GAO Highlights

Highlights of GAO-24-105364, a report to congressional requesters

March 2024

401(k) RETIREMENT PLANS

Department of Labor Should Update Guidance on Target Date Funds

Why GAO Did This Study

Millions of Americans depend on TDF investment options offered by their 401(k) plans for financial security in retirement. According to Morningstar, a financial services firm, and the Investment Company Institute, an association that represents regulated investment funds, there was about $2.8 trillion in TDF assets held in defined contribution plans as of June 2023. As the stock market dropped precipitously at the start of COVID-19, retirement experts and members of Congress raised questions about variation in the performance and risk exposure in TDFs, particularly those held by participants close to retirement.

GAO was asked to examine TDFs' performance and risk. This report examines the extent to which 401(k) plans and participants use TDFs; how asset allocations, risk, performance, and fees vary across TDFs; and how DOL, OCC, and SEC oversee TDFs, among other topics.

GAO analyzed Morningstar Direct data, including all TDFs structured as mutual funds that were active from 2017 to 2021, the most recent available data at the time of the request. GAO also reviewed retirement industry documents; and interviewed industry representatives and officials from DOL, OCC, and SEC.

What GAO Recommends

GAO is recommending that DOL update (1) its 2013 guidance for plan sponsors and (2) its 2010 guidance for plan participants on selecting TDFs. DOL disagreed with both recommendations. GAO continues to believe both are warranted, as discussed in the report.

View GAO-24-105364. For more information, contact Tranchau (Kris) T. Nguyen at (202) 512-7215 or nguyentt@gao.gov.

What GAO Found

Target date funds (TDFs) are widely offered and have become the most popular investment option used by 401(k) plan participants. TDFs allocate assets over time based on participants' targeted retirement dates. The Pension Protection Act of 2006 facilitated plan sponsors' automatic enrollment of employees into their plans using default investments, including TDFs. Plan sponsors GAO spoke with said they choose TDFs as their default investment because TDFs offer low fees, a well-diversified all-in-one portfolio, and a "set it and forget it" option for participants. A nationwide study showed that the share of participants offered TDFs increased from 42 percent in 2006 to 84 percent in 2020. According to other studies, auto-enrollment contributed to a majority of participants investing solely or primarily in TDFs, which represent more than a quarter of 401(k) assets.

Variation in TDF design affects their performance and risk. Asset managers design TDFs' investment mixes to shift from higher risk assets (e.g., stocks) to lower risk assets (e.g., fixed income) over time, based on participants' targeted retirement dates. These mixes varied more within 10 years of the target date, according to GAO's analysis of Morningstar Direct data.

In addition, as COVID-19 disrupted financial markets in March 2020, TDFs that were further from their target dates lost a larger share of their value than TDFs closer to their target dates because they were more heavily invested in higher risk assets. For instance, an average TDF with a 2060 target date lost 14 percent of its value from February to March 2020, whereas the average TDF with a 2020 target date lost 8 percent of its value. While TDFs closer to their target dates experienced smaller losses in March 2020 than those further from their target dates, their performance varied more. This was due to more variation in their investment mixes. Negative returns are significant for participants close to, or in, retirement because they have less time to recover from them than those who are further from retirement.

The Department of Labor (DOL), the Office of the Comptroller of the Currency (OCC), and the Securities and Exchange Commission (SEC) oversee TDFs through disclosure requirements, enforcement, and examinations. But DOL's guidance has not been updated and lacks detail. For example, DOL developed guidance in 2010 for participants and in 2013 for plan sponsors to help them select TDFs. However, the guidance does not include recent developments such as the increase of TDFs structured as collective investment trusts. Collective investment trusts are bank-administered pooled funds established exclusively for qualified plans such as 401(k)s. The responsible bank acts as the fiduciary and holds legal title to the assets. Without updated guidance, plan sponsors and participants may experience challenges identifying and understanding disclosures for collective investment trust TDFs.