

THE BENEFIT BULLETIN

FAST FACTS ABOUT RETIREMENT PLANS

The following article contains general plan facts and is intended for informational purposes only. To ensure that your plan contains specific provisions outlined in this and future articles, please contact your third party administrator or plan ERISA attorney.

Protection May Now Be Available for Employers When Default Investments Used in Retirement Plan

What was the problem with “default investments” in a retirement plan?

Historically, when an employer sponsored a retirement plan (i.e., a 401(k) or profit sharing plan) which allowed a participant to direct his/her own account investment, the participant often failed to return the investment allocation and direction forms to the employer in a timely manner. Meanwhile, salary deferrals may have been deposited into the participant’s account. This left the plan sponsor/ employer in a predicament – what investment vehicle should be used for the participant’s account until the participant provided the investment direction requested? Often, in an abundance of caution, the employer placed the participant’s funds in a low interest and principal-protected investment. However, regardless of the employer’s prudence, as a fiduciary responsible for acting in the interest of the participant, the employer could not rest assured that the participant would be accepting of the potentially low rate of return received. Plan sponsors already have protection available as to the investment choices they offer participants in a participant-directed plan if they follow the requirements under ERISA Section 404(c)(1). They needed protection and guidance as to how they could be protected from liability, in the situation described above, by placing the funds in what is now referred to as a “qualified default investment alternative”.

What protection is now available as a solution?

The Department of Labor (DOL) has issued final regulations on the Qualified Default Investment Alternative (“QDIA”) rules. These rules were promulgated to provide plan fiduciaries with safe harbor relief under ERISA Section 404(c)(5) if, in the event a participant fails to provide investment directions, the fiduciaries invest the participant’s account in a QDIA.

The regulations are effective December 24, 2007. They basically explain that a participant who provides no investment direction (and whose account is invested in a QDIA) is deemed to have actually exercised control over his or her assets. This is extremely important as it serves as the justification for plan fiduciaries who comply with the regulations to not be liable for any investment loss the participant may experience due to investment in the QDIA.

Are QDIA rules under 404(c)(5) mandatory for plan sponsors/employers?

No. The protection available under the QDIA rules is voluntary, just as is the protection available under 404(c)(1), referenced above.

What constitutes a “QDIA” under the new rules?

There are three basic categories of QDIA default funds or strategies:

- 1) A target date fund – fund based on individual’s age, life expectancy, or years until retirement age;
- 2) Balanced fund (or “risk-based fund”) – investment strategy based on demographics of the plan as a whole, such as average age of participants;
- 3) Managed account – investment manager using a strategy based on individual’s age, years to retirement age, etc.

Are traditional capital preservation funds, such as money market options and stable value funds considered QDIAs?

No. In general, the final regulations provide that these types of funds are not QDIA’s. Although, there are limited exceptions as to certain types of funds purchased prior to December 24, 2007, and also for funds invested on behalf of the participant during the first 120 days of participation.

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Are there notices that must be given to participants in order to comply with the new regulations?

Yes. Both initial and annual notices are required.

- Initial Notice – This notice must be provided at least 30 days before 1) the participant becomes eligible to participate in the plan, or 2) the initial investment on behalf of the participant in the QDIA .
- Annual Notice – This notice must be provided to all participants at least 30 days in advance of the first day of each plan year.

Is there any retroactive protection available for default investments used previously?

Possibly. This requires an additional “transition notice” which provides the protection of the QDIA rules to assets previously invested under default investments, if the proper notice and actions are taken.

<p>The Benefit Bulletin is a publication of: Pension Plan Administration, LLC 200 Louisiana, Little Rock, Arkansas 72201 Phone: 501-320-2430 Fax: 501-320-2440 Website: www.pensionplanadmin.com</p>

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