

DEPARTMENT OF LABOR AND SEC ISSUE GUIDANCE ON TARGET DATE FUNDS

On May 6, 2010, the Department of Labor (“DOL”) and the Securities and Exchange Commission (“SEC”) jointly issued an investor bulletin to help investors and plan participants better understand the operations and risks of target date fund investments. Subsequently, the SEC voted unanimously on June 16, 2010 to propose tougher disclosure rules on the investment companies that offer target date funds as an investment option. These proposals are designed to increase awareness of both the value and risks associated with target date funds.

Target date funds (also known as “lifecycle funds”) are commonly offered as investment options in 401(k) and other participant-directed retirement plans in part because they were approved by the DOL as a Qualified Default Investment Alternative (“QDIA”) in a DOL regulation adopted October 2007. Designed to become more conservative as the pre-set target date (generally, a participants retirement date) approaches, target date funds simplify long-term investing by automatically changing the asset allocation among different types of investments over time. However, these funds are not as simple as they seem upon first glance and must be carefully examined by plan sponsors and communicated to protect plan participants.

For example, a target date fund does not guarantee retirement income at the target date nor does it guarantee that an investor will not lose money. Furthermore, target date funds that share the same target date may have very different investment strategies and risks.

The DOL and SEC recommend that, before investing in a target date fund, investors and plan participants do the following: (1) consider their investment style; (2) look at the fund’s prospectus to see where the fund will invest the money; (3) understand how the asset allocation will change over time; (4) take into account when they will need to access the money in the funds; and, (5) examine the fund’s fees.

The target date fund’s inclusion as a category of permissible investments in the DOL’s QDIA regulation has increased the popularity of target date funds. Because target date funds can be used as a QDIA, employers are protected from liability when investing an employee’s contribution in a target date fund,



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when that employee has not given investment directions. A fiduciary that complies with the QDIA regulation will not be liable for any loss or breach that occurs as a result of plan participants being defaulted in a QDIA.

However, the DOL guidance on QDIAs is clear that this fiduciary protection is not unlimited. As fiduciaries, plan sponsors are obligated to act prudently in selecting and monitoring all investment choices – neither QDIAs nor target date funds change this fiduciary requirement. Plan sponsors who fail to follow the QDIA regulation can be exposed to significant fiduciary risk, even when the investments involved are target date funds.

The DOL plans to release a proposed amendment to the QDIA regulation in August 2010. This amendment is expected to require that plan participants are given comprehensive information so they can better evaluate the target date funds that have been selected as their plans' default investments. The DOL intends that the information in the QDIA notice is consistent with the information disclosed to plan participants who actively make decisions among their plans' investment options.

We will update you with a detailed analysis of the amendment to the QDIA regulation when it is released.

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