

Automatic 403(b) Feature Provides Fiduciary Relief for Plan Sponsors

In the world of ERISA-governed defined contribution plans, plan sponsors have a lot to deal with. An important decision that comes with sponsoring a plan is choosing an appropriate default investment. For example, sponsors find themselves having to deal with contributions where employees have not made specific investment elections. In these cases, most employers have historically chosen capital preservation funds as the default. They perceived these funds as the best way to protect themselves from fiduciary liability for investment losses.

Now, in the post-Pension Protection Act (PPA) world, many plan sponsors select equity-based default investments. This change is a direct response to the passage of PPA and ensuing DOL guidance.

Smart Resource

The Department of Labor's Employee Benefits Security Administration (EBSA) recently launched outreach and compliance assistance efforts for 403(b) pension plans subject to Title I of the Employee Retirement Income Security Act (ERISA). The initiatives are part of the agency's ongoing compliance assistance program to help employers, plan officials and service providers, including the growing number of employers offering automatic features. Visit: www.dol.gov/ebsa/403b.html

The Current Landscape

Under today's rules, plan sponsors qualify for fiduciary relief for investment losses if the default investment is a Qualified Default Investment Alternative (QDIA). Even with QDIAs, though, plan sponsors are still responsible for the prudent selection and monitoring of plan investment options.

The focus of the new guidance is on default investments in plans with automatic design. (See "Automatic 403(b) Basics—What You Need to Know" for an overview.) However, it is applicable also to default investments in traditional plan design.

To qualify for fiduciary relief, sponsors need to offer participants the chance to direct their own investments, and the participants must fail to do so. If the participants are defaulted into a QDIA, sponsors qualify for the relief.



A condition for fiduciary relief is that employees must fail to choose their own investment when offered the opportunity.

Accepted QDIAs

The regulations do not identify specific investment products, but rather types of investment funds. Default investments that qualify as QDIAs include life cycle funds, balanced funds and managed accounts. A fourth type—capital preservation funds—is acceptable only as a temporary holding place for contributions.

A **life cycle fund** or model portfolio, also known as a target retirement date fund, contains a mix of investments based on a participant's age and expected retirement date. The investment mix becomes more conservative as the participant gets closer to retirement, usually by shifting assets out of stocks and into bonds.

A **balanced fund** or model portfolio is a blend of investments that seeks both principal preservation (such as money market funds) and capital growth (like stock funds) based on the plan's participant demographics as a whole.

Under a **managed account**, an investment manager chooses investments available in the plan based on an individual's age, target retirement date or life expectancy.

A plan sponsor may elect to use a capital preservation fund for the QDIA as long as the sponsor transfers amounts invested in it to one of the other QDIA fund types within 120 days of deposit. The DOL added this option to accommodate plan sponsors wanting to simplify administration for workers that opt out.

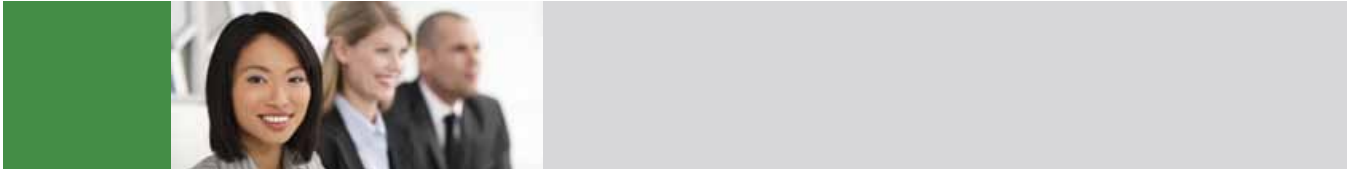
Additional Provisions

The DOL's final rule clarified that plan sponsors may offer a QDIA through a variable annuity contract or other pooled investment funds. It also clarified that ERISA supersedes state laws that would otherwise prohibit or restrict automatic contribution plans.

The fiduciary protection that comes with QDIA selection is contingent in part on providing initial and annual notification to employees.

Employees must receive *initial* notice at least 30 days prior to plan eligibility or the first QDIA investment. Employees may receive the notice on the date of plan eligibility if the plan permits penalty-free withdrawals within the first 90 days. The *annual* notice must occur at least 30 days in advance of the start of each plan year.

The notice needs to describe the circumstances under which the plan directs contributions to a QDIA. It has to explain the participant's right to direct the investment. It also needs to describe the QDIA and how to move assets to other investments. The notice must identify how participants can get information about other plan investment options. (See "Automatic 403(b) Notification Rules" for more detail on these requirements.)



Plan sponsors have to notify participants before contributions go into the default investment, and before the start of each plan year.

The sponsor is required to make fund prospectuses and other investment materials available to participants and beneficiaries. Further, automatically enrolled participants need to have the same opportunity as other participants to transfer assets within the plan without financial penalty. Finally, the plan must offer a broad range of investment alternatives.

The Movement to Automatic Plan Design

PPA and the regulations that followed have led to a dramatic increase in the adoption of automatic plan design by private sector 401(k) plans. Forty percent of 401(k) plan sponsors have instituted automatic plan features.⁸ Now that recent and significant changes in the rules that govern 403(b) plans generally have been finalized, expect to see an upward trend in 403(b) automatic plan design, too.

If you are considering automatic plan design, seek out organizations that have gone before you to learn from their experiences. Talk with your plan service providers about your options. And refer to **www.retirementmadesimpler.org** for help and insights. The site intends to encourage automatic plan design adoption. It is a collaborative effort of **AARP**, the **Financial Industry Regulatory Authority (FINRA)**, and the **Retirement Security Project (RSP)**.

Once you have looked into the benefits and opportunities to your organization and your employees, you may find little reason not to adopt automatic plan features.

⁸ Profit Sharing/401(k) Council of America, *52nd Annual Survey of Profit Sharing and 401(k) Plans*. September 2009.