

Update

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Department of Labor clarifies default investment alternatives for 401(k)-type plans

Fiduciaries looking to minimize their liability for default investment decisions in participant-directed retirement plans have raised a number of questions about last year's final regulations from the Department of Labor (DOL). In response, on April 29, the DOL issued two sets of additional guidance on "qualified default investment alternatives" or QDIAs. Mercer is working closely with clients to ensure they have a clear understanding of the new guidance and the implications for plan design, operation and fiduciary risk management.

In the past, employers may have felt compelled to use very conservative default funds, out of concern for fiduciary exposure as well as preservation of participants' capital. The QDIA rules give employers an incentive to favor life-cycle funds, balanced funds or managed accounts for default investments. This is a good time to review the new DOL guidance with your Mercer consultant and consider the investment strategy opportunities presented by the final regulations.

New DOL guidance aims to address plan sponsor concerns

The DOL's final regulations took effect Dec. 24, 2007, and provide guidance in cases where participants in 401(k) and similar plans fail to provide investment instructions – for example, when participants are auto-enrolled or when the plan changes record keepers. Plan fiduciaries will be shielded from liability for directing these participant's plan assets to QDIAs, such as life-cycle funds, balanced funds or managed accounts, although they still must prudently select and monitor default funds and meet certain other requirements.

The fiduciary relief is available for participant-directed account plans, such as 401(k), profit-sharing, money purchase and 403(b) plans. (Non-ERISA plans – such as governmental, church and some 403(b) plans – are not covered.)

Responding to concerns expressed by plan sponsors and industry groups, the DOL has now adopted several corrections to the final QDIA rules. Additional insights can be found in the agency's responses to 22 frequently asked questions (Field Assistance Bulletin 2008-03).

More capital preservation funds qualify for grandfather relief

One helpful clarification allows plan sponsors to move forward on establishing QDIA status for certain capital preservation assets invested before Dec. 24, 2007. Many plan sponsors were concerned that the original standard for this grandfather relief was too restrictive – the final rules required that the product or fund be designed to “guarantee” principal and interest. The DOL redefined the grandfathered class to cover certain stable-value products or funds that are designed to “preserve” principal and that invest primarily in investment products backed by regulated financial institutions.

To qualify for the grandfather relief, products or funds must provide a rate of return consistent with intermediate grade bonds, while providing liquidity for withdrawals and transfers. No fees or surrender charges may be imposed on withdrawals initiated by participants.

Round-trip restrictions do not infringe transfer rights

Individuals electing to transfer (or withdraw money) out of a QDIA must be exempt from any restrictions or other fees normally imposed by the plan or underlying investment product for 90 days after the individual's initial investment. The final regulations raised concerns that round-trip restrictions in place to curb frequent trading might prevent some funds from qualifying as QDIAs.

To alleviate these concerns, the DOL has clarified that round-trip restrictions – those barring reinvestments in the QDIA for a limited period of time – are allowed as long as they do not affect the right to transfer out of a QDIA or to invest in any other option in the plan's lineup.



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Plan committees may handle in-house investment management

The final regulations allow QDIAs to be managed by a plan sponsor who is a named fiduciary, but it wasn't clear if funds managed by in-house plan committees – a common practice for customized life-cycle funds – would qualify as QDIAs. Now the DOL has clarified that QDIAs can be managed by a named fiduciary that is “a committee comprised primarily of employees of the plan sponsor.” This welcome change reflects the DOL's recognition that in-house investment management can yield potential cost savings for participants.

FAQs provide additional insights

The DOL Q&As also provide helpful detail on some outstanding transition issues, generally designed to make QDIAs easier to adopt and administer. For example, once QDIA status is secured, the relief will extend to all assets held in the QDIA by default, even if the assets were contributed before the regulations took effect on Dec. 24, 2007. In addition, when converting an existing fund to a QDIA, it doesn't matter if the fiduciary cannot determine whether participants initially chose or defaulted into the existing fund. The key is whether participants fail to provide investment direction *after* receiving the appropriate QDIA notice. The DOL also answered questions about fee restrictions and participant notices, although some open issues remain.

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