ERIC
The
ERISA
Industry
Committee

January 14, 2011

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

Ladies and Gentlemen:

The ERISA Industry Committee ("ERIC") is pleased to submit these comments on the proposed disclosure requirements for qualified default investment alternatives ("QDIAs") and target date funds ("TDFs"). The proposed requirements are set forth in a proposed regulation entitled "Target Date Disclosure," published in the *Federal Register* on November 30, 2010.

ERIC is a nonprofit association committed to the advancement of the employee retirement, health, incentive, and welfare benefit plans of America's largest employers. All of ERIC's members sponsor individual account plans, including many of the largest individual account plans in the country. In the great majority of these plans, participants are responsible for directing how their accounts are allocated among the plan's investment options. ERIC's members have a vital interest in making sure that participants have access to sufficient information to make informed choices. ERIC's members are also dedicated to ensuring that myriad disclosure requirements work together efficiently and effectively, to advance the goal of keeping participants engaged and attending to their responsibilities—without overwhelming them.[1]

Summary

ERIC supports the Department's goal of making available to participants sufficient information to make informed investment decisions. However, the desire to provide more information must be balanced against the cost and effort required to prepare disclosures and the risk of information overload: many participants who are inundated with information respond by simply ignoring the materials. When this happens, participants end up neglecting their responsibilities to manage their accounts based on their individual needs.

The comments below are intended to ensure not only that sufficient information is made available, but that participants remain engaged and focused on their responsibilities.

[1] The references in this letter to participants are intended to include participants, beneficiaries, and alternate payees.

1400 L Street, N.W.
Suite 350
Washington, DC 20005
T (202) 789-1400
F (202) 789-1120
www.eric.org

1. The final regulation should (i) treat QDIAs and TDFs more like other investment alternatives; (ii) allow incorporation by reference to the same extent as it is permitted by the final participant disclosure regulation (29 C.F.R. § 2550.404a-5); and (iii) clarify that QDIA notices may be combined with other disclosures. *See* Part 1, beginning on page 3, below.

2. The final regulation should include model disclosures. *See* Part 2, beginning on page 5, below.

3. The final regulation should clarify that the requirement to explain a TDF's asset allocation can be satisfied by describing the design of the TDF, without minute details about the underlying funds. *See* Part 3, beginning on page 5, below.

4. The TDF rule should not require an explanation of assumptions about a participant's or beneficiary's contribution or withdrawal intentions. A description of the underlying investments, the glidepath, the landing point, the risks, the age group for whom the TDF is designed, and the relevance of the target date should be sufficient to help participants understand the TDF alternative. *See* Part 4, beginning on page 6, below.

5. The TDF disclosure rule should not require disclosure of any information that SEC regulations do not require to be disclosed. *See* Part 5, on page 7, below.

6. The final regulation should include more detail on the requirement to disclose historical performance data. In particular, the QDIA rule should address managed accounts, and the regulation should include the same transition relief as was provided in the final participant disclosure regulation. *See* Part 6, on page 7, below.

7. The Department should reexamine its estimated compliance burden for the new requirements. *See* Part 7, on page 8, below.

8. The regulation should not be effective before the later of (i) 180 days after the regulation is published in the *Federal Register* or (ii) the applicability date of the final participant disclosure regulation. *See* Part 8, on page 8, below.

Discussion

1. Avoiding Information Overload and Keeping Participants Engaged

ERIC's members invest considerable time and treasure to improve communications and to encourage participants to attend to their investment strategies. As a result of these efforts, most of the information required by the proposed regulation is already made available to participants. Our members do so because they are concerned about their employees' future and because employers have a considerable stake in managing their workforces.

A barrage of detailed notices can turn participants away from attending to their investment responsibilities. Many participants who receive excessive notices and other disclosures will simply ignore what they receive and end up investing in a default fund without considering whether it is suitable for their needs. The average investor's reaction to a prospectus exemplifies this concern. Although prospectuses are designed to provide investors with sufficient information to make informed investment decisions, they have become so long and detailed that they are routinely ignored.[2]

Inundating participants with too much detail can have serious consequences. In a defined contribution plan, participants are exposed to a range of risks, including:

- investment risk (the risk of adverse investment experience);
- inflation risk (the risk that inflation will erode the value of an account);
- longevity risk (the risk of exhausting savings before the participant dies);
- early termination risk (the risk of employment terminating prematurely and unexpectedly); and
- inattention risk (the risk of failing to adjust investments in response to changed circumstances).

In a participant-directed plan, the responsibility for balancing these risks, and making adjustments as circumstances change, falls on the participant. No investment alternative (target date fund or otherwise) is designed to relieve a participant of this responsibility. Accordingly, it is critical that the disclosure requirements be calibrated to keep participants engaged.

---

[2] The Department acknowledged the shortfalls of the prospectus in its preamble to the proposed participant disclosure regulation. *See* 73 Fed. Reg. 43,014, 43,020 (July 23, 2008) (citing Report of the Working Group on Prudent Investment Process, 2006, *available at* http://www.dol.gov/ebsa/publications/AC_1106A_report.html).

The following recommendations are intended to strike an appropriate balance between making adequate information available and keeping participants engaged:

- The final regulation should not single out QDIAs and TDFs for disclosure of information that is also relevant for other investment alternatives. For example, the risk of losing money, including near and following retirement, and the lack of a guarantee that an investment will provide adequate retirement income are not unique to TDFs. Those concerns apply with respect to almost all investment alternatives. At a minimum, the required statements should recognize that the risks associated with TDFs are comparable to the risks inherent in most other investments. For example:

  > "***As with most other investment alternatives,*** you may lose money by investing in the TDF, including near and following retirement, and there is no guarantee that investment in the TDF will provide adequate retirement income."

- The final regulation should allow required disclosures for QDIAs and TDFs to be incorporated by reference to the same extent permitted by the final participant disclosure regulation. For example, the final QDIA regulation should allow the description of the QDIA's objectives, goals, and principal strategies to be provided on a Web site rather than in the notice itself. Indeed, the Department recently acknowledged that the "Web site approach to disclosure strikes an appropriate balance . . . accommodating different levels of participant interest in more detailed investment-related disclosures." 75 Fed. Reg. 64,910, 64,918 (Oct. 20, 2010).

- The final regulation should clarify that plans may combine QDIA notices with other required disclosures. In particular, the final regulation should state that the QDIA notices may be combined with automatic enrollment notices (as permitted by Field Assistance Bulletin 2008-03) and/or the disclosures required by the Department's regulations under ERISA § 404(a) and (c). Combining notices saves paper and avoids duplicative disclosure.

Although providing concise communications that are comprehensive enough to tell participants everything they need to know is a laudable objective, the reality is that participants making investment decisions should consider a wide array of information—not only about the QDIA, but also about the other investment alternatives. It is not feasible to include all of this information in a single notice; and it is not realistic to expect participants who receive a notice with so much information to read it—let alone process it. Treating QDIAs and TDFs more like other investment alternatives and directing participants to a Web site for more information should demonstrate to participants the breadth of information that they should be considering, without overwhelming them.

2. Model Disclosures

To improve consistency, quality, and efficiency, the final regulation should include model disclosures.

- A model QDIA notice should expand on the existing model automatic enrollment notice (*available at* http://www.irs.gov/pub/irs-tege/ sample_notice.pdf) by illustrating the level of detail that is appropriate. Like the Model Comparative Chart included in the final participant disclosure regulation, the model QDIA notice should be drafted in a straightforward and replicable format.

- Model TDF disclosures should be comparable to the Model Comparative Chart included in the final participant disclosure regulation. They should be adaptable for use in a QDIA notice or for satisfying the requirements of the final participant disclosure regulation.

Good models would help to ensure compliance with the intended disclosure standard, and would improve the level of consistency and quality of disclosures, by providing a much-needed roadmap for disclosing the right information in a useful format. Models would be especially helpful for investment alternatives that are not subject to SEC disclosure requirements, such as unregistered investment alternatives. For these investment alternatives, illustrative examples will mitigate the potential for disputes between plans and fund managers over the appropriate level of detail. In addition, preparing model disclosures will help the Department to fine-tune its regulatory impact analysis (see Part 7, beginning on page 8, below).

Of course, any model disclosure should be treated as exemplary rather than a required form. The final regulation should not prohibit custom disclosures that do not follow the model but otherwise satisfy the disclosure requirements.

3. Level of Detail Required for TDF Disclosure

Although TDFs generally have designs and strategies that can be described succinctly, most fund managers retain the flexibility to adjust the underlying investments and asset mix at any time. For example, although TDFs generally specify the asset classes in which they invest and follow a basic glidepath, the actual investments at any time are not set in stone.

This flexibility is important because it enables fund managers to react efficiently to market events and changed circumstances, without the need for constant updates to the disclosure materials. In order to protect this flexibility, the final regulation should clarify that the requirement to explain a TDF's asset allocation can be satisfied by describing the design of the TDF, without getting into minute details regarding the underlying funds. In particular, the final regulation should include the following principles:

- It is sufficient to describe the asset classes in which the TDF invests (*e.g.*, 80% equities and 20% fixed income) and how the underlying funds are selected, without naming specific underlying funds. If a TDF limits itself to investing in a particular fund family (*e.g.*, in-house mutual funds), it should be sufficient to disclose this fact without naming particular funds or the precise allocation among those funds.

- The description of how the asset allocation will change over time may include windows of time during which the allocation will gradually change, without specifying a precise allocation as of any specific time.

- The point in time when the TDF will reach its most conservative allocation may be expressed as a window—*e.g.*, between five and ten years after the target year.

These principles should also be illustrated in examples or model disclosures.

This level of detail will not compromise the usefulness of the disclosure. Descriptions within the parameters described above will give participants a useful understanding of the fund design; and significant changes that affect the characteristics of the TDF (*e.g.*, a change to the glidepath or investment philosophy) will have to be disclosed.

4. Assumptions About Contribution and Withdrawal Intentions

Under the proposed regulation, the disclosure for a TDF named or described by reference to a date must include an explanation of the age group for whom the TDF is designed, the relevance of the date, and any assumptions about a participant's or beneficiary's contribution or withdrawal intentions on or after the target date.

ERIC supports addressing the concern that target date funds with similar names often have materially different designs and investment philosophies.[3] However, an explanation of assumptions about what a participant or beneficiary intends to do after the target date is not necessary and incorrectly implies that knowledge or expectations about an individual's future behavior are (or should be) considered in the design or selection of TDFs.

TDFs are not designed to suit the needs of actual participants or beneficiaries. Rather, TDFs are designed to meet the assumed needs of hypothetical individuals, based solely on their target retirement years. TDFs do not (and cannot) take into account critical unpredictable and

---

[3] This concern has been raised by Congress, regulators, and others over the last few years. *See, e.g.*, SEC Proposed TDF Advertising Rule, 75 Fed. Reg. 35,920, 95,922 (June 23, 2010) ("[T]arget date funds sharing the same target date have significantly different degrees of exposure to more volatile asset classes, such as stocks."); DOL-SEC Joint Investor Bulletin on Target Date Retirement Funds (May 6, 2010), available at http://www.dol.gov/ebsa/pdf/TDFInvestorBulletin.pdf ("[T]arget date funds, even if they share the same target date . . . may have very different investment strategies and risks."); Default Nation: Are 401(k) Target Date Funds Missing the Mark?: Hearing Before the Joint Special Committee on Aging (Oct. 28, 2009) (opening statement of Sen. Kohl), available at http://aging.senate.gov/ hearing detail.cfm?id=319426; Public Hearing on Target Date Funds and Other Similar Investment Options before the SEC and Department of Labor, at 11, 14-15 (June 18, 2009) (opening remarks of Dep. Sec. Harris and Chairman Schapiro).

personal factors, such as when an individual actually retires, the individual's accumulated savings and risk tolerance, how much the individual will save in the future, what the individual intends to do (and actually does) after retiring, and the individual's health.

Given the limitations of TDFs, it would be misleading to suggest in any way that a TDF has been designed or selected to meet the assumed needs of any individual. Describing assumptions about a participant's or beneficiary's contribution or withdrawal assumptions perpetuates a dangerous misconception that participants who are inclined to follow the herd do not have to put effort into investing for a secure retirement.

Accordingly, ERIC recommends deleting the requirement to explain assumptions about a participant's contribution or withdrawal intentions. The regulation would still require a description of the underlying asset classes; the glidepath; the landing point; the risks; the age group for whom the TDF is designed; and the relevance of the target date. This information should be sufficient to help participants understand the TDF alternative.

5. Consistency With SEC Disclosure Requirements

The final regulation should not require disclosure of any information that is not also subject to disclosure under SEC rules—including existing SEC regulations and the advertising rules currently being developed. *See* 75 Fed. Reg. 35,920 (June 23, 2010). In practice, it is very difficult, if not impossible, for plans to collect information that the SEC does not require to be disclosed.

For example, the SEC rules do not expressly require disclosure of assumptions about an investor's contribution or withdrawal intentions (discussed in Part 4, above). ERIC members are concerned that it would be very difficult to obtain this information; and plan fiduciaries are not in a position to speculate on what the underlying assumptions might be (or whether contribution or withdrawal intentions are even considered). This practical problem is another reason why the Department should delete the requirement to disclose assumptions about withdrawal and contribution assumptions.

6. Disclosing Historical Performance Data

Like the final participant disclosure regulation, the proposed QDIA regulation would require disclosure of historical performance data. The final regulation should include more detail on this requirement.

First, the final regulation should include guidance on how to provide historical performance data if the QDIA is an investment management service permitted by 29 C.F.R. § 2550.404c-5(e)(4)(iii). Historical performance data is particularly misleading for this kind of QDIA, because performance is generally affected by variables related to individual circumstances (*e.g.*, age, service, and/or perceived risk tolerance). If the Department nevertheless concludes that historical performance data is required for investment management services, the final regulation should allow the performance data to be based on the aggregate performance of all plan accounts invested by the management service during the relevant period, or broken down by class of participant (*e.g.*, performance by age band).

The final regulation should also clarify that the historical performance data required for a QDIA is the same as the historical performance data required for other investment alternatives under the final participant disclosure regulation—*i.e.*, the average annual total return for 1-, 5-, and 10-year periods (or, if shorter, since inception). For TDFs that are customized for individual plans, the final regulation should not require historical performance information for any period before the inception of the customized TDF.

In addition, the final regulation should include the same transition relief as was included in the final participant disclosure regulation. For example, for investment alternatives that are not subject to SEC regulation, the final regulation should include transition relief for the first 10 years after the regulation becomes effective. *See* 29 C.F.R. § 2550.404a-5(j)(3)(ii).

7. Compliance Burden

The Department has estimated that it would take only 15 minutes to incorporate the new TDF disclosures into a QDIA notice, that the compliance burden for TDFs that are not QDIAs is de minimis, and that the new disclosure would be only two pages. ERIC believes that these estimates are unrealistically low.

First, the time estimate does not appear to take into account the burden on plans with TDFs that are not subject to SEC disclosure requirements. For these funds, the exercise of compiling the required information and organizing it in the required format will take considerably more than 15 minutes.

Second, although ERIC's members certainly hope that the additional TDF disclosures can be made in only two pages, it is not clear that this is possible. As a point of reference, the recent DOL-SEC Joint Investor Bulletin on Target Date Retirement Funds (May 6, 2010) did not include all of the information required by the proposed regulation and was still almost four pages.

As noted above, allowing more incorporation by reference to a Web site and making model disclosures available would help to reduce the cost of compliance. In addition, preparing model disclosures would give the Department and stakeholders a better sense of the effort and number of pages that will likely be required.

8. Effective Date

The proposed regulation states that it will be effective 90 days after the final rule is published in the *Federal Register*. After the regulation is finalized, it will take time to develop systems for collecting information, producing the required disclosures, and bringing plans into compliance. Also, the new disclosure requirements build on the disclosures required by the final participant disclosure regulation, which will not apply until plan years starting on or after November 1, 2011.

Accordingly, the QDIA and TDF regulation should not be effective before the later of (i) 180 days after the final rule is published in the *Federal Register*, or (ii) the first plan year that starts on or after November 1, 2011.

In setting the effective date, the Department should also consider carefully the interrelationships of the Department's series of recent guidance—*e.g.*, the QDIA and TDF regulation; the final participant disclosure regulation; the fee disclosure regulation; the investment advice regulation; the new definition of fiduciary; and the new electronic disclosure rules that the Department is currently working on. The effective dates for all of the new guidance should be set in a way that enables stakeholders to establish compliance strategies without having to make repeated adjustments for multiple pieces of guidance that become effective over a short period.

* * * * *

ERIC appreciates the opportunity to submit these comments. If we can be of further assistance, please let us know.

Sincerely,

Mark J. Ugoretz
President & CEO