U.S. Department of Labor

Proposed Regulation Relating To Default Investment Alternatives Under Participant Directed Individual Account Plans

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Employee Benefits Security Administration
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Background

Approximately one-third of eligible workers do not participate in their employer-sponsored defined contribution plans (such as 401(k) plans). Studies suggest that almost all of these workers would choose to remain participants if they were automatically enrolled. The increased savings would significantly improve their retirement security.

Some employers have adopted automatic enrollment plans and many more are interested, but the fact that they are potentially liable for investment losses that may occur in such plans has been a major impediment to wider adoption of this plan design.

The Pension Protection Act of 2006, signed by President Bush on August 17, 2006, removes several impediments to automatic enrollment plans. A key one of these is amending the Employee Retirement Income Security Act (ERISA) to provide a safe harbor for plan fiduciaries investing participant assets in certain types of default investment alternatives in the absence of participant investment direction.

The Labor Department's Employee Benefits Security Administration (EBSA) has proposed a regulation implementing the default investment amendments made to ERISA by the Pension Protection Act.

Overview Of Proposed Regulation

ERISA provides relief from liability for investment outcomes to fiduciaries of individual account plans that allow participants to exercise control over the investment of assets in their plan accounts.

The proposed regulation deems a participant to have exercised control over assets in his or her account if, in the absence of investment direction from the participant, the plan fiduciary invests the assets in a qualified default investment alternative (QDIA).

The Department estimates that the proposal will increase aggregate 401(k) plan account balances by between $45 billion and $90 billion.

The proposal establishes the following conditions for fiduciary relief:

- Assets must be invested in a "qualified default investment alternative" as defined in the proposal.
- Participants and beneficiaries must have been given an opportunity to provide investment direction, but failed to do so.
- A notice must be furnished to participants and beneficiaries 30 days in advance of the first investment, and at least 30 days in advance of each subsequent plan year, and must include: a description of the circumstances under which assets will be invested in a QDIA; a description of the investment objectives of the QDIA; and an explanation of the right of participants and beneficiaries to direct investment of the assets out of the QDIA.
- Any material, such as investment prospectuses and other notices, provided to the plan by the QDIA must be furnished to participants and beneficiaries.
- Participants and beneficiaries must have the opportunity to direct investments out of a QDIA with the same frequency available for other plan investments but no less frequently than quarterly, without financial penalty.
- The plan must offer a "broad range of investment alternatives" as defined in the Department's regulation under section 404(c) of ERISA.

Plan fiduciaries would not be relieved of liability for the prudent selection and monitoring of a QDIA.

Qualified Default Investment Alternatives
Under the proposed regulation, a QDIA must satisfy the following requirements:

A QDIA may not impose financial penalties or otherwise restrict the ability of a participant or beneficiary to transfer the investment from the qualified default investment alternative to any other investment alternative available under the plan.

A QDIA must be either managed by an investment manager, or an investment company registered under the Investment Company Act of 1940.

A QDIA must be diversified so as to minimize the risk of large losses.

A QDIA may not invest participant contributions directly in employer securities.

A QDIA may be:

- Life-cycle or targeted-retirement-date fund;
- Balanced fund; or
- Professionally managed account.