The Department of Labor on Monday proposed a rule that will require employers to provide more information to their employees about the role of “target date” mutual funds in retirement plans.

Target date funds are often included in employer-sponsored retirement plans, such as 401(k)s, as a default option if employees fail to actively pick their own investments.

These funds are designed to automatically alter their asset mix over time so they become more conservative as an investor approaches retirement.

Under the proposed rule, employers, with the help of financial advisers who work on their plans, will have to provide information about how a particular target date fund allocates investments, for example between stocks, bonds and cash, and how that allocation will change over time.

They will also have to explain what the “target date” means. For example, one fund company may have a 2012 target date fund designed to provide a lump sum to an investor upon retirement in 2012, while another company may have designed the fund to last through the investor’s retirement.

This difference caused a lot of confusion among investors in 2008, when 2010 target date funds lost an average of 24 percent, according to the U.S. Securities and Exchange Commission.

“Some people bought these funds expecting them to be invested conservatively in fixed income only two years out from retirement,” said Marcia Wagner, managing director of the Wagner Law Group, which specializes in employee benefits.

But when the funds dropped in value the fund companies told investors they were designed to last another 20 years through their retirement and so they were still heavily exposed to the falling stock market, said Wagner.

Employers will also have to warn employees that they still may lose money in target date funds, even if they are close to retirement.

The Labor Department is accepting comments on the proposed rule until January 14, 2011.

The SEC in June also proposed rules that would increase disclosure on target date funds but has yet to publish any final regulations.
With the SEC preoccupied with financial regulatory reform, it appears that the Labor Department has taken up the cause, said Wagner.