

July 8, 2014

**Ashley diMayorca**  
Senior Investment Analyst

## **Comments to the Employee Benefits Security Administration (EBSA) regarding the proposed adjustments on disclosures for target date funds (originally proposed in 2010, SEC, 17 CFR Parts 230 and 270)**

Portfolio Evaluations, Inc. (PEI) is a privately-owned consulting firm focused on providing institutional investment and retirement plan consulting services. Founded in 1992, PEI operates in an independent, non-affiliated capacity to provide advice, guidance, direction, and education to the fiduciaries of institutional investment programs. Our independence allows us to serve our clients in a manner that is free from influence from investment management firms, mutual fund companies, broker-dealers, insurance companies and others in the industry. PEI currently maintains more than 200 institutional relationships representing over \$40 billion in assets under advisement. More than 65% of our book of business is in defined contribution plan assets.

PEI's Research Group, which is comprised of 12 research analysts, conducts comprehensive due diligence on the target date fund (TDF) industry and managers. We maintain a proprietary database of TDF providers, comprised of over thirty TDF providers, on which we conduct through and frequent due diligence. Annually, PEI distributes a very detailed Request for Information (RFI) to these providers. The RFIs allow us to evaluate many facets of each provider's philosophy guiding glide path construction, their objectives, how they manage the trade-offs between longevity risk and shortfall (volatility) risk, asset class diversification, underlying fund selection, etc. Additionally, PEI meets with each of these providers regularly to discuss performance attribution, the composition of the management team, changes to underlying assumptions used in glide path construction, capacity issues in the underlying funds and any changes to the glide path or its underlying asset classes or funds.

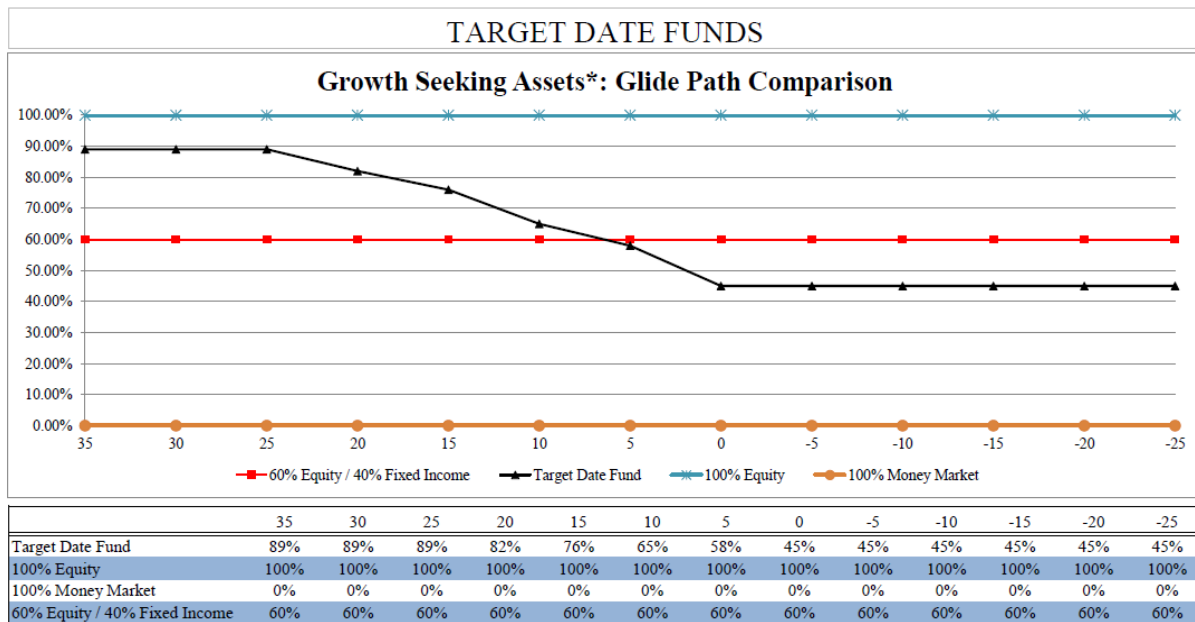
PEI has the following comments for the Employee Benefits Security Administration relating to proposed regulatory amendments on disclosures for target date funds (TDFs) that were originally proposed in 2010 (SEC, 17 CFR Parts 230 and 270):

1. The 2010 proposal contained a requirement for TDFs to provide an illustration of the asset allocation along the glide path on all TDF marketing materials. In 2013, the SEC's Investor Advisory Committee recommended that the Commission develop a glide path illustration for TDFs based on a standard measure of fund risk as a replacement or a supplement to the asset allocation/glide path illustration.

- PEI does not believe that any single standard measure of risk would be understandable or meaningful to most participants. First, any single measure of risk (such as standard deviation, for example) does not capture all the risks associated with any given asset class. For example, high yield bonds over the past five years may not appear to be a very risky asset class if one were to look at standard deviation alone. However, the standard deviation of high yield bonds does not reflect the fact that its returns in declining markets are highly correlated to equity returns. In other words, high yield bonds do not provide the diversification benefits commonly associated with fixed income investments. Secondly, PEI believes that simplicity is paramount in messaging to TDF investors. Participant inertia is a well-researched phenomenon. If messaging regarding investments is complicated, investors will ignore the message all-together. Standard measures of risk, such as standard deviation, would not be understood by most participants and, as such, would not be meaningful or impactful in illustrating the risks in any given TDF.
- PEI believes that an illustration of a TDF's exposure to more volatile asset classes would be more impactful to the overwhelming majority of TDF investors than would be an actual measure of risk. PEI suggests TDF providers be required to show their allocation to "risk-seeking assets." Accompanying the illustration, there should be a notation that risk-seeking assets are those that have exhibited higher levels of historic volatility and include the following asset classes: US equities (small, mid and large cap), non-US equities, high yield (below investment grade) fixed income, real estate and commodities. Expressing the glide path allocations in terms of allocation to risk-seeking assets provides a more comprehensive and accurate view of the risk of a given TDF at any point along the glide path. Participants would easily be able to see what their exposure to riskier asset classes would be at retirement, which is something many participants may not realize today.
- Recognizing the importance of providing a balance between simplicity and meaningful disclosure about risk in TDFs, PEI recommends that the asset allocation/glide path depiction of exposure to risky assets be juxtaposed to that of a traditional balanced fund allocation of 60% equities/40% bonds. The inclusion of a traditional balanced fund (which was widely used as a QDIA before the recent TDF surge) would highlight the level of volatility risk in a given TDF in a more meaningful way for participants, without unnecessarily complicating the message. PEI also suggests that a representation of a static 100% equity and 100% money market fund also be shown on the illustration, thus providing additional relevant points of comparison for investors.
- PEI suggests that the exposure to riskier assets illustration include a graphic reflection of the TDF's exposure to more volatile asset classes, accompanied by a simple table.
- PEI suggests that the information on the graph and in the table be expressed in terms of "years to retirement" so that investors can see their expected exposure to riskier asset classes change in the years preceding retirement, at retirement, and in the years after retirement should they leave their assets in the TDF after retirement.

- TDF providers should use actual asset allocation information in their illustrations, regardless if the underlying funds are sub-advised. Allocations to types of funds in lieu of actual asset allocation should not be acceptable.

Please see suggested illustration below:



- There are many providers who make shifts to their strategic (expected) allocations along the glide path to take advantage of (or protect against) expected market movements in various asset classes over a shorter time period (6 months to 18 months, typically). Commonly called tactical allocations, these short term shifts in allocations are typically made within a 2-10% band around the strategic weights for the asset classes. For TDFs whose managements employ (or can employ) a tactical asset allocation overlay, PEI suggests that the potential for tactical changes to the glide path should be disclosed alongside the asset allocation/glide path illustration. Normal (or allowable) ranges for the tactical under/overweights to asset classes should also be included.

Every effort has been made to provide accurate and authoritative information in regard to the subject matter in this alert; however, accuracy and completeness cannot be guaranteed and is not warranted as such. Many statements and sources were used in compiling the data for this alert. PEI does not assume responsibility for the accuracy or completeness of such information. In addition, certain information contained in this alert may be obtained from multiple sources. PEI does not warrant that such information is accurate, correct, complete or timely. This information is provided with the understanding that PEI is not engaged in rendering legal, accounting, or actuarial advice. If such advice is required, the services of a competent professional of this kind should be sought. The information contained in this alert does not constitute the recommendation of any investment advisor or their services nor does PEI assume responsibility for the conduct of any investment manager including the investment performance or compliance with the laws and regulations to which they are subject. This alert has been prepared exclusively, and confidentially, for the informational use of the recipient and any other use, including the reproduction of this report in any form, is prohibited without the prior express written permission of PEI. CA 07.08.14