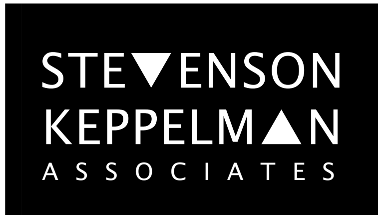

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DOL ISSUES FINAL REGULATIONS ON “QUALIFIED DEFAULT INVESTMENT ALTERNATIVES”

ALERT: IN ORDER TO COMPLY WITH RESPECT TO DEFAULT INVESTMENTS MADE ON OR AFTER JANUARY 1, 2008, PLAN SPONSORS WILL NEED TO PROVIDE THE ANNUAL NOTICE REQUIRED BY THE REGULATIONS NO LATER THAN DECEMBER 1, 2007.

In defined contribution plans (such as 401(k) plans), that allow participants to direct how their accounts are invested, plan fiduciaries have historically enjoyed relief from fiduciary responsibility for participants' affirmative asset allocation decisions. However, this relief has not extended to accounts (or parts of accounts) on which participants failed to give investment direction. These funds, invested in a "default fund" choice, remained the plan fiduciaries' responsibility.*

Historically, many plans utilized as a default choice money market funds, stable value funds or the like, on the basis that losses were unlikely to occur. But money market and similar cash type funds aren't generally considered as prudent long-term retirement investments. The Pension Protection Act of 2006 ("PPA") provided relief from fiduciary liability over default-invested funds if certain requirements are met. A significant requirement is that the default investment be a "Qualified Default Investment Alternative ("QDIA.")

The Department of Labor has now published final regulations which clarify the availability and scope of this new fiduciary relief, the types of investment alternatives considered to be QDIAs and participant notification requirements.

*Note that plan fiduciaries were, and continue to be, responsible for the prudent selection and monitoring of the investment funds which are made available for participants' choice. For example, these choices should be solid performing investments, and should not charge excessive fees.

Fiduciary Relief

Plan fiduciaries remain otherwise responsible for the prudent selection and monitoring of QDIAs, but will avoid liability for investment outcomes if all of the following conditions are satisfied --

- Assets are invested in a QDIA.
- Participants had an opportunity to direct their investments but did not do so.
- Participants received advance notice of the plan’s default investment alternatives according to certain minimum requirements.

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- Investment materials (e.g., prospectuses) for the QDIA were provided to participants.
- Participants are permitted to transfer assets to other plan investment alternatives without financial penalty at least quarterly.
- A broad range of ERISA Section 404(c) investment alternatives are offered by the plan.

Qualified Default Investment Alternatives (QDIAs)

The final regulations recognize four categories of QDIAs. The categories include the following: (a) lifecycle or targeted retirement date funds; (b) professionally managed accounts; (c) group investment products consisting of a mixture of equity and fixed income exposures for the plan as a whole (e.g., a balanced fund); and (d) a capital preservation fund (e.g., money market, stable value.) NOTE that the capital preservation alternative ([d] above) qualifies as a QDIA for only a period of up to 120 days. At the end of the 120-day period, the plan fiduciary must redirect the investments to one of the three recognized QDIAs to comply with the regulations.

To be qualified, a QDIA must be managed by an investment manager (as defined under ERISA), a plan trustee, or a plan sponsor who is a named fiduciary. Alternatively, it can be managed by a registered investment company, or it can be an investment product or fund that meets conditions specified in the regulations. A QDIA may be offered through a variable annuity contract, common or collective funds or other pooled investment funds, such as mutual funds.

Grandfathered Protection for Pre-December 24, 2007 Investments

The DOL provided grandfathered protection for plan sponsors that currently utilize as default investments certain capital preservation funds, such as stable value funds. Contributions defaulted to those funds, as long as made prior to December 24, 2007, will be considered to have been made into QDIAs under the final regulations. However, no relief is provided for subsequent contributions to these funds. This provides until this Christmas Eve to get a new default fund in place. ("Ho Ho Ho!")

QDIA Notice for Participants and Beneficiaries

Plan sponsors must provide two types of notice to participants and beneficiaries who have not directed the investment of their individual accounts. One is an initial written notice of the plan's default investment provisions and their election rights; the other is an annual notice.

Timeframes for Providing the QDIA Notice.

1. *Initial Notice.*

Must be provided at least 30 days in advance of the date of plan eligibility; or at least 30 days in advance of the date of any first investment in the QDIA; or

If the plan permits participants to opt out of an automatic enrollment program and withdraw contributions made during the first 90 days in accordance with Internal Revenue Code Section 414(w), notice may be given as late as the date of plan eligibility.

The idea behind the second option is this: if your plan automatically enrolls participants, but some may want to opt out and get their contributions back, this alternative notice, coupled with the 120-day capital preservation QDIA, will give participants timely notice, while avoiding investment losses during the opt-out period. This update does not discuss automatic enrollment rules.

2. *Annual Notice*.

Fiduciaries must provide an annual notice within a reasonable period of time of at least 30 days in advance of each subsequent plan year. (If your plan is a safe harbor 401(k) plan, this is also when you must give a safe harbor notice. The two notices may be provided at the same time but cannot be combined.)

Notice Content Requirements.

The notices must describe when and to what extent assets may be invested in a QDIA, the participant's right to direct the investment of individual account assets, must identify the default QDIA (including its investment objectives, risk and return characteristics, fees and expenses), the participant's right to opt out or elect other investment alternatives offered under the plan, and where participants can obtain additional information about those alternatives.

Miscellaneous Notice Requirements.

The notice may be part of an automatic enrollment notice but may not be part of the SPD or SMM. The notice must be written in a manner easily understood by plan participants. The notice may be provided electronically in accordance with the DOL or IRS safe harbor rules for electronic disclosures.

Notice for Automatic Enrollment Plans

A participant notice in an automatic enrollment plan must contain the information described above as well as the additional the following information:

- an explanation of the circumstances under which the elective deferral will be made, to include the percentage of such contribution;
- the right of the participant to opt out or change the deferral amount; and
- an explanation of the right of the participant to direct the investment of their accounts.

Effective Date

The final regulations take effect on December 24, 2007 (Merry Christmas!) **In order to comply with respect to default investments made on or after January 1, 2008, plan sponsors will need to provide the annual notice required by the regulations no later than December 1, 2007**.

As noted above, contributions made to stable value or money market funds before December 24, 2007 are grandfathered and will be treated as having been invested in a QDIA. Plan sponsors may want to review the existing default investment option to determine whether it is a QDIA and, if not, conduct a fiduciary review to select a new QDIA.

Plan sponsors should also conduct a review of compliance with ERISA Section 404(c), which shifts from fiduciaries to participants the responsibility for participants affirmative (non-default) investment choices.

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