

Navigating the QDIA Notice Requirements

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This is the third in a series of bulletins about the DOL's final regulation on Qualified Default Investment Alternatives, or QDIAs, and the fiduciary protections they afford. The first bulletin provided a general overview of the fiduciary protections and the requirements imposed by the regulation. (www.reish.com/publications/pdf/investqualif.pdf.) The second bulletin was a detailed discussion of the investments that are eligible to be QDIAs and some of the specific investment related issues. (www.reish.com/publications/pdf/finalqdiareg.pdf.) This bulletin discusses the notice and information requirements and the practical application of those rules.

As background, the Pension Protection Act of 2006 (PPA) provides fiduciaries with protection under ERISA section 404(c)(5) from losses that result from investing a defaulted participant's account. (The fiduciary protection afforded by the QDIA regulation is commonly being called a "safe harbor" and we use that term in this bulletin.) The DOL issued a regulation that sets forth the requirements that plans must satisfy to receive that protection. Included in the requirements are that the accounts of participants who do not select the investments for their money be invested in a "qualified default investment alternative" or "QDIA" and that these individuals be given notices and specified information. (For ease of reference, we use the term "participants" in this bulletin to refer to participants and beneficiaries, except as otherwise indicated.)

On April 29, 2008, the DOL issued Field Assistance Bulletin (FAB) 2008-03 which provides questions and answers to respond to the 401(k) community's requests for further clarification.

This bulletin discusses the notice and information requirements contained in the DOL's regulation and FAB in a question-and-answer format and includes a summary Chart at the end.

Q1: Are notices required in order to obtain relief under ERISA section 404(c)(5)?

Yes. The statute, ERISA section 404(c)(5), requires notices to be provided in order for the fiduciary protection to apply. Section 404(c)(5)(A) states "a participant in an individual account plan meeting the notice requirements of subparagraph (B) shall be treated as exercising control over the assets in the account..." Similarly, DOL Regulation § 2550.404c-5(c)(3) states: "a fiduciary shall qualify for the relief described in paragraph (b)(1) of this section if:...The participant or beneficiary on whose behalf an investment in a qualified default investment alternative may be

made is furnished a notice that meets the requirements of paragraph (d) of this section..."

COMMENT: We are concerned that many plans failed to give the notices late last year when the opportunity was first available. The failure to give the notice, either initially or annually, will cause the loss of the 404(c)(5) fiduciary safe harbor. However, it may be restored, at least prospectively. (See Q4 and Q6 below.) It is highly likely that, independent of the protection afforded by the notice (and the resulting safe harbor), placing defaulting participants in a QDIA-type investment is a prudent investment decision by plan fiduciaries. (This is particularly true of the managed account QDIA, since ERISA provides separate fiduciary protections where managed accounts are used.) As a result, there appears to be little, if any, risk to fiduciaries if the safe harbor is lost. Nonetheless, there is much to be said for a "belt-and-suspenders" approach to fiduciary risk management and, as a result, adherence to the QDIA conditions is recommended.

Q2: What types of notices need to be given?

Participants need to be given both initial notices and annual notices. Initial notices must be given to employees before their assets are invested in the QDIA. Annual notices must be given every year and serve to remind participants about their default into the QDIA and their right to direct the investment of their accounts. (See the Chart at the end of this bulletin describing what types of notices need to be provided.)

Fiduciaries of plans that had default investments before the regulation became effective (that is, December 24, 2007) must give participants in the default investment "a transition" notice in order to receive the protection under ERISA section 404(c)(5) for the old defaults. A transition notice serves as the initial notice for these individuals and explains to participants any changes being made to the default account.

(See Q7 below and the Chart at the end of the bulletin describing the types of transition notices.)

Q3: When does the initial notice need to be given and to whom?

The initial notice must be given:

- 1) at least 30 days before the date the employee becomes eligible to participate in the plan (e.g., for a new participant), or at least 30 days before the date the participant's assets are invested

in the QDIA (e.g., for a rollover before satisfying the eligibility requirements); or

- 2) on or before the employee becomes eligible to participate for an automatically enrolled plan if participants can withdraw their deferrals within 90 days in accordance with Internal Revenue Code (“Code”) section 414(w).

The regulation does not define when an employee is considered to be “eligible to participate.” For example, an employee may satisfy the eligibility provisions several months before her entry date. It is unclear whether the notice would need to be given 30 days before the employee (i) satisfied the eligibility provisions or (ii) reached her entry date. However, we believe that the correct timing would be to provide the initial notice at least 30 days before her entry date for the plan.

When defaults occur, it is most often either because an employee was automatically enrolled or an employee regularly enrolled, but did not direct her investments. In those cases, the notice must be given at least 30 days before the employee “entered” the plan. As a result, the initial notice is, by definition, given to employees, rather than to participants.

The notice has to go out to all employees who are anticipated to enter the plan, because fiduciaries cannot know who will or will not default in advance. Large plan sponsors will probably handle those notices internally. However, small plan sponsors and many mid-sized plan sponsors will need external help from their providers and advisers. As a result, some providers will need to modify their systems to include new hires in order to help provide notices to employees before they enter the plans.

Neither the statute nor the regulation provides an outer limit in terms of how far in advance the initial notice can be provided. However, the FAB provides that a notice will be deemed to satisfy the timing requirements if it is provided not more than 90 days before the employee’s eligibility date.

Q4: What happens if the initial QDIA notice isn’t given?

Fiduciaries will not have 404(c)(5) protection for default amounts invested in the QDIA until the initial notice has been given and the 30-day notice period has elapsed.

Q5: When does the annual notice need to be given and to whom?

The annual notice must be given at least 30 days before each following plan year. The annual notice must be given to all active participants, former employees with account balances, and beneficiaries, who were defaulted into the QDIA and who have not subsequently directed the investment of their account. (See the Chart at the end of this bulletin describing when the annual notice needs to be provided and to whom.)

The regulation seems to require that the notice state that the participant was defaulted into a QDIA. As a result, it appears that the notice must be given only to defaulted participants. For example, the preamble states: “Further, the Department believes that it is important to

provide regular and ongoing notice to participants and beneficiaries whose assets are invested in a qualified default investment alternative to ensure that they are in a position to make informed decisions concerning their participation in their employer’s plan.” However, at several conferences DOL speakers have stated that the annual notice could be given to all plan participants, which could simplify the distribution process for many plans and, particularly, small plans.

Q6: What happens if an annual notice isn’t given?

Providing an annual notice is a condition of receiving fiduciary protection. As a result, the failure to provide annual notices will result in a lack of protection during the time periods for which annual notices should have been provided, but were not.

However, this would not cause a fiduciary to lose protection for the prior years in which the notice had been properly given. At worst, it would only cause the fiduciary to lose protection for the year for which it was not timely distributed. Neither the preamble nor regulation addresses whether the failure to give an annual notice can be corrected by a late notice. However, there is the possibility—perhaps even a probability—that fiduciaries could receive protection for that year after they have distributed the notice. As a result, if the annual notice is not delivered timely, the better practice would be to give the notice late rather than not at all.

Q7: When are plans giving out transition notices and to whom?

Transition notices apply to specific limited circumstances. (Technically, a transition notice is an initial notice, but the notice needs to be modified to take into account special circumstances that exist during a transition from one default investment to another or in declaring an existing default investment to be a QDIA, such as, a grandfathered stable value.) Transition notices are only given out once. Thereafter, newly eligible employees are given initial notices and annual notices are given to defaulted participants who continue to be invested in the QDIA.

The following are examples of situations that require a transition notice:

- Grandfathered protection is available for amounts contributed before December 24, 2007 if the plan was invested in a qualifying stable value investment before the regulation became effective and a transition notice is distributed. However amounts contributed thereafter would need to be placed in a qualifying target-date investment, a risk-based investment, or a managed account QDIA in order for fiduciaries to have protection under ERISA section 404(c)(5).
- If the plan used a money market account before the regulation became effective, fiduciaries would not receive protection unless the assets in the money market account and newly defaulted money was placed in a QDIA. Even then, the safe harbor protection would only be prospective.
- Plans that used a default investment that satisfies the requirements for a QDIA before the regulation became effective may continue to use it as the plan’s QDIA, if the transition notice is given. The safe harbor will only begin 30 days after the notice is given.

Q8: How often will plans be giving out notices?

Plans will need to give out several notices during the same year. Initial notices will be given to employees before they begin participating and annual notices will be given to participants who stay in the QDIA default investments.

For example, assume a plan that has quarterly entry dates on the first day of each calendar quarter. In that case, five notices would need to be given over the course of the year. The first four would be initial notices and would only go to the employees who are eligible for that quarterly entry date. The fifth would be the annual notice which would go to all participants who were defaulted that year and in prior years into QDIAs and who continue to be invested in them. That would include participants in grandfathered stable value investments.

Note that once participants direct any part of their accounts, then they are no longer considered to be in a QDIA, but instead are considered to have affirmatively directed the investment of their account. The preamble to the regulation states “[N]o relief is available when a participant or beneficiary has provided affirmative investment direction concerning the assets invested on the participant’s or beneficiary’s behalf.” Therefore, no ongoing notices would be required for them.

Q9: What information needs to be contained in the initial and annual notices?

The regulation requires that notices contain the following information:

- A description of the circumstances under which a participant’s account may be invested in a qualified default investment alternative (“QDIA”). That is, the notice must tell employees that, if they do not file affirmative investment elections, the accounts will be invested by the fiduciaries on their behalf.
- An explanation that participants have the right to direct their investments. A conservative interpretation would be that the notice should include instructions that let participants know how to direct their investments.
- A description of the QDIA, including its investment objectives, risk and return characteristics, and fees and expenses. The FAB explains “participants and beneficiaries generally should be provided information concerning: (1) the amount and a description of any shareholder-type fees such as sales loads, sales charges, deferred sales charges, redemption fees, surrender charges, exchange fees, account fees, purchase fees, and mortality and expense fees and (2) for investments with respect to which performance may vary over the term of the investment, the total annual operating expenses of the investment expressed as a percentage (*e.g.*, expense ratio).” Our experience is that many plans attach fund sheets that provide information about the QDIAs for this purpose. The FAB indicates that this method is acceptable. It states “the Department notes that there is nothing in the QDIA regulation that would preclude the use of separate, but simultaneously furnished, documents to satisfy the notice requirements....”

- A description of a participant’s right to transfer the investment of his account from a QDIA into any other investment alternative under the plan and a description of any applicable restrictions, fees or expenses that would apply in connection with a transfer. This can be a significant issue as some investments do not satisfy the requirements for a QDIA because they impose restrictions or fees (for example, a redemption fee) if a participant transfers out of a QDIA within 90 days of the first investment in the QDIA.
- An explanation of where participants can obtain information about the plan’s other investments. Plans may provide participants with contact information for the provider and/or the responsible person at the plan sponsor, in addition to the provider’s web site, to satisfy this requirement.
- For automatically enrolled plans, an explanation of the circumstances under which deferrals will be made on behalf of a participant, the percentage of the deferrals, and the right of the participant to elect a different percentage or to opt out of participating in the plan. These provisions also satisfy the requirements for the notice that is needed to preempt state laws that might affect or limit payroll withholding for automatic enrollment.

Additional information must be provided to participants. However, this information does not have to be included in the notices. The FAB explains that defaulted participants are entitled to the same amount of information as participants who direct their own investments in a 404(c) plan. Thus, defaulted participants are required to be automatically furnished, in the case of registered investment companies, the most recent prospectus or profile prospectus as well as any material relating to voting, tender or similar rights provided to the plan. Plans that invest in group annuity contracts typically do not receive these materials and therefore would not be required to provide them to participants. Plans are also required to provide either automatically or upon request certain information concerning the plan’s investment alternatives, such as annual operating expenses and the value of shares or units in the investment alternatives.

Q10: Can fact sheets be provided to the notices to meet the notice content requirements?

While all of that information must be included in the notice, or an attachment which is part of the notice, there are no requirements about the form. So, if the fact sheet for an investment has all of the required information about the QDIA, it should satisfy the requirements if attached to the notice (or distributed simultaneously). As a word of caution, though, the information on the fact sheet should be easy to find, that is, a participant should not be required to search through lengthy materials in order to find the required description. In addition, it should be easy to read, since the regulation requires that the notice must “be written in a manner calculated to be understood by the average plan participant.”

Q11: Can the notice refer participants to a web site for information about the QDIA?

At this time, it appears that the participant must be provided with certain information, such as prospectuses (if they are provided to the plan), rather than be given information about where they can find it.

Specifically, the QDIA regulation states that the requirement is: “A fiduciary provides to a participant or beneficiary the materials set forth in . . . [the 404(c) regulation].” The preamble to the 404(c) regulation, by analogy, says that it is not adequate to direct participants to where they can find the information required for the 404(c) regulation, and we believe that would apply here as well. The preamble to the 404(c) regulation states “The Department is persuaded that merely referring participants and beneficiaries to a source for investment information and requiring them to obtain the information is insufficient to ensure that participants and beneficiaries are in a position to make informed investment decisions.”

Q12: Can the notice be sent electronically?

Theoretically, yes. However, as a practical matter, it would be difficult to do that in a way that satisfies the requirements. The DOL specifically addressed that issue in the preamble. The preamble states, to satisfy the notice requirement through electronic distribution, the plan would need to “rely on either guidance issued by the Department of Labor at 29 CFR §2520.104b-1(c) or the guidance issued by the Department of the Treasury and Internal Revenue Service at 26 CFR §1.401(a)-21 relating to the use of electronic media.”

However, we have found that, as a practical matter, it is difficult for employers to comply with all of the requirements in those regulations. One of the requirements that is particularly troublesome is that, in order to use participants’ non-work email addresses, their consent must be affirmatively obtained.

Q13: Can the notice be combined with other materials that are provided to participants?

The regulation does not specifically say that the QDIA notice can be combined with any other notices, but does encourage the distribution of multiple notices at the same time to minimize costs to the plan, *i.e.*, the preamble states “In this regard, the Department recognizes that there may be cost savings that result from distributing multiple disclosures simultaneously and, to the extent that distribution costs may be charged to the accounts of individual participants, efforts to minimize such costs should be encouraged.”

Further, in the preamble to the regulation and in the FAB, the DOL states that it anticipates that the notice requirements for ERISA section 404(c)(5), the safe harbor automatic enrollment provisions under Code section 401(k)(13) and the 90-day withdrawal right under Code section 414(w)(4) would be combined in a single document.

Q14: Can the notice be included in the summary plan description (SPD) or the statement of materials modifications(SMM)?

No. The DOL explicitly states that the QDIA notice may not be included in a summary plan description or statement of material modifications. The DOL comments in the preamble to the regulation that “The Department is persuaded that, given the potential length and complexity of summary plan descriptions and summaries of material modifications, the furnishing of the required disclosures through a separate notice will reduce the likelihood of a participant or beneficiary missing or ignoring information about his or her plan participation and the investment of the assets in his or her account in a qualified default investment alternative.”

CHART

WHAT	WHEN	WHO	INVESTMENTS DESCRIBED
Initial Notice	At least 30 days before the date: (i) the employee becomes eligible to participate in the plan; (ii) the employee's assets are invested in the QDIA; or (iii) on or before the employee becomes eligible to participate if participants are automatically enrolled and can withdraw their deferrals within 90 days in accordance with Internal Revenue Code section 414(w).	Eligible employees	QDIA
Annual Notice	At least 30 days before each plan year.	All participants defaulted into the QDIA and, if applicable, the grandfathered stable value.	QDIA and, if applicable, the grandfathered stable value.
Transition Notice where pre-QDIA default investment was:			
• Money Market	At least 30 days before 404(c)(5) protection is sought.	All participants in the default account.	QDIA
• Stable Value	At least 30 days before the grandfathered 404(c)(5) protection is available.	All participants in the pre-December 24 stable value default account.	QDIA and stable value
• QDIA type	At least 30 days before prospective 404(c)(5) protection is sought.	All participants in the default account.	QDIA

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