

## *New DOL Proposed Regulations Require Additional Disclosures for QDIAs and Target Date Retirement Funds*

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Two weeks ago, the Department of Labor (“DOL”) issued proposed regulations that, if finalized, would require plan fiduciaries of defined contribution plans with participant-directed investments to provide additional disclosures to an estimated 43.6 million participants regarding target date retirement or similar funds that are designated investment alternatives. See <http://webapps.dol.gov/FederalRegister/PdfDisplay.aspx?DocId=24466>. The regulations also would expand the type of information that must be furnished to participants for qualified default investment alternatives (“QDIAs”), particularly QDIAs that are target date funds.

Part I of this Client Alert provides historical background regarding target date retirement funds and why the DOL believes additional rulemaking in this area is necessary, part II provides an overview of the proposed regulation’s requirements and compares them to similar proposed regulations issued by the Securities and Exchange Commission (“SEC”), and part III recommends actions plan fiduciaries should take now in light of the proposed regulations.

### **I. Background Regarding Target Date Funds**

Target date or “life cycle” retirement funds are investment offerings that provide a diversified investment portfolio designed to become more conservative as participants near retirement age. Many target date funds have names with a specific year (e.g., 2010, 2020, 2030) and are marketed as being designed for investors who anticipate retiring within that year. These funds have been available in the marketplace for many years, but their popularity as investment options in defined contribution plans skyrocketed after the DOL issued final regulations in 2007 designating target date retirement funds as one of three types of investments eligible for QDIA status.<sup>1</sup>

Although different target date fund offerings may contain the same specific year in their name, they may have significantly different risk and investment characteristics. This fact gained special attention when the capital markets declined dramatically in 2008 and several 2010 target date funds (suggesting they were designed for individuals planning to retire in just two years) suffered market declines in excess of 40 percent. This led to intense focus on target date funds by many, including Congress, the DOL and the SEC. As a result, the DOL and the SEC held a joint public hearing in 2009 to explore issues related to target date funds, including how they are managed at the investment level, how they are selected by plan fiduciaries and investors, and how information about them is

disclosed to plan participants. Following the hearing, DOL officials indicated that the agency determined that more information about target date funds needed to be made available to plan fiduciaries and participants. For example, the DOL learned from the hearings that target date funds utilize different “glide paths” for their asset allocations. In addition, the DOL learned that many fund managers assume that funds will be gradually withdrawn during the estimated life of the investor after he or she attains the designated retirement date. Consequently, the portion of the fund’s portfolio invested in equities is higher than it would be if the fund manager assumed that amounts would be withdrawn in a lump sum at the target retirement date. In the preamble to these proposed regulations, the DOL stated that it intends to publish “a series of tips intended to assist plan fiduciaries in obtaining and evaluating relevant information when selecting and monitoring” target date funds as investment options for participant-directed defined contribution plans.

## II. Required Disclosures

*General Overview.* The proposed regulations would amend the existing QDIA disclosure requirements to require disclosure to participants of the following information for all QDIAs, even if they are not target date funds:

- the issuer’s name;
- the investment’s objectives or goals;
- the investment’s principal strategies (including a general description of the types of assets held by the investment) and principal risks (e.g., the information on SEC Form N-1A);
- the investment’s historical performance data (e.g., 1-, 5-, and 10-year returns) and a statement indicating that an investment’s past performance is not necessarily an indication of how the investment will perform in the future; and, if applicable, a description of any fixed returns, annuities, guarantees, death benefits, or other ancillary features;
- the investment’s fees and expenses including: (i) any fees charged directly against the investment in connection with the 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); (ii) any annual operating expenses (e.g., expense ratio); and (iii) any ongoing expenses in addition to annual operating expenses (e.g., mortality and expense fees);
- an explanation of where the participants and beneficiaries can obtain additional investment information concerning the QDIA;
- subsequent to an investment, any materials provided to the plan relating to the exercise of voting, tender and similar rights appurtenant to the investment, to the extent that such rights are passed through to the participant or beneficiary; and
- prior to the date that the participant or beneficiary can direct its investment and at least annually thereafter or upon request, (i) the prospectus of the investment or similar documents if the investment is unregistered; (ii) financial statements or reports and any other similar materials to the extent that such materials are provided to the plan; (iii) a statement of the value of a share or unit of the investment, as well as the date of valuation; and (iv) a list of all assets comprising the portfolio of the investment which constitute plan assets and the value of each such asset.

In addition, disclosure to participants of the following information must be made for target date, life cycle or similar funds (regardless of whether they are intended to be QDIAs):

- an explanation of the target date fund's asset allocation, how the asset allocation will change over time, and the point in time when the target date fund 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";
- if the target date fund 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 investment 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 target date fund, including losses near and following retirement, and that there is no guarantee that the investment will provide adequate retirement income.

**Practice Pointer:** If the disclosures required by the final regulations (once issued) are not timely provided to participants, the investment will not be a QDIA and plan fiduciaries will not automatically be exempt from the normal fiduciary requirements and associated potential liability.

*Potential Penalties.* Although the information required by the proposed regulations must automatically be disclosed, plan administrators may face a \$110 per day penalty under ERISA Section 502(c) if they fail to provide the required disclosures to a plan participant on request.

*Method of Disclosure.* The DOL indicated in the preamble to the proposed regulations that it is considering whether to change the electronic disclosure safe harbor. The DOL further indicates that, for the time being, plans may rely on the general disclosure regulation, including the electronic disclosure safe harbor, found at 29 CFR § 2520.104b-1.

*Related SEC Action.* Earlier this year, the SEC issued proposed new advertising and sales literature disclosure requirements for target date funds.<sup>2</sup> The SEC's proposal would require all target date funds to include a prominent table, chart or graph depicting the percentage allocations or "glide path" of the different asset classes over the life of the fund. The proposal also includes examples of proposed tables, charts, and graphs. The SEC's proposal also would require that disclosure include (i) a statement that the fund's asset allocation changes over time; (ii) an explanation that the asset allocation becomes fixed at the "landing point"; and (iii) a statement as to whether, and to what extent, asset allocations among targeted ranges may be modified without shareholder vote. While the SEC's proposal differs from the proposed regulations promulgated by the DOL, there is considerable overlap between the two (i.e., the requirement of including a chart depicting a target date fund's "glide path" over time). For more information regarding the SEC's proposal, please see our prior Client Alert.<sup>3</sup>

### III. Action Items for Plan Fiduciaries

There is no reason for plan fiduciaries to wait for final regulations to take action, as many of the issues highlighted by the proposed regulations can easily be addressed now, to the extent not already addressed by the plan sponsor. For example:

- Plan fiduciaries should make sure they understand how target date funds work, including the “glide path” of all target date funds in their fund line up, specifically how the allocations between asset classes change over time and the assumptions utilized by the target date fund in making those allocations, and evaluate their use of target date funds in light of such understanding. The DOL and the SEC recently published a bulletin that provides an overview of target date funds (see [www.dol.gov/ebsa/pdf/TDFInvestorBulletin.pdf](http://www.dol.gov/ebsa/pdf/TDFInvestorBulletin.pdf)).
- Plan fiduciaries should ensure they have a thorough understanding of target date fund fees. For example, if the target date fund uses a “fund of funds” approach by investing in other mutual funds, the fiduciaries should determine whether this results in unnecessary fees or whether the target date fund sponsor adjusts the fees to avoid fee duplication.
- Plan fiduciaries should also review participant disclosures for their target date funds and determine whether they should be enhanced in light of the disclosures required by the proposed regulations. Some target date funds already have information available that could facilitate these disclosures.



*If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:*

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<sup>1</sup> If an investment alternative meets all of the QDIA requirements set forth in the QDIA regulations, plan participants will be treated as having elected to invest in the QDIA, even though they did not make an affirmative election to do so. As a result, plan fiduciaries are relieved from certain fiduciary responsibilities with respect to investment in the QDIA (e.g., liability for losses or breaches that occur with respect to the participant’s investment in the QDIA).

<sup>2</sup> SEC Release 33-9126; 34-62300; IC-29301 (June 16, 2010).

<sup>3</sup> SEC *Proposes New Advertising Disclosure Requirements for Target-Date Funds* (June 2010), available at [www.paulhastings.com/publications](http://www.paulhastings.com/publications).