From the compliance desk...

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Qualified Default Investment Alternative (QDIA) in a Retirement Plan

Fiduciary Responsibility Regarding the Investment of Retirement Plan Assets

When it comes to the investment of retirement plan assets, the Employee Retirement Income Security Act of 1974 (ERISA) requires plan fiduciaries to:

- Act solely in the best interest of the plan participants and their beneficiaries
- Manage plan assets prudently as an individual with expertise in investments
- Diversify plan assets so as to minimize large losses

If the plan sponsor directs the investment of the plan assets, the plan sponsor can be held liable for investment losses if the assets are not prudently invested. However, if the participants are able to direct how the assets under their retirement account are invested, the plan fiduciaries are not liable for losses incurred as a result of those investment elections as long as certain requirements under ERISA Section 404(c) are satisfied. In general, the plan must:

- Offer at least three diversified investment options that provide a broad range of investment alternatives. Each of the core investments must offer materially different risk and return characteristics so that in aggregate the participant or beneficiary is able to achieve a portfolio with aggregate risk and return characteristics appropriate for that individual
- Provide the participant the opportunity to make changes to their investments at a frequency that is appropriate to the volatility of the investment. At a minimum, changes must be allowed on a quarterly basis.
- Provide the participant the investment information necessary to make an informed decision regarding the investment offerings under the plan

The plan fiduciary is still responsible for the prudent selection and monitoring of the investment options available under the plan. In addition, the relief under Section 404(c) is only available if the participant actually makes an affirmative election on how he/she would like the plan contributions invested. If the participant does not make an election (e.g., the participant receives a portion of the annual profit sharing allocation but had not completed an enrollment/investment election form) and the contributions are invested in the plan's default fund, the plan fiduciary can be held liable for investment losses on those dollars.

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Fiduciary Relief for Default Investment

The Pension Protection Act of 2006 (PPA) added a provision under ERISA Section 404(c)(5) which extends the liability protection to plan fiduciaries where the participant does not make an affirmative investment election. In order to obtain the relief provided under the PPA, the plan's default investment must satisfy the requirements of what is known as a Qualified Default Investment Alternative (QDIA). The PPA directed the Department of Labor (DOL) to issue regulations/ guidance detailing what constitutes a QDIA and what action is necessary for the plan fiduciary to obtain the liability protection of the QDIA. In the regulations, the DOL indicated that default investments that simply preserve capital would not qualify for the fiduciary protection. The default investment must provide a mix of long-term appreciation and capital preservation. The DOL has approved three different types of investment categories as a QDIA, which include:

1. Life Cycle/Target Retirement Date Funds: designed to provide investment exposure appropriate for the individual based on the participant's age, target retirement date or life expectancy. Such product or portfolio should change their asset allocation and associated risk levels over time with the objective of becoming more conservative with the participant's increasing age
2. Balanced Fund: designed to provide long-term appreciation and capital preservation through a mix of equity and fixed income exposures consistent with a target level of risk appropriate for participants of the plan as a whole.
3. Managed Fund: an investment management service where an investment manager allocates the assets of a participant's individual account to achieve varying degrees of long term appreciation and capital preservation through a mix of equity and fixed income exposures offered through investment alternatives available under the plan. The participant's default portfolio is designed to become more conservative with increasing age

Each must apply generally accepted investment theories, be diversified to avoid the risk of large losses and be designed to provide varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures.

American Trust's QDIA Selection

As discretionary trustee and investment manager, American Trust & Savings Bank (ATSB) is a plan fiduciary and is responsible for determining the default investment election for those participants that fail to make an affirmative election. The current default fund is the Vanguard Wellington Balanced Fund. While this fund is considered a prudent default it does not satisfy the requirements of a QDIA as outlined in the DOL regulations and therefore does not have the protection of a QDIA. As such, ATSB has made the decision to change the default fund to the American Trust Managed Models. The Models fall within the Managed Fund option that has been approved by the DOL as an acceptable QDIA.

Individuals that are invested 100 percent in the prior default fund at the time of the change will be provided an opportunity to make an affirmative investment election or will be moved into the QDIA. Individuals who become eligible for the plan after the date of the change will have their contributions invested in the QDIA if no investment direction is provided. Under the QDIA, the participant's assets will be placed in an age appropriate Model and will migrate to a more conservative model as the participant's age increases.

Notice Requirements

The rules require that the participant receive a Notice explaining what the QDIA is and under what circumstances the participant's assets will be invested in the QDIA. Each eligible participant must be provided an initial Notice at least 30 days prior to the first investment in the QDIA. In addition, each participant who does not make an affirmative investment election must be provided an annual notice at least 30 days prior to each subsequent plan year. The notice must include the following information:

- An explanation of the participant's right to make an affirmative investment election
- A description of the QDIA, including a description of the investment objectives, risk and return characteristics, as well as any applicable fees or expenses
- A description of the participant's right to transfer money out of the QDIA
- An explanation of where the participant can obtain investment information on the other investment alternatives available under the plan.
- A description of the circumstances in which the participant's assets will be invested in the QDIA. In addition, if the plan provides for automatic enrollment into the plan, an explanation of the plan's automatic enrollment features

Once a participant makes an affirmative investment election they will no longer receive the QDIA Notice.