Many 401(k) and other individual account retirement plans contain target date retirement funds as an investment option. These funds automatically rebalance their asset allocation to become more conservative as a plan participant gets closer to retirement (the target date). Often, these funds are used as a plan’s qualified default investment alternative (QDIA) under Department of Labor regulations, in the event that a plan participant does not make an election regarding investment of his or her account balances.

The Department of Labor recently issued guidance on the issues that plan fiduciaries should consider in connection with target date retirement funds, since there are considerable differences among these funds offered by various providers. These funds may have different investment strategies, including whether the funds’ “glide path” -- or gradual shift in asset allocation over time to more conservative investments -- culminates at the target date (an investment strategy designed “to” retirement) or whether it occurs years after the target date (an investment strategy designed “through” retirement).
When evaluating target date funds, the DOL’s new guidance provides that plan fiduciaries should consider the following:

- **Establish a process for comparison and selection:** Plan fiduciaries should follow an objective process to obtain information that will help them evaluate the appropriateness of any investment option made available under the plan. This should include review of prospectus information, investment returns and investment fees and expenses. It would also be wise to consider specific characteristics of your workforce, such as eligible employees’ ages and projected retirement dates. The guidance suggests discussing with prospective fund providers the possible significance of other characteristics of your participant pool, such as participation in other retirement plans, salary levels, turnover rates, contribution rates, and withdrawal patterns.

- **Establish a process for the periodic review of funds:** At a minimum, plan fiduciaries should have a process in place to periodically review the target date retirement funds they have selected, in order to determine whether they continue to be an appropriate investment option under the plan. Factors to be considered in this review include whether there have been any changes in management team membership; whether the funds’ manager is effectively carrying out the funds’ stated investment strategy; and whether your plan’s objectives in offering the target date funds have changed.

- **Understand the investments underlying the target date funds:** The guidance makes clear that plan fiduciaries are responsible for understanding the funds’ allocation in different asset classes, individual investments, and how these will change over time. Understanding the funds’ glide path, and whether the funds are managed with a “to” and “through” philosophy, is crucial.

- **Review the fund’s fees and investment expenses:** Because small differences in investment fees and expenses can have a substantial long-term impact on retirement savings, plan fiduciaries must understand the amount and types of fees associated with target date funds. They should also consider the fees and expenses for any underlying funds, as well. For example, expense ratios of the individual component funds that comprise a family of target date funds may be substantially less than the overall target date fund. In that case, plan fiduciaries should know what services and expenses account for the difference and make a determination that the fees are reasonable.

- **Consider a custom or non-proprietary target date fund if available:** Some vendors may offer a pre-packaged product that only utilizes the vendor’s proprietary funds as the target date funds’ component investments. In some cases, a custom target date fund that takes advantage of a plan’s open architecture investment plan and incorporates the plan’s existing funds into a custom target date fund may be available, and may be worth considering as it would diversify participants’ exposure to one investment provider. There may be additional costs and administration involved with creating a custom or non-proprietary target date fund, but plan fiduciaries should inquire whether they are available and determine whether they would be a better alternative for their particular plan.
• **Develop effective employee communication**: Plan fiduciaries should ensure that participants receive information about target date funds as a type of investment option generally, and about individual target date funds offered under their plan, specifically. Participants in 401(k)-type individual account retirement plans already must receive information about fees and expenses, and the Department of Labor is working on additional regulations to improve disclosures to participants specifically about target date funds. Regulations proposed in 2010 (but not yet finalized) call for disclosures to include an explanation that an investment in a target date fund is not guaranteed, and that money is at risk even after the target date.

• **Take advantage of available sources of information**: It is important that plan fiduciaries review commercially available sources for information and services to assist them in their decision-making and review process. This should be done to evaluate specific target date retirement funds and any recommendations received regarding the target date fund selection.

• **Document the process**: As with other investment options offered under any retirement plan, plan fiduciaries should document the selection and review process.

Plan fiduciaries should, at a minimum, consider the foregoing factors when determining which target date funds, if any, should be included in their retirement fund line-up, and when reviewing the performance, fees and strategic role of target date funds for their plan. As always, it is important for plan fiduciaries to be proactive when it comes to satisfying their fiduciary responsibilities. This most recent guidance from the DOL makes clear that because the characteristics of target date funds vary widely, plan fiduciaries should approach their selection and review process carefully and thoughtfully.

If you have any questions about target date retirement funds, or your employee benefit plans in general, please let us know.

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