, and benchmarking of target date funds. Target Date Analytics solves target date problems for plan sponsors and their advisors.

Target Date Analytics developed and maintains the OnTarget Indexes, built on proven investment principles and a fundamental glidepath, suitable for benchmarking the widely divergent strategies employed by target date portfolio managers. Target Date Analytics is also home to *Popping the Hood*, a comprehensive analysis of target date fund families that helps investors, advisors and plan sponsors make informed selection and monitoring decisions.

DALBAR, Inc. **Federal Reserve Plaza** **Boston, MA 02210**
Phone: 617-723-6400 **600 Atlantic Avenue** **Fax: 617-624-7200**

Basis for Comments

Responses provided are informed by research, analysis and evaluations of industry practices that relate to target date funds. These include:

Popping the Hood versions I through VI, 2006 –2013, by Target Date Analytics and partners (Plan Sponsor and BrightScope, Inc.).

Plan sponsors and their advisors have the duty of selecting and monitoring a family of target date funds for their retirement plan participants; Popping the Hood is designed to help them complete this federally mandated due diligence. Popping the Hood evaluates target date fund families and companies, not just individual funds. Each fund series receives an Overall score as well as a detailed evaluation in five major categories: Company/Organization, Strategy, Performance, Risk and Fees.

Asset Allocator Rating Methodology (Paper). The background, rationale and process used to assign DALBAR ratings to those who recommend or perform asset allocations strategies and tactics. Prudent asset allocation consists of deciding how much of a capital base will be subject to the risk of loss, in pursuit of appreciation. This straightforward concept is corrupted by investors' instinctive desire for appreciation without a risk of loss.

Responding to the instinctive desire for both appreciation and capital preservation distorts many asset allocation programs, leading to expectations that can never be met.

Fatally flawed methods of evaluating asset allocation strategies compound the problem by rewarding failed strategies and punishing strategies that produce the intended results. Today's most popular evaluation strategies tend to ignore capital preservation results, recognize only the cumulative net returns or simply make adjustments for portfolio risk.

Target Date Plan Sponsor Analysis. These reports are intended to help the Plan Sponsor better evaluate the quality of the investments elected for their employees and to determine how well each one has met the overarching goal of all such funds: to provide reasonable capital preservation balanced with the potential for appreciation. The report incorporates the principles and methods described in the paper: *Asset Allocator Rating Methodology* originally published by DALBAR, Inc. in 2013.

QDIA Validation. The QDIA Validation, which includes target date funds, establishes a standard for evaluating QDIAs for compliance with regulatory requirements and to support the process of selection and monitoring of QDIAs required of ERISA plan fiduciaries. The standards of the QDIA Validation permit plan fiduciaries and advisers to use consistent metrics to compare the variety of QDIA alternatives with very different styles and methods.

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Quantitative Analysis of Investor Behavior (QAIB) Since 1994, DALBAR'S QAIB has been measuring the effects of investor decisions to buy, sell and switch into and out of mutual funds over both short and long-term timeframes. The results consistently show that the average investor earns less – in many cases, much less – than mutual fund performance reports would suggest. The goal of QAIB is to continue to improve the performance of independent investors on the one hand and of professional financial advisors on the other hand by incorporating the factors that influence behaviors that determine the outcome of investment or savings strategies. QAIB offers guidance on how and where investor behaviors can be improved.

General Comments

Before addressing your specific questions and requests we would like to make some general contextual comments.

1) We think it is important to differentiate distinct target audiences before defining the content of guidelines for TDF fund names and marketing. The end user, or plan participant, represents the largest segment of that audience and (as will be demonstrated) these investors are determinedly "non-professional." They do not and will not read complex disclosures. Rather than viewing that fact as a fault or deficiency of the investor, we should approach it pragmatically as a useful piece of input. In other words, we need to develop guidelines for TDF names and marketing that facilitate effective communication to that group.

   Additionally, plan sponsors and their professional providers need marketing materials that aid in their completion of their fiduciary duties. These disclosures will naturally be more technical and detailed than names and materials designed for the "non-professional." These more complex disclosures are not only useless to the non-professional audience but they have been counterproductive by adding confusion and lead to abandoning all interest in disclosures.

   In short, we believe two different sets of guidelines for TDF names and marketing are required. Our comments below address both sets of guidelines. In some cases we specify which party our comments are designed for; in other cases the context makes that distinction apparent.

2) While the term "SEC Comments on TDF Fund Names and Marketing" is used to identify the inquiry, there are no requests or questions addressing the naming of target date funds. Given the differentiated audiences described in 1) above, it is important to recognize the limits on effectiveness of additional disclosures and therefore the communication burden carried by the name of each fund itself.

   Non-professionals simply will not read lengthy disclosures so that the names of the funds that have a high probability of misleading participants should be prohibited. In the same way that an asset allocation fund holding equal amounts of large cap, mid cap and small cap domestic equities is not permitted to name itself a "small cap fund", a glidepath based fund that reaches its landing point in 2045 should not be permitted to name itself a 2015 fund.

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Rather than expecting non-professionals to study complex charts, graphs and explanations in order to recognize that a fund's investment strategy is not consistent with the objective implied by its name, the Commission should prohibit such inconsistencies. A fund with a glidepath that reaches its landing point at 2015 can use 2015 in its name. A fund with a glidepath that reaches its landing point at 2045 should use that date in its name.

Terms Defined

The following terms are used in the comments that follow:

- **Asset Allocator**. It is usual for a separate individual or committee to make strategic decisions concerning how and when assets are used in target date funds. This is the case when the fund has the authority to change allocations or operates within a range of allocations. Such a separation is desirable to avoid the potential for investment return incentives of investment managers to cause reckless pursuit of returns. The individual or committee responsible for asset allocation is referred to as the fund's asset allocator.
- **Capital Preservation**. Somewhat aligned with the professional understanding of the term "risk" capital preservation is has a much broader meaning and is the inverse of risk. Capital preservation includes static conditions ans well as the steps that can be taken to reduce the exposure to loss.
- **Non-professional Investor**. The majority of target date fund investors became investors in the fund by default. The investment choice was most likely made for them by their employer. The term "non-professional investor" is used to differentiate these investors from other mutual fund investors who are more likely to study and understand complex investment presentations. Many of these investors have actively elected to remain "non-professional"; that is, they prefer to have their retirement assets managed for them, rather than manage them directly.

Management of Target Date Funds According to Risk.

We request comment on the degree to which managers of target date funds use measures of risk as part of their investment strategy.

- Are target date fund strategies primarily based on a changing target risk level or a changing target asset allocation over time, or some combination of these approaches? If target risk levels are used, what risk measures are generally employed?

Basis of Target Date Fund Strategies

While the primary focus of target date fund management has been on asset allocation over time so as to comply with ERISA requirements, a limited number of firms have adopted various strategies designed to achieve an outcome of targeted levels of capital preservation.

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<u>Use of Risk Measures</u>

The most frequent measure of risk used by target date funds is volatility (standard deviation, beta and R^2). Volatility, by itself, is inadequate since it has only modest relevance on eventual outcomes such as:

- **Retirement income**
- **Capital preservation over time and**
- **Other factors such as systemic risk, credit risk, economic conditions, current interest rate levels, political risk, etc.**

- Do managers instead first set an asset allocation strategy and then monitor the risks that follow from the asset allocation? If so, what risk measures do they generally monitor?

<u>Asset Allocations Defined First</u>

Most asset allocators follow specified allocation guidelines, making the questionable assumption that the risk among asset classes is predictable and correlation remains essentially unchanged. Ongoing monitoring of these risk assumptions is rarely done.

<u>Use of Risk Measures</u>

The most frequent measure of risk used by target date funds is volatility (standard deviation, beta and R2). Volatility, by itself, is inadequate since it has only modest relevance on eventual outcomes such as:

- **Retirement income**
- **Capital preservation over time and**
- **Other factors such as systemic risk, credit risk, economic conditions, current interest rate levels, political risk, etc.**

- Are there other ways in which target date fund managers use risk measures? If so, please describe those ways and the particular risk measures used.

<u>Other Measures to Control Risk</u>

Asset allocators that actively manage capital preservation use a variety of leading indicators and tools to protect portfolios from losses. These include:

- **Assessment of economic conditions (inflationary growth, non-inflationary growth or recession).**
- **Equity valuations of specific asset classes reaching new highs or new lows or changes in valuation patterns.**
- **Interest rate levels that breach historical norms.**

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- **Hedging strategies, using derivatives to offset losses.**
- **Sell disciplines that limit losses to predicted levels.**
- **Guarantees of income and/or of principal.**
- **Procedures and technology to detect and respond to unexpected conditions**
- **Controls to maintain compliance with policies and practices**

Usefulness and Understandability of Risk Measures.

We request comment on whether there are quantitative measures of risk that would be useful to and understandable by investors as the basis for a target date fund risk-based glide path illustration. We note that there are a variety of quantitative measures of risk used in the financial services industry. Some target date funds already provide quantitative risk measures in certain materials on a historical basis. For example, the risk associated with a portfolio can be captured by the variability of its returns, measured by the standard deviation (or volatility) or semi-variance of those returns. Both of these risk measures are "total risk measures" that quantify the total variability of a portfolio's returns around, or below, its average return. Another risk measure is "beta," which specifically measures the sensitivity of the portfolio's return to the market's return. The market's beta is by definition equal to 1. Portfolios with betas greater than 1 tend to move more than one-for-one with the market's return, and portfolios with betas less than 1 tend to move less than one-for-one with the market's return. Determination of a fund's beta requires the selection of a benchmark market index to which one compares the portfolio's returns.

- Is there a particular quantitative risk measure, or group of risk measures, that are helpful in evaluating the risks of target date funds? Would fund investors be likely to understand these risk measures and be able to effectively use them in making investment decisions?

Helpfulness of Risk Measures

Quantitative measures do not lend themselves to effective decision making by non-professional investors. Our research has shown that quantitative measures of risk are non-intuitive to non-professional investors and these measures have confused investors and made decisions less prudent, even after significant educational efforts.

For example, take three funds, all with identical histories, portfolio contents and investment strategies.

- **Fund 1 has no additional capital preservation strategies.**
- **Fund 2 has a policy of selling any investments with a loss of 10% below its year end valuation.**

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600 Atlantic Avenue
Federal Reserve Plaza
Boston, MA 02210
Fax: 617-624-7200

- **Fund 3 guarantees a retirement income based on the highest average balance during any full year that the fund is held.**
- **For the "non-professional" investor, the most useful indicator of risk, or more broadly, of capital preservation, is a simple scale of "High", "Moderately High", "Moderate", "Moderately Low" and "Low". Highlighting explanations beyond these indicators tend to be overly complex and counterproductive.**

- The Committee recommended that the Commission, in determining an appropriate risk measure, focus on factors such as maximum exposure to loss or volatility of returns that are directly relevant to the primary concerns of those approaching retirement. Do commenters agree with this approach? If so, what are the primary concerns of those approaching retirement and what specific measures of risk would be directly relevant to those concerns? Are there other risk factors that are relevant to target date fund investors, including longevity risk and inflation risk? In determining an appropriate measure of risk, how should various aspects of risk be considered? How should concerns of investors at different points in the cycle of accumulating and distributing retirement assets be addressed?

Relevant Factors

Focusing exclusively on either maximum exposure to loss or volatility will not serve the non-professional investor. While both have some effect on outcomes and investor behavior, these measures place an unrealistic burden on the investor to determine the extent to which they should influence investment decisions.

There is one factor that overwhelms all other investment considerations for non-professional investors. This is protection from the loss of capital.

Maximum exposure is not a meaningful measure, since it is always total loss of assets. Probable or expected exposure to loss may be more helpful.

Volatility affects decisions only to the extent that there are unexpected declines or returns that are below expectations.

Volatility relies on the assumption that recovery has already occurred so that long slow declines are not recognized or measured.

Concerns of those Approaching Retirement

The two concerns (protection from the loss of capital and achieving personal financial goals) apply to all non-professional investors, whether approaching retirement or not.

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Investors approaching retirement have a heightened awareness of these concerns, but the concerns are universal.

Measures of Risk

The term "Risk" can be interpreted in a variety of ways. Within the investment community, risk is viewed as a continuum and there are a large number of types of risk. For the non-professional investor risk connotes a total loss. This is not a choice, it is the way investors react and it is important to recognize that fact.

More appropriate terms are "exposure to loss" or "capital preservation". These terms have similar meaning in both the investment community and for the non-professional. Additionally, all measures of risk that exist today as well as future measures can be accommodated by these terms.

The suggested terms also imply outcomes or results and draws attention away from temporary fluctuations that often lead to bad investment decisions. Historically, these bad decisions have led to losses in returns of 52% up to 79% per year over various 20 year spans.

A recommended approach is to determine the probable effect of each known measure of risk. The effect is then applied to determine the measure of capital preservation.

Factors that should be used to determine an investors' exposure to loss in a target date fund includes:

- **Risk measures of underlying asset classes (volatility, capitalization, length of history, highest return, lowest return) and underlying individual investments (returns in relation to other investments in the same class)**
- **Asset allocator practices used to limit exposure to losses (method of monitoring exposure, actions to be taken in response to detected exposure, ability to handle exceptional conditions, internal controls on asset allocation process, guarantees and capital backing the guarantees, blend of underlying asset classes and investments and hedging/derivative strategies).**
- **History of performance in severe down markets and in volatile markets.**

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600 Atlantic Avenue
Federal Reserve Plaza
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Fax: 617-624-7200

Longevity & Inflation

Longevity risk cannot be applied to the fund itself since it attaches to the individual investor, not the fund. It is therefore inappropriate as part of an investment disclosure.

Inflation risks are systemic and not applicable to a particular investment or investor.

How Various Risks Should Be Considered

Asset allocators should have the responsibility to consider the specific facts that relate to the target date fund and make the determination of which category of capital preservation is applicable to that fund.

Supporting documentation for the determination should be made public in the "*Shareholder Reports*", "*Statutory Prospectus*" and the "*Statement of Additional Information*".

There are four instruments that the SEC controls that can be useful for disclosure of risks to various audiences:

1) Shareholder Reports…. Targeted at non-professionals
2) Summary Prospectus…. Should be targeted at the more attentive non-professional
3) Prospectus… Targeted at plan sponsor/advisor
4) SAI… Targeted at analysts, experts, attorneys

Employment Life Cycle and Risk

The employment life cycle applicable to target date funds consists of six stages:

EMPLOY: Start of career, typically has little awareness of and not yet involved with retirement plans.

QUALIFY: Enters the full time workforce and qualifies for participation in a retirement plan that is their first investment. At this stage, the investor has no personal experience with financial losses and is highly risk averse.

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GROWTH: At this stage, the worker has five to ten years in the workforce and had some exposure to retirement plan investing. Issues of family and children become dominant. At this stage, the tolerance for risk has increased but is subject to significant changes as dictated by personal issues.

KEY: Workers that become key employees have added responsibilities and understand the need to take risks. Key employees are most willing to take risks.

PRE-RETIRE: The pre-retiree typically has a deep interest in maximum appreciation. This group is most vulnerable to taking a blind eye to the exposure for capital losses when making investment decisions. This is the group that is most likely to abandon investments at the point when values are low.

RETIRED: The interest during the early years of retirement is to obtain a steady cash flow. After five to ten years of retirement, successful investors become more comfortable with risk.

- If we require disclosure of a risk measure, should we require such disclosure at only a single point in time, such as the target date, or should we require disclosure of the measure at multiple points over the life of the fund? If the latter, which specific points over the life of the fund?

Should Risk Measure Be Required?

Risk measures should be required.

The current annual return for ten years is the single most useful information in a prospectus but this could be greatly enhanced to address the most important consideration in investment decision making… capital preservation.

When Should Risk Measure Be Disclosed:

Risk measures or measures of capital preservation, should take the form of indicators (High, Moderately High, Moderate, Moderately Low and Low) and should be provided for each date specified in a series of target date funds alongside the asset allocation.

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Points Where Measures ar Shown

Each target date should have a single indicator that represents the best current assessment of exposure to loss or capital preservation. Estimates of future assessments can be provided in supplemental information. Actuals apply only to certain risk measures, so comparison would not be meaningful in aggregate.

Certain managers specifically make the glidepath a secondary consideration. The primary focus being current market conditions. The assignment of risk indicators addresses the concern that investors and especially "non-professional" investors will be misled into believing their fund is subject to generally accepted investment theory (aggressive-to-conservative toward the target date) when it may be subject to the market assessment skills of a manager or management team.

- Should a target date fund be required to disclose the same measure or measures that the fund's manager uses to guide its management of the fund, or would other measures be more appropriate?

Should Manager's Measures Be Disclosed

Measures used by fund managers or asset allocators serve no useful purpose to the non-professional investor who is ill-equipped to evaluate them. In fact, such disclosures would only further confuse most investors, leading them to abandon the disclosure and base the investment decision on "gut" or information that is easily understood.

Investors need a disclosure that meet three conditions:

- **Immediately makes sense to them,**
- **Is consistent across all comparable investment alternatives and**
- **Apply directly to the investor's own decision making.**

- Should the risk measure reflect the variance, or volatility, in returns around the fund's average return? Should the measure, instead, reflect the sensitivity of the portfolio's return to the market's return? Or should some other type of risk measure be used? Should these risk measures reflect the characteristics of nominal returns or real returns, which account for the effect of inflation?

- **For the professional target audience:**

Should Measure Include Volatility?

All relevant measures of risk should be considered in determining the rating of the funds' capital appreciation. Volatility is certainly a relevant measure for most investment classes.

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<u>Should Measure Reflect Sensitivity to Market Return?</u>

All relevant measures of risk should be considered in determining the rating of the funds' capital appreciation. Sensitivity to market return is certainly a relevant measure for most investment classes.

<u>Should Other Types of Risk Measures Be Used?</u>

All relevant measures of risk should be considered in determining the rating of the funds' capital appreciation. Any measure that is a relevant measure for an investment classes should be part of the determination.

<u>What Should Disclosure Reflect?</u>

For purposes on the non-professional investor, only an indicator of the level of exposure to capital loss will serve the essential purpose. These indicators specify if the exposure to capital loss. or effectiveness of capital preservation is "High", "Moderately High", "Moderate", "Moderately Low" or "Low". These indicators should reflect the probability and degree of potential capital loss.

Non-professional investors also need a forecast of returns coupled with a statistical probability of the return being achieved. Returns are a psychologically different concept from risk and should never be blended for purposes of decision making by non-professional investors.

Illustration of Risk Measures.

We request comment on whether the Commission should develop a glide path illustration for target date funds that is based on a standardized measure of fund risk as either a replacement for, or supplement to, its proposed asset allocation glide path illustration and adopt a standard methodology or methodologies to be used in the risk-based glide path illustration.

- Should the rules require a glide path illustration for target date funds that is based on a standardized measure of fund risk as either a replacement for, or supplement to, the proposed asset allocation glide path illustration? Would the inclusion of two glide path illustrations in the same document tend to confuse investors, and, if so, how could the information be presented in a way that would minimize any confusion?

<u>Standardized Illustration</u>

The rules should require a uniform presentation of risk indicators based on standardized measures.

<u>Should There Be Two Glide Path Illustrations</u>

The mandating of two glide paths would render both ineffective, since the burden of explaining each and the differences between them would cause non-professional investors to abandon both.

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The only reasonable method of avoiding confusion is to present only one glide path that is easily understood and designed to drive investment decisions.

The glidepath should show the appropriate risk indicator at each data point of the graph.

- Would the proposed asset allocation glide path illustration, without a risk-based glide path illustration, adequately convey risk information to investors? If not, would an asset allocation glide path illustration alone adequately convey risk information if we specify the particular asset categories required to be shown? If so, how narrow should those asset categories be, and what particular asset categories should we specify? Could risk information be adequately conveyed to investors using narrative disclosures in lieu of a glide path illustration?

Would Illustration of Asset Classes Be Effective?

The proposed asset allocation glide path illustration would not adequately convey information that non-professional investors can use to make investment decisions. Investors would be unable to appropriately match an allocation with the level of concern over exposure to capital loss.

A glide path, populated with indicators of capital preservation would be highly effective for non-professional investors to select investments that were aligned with their personal concern over exposure to capital loss.

Can Specifying Multiple Asset Categories Be Effective?

Specifying asset composition in categories would be counterproductive since this would require non-professional investors to learn about and track the characteristics of each asset class. The history of investor behavior shows that investors have not been willing or able to study and then apply such knowledge.

A narrative disclosure of risk as required in a statutory prospectus would be of no value to the non-professional investor. Simple indicators, as described earlier, that are consistently applied would be of great assistance to investor decisions.

- What are the advantages and disadvantages of asset allocation glide paths and risk-based glide paths relative to each other? If the rules should require a risk- based glide path, what risk measure(s) should be prescribed and how should the risk measures be presented? Please provide specific examples.

Asset Allocation Glide Path Advantages

An asset allocation glide path would be helpful to investors who are willing and able to translate the chart into an awareness of the level of exposure to loss that is conveyed.

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<u>Asset Allocation Glide Path Disadvantages</u>

Two disadvantages are apparent. First is that only a very few investors could make use of the charts, without an interpretation, which is most likely to come from the seller of the investment.

The second disadvantage is that a large number of investors will be further confused by the additional information. These illustrations are not useful to non-professionals.

<u>Risk Based Glide Path Advantages</u>

A risk based glide path that conveys a single measure of exposure to loss or the level of capital preservation will address an investor's most important investment consideration.

This is useful to both professional and non-professional investors.

<u>Risk Based Glide Path Disadvantages</u>

The disadvantage of a simplified indicator of capital preservation is a literal interpretation. Instead of being viewed as an aspiration or goal, some investors will interpret this as absolute fact.

Unfortunately this is a disadvantage of any clear disclosure.

<u>Risk Measures that Should Be Presented</u>

For purposes of the non-professional investor, only an indicator of the level of exposure to capital loss will serve the essential purpose. These indicators specify if the risk or effectiveness of capital preservation is "High", "Moderately High", "Moderate", "Moderately Low" or "Low". These indicators should reflect the probability and degree of potential capital loss

These indicators should reflect the aggregation of all the relevant risks to capital preservation.

<u>How Risk Based Glide Path Measures Should Be Presented</u>

The most effective presentation of capital preservation is a graphic consisting of a vertical bar with five marked levels that show "High", Moderately High", "Moderate", "Moderately Low" and "Low". A pointer would show the position of the investment on that bar.

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600 Atlantic Avenue
Federal Reserve Plaza
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Fax: 617-624-7200

Example of Capital Preservation Ratings:

High	✓							
Moderately High		✓	✓					
Moderate				✓				✓
Moderately Low					✓		✓	
Low						✓		
	2025	2030	2035	2040	2045	2050	2055	2060

- Should a risk-based glide path illustration be required for all target date funds, regardless of a fund's investment objective or strategies? Should a risk-based glide path illustration instead be required only for target date funds with an investment objective or strategy of managing to a target risk level?

Required for All Funds

The primary purpose of a risk-based glide path disclosure is to enable investors to make prudent investment decisions. Omitting this information for certain funds defeats this purpose. The omission also befuddles the investor who is left to guess about why certain funds are omitted.

In order to serve any useful purpose the disclosure must appear for every target date fund, regardless of the investment strategy or objective.

Furthermore, any target date fund with no asset preservation strategy should not be permitted. Such a fund would not be permitted in ERISA plans, where most target date funds are used.

- Should a risk-based glide path illustration be backward-looking (showing past actual risk measures of a target date fund or group of target date funds) or forward-looking (showing projected risk targets for a target date fund or family of target date funds)? Commenters are asked to address, with specificity, how each of these approaches could be applied to a single target date fund or group of target date funds. What are the advantages and disadvantages of each approach, *e.g.*, ease of construction, understandability, or potential to confuse or mislead?

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600 Atlantic Avenue
Federal Reserve Plaza
Boston, MA 02210
Fax: 617-624-7200

Backward or Forward Looking

A forward looking component informs the investor of the aspiration of the asset allocator. The backward looking component is the measure of success of the allocator in achieving the aspiration.

Backward looking indicators are of low relevance to non-professional investors and should not be required disclosures.

Application to a Fund or Group

(See example provided earlier)

- If we require a risk-based glide path illustration, should we prescribe the format of the risk-based glide path illustration in order to enhance comparability for investors? For example, would one form (e.g., graph) be more easily understandable by investors than another (e.g., table)?

Prescribed Format

A prescribed format is the only way to achieve comparability and therefore usefulness. Without a prescribed format, investors would be faced with various presentations that would make prudent decision making more difficult.

- If we require a risk-based glide path illustration, should we require it to be prominent within the materials where it is included? Are there other presentation requirements that would be more appropriate?

Prominence of Disclosure

The risk-based glide path, if simple and immediately understandable, will be the most important consideration in the investor's decision making. As such, it should accompany every presentation of the fund(s) and be highly visible.

Such a disclosure is more important than investment returns and expenses.

- Should there be differences in requirements for marketing materials that relate to a single target date fund, as compared with those that relate to multiple target date funds? Should a risk-based glide path illustration for a single target date fund be required to show the fund's actual historical risk levels? Would the use of actual historical risk levels be helpful or confusing to investors in cases where a fund has changed its previous glide path? Should the risk-based glide path illustration for a single target date fund instead be permitted to show the current glide path that is common to all target date funds in a fund family? Would it be misleading for marketing materials for a single target date fund to omit the fund's historical risk levels?

<u>Single versus Multi Fund Requirements</u>

Whether one target date fund is offered or there is a group of funds, investors will almost always select just one. If only one fund is offered, the prudent investor will seek others from another source.

In all cases the requirements should be identical, whether there is just one fund or many funds.

<u>Display of Historical Risk Levels</u>

Each target date should have a single indicator that represents the best current assessment of exposure to future loss or capital preservation. Historical assessments can be provided in supplemental information.

Actuals apply only to certain risk measures, so comparison would not be meaningful in an aggregate measure.

<u>Common Glide Paths</u>

Focusing on the investor's decision to invest or not to invest, the glide path of other funds should not be singled out for display. If other funds are being considered, all the relevant information for the other funds should be present.

<u>Omission of Historical Glide Path</u>

Since the historical glide path is not relevant to the current decision making, its presence adds confusion. There is nothing misleading about omitting this.

- Should the risk-based glide path illustration for a single target date fund be required to clearly depict the current risk level? Should we require the risk level as of the most recent calendar quarter ended prior to the submission of the marketing materials for publication? Are there any circumstances where we should permit the risk-based glide path illustration for a single target date fund to exclude risk levels for past periods? If we permit a single target date fund to exclude past risk levels in any circumstances, should we nonetheless prohibit a fund from excluding past risk levels if the marketing materials contain past performance information for the fund? Are past risk levels helpful to allow an investor to assess the performance of the target date fund relative to the risk taken? Would disclosure of past performance information without disclosure of past risk levels confuse or mislead investors?

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Requiring Current Risk Level

The current risk level is the single most important factor in making the investment decision and should be required in the glide path illustration of all single and of all multiple target date funds.

Age of Risk Level Assessment

Risk level assessments are subject to change, driven by a large number of conditions. It is essential that this information is as current as possible, without making the requirements needlessly burdensome.

The most practical way to update the risk level assessment is to require that the age be consistent with existing aging requirements for communications in which the risk level is displayed.

Historical Risk Levels

Unlike past investment returns, past risk levels are not reflective of performance. Viewing past risk levels would, in effect, be trying to assess why investors did *not* lose money! Risk control strategies are implemented as a defense against the unexpected. Benefiting from expected conditions are reflected in returns and not in risk levels.

- What is the appropriate maximum interval for depicting a fund's risk level over time? Is the maximum five-year interval that we proposed for an asset allocation glide path appropriate? Should it be shorter (e.g., 1 year or 3 years) or longer (e.g., 10, 15, or 20 years)? Are there any periods for which intervals of shorter duration should be shown? For example, should the risk-based glide path illustration depict the five years before the target date and/or landing point (i.e., the date at which the asset allocation becomes static) using one-year intervals? Is it necessary to require any particular interval? Is it appropriate to require risk levels at the fund's inception, target date, and landing point?

Assessing Risk Levels Over Time Periods

The risk level assessment should always be a current point in time measure. The measure of current risk should contemplate events that can take place in the future and reflect past experiences. It is impractical to attempt to accumulate risk levels in the way that investment returns are accumulated.

Future events are relevant to ensure that the required action can be taken or the required defenses are in place.

Past events are also informative about how to most effectively limit ill-effects, should an event re-occur.

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- Would a required explanatory statement preceding or accompanying the risk- based glide path illustration be helpful to investors? What information would be necessary? Should we prescribe the particular content of the statement? Should any of the following information be required in an explanatory statement: (i) the investment risk level changes over time; (ii) the landing point; (iii) an explanation that the investment risk level becomes fixed at the landing point and the projected risk level at the landing point; (iv) whether, and the extent to which, the intended risk levels may be modified without a shareholder vote; and (v) an explanation of risks that are not captured by the illustration? Should the statement be required to use particular language? Should any particular presentation requirements, such as font size or style, apply to the statement that is required to accompany the risk- based glide path illustration?

Explanatory Statement

An explanatory statement is essential to making a risk based glide path illustration useful to investors and should be required. Explanation should be as brief as possible and in very simple language.

Contents of Explanatory Statement

The explanatory statement should contain three elements:

1) **Why the information is shown. Example:** *"Understanding the extent to which this investment protects your capital from possible losses is critical to deciding to invest. The following chart shows the level of protection afforded by this investment."*
2) **How it is to be used. Example:** *"Before investing, you should determine if you require the safest investment available or you are willing to consider the possibility of a loss as indicated in the chart."*
3) **Where to find out how determinations were made. Example:** *For more information about the meaning of this chart and how determinations were made please go to www.fundnamerisk.com.*

Use of Language in Explanatory Statement

The precise language should be prescribed, but variants permitted in special circumstances. Variants must be of similar length and simplicity as the prescribed language.

Presentation Requirements in Explanatory Statement

The placement, font, colors, etc of the explanatory statement should be as attention-getting as the most important information in the material.

- Should radio and television advertisements be required to include information about a target date fund's risk-based glide path? What information should be required to be included in radio and television advertisements? For example, is there a means of effectively communicating information comparable to that contained in a risk-based glide path illustration in radio or television advertisements?

 Use in TV and Radio

 Disclosures of this nature serve no useful purpose in TV or radio advertisements unless investors are given the explicit option to "send money". The fast moving nature of these media does not permit the time for viewers to gain any insight from such disclosures.

 There should be no prohibitions against using the risk-based glide path in TV or Radio ads but it should not be required either.

- Should information about a target date fund's risk-based glide path be required in marketing materials that are submitted for use on or after the landing point?

 Requirements on Marketing Materials

 Marketing materials should provide potential investors with the relevant information to make a decision. The risk-based glide path is highly relevant to target date funds.

- Are there alternative presentations of risk-based measures that would be more helpful to target date fund investors than a risk-based glide path? For example, would it be more helpful to require disclosure of risk measure targets at particular points in time (e.g., target date, landing point) rather than requiring an illustration over the whole life of a target date fund? If so, which points in time would be most important to investors? Should the measures, for example, focus on the target date, landing point, and/or the time period within 5 to 10 years before and after the target date?

 Alternative Points in Time

 There are three points in time when risk-based glide path should be presented to investors:

 Decision 1: Investors should be made aware of the current risk at the time of starting an investment and of the projected risk (using the manager's stated asset preservation strategy) at the nominal target date

 Decision 2: Investors should be made aware of the current risk when considering withdrawing the investment.

 Change in Glide Path: If the risk indicator should change, whether planned or unplanned, investors should be notified.

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Given the points made above about non-professional investors, it is unrealistic to expect that they will read far enough to understand the difference between a fund that is called a target date fund and "lands" at the target date and another fund that is also called a target date fund but which does not "land" at the target date. Fund names should not be permitted to include a date other than the landing date.

Placement of Risk-Based Glide Path Illustration.

We request comment on the materials, if any, in which a risk-based glide path illustration for target date funds should be included.

- Are marketing materials for target date funds an appropriate location for inclusion of a risk-based glide path illustration or other information about risk measures? Should illustrations instead be part of the mandated disclosures in a fund's summary prospectus, statutory prospectus, statement of additional information, shareholder reports, or other reports to the Commission?

Marketing Materials

Omission of risk-based disclosure should be considered to be misleading. As mentioned elsewhere in this response, funds that appear to be identical based on traditional investment measures can be very different in their exposure to loss.

Consequently, capital preservation indicators should be required on any marketing material that invites an investment or suggests the retention of an investment.

Other Media for Disclosures

Capital preservation indicators should be required on other materials and notices that are required under the Investment Company Act of 1940 and its rules or under other regulations, such as Internal Revenue Code and the Employee Retirement Security Act of 1974 and it rules. These would include:

- **Shareholder reports**
- **Other reports to the commission**
- **IRS required QACA Notices**
- **ERISA Fee Disclosure Notices**
- **Form 5500 filings**

Explanations of how the capital preservation indicators are determined should be included in the shareholder reports, statutory prospectus and statement of additional information.

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Calculation of Risk Measures.

We request comment on whether required risk measures, if adopted in final rules, should be based on a standardized methodology or methodologies developed by the Commission.

- Should we try to enhance comparability among target date funds by prescribing a standardized methodology for computing a fund's historical and/or projected risk levels?

  <u>Prescribed Standardized Methodology</u>

  Prescribing standardized methodology for capital preservation indicators will have a chilling effect on initiatives to preserve investors' capital.

  It should be anticipated that the "safe harbor" created by such a prescription would diminish the incentive to develop new capital preservation methods. Fund managers would take the path of least resistance with the knowledge that there would be no competitive advantage to exceeding regulatory boundaries. Complete protection through adherence to the standard creates the disincentive.

  Clearly, this would not be in the best interest of investors.

  Instead, the indicators should be prescribed, but the methodologies left to the marketplace with added controls afforded by expert auditors and the threat of litigation in the event of misrepresentation.

- What are the parameters and assumptions that the Commission would need to specify in order to prescribe a standardized methodology, e.g., the measures to be used, benchmarks, time periods over which calculated?

  <u>Parameters and Assumptions</u>

  It is strongly recommended that no such methodology be prescribed because of the negative effect such specificity would have on investors.

- For risk measures that are calculated using a benchmark index (e.g., beta), what issues, if any, are associated with the selection of an appropriate benchmark? Do any quantitative risk measures rely on assumptions, other than a benchmark, that could lead to lack of standardization if not specified by the Commission? Can quantitative risk measures be manipulated, and how do the various measures differ in their susceptibility to manipulation? How can the potential for such manipulation be reduced or eliminated?

<u>Benchmark Issues</u>

Many of the most important risk factors (guarantees, expectations, practices, policies, creditworthiness, capitalization, stop loss) cannot be addressed by a simple benchmark

For example, take three funds, all with identical histories, portfolio contents and investment strategies.

- **Fund 1 has no additional capital preservation strategies.**
- **Fund 2 has a policy of selling any investments with a loss ot 10% below its year end valuation.**
- **Fund 3 guarantees a retirement income based on the highest average balance during any full year that the fund is held.**

It should be clear that the exposure to loss of these three funds is vastly different, even though the investment statistics are identical. No simple benchmark can reflect these differences.

The practical way to measure these disparate factors is to convert each to a common point system, assigning the appropriate weight to each. In this way, an aggregated result can give investors a fair and simple indication of the risks associated with making an investment.

<u>Manipulation</u>

Risk measures are, like all public disclosures, are subject to manipulation. The manipulation can be effectively controlled by an independent audit. In the same way that independent experts audit a fund's financials, experts need to be appointed to audit the fund's rating of capital preservation, exposure to loss and risk characteristics.

- Should the risk measures reflect the target date fund's predictions about future risk or goals related to future risk? In what manner should these risk measures incorporate historical data from a particular target date fund or group of target date funds? To what extent can historical data predict future risk?

<u>Future Risk</u>

The capital preservation objective is equally important as the investment objective of a fund and should be given the same prominence.

Investors can make meaningful decisions to buy, hold or sell an investment based on the stated capital preservation objective.

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Differences between the capital preservation objective and the actual rating is a key measure of success of the investment.

Because of the date in the name of the fund, (the primary disclosure about the fund that will ever be viewed by the non-professional investor) particular attention must be paid to disclosing projected risk *at that date.*

Use of Historical Risk Data

Unless a fund is prevented from taking new measures to protect investors from losses, historical data is of limited use for purposes of disclosures to investors.

Historical risk data are instructive as to the adequacy of capital preservation practices. Asset allocators should monitor this data to determine when and how risk policies need to be altered.

Reliability of Historical Risk as a Predictor

Historical ratings of a fund's capital preservation are only anecdotal, since the policies and practices can and should change with new experiences.

- If a forward-looking risk measure is used, should the risk measure be calculated using portfolio-based computation, which calculates a portfolio risk measure at each point in time based on the historical behavior of the securities or asset classes that the portfolio is expected to include at that point in time? Should the risk measure instead be a risk objective or target? Do the merits of each approach differ among funds or groups of funds with significant operating histories, new funds, and/or funds that have flexibility to change their risk-based glide paths?

Calculating Forward Looking Risk Measures

Forward looking risk measures should never be limited to portfolio composition. It is necessary to evaluate all factors that are likely to protect investors from losses.

For example, take three funds, all with identical histories, portfolio contents and investment strategies.

- **Fund 1 has no additional capital preservation strategies.**
- **Fund 2 has a policy of selling any investments with a loss ot 10% below its year end valuation.**
- **Fund 3 guarantees a retirement income based on the highest average balance during any full year that the fund is held.**

Limiting a risk measure to a portfolio based computation would yield the same result for all three of these very different funds.

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Should Forward Looking Measures Be an Objective or Target

Every fund should have clear and simple indication of the investor's exposure to loss or capital preservation. Investors can then make a decision as to whether the fund is aligned with their own preferences or objectives.

The stated capital preservation objective should direct the future policies and practices of the fund.

A periodic measure of the capital preservation rating should be compared to this objective and differences noted and explained.

Differing Approach for Certain Circumstances

Funds with different operating histories, new funds, and/or funds that have flexibility to change their risk-based glide paths should come under the same regulatory framework. All should be able to make changes to their capital preservation rating, with notification to investors.

Different operating histories are effectively accommodated by changes in the capital preservation rating and a requisite explanation of why the changes were made.

New funds are accommodated by the capital preservation objective, which is supported by the current rating when an audited result becomes available.

Changing glide paths are in essence changing the capital preservation rating. Material changes here require an explanation.

- If a standard based on historical risk characteristics were adopted, what requirements should be imposed on funds with a short operating history?

Standard Based on Historical Risk

No standard based solely on historical risk can provide a fair representation of the investors' exposure to loss. It is impossible to predict the nature or magnititude of future losses so any attention paid to how well earlier crises were managed are deceptive at best.

Such historical standards will inhibit changes in capital preservation strategies, even in the event of new experiences and exposures. In effect, these standards will discourage protective measures after another crisis occurs.

Funds with Short Histories

If historical data is not used in this way, funds with short histories will only be affected by the inability to display an *audited* capital preservation indicator.

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- Persons submitting comments are also asked to describe as specifically as possible the computation method they would recommend for any quantitative risk measure they favor. For example, persons favoring standard deviation should specify whether monthly returns, quarterly returns, or returns over some other period should be used. As another example, persons favoring beta should describe the benchmark or benchmarks that should be used. Persons submitting comments are also asked to discuss the benefits and limitations associated with their recommended method of computation.

Recommended Method of Computation

It is recommended that the Commission adopt no preferred or standard method of computation. The reasons for this recommendation are outlined under the limitations presented below.

Limitations of Any Method of Computation

The primary reasons for recommending against a prescribed method of computation are that:

- **No single method presents a fair and complete representation.**
- **The issues keep changing in response to actual experiences.**
- **The facts and circumstance differ across various funds.**
- **Limiting computation to quantitative measures and simple benchmarks excludes the most important capital preservation strategies available.**
- **Standardized methodology will cripple innovation since there will be no incentive to develop capital preservation strategies that are outside the scope of the prescribed methodologies.**
- **Reacting to new experiences, will be inhibited or delayed until the adopted methodology is revised.**
- **Investor protection is compromised.**

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Impact on Investors.

We request comment on the impact that disclosure of risk measures and risk-based glide paths would have on investors.

- Would investors in target date funds be likely to understand risk measures, or any related illustrations based on those measures? What means could be used to present risk measures for target date funds in a way that would be understandable to investors? Could investors interpret risk-based illustrations as predicting the future returns of the fund? Can future risk levels of a target date fund be projected in a manner that is likely to be accurate? Could the use of projected or target risk measures be misleading and, if so, under what circumstances?

Investor Understanding of Risk Measures

There is no question that investors are confused by current risk measures. There is also little chance that using proposed measures in better illustrations will enhance investor understanding. Current measures are inconsistent, incomplete and only partially relevant.

Furthermore, if investors did understand the proposed measures, they would be unlikely to prudently apply them to investment decisions.

The basic issue is that the currently available measures do not provide the most important information that an investor needs to make a prudent decision. That most important information is the exposure to loss or the converse, the level of capital preservation afforded by the investment.

An all-encompassing measure of exposure to loss, presented in an easily understandable form is the only reasonable way to assist investors to make prudent decisions.

Understandable Measures of Risk

The most widely held perception of the term "risk" by non-professional investors is the potential for total loss. Investors fear that their investment will or will not be lost in its entirety.

The meaning of quantitative measures of risk is lost since they do not answer the basic question of whether the investment will or can be lost in its entirety. Additionally, there is no measure of the probability of a total loss. As a result, the quantitative measures are often disregarded.

Understandable measures of risk must relate directly to the concern, in terms that investors can apply to that concern.

Predictive Value of Risk Measures

Making a prudent decision to buy, hold or sell an investment requires the investor to make an assessment of the potential returns and the possibility of loss.

Making these assessments requires the investor to make or accept a forecast of returns and a forecast of loss as well as the probability of each occurring.

Investors will use the information available to predict the profit or loss outcome and the respective probabilities.

Risk disclosures are of no use unless there is some predictive value.

Accuracy of the Assessment of Future Risk

The exposure to loss is not static but is continually changing as new threats are introduced and measures developed to protect investors from those risks.

The accuracy of risk measures is therefore not static and changes as circumstances change. Future risk measures are by definition incomplete and can only be the best estimate of those who are most informed.

Can Target Risk Be Misleading?

A target risk is no more misleading than an investment objective and should be presented in that way. It is the objective of the asset allocator to provide a specified level of protection to investors.

Investors should be protected from misleading objectives by an independent audit by a qualified expert.

- Would investors be confused if a measure of risk is characterized as "risk"? Should the disclosure of risk measures use the term "risk," or some other term such as volatility, variance, or variability? Should the terminology distinguish investment risk from other risks, e.g., inflation risk or longevity risk?

Confusion About "Risk"

The term "Risk" is most often applied to life threatening situations and to making bets, that conjure the notion of a total loss.

The concept of measuring risk presents a contradiction, when the risk is perceived to be total loss.

Investors will be confused if the term "Risk" is used.

Use of Other Terms for "Risk"

Investors' genuine interest is in the preservation of their investment. This concept is easily understood. The term "investment preservation" may be somewhat misleading by implying that the entire investment is preserved.

The term "capital preservation" may be the ideal compromise between simplicity and accurate interpretation.

Distinguishing Investment Risk from Other Risk

Explaining all the different potential risks that can be defended against is unrealistic. There are too many possibilities today and new risks continue to emerge.

Selecting one "investment risk" for highlighting is meaningless and counterproductive.

- How would investor behavior be affected by disclosure of a particular risk measure? Could disclosure of risk measures influence investors to choose investments that better align with their individual investment objective or could it reduce alignment between investment objectives and investor behavior? For example, could disclosure of risk measures influence investors to choose lower or higher risk investments than would be consistent with their goals for accumulating retirement assets? Commenters are asked to provide their views and any supporting data about the impact of risk measures on investor behavior.

Effect of Risk Disclosures

Investor behavior will be affected by the disclosure of any particular risk measure. Such an action would drive investors away from investments with high risks by that measure and into others that had lower risks by that measure but in fact have far greater risks.

Any measure of risk that fails to capture all known and expected risks will have a deleterious effect on investor decisions.

Enhancing Alignment With Preferences/Needs

A broad based indicator of risks that cover all known types of risks would be a powerful enhancement to investor decision making.

Such an indicator will permit the investor to select investments that are aligned with their personal willingness to expose their portfolios to potential loss.

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- One potential effect of risk disclosures may be to cause investors or fund managers to place too much importance on the prospect of investment loss. This effect could potentially be offset by counterbalancing information on the prospect of investment gains. To what extent should investors receive information on future expected returns on investment to accompany information on risk? Would investors understand what the information would portray? Would such information cause investors to believe that the expected returns imply some level of guarantee or projection of future performance? How should this expected return be computed if it is required? If investors are to receive this information, how best should it be disclosed or presented? Should expected return information be provided as a statistic separate from risk measures or integrated with risk measures as with a confidence interval for returns?

Importance of Investment Loss

Nothing is more important to an investor than preventing the loss of the investment. It is therefore impossible to place too much importance on this issue. Consider that the assets used to make the investment were obtained in some way and its loss would require repeating whatever conditions produced the asset. Whether the result of a lifetime of work, a gift, an inheritance, another investment or the luck at the lottery, it is virtually impossible to repeat.

This is one of the key principles of the entire field of behavioral finance – investors feel loss much more than they appreciate gain.

Disclosing an understandable and broad based exposure to loss is immensely beneficial to investors and it is difficult to overestimate the value of such a disclosure.

Accompany Expected Returns with Risk

Combining risk and return in a single measure simply adds confusion, with no benefit to the investor. At their core, one appeals to the greed emotion (return) and the other responds to fear (risk). This is borne out by investor behavior studies that show investor reaction to gains is to buy and the reaction to losses is to sell.

Combining fear and greed into a single emotion is irrational, whether or not the measures can be combined mathematically. The mathematical combination has proven to be meaningless since a combination of the actions of buying and selling is incomprehensible.

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Computation of Expected Return

As is the case with risk forecasts, mathematical computations of expected returns from past performance are inadequate in informing investor decisions. The expected returns should be based on a determination by the investment manager or asset allocator of the facts relevant to the investment. Any uniform calculation of expected return cannot fit all investments and will omit relevant factors and improperly weight others.

Regulations should specify that the determination of expected return must be fully documented and audited by an independent expert. In this way, various investment strategies can be properly accommodated, without favoring one over another. Newly invented strategies and investments can be accommodated when they occur. Regulations should include disclosure of the mathematical probability of achieving the stated expected return.

As with the measure of risk, the investment manager or asset allocator should be required to consider all relevant data in determining the expected return. Such data include:

- **Past performance of the investment in up, down, volatile and recent market conditions.**
- **Past performance of comparable investments in up, down, volatile and recent market conditions.**
- **Past performance of underlying investment classes in up, down, volatile and recent market conditions.**
- **Relative performance of the investment to comparable investments in up, down, volatile and recent market conditions.**
- **Current economic and interest rate cycle.**
- **Strategies being employed to maximize returns.**
- **Strategies being used to preserve capital.**
- **Experience of the management structure that is in place.**
- **Expenses and the effect on returns.**
- **The historical difference between actual returns earned by investors and market returns, due to typical investor behavior.**
- **Strategies used to prevent imprudent investor decisions (buy high and sell low).**
- **Forecasted events and changes that will affect returns.**

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How to Present Expected Return

Expected return should be presented for the period that comparable investments are most often held.

For example, if the typical holding period for 2035 target date funds is 3.2 years, the expected return for each fund in that group should be 3 years (3.2 years, rounded).

In addition, because of the special nature of target date funds, there must be a disclosure of the expected risk of the fund at the target date.

Other periods may be used at the discretion of the investment manager or asset allocator.

The expected return should always be presented with the probability of the fund achieving that return. For examples:

> **Expected return of the 2035 target date fund for 3 years is 7.4% annually with a 55% probability of success.**
>
> **Expected return of the 2035 target date fund at that date is 6.9% annually with a 30% probability of success.**

Would forward-looking disclosures such as projected future volatility (or other risk measures) or expected returns give rise to potential liability concerns? If so, what relief would be necessary to allow funds to provide such disclosures?

Liability for Future Risk and Expected Returns

Expected returns and exposure to loss will set investor expectations, which if not met, have the potential for litigation.

The best protection against such a liability is the use of a prudent process to determine the expected returns and exposure to loss.

Relief Necessary for Liability

The Commission should establish rules that grant relief, subject to an independent expert audit. Such a step would avoid a lengthy debate over the potential liability of disclosing risk.

To what extent might special emphasis on investment risk level or asset allocation cause investors to prioritize investment risk at a particular moment in time over longevity risk, inflation risk, or other risks? Should we require additional disclosure to focus investor attention on inflation risks and longevity risks? Are there useful measures of risk that reflect longevity and inflation risk as well as investment risk?

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Overemphasis on Investment Risk

It is a safe assumption that any risk that is disclosed will be treated as either the total risk or the most important risk. Recognizing this inevitable outcome, the Commission should prohibit a risk disclosure that is known to be incomplete or less than the most important.

Risk should be viewed in three categories… Systemic (that is not controllable), Investment (that is subject to past, present and future decisions by the investment manager) and Consequential (consequences of a loss for a specific investor). All play critical roles.

Singling out one aspect of one of these categories is deceptive, suggesting that it is the only one or the most significant.

In order to avoid disproportionate emphasis, any required risk disclosure should incorporate all the risks that are known to the asset allocator. Such a requirement will permit the addition of new types of risks that are uncovered and appropriately places the responsibility where the greatest knowledge exists.

This would make it impossible for the Commission to specify which risks are required to be in a disclosure. This is appropriate because the same set of risks do not apply to all investments.

Additional Useful Measures of Risk

It is a tragic error to disclose only one dimension of risk. In fact it is preferable to make no disclosure than to select only one dimension (such as volatility) to be highlighted. Such a limited dimensional requirement would falsely indicate that the selected item is the only or most important risk.

Investors would be grossly misled.

Instead, the more reasonable course of action is to have asset allocators determine the total exposure to loss or the capital preservation level and have this confirmed through an independent audit.

Effects on Portfolio Management.

We recognize that required disclosures may affect the management of a fund, such as by causing a fund to adopt investment strategies that result in disclosure that could be perceived more favorably by investors.

- Comments are requested regarding whether, and how, disclosure of a quantitative risk measure or risk-based glide path for target date funds might influence portfolio management. What would be the associated benefits and detriments?

  For example, might disclosure of a risk measure by target date funds cause those funds to become more conservative either throughout their glide paths or at certain points on the glide path? If so, how would this affect investors, including investors who are accumulating assets for retirement? Commenters are asked to provide data about the impact of risk measures on portfolio management decisions.

Effect of Quantitative Risk Disclosure

Mandating the disclosure of certain quantitative risk measures will drive portfolio managers and asset allocators to optimize the characteristic being measured.

This is why it is essential that the disclosure incorporates the total known exposure to loss and not limit the disclosure.

The benefits of disclosing the total known exposure to loss will be that in seeking to optimize, the portfolio managers and asset allocators will seek ways to reduce the investor exposure.

Benefits and Costs.

We request comment on the benefits and costs of possible risk disclosure requirements.

- What would be the benefits and costs of requiring a glide path illustration for target date funds that is based on a standardized measure of fund risk as either a replacement for, or supplement to, our proposed asset allocation glide path illustration and adopting a standard methodology or methodologies to be used in the risk-based glide path illustration? What effects would such a requirement have on efficiency, competition, and capital formation? For instance, would such disclosure increase allocative efficiency by increasing the transparency of the underlying risks of target date investing? Would it have an effect on competition among target date funds or between target date funds and other types of investment options? Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

Direct Costs/Benefits of Disclosure of Standardized Measure

The cost of preparing and disclosing a risk based glide path is limited to the implementation. Cost is insignificant in relation to total operating cost of the fund.

The direct benefits of requiring such a disclosure are that investors become more informed about risks of investing.

Indirect Costs/Benefits of Disclosure of Standardized Measure

The indirect cost of a standardized risk measure will include:

- **Investor education of what the standardized risk measure is, the rationale for its inclusion, or exclusion.**
- **Investor service cost of responding to the confusion that is likely to be caused.**
- **Confusion and potential litigation when losses are incurred that are inconsistent with the standardized risk measure.**

Investors will move investments away from funds identified by the standardized measure as high risks.

Effects on Efficiency, Competition, and Capital Formation

A standardized measure is most efficient. By eliminating the ambiguities disclosures can be implemented quickly, without much deliberation.

The standardized measure would end the competition to find better strategies for capital preservation.

A standardized measure of risk would be an obstacle to capital formation. Investment managers would add the standardized measure to the screens used, thus lowering the availability to seekers of capital that score poorly with those measures.

- If we were to require disclosure of a risk-based glide illustration, what changes in behavior by either investors or target date fund managers may result, and what would be the associated benefits and costs?

Changes in Investor Behavior

Two changes in investor behavior can be expected.

First are the investors who assume that the risk measure represents the fund's total exposure to loss. These investors will move assets from what appears to be risky investments to less risky ones. If the assumption about the total exposure to loss is correct, this action will be prudent.

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Second are the non-professional investors who will ignore the disclosure and take no action.

Changes in Fund Manager Behavior

Fund managers will be forced to add the risk measures and use them screen out potential investments.

A well constructed requirement (total known exposure to loss) will mean that additional risk factors will be considered in the selection and disposition of investments.

A poorly constructed requirement (selective view of risk) will reduce the number of factors that are considered. In time, only those factors contained in the regulation will be considered.

- To what extent do target date fund managers already undertake risk analysis in the course of prudent risk management? Do target date funds already calculate the types of risk measures discussed above? If so, how and in what form? Is there an industry standard for calculation of risk measures, and, if so, what is it?

Current Risk Analysis Practices

The guidelines provided by ERISA regulations are used extensively by target date funds (which are primarily used as defaults in ERISA plans). The ERISA guidelines require that the investment "*is diversified so as to minimize the risk of large losses*" and "*change their asset allocations and associated risk levels over time with the objective of becoming more conservative (i.e., decreasing risk of losses) with increasing age*."

The determination of what constitutes a "*risk of large losses*" and the path of the change over time is left to the discretion of the investment manager or asset allocator. There are a variety of interpretations in current use.

- If a target date fund does not already calculate the risk measures discussed above, what would the costs—such as programming costs—of calculating such measures be?

Cost of Calculating Risk

All known target date funds use some form of risk calculation in order to comply with ERISA requirements. The cost of changing the current practice will depend on each firm's current practice and how close that is to the new requirements.

- How would the costs and the effects on efficiency, competition, and capital formation of requiring disclosure of a risk-based glide path compare with the costs and effects of the proposed requirements? For example, would a risk-based glide path enhance comparability across different target date funds?

DALBAR, Inc.
Phone: 617-723-6400
600 Atlantic Avenue
Federal Reserve Plaza
Boston, MA 02210
Fax: 617-624-7200

<u>Risk-Based versus Proposed Requirements</u>

The proposed requirements differ from any known current practice and would need to be developed anew. On the other hand, risk based measures are in current use and would require only a modification of current practices.

It is clear that a total risk based disclosure would greatly enhance the decision making of non-professional investors regarding target date funds. On the other hand, the benefits of details of asset allocation being proposed would be of value only to investment professionals.

Thank you for your consideration.

Louis S. Harvey,
President and CEO
DALBAR, Inc.

Joseph Nagengast
Managing Partner
Target Date Analytics LLC

DALBAR, Inc.
Phone: 617-723-6400
600 Atlantic Avenue
Federal Reserve Plaza
Boston, MA 02210
Fax: 617-624-7200