U.S. Department of Labor

Regulation Relating To Qualified Default Investment Alternatives In Participant-Directed Individual Account Plans

Background

Approximately one-third of eligible workers do not participate in their employers' 401(k)-type plans. Studies suggest that automatic enrollment plans (in which workers "opt-out" of plan participation rather than "opt-in") could reduce this rate to less than 10%, significantly increasing retirement savings.

The Pension Protection Act (PPA) President Bush signed into law last year removed impediments to employers adopting automatic enrollment, including employer fears about legal liability for market fluctuations and the applicability of state wage withholding laws.

These impediments prevented many employers from adopting automatic enrollment, or led them to invest workers' contributions in low-risk, low-return "default" investments.

The PPA directed the Department of Labor to issue a regulation to assist employers in selecting default investments that best serve the retirement needs of workers who do not direct their own investments.

The Department issued a proposed regulation on September 27, 2006 and received more than 120 public comments. After considering the many issues raised by commenters, the Department's Employee Benefits Security Administration today promulgates the final regulation.

Overview Of Final Regulation

By facilitating the adoption of automatic enrollment plans, and by encouraging investments appropriate for long-term retirement savings, the Department estimates the rule will result in between $70 billion and $134 billion in additional retirement savings by 2034.

The final regulation provides 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) as defined in the regulation.

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

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 at least quarterly.

The rule limits the fees that can be imposed on a participant who opts out of participation in the plan or who decides to direct their investments.

The plan must offer a "broad range of investment alternatives" as defined in the Department's regulation under section 404(c) of ERISA.

The final regulation does not absolve fiduciaries of the duty to prudently select and monitor QDIAs.

Qualified Default Investment Alternatives

The final regulation does not identify specific investment products – rather, it describes mechanisms for investing participant contributions. The intent is to ensure that an investment qualifying as a QDIA is appropriate as a single investment capable of meeting a worker's long-term retirement savings needs. The final regulation identifies two individually-based mechanisms and one group-based mechanism – it also provides for a short-term investment for administrative convenience.

The final regulation provides for four types of QDIAs:

1. A product with a mix of investments that takes into account the individual's age or retirement date (an example of such a product could be a life-cycle or targeted-retirement-date fund);
2. 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 (an example of such a service could be a professionally-managed account);
3. 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 (an example of such a product could be a balanced fund); and
4. A capital preservation product for only the first 120 days of participation (an option for plan sponsors wishing to simplify administration if workers opt-out of participation before incurring an additional tax).

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.

Other Significant Provisions

Recognizing that some plan sponsors adopted stable value products as their default investment prior to passage of the Pension Protection Act and this final regulation, the regulation provides a transition rule. The regulation "grandfathers" 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.

The final regulation clarifies that a QDIA may be offered through variable annuity contracts or other pooled investment funds.

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.

A copy of the regulation will be available on the agency's Web site under "Laws and Regulations."

This fact sheet has been developed by the U.S. Department of Labor, Employee Benefits Security Administration, Washington, DC 20210. It will be made available in alternate formats upon request: Voice Telephone: 202.693.8664; Text Telephone: 202.501.3911. In addition, the information in this fact sheet constitutes a small entity compliance guide for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.