

# Employee Benefits Update

An informational newsletter from Goodwin Procter's ERISA/Employee Benefits Practice

## Final Regulations Issued Regarding Qualified Default Investment Alternatives

### Overview

The U.S. Department of Labor (the "DOL") recently finalized a regulation (the "Final Regulation") regarding a safe harbor under the Employee Retirement Income Security Act of 1974, as amended ("ERISA") for the investment of plan assets and certain default investment options that qualify as "qualified default investment alternatives ("QDIAs"). The safe harbor protects the plan fiduciary from fiduciary liability when selecting an investment for a plan participant or beneficiary who fails to choose his or her own investment under a defined contribution plan, such as a 401(k) plan, provided that the conditions set forth in the Final Regulation, as discussed below, are satisfied.

Significantly, plan fiduciaries remain responsible for the prudent selection and monitoring of the QDIA. *The Final Regulation is effective December 24, 2007.* However, any plan fiduciaries who wish to take advantage of the protections provided in the Final Regulation, must take action as soon as possible, including providing certain advance notice to participants and beneficiaries concerning the investments that may be made on their behalf.

### Safe Harbor Conditions Established

The Final Regulation imposes the following six conditions for relief from fiduciary liability:

- 1. QDIA Investment.** The assets invested on behalf of the participants or beneficiaries who have not provided an investment direction must be invested in a QDIA (as described below).
- 2. Investment Direction Opportunity.** The participant or beneficiary on whose behalf the investment is being made must have been given the opportunity to direct the investment of assets in his or her account but have failed to do so.
- 3. Notice Requirement.** Both an initial notice and an annual notice must be provided to participants and beneficiaries informing them of the QDIA. The initial notice must be provided at least 30 days in advance of plan eligibility, or at least 30 days in advance of any first investment for the participant in the QDIA. With respect to automatic enrollment plans, the initial notice may be provided on or before the date of plan eligibility if the plan permits participants to make a penalty-free withdrawal of all automatic contributions within the 90-day period following

the initial contribution. The annual notice must be provided at least 30 days in advance of the plan year. Generally, the Final Regulation does not permit either the initial notice or annual notice to be combined into another plan-related document, such as the summary plan description, though the notices may be distributed in conjunction with other disclosures or notices to plan participants or beneficiaries. However, the initial notice and annual notice may be combined with the notice applicable to automatic contribution arrangements. The Final Regulation also requires the initial notice and annual notice to include the following information:

- a description of the circumstances under which assets in the individual account of a participant or beneficiary may be invested on behalf of the participant or beneficiary in a QDIA;
- in cases where automatic enrollment is in use, an explanation of the circumstances under which elective contributions will be made, the percentage of such contributions and the right of the participant to elect not to have such contributions made on the participant's behalf or to elect a different contribution rate;
- an explanation of the right of participants and beneficiaries to direct the investment of assets in their individual accounts;
- a description of the QDIA, including a description of the investment objectives, risk and return characteristics (if applicable), and fees and expenses related to the investment alternative;
- a description of the right of the participants and beneficiaries on whose behalf assets are invested in a QDIA to direct the investment of those assets to any other investment alternative under the plan, including a description of any applicable restrictions, fees or expenses in connection with such transfer; and
- an explanation of where the participants and beneficiaries can obtain investment information concerning the other investment alternatives available under the plan.

**4. Delivery of QDIA Materials.** Materials, such as investment prospectuses, provided to the plan with respect to the QDIA must be given to participants and beneficiaries who have been defaulted into the QDIA.

**5. Opportunity to Transfer Plan Assets Without Penalty.** Plan participants or beneficiaries who are defaulted into a QDIA must be given the opportunity to direct investments out of a QDIA with the same frequency as is available for other plan investments (but no less frequently than quarterly). In addition, such participants and beneficiaries may not have any restrictions, fees or expenses (other than investment management and other types of ongoing fees and expenses) imposed during the first 90 days of their initial default investment in the QDIA. After such 90-day period, such plan participant and beneficiary may be subject to the same restrictions, fees or expenses as are applicable to other plan participants and beneficiaries.

**6. Broad Range of Investment Alternatives.** Lastly, a plan must also offer a “broad range of investment alternatives” as defined in the DOL’s regulation under Section 404(c) of ERISA. This requirement gives participants the opportunity to create a diversified portfolio with aggregate risk and return characteristics at any point within the range normally appropriate for a plan participant or beneficiary.

### **Qualified Default Investment Alternatives Defined**

To be a QDIA, the default investment alternative must meet certain requirements. Generally, a life cycle or targeted-retirement-date fund (geared to the individual participant’s age or projected retirement date), certain balanced funds (geared to the ages or projected retirement dates of the plan participants as a group) or a professionally managed account (geared to the individual participant’s age or projected retirement date) can qualify as a QDIA. In addition, the default investment alternative must either be (i) managed by an investment manager (as defined in ERISA), a Plan trustee that could qualify as an investment manager under ERISA or a Plan sponsor who is a named fiduciary, or (ii) an investment company registered under the Investment Company Act of 1940. The default investment alternative generally cannot invest participant contributions directly in employer securities. In addition, under the Final Regulation a short-term capital preservation investment product (such as a money market fund) can qualify as a QDIA but only for the first 120 days after the initial investment in such product.

Another important aspect of the Final Regulation is that stable value products will not qualify as QDIAs for contributions invested after December 24, 2007 (except under the limited 120-day rule described above). However, since many plan sponsors adopted stable value products as their default investment prior to the Pension Protection Act and the Final Regulation, the Final Regulation “grandfathers” such arrangements by exempting contributions invested in certain stable value products prior to December 24, 2007. For this purpose, a money market fund is not considered a stable value product. As currently drafted, the Final Regulation does not cover many existing stable value products (*e.g.*, stable value funds organized as bank collective investment funds), nor does the Final Regulation adequately address how the notice requirement as described above can be satisfied for such grandfathered QDIAs. It is possible that the DOL will provide additional guidance on these issues in the near future.

### **Action Items Suggested**

In order to take advantage of the relief provided by the Final Regulation as of December 24, 2007 (the earliest possible date), plan fiduciaries need to take certain actions immediately, such as:

- Designating a default investment alternative that qualifies as a QDIA under the Final Regulation (unless the existing default investment already qualifies) and establishing procedures for complying with the requirement

that QDIA materials provided to the plan be passed on to participants and beneficiaries defaulted into the QDIA.

- Sending both the initial and annual notice to participants and beneficiaries as soon as possible (relief is generally available 30 days after the notice is sent).
- For automatic enrollment 401(k) plans that will be providing the QDIA notice less than 30 days in advance, amending the plan to include the 90-day in-service withdrawal feature (if the plan does not already include a withdrawal feature that would satisfy this requirement)

If you would like additional information about the issues addressed in this update, please contact:

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