MORNINGSTAR®

22 West Washington Street
Chicago
Illinois 60602

Telephone: +1 312 696-6000
Facsimile: +1 312 696-6001

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Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

RE: Comments on File Number S7-12-10

Dear Ms. Murphy,

Morningstar appreciates the opportunity to comment on the Securities and Exchange Commission's proposed rule amendments that seek to improve investors' knowledge and understanding of target-date funds. This letter reflects the views of Morningstar's Fund Research Group, the team responsible for the Morningstar Target-Date Series Ratings and Reports, which are issued quarterly, as well as the annual Morningstar Target-Date Series Research Paper.

As the Commission has noted, target-date funds quickly are becoming Americans' retirement-savings vehicle of choice, having garnered more than $146 billion in inflows in the past three calendar years. Given target-date funds' prominence in retirement portfolios, it's crucial that investors understand what they own, especially because target-date funds' approach to asset allocation is relatively new.

Morningstar's research has shown that there isn't much consistency in how fund companies disclose and explain target-date funds' complex investment approach. A March 2010 Morningstar study of 20 of the largest target-date series showed that none of the series even met the industry's own suggestions for thorough disclosure (as defined by the Investment Company Institute's "Principles to Enhance Understanding of Target Date Funds"). We believe target-date series would benefit from a more comprehensive set of disclosure guidelines from the Commission.

Show How a Fund's Asset Allocation Shifts

It's important that shareholders have the tools they need to easily understand their expected exposure to broad asset classes, such as stocks, bonds, and cash, at any point during the decades over which they may own the fund. When investors know what they own and have reasonable expectations for their funds' returns, they're more likely to own the funds well.

Easily accessible, intuitive graphics that illustrate how a fund's asset allocation shifts over time should be required disclosure to individual investors because they'll help tell a complex story. Morningstar suggests that target-date fund providers also include the table of data from which they derive such graphics. Today, some fund companies supply one without the other, making it difficult to accurately compare multiple series.

Disclose Expected Subasset Class Allocations

Knowing a fund's expected stock, bond, and cash allocations is a good starting point, but Morningstar also suggests that the Commission require further disclosure. It would be helpful to know, for example, a fund's intended subasset class allocation within those broader asset classes. Two funds with identical equity-bond-cash allocations may have very different risk profiles. One fund predominantly invested in equities tied to commodities and in bonds rated junk may be much more volatile than one invested mostly in blue-chip, U.S.-based stocks and short-duration government bonds. By emphasizing the equity-bond-cash allocations, those important differences are lost.

To be sure, the Commission would need to define what types of securities are included in each subasset class and determine, for example, where to classify nontraditional securities that are becoming more common in target-date offerings, including foreign currencies, commodities and commodity futures, and derivatives.

The goal of the subasset class disclosure is to help investors gauge target-date series' risk profiles, anticipate how the funds may behave in various market conditions, and measure returns—not to restrict skilled asset allocators from moving the funds' assets into areas where they see opportunity. That said, if managers are likely to stray from the forecasted asset allocation, they also should disclose that tactical asset-allocation budget.

Limit Emphasis on Retirement Date

We have a concern about the Commission's proposal that funds highlight their target-year asset allocations following the fund names in their marketing materials. This regulation may place too much emphasis on one moment in these funds' long lives and perhaps give the mistaken impression to investors that a target-date fund's asset allocation won't shift after the retirement date.

If investors know how their target-date funds will be managed over the entire ownership period—as some of the above suggestions help facilitate—there's less need to draw attention to one year over others through decades of investment. In a sense, the target-year allocation is a "sound bite" description of the overall glide path discussed above. A major problem with target-date funds has been that investors assume that all funds with the 2010 or 2030 moniker will perform similarly. So, too, might they erroneously assume that funds with identical target-year allocations will perform alike. We believe that asset allocation is better portrayed by graphs and tables than by sound bites. Therefore, Morningstar suggests that the Commission strike this proposed requirement.

Thank you for considering Morningstar's view on this very important topic. We'd be happy to further discuss our position at the Commission's convenience.

Sincerely,

Laura Pavlenko Lutton
Editorial Director
Fund Research Group
Morningstar, Inc.

cc: Honorable Mary L. Schapiro, Chairman
Honorable Luis A. Aguilar, Commissioner
Honorable Kathleen L. Casey, Commissioner
Honorable Troy A. Paredes, Commissioner
Honorable Elisse B. Walter, Commissioner

Andrew J. Donohue, Director, Division of Investment Management
Susan Nash, Associate Director, Division of Investment Management