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November 2007 / Special Alert

A legal update from Dechert's Employee Benefits and Executive Compensation and Financial Services Groups

DOL Issues Final Default Investment Alternative Regulations

Final U.S. Department of Labor ("DOL") regulations, effective December 24, 2007, implement certain provisions of the Pension Protection Act of 2006 ("PPA") that provide relief from liability for retirement plan fiduciaries who, in the absence of participant investment direction, invest participant accounts in default investment funds.

After issuing the proposed regulations, the DOL received numerous comments primarily on the issue of whether to include stable value or other capital preservation products as qualified default investment alternatives ("QDIAs").

In general, under the final regulations, three types of investments may qualify as a QDIA:

- "Life cycle" or "targeted-retirement-date" investment fund products or model portfolios that vary asset allocations (e.g., stocks, bonds), based on the individual's age, target retirement date (e.g., the plan's normal retirement date), or life expectancy;
- "Balanced" investment fund products or model portfolios that vary asset allocations based on the demographics of the participant group as a whole; and
- Professionally managed accounts in which an investment manager allocates, through investment alternatives available under the plan, the assets of the individual's account in a manner similar to a life cycle or targeted retirement-date-fund.

Note that the DOL clarified that QDIAs may include products and portfolios offered through variable annuity and similar contracts, as well as through common and collective trust funds or other pooled investment funds.

The DOL ultimately decided not to include stable value funds as QDIAs. The DOL stated that investments made on behalf of participants who fail to provide investment direction ought to be long-term investments. Investment of such participants' contributions and earnings in money market and stable value funds will not, over the long-term, produce rates of return as favorable as those generated by products, portfolios, and services included as QDIAs, thereby decreasing the likelihood that participants invested in capital preservation products will have adequate retirement savings.

The DOL was also concerned that including capital preservation and stable value products as a QDIA for future contributions on behalf of participants who fail to provide investment direction may impede, or even reverse, the current trend away from the use of such products as default investments. It also stated that inclusion of a capital preservation product as a QDIA may be perceived by participants and beneficiaries as an endorsement by the government, by virtue of its inclusion in the regulation, or as an endorsement by the employer, by virtue of its selection as the QDIA, as an appropriate investment for long-term retirement savings.

However, the final regulations, in general, treat investments in capital preservation products or funds as an investment in a QDIA for a 120-day period following a participant's first elective contribution. In addition, they include a ''grandfather'' provision pursuant to which stable value products and funds will constitute a QDIA for purposes of investments made prior to the effective date of the regulation.

Finally, unrelated to stable value funds, the DOL clarified that a state law that would directly or

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indirectly prohibit or restrict the inclusion in any pension plan of an automatic contribution arrangement is superseded as to any pension plan.

Other highlights from the regulations, which were adopted substantially as proposed, include the following (also see our memorandum entitled "DOL Issues Default Investment Regulations," dated October 2006, for a more detailed discussion):

- Participants and beneficiaries must have been given the opportunity to provide investment direction, but failed to do so.
- A notice must be furnished to participants and beneficiaries at least 30 days in advance of the first investment into the QDIA, and at least 30 days in advance of each subsequent plan year.
- Any materials provided to the plan by the QDIA (e.g., statements, prospectuses, proxy materials) must be provided to participants and beneficiaries.
- Participants and beneficiaries must have the opportunity to make transfers out of the QDIA with the same frequency that transfers are available with respect to other plan investments, but no less frequently than once within any three month period.
- Generally, any transfer or withdrawal by a participant or beneficiary of assets invested in a QDIA during the 90-day period beginning on the date of the first investment in the QDIA on behalf of the participant or beneficiary shall not be subject to any restrictions, fees, or expenses.
- The plan must satisfy the "broad range of investment alternatives" requirement under the ERISA 404(c) regulations. Generally, this requirement will be satisfied if the plan offers at least three investment alternatives that are diversified and have materially different risk and return characteristics.

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