

# Employee Benefits Briefing

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A bulletin designed to keep clients and other friends informed on employee benefits law matters

October 2006

## Department of Labor Issues Proposed Regulations on Default Investment Alternatives

The Pension Protection Act of 2006 amended ERISA, effective for plan years beginning in 2007, to provide 404(c) relief for plan fiduciaries who select default investment options for participants who fail to provide investment instruction. The Department of Labor (DOL) has recently issued a proposed regulation implementing provisions of the PPA pertaining to default investment alternatives.

The proposed regulation provides relief to fiduciaries for default investments, regardless of whether or not the plan otherwise meets the DOL's requirements under ERISA section 404(c). Under the proposed regulations, a participant or beneficiary who fails to give investment directions will be treated as exercising control over his or her account with respect to the assets that are invested in a qualified default investment alternative (QDIA). As a result, a plan fiduciary may avoid liability for investment losses resulting from investing a participant's or beneficiary's account in a QDIA, or for investment decisions made by the manager of the investment alternative.

***Conditions for Fiduciary Relief.*** To qualify for the safe harbor, the following six conditions must be satisfied:

- 1) The assets must be invested in a QDIA (defined below);
- 2) The affected participant or beneficiary must have had an opportunity to direct the investment of assets in his or her account, but failed to do so;
- 3) The affected participant or beneficiary must have been furnished with a notice within thirty (30) days in advance of the first default investment and at least thirty (30) days in advance of each subsequent plan year (the requirements are further discussed below). The notice can be included as a part of the summary plan description or a summary of material modifications;
- 4) The terms of the plan provide that any material provided to the plan by a QDIA (e.g., investment prospectuses, account statements, proxy voting materials, etc.) relating to an affected participant or beneficiary's investment in such QDIA must be furnished to the affected participant or beneficiary;
- 5) The affected participant or beneficiary must be allowed to transfer such assets to any other investment alternative available under the plan at least once in any three-month period, without financial penalty; and

- 6) The plan must offer participants and beneficiaries a “broad range of investment alternatives” as defined in the DOL’s regulations under ERISA section 404(c).

Plan fiduciaries still have a duty to prudently select and monitor a QDIA and its investment manager, and are still liable for any losses resulting from a failure to satisfy such duty.

***Qualified Default Investment Alternative.*** In order to be a QDIA, the following five conditions must be satisfied:

- 1) A QDIA must be one of the following: (1) “life-cycle” or “targeted-retirement-date” fund, (2) a “balanced fund”; or (3) a “managed account.” A money market or stable value fund is *not* listed as an eligible QDIA.
- 2) A QDIA must not hold or acquire employer securities, with two exceptions: (1) employer securities held or acquired by an investment company registered under the Investment Company Act of 1940 or by a similar pooled investment vehicle, and (2) employer securities acquired as a matching contribution or at the participant’s direction;
- 3) A QDIA may not impose financial penalties or otherwise restrict the ability of an affected participant or beneficiary to transfer his or her investment from the QDIA to any other investment alternative available under the plan;
- 4) A QDIA must be managed by an investment manager as defined in ERISA section 3(38) or an investment company registered under the Investment Company Act of 1940; and
- 5) A QDIA must be diversified so as to minimize the risk of large losses.

***Notice Requirements.*** The 30-day advance notice must be written in a manner calculated to be understood by the average plan participant and contain the following information:

- A description of the circumstances under which assets in an affected participant’s or beneficiary’s account may be invested in a QDIA;
- A description of the QDIA, including a description of the investment objectives, risk and return characteristics (if applicable), and fees and expenses;
- A description of the affected participant’s or beneficiary’s right to transfer investment of his or her account to any other investment alternative under the plan, without financial penalty; and
- An explanation of how affected participants and beneficiaries can obtain investment information pertaining to the other investment alternatives available under the plan.

The regulation will become effective 60 days following the publication of the final regulation in the Federal Register, and the DOL is directed to issue the final regulation by February 17, 2007.

If you have any questions regarding material in this issue of *Employee Benefits Briefing*, contact Paul F. Russell (practice leader) at 312-609-7740 or at [prussell@vedderprice.com](mailto:prussell@vedderprice.com), Jonathan E. Hyun at 312-609-7791 or at [jhyun@vedderprice.com](mailto:jhyun@vedderprice.com) or any member of the Employee Benefits Group.

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## VEDDER, PRICE, KAUFMAN & KAMMHOLZ, P.C.

### About Vedder Price

Vedder, Price, Kaufman & Kammholz, P.C. is a national full-service law firm with approximately 230 attorneys in Chicago, New York City, Washington, D.C. and Roseland, New Jersey.

### Chicago

222 North LaSalle Street  
Chicago, Illinois 60601  
312-609-7500  
Fax: 312-609-5005  
Paul F. Russell

### New York

805 Third Avenue  
New York, New York 10022  
212-407-7700  
Fax: 212-407-7799  
Neal I. Korval

### Washington, D.C.

888 16th Street, N.W., Suite 800  
Washington, D.C. 20006  
202-355-1395  
Fax: 202-355-1394  
Edward Gross

### New Jersey

Five Becker Farm Road  
Roseland, New Jersey 07068  
973-597-1100  
Fax: 973-597-9607  
John E. Bradley

[www.vedderprice.com](http://www.vedderprice.com)

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### The Employee Benefits Group:

|  |              |
|--|--------------|
| Mark I. Bogart.....                    | 312/609-7878 |
| Michael G. Cleveland.....              | 312/609-7860 |
| Christopher T. Collins.....            | 312/609-7706 |
| Thomas P. Desmond.....                 | 312/609-7647 |
| John H. Eickemeyer.....                | 212/407-7760 |
| Thomas G. Hancuch.....                 | 312/609-7824 |
| Jonathan E. Hyun.....                  | 312/609-7791 |
| John J. Jacobsen, Jr.....              | 312/609-7680 |
| Michael C. Joyce.....                  | 312/609-7627 |
| Neal I. Korval.....                    | 212/407-7780 |
| Alison J. Maki.....                    | 312/609-7720 |
| Phillip L. Mowery.....                 | 312/609-7642 |
| Stewart Reifler.....                   | 212/407-7742 |
| Paul F. Russell (Practice Leader)..... | 312/609-7740 |
| Robert F. Simon.....                   | 312/609-7550 |
| Kelly A. Starr.....                    | 312/609-7768 |
| Lawrence L. Summers.....               | 312/609-7750 |
| Charles B. Wolf.....                   | 312/609-7888 |