Morgan Stanley

Understanding Qualified Default Investment Alternatives

The Department of Labor's (DOL) regulations governing qualified default investment alternatives (QDIAs) outline the availability and scope of fiduciary relief, the types of investments considered QDIAs, and participant notification requirements.

What is the QDIA Safe Harbor?

The Pension Protection Act (PPA) offered a number of incentives for plan sponsors to adopt automatic enrollment features into their 401(k) plans—one of the most significant being the safe harbor provision on QDIAs. This provision protects plan sponsors when selecting default investments on behalf of employees who neglect to make an investment election of their own. Historically, selecting investments for these employee contributions had been a decision fraught with fiduciary liability concerns for plan sponsors. The creation of this safe harbor to protect the employer from fiduciary liability resulting from these decisions has been a welcome change.

Qualifications for QDIA Safe Harbor

The following is a summary of the conditions that must be satisfied in order to qualify for safe harbor protection:

- Assets must be invested in a 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 regulation describes the information that must be included in the notice.
- Certain investment information on the QDIA, such as investment prospectuses, 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.
- Fees must generally be limited to those that would have otherwise been charged to participants using that investment option.
- The plan must offer a "broad range of investment alternatives" as defined in the DOL's regulations under section 404(c) of ERISA.[1]

Investments That Qualify as QDIAs

The DOL regulations do not identify specific investment products that qualify as QDIAs. Instead, they describe types of investments that the DOL has determined are appropriate for meeting a participant's long-term retirement savings needs. 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 and retirement date (an example 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 (such as a money market fund) for only the first 120 days of participation—an option for plan sponsors wishing to simplify administration if workers opt out of participation.

In addition, QDIAs generally may not invest participant contributions in employer securities, nor do stable value funds qualify as a QDIA. However, plan sponsors who used a stable value fund as the plan's default option prior to the effective date of the final regulation have fiduciary protection on the "grandfathered" amounts, i.e., amounts invested prior to the December 24, 2007 effective date.

Other Important Provisions

It is important to note that this safe harbor protection does not absolve fiduciaries of the duty to prudently select and monitor QDIAs. There are also a few operational points that may be of interest to plan sponsors contemplating the QDIA regulations The QDIA rules are not limited to plans utilizing an automatic enrollment feature (although the use of a capital preservation product such as a QDIA is). Plan sponsors may take advantage of the QDIA safe harbor in any situation in which a plan participant fails to make an investment election, such as when a participant neglects to provide investment direction following the elimination of an investment option, or when the participant fails to provide investment instruction following a rollover contribution to the plan.

Summary

Based on the fact that automatic enrollment is a growing trend, and yet many participants who are automatically enrolled in a plan fail to make investment decisions, it is anticipated that many plan sponsors will include a QDIA in their plans' investment lineup. QDIAs hold a special place in the investment lineup of a plan and may increase retirement savings by increasing participant contributions. When considering a QDIA, plan sponsors should consult a legal advisor to learn about any implications that may result from acting on a particular recommendation.

[1] Section 404(c) of ERISA provides plan fiduciaries with certain protections from fiduciary liability with respect to investment decisions made by plan participants, provided the requirements of Section 404(c) are satisfied. Plan participants must have sufficient information to make informed investment decisions.