

Financial Services and Products ADVISORY

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SEC Proposes Rules for Marketing and Naming of Target Date Retirement Funds

On June 16, 2010, the Securities and Exchange Commission (SEC) proposed several amendments to its investment company advertising rules to help clarify the meaning of a “date” in target date funds¹ and enhance the information provided to investors in these funds as they invest for retirement. Generally, target date funds are attractive to investors because they rebalance allocation among asset classes automatically, without investor action. The proposed amendments to Rule 482 (“Rule 482”) of the Securities Act of 1933, as amended, (the “Securities Act”) and Rule 34b-1 (“Rule 34b-1”) of the Investment Company Act of 1940, as amended, aim to reduce the potential for investors to be confused or misled by simplistic target date fund presentations (the “Proposal”). The Proposal addresses the marketing and naming of target date funds in order to (i) better capture the divergent asset management practices among target date funds with similar names; and (ii) disclose that target date funds are not guaranteed investments and should not be chosen based purely on age or retirement date. Specifically, the Proposal, which would apply to advertisements and supplemental sales literature that place a “more than insubstantial focus on one or more target date funds,” would:

- require target date funds whose names include their target date to disclose their asset allocation at the target date immediately following the first time the funds’ names are used in marketing materials;
- require marketing materials used by a target date fund to contain a table, chart or graph showing the fund’s asset allocation over time, coupled with a statement highlighting the fund’s final asset allocation; and
- require a target date fund’s marketing materials to include a statement advising investors that they should not invest in the fund based solely on their age or retirement date, that an investment in the fund is not guaranteed and that the asset allocation of the fund is subject to change.

It also contains amendments to Rule 156 of the Securities Act that would provide additional guidance regarding statements in marketing materials for target date funds and other investment companies that could be misleading.

Comments on the proposed amendments must be received by the SEC on or before **August 23, 2010**.

¹ For the purpose of the Proposal, a “target date fund” is defined as an investment company that has an objective or strategy of providing varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed-income exposures that changes over time based on an investor’s age, target retirement date or life expectancy.

Background

Target date funds allow investors to receive the benefits of a diverse portfolio without having to manage their portfolios personally, as assets are automatically rebalanced based on the stated target date of the fund. Each target date fund is intended for investors whose anticipated retirement date approximately matches the stated target date of that fund. Generally, as the target date approaches, the asset allocation of the fund becomes more conservative, tending to shift away from equity exposure. The scheduled reduction in equity exposure as the target date nears is commonly referred to as a fund's "glide path." The point at which the asset allocation becomes static is referred to as a fund's "landing point."

While target date funds may offer investors an easy means of holding a diverse portfolio, they also carry the risk that investors will choose a fund solely on the basis of the fund's target date, without giving consideration to other factors such as the fund's portfolio composition. Market losses suffered by target date funds in 2008 gave rise to a number of concerns about the funds. Despite having the same stated target date, these funds often used widely divergent glide paths based upon whether the landing point was expected to fall on the target date or at some significant time after the target date. For instance, the SEC noted that different funds with the same stated target date suffered losses ranging from nine percent to 41 percent in 2008. Differing glide paths result in differing equity exposure, thereby exposing investors in some funds to greater losses than investors in other funds bearing the same target date. The SEC has expressed concern that investors may assume that most of their assets will be invested conservatively at the target date or that all funds with the same target date are managed similarly. The SEC has also noted that the marketing materials for target date funds have the potential to present an overly simplistic picture that fails to capture the target date funds' management strategies and how they may accord with an investor's individual needs.

Content Requirements for Target Date Funds Marketing Materials

In an effort to eliminate these concerns, the Proposal, which would apply to advertisements and supplemental sales literature that place a "more than insubstantial focus on one or more target date funds,"² would require the following:

1. Disclosure of Asset Allocation for Funds with a Target Date in Their Name

The Proposal would require a target date fund that includes the target date in its name to disclose, at the first use of the name, the asset allocation of the fund at the target date. Specifically, the Proposal would amend Rule 482 and Rule 34b-1 to require any advertisement or supplemental sales literature that refers to a target date fund whose name includes a date (including a year) to disclose the percentage allocations of the fund among types of investments.

² Under the Proposal, whether an advertisement or supplemental sales literature places a more than insubstantial focus on one or more target date funds would depend on the particular facts and circumstances. Generally, "materials that relate exclusively to one or more Target Date Funds would be covered," as well as "materials that cover a broad range of funds, such as a bound volume of fact sheets that include Target Date Funds or a Web site that includes Web pages for Target Date Funds." However, "materials that may not be primarily focused on marketing Target Date Funds to investors (e.g., a complete list of each fund within a fund complex, together with its performance)" would not be covered.

- **Advertisements Used Prior to Target Date.** Any such marketing materials submitted for publication or use prior to the stated target date must disclose the fund's intended asset allocation as of the stated target date, and must clearly indicate that the allocations provided are as of that date.
- **Advertisements Used After Target Date.** Marketing materials submitted for use or publication after the stated target date must disclose the fund's actual asset allocations as of the most recent calendar quarter ended prior to the use or publication of the advertisement or supplemental sales literature, and must clearly indicate that the allocations provided are as of that date. The Proposal would require that the current allocation be used starting on January 1 of the target date year, even if the fund is expected to reach its target date later in that year.

These disclosures must appear immediately adjacent to (or, in the case of radio or television advertisements, immediately following) the first use of the fund's name and must be presented in a manner that attracts investor attention.

While the Proposal would require the disclosure of the asset allocation among types of investments, they do not prescribe the asset classes to be used in such disclosure, nor do they specify a methodology to be used in determining percentage allocations, leaving each target date fund to make these determinations on its own. The Proposal does make clear that target date funds must disclose the percentage allocations of investments in underlying asset classes, whether such investments are made directly or through underlying funds, rather than disclosing the percentage allocations of investments in types of investment companies.

Any disclosures of asset allocations made by target date funds are subject to the antifraud provisions of the federal securities laws, as well as to Section 12(a)(2) of the Securities Act, which imposes liability for materially false or misleading prospectuses or oral communications. If a target date fund chooses to disclose a range of potential percentages for allocations to various asset classes at the target date, such ranges (1) should be consistent with disclosures made in the fund's prospectus; (2) should not be overly broad; and (3) should not be intended to replace the specific allocations disclosed in the prospectus. Target date funds should not disclose a range of potential allocations with the intention of only investing at one end of that range.

Request for Comments. The SEC is seeking comment on these proposed amendments. Specifically, it has asked whether the proposed method set forth for disclosing target date asset allocations adequately conveys investment risks, so as to prevent investors from being misled or confused, or whether additional disclosure or disclaimers (e.g., a risk rating based on a scale or index that could be compared to other funds) should be required. If the proposed method is appropriate, the SEC is seeking comment on whether (1) the asset allocation disclosure requirements should apply only if the target date fund's name contains the target date; (2) the proposed method for disclosing asset allocation is sufficient as to format and content; (3) the SEC should provide a standard methodology for calculating fund asset allocations and applicable categories of investments; and (4) the landing point should be used as a disclosure milestone in place of the target date. In the alternative, the SEC is seeking comment on whether the use of a date in a target fund date name should be prohibited.

2. Asset Allocation Table, Chart or Graph

The Proposal would require that printed or electronically delivered marketing materials “include a prominent table, chart, or graph that clearly depicts the percentage allocations among types of investments (e.g., equity securities, fixed income securities, and cash and cash equivalents) over the entire life of the fund or funds at identified periodic intervals that are no longer than five years in duration.” The table, chart or graph must clearly depict the percentage allocations among types of investments at various points, including inception of the fund, the target date, the landing point and, where specific to a particular fund, the close of the most recent calendar quarter.³ This requirement would apply to all target date funds, regardless of whether or not the target date is included in the fund’s name.

The table, chart or graph is intended to provide investors with basic information regarding the target date fund’s glide path.

- **Single Target Date Fund Advertisements.** The table, chart or graph contained in marketing materials that relate to a single target date fund must specify (1) the actual percentage allocations among types of investments for the period running from the fund’s inception to the end of the most recent calendar quarter prior to the submission of the marketing materials for publication; and (2) the future intended percentage allocations of the fund. Specific dates must be used when referencing the inception date, the target date, the landing point and the most recent calendar quarter.
- **Multiple Target Date Fund Advertisements.** Tables, charts and graphs contained in marketing materials that relate to multiple target date funds with different target dates but similar glide paths may present either a chart for each fund that meets the requirements detailed above or a single table, chart or graph identifying the intended asset allocations of the funds among investment types over periodic intervals and at the required points using numbers of years before and after the target date.

Target date funds whose asset allocations vary within a range must disclose such range in their tables, charts or graphs. In the case of single funds, ranges may only be used for future periods.

Required Legend. Tables, charts and graphs contained in marketing materials pertaining to a single target date fund that are submitted for publication prior to the landing point or multiple target date funds with different target dates but the same pattern of asset allocations must be immediately preceded by a statement explaining the table, chart or graph. Such statements must include:

- an explanation that asset allocation changes over time;
- the landing point (or in the case of a table, chart or graph for multiple target date funds, the number of years after the target date at which the landing point will be reached) and the intended percentage allocations among types of investments (e.g., equity securities, fixed income securities, and cash and cash equivalents) at the landing point; and

³ For the purpose of the Proposal, “target date” is defined as the date indicated in the name of the fund or the date described in the fund’s prospectus as the approximate date at which the investor intends to retire or cease purchasing shares of the fund, while “landing point” would be defined as the point at which the asset allocation first reaches its final balance among types of investments.

- whether, and the extent to which, the intended percentage allocations among types of investments may be modified without a shareholder vote.

The Proposal does not contain any specific presentation requirements for this statement other than the requirement that it immediately precede the table, chart or graph to which it pertains. Such statements are not required for marketing materials relating to a single target date fund that are submitted for publication on or after the landing point.

Request for Comment. The SEC is seeking comment on these proposed amendments. Specifically, it is seeking comment as to whether (1) the proposed definition of “target date” is appropriate; (2) the Proposal should apply only to target date funds whose names contain their target dates; (3) the proposed table, chart or graph will be helpful to investors and whether the requirements for such are appropriate as set out; (4) the distinctions between marketing materials for multiple funds and single funds are useful; (5) the statement required to precede tables, charts and graphs will prove useful to investors; and (6) the proposed amendments relating to radio and television advertisements are sufficient.

3. Statement of Risk

The Proposal would require that marketing materials pertaining to target date funds include a statement informing investors of the particular risks and considerations relevant to their decision to invest in a target date fund. This statement would be subject to the presentation requirements that currently apply to other important legend disclosures under Rule 482 and Rule 34b-1, and must advise investors of the following:

- that factors such as the investor’s risk tolerance, personal circumstances and complete financial situation should be considered in addition to the investor’s age or anticipated retirement date;
- that an investment in the target date fund is not guaranteed and that it is possible to lose money by investing in the target date fund, including at or after the stated target date; and
- whether, and the extent to which, the intended asset allocations can be altered without a shareholder vote, if such information is not already disclosed pursuant to the amendment proposed above.

This statement would be required for marketing materials of all target date funds, including those that do not contain a target date in their names.

Request for Comment. The SEC has requested comment on whether (1) the proposed amendments should apply only to target date funds that contain the target date in their name; (2) the required statement will be effective in alerting investors to important risks and considerations; (3) the presentation requirements under Rule 482 and Rule 34b-1 should apply to the required statement; and (4) any additional rule amendments might be helpful in addressing concerns regarding target date fund marketing materials.

4. Television and Radio Advertisements

Television and radio advertisements that are submitted for use prior to the landing point and that refer to a target date fund whose name includes the target date must disclose the landing point, explain that the asset allocation becomes fixed at the landing point and disclose the intended percentage allocations of the fund among types of investments at the landing point.

5. Compliance Date

If the content requirements for target date funds marketing materials are adopted, target date fund advertisements and supplemental sales literature that are used 90 days or more after the effective date of the amendments would be required to comply with the amendments.

Antifraud Guidance

Amendments to Rule 156

The proposed amendments also include revisions to Rule 156 of the Securities Act (“Rule 156”), which relates to whether a statement in an investment fund’s marketing materials could be considered misleading. The proposed amendment to Rule 156 would provide that statements suggesting the appropriateness of an investment in the securities of an investment company could be misleading in two circumstances: (1) because of the emphasis they place on a single factor, such as the investor’s age or tax bracket, as the basis for determining that an investment is appropriate; and (2) because of representations, express or implied, that investing in such securities is a simple investment plan or that it requires little or no monitoring by the investor.

If adopted, these proposed amendments to Rule 156 would apply to all types of investment companies, not just target date funds.

The SEC is seeking comment on whether this amendment is appropriate, whether it should apply to all investment companies or only target date funds, the effect it will have on target date fund marketing materials and whether any other factors should be included in the amendments as examples of single factors that could be overemphasized in determining whether an investment is appropriate.

If the antifraud guidance is adopted, these amendments to Rule 156 would be effective immediately.

Additional Requests for Comment on Prospectus Disclosure Requirements

While the Proposal does not contain amendments to the prospectus disclosure requirements, the SEC is nonetheless seeking comment on possible changes to those requirements. Specifically, the SEC is seeking comment on whether Form N-1A should be amended to provide specific requirements for target date funds. The SEC is also seeking comment on whether target date fund prospectuses and/or statements of additional information should be expressly required to disclose:

- the fund’s landing point and whether the fund is being managed “to” or “through” such date;
- the underlying assumptions that led the target date fund manager to select the fund’s current glide path;
- the flexibility retained by the target date fund manager to change the glide path in the future, as well as the number of times the manager has changed the glide path in the past;
- the latitude the fund has to deviate from its stated glide path, the circumstances under which it may deviate from its stated glide path, past instances when it has deviated from its stated glide path and the reasons for any past deviations; and
- the use of any commodities, derivatives or other alternative investments.

Finally, the SEC is seeking comment on whether these additional requirements, if proposed and adopted, should be included in the prospectus or the statement of additional information.

Coordination with DOL Safe Harbor for Qualified Default Investment Alternatives

Both the SEC and the Department of Labor (DOL) have concerns about how target date funds are communicated to investors, which in the case of a defined contribution retirement plan governed by the Employee Retirement Income Security Act of 1974 (ERISA), as amended, includes plan participants. In fact, both the SEC and the DOL conducted joint hearings on target date funds on June 18, 2009, and jointly issued guidance on May 6, 2010, to help investors and plan participants better understand the operations and risks of target date fund investments. The SEC's Proposal arose out of those joint efforts.

We anticipate that the DOL will issue additional guidance and possibly take some form of regulatory action by the end of 2010 in order to address its concerns regarding the accurate communication of certain aspects of target date funds and how that communication process correlates to taking advantage of the safe harbor provided under section 404(c)(5) of ERISA for qualified default investment alternatives (QDIAs). Because many advisers of target date funds or their affiliates also prepare communications on behalf of their retirement plan clients who wish to avail themselves of the QDIA safe harbor (e.g., annual QDIA notices), those advisers and their affiliates should consider how future DOL guidance will impact said communication materials and any necessary coordination between the Proposal and the DOL's regulatory efforts.

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For the full text of the proposed rule amendments, please visit <http://www.sec.gov/rules/proposed/2010/33-9126.pdf>

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