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Pension ANALYST

Compliance Bulletin

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DOL Clarifies QDIA Rules

On October 24, 2007, the Department of Labor (DOL) issued final rules on safe harbor default investments for participant-directed defined contribution plans subject to ERISA. In response to many comments and questions received on those rules, the DOL published clarifying guidance on April 29, 2008, in the form of technical corrections and Field Assistance Bulletin (FAB) 2008-03. This Compliance Bulletin discusses the highlights of these clarifications.

Scope of QDIA Rules

The new DOL guidance clarifies that plan fiduciaries who satisfy all of the requirements for "qualified default investment alternative" (QDIA) relief, will be relieved of fiduciary liability with respect to all assets invested in a QDIA, regardless of whether the assets were attributable to contributions made before the effective date of the final rules, December 24, 2007. *For example, Plan A provided QDIA notices to participants on April 30, 2008. As of May 30, 2008, Plan A satisfies the QDIA requirements. Beginning May 30, 2008, fiduciary relief applies to all assets in the QDIA, including those amounts attributable to contributions made before December 24, 2007.*

Fiduciary relief is also provided for assets invested in a QDIA on behalf of participants or beneficiaries that do not provide investment elections after receiving the QDIA notice, even if those individuals had made a prior affirmative election to invest in the fund. This is important where plan sponsors are not able to determine whether or not participants ever made an affirmative investment election.

In addition, a plan sponsor may create and manage a QDIA using a mix of the plan's available investment alternatives, as long as the plan sponsor is a named fiduciary. The plan sponsor will receive fiduciary relief with respect to any investment losses. However, the plan sponsor is still responsible for the management of the QDIA, and the prudent selection and monitoring of the QDIA investments.

Notice Requirements

Under the final rules, a QDIA notice generally must be a separate, stand-alone notice that may be mailed in the same envelope as other notices. However, the rules specifically allow a plan sponsor to combine a QDIA notice, an "eligible automatic contribution arrangement" (EACA) notice and/or a "qualified automatic contribution arrangement" (QACA) notice into a single notice. The new DOL guidance also allows a plan sponsor to combine a QDIA notice with a traditional 401(k) plan safe harbor notice.

As provided by the final QDIA rules, the notice must provide a description of the fees and expenses that apply to the investment alternative. A separate, but simultaneously furnished document, such as a prospectus, may be sent with the QDIA notice for these purposes. FAB 2008-03 indicates that until DOL issues further guidance, the following information may be provided to participants and beneficiaries regarding QDIA fees and expenses:

- The amount and description of any shareholder-type fees, such as sales loads, sales charges, deferred sales charges, redemption fees, surrender charges, exchange fees, account fees, purchase fees, and mortality and expense fees; and
- Expense ratios, where applicable.

90-Day Limitation on Fees and Restrictions

For a 90-day period following the first investment in a QDIA on behalf of a participant or beneficiary, any transfer or withdrawal of assets from the QDIA by the participant or beneficiary cannot be subject to certain restrictions, fees, and similar expenses. In response to concerns that fund companies may be unable or unwilling to waive redemption fees during a 90-day period, the new DOL guidance clarifies that a plan sponsor or service provider may pay the redemption fee for the participant or beneficiary. However, the DOL guidance does not address the character of these payments for Internal Revenue Code purposes. For example, it is not clear whether such payments would be considered annual additions for the participants or subject to the deductible contribution limits, if made by the plan sponsor. In addition, the DOL guidance did not discuss the effect of agreements between fund companies and service providers that may restrict sponsors and service providers from paying the redemption fees on behalf of a participant or beneficiary.

The new DOL guidance also explains the application of the 90-day period during which no fees or expenses may be imposed. While the 90-day limitation applies to amounts invested in the QDIA on behalf of new participants enrolled in the plan on or after the effective date of the QDIA rules, it does not apply to participants who had assets in the default fund before the effective date of the QDIA rules.

In addition, FAB 2008-03 clarifies that certain types of round-trip restrictions may be applied during this 90-day period. A “round-trip restriction” prevents participants from reinvesting in a fund once they have transferred assets out of that fund. According to the new guidance, a round-trip restriction is permitted if it only affects the participant’s ability to reinvest in the QDIA for a limited period of time. However, a restriction is not permitted if it affects the participant’s ability to liquidate or transfer from the QDIA or restricts his ability to invest in any other investment alternative available under the plan.

QDIA Management and Asset Allocation

The final rules require a QDIA to be “diversified so as to minimize the risk of large losses” and to be designed to provide varying degrees of long-term appreciation through a mix of equity and fixed income exposures. FAB 2008-03 clarifies that an investment product with no fixed income exposure cannot qualify as a QDIA. Similarly, an investment product with no equity exposure cannot qualify as a QDIA. The DOL did not provide a minimum for the amounts of fixed income and equity that would satisfy the requirement for a mix, and does not plan to provide further guidance on the issue.

A plan sponsor may use more than one QDIA, as long as all the QDIA rules are satisfied with each QDIA. *For example, a plan may use one QDIA for its automatic contribution arrangement, and another for rollover contributions made to the plan.*

In addition, FAB 2008-03 clarifies that a committee comprised primarily of employees of the plan sponsor may manage a QDIA if it is a named fiduciary of the plan.

120-Day Capital Preservation QDIA

The final rules allowed plans to use a capital preservation product as a QDIA for a 120-day period following the participant's first elective contribution. Before the end of the 120-day period, the amounts must be moved from the capital preservation product to the plan's QDIA. FAB 2008-03 clarifies that the 120-day capital preservation QDIA is only permitted for plans with an EACA that permits employees to request a refund of accidental deferrals within 90 days following their first elective contribution.

The 120-day provision provides protection from investment loss for the few "accidental" participants who are unwittingly automatically enrolled, whose short-lived participation—and relatively small investment—would otherwise have resulted in a market-value loss (had it been invested in the plan's core QDIA), and who request a refund of their automatic contributions within 90 days. However, this provision does not provide any additional fiduciary protection for plan sponsors. Plan sponsors will need to weigh the costs (including potentially substantial administrative burden) against the perceived benefits of this provision before deciding to adopt it. This is an optional provision. If it is not adopted, the plan sponsor still gets full QDIA protection, and an "accidental" participant's automatic enrollment refund would include any market value losses *or gains* resulting from his short-lived participation in the plan's QDIA.

Grandfather Relief for Stable Value Funds

The new DOL guidance clarifies that plan sponsors were not required to send QDIA notices by November 24, 2007, thirty days before the effective date of the QDIA rules, to be eligible to receive grandfather protection for amounts invested in a stable value fund before December 24, 2007. The grandfather relief takes effect once the requirements are met (thirty days following the time the initial notice is provided). *For example, if Plan Sponsor B provided the initial notice on January 1, 2008, to participants and beneficiaries who were defaulted into a stable value fund prior to the regulation, and if all other QDIA requirements have been met, the fiduciary relief provided by the regulation would be available on January 31, 2008. The grandfather protection only applies to assets invested in the stable value product or fund on or before the effective date of the final rules, December 24, 2007.*

Next Steps

With the exception of EACA plans, plan sponsors are not required to comply with the QDIA rules. Prudential Retirement has developed a QDIA Decision Tree to assist plan sponsors with the decision on whether to comply with the QDIA rules. If you are interested in complying with the QDIA rules for the additional layer of fiduciary protection for your plan, please contact your Prudential Retirement representative.

Prudential Financial