BDELLIUM®
WE HELP BUSINESS GROW

Re: Investment Company Advertising:
Target Date Retirement Fund Names and Marketing

Ladies and Gentlemen:

1. Introduction

1.1 These comments are submitted by Bdellium, Inc., a firm that provides decision-support tools that help individuals to achieve their financial goals, plan sponsors to meet their fiduciary responsibilities and financial service providers to grow their business.

1.2 We welcome this opportunity to comment on the Commission's proposed rule amendments relating to marketing materials used by so-called "target date funds" that are "intended to provide enhanced information to investors concerning target date funds and to reduce the potential for investors to be confused or misled regarding these funds." The Commission has invited comments on the usefulness, ease of interpretation, potential impact on investors or fund manager behavior and potential adverse effects of a proposed asset allocation glide path illustration, a risk-based glide path illustration, the use of a standardized measure of fund risk and the choice of risk measurements to be used.

1.3 Bdellium agrees that target date fund marketing materials need to better inform investors, plan fiduciaries and their advisors so they can make sound decisions. We hope that our comments below will contribute to the achievement of that objective.

1.4 The commission has asked more than 100 specific questions. In providing our comments, we have not tried to answer each question individually but rather we submit recommendations on 5 key topics, each of which was prompted by a subset of the Commission's questions that are identified at the start of each Section below.

2. To Which Funds Should Disclosure Rules Apply?

2.1 The comments in this section are prompted by the following questions that were asked by the Commission:

- *Should a risk-based glide path illustration be required for all target date funds, regardless of a fund's investment objective or strategies?*
- *Should a risk-based glide path illustration instead be required only for target date funds with an investment objective or strategy of managing to a target risk level?*
- *Should there be differences in requirements for marketing materials that relate to a single target date fund, as compared with those that relate to multiple target date funds?*

- *Are target date fund strategies primarily based on a changing target risk level or a changing target asset allocation over time, or some combination of these approaches?*
- *Do commentators agree with the approach of focusing on factors such as maximum exposure to loss or volatility of returns that are the directly relevant to the primary concern of those approaching retirement?*
- *What are the primary concerns of those approaching retirement and what specific measures of risk would be directly relevant to those concerns?*
- *Are there other risk factors that are relevant to target date fund investors, including longevity risk and inflation risk?*
- *Should information about a target date fund's risk-based glide path be required in marketing materials that are submitted for use on or after the landing point?*
- *Do the merits of each approach differ among funds or groups of funds with significant operating histories, new funds, and/or funds that have flexibility to change their risk-based glide paths?*
- *What effects would [requiring a glide path illustration for target date funds that is based on a standardized measure of fund risk]have on efficiency, competition, and capital formation? For instance, would such disclosure increase allocative efficiency by increasing the transparency of the underlying risks of target date investing? Would it have an effect on competition among target date funds or between target date funds and other types of investment options?*

2.2 Behavioral psychology suggests that most consumers buy with the heart and not the head. Good investment decisions need to be made with the head and not the heart. How can disclosure rules help to convert emotional consumers into rational investors and improve protection without hurting business?

2.3 Skilled marketers know that segmenting their customer base using slight differences in product characteristics is an effective way to grow market share. Each customer segment is attracted by a few differentiating product characteristics, while the manufacturer enjoys economic benefits from the high degree of commonality across all product offerings. This strategy is usually backed by simple, emotionally-charged messages that emphasis the distinguishing characteristics and downplay the potential suitability of other product variants.

2.4 Skilled investors understand that selecting any investment is an exercise in comparative analysis across all potential candidates. It requires the investor to differentiate between candidates based not only on how well each performs on multiple evaluation criteria but also on how important each criterion is to the investor. A decision process loses reliability and effectiveness if it can only be applied to a subset of all candidates. Stated another way, a process that requires candidates to firstly be segregated into groups and then requires each group to be evaluated using different criteria or measurements, cannot reliably identify the best overall candidate to fulfill the investor's particular needs.

2.5 Applying these general observations to the retirement market, we see that target date funds differentiate themselves by focusing attention on their asset allocation policies while de-emphasizing the risks associated with those allocations. Target risk funds emphasize some measure of risk-taking but do not focus on the specific asset allocations made to achieve those risk levels. Interestingly both fund types have enjoyed remarkable sales success whereas balanced funds, which have not been so successful at articulating a single differentiating characteristic, have struggled to maintain market share.

2.6 Investment companies can further segment the target date market based on a fund's use of "to" or "through" glide paths, active or passive investment vehicles and proprietary or non-proprietary managers. The largest provider in any market segment tends to become the default choice so micro-segmentation increases opportunities to achieve this status.

2.7 The truth, however, is that an investor who considers target date funds could reasonably have their needs fulfilled by funds that are not labeled as "target date" or do not have a specific year in their name, such as a target risk fund or a balanced fund.

2.8 Target date funds, target risk funds and balanced funds differ in how they make asset allocation decisions but otherwise they are essentially the same. All of these fund types allocate to multiple asset classes, each rebalances regularly to policy allocations and each seeks to earn some return while managing market, inflation and longevity risks.

2.9 The difference between "to" and "through" glide paths is only the level of exposure to certain higher-risk asset classes at different periods before or after retirement. Simplistically, "to" glide paths are considered less risky than "through" glide paths. However, even a cursory review of the policy glide paths of different providers reveals a "to" glide path that have a higher equity exposure for every target year in the series than certain "through" glide paths and a "through" glide path that has a lower average equity exposure across all target years than multiple "to" glide paths.

2.10 It is also worth noting the mathematical fact that for any policy glide path there is a corresponding fixed allocation that will generate exactly the same expected return with lower volatility. Note also that a target date fund that has passed its landing point becomes, in effect, a balanced fund, with continuing exposure to risky investments.

2.11 While segmentation is a powerful marketing technique, disqualifying a large group of candidates based merely on whether their allocation policy conforms to a particular label ("to", through" or "balanced") can be dangerously sub-optimal. Similarly, while using active investment vehicles might increase costs and a single provider is unlikely to have the best candidate in all asset classes, a skilled investor understands that these disadvantages could easily be offset by other positive attributes and would evaluate all candidates against all relevant criteria before taking a decision.

2.12 The relevant question is whether an investor needs to know what equity risk exposure a candidate fund is taking. If that is true, then no fund should be exempt just because its allocation policy reflected the landing point of a glide path as compared to any other allocation policy. Nor should a fund be exempt simply because of its name or its stated objectives (particularly when those stated objectives are very vague – see section 4.4 below).

2.13 If the Commission mandates disclosures that reinforce fuzzy, label-based segmentation, there is a danger that it will be encouraging investors to make inappropriate decisions based on a limited subset of all relevant evaluation criteria and/or suitable candidates.

2.14 In contrast, we believe that Commission-mandated disclosures of performance and risk will best serve the public interest if they are designed to facilitate evaluation of all relevant criteria across all candidates, within a single, unified and consistent framework without regard to fund names or other labels.

2.15 Such a decision-making framework should enable an investor to accomplish the following steps:

1. Quantify relative importance of all evaluation criteria.
2. Profile all candidates using standardized measurements of success at meeting evaluation criteria.
3. Rate or rank candidates for suitability, reflecting both importance and success.

2.16 This framework should include all relevant criteria and enable an investor to assign different relative importance to the various criteria depending on the investor's current priorities. For example, an investor who is near retirement would likely place greater importance on the level, sustainability (longevity risk) and purchasing power (inflation risk) of fundable retirement income compared to a young investor who might be more interested in maximizing current asset value while minimizing expenses. Whatever the specifics, the important requirement is that variations can be accommodated within a single methodology.

2.17 Fortunately, the methods and tools to build such a framework already exist. Since the 1960s and early 1970s in particular, a number of mathematicians and psychologists have dedicated themselves to developing methods for reliably assessing performance, understanding what is important to consumers and making better capital expenditure decisions. As computers became more powerful, theoretical methods such as Rasch Models, Maximum Difference Scaling and Conjoint Analysis (to name just a few examples) could be transformed into practical tools that have become the cornerstone of modern market research, product development and other applications of multi-criteria decision making, backed by decades of proven success and reliability.

2.18 These tools are already being used by a small group of retirement industry leaders in ways that can transform investment decision-making. Within minutes an investor can reliably assess the suitability of a wide choice of candidates based on a comprehensive set of evaluation criteria that reflect their personal priorities – all without suffering data overload or requiring advanced mathematical skills.

2.19 As an added benefit, the same methods enable service providers to differentiate their solutions in more nuanced ways than the crude labels in use today. Indeed, using these established methods, service providers can more efficiently identify customers for whom their solutions are demonstrably most suitable.

2.20 The Commission asked for comments on the affect its proposed disclosures might have on competition among target date funds and other types of investment options. We do not have any comment on whether the specific proposed disclosures might increase competition but we do believe that a disclosure regime that does not enable investors to directly compare target date funds with all possible substitutes will inevitably increase inefficiencies and reduce effective competition.

Recommendation #1

Bdellium recommends that (a) every information or risk measurement disclosure that is mandated by the Commission should be defined in a manner that would enable any fund, and not just a Target Date Fund, to comply; and (b) such disclosures should be mandated for all investments that are marketed for use in a retirement plan, irrespective of the fund name.

3. Are Disclosures Well-Aligned with Investor Skill Levels?

3.1 These comments in this section are prompted by the following questions that were asked by the Commission:

- *Would fund investors be likely to understand these risk measures and be able to effectively use them in making investment decisions?*
- *Would investors in target date funds be likely to understand risk measures, or any related illustrations based on those measures?*
- *Would one form of the risk-based glide path illustration (e.g., graph) be more easily understandable by investors than another (e.g., table)?*

- *If we require a risk-based glide path illustration, should we require it to be prominent within the materials where it is included? Are there other presentation requirements that would be more appropriate?*
- *Could investors interpret risk-based illustrations as predicting the future returns of the fund?*
- *Would investors be confused if a measure of risk is characterized as "risk"? Should the disclosure of risk measures use the term "risk," or some other term such as volatility, variance, or variability?*
- *Should the terminology distinguish investment risk from other risks, e.g., inflation risk or longevity risk?*
- *Are marketing materials for target date funds an appropriate location for inclusion of a risk-based glide path illustration or other information about risk measures? Should illustrations instead be part of the mandated disclosures in a fund's summary prospectus, statutory prospectus, statement of additional information, shareholder reports, or other reports to the Commission?*

3.2 We suggest that any disclosed information and the methods used to calculate reported measurements should be:

- <u>Simple</u>, so they can be understood
- <u>Transparent</u>, so they can be verified
- <u>Actionable</u>, so they directly support better decision-making; and
- <u>Responsive</u>, so they address each individual's specific needs

3.3 When applying these quality standards to any mandated disclosures, it is necessary to take account of the relevant skill and experience of the target audience. While skill levels differ significantly among individuals we believe that it is useful to think in terms of two representative groups, namely (a) unskilled investors who essentially lack the technical knowledge and experience to independently make sound investment decisions but do so anyway and (b) skilled investors who seek and have the ability to use detailed information and sophisticated methods when evaluating candidate investments.

3.4 Skilled investors tend to have a better understanding of the many trading, operational, agency and enterprise risks to which their investments are exposed, than that of unskilled investors. They also tend to have greater motivation, resources and ability to understand and use sophisticated methods to evaluate candidate investments.

3.5 Bdellium is concerned that while appearing simple or even simplistic to skilled investors, current disclosures might actually be too difficult for a significant proportion of unskilled investors to understand and use safely.

3.6 The 2012 National Financial Capability Study included the following short Financial Literacy Quiz:

Q1. Suppose you have $100 in a savings account earning 2 percent interest a year. After five years, how much would you have? (a) More than $102, (b) Exactly $102, (c) Less than $102, (d) Don't Know.

Q2. Imagine that the interest rate on your savings account is 1 percent a year and inflation is 2 percent a year. After one year, would the money in the account buy more than it does today, exactly the same or less than today? (a) More, (b) Same, (c) Less, (d) Don't Know

Q3. If interest rates rise, what will typically happen to bond prices? Rise, fall, stay the same, or is there no relationship? (a) Rise, (b) Fall, (c) Stay the Same, (d) No Relationship, (d) Don't Know.

Q4. True or false: A 15-year mortgage typically requires higher monthly payments than a 30-year mortgage but the total interest over the life of the loan will be less. (a) True, (b) False, (c) Don't Know

Q5. True or false: Buying a single company's stock usually provides a safer return than a stock mutual fund. (a) True, (b) False, (c) Don't Know.

3.7 In 2012, 61% of US respondents were unable to answer more than three of the five questions correctly and the percentage who could answer 4 or more questions fell from 42% in 2009 to 39% in 2012. Not surprisingly, the Study concluded that "Americans demonstrate relatively low levels of financial literacy and have difficulty applying financial decision-making skills to real life situations." Only 28% of respondents to the Financial Literacy Quiz were able to correctly answer the bond question (Q3). If an investor cannot understand that higher interest rates lead to lower bond prices, they are unlikely to understand risk measurements such as semi-variance or Value-at-Risk or the intricacies of duration hedging retirement income needs.

3.8 The Study also found that "most Americans do not comparison shop for credit cards, with 61% saying that in obtaining their most recent credit card they did not collect and compare information about cards from more than one company." If individuals will not research a familiar product they use every day, how diligently will they apply themselves to evaluate investment products, particularly if that requires them to decipher unfamiliar mathematical formulae?

3.9 Furthermore, only 29% of respondents had consulted a financial professional in the preceding 5 years about savings or investments. Therefore, we cannot assume that unskilled investors simply delegate to advisors and that disclosure need only be intelligible to a skilled audience.

3.10 If a majority of individuals are lacking essential ability, self-application or advice, mandating more of the same type of disclosures is not likely to improve investment decisions.

Bdellium therefore recommends that before mandating additional disclosures, the Commission ensure that both current and any future mandated disclosures are simple, transparent, actionable and responsive enough to serve the needs to their intended users.

3.11 In addition, Bdellium suggests that disclosures intended for use by skilled investors should not be included in a fund's general marketing material or advertisements because (a) if an unskilled investor sees information they do not understand, the investor might be inhibited from further research or (b) an unskilled investor might incorrectly interpret the advanced information and make unsound decisions. We recommend that information intended for skilled investors should be disclosed in the fund's prospectus or Statement of Additional Information, with a notice provided in all general marketing and advertisements of the location at which such advanced information is available.

Recommendation 2

Bdellium recommends that the Commission (a) assess current and proposed disclosures for their effectiveness in addressing the different abilities and needs of skilled and unskilled investors and (b) ensure that mandated disclosures provide skilled and unskilled investors with information that each group can understand, verify and act upon, commensurate with their financial literacy and capability levels.

4. What Disclosures Would Best Serve Unskilled Investors?

4.1 The comments in this section are prompted by the following questions that were asked by the Commission:

- *Could risk information be adequately conveyed to investors using narrative disclosures in lieu of a glide path illustration?*
- *Should a target date fund be required to disclose the same measure or measures that the fund's manager uses to guide its management of the fund, or would other measures be more appropriate?*
- *What means could be used to present risk measures for target date funds in a way that would be understandable to investors?*
- *Would investors be confused if a measure of risk is characterized as "risk"? Should the disclosure of risk measures use the term "risk," or some other term such as volatility, variance, or variability?*
- *How would investor behavior be affected by disclosure of a particular risk measure?*
- *Could disclosure of risk measures influence investors to choose investments that better align with their individual investment objective or could it reduce alignment between investment objectives and investor behavior? For example, could disclosure*

of risk measures influence investors to choose lower or higher risk investments than would be consistent with their goals for accumulating retirement assets?

- *To what extent might special emphasis on investment risk level or asset allocation cause investors to prioritize investment risk at a particular moment in time over longevity risk, inflation risk, or other risks?*
- *Should we require additional disclosure to focus investor attention on inflation risks and longevity risks?*

4.2 Bdellium believes that investors will prioritize risks that are disclosed in marketing materials over risks that are not disclosed. The danger is that investors might believe that the limited range of extremely simplified data presented in mandated disclosures is sufficient to make a reliable investment decision. We need some way to broaden the range of relevant risks that investors recognize and explicitly incorporate into their evaluation of candidate investments. However, for reasons discussed in section 3 above, the approach used must also take account of the demonstrated low level of investor financial literacy.

4.3 An important first step in any evaluation process is to ask what a fund manager intends to achieve and how they prioritize or tradeoff among competing objectives. Enabling unskilled investors to evaluate whether their personal priorities and those of a candidate fund are well-aligned is probably more useful to them than a risk measurement disclosure such as "based on a Monte Carlo simulation, the candidate fund's semi-variance over the next three years is expected to be x".

4.4 The disclosure that most closely addresses this issue is probably the statement of a fund's objectives. Unfortunately, however, statements such as:

> "seeks the highest total return over time consistent with its asset mix"
>
> "seeks to provide capital appreciation and current income consistent with its current asset allocation"
>
> "seeks high total return with a secondary objective of principal preservation"
>
> "seeks the highest total return over time consistent with an emphasis on both capital growth and income"
>
> "investment objectives include long-term growth, long-term growth and income, income and growth, long-term growth and current income and current income"

are both typical and so general or circular as to be almost useless in evaluating different candidates.

4.5 We therefore recommend the disclosure in respect of every investment fund of a prioritized list of objectives, the standardized wording of which would be pre-defined by the Commissions (see recommendation #3 below). Such a prioritized list could easily be used, even by unskilled investors, to evaluate how well the objectives of each candidate investment aligns with their priorities, as follows:

1. The investor numbers each of the objectives on the list from 1 to 13 in the order that best reflects the investor's priorities.
2. For each objective, the investor lines up the priority rank (1 to 13) that they assigned with the priority rank assigned by the investment manager for a candidate fund.
3. For each objective, the investor calculates the difference in the ranks assigned by themselves and the candidate fund and sums all of the differences (ignoring negative signs).
4. The investor repeats steps 2 and 3 for all candidate investments and the candidate with the lowest total number is the most closely aligned with the investor's priorities.

4.6 A skilled investor should also benefit from such a disclosure and, in addition, should reasonably be able to identify quantitative measurements that could be used to assess a candidate investment's success at achieving each of these prioritized objectives. Unskilled investors could be helped to better understand how successful each fund is at achieving each of the 13 objectives by following recommendation #5 in section 6 below.

Recommendation #3

Bdellium recommends that the Commission require the following list of investment objectives to be prioritized and disclosed to every prospective investor in respect of each fund that is offered as a retirement investment:

- *Maximize the current value of investments*
- *Maximize fundable retirement income*
- *Reduce the risk of outliving available retirement income (longevity risk)*
- *Preserve the purchasing power of investment assets (inflation risk)*
- *Reduce the risk of losing money in down markets*
- *Avoid any sudden large losses*
- *Achieve a stable fixed return irrespective of market changes*

- *Closely track the ups and downs of the markets*
- *Never achieve a lower return than the market average*
- *Do not invest in high risk assets such as high yield bonds, derivatives or unlisted stocks*
- *Diversify risk by spreading investments over many different asset classes, markets and sectors*
- *Minimize fund expenses*
- *Allow the fund manager freedom to make independent decisions (agency risk)*

5. What Asset Allocation Disclosure Should the Commission Prescribe?

5.1 The comments in this section are prompted by the following questions that were asked by the Commission:

- *Would the proposed disclosure of asset allocations effectively convey the level of a fund's investment risk to investors?*
- *Would the proposed disclosure of asset allocations adequately convey [all of] the risks associated with a target date fund?*
- *Might the emphasis on asset allocation cause investors to prioritize investment risk over longevity, inflation risk, or other risks?*
- *Might fund managers take more risk than the asset allocation would reflect?*
- *Would the proposed asset allocation glide path illustration, without a risk-based glide path illustration, adequately convey risk information to investors?*
- *If not, would an asset allocation glide path illustration alone adequately convey risk information if we specify the particular asset categories required to be shown?*
- *Would the inclusion of two glide path illustrations in the same document tend to confuse investors, and, if so, how could the information be presented in a way that would minimize any confusion?*
- *What are the advantages and disadvantages of asset allocation glide paths and risk-based glide paths relative to each other?*

5.2 In 2010 the Commission proposed a requirement that certain marketing materials for target date funds include a table, chart or graph depicting the fund's asset allocation over time i.e. an illustration of the fund's so-called asset-allocation glide path. This requirement was intended to ensure that investors receive basic information about the glide path in the fund marketing material.

5.3 Bdellium agrees that investors should understand clearly the holdings of the investment offering and since it often changes, either by manager discretion or by market forces or by changes in allocation philosophy, this needs to be addressed in a manner that permits comparison to other available options.

5.4 Currently the most common method used to represent a target date fund's glide path is a line graph that shows years before and after retirement on the x-axis and percentage of the total portfolio invested in equities on the y-axis. Such a graphic can serve a useful purpose in communicating clearly to investors that allocations change over time. However, the chart has a number of deficiencies, namely:

- It would be practically difficult even for a skilled investor to visually compare graphs from separate disclosure documents for multiple funds, given that the design and scaling of the graphs would likely be different in each case;
- Because there is currently no standardized definition of asset classes or standard rules for the representation of glide paths, the information currently provided by different investment companies is not always compatible;
- If the glide paths for multiple target date series were to be presented on a single graph with a common construction method and scales, it is practically impossible to interpret the relative risk-exposures of multiple glide paths solely from the various shapes of multiple line graphs; and
- The difficulty of interpreting the graphic is compounded in cases where the simple line graph is replaced by a stacked area graph, with each color-coded area represents one of multiple asset classes.

5.5 As noted by the Commission,

> "In April 2013, the Investor Advisory Committee … stated that "choices of assets within various asset classes … can also have a significant impact on fund risk levels. The Committee also stated that asset allocation may mask significant differences in risk levels of funds with apparently similar or even identical asset allocation glide paths, particularly when asset classes are defined broadly. The Committee therefore opined that a glide path illustration based on an appropriate, standardized measure of fund risk would be more accurate than an illustration based on asset allocation alone."

5.6 Bdellium agrees with the Committee's statement of the problem but suggests a different solution to that of a prescribing a risk-based glide path illustration. We begin with the idea that a simple disclosure should be required in marketing material for use by unskilled investors, with a more detailed disclosure being made available in the fund's prospectus for use by skilled investors.

5.7 Our second suggestion is that for the purpose of the proposed disclosure, the Commission should designate different types of investments as either "risk-assets" or "reserve-assets"). We would expect that all equities (both listed and unlisted) would fall into the risk-asset group and, in addition, high-yield bonds, unhedged non-USD bonds, derivative contracts and real estate could reasonably be included. Alternatively, the Commission could require that any security (whether a collective investment or a single security) in which the fund is invested that had a trailing 3-year volatility in excess of a specified threshold should be included as a risk-asset.

5.8 The time period over which asset allocations should be disclosed also needs to be standardized to facilitate comparisons. We recommend that this period should range from 45 years before retirement to 15 years after retirement and that all disclosures should be based on the asset allocations at the end of each calendar year. We acknowledge that this is a very broad range and that the values will be identical for a number of years at both ends of the range, but that will ensure that we always have a comparable set of data.

5.9 We then suggest that for unskilled investors, the fund's marketing material would show a simple line graph in which the x-axis covers the proposed 60-year period and the y-axis reports the percentage of the portfolio allocated, in aggregate, to "risk-assets" each year. This disclosure should also be accompanied by a note that states how frequently and in what month (e.g. every year on or around June 30th" or "every 3 years on or around December 31st") the fund's allocations are rebalanced to match the disclosed allocations.

5.10 For skilled investors, we recommend that the prospectus contain a table showing the allocations at the end of each year to each of the asset classes that constitute both the risk-assets and reserve-assets. This detailed disclosure is currently not readily available to the public and would be very useful as raw material for advanced risk analysis.

5.11 We think that by classifying assets as 'risk assets' or 'reserve assets', the Commission's asset allocation disclosure proposal could address the main points made by the Investor Advisory Committee without requiring a second graph or set of data.

Recommendation #4

Bdellium recommends that the Commission specify a method for designating different investments as either 'risk-assets' or 'reserve-assets' and require each fund that is offered as a retirement investment to make the following risk-allocation disclosures:

A line graph to be displayed in each fund's marketing materials, showing the policy allocation to risk assets at the end of each calendar year beginning 45 years prior to retirement and ending 15 years after retirement;

A table to be included in the fund prospectus showing the categorization (i.e. 'risk asset' or 'reserve asset') and percentage allocated to each asset class for each of the years from 45 before retirement to 15 years after retirement.

6. Should The Commission Prescribe Specific Risk Measurements?

6.1 The comments in this section are prompted by the following questions that were asked by the Commission:

- *If we require a risk-based glide path illustration, should we prescribe the format of the risk-based glide path illustration in order to enhance comparability for investors?*
- *Should we try to enhance comparability among target date funds by prescribing a standardized methodology for computing a fund's historical and/or projected risk levels? What are the parameters and assumptions that the Commission would need to specify in order to prescribe a standardized methodology, e.g., the measures to be used, benchmarks, time periods over which calculated?*
- *Should the rule require disclosure of a risk rating based on a scale or index that could be compared to other target date funds.*
- *Should the rules require a glide path illustration for target date funds that is based on a standardized measure of fund risk as either a replacement for, or supplement to, the proposed asset allocation glide path illustration?*
- *What would be the benefits and costs of requiring a glide path illustration for target date funds that is based on a standardized measure of fund risk as either a replacement for, or supplement to, our proposed asset allocation glide path illustration and adopting a standard methodology or methodologies to be used in the risk-based glide path illustration?*
- *If the rules should require a risk-based glide path, what risk measure(s) should be prescribed and how should the risk measures be presented?*
- *Is there a particular quantitative risk measure, or group of risk measures, that are helpful in evaluating the risks of target date funds?*

- *Are there useful measures of risk that reflect longevity and inflation risk as well as investment risk?*
- *Should the risk measure reflect the variance, or volatility, in returns around the fund's average return?*
- *Should the measure, instead, reflect the sensitivity of the portfolio's return to the market's return?*
- *Should these risk measures reflect the characteristics of nominal returns or real returns, which account for the effect of inflation?*
- *Persons submitting comments are also asked to describe as specifically as possible the computation method they would recommend for any quantitative risk measure they favor. For example, persons favoring standard deviation should specify whether monthly returns, quarterly returns, or returns over some other period should be used. As another example, persons favoring beta should describe the benchmark or benchmarks that should be used. Persons submitting comments are also asked to discuss the benefits and limitations associated with their recommended method of computation.*
- *For risk measures that are calculated using a benchmark index (e.g., beta), what issues, if any, are associated with the selection of an appropriate benchmark?*
- *In determining an appropriate measure of risk, how should various aspects of risk be considered?*
- *Should the risk measure reflect the variance, or volatility, in returns around the fund's average return?*
- *Should some other type of risk measure be used?*
- *Should expected return information be provided as a statistic separate from risk measures or integrated with risk measures as with a confidence interval for returns?*
- *Can quantitative risk measures be manipulated, and how do the various measures differ in their susceptibility to manipulation? How can the potential for such manipulation be reduced or eliminated?*

6.2 The best way to select an investment is to evaluate all candidates against a common set of criteria using a standard set of measurements. The Commission recognizes that for reliable comparative analysis, each measurement used to evaluate candidates must be calculated using the same formula. Understandably, the Commission has therefore asked for comments on what measurements, calculation methods and presentation format it should prescribe for this purpose. However, for the reasons discussed below, Bdellium's view is that the Commission should not define or require disclosure of any specific risk measurement(s) but should take other steps detailed below to protect investors.

6.3 Any risk disclosures that the Commission prescribes should be both necessary and sufficient for their purpose. Obviously, they must be necessary because otherwise the Commission would be wasting the time and resources of investment companies and investors.

By “sufficient” we mean that if an investors were to consider only the prescribed risk disclosures they would have sufficient information to make a sound decision.

6.4 By definition, unskilled investors do not know the full range of risks they face, they are unlikely to understand most of the more advanced risk measurements used in the industry and they cannot independently assess whether any particular set of risk measurements is sufficient to make a sound decision. For example, if mandated disclosures focus on glide path, returns, volatility and expenses, investors might fail to adequately investigate many other criteria that they should take into account when selecting an investment, including (but not limited to):

- Diversification across and within major asset classes
- Exposure to high-risk investments
- Downside Correlation
- Credit Quality
- Inflation Protection
- Duration
- Quality of Governance and Oversight
- Manager Tenure and Experience

6.5 One solution might be to require a statement in marketing materials listing these criteria and recommending that an investor should include these in any evaluation of candidate investments. However, our concern is that if unskilled investors see every fund disclosing the same risk data and know that this has been mandated by the Commission, they will ignore risks that are not explicitly included in the disclosures *even if warned of the fact that the disclosures are not complete*.

6.6 How should the Commission mitigate the risk that prescribing a limited set of risk disclosures to serve skilled investors might cause dangerous risk-myopia for unskilled ones? Even if the Commission could and would take on the task of prescribing a comprehensive set of measurements that address all essential market, inflation, longevity and agency risks the problem, as discussed in Section 3 above, is that unskilled investors (who constitute the majority), are unlikely to have the ability or attention span to absorb so much detail. Also, the more the Commission prescribes standard calculation methods, the more difficult it would become to implement changes, which would probably discourage the development and use of innovative measurements.

6.7 Bdellium’s approach is to tailor different solutions for each skill level. To help unskilled investors we recommend that funds be required to explain in non-technical English what steps they take to achieve each the 13 objectives described in recommendation #3 above and how successful they believe they are relative to their competitors at achieving each. We recognize that since the answers provided by each fund would not be in a standard format or use common measurements, they would not support a quantitative comparative analysis. Nonetheless, in combination with the prioritization of objectives in recommendation #3 above, we believe that this proposed self-explanation and assessment could be of more practical benefit to unskilled investors than almost any quantitative risk measurement.

6.8 Unskilled investors are less likely than skilled investors to be willing or able to seek out information and conduct a careful evaluation of multiple candidates. We therefore expect that their decisions will be most heavily influenced by the information available to them solely from a single fund's marketing material and prospectus. For that reason providing a more holistic and understandable assessment of each individual fund, even at the expense of standardization across funds, seems like a reasonable tradeoff.

6.9 For skilled investors, having access to pre-calculated standardized risk measurements might also be less critical than (a) having access to raw data that they can use to calculate their own risk measurements and (b) they understand exactly how any disclosed measurement was calculated. Consider for example that:

1. The results for even a relatively common measurement such as a Sharpe Ratio will vary significantly depending on how the "risk-free rate" is determined.

2. While many funds report holdings using what appear to be similar labels, the underlying definition of "large value" or "mid-core" used by the reporting entities can be sufficiently different to significantly undermine the validity of any direct comparison.

3. Many advanced risk measurements, particularly those that aim to estimate future outcomes, use simulation methods to derive their results. Without detailed information about the assumptions used in such simulations, an investor is completely dependent not only on the good faith but also the skill and diligence of the creator of the model. Furthermore, it is not unusual for different models to produce quite different answers to the same question. For example, in the recent past one published study concluded that "to" glide paths are generally more suitable for all investors while a few weeks later a second study concluded that "through" glide paths generally delivered better results. Both studies use simulations to support their conclusions but without knowing in detail how those simulations were constructed, even a skilled investor could not reliably determine to what extent each study's conclusions are valid.

6.10 Bdellium requests that the Commission grant investment companies broad latitude in the measurements they may disclose, provided that the calculation method used for each measurement is also disclosed.

6.11 Investment companies might believe that keeping their calculation methods secret is necessary to protect competitive advantage. However, the Commission must balance these concerns against past experience where the assumption that 'black-box' models were safe proved to be dangerously incorrect[1]. Furthermore, to reference the experience of another highly competitive industry, the Open Source software movement has demonstrated the value of transparency for ensuring better, safer performance without eliminating opportunities to profit from superior skill and service quality.

Recommendation #5

Bdellium recommends that every investment company should be required to provide an explanation, in non-technical language, of what measures they take to achieve each of the 13 prioritized objectives specified in recommendation #3 above, and also a self-assessment of how well they are succeeding at achieving each objective.

Recommendation #6

Bdellium recommends that every investment company should be required to provide an explanation and worked example or how it has calculated each performance or risk measurement that it uses in advertisements and supplemental sales material, sufficient to enable a third party to reproduce the result. These explanations should be publically accessible in electronic format over the internet.

7. Conclusion

7.1 We would be pleased to discuss any of these concepts with all parties or provide elaboration of our views if that would be helpful. We would be pleased to assist the Securities and Exchange Commission in any way that might be helpful.

Respectfully submitted,

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[1] See http://bdellium.com/2011/10/24/lessons-from-the-copula-function/