



Final QDIA Rules

October 26, 2007

The Pension Protection Act of 2006 (PPA) created the Qualified Default Investment Alternative (QDIA) largely to promote the offering of automatic enrollment 401(k) plans. The QDIA provides employers a safe harbor from fiduciary risk when selecting an investment for a participant or beneficiary who fails to elect his or her own investment. PPA directed the Department of Labor to issue the QDIA regulations. Employers following the QDIA regulations will have no legal liability for market fluctuations when providing a QDIA for employees who do not choose their own investments.

The proposed regulations, issued September 27, 2006, received more than 120 public comments. After review and consideration of these comments, the DOL issued [final regulations for QDIAs](#) on Wednesday, October 24, 2007. The effective date for these regulations is Dec. 24, 2007. This is a nice holiday season gift — just in time for the new year of 2008 and the qualified automatic contribution arrangement.

Qualified Default Investment Alternatives

The PPA goal for the QDIA is that it meet a worker's long-term retirement savings needs, rather than just preserving capital. The final regulations provide four QDIA investment alternative mechanisms, rather than specific products. An example of a product for each category is provided.

1. A product with a mix of investments that takes into account the individual's age, retirement date, or life expectancy (for example, a life-cycle or targeted-retirement-date fund);
2. A product with a mix of investments that takes into account the characteristics of the group of employees as a whole, rather than each individual (for example, a balanced fund);
3. An investment service that allocates contributions among existing plan options to provide an asset mix that takes into account the individual's age or retirement date (for example, a professionally-managed account); and
4. A capital preservation product for only the first 120 days of participation. This eases administration, for example, in the case of workers that opt-out of participation within 90 days. After 120 days, the plan fiduciary must redirect the participant's investment into the above three QDIA categories (unless the participant opted-out of the plan or redirected investments during the 90 days).

Variable Annuity and Other Pooled Investments

The QDIAs above may be offered through a variable annuity contracts and similar contracts as well as through common and collective trust funds or other pooled investment funds; provided the QDIA satisfies all the rules of the regulations.

Existing Stable Value Funds Grandfathered

Prior to PPA some plan sponsors adopted stable value products as their default investment. The final regulations "grandfather" these arrangements by providing relief for contributions invested

in stable value products prior to the effective date of the final rule. The transition rule does not provide relief for future contributions to stable value products.

ERISA Supersedes State Law

The rule provides 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.

Additional QDIA Requirements

- With limited exception, a QDIA may not be invested in employer securities;
- A plan may not restrict the participant or beneficiary from transferring the funds in a QDIA to any other investment alternative available under the plan; the transfer must be permitted with the same frequency that applies to other plan investments, but not less than on a quarterly basis and may not impose any restrictions, fees or expenses inconsistent with these regulations;
- Must be managed by an investment manager or an investment company registered under the Investment Company Act of 1940; thus, those responsible for the QDIA are “investment managers” within the meaning of ERISA section 3(38); the final regulations added to this list plan sponsor’s that are willing to serve as named fiduciary for the management of the plan’s investments in order to save the plan (and thus its participants) management costs; bank trustees of collective investment funds are permitted, provided they meet ERISA Section 3(38)(A), (B), and (C).

Conditions for Fiduciary Liability Relief

1. Assets must be invested in one of the QDIA investment categories above.
2. The participant or beneficiary must first be given the opportunity to provide investment direction. If the participant or beneficiary fails to make an investment election, the QDIA may be used. If they respond after the QDIA is established, then the investment direction from the participant or beneficiary will supersede the QDIA.
3. A notice must generally be provided at least 30 days in advance of the first investment in a QDIA and 30 days in advance of each subsequent plan year. More information on the notice requirements is provided below.
4. Material provided to the plan for the QDIA investments must be furnished to participants and beneficiaries invested in the QDIA. For example, prospectuses, account statements, and proxy-voting materials. The rules for pass-through disclosure information provided to participants not invested in a QDIA will also apply to those invested in a QDIA. The information may be mailed directly from the provider to the participant or beneficiary.
5. Participants and beneficiaries must have the opportunity to direct investments out of a QDIA at least as frequently as from other plan investments, but at least quarterly. During the first 90 days after the first automatic enrollment deferral is withheld, QDIA withdrawal requests will not be subjected to a surrender charge, liquidation or exchange fee, redemption fee, or similar expenses. However, on-going fees for the operation of the investment may be charged. After the 90-day period, the restrictions, fees and expenses of the plan will apply to a QDIA.
6. The plan must offer a “broad range of investment alternatives” as defined in the regulations under section 404(c) of ERISA.

Fiduciary Prudence Requirement

The plan fiduciary must prudently select and monitor an investment fund, model portfolio, or investment management service within any category of QDIAs. For example, a plan fiduciary that chooses an investment management service must undertake a careful evaluation to prudently select among different investment services.

Fiduciary relief is not based upon which of the QDIA investment options is selected. Any one or a mix thereof is permitted.

As fiduciaries, plan sponsors must exercise the ERISA prudent person rules when considering the market value adjustments or similar withdrawal penalties that may apply to a QDIA. If a QDIA would be a less prudent investment because of the fees and/or penalties, the fiduciary must weigh that finding before deciding on a QDIA. In the final regulations, we are reminded that under PPA, the final QDIA regulations are not the exclusive means of satisfying PPA, though they do provide a safe harbor.

Transition Issues

Those participants considered to be in a qualified default investment prior to the final regulations who now are sent a QDIA notice will be considered to be in a QDIA, provided the final regulations are otherwise complied with.

Notice Specifications

Specific timeframes for providing the QDIA notice from the regulations:

- (i) (A) 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; OR
- (B) On or before the date of plan eligibility provided the participant has the opportunity to make a permissible withdrawal (as determined under section 414(w) of the Internal Revenue Code of 1986, as amended (Code)); and
- (ii) Within a reasonable period of time of at least 30 days in advance of each subsequent plan year.

The notice requirements:

- 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; and, if applicable, an explanation of the circumstances under which elective contributions will be made on behalf of a participant, 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 to have such contributions made at a different percentage);
- 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 attendant 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

Additional Points About the Notice

- Written in a manner to be understood by the average plan participant.
- The notice may not be part of the SPD or SMM, but it may be part of the QACA safe

harbor notice and the automatic enrollment notice.

- The notice may be provided electronically, provided the DOL or IRS rules for providing electronic communications are satisfied.

The final regulations do not contain a model notice. The department stated that it would not be possible to create a model that could accommodate the flexibility needed for the complex variety of different plans and different investment products and portfolios. However, the DOL will explore this further with the Treasury concerning the similar notice requirements of safe harbor 401(k) plans and automatic enrollment plans.

The DOL has modified the notice content to broaden the required disclosures incorporated into this notice. The notice will satisfy the requirements of the ERISA preemption of state withholding laws for automatic enrollment plans and the requirement to inform participant's of how investments will be made in absence of their investment choices.

Notices required for automatic enrollment plans will contain, in addition to the above, an explanation of the circumstances under which an elective deferral will be made for a participant or beneficiary and the percentage of such contribution. It will also include the right of the participant to opt out of or change the amount of such deferrals and an explanation of the right to direct the investment of their accounts.

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