

CERTIFIED FINANCIAL PLANNER  
BOARD OF STANDARDS, INC.

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BY ELECTRONIC MAIL

January 14, 2011

Office of Regulations and Interpretations  
Employee Benefits Security Administration  
Room N-5655  
U.S. Department of Labor  
200 Constitution Avenue, NW  
Washington, DC 20210

**RE: Target Date Amendments**

Dear Sir or Madam:

Certified Financial Planner Board of Standards, Inc. (CFP Board) appreciates the opportunity to comment on the Department of Labor's (DOL) proposed regulation regarding target date fund (TDF) disclosure.<sup>1</sup> In the Proposing Release, the DOL stated that the proposed regulation is designed "to more specifically describe certain investment-related information that must be included in the required notice to participants" under the qualified default investment alternative (QDIA) regulation and the participant-level disclosure regulation.<sup>2</sup> The DOL has requested comment regarding whether there are concepts in the Securities and Exchange Commission's (SEC) rulemaking<sup>3</sup> that should be included in the final rule.<sup>4</sup>

We commend the DOL for taking steps to provide plan participants with better information regarding TDFs. While we generally support the adoption of the DOL's proposed regulations, we are concerned they do not go far enough to address the concern that plan participants do not sufficiently understand the extent to which many TDFs are managed in ways different than what may reasonably be expected. To that end, we recommend the DOL incorporate certain concepts from the SEC's rulemaking into the final rule. Additionally, we believe the DOL should require clear and prominent disclosures that will alert investors when a TDF's equity allocation differs materially from the average allocation of peer funds with the same target date at the target date, at the landing point, and during the five-year periods immediately preceding those dates.

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<sup>1</sup> Target Date Disclosure, 75 Fed. Reg. 73,987 (Nov. 30, 2010) (to be codified at 29 C.F.R. pt. 2550) [hereinafter Proposing Release].

<sup>2</sup> *Id.* at 73,989-90.

<sup>3</sup> Investment Company Advertising: Target Date Retirement Fund Names and Marketing, Investment Company Act Release No. 29,301, 75 Fed. Reg. 35,920 (proposed June 23, 2010) (to be codified at 17 C.F.R. pts. 230, 275) [hereinafter SEC Proposed Rule].

<sup>4</sup> Proposing Release, 75 Fed. Reg. at 73,990.



CERTIFIED FINANCIAL PLANNER™

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## **I. Background on CFP Board**

CFP Board is a non-profit organization that acts in the public interest by fostering professional standards in personal financial planning through setting and enforcing education, examination, experience, and ethics standards for financial planner professionals who hold the CFP® certification. Our mission is to benefit the public by granting the CFP® certification and upholding it as the recognized standard of excellence for personal financial planning. We currently oversee nearly 62,000 CFP® professionals who agree on a voluntary basis to comply with our competency and ethical standards and subject themselves to the disciplinary oversight of CFP Board.

Financial planning professionals provide services that integrate knowledge and practices across the financial services industry. Financial planning typically covers a broad range of subject areas, including investment, income tax, education, insurance, employee benefits, retirement, and estate planning. Financial planners work with their clients to determine whether and how they can meet their life goals through the proper management of their financial resources. CFP® professionals are heavily involved in retirement planning, and many are employees, agents, or registered representatives of fiduciary advisers under the Employee Retirement Income Security Act (ERISA). They help individuals plan for retirement by determining retirement needs, selecting a retirement plan, determining contribution levels, choosing investments, and planning distributions in retirement. This typically requires the planner to take into account Social Security income, personal savings and investments, income tax issues, Medicare choices, investment risk, and the appropriate asset allocation.

## **II. TDFs Are Not the Simple Investment Solutions Investors Believe Them to Be**

Today, plan participants are increasingly responsible for their retirement security due to a shift from defined benefit plans to defined contribution plans, such as 401(k) plans. Defined contribution plans place the burden on plan participants to accumulate sufficient assets for retirement—including responsibility for ensuring adequate contributions as well as constructing and managing their own investment portfolios. Employers and plan participants alike are increasingly turning to TDFs as the retirement strategy of choice, both inside and outside of retirement plans. A recent Towers Watson survey of large employers found that 72% use TDFs as the default option for their defined contribution plans.<sup>5</sup>

We believe that the use of a target date in a fund's name carries with it a message that is generally understood in a certain way by investors. For example, the name "Target Date 2015" says to the investor: "This fund will invest in an appropriate mix of investments for someone retiring around the year 2015." This is a reasonable interpretation for investors to make. In planning for retirement, the average investor will identify the year in which she would like to retire and plan her investments so the funds are available as retirement income at that point in time. Investors have a reasonable expectation that a TDF will be subject to relatively low volatility at the target date and in the period immediately preceding that date.

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<sup>5</sup> TOWERS WATSON, 2010 DEFINED CONTRIBUTION SURVEY (2010), *available at* [http://www.towerswatson.com/assets/pdf/2376/Towers-Watson-2010-DC-Survey-Short\(1\).pdf](http://www.towerswatson.com/assets/pdf/2376/Towers-Watson-2010-DC-Survey-Short(1).pdf).

Additionally, TDFs are generally marketed as simple solutions for investors' retirement needs. Marketing materials often label TDFs as "auto pilot" or "cruise control" investments pegged to an investor's expected retirement date. This message gives investors the impression that they can select a fund without considering their individual retirement needs or risk tolerance, and that they do not need to monitor the fund over time.

Because of their names and their marketing, many investors incorrectly believe TDFs are simple investment solutions. They do not realize that TDFs are generally managed to account for factors other than stability of principal approaching the retirement date, including time horizon, risk aversion, longevity risk, and inflation risk. For example, some TDFs are designed and managed to account for inflation risk and/or longevity risk, and maintain a high level of exposure to equity securities at and after the target date.

Investors in TDFs are generally passive investors. They are unlikely to look at a fund's prospectus to determine the fund's asset allocation or portfolio composition. TDFs, by providing a simple investment solution, are designed to meet the needs of investors who do not have the time or inclination to develop and manage their own portfolios. Once invested in a TDF, they are unlikely to monitor the performance of the fund.<sup>6</sup>

As a result of the Pension Protection Act of 2006, this may now be of greater concern in the context of defined contribution plans where participants are responsible for the investment of their own accounts. Employers may now benefit from the protective effect of Section 404(c) of ERISA when they default plan participants into certain QDIAs, which include TDFs. Qualifying TDFs as QDIAs serves an important public policy goal: it allows employers to place their employees in default investment options that are designed to outpace inflation—something that defaulting funds into money market funds proved incapable of doing. However, the fact that the federal government has qualified TDFs as QDIAs sends two important messages. First, it conveys to employers that the government believes that the asset allocations in *all* TDFs with a common retirement date are appropriate for individuals with that anticipated retirement date. An employer generally defaults its employees into TDFs based on an employee's age. Such defaults are based on the assumption that the employee will be living off the account's lump sum when the employee reaches retirement age. Second, qualification of TDFs as QDIAs conveys to employees that their employer is making an appropriate investment decision on their behalf and that their retirement funds are invested in a manner that is designed to ensure their retirement security. Employees who are *defaulted* into a TDF often make no subsequent investment decisions in relation to their plan accounts.<sup>7</sup>

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<sup>6</sup> See Vallapuzha V. Sandhya, *Agency Problems in Target-Date Funds* 4 (2010), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1570578](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1570578) (discussing research "indicating that investors are not monitoring the performance of" TDFs).

<sup>7</sup> See, e.g., Craig Copeland, *Use of Target Date Funds in 401(k) Plans*, EMPLOYEE BENEFIT RESEARCH INSTITUTE ISSUE BRIEF 327, March 2009, at 6, available at [http://www.ebri.org/pdf/briefspdf/EBRI\\_IB\\_3-2009\\_TrgtDtFnds.pdf](http://www.ebri.org/pdf/briefspdf/EBRI_IB_3-2009_TrgtDtFnds.pdf) (indicating that "[e]xcept for participants in the largest plans (more than 10,000 participants), more than 90 percent of those automatically enrolled into target-date funds had all of their allocation in target-date funds").

### **III. QDIA Notice and Participant-Level Disclosure Should Alert Plan Participants of the Risk Associated with Investing in TDFs**

Recognizing that plan participants would benefit from additional information regarding TDFs, the DOL has proposed amendments to the required notice to participants under the QDIA regulation as well as to the participant-level disclosure regulation. While we strongly support the DOL's efforts to enhance disclosures to plan participants, we believe improvements can be made to the DOL's proposed amendments that would maximize awareness and understanding among plan participants of the risks associated with investing in TDFs. Specifically, the following concepts proposed by the SEC were designed "to alert investors to the existence of investment risk associated with [a TDF] at and after the target date,"<sup>8</sup> and should be incorporated into the final rule.

#### **A. Asset Allocation and Glide Path**

The DOL has proposed requiring additional information regarding a TDF's asset allocation and glide path. Specifically, the proposed regulation would require

an explanation of the asset allocation, how the asset allocation will change over time, and the point in time when the investment will reach its most conservative asset allocation, including a chart, table, or other graphical representation that illustrates such change in asset allocation over time and that does not obscure or impede a participant's or beneficiary's understanding of the information explained pursuant to this requirement.<sup>9</sup>

We support the DOL in its efforts to enhance plan participants' understanding of a TDF's asset allocation and glide path. In particular, we support the proposal to require the QDIA notice and participant-level disclosure to include a "chart, table, or other graphical representation" that depicts the TDF's glide path. Requiring a prominent visual depiction of the glide path should provide plan participants with useful information regarding how a TDF reaches the target date and landing point. This requirement should also allow plan participants to distinguish a TDF that changes its asset allocation gradually over time from one that does so aggressively with a steeper glide path at the end.

However, the SEC's proposed rulemaking goes somewhat further in requiring disclosure of asset allocation among specific types of investments (i.e., the actual underlying asset classes in which the TDF invests, including those asset classes in which it invests indirectly through any underlying funds).<sup>10</sup> In taking this approach, the SEC recognized that many TDFs invest in other mutual funds rather than directly in the underlying asset classes. We supported the SEC's proposal believing it would help ensure that all TDFs disclose asset allocations in a consistent manner and, hopefully, enhance the ability of investors to compare

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<sup>8</sup> SEC Proposed Rule, 75 Fed Reg. at 35,925.

<sup>9</sup> Proposing Release, 75 Fed. Reg. at 73,989.

<sup>10</sup> SEC Proposed Rule, 75 Fed. Reg. at 35,926.

funds.<sup>11</sup> We believe requiring disclosure of the entire asset allocation will “convey better information about investment risk than alternatives that disclose only part of the asset allocation.”<sup>12</sup> We are of the view that the SEC’s approach will convey better information about investment risk to investors, and urge the DOL to follow the SEC’s lead in this regard.

Additionally, the DOL’s proposed amendments do not indicate what asset classes should be used in explaining a TDF’s asset allocation. The SEC’s proposal contemplates that TDFs will continue to present information about asset allocation using the broad asset classes of equity, fixed income, and cash. We are concerned that these classes are so broad that they do not communicate sufficient information about a TDF’s actual asset allocation, investments, and risks. Disclosing only the broad asset classes in which two TDFs invest may not effectively convey the level of investment risk presented where they follow different investment strategies within a broader asset class. When two TDFs have the same allocation based upon broad asset classes (e.g., they both invest the same percentage in equities at a particular point in the glide path), but are managed according to different investment strategies (e.g., one TDF invests primarily in the domestic large cap equity market while the other places greater emphasis on global equities), they would likely have disparate allocations at the portfolio level.

In 2008, those 2010 TDFs with asset allocations that better-reflected investor expectations—those with lower exposure to equity securities—generally withstood the market downturn better than those with higher target equity allocations.<sup>13</sup> However, some 2010 TDFs with lower exposure to equities suffered higher-than-average losses, likely due to investments in more aggressive fixed income instruments. Similarly, in 2009, for example, Wells Fargo Advantage DJ Target 2010 outperformed American Indep NestEgg 2010 “by nearly 5 percentage points in 2009 despite holding the same percentage common stocks, thereby demonstrating that the glide path is a valuable method for evaluating target-date performances, but this is far from the full story.”<sup>14</sup> To address this concern, the DOL should require TDFs to provide additional information about specific asset sub-classes in both the QDIA notice and the participant-level disclosure.

## **B. Importance of the Date Used in a TDF**

The DOL has proposed requiring additional information when a TDF uses or references a particular date. For these TDFs, the QDIA “notice must explain the age group for whom the investment is designed, the relevance of the date, and any assumptions about a participant’s or beneficiary’s contribution and withdrawal intentions on or after such date.”<sup>15</sup> We believe it is critical that plan participants understand the meaning of the date used in a TDF’s name, and support this aspect of the DOL’s proposal. As we have

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<sup>11</sup> Letter from Kevin R. Keller, Chief Executive Officer, Certified Financial Planner Board of Standards, Inc., to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission (Aug. 23, 2010), *available at* <http://sec.gov/comments/s7-12-10/s71210-41.pdf>.

<sup>12</sup> SEC Proposed Rule, 75 Fed. Reg. at 35,925.

<sup>13</sup> MORNINGSTAR, TARGET-DATE SERIES RESEARCH PAPER: 2010 INDUSTRY SURVEY 9 (2010), [http://corporate.morningstar.com/US/documents/MethodologyDocuments/MethodologyPapers/TargetDateFundSurvey\\_2010.pdf](http://corporate.morningstar.com/US/documents/MethodologyDocuments/MethodologyPapers/TargetDateFundSurvey_2010.pdf) [hereinafter MORNINGSTAR SURVEY] (finding that of the fourteen TDFs with a 2010 target date that suffered above-average losses in 2008 (i.e., greater than 24%), eleven had a target equity allocation of 50% or greater).

<sup>14</sup> *Id.* at 10.

<sup>15</sup> Proposing Release, 75 Fed. Reg. at 73,989.

stated previously, we believe that the date used in a TDF has a commonly understood meaning for plan participants—namely, that the TDF will invest in an appropriate mix of investments for someone retiring around that year. However, many investors and plan participants do not understand that some TDFs are designed to rebalance “through” the target date, and that the asset mix will therefore continue to change after the target date and during the participant’s expected period of retirement. Plan fiduciaries should be required to disclose a TDF’s asset allocation at the target date and then identify when the asset allocation will become fixed.

We believe the “to” or “through” nature of a TDF’s glide path can be disclosed in a narrative statement. For example, a 2015 TDF designed to reach its most conservative asset allocation in 2015 could be described as follows:

The fund invests in a diversified portfolio of stocks and bonds that is rebalanced to maintain its asset allocation and progressively becomes more conservative over time. The fund reaches its most conservative asset allocation (40% equity securities, 40% fixed income securities, 20% cash and cash equivalents) in the year 2015; this allocation will not markedly change after that date. Therefore, the fund is designed for an investor who plans to withdraw the value of the account in, or close to, the year 2015.<sup>16</sup>

In comparison, a 2015 TDF designed to reach its most conservative allocation in 2040 could be described as follows:

The fund invests in a diversified portfolio of stocks and bonds that is rebalanced to maintain its asset allocation and progressively becomes more conservative over time. “2015” in the fund name refers to the approximate year an investor in the fund would plan to retire and likely would stop making new investments in the fund. The fund does not reach its most conservative asset allocation (40% equity securities, 40% fixed income securities, 20% cash and cash equivalents) until the year 2040; this allocation will not markedly change after that date. Therefore, the fund is designed for an investor who plans to withdraw the value of the investor’s account in the fund *gradually* after retirement.<sup>17</sup>

### **C. Investment Risk**

The DOL has proposed requiring a statement regarding the risk associated with investing in a TDF—specifically, that plan participants can lose money by investing in a TDF, including near or after the target date, and that a TDF does not provide a guaranteed source of retirement income. We also believe it is

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<sup>16</sup> This statement mirrors one proposed by the Investment Company Institute (ICI) Target Date Fund Disclosure Working Group, but deletes an explanation of the year in the fund name and adds a specific disclosure about the year in which the fund reaches its most conservative asset allocation as well as the actual asset allocation at that date. See INVESTMENT COMPANY INSTITUTE, PRINCIPLES TO ENHANCE UNDERSTANDING OF TARGET DATE FUNDS (2009), available at [http://www.ici.org/pdf/ppr\\_09\\_principles.pdf](http://www.ici.org/pdf/ppr_09_principles.pdf) [ICI PRINCIPLES].

<sup>17</sup> This statement is identical to the one proposed in the ICI Principles, but includes the additional disclosure regarding the landing point included in the prior proposed statement. See *id.*

important that participants understand that they must monitor and reevaluate the appropriateness of a TDF over time. Therefore, we believe the DOL should require an additional statement recommending that investors periodically revisit whether a TDF remains an appropriate investment given the plan participant's particular circumstances and needs, as well as a statement recommending that plan participants consider whether an investment adviser or CERTIFIED FINANCIAL PLANNER™ professional would be helpful in assessing whether a TDF is an appropriate investment.

#### **IV. The DOL Should Seek Ways to Enhance Comparability to Peer TDFs**

We have previously expressed serious concerns that the names of TDFs are materially misleading to investors because some TDFs are managed in ways that are inconsistent with investors' reasonable expectations created by the names of the funds.<sup>18</sup> Specifically, the use of a date in a TDF's name implies stability of principal in the period immediately preceding that date. We believe it is inconsistent with those investors' reasonable expectations for a TDF to have high equity exposure at the target date. For these reasons, we recommended in our testimony at the DOL/SEC hearing on TDFs that the SEC amend rule 35d-1 under the Investment Company Act of 1940 to provide that a TDF's name is materially deceptive and misleading unless the fund's investments fall within an acceptable range of asset allocations consistent with its name.<sup>19</sup> We also urged the DOL to work with the SEC to put in place a process to develop accepted industry standards that will ensure that TDFs are not misleading to investors. We remain concerned that disclosure may not be sufficient to ensure that plan participants understand how TDFs may operate differently from their reasonable expectations. While we applaud the DOL for taking steps to enhance disclosures regarding TDFs, we do not believe this approach goes far enough.

We urge the DOL to require clear and prominent disclosures that will alert plan participants when a TDF's equity allocation differs materially from the average allocation of peer TDFs with the same target date at the target date, at the landing point, and during the five-year periods immediately preceding those dates. We believe this type of disclosure will be most effective in raising awareness among plan participants that some TDFs may experience greater volatility than their peers.

Specifically, we believe there are two comparisons that would provide the greatest benefit to plan participants. First, TDFs should be required to identify the average target equity allocation for all TDFs with the same target date and disclose the extent to which its target equity allocation differs from the average. Second, they should be required to provide a graphical comparison of the average glide path for all TDFs with the same target date along with the TDF's stated glide path. Information about the average allocations of their peers with the same target date can be obtained from several sources. At present, this information is available from private sources such as Morningstar and Lipper. In addition, if the SEC adopts our recommendation to include asset allocation information in fund prospectuses, that information could be easily tabulated and analyzed using XBRL coding of that data.

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<sup>18</sup> *Target Date Funds and Other Similar Investment Options: Hearing Before the U.S. Securities and Exchange Commission and the U.S. Department of Labor 4* (June 18, 2009) (statement of Marilyn Capelli Dimitroff, Chairman, Certified Financial Planner Board of Standards, Inc., President, Capelli Financial Services, Inc.), available at <http://www.dol.gov/ebsa/pdf/cmt-07200902.pdf>.

<sup>19</sup> *Id.* at 6.

These disclosures will effectively alert plan participants to the level of investment risk presented by a particular TDF. Simply disclosing a TDF's asset allocation without providing a baseline from which to compare to other TDFs fails to provide meaningful protection for plan participants. Many plan participants rely on rules established by the DOL to protect their interests, do not research investments sufficiently, and are unlikely to pursue professional advice. It is unlikely those plan participants would understand that TDFs with the same target date can be managed according to different asset allocations. Requiring these types of comparisons would provide plan participants with useful information in understanding the investment risk associated with a TDF.

**V. Conclusion**

CFP Board appreciates the opportunity to comment on the DOL's proposed regulation regarding target date disclosure. If you should have any questions regarding this comment letter, CFP Board, the financial planners it certifies, or the CFP<sup>®</sup> marks, please contact Marilyn Mohrman-Gillis, Managing Director, Public Policy and Communications, at (202) 379-2235, or visit CFP Board's Web site at [www.CFP.net](http://www.CFP.net).

Sincerely,

A handwritten signature in black ink that reads "Kevin R. Keller". The signature is written in a cursive style with a large initial 'K'.

Kevin R. Keller, CAE  
Chief Executive Officer