TRANSAMERICA CENTER FOR RETIREMENT STUDIES®

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TCRS 2010-11: DOL Proposed Regulations On Target Date Funds

On November 30, 2010, the Department of Labor (DOL) published proposed regulations imposing additional disclosure requirements relating to Target Date Funds and similar investments (TDFs).

Briefly, a TDF is an investment vehicle in which the asset allocation adjusts over time, which is typically intended to reduce the potential for investment volatility as an employee approaches retirement age. A TDF may consist of a mix of other funds, referred to as the underlying funds.

The regulations contain proposed amendments to the Qualified Default Investment Alternative (QDIA) final regulations published on October 24, 2007, and to the Participant Fee Disclosure final regulations published on October 20, 2010.

Effective Date

The regulations are proposed to be effective 90 days after publication of final regulations in the Federal Register.

Background

The QDIA regulations provide limited relief from certain fiduciary responsibilities for fiduciaries of participant-directed individual account plans who invest a participant's accounts in a QDIA absent investment direction from the participant. If the requirements of the QDIA regulations are satisfied, plan fiduciaries will not be liable for any loss that is the direct and necessary result of investing a participant's account in the QDIA.

The Participant Fee Disclosure regulations require the disclosure of certain information regarding the plan as well as information regarding the designated investment alternatives available under such plan.

Since publication of the QDIA final regulations, which included TDFs as one of the permissible categories of QDIAs, the popularity of TDFs has grown significantly. This popularity has led to a focus on issues relating to the design, operation and selection of TDFs as a QDIA.

After the significant losses of 2008 and 2009 in certain TDFs nearing their target retirement date, the Senate Special Committee on Aging held a hearing that focused on regulating TDFs. The DOL and the Securities and Exchange Commission (SEC) were requested to evaluate TDFs and determine whether additional guidance would be necessary. In mid 2009, following a one-day hearing on TDFs, the DOL and the SEC indicated that they were considering additional guidance on TDFs. In May, 2010, the DOL and the SEC jointly issued an investor bulletin, positioned as a primer on TDFs for retirement plan investors, which provided information on the basics of TDFs and how an investor should evaluate a TDF. The investor bulletin also advised investors not to rely solely on the date stated in the TDF. Instead, the investor should consider the TDF's asset allocation over time and at the chosen target date. Following release of the investor bulletin, the SEC issued a proposed regulation, in June, 2010, that focused on the manner in which TDFs that are mutual funds are named and described in various marketing collateral. According to the SEC, the proposed regulation would help investors assess the risks associated with TDFs and gain a better understanding of a particular TDF's "glide-path" (i.e. the shift in holdings from stocks to less volatile bonds and cash as the target date nears).

The DOL indicated that it intends to publish a series of tips designed to assist plan fiduciaries in obtaining and evaluating relevant information when selecting and monitoring TDFs as investments in participant-directed individual account plans.

QDIA Amendments

The proposed amendments to the QDIA regulations are designed to provide more specificity as to the information that must be disclosed in the required notice to participants and beneficiaries concerning investments in QDIAs, including TDFs. The DOL believes that the amendments will ensure plan fiduciaries understand the specific investment information that must be disclosed about QDIAs and to better conform the requirements to those in the Participant Fee Disclosure regulations.

The proposed amendments to the QDIA regulations would require plan fiduciaries to provide participants and beneficiaries with information similar to what is required to be disclosed in the Participant Fee Disclosure regulations.

The proposed regulations also modify and expand on the notice requirements for all QDIAs, which require plan fiduciaries to provide participants and beneficiaries a description of the QDIA, including:

- The name of the investment issuer;
- The investment's objectives or goals;
- The investment's principal strategies (including a general description of the types of assets held by the QDIA) and principal risks;
- The investment's historical performance data and a statement indicating that an investment's past performance is not necessarily an indication of future performance, and, if applicable, a description of any fixed return, annuity, guarantee, death benefit, or other ancillary features; and
- The investment's attendant fees and expenses, including: any fees charged directly against the amount invested in connection with acquisition, sale, transfer of, or withdrawal (e.g. commissions, sales loads, sales charges, deferred sales charges, redemption fees, surrender charges, exchange fees, account fees and purchase fees); any annual operating expenses (e.g. expense ratio); and any ongoing expenses in addition to annual operating expenses (e.g. mortality and expense fees).

For a TDF and to the extent the information is not already disclosed above:

- An explanation of the asset allocation, how the asset allocation will change over time, and the point in time when the investment will reach its most conservative asset allocation, including a chart, table, or other graphical representation that illustrates such change in asset allocation over time and that does not obscure or impede a participant's or beneficiary's understanding of the information explained in this paragraph;
- If the alternative is named, or otherwise described, with reference to a particular date (e.g., a target date), an explanation of the age group for whom the alternative is designed, the relevance of the date, and any assumptions about a participant's or beneficiary's contribution and withdrawal intentions on or after such date; and
- A statement that the participant or beneficiary may lose money by investing in the alternative, including losses near and following retirement, and that there is no guarantee that the alternative will provide adequate retirement income.

Participant Fee Disclosure Amendment

To ensure all participants and beneficiaries receive the same information regarding TDFs, the proposed regulations would amend the Participant Fee Disclosure regulations to require fiduciaries to provide participants with the same three disclosure elements described above, relating to TDFs. This information is in addition to investment-related information already required to be furnished under the Participant Fee Disclosure regulations. According to the DOL, the additional disclosure is necessary to help ensure participants understand TDFs and to clarify the misconception that TDFs guarantee income at the chosen target date. Due to the conformity requirement in the proposed regulations, if any changes are made in the proposed regulations, those changes would also impact the Participant Fee Disclosure regulations and the QDIA regulations.

Comments regarding the TDF proposed regulations are due at the DOL on or before January 14, 2011.