



Investment Menu Design

A PLAN-SPONSOR'S GUIDE
INVESTMENT MENU DESIGN



Welcome Message

Dear Plan-Sponsor,

At Cognis Retirement Group, we recognize the dedication and sacrifices healthcare professionals make to care for others. Our mission is to provide the same level of care and attention to your employees' financial well-being.

This guide is designed to help you and your investment committee build a strong fiduciary governance foundation for your retirement plan, manage your plan assets with confidence, and create a legacy for your employees that reflects your values. Whether you are setting up a new plan or improving an existing plan, we are here to walk alongside you every step of the way.

We hope that this 4th guide, in our *Best Practices* series, serves as both a resource and a roadmap — enabling you to make informed decisions, stay compliant, and empower your employees to achieve lasting financial security.

With gratitude and commitment,



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Item 1

Introduction

Designing a 401(k)-investment menu is one of the most important responsibilities for plan sponsors. The menu you create directly impacts your employees' retirement outcomes and your company's fiduciary responsibilities. **A well-designed 401(k) investment menu offering enough choices to meet diverse participant needs while avoiding overwhelming employees with too many options that can lead to poor decision-making.**

Research shows that [the efficiency of pension menus](#) significantly affects participant outcomes. Rather than simply adding more funds, you need to create a strategic selection that guides participants toward appropriate investment choices. Studies indicate that [smarter menu design](#) is more effective than merely expanding options, as it helps employees make better choices while reducing your legal exposure under ERISA regulations.

When crafting your investment lineup, you should consider both [sponsor responsibilities and participant behavior](#). Finding this balance requires understanding your workforce demographics, retirement goals, and investment knowledge levels. Your menu design choices will directly influence whether employees achieve their retirement goals while keeping your organization protected from potential compliance issues.

Key Takeaways

- A strategic 401(k) menu offers sufficient diversity without overwhelming participants with too many options.
- Your investment menu design impacts both participant retirement outcomes and your company's fiduciary responsibilities.
- Regular monitoring and evaluation of menu performance ensures your plan remains effective and compliant with changing regulations.

Item 2

Understanding 401(k) Plans

401(k) plans serve as vital tools for retirement savings in America, offering tax advantages and investment options designed to help workers build their nest egg. These employer-sponsored plans have specific rules, contribution limits, and investment menus that vary across different plan types.



Definition and Purpose of 401(k)

A 401(k) is an employer-sponsored retirement savings plan that allows you to contribute a portion of your paycheck before taxes are taken out. This tax-deferred status means you don't pay income tax on the money you contribute until you withdraw it in retirement.

The primary purpose of a 401(k) is to help you save for retirement while reducing your current tax burden. Many employers offer matching contributions—essentially free money added to your account when you contribute.

These plans are named after section 401(k) of the Internal Revenue Code. They replace traditional pension plans in many workplaces, shifting responsibility for retirement planning to you rather than your employer. [Investment menus](#) within these plans are designed to provide different options to match your retirement goals and risk tolerance.

Types of 401(k) Plans

Traditional 401(k): Contributions are made with pre-tax dollars, reducing your current taxable income. The money grows tax-deferred until withdrawal during retirement, when it's taxed as ordinary income.

Roth 401(k): You contribute after-tax money, but withdrawals in retirement are completely tax-free if certain conditions are met. This option works well if you expect to be in a higher tax bracket during retirement.

Safe Harbor 401(k): These plans automatically pass nondiscrimination tests by requiring employers to make contributions that fully vest when made. They're popular among small businesses.

SIMPLE 401(k): Designed for small businesses with fewer than 100 employees, these plans have lower contribution limits but simpler administration requirements. [Plan design](#) for these variations specifically addresses deficiencies found in standard 401(k) options.

Item 3

Key Components of 401(k) Investment Menus

Effective 401(k) investment menus balance simplicity and choice, giving you access to diverse asset classes while preventing choice overload. [Research shows](#) that menu design significantly impacts participant outcomes and plan efficiency.

Core Investment Options

Core investment options form the foundation of your 401(k) menu. These typically include:

- **Stock funds:** Domestic large-cap, mid-cap, small-cap, and international equity options



- **Bond funds:** Government, corporate, and sometimes international fixed-income choices
- **Cash equivalents:** Money market funds or stable value options for capital preservation

The ideal menu provides enough variety to build a diversified portfolio without overwhelming you with choices. [Studies indicate](#) that the quality of options is more important than quantity.

When evaluating core options, look for funds with reasonable expense ratios, consistent management, and clear investment objectives. Your plan should include options across the risk spectrum to accommodate your personal risk tolerance.

Target Date Funds

Target date funds (TDFs) offer a one-stop investment solution that automatically adjusts risk based on your projected retirement date. These funds:

Key Features:

- **Automatic rebalancing:** Shifts from aggressive to conservative as retirement approaches
- **Professional management:** Eliminates need for you to make complex allocation decisions
- **Diversification:** Provides exposure to multiple asset classes in a single fund

Many plans now designate TDFs as the [default investment option](#) for participants who don't make an active choice. This design element helps overcome participant inertia.

You should evaluate the TDF's glide path (how it transitions from stocks to bonds over time) to ensure it aligns with your retirement goals and risk tolerance.

Managed Accounts

Managed accounts provide personalized investment management within your 401(k) plan. This option offers:

- **Customized portfolios:** Tailored to your specific financial situation
- **Professional oversight:** Investment professionals make allocation decisions
- **Ongoing adjustments:** Regular rebalancing and strategy updates based on market conditions

Unlike target date funds, managed accounts consider factors beyond just your age, such as outside assets, savings rate, and specific retirement goals. [Research suggests](#) that this personalization can improve outcomes for some participants.



Managed accounts typically charge additional fees for this personalized service. You should carefully weigh whether the potential benefits justify the extra cost compared to simpler options like target date funds.

Item 4

Designing a Diversified Investment Menu

Creating an effective 401(k) investment menu requires careful planning to balance choice with simplicity. A well-designed menu helps employees build retirement portfolios that match their needs while avoiding the confusion that can come with too many options.

Asset Class Coverage

A strong 401(k) investment menu should include options across major asset classes to enable proper [portfolio diversification](#). Your menu should at minimum include:

- **U.S. equity funds** (large, mid, and small cap)
- **International equity funds** (developed and emerging markets)
- **Fixed income options** (government and corporate bonds)
- **Cash equivalents** (money market or stable value funds)
- **Real asset funds** (REITs, commodities, inflation-protected securities)

Including these fundamental asset classes gives participants the building blocks to construct portfolios that match their goals. Research shows that [well-designed menus](#) don't need excessive options to achieve diversification benefits.

Consider adding a target-date fund series as a qualified default investment alternative (QDIA). These funds automatically adjust asset allocation as employees approach retirement.

Risk and Return Profiles

Your menu should offer investments with varying risk-return characteristics to accommodate different investor preferences. This approach fulfills your [fiduciary responsibility](#) to provide reasonable options for all participants.

Include these risk-return categories:

1. **Conservative options** (1-4% expected return, low volatility)
2. **Moderate options** (4-7% expected return, medium volatility)
3. **Aggressive options** (7%+ expected return, higher volatility)



Each employee has unique risk tolerance based on factors like age, savings rate, and retirement timeline. Younger employees often benefit from higher-risk investments with greater growth potential, while those nearing retirement typically prefer stability.

Clearly communicate the risk level of each investment option. Use simple risk scales or categories rather than complex statistical measures to help participants understand their choices.

Investment Styles and Categories

Diverse investment styles provide participants flexibility to align their portfolios with personal beliefs and investment philosophies. Research shows [investors value both fees and diversification options](#) when evaluating plan menus.

Include these key investment styles:

Active vs. Passive Management

- Offer low-cost index funds that track market benchmarks
- Include actively managed options that aim to outperform benchmarks
- Consider providing both approaches within each asset class

Specialized Categories

- ESG/Sustainable funds for socially conscious investors
- Value and growth options within equity categories
- Different duration strategies for bond investments

Keep investment expenses reasonable across all categories. Research indicates that [plan participants significantly shape their investment decisions](#) based on the available menu options, making thoughtful design crucial.

Item 5

Regulatory Considerations for Menu Design

401(k) plan sponsors must navigate complex regulatory requirements when designing investment menus. These requirements protect participants while ensuring the plan meets legal standards for prudence, diversification, and fee reasonableness.

ERISA Compliance

The Employee Retirement Income Security Act (1974) establishes fundamental requirements for 401(k) plans. ERISA requires plan fiduciaries to act solely in the interest of participants and beneficiaries.



Your plan menu must offer [sufficient diversification](#) to minimize the risk of large losses. This typically means providing options across major asset classes.

ERISA Section 404(c) offers liability protection for fiduciaries when participants direct their investments, but only if your menu meets specific requirements:

- At least three investment alternatives with materially different risk/return profiles
- Sufficient diversity to minimize risk through a portfolio mix
- Options allowing participants to achieve risk/return objectives appropriate for their situations

The 2006 Pension Protection Act introduced Qualified Default Investment Alternative (QDIA) regulations, giving you safe harbor protection when automatically enrolling participants into qualified investments like target-date funds.

Investment Policy Statement

An Investment Policy Statement (IPS) serves as your roadmap for menu design decisions. While not explicitly required by law, an IPS demonstrates procedural prudence.

Your IPS should clearly outline:

- Investment objectives and plan goals
- Criteria for selecting, monitoring, and replacing investments
- Fee evaluation methodology
- Roles and responsibilities of all parties involved

The IPS should establish benchmarks for performance evaluation and define what triggers a fund review or replacement. This helps you maintain [consistent oversight](#) of the menu.

Regularly review and update your IPS as market conditions, participant demographics, or regulations change. Document all reviews to demonstrate ongoing diligence.

Fiduciary Responsibilities

As a plan sponsor, you have a fiduciary duty to act prudently when designing and managing the investment menu. This includes careful selection and ongoing monitoring of investment options.

Recent court cases emphasize the importance of [controlling plan costs](#) and avoiding excessive fees. Your responsibility includes:

- Regularly benchmarking fees against industry standards
- Evaluating whether higher-cost funds deliver value proportionate to their costs



- Removing consistently underperforming options

The DOL's 2022 guidance clarifies that you may [consider participant preferences](#) when designing menus, including demand for sustainable investments—provided they meet prudence standards.

Be cautious about menu size. Research suggests that [excessive choice may overwhelm participants](#), potentially leading to poor investment decisions or non-participation.

Item 6

Evaluating and Selecting Investment Options

Choosing the right investments for a 401(k)-plan menu requires careful evaluation of several key factors. Plan sponsors must balance investment performance, cost effectiveness, and reliability when building a menu that serves participants' needs.

Performance Metrics

When evaluating investment options, you should consider both absolute and relative performance metrics. [Past performance](#) should be measured over multiple time periods (1, 3, 5, and 10 years) to identify consistency and trends.

Risk-adjusted returns, such as Sharpe ratios and alpha, provide deeper insight than raw returns alone. These metrics help you understand how much risk was taken to achieve the stated returns.

Benchmarking each fund against appropriate indices is critical. An S&P 500 index fund should be compared to the S&P 500, while an emerging market fund requires a different benchmark.

Consider tracking error to determine how closely a fund follows its benchmark. Lower tracking error in passive funds indicates better index replication, while active funds may deliberately maintain higher tracking error to outperform.

Fee Structures

Fee structures directly impact investment returns and should be a primary consideration. [Research shows](#) that excessive fees can significantly diminish retirement savings over time.

Common fee types include:

- Expense ratios (annual fund operating costs)
- Administrative fees
- Trading costs
- Load fees (front-end or back-end)



You should prioritize including low-cost index funds in your menu. These typically have expense ratios below 0.20%, compared to active funds that may charge 0.75-1.50%.

For active management, evaluate whether higher fees are justified by superior performance. The concept of "value for money" applies—participants should only pay premium fees for genuinely valuable active management.

Fee benchmarking against industry averages helps identify outliers. [Plan-level efficiency](#) improves when you regularly review and negotiate fees with providers.

Fund Manager Reputation

The team managing the investments deserves thorough scrutiny. Manager tenure indicates stability—look for fund managers with at least 5 years of experience with their current fund.

Investment philosophy should align with the fund's stated objectives. Consistency between stated approach and actual implementation builds trust and predictability.

Examine the fund company's resources and research capabilities. Larger firms often have more robust research departments but may lack nimbleness in execution.

[Portfolio turnover rates](#) can signal investment style. High turnover may indicate short-term thinking or style drift, while low turnover typically suggests a disciplined, long-term approach.

Consider the fund company's stewardship grade from independent rating agencies. This evaluates how well the company aligns its interests with investors through reasonable fees, manager incentives, and corporate culture.

Item 7

Participant Communication and Education

Effective communication strategies and educational tools significantly influence how employees interact with their 401(k) plans. Clear information helps participants make informed investment decisions aligned with their retirement goals.

Investment Menu Descriptions

Your plan participants need clear, jargon-free descriptions of each investment option. [Menu design strongly influences participant choices](#), so descriptions should be standardized and easy to compare.

Include these key elements for each fund:

- **Investment objective** (growth, income, preservation)
- **Risk level** (low, moderate, high)
- **Fees and expense ratios**



- **Historical performance** (with appropriate disclaimers)
- **Asset class** and investment strategy

Use visual aids like risk-return graphs to help participants understand the relationship between potential returns and volatility. Consider creating simple comparison charts that allow side-by-side evaluation of similar funds.

Research shows that [participation rates decrease when too many options are presented](#). Focus your communications on a manageable core set of investments to prevent overwhelming participants.

Educational Resources and Tools

Provide diverse educational resources that accommodate different learning preferences and knowledge levels. [Financial education significantly impacts saving behavior](#), especially for participants with lower income and education levels.

Effective educational tools include:

- **Interactive calculators** to project retirement savings
- **Short videos** explaining investment concepts
- **Webinars** on retirement planning strategies
- **Mobile apps** for monitoring performance
- **Glossaries** defining financial terms

Schedule regular educational sessions during work hours to increase attendance. Consider offering personalized guidance for employees at different career stages—new hires, mid-career professionals, and those approaching retirement.

Create customized education paths for participants with different knowledge levels. [Investor knowledge moderates the effectiveness](#) of different plan designs, so tailor your approach accordingly.

Enrollment and Decision Support

Make the enrollment process simple and intuitive. Provide decision support tools that guide participants through their choices without overwhelming them.

Effective enrollment support includes:

- **Step-by-step guides** for completing enrollment
- **Pre-populated forms** with default options
- **Online enrollment wizards** with plain language
- **Automatic escalation** features explanation
- **Investment risk assessment** questionnaires



Many participants follow the [path of least resistance](#) when making retirement decisions. Use this behavioral tendency constructively by designing smart defaults that encourage appropriate saving levels.

Consider implementing a tiered approach to investment choices. Start with a simple set of options for newer investors and provide additional choices for more experienced participants. This prevents decision paralysis while still offering flexibility.

Track engagement metrics to identify which communications are most effective and adjust your strategy accordingly.

Item 8

Monitoring and Reviewing the Investment Menu

Effective oversight of your 401(k) investment options requires continuous evaluation against performance targets, understanding how employees use available choices, and implementing a structured review schedule. These practices help maintain a competitive and compliant retirement offering.

Performance Benchmarks

401(k) plan fiduciaries must compare investment options against appropriate market benchmarks. You should track each fund's performance relative to its peer group and relevant indexes like the S&P 500 for equity funds.

[Low-cost index funds](#) often serve as baseline comparisons for more expensive actively managed options. Consider these key metrics:

- **Risk-adjusted returns** (Sharpe ratio, information ratio)
- **Expense ratios** compared to category averages
- **Manager tenure** and organizational stability
- **Style drift** that may change a fund's risk profile

Document your benchmarking process thoroughly. This demonstrates your [fiduciary commitment to monitoring](#) the plan investments and can help protect against potential litigation.

Participant Usage and Feedback

Examine how employees interact with your investment menu. Usage patterns reveal whether your offerings match participant's needs and preferences.

Look for these indicators:

- Concentration in default options
- Underutilized fund categories
- Age-appropriate allocation trends
- Contribution rates across demographics



[Employee preferences should influence menu design](#), especially regarding sustainable investing options that increasingly matter to younger workers. Consider annual surveys to gather direct feedback.

Track engagement with educational resources and advisory services. Low utilization might indicate either satisfaction with current selections or confusion about available options.

Regular Review Cycle

Establish a formal schedule for investment menu evaluations. Quarterly reviews allow you to address performance issues promptly, while comprehensive annual assessments examine the menu holistically.

Your review committee should include:

- HR representatives
- Finance team members
- Third-party advisors or consultants
- Executive stakeholders

[Plan sponsors should review their menus often](#), documenting all decisions and their rationale. Create a standard evaluation framework with clear criteria for fund retention, replacement, or addition.

Consider [how your menu design affects investor welfare](#) during these reviews. The goal isn't simply avoiding litigation but optimizing outcomes for participants.

Set calendar reminders for regulatory updates that might affect investment options. ERISA requirements and Department of Labor guidance change periodically.

Item 9

Customization and Personalization Options

Modern 401(k) plans offer several ways to tailor investment strategies to your personal needs. These options give you more control over how your retirement funds are invested while still maintaining important protections.

Self-Directed Brokerage Accounts

Self-directed brokerage accounts (SDBAs) expand your investment choices beyond the standard 401(k) menu. These accounts let you select from thousands of investment options including individual stocks, bonds, ETFs, and mutual funds.

With an SDBA, you gain significant flexibility to [design your own investment plan](#) tailored to your specific goals. However, this freedom comes with added responsibility.



Key considerations for SDBAs:

- **Higher fees:** Typically charge additional maintenance fees and transaction costs
- **No fiduciary screening:** Investments aren't pre-vetted by plan sponsors
- **Greater complexity:** Requires more investment knowledge and monitoring
- **Contribution limits:** Many plans restrict the percentage of your 401(k) that can go into an SDBA

Only about 20% of plan participants with SDBA access actually use them, as most prefer the simplicity of core investment menus.

Custom Target Date Portfolios

[Personalized target-date funds](#) improve upon standard TDFs by adapting to your specific situation rather than just your retirement date. These custom portfolios consider factors like:

- Your current savings rate and account balance
- Expected retirement income from other sources
- Risk tolerance and investment preferences
- Additional financial goals beyond retirement

Many providers now offer [customizable managed accounts](#) that automatically adjust your investments based on your personal data. These solutions can provide the benefits of professional management while still reflecting your unique circumstances.

Recent innovations include digital tools that let you [personalize enrollment options](#) and receive customized alerts when your investments need attention. These technologies make sophisticated personalization accessible to more investors.

Item 10

Best Practices in Menu Design

Effective 401(k) menu design follows key principles that balance simplicity with choice while meeting diverse participant needs. These practices help [plan fiduciaries create investment menus](#) that serve participants well while fulfilling legal obligations.

Simplifying Choices

Too many investment options can overwhelm participants and lead to poor decisions. Research shows that [most sponsors offer efficient investment menus](#), but the key is striking the right balance.



When designing your plan menu, consider these proven approaches:

- Limit core options to 12-15 carefully selected funds
- Use tiered structures to organize choices by complexity level
- Include well-designed target date funds as default options
- Label funds clearly by asset class and risk level

Many successful plans now use "white label" funds that combine multiple managers under simple descriptive names like "Large Cap Growth Fund" rather than using brand names. This approach reduces confusion and helps participants focus on asset allocation rather than fund selection.

Aligning with Participant Demographics

Your workforce's unique characteristics should directly influence menu design. [Plan sponsors must consider participants' needs](#) when constructing retirement menus.

Key demographic factors to analyze include:

Age distribution: Younger workforces benefit from growth-oriented options, while older groups need more conservative choices.

Financial literacy levels: Companies with varying education levels may need more robust default options and simpler overall menus.

Income ranges: Higher-income participants often seek more sophisticated investment vehicles, while lower-income employees may prioritize principal protection.

Consider conducting regular surveys to understand participant preferences. This data helps you offer appropriate investment options without overwhelming your workforce with choices they don't need or understand.

The Role of Alternatives

Alternative investments can enhance diversification and potentially improve returns in 401(k) plans. However, their inclusion requires careful consideration.

Common alternatives now appearing in 401(k) menus include:

- Real estate investment trusts (REITs)
- Inflation-protected securities
- Socially responsible investment options
- Managed accounts with professional oversight

[Sustainable investing options](#) have become increasingly important to many participants. According to recent trends, plans that include environmental, social and governance (ESG) funds often see higher participation rates among younger employees.



When adding alternatives, ensure they have reasonable fees and sufficient liquidity. Provide clear educational materials explaining how these options differ from traditional investments. Remember that [fund families involved in plan design may face conflicting incentives](#), so maintain oversight of all offerings.

Item 11

Frequently Asked Questions

401k investment menu design involves balancing simplicity with comprehensive investment options. Plan sponsors must consider participant behavior, regulatory requirements, and investment best practices when creating effective lineups.

What are the best practices for structuring a 401k investment menu?

Creating a well-structured 401k menu requires a tiered approach to accommodate different investor types. You should include [core options that are reasonably designed to further the purposes of the plan](#).

Consider offering three distinct tiers: a qualified default investment alternative (typically target-date funds), a core lineup of diversified options, and an extended tier for sophisticated investors.

Regular menu reviews and benchmarking against industry standards help ensure your 401k plan remains competitive and appropriate for participants' needs.

How many investment options should be included in a 401k plan for optimal diversification?

Research suggests that [efficient investment menus](#) don't necessarily require numerous options. Most experts recommend between 15-20 total investment options for optimal participant outcomes.

Too few options can limit diversification, while [too many choices can overwhelm participants](#) and lead to decision paralysis or poor investment selections.

Focus on quality over quantity, ensuring each option serves a distinct purpose in the overall investment lineup.

What types of asset classes are essential to include in a 401k investment lineup?

Your 401k menu should include options across major asset classes to enable proper diversification. Essential categories include domestic large-cap, mid-cap, and small-cap equity funds.

International developed market and emerging market equity funds provide global exposure. Fixed income options should include core bond funds and potentially inflation-protected securities.



Consider adding real estate (REITs) and possibly other alternatives like commodities to provide additional diversification benefits beyond traditional stocks and bonds.

What criteria should be used to select specific investments for a 401k plan?

Investment selection should focus on performance consistency, appropriate risk levels, and reasonable fees. Examine each fund's track record against relevant benchmarks over multiple time periods.

You should evaluate fund manager experience, investment approach consistency, and the fund's underlying holdings to ensure alignment with stated objectives.

[Smart menu design factors](#) include fee structure, fund stability, and whether the investment complements other menu options without unnecessary overlap.

How can a 401k investment menu be designed to cater to different risk tolerances among participants?

Design your menu to accommodate varying risk preferences through a spectrum of investment options. For conservative investors, include stable value funds, short-term bond funds, and balanced options.

Moderate-risk investors benefit from blend funds, core fixed income, and blue-chip equity options. For aggressive investors, provide growth-oriented domestic equity, international stocks, and possibly sector-specific funds.

Consider including a risk assessment tool to help participants identify their risk tolerance and match it to appropriate investment selections.

What role do target-date funds play in a 401k investment menu?

Target-date funds serve as the cornerstone of modern 401k menus, providing automatic diversification and age-appropriate risk adjustment. They function as qualified default investment alternatives for participants who don't make active selections.

These funds automatically shift asset allocation from growth-oriented to more conservative as participants approach retirement age. This "set it and forget it" approach helps overcome [participant portfolio choice challenges](#).

You should carefully evaluate target-date fund glide paths, underlying investments, and fee structures, as they typically hold the largest percentage of plan assets.