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# Employee Benefits Briefing

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

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

The Pension Protection Act of 2006 ("PPA") amended ERISA by adding a new section 404(c)(5) to provide relief for plan fiduciaries who select default investment options for a participant (or beneficiary) who fails to provide investment instruction. After review and consideration of comments on the proposed regulations issued in September 2006, the Department of Labor ("DOL") published final regulations relating to "qualified default investment alternatives" ("QDIAs") in 401(k) and other defined contribution plans on October 24, 2007.

### *Effective Date*

- The final regulations are effective on December 24, 2007.

### *General*

- Relief is provided to fiduciaries for default investments, regardless of whether or not the plan is an "ERISA 404(c) plan" or otherwise meets the requirements of the DOL's regulations under ERISA section 404(c).
- A participant 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 QDIA.
- A plan fiduciary will generally be protected from liability for investment losses resulting from investing all or a portion of the account in a QDIA.

### *Conditions for Fiduciary Relief*

Six conditions must be satisfied for a plan fiduciary to qualify for safe harbor relief:

(1) The assets must be invested in a QDIA;

(2) The participant must have had an opportunity to direct the investment of assets in his or her account but failed to do so;

(3) The participant must have been furnished with a notice, the requirements of which are set forth below:

(a) either (i) within thirty (30) days in advance of the date of plan eligibility or within thirty (30) days in advance of the first QDIA investment, or (ii) on or before the date of plan eligibility if the participant is provided the opportunity to make a permitted withdrawal within the first 90

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days under Internal Revenue Code Section 414(w) (initial notice), and

(b) at least thirty (30) days in advance of each subsequent plan year (annual notice).

Note that the notices may not simply be included as part of the summary plan description or a summary of material modifications. Instead, each notice must be provided as a separate notice, although the notice may be combined with the automatic enrollment notice;

(4) Any material provided to the plan for the QDIA (e.g., investment prospectuses, account statements, proxy voting materials, etc.) relating to the participant's investment in such QDIA must be furnished to the participant;

(5) The participant must be allowed to transfer such assets to any other investment alternative available under the plan, as often as for other plan investments, but at least once every quarter. Restrictions, fees and expenses may not be imposed for transfers (or withdrawals) made for the first 90 days, after the affected participant's assets are invested in a QDIA. After this initial 90-day period, the participant can be subject to the same restrictions, fees and expenses on transfers that apply to all plan participants invested in that QDIA; and

(6) The plan must offer participants a "broad range of investment alternatives," as defined in the DOL's regulations under ERISA section 404(c).

The final regulations reaffirm that plan fiduciaries still have a duty to prudently select and monitor a QDIA and its investment manager.

***Qualified Default Investment Alternative***

In order to be a QDIA, the following conditions must be satisfied:

- A QDIA must consist of one of the following types of investment products:

  (1) Life-cycle or targeted-retirement-date type fund, which provides a mix of investments based on the participant's age, target date of retirement or life expectancy.

  (2) Balanced type fund, which provides a mix of investments that takes into account the characteristics of the group of plan participants as a whole, rather than each individual.

  (3) Professionally managed account, whereby an investment management service invests the assets of each participant in a mix of investments offered under the plan based on the participant's age, target date of retirement or life expectancy.

**NOTE:** a capital preservation product (money market and stable value funds) may be used as a QDIA, but only for the first 120 days after a participant's first elective deferral to the plan. After this initial 120-day period, the fiduciary must transfer the participant's investment into one of the three QDIAs set forth above (unless during the initial 90-day period the participant directed the investment of the account or opted out of the plan). Further, the regulations "grandfather" default investments made before December 24, 2007 to certain stable value funds that provide a guarantee of principal and the rate of return by a state or federally regulated financial institution.

- 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;

- A QDIA may not impose financial penalties or otherwise restrict the ability of a participant to transfer his or her investment from the QDIA to any other investment alternative available under the plan; and
- 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.

***Notice Requirements***

The initial and annual notice mentioned above 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 a participant's account may be invested in a QDIA, including, if applicable, a description of the circumstances under which elective deferrals will be made on behalf of the participant, the percentage of the deferral, and the participant's right to elect not to have such deferrals made;
- A description of the affected participant's right to direct the investment of his or her accounts;
- 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 participant's right to transfer investment of his or her account 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 participants can obtain investment information pertaining to the other investment alternatives available under the plan.

***Other Points***

- The notice may be provided electronically under the DOL or IRS rules for providing electronic communications.
- The final regulations do not contain a model notice.
- The final regulations provide that ERISA supersedes any state law that would prohibit or restrict automatic contribution arrangements, regardless of whether such automatic contribution arrangements qualify for the safe harbor.
- A plan sponsor may determine that it is prudent to continue using a stable value or other "nonqualified" fund as the default option, but would not have the safe harbor protection afforded by this new rule.

If you have any questions or wish to discuss this topic further, please contact Jonathan E. Hyun at 312-609-7791, jhyun@vedderprice.com, Paul F. Russell at 312-609-7740, prussell@vedderprice.com or any member of the Employee Benefits Group.

## ERISA Bond to Increase When Plan Holds Employer Securities

The Pension Protection Act of 2006 increased the amount of the required ERISA bond from $500,000 to $1,000,000 for plans that hold employer securities. The change is effective for plan years beginning on and after January 1, 2008.

The Department of Labor has not yet issued any guidance on questions related to this statutory change. Nevertheless, the legislative history indicates that the increased amount would not be required when the employer securities are held in a widely diversified fund of assets, such as a mutual or index fund.

## Safe Harbor Notice Reminder

An employer that has designed its 401(k) Plan to eliminate the need for contribution testing, with either (1) a minimum employer contribution of 3% of compensation or (2) a minimum matching contribution of dollar-for-dollar on the first 3% of compensation contributed and 50 cents on the dollar for the next 2% of compensation contributed (a so-called "safe harbor plan"), must also issue an annual notice to participants at least 30 days in advance of the beginning of the plan year. For calendar year plans, this notice must be issued by December 1.



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### *The Employee Benefits Group*

Vedder Price has one of the nation's largest employee benefits practices, with ongoing responsibility for the design, administration and legal compliance of pension, profit sharing and welfare benefit plans with aggregate assets of several billion dollars. Our employee benefits lawyers also have been involved in major litigation on behalf of benefit plans and their sponsors. Our clients include large national corporations, smaller professional and business corporations, multiemployer trust funds, investment managers and other plan fiduciaries.

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