

Fiduciary protection for plan sponsors



Wealth
Management

Does your plan offer a QDIA as your “default” option?

The Pension Protection Act (PPA) of 2006 added a new Section 404(c) (5) to ERISA. That particular section provides a fiduciary defense for default investments for participants in 401(k) and ERISA 403(b) participant-directed plans. In essence, plan sponsors can get fiduciary protection by designating qualified default investment alternatives (QDIAs) as the “default” investments for participants who fail to exercise their own investment elections. Plan sponsors who comply with the notice and investment requirements under the regulations will not be liable for any investment losses or any breach that occurs as a result of being invested in the QDIA. Plan sponsors remain responsible for the prudent selection and monitoring of the QDIA.

Until these new regulations, the most common default funds for qualified retirement plans were money market or stable value funds. Under the final regulations, these types of investments do not qualify as a QDIA, except for the first 120 days of plan participation. Today, more and more plan sponsors will be taking advantage of the fiduciary protection they will receive from offering their participants QDIAs as their “default” options.

The final regulations from the Department of Labor (DOL) became effective December 24, 2007.

What is a QDIA?

The final regulations provide four types of QDIAs:

1. A product with a mix of investments that takes into account the individual’s age or retirement date (for example, life-cycle/target-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)
4. A capital preservation product for only the first 120 days of participation (for example, a money market fund); after 120 days the money must be transferred into one of the other QDIAs

A QDIA must either be managed by an investment manager, plan trustee or plan sponsor who is a named fiduciary, or be an investment company registered under the Investment Company Act of 1940.

A QDIA generally may not invest participant contributions in employer securities. (There are two exceptions to this rule: pooled investment vehicles and employer stock received as a match or by participant direction.)

Grandfathered provisions for stable value funds

Some plan sponsors adopted stable value products as their default investment prior to the passage of this regulation. The final regulations “grandfathered” these arrangements by providing relief for contributions invested in stable value products prior to December 24, 2007. The transition rule does not provide relief for future contributions to stable value products.

Conditions for fiduciary protection

The final regulations provide the following conditions that must be satisfied in order to obtain “safe harbor” relief from fiduciary liability for investment outcomes:

- Assets must be invested in a “qualified default investment alternative” (QDIA).
- Participants and beneficiaries must have been given an opportunity to provide investment direction, but have not done so.
- A notice generally must be furnished to participants and beneficiaries in advance of the first investment in the QDIA and annually thereafter. The rule describes the information that must be included in the notice.
- Material, such as investment prospectuses, provided to the plan for the QDIA must be furnished to participants and beneficiaries.

- Participants and beneficiaries must have the opportunity to direct investments out of a QDIA as frequently as from other plan investments, but no less frequently than once in a three-month period.
- Transfer fees or restrictions cannot be imposed upon a defaulted participant who opts out of the QDIA within 90 days of the first investment in the QDIA. This prohibition includes mutual fund redemption fees.
- The plan must offer a “broad range of investment alternatives” as defined in the Department of Labor’s regulation under section 404(c) of ERISA.

Notification to participants or beneficiaries

Initial notice

The notice must be provided (a) at least 30 days before the employee becomes eligible to participate in the plan or before the participant’s account will first be invested in the QDIA, or (b) if the plan has an automatic enrollment feature, then the initial notice may be provided on or before the date of plan eligibility, provided the plan participant has the opportunity to opt out of the plan and withdraw (within 90 days) contributions made as a result of automatic enrollment without tax consequences (as per Internal Revenue Code Section 414[w]).

Annual notice

Must be given at least 30 days in advance of each plan year.

How RBC Wealth Management can help

As your financial advisor, we can help you review your qualified default investment alternatives (QDIAs). For example, should you add a lifecycle fund versus a balanced fund? We can help you explore the QDIA options offered on your recordkeeping platform, and assist with the employee communications. For additional questions regarding QDIAs, please contact us.