AARP
Real Possibilities

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

Re: RIN 1210-AB38
Target Date Disclosures

Ladies and Gentlemen:

We are writing on behalf of AARP, the largest nonprofit, nonpartisan membership organization representing nearly 38 million members age 50 and older, to support the Department of Labor's (DOL) efforts to address appropriate disclosures in Target Date Funds (TDFs) to ensure that participants are provided clear, understandable and comprehensive information concerning TDFs, and to reduce the potential for their confusion and the risks of being misled with respect to those funds. Of particular concern is appropriate disclosure to inform participants about the risk and volatility of the investments in TDFs.

AARP has long supported disclosure and transparency of investment information. However, any required disclosures must be clear, understandable, and comprehensive enough to provide necessary and useful information without being overwhelming to the investor.[1] Indeed, providing too much information can be as unhelpful as providing insufficient or inadequate information.[2]

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[1] We cannot stress strongly enough that any proposed disclosures – *e.g.*, written notices, graphs, and/ or charts – must be tested on focus groups. See generally C. Thayer, *Comparison of 401(k) Participants' Understanding of Model Fee Disclosure Forms Developed by Department of Labor and AARP* (September 2008), *available at* http://www.assets.aarp.org/rgcenter/econ/401k_fees.
.pdf.

[2] *Cf*. Christopher Carosa, *How Many Investment Options Should 401k Plan Sponsors Offer?,* FIDUCIARY NEWS (Oct. 18, 2011), http://fiduciarynews.com/2011/10/how-many-investment-options-should-401k-plan-sponsors-offer/ (compiling studies demonstrating that too many investment options leads to suboptimal results).

When formulating any type of disclosures, it is important to first determine who will be using the disclosures and for what purposes. Most 401(k) plan participants are average income earners, many of whom are investing somewhat passively through their employer-sponsored retirement plans. Since the Pension Protection Act of 2006 endorsed TDFs as "default" investments for passive retirement participant-investors, they have become the fastest growing investment option in 401(k) and similar type retirement plans, and may include a majority of retirement plan participants within a decade. Accordingly, disclosures will apply to a diverse and distinct set of users, with different levels of sophistication.

Participants will be choosing from among the plan's fund options, and will compare TDF funds with other plan offerings. Those participants who are more thorough in their research may scrutinize all available disclosures. In contrast, however, the majority of participants will be less inclined to use all available disclosures. Many will ignore disclosures if they are too complicated. 401(k) plan participants generally will be presented with pre-screened investment options – one family of funds – so that their choice will be more limited. In this instance, 401(k) participants will simply need to determine which "retirement" date fund they will choose. Finally, some 401(k) participants will not make a decision at all, but will be placed into TDFs as the default investment option in their 401(k) plan. Disclosures to this group particularly need to be clear and concise.

These participants need "apples-to-apples" comparisons so they can make distinctions between the TDFs. Most 401(k) retirement plan participants need simplified information for their decision-making, except for the most sophisticated and seasoned participant. At the least, the disclosure provided should be appropriate to the user of the information provided in the disclosures.

Consequently, AARP favors "tiered" disclosures that provide basic information to all plan participants. Additional, more detailed disclosures and other information should be clearly identified and easily available to those participants who are interested. By using tiered disclosures, participants will receive the information they absolutely should have, but have the opportunity to obtain more substantial and detailed information if they desire. Such tiered disclosures will be particularly useful inasmuch as these disclosures will necessarily be provided to participants at regular intervals, along with information about fees for example, not only at the time of the initial selection or default.

AARP agrees with the Recommendation of the SEC's Investor Advisory Committee: Target Date Mutual Funds (adopted April 11, 2013) that there should be a uniform or standardized definition of risk so that when participants compare the disclosures they are making an "apples to apples" comparison. Absent the use of a uniform definition, the disclosures will not be meaningful.

As the SEC's 2012 *Study Regarding Financial Literacy Among Investors* noted, there are high levels of financial illiteracy among investors. Numerous studies have confirmed that many individual investors do not understand even basic investment concepts.[3] Even sophisticated investors often make basic investing mistakes and can be over-confident. Accordingly, it should not be assumed that individuals who invest in TDFs actually understand investment concepts. Risk measures such as loss or volatility of returns, standard deviation, beta and duration will frequently be meaningless to participants, especially those who are defaulted into TDFs through the automatic enrollment process. As a result, the DOL should focus on formulating a tiered set of disclosures that is designed with a range of participant financial sophistication in mind so that the greatest number of users will be able to understand and use the data effectively.[4]

AARP also agrees with the Recommendation of the SEC's Investor Advisory Committee: Target Date Mutual Funds (adopted April 11, 2013) that it is insufficient merely to inform an individual investor that a TDF contains a certain percentage allocation of stocks and bonds (or other investments) in particular fund. The disclosures should also explain what these percentage allocations mean in terms of asset allocation (diversification), historical net performance over long periods of time, volatility, and in particular, investment risk. The impact of asset allocation must be translated into terms (perhaps with examples) that participants understand. All effort should be made to avoid a repeat of participants' experiences following the 2008-09 financial crisis where many participants learned – too late – that their risk tolerance and loss aversion was much different from the TDF fund in which they were invested.

While AARP supports clear disclosure of TDF glide paths, that subject is not the only important issue for investing in TDFs. The surprises and failures that occurred in some TDFs in the aftermath of the 2008-09 financial crisis were not simply because of the glide path. The glide path debate should not shift the focus away from net investment performance and underlying fund investments. As always, participants need to know fund asset allocation (including glide path), net performance and fees.

AARP urges a glide path illustration – provided to all participants – that demonstrates the inherent risk of various TDFs. We envision additional glide path illustrations that indicate the fund changes in asset allocation, investment return assumptions, and interest rate assumptions, if any. The method by which a fund manager changes the asset allocation is important. Will asset class transitions be executed gradually throughout or more steeply at

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[3] Kathi Brown, and Rebecca Perron, *Determining How Current and Future Social Security Beneficiaries Make Retirement Decisions* at 2, 36-37, AARP (2011) (noting almost half of survey respondents did not understand the concept of inflation on purchasing power and one-third did not understand how compound interest worked).

[4] For example, AARP's survey on DOL's 401(k) fee disclosure form showed that people like graphic representations and many people find them easier to read than prose. See generally C. Thayer, *Comparison of 401(k) Participants' Understanding of Model Fee Disclosure Forms Developed by Department of Labor and AARP* (September 2008), available at http://www.assets.aarp.org/rgcenter/econ/401k_fees.pdf.

times? The methodology could be crucial to participants' plans. Of course, the glide path illustration should specifically show whether the glide path is "to" the retirement date or "through" retirement and what that means for when and how to draw down assets. The importance of this information is obvious. If participants who hold TDFs plan to sell these funds at their retirement date (or otherwise prior to the "through" date), then high exposure to equities at the target date may not be reasonable.

The risk and asset allocation should be marked out in five-year increments so participants will have a sense of the glide path. To limit the volume of disclosure, the level of information could be increased for those closer to retirement – such as those age 50 and over – when individuals are more likely to start focusing on retirement. In particular, TDFs need to disclose the target date, the asset allocation on that date, the landing date or point and the asset allocation at the landing date – accurately and in a manner to be understood by the typical participant. It is also critical to disclose what factors could cause a reassessment of the fund's investment strategy.

When a participant is approaching or reaches retirement, some issues become even more important. For example, a plan's historical data may show that most of its participants sell their "through TDF" when they leave the plan. If so, is a "through TDF" a prudent plan choice, and is there a breach of fiduciary duty if the trustees continue to offer a "through" TDF as an investment option, especially if that TDF is the QDIA.[5]

Second, in 2013, the Government Accountability Office reported that many service providers were encouraging 401(k) rollovers to IRAs without full – or any – disclosure of fees and other key variables. The importance of the proposed disclosures should be obvious. In fact, a reassessment of one's investment needs at retirement is wholly appropriate, including health, marriage status, other sources of income, and risk tolerance. If participants who hold TDFs sell these funds at or soon after their roll over into an IRA, then higher exposure to equities at the target date may be unreasonable. TDFs that invest in a high proportion of equities at retirement ages may make it more difficult to convert such amounts to annuities or other income producing assets because of liquidity concerns and the potential for significant losses in their accounts due to high equity exposure at participants' retirement date. Again, disclosures need to be conspicuous and clearly explain to investors the risk and costs of maintaining a fund to or through the target date.

Third, if an investment advisor, especially one at the service provider of the plan's TDF, suggests that when the participant rolls over his or her 401(k) account consisting of a "through TDF," he or she should sell the "through TDF," query whether a breach of fiduciary duty has occurred. In the same vein, query whether managed payout accounts

[5] These issues indicate that the plan fiduciaries also must receive adequate disclosures concerning TDFs so that the family of funds that they select as a plan option is in the best interest of the participants.

can be reconciled with a "through TDF." In addition, should it make any difference if these transactions occur between a call center employee and the participant? We think not.

Finally, over 60% of participants who withdraw money from their IRAs when they are age 70 or older do so to meet the minimum distribution rules.[6] The asset allocation of a "through TDF", with a significant amount of equity exposure at or near the year in which the account holder turns age 70-1/2, may be inappropriate with the minimum distribution requirements. (Theoretically, this would be less of an issue for "to TDFs.") This scenario became a reality for many participants after the downturn in 2008, when the required distributions rules became problematic and were temporarily suspended.[7]

Not surprisingly, at or around retirement, due to changed circumstances, many individuals reassess their financial situation, including their risk tolerance and/or loss aversion. They realize that it will be difficult to recover from a significant market drop. Thus, it is essential that disclosures provide sufficient context or explanation that would help participants determine if the final allocation on the target date or the landing point is appropriate for them and would further fulfillment of their goals. The disclosures should help mitigate potential conflicts of interest and avoid higher than appropriate risk at or after retirement.

Finally, AARP believes that, five years after the effective date of the disclosures, it would be prudent and helpful to participants for another review to be undertaken of these TDF products, the disclosures, and the reactions of the marketplace, plans and participants.

We strongly support the DOL's efforts to provide participants with useable, understandable, clear and comprehensive information. We urge the DOL to continue its efforts to protect and improve Americans' economic and retirement security.

Sincerely,

David Certner

David Certner
Legislative Counsel and Legislative Policy Director
Government Affairs

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[6] *See* The Role of IRAs in U.S. Households Saving for Retirement, 2009 (Jan 21, 2010), available at www.ici.org/pdf/fm-v19n1.pdf.

[7] Jack Howell, Treasury Official: No required minimum distribution relief for 2008 (Dec. 23, 2008), available at http://taxlaw.sprouselaw.com/2008/12/articles/new-developments/treasury-official-no-required-minimum-distribution-relief-for-2008/.