QDIAs under the Pension Protection Act

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When Congress passed the Pension Protection Act of 2006 ("PPA"), they addressed a major problem faced by many employers sponsoring profit sharing, 401(k), and 403(b) plans --- how to handle a case in which a participant is given investment options, but does not make a written investment election on how to invest his money.

PPA added ERISA Section 404(c)(5) to provide relief to plan fiduciaries who invest participant assets in default investments, in cases where the participant has not made an affirmative investment election. Under this rule, if a participant fails to exercise control over their investments, they will be deemed to have exercised control if the employer defaults them into a qualified default investment alternative, or QDIA. This means fiduciaries will not be liable for any loss that is the direct and necessary result of investing in the QDIA provided that the participants are given appropriate notice and opportunity to provide affirmative investment direction.

If the only plans with participant investment direction were 401(k) plans in which the participant completed a payroll withholding election, and the election was not considered valid until he also completed an investment election, this problem might not exist. However, there are a number of plans in which the participant has money in the plan even without his making a payroll withholding election. For example,

1) The participant may share in a *non-matching* company contribution (e.g., a "profit sharing" contribution), or

2) The plan has an "automatic enrollment" provision, whereby the employee is automatically treated as deferring part of his pay into the plan, even without making any written election.

Congress assigned to the Department of Labor (DOL) the job of defining a Qualified Default Investment Alternative which can be used in these cases. On October 24, 2007, the DOL issued final regulations with an effective date of December 24, 2007. The regulations were then updated in 2008 with technical amendments that clarified certain provisions. These regulations are summarized in this paper, along with some related observations and requirements.

CONDITIONS FOR QUALIFICATION

There are six conditions that must be satisfied by plan fiduciaries in order to qualify for relief.

1) The investments must be put into a QDIA (defined below).

2) The participants must have been given the opportunity to direct their investments, but did not give direction.

3) Both an initial and an annual notice must be given to participants (see below).

4) A fiduciary must provide the participant with investment materials related to the investment in the QDIA.

5) The participant must have the option to transfer some or all of his money out of the QDIA, without penalty, to any available investment alternative. This option must be provided at least quarterly.

6) The plan must offer a broad range of investment alternatives.

FUND INFORMATION

Some requirements must be met for the plan QDIA to be used:

1) The QDIA must not hold or permit the acquisition of employer securities. (There are a couple of minor exceptions.)

2) There must be no penalty imposed on the participant who chooses to later move out of the QDIA.

3) The QDIA must be managed by a “permitted” manager. A “permitted” manager is a registered investment company, an investment manager as defined in ERISA section 3(38), a trustee of the plan that meets the requirements of ERISA section 3(38), or the plan sponsor who is a named fiduciary within ERISA section 402(a)(2).

4) The plan must offer a broad range of investment alternatives.

5) The QDIA must be either a:

   - Balanced fund;
   - Capital preservation fund (however, this fund is only allowed if the plan uses automatic enrollment and assets may not remain in the fund for any specific participant for more than 120 days);
   - Age, target retirement date, life expectancy fund or model portfolio; or
   - Professionally managed account where a mix of fixed income and equity investments are utilized.

The DOL has made it clear that putting all of a participant's account into a stable value fund does not qualify as a QDIA, although there is an exception for any assets invested in a stable value fund before December 24, 2007.

It is important to note that plan fiduciaries are required to periodically review the plan's investment options to ensure that they should continue to be offered. This duty to monitor the investments includes a duty to make sure the chosen QDIA continues to be the appropriate option for the plan.

NOTICE REQUIREMENT

The participant must be given an advance notice of how his investments will be handled absent his personal election. The 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 a QDIA AND within a reasonable period of time at least 30 days in advance of each subsequent year. The QDIA Notice may be combined with other notices, like an automatic enrollment notice or a safe harbor notice.

The notice must explain the investment objectives, risk and return characteristics, and fees and expenses of the QDIA. *It is important to also realize the effect of the 2010 final regulation for disclosure of certain plan and investment-related information that is commonly referred to as the "Fee Disclosure Rules."* These rules require that participants who are allowed to direct their investments must receive detailed investment performance and fee and expense information about all mutual funds offered by the Plan, not just the QDIA. But the Fee Disclosure Notice is a separate notice requirement from the QDIA Notice.

Simultaneously furnished documents may be used to satisfy the notice requirement and furnishing a prospectus with the other required information can satisfy the disclosure requirement.

PROPOSED NOTICE REQUIREMENTS FOR TARGET DATE QDIAs

In late 2010, the DOL issued proposed rules that would expand the required content of QDIA notices. The DOL proposed that QDIA notices include:

- The name of the investment issuer;
- A description of the investment's objectives, principal strategies and risks;
- A description of the investment's historical performance data; and
- A description of the investment's attendant fees and expenses.

In addition, if the QDIA is a target date fund, the notice must also include:

- an explanation of the asset allocation;
- how the asset allocation will change over time and the point in time when the QDIA will reach its most conservative asset allocation, including a chart, table or other graphical representation that illustrates changes in asset allocations over time;
- an explanation of the age group for whom the fund is designed, the relevance of the target date and any assumptions about a participant's or beneficiary's contribution and withdrawal intentions on or after such target date;
- a statement that the participant or beneficiary may lose money by investing in the QDIA, including losses near and following retirement, and that there is no guarantee that the QDIA will provide adequate retirement income.

The proposed regulations will be effective 90 days following publication of the final regulations in the *Federal Register*. The DOL has yet to indicate when the final regulations will be published. In February of 2013, the DOL did issue a Fact Sheet, entitled *"Target Date Funds—Tips for ERISA Plan Fiduciaries"* which provides helpful guidance on selecting and monitoring target date funds. The tip sheet may be viewed here:
http://www.dol.gov/ebsa/newsroom/fsTDF.html