

## CLIENT ACTION BULLETIN

May 9, 2008

CAB 08-11

### DOL Corrects and Clarifies Qualified Default Investment Guidance

#### SUMMARY

On April 29, 2008, the Department of Labor (DOL) issued corrections and clarifications to its "qualified default investment alternative" (QDIA) rules for participant-directed defined contribution plans. With these corrections to the October 24, 2007, final rules, the DOL addresses three key issues: "round-trip restrictions" on reinvestments; management of a QDIA by a committee; and the definition of a "stable value fund." The DOL's separate *Field Assistance Bulletin 2008-03* ("FAB") provides, in question-and-answer format, additional guidance in several areas, including: the final rules' scope; notice requirements; 90-day limitation on fees and restrictions; management and asset allocation; and grandfather relief for stable value funds. Both pieces of guidance are effective beginning on and after December 24, 2007.

#### DISCUSSION

The DOL's final rules on QDIAs were issued on October 24, 2007, and became effective as of December 24, 2007. These rules provided plan sponsors with safe-harbor relief from liability associated with their investment choices on behalf of nonresponding participants. (For more detailed information on the final rules, see [Client Action Bulletin 07-13](#).) The DOL received a number of questions on the meaning and scope of various provisions in the rules, and it answers these in the FAB. Additionally, the DOL determined that three provisions in the final rules were stated incorrectly and required modification.

#### QDIA Corrections

1. The final rules prohibit a plan from imposing any restrictions, fees, or expenses on a participant's transfer or withdrawal from a QDIA during the 90-day period that begins on the date deferrals or contributions made on behalf of a participant are first defaulted into a QDIA. One of the DOL's examples of an impermissible restriction was a so-called "round-trip restriction," which penalizes the participant when reinvesting in the QDIA within a defined period of time after having withdrawn amounts from it. The DOL concluded that this example should not have been included because it was too broad, and the example has been removed. Under the DOL's correction, a round-trip restriction is only considered impermissible if it affects the participant's ability to liquidate or transfer amounts from the QDIA or to invest amounts in any other fund available under the plan.
2. To accommodate in-house management of the QDIA, the final rules allowed a plan sponsor that is the plan's named fiduciary to be one of the permissible managers of a QDIA. The correcting amendments clarify that the definition of a plan sponsor includes a committee consisting primarily of employees of the plan sponsor. The committee's role as a plan fiduciary must be identified within the plan document and allow for the in-house management of the QDIA.
3. The final QDIA rules also permitted default contributions made to stable value funds prior to December 24, 2007, to receive QDIA safe-harbor protection (potentially avoiding unnecessary withdrawal penalties). However, one precondition for the stable value fund was that it be **guaranteed** by a state or federally regulated financial institution. The DOL determined that this requirement was not broad enough. The modified definition requires that the stable value fund be primarily invested in products that are backed by state or federally regulated financial institutions. This includes products issued directly by financial institutions or backed by contracts issued by financial institutions.

#### Scope of the QDIA Rules

The FAB stresses that fiduciary relief is granted only with respect to the decision to invest a participant's account in the QDIA by a plan sponsor managing the QDIA. Relief is not granted for the management or the prudent selection and monitoring of the QDIA. In addition, if a participant

fails to make an investment election after the December 24, 2007, effective date of the QDIA rules and after receiving the required notification, fiduciary relief will extend to all assets invested in the QDIA (i.e., including assets invested in the QDIA before the rules' effective date) and without regard to whether the investment was made as a result of a default investment or an affirmative election. This clarification provides welcome relief for plan sponsors who do not maintain records indicating whether assets were invested by default. However, if a participant has not been given the opportunity to direct his or her investment, fiduciary relief will not be available. Finally, the FAB clarifies that the QDIA rules apply to all qualified plans (e.g., 401(k) plans) and 403(b) plans that are subject to ERISA.

### Notice Requirements

The FAB's clarification that the required notice to participants may consist of more than one document provides additional good news for plan sponsors. Specifically, until the DOL issues forthcoming guidance, a prospectus may be used to satisfy the description of the QDIA, fees, charges, fund performance, etc. In addition, the QDIA notice is permitted to be combined with the notices required for a qualified automatic contribution arrangement (QACA), eligible automatic contribution arrangement (EACA), or 401(k) safe-harbor plan. The notice (combined or not) may be issued electronically; until further guidance is issued, however, the electronic distribution may not include pass-through of investment materials. The FAB also clearly states that although the timing of the various notices is not identical, the timing requirements can be easily satisfied on a combined basis. For example, if the annual notice is provided at least 30 (and no more than 90) days before the beginning of each plan year, the timing requirements for all the notices would be satisfied.

### 90-Day Limitation on Fees and Restrictions

The 90-day period during which assets invested in the QDIA cannot be subject to restrictions, fees, or expenses upon transfer or withdrawal by a participant begins on the date the first contribution or investment is defaulted into the QDIA. It does not apply to default investments made on behalf of participants prior to December 24, 2007. If the plan sponsor or service provider chooses to pay any fees or expenses that would otherwise be assessed to the participant's account during the 90-day period, the requirements will be satisfied.

### Management and Allocation

A plan may have more than one QDIA. In general, a QDIA must be "diversified so as to minimize the risk of large losses." The FAB states definitively that an undiversified fund—one with zero fixed income investment or zero equity investment—would not satisfy this requirement.

### Grandfather Relief

The grandfather relief for assets invested in a stable value default fund prior to the effective date of the QDIA rules takes effect 30 days after the required QDIA notice is given to participants.

**ACTION** Plan sponsors who already have adopted or are considering adopting a QDIA should:

- review the stable value fund if grandfathering is an issue;
- review the 90-day limitation period and consider the merits of retaining any round-trip restrictions associated with the fund (to the extent liquidation rules are satisfied);
- consider appointing a committee if in-house management is desired;
- consider using a prospectus for some of the required information in the notice;
- consider combining QDIA notices with QACA, EACA, or safe-harbor 401(k) notices and distributing them electronically; and
- review the fiduciary relief requirements and ensure compliance.

For more information about the DOL's new guidance on QDIAs, please contact your Milliman consultant.