

## QDIA Q&A

A resource for plan sponsors

A qualified default investment alternative, or QDIA, is intended to encourage investment of employee assets in appropriate vehicles for long-term retirement savings. This brochure will help you understand how selecting QDIAs that comply with the Department of Labor (DOL) regulations can reduce fiduciary liability for plan sponsors and help participants save for retirement.

**Q: Why is it important for plan sponsors to know about QDIAs?**

**A:** ERISA section 404(c) and the corresponding DOL regulations define how a plan sponsor can establish protective relief from liability as a fiduciary for investment decisions made by employees in participant-directed 401(k) plans. Recent DOL changes to 404(c) regulations – effective since Dec. 24, 2007 – direct plan sponsors to designate a default fund, which must qualify as a QDIA for plan sponsors to establish or retain 404(c) fiduciary liability protection.

**Q: What is a default investment?**

**A:** When participants fail to make investment elections and a decision must be made to invest their participant-directed contributions, plan fiduciaries must step into the decision-making role and invest their contributions in a default investment.

**Q: What happens if a plan sponsor doesn't designate an approved QDIA?**

**A:** Without an approved QDIA, plan fiduciaries remain potentially liable for losses when a participant fails to actively direct investments.

**Q: When is a QDIA appropriate for a plan?**

**A:** A QDIA is appropriate for any plan with participant assets that lack participant investment direction. Plans with automatic enrollment features obviously have default investment needs, but situations frequently occur in the life of a 401(k) that may result in the need for a QDIA, including:

- Incomplete enrollment forms.
- Beneficiary/alternative payee balances.
- Qualified domestic relations order (QDRO).
- Removal of investment options.
- Rollovers.
- Missing persons.
- Disputes.



Recent DOL changes to 404(c) regulations direct plan sponsors to designate a default fund, which must qualify as a QDIA for plan sponsors to establish or retain 404(c) fiduciary liability protection.

**Q: Are QDIAs an option only for plans with automatic enrollment?**

**A:** No. A plan without automatic enrollment can designate a QDIA, which would become the default election when, for example, a participant completes a deferral election form but fails to designate investment elections.

Advantages of a QDIA	
For plan sponsors:	For participants:
<ul style="list-style-type: none"> <li>■ May relieve plan sponsors from certain fiduciary responsibility with respect to selecting default investments for automatic enrollment plans (provided the QDIA meets certain criteria)</li> <li>■ Reduces the concern that plan participants may not have the level of understanding to make good investment decisions</li> <li>■ Enhances the ability of the 401(k) benefit to provide a secure retirement for employees</li> </ul>	<ul style="list-style-type: none"> <li>■ “Automates” investment decisions for employees who often feel overwhelmed and undereducated when it comes to selecting 401(k) investment options</li> <li>■ Allows participants to opt out of the active investment process simply by doing nothing</li> <li>■ Ensures that employee contributions are invested appropriately for long-term retirement savings</li> </ul>

**Q: What is an approved QDIA?**

**A:** The DOL has approved these four types of QDIAs:

1. A product with a mix of investments that takes into account the individual’s age or retirement date – a lifecycle or target-retirement-date fund is an example.
2. An investment service that allocates contributions among existing plan options to provide an asset mix that takes into account the individual’s age or retirement date – a professionally managed account is an example.
3. A product with a mix of investments that takes into account the characteristics of the group of employees as a whole, rather than each individual – a balanced fund is an example.
4. A capital preservation product for only the first 120 days of participation – a stable value fund is an example.

QDIAs at a Glance
<p><b>A lifecycle or target-retirement-date fund:</b></p> <ul style="list-style-type: none"> <li>■ Creates an investment model based on a participant’s age, retirement date and life expectancy.</li> <li>■ Is not professionally managed for individual investors.</li> </ul>
<p><b>A professionally managed account:</b></p> <ul style="list-style-type: none"> <li>■ Is actively managed by investment managers.</li> <li>■ Provides an appropriate asset mix of equities and fixed income for each individual participant.</li> <li>■ Takes into account the primary decision factors of age, retirement date and life expectancy.</li> </ul>
<p><b>A balanced fund:</b></p> <ul style="list-style-type: none"> <li>■ Offers a mix of equity and fixed income investments.</li> <li>■ Is based on group demographics of the plan as a whole.</li> <li>■ May not consider risk tolerances of individual participants.</li> </ul>
<p><b>A stable value fund:</b></p> <ul style="list-style-type: none"> <li>■ Serves as a capital preservation product for the first 120 days of participation.</li> <li>■ Offers an option for plan sponsors who want to simplify administration if employees opt out of participating before incurring an additional tax.</li> </ul>

**Q: What is the significance of the 120-day limit for the stable value fund?**

**A:** The participant can withdraw unintended deferrals during the first 90 days without penalty or restrictions or redirect assets into another investment option within 120 days after enrollment. If the participant does neither, the plan is required to transfer participant assets to one of the other three approved types of QDIAs discussed above before the time limit expires.

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The most appropriate QDIA for your plan depends on income and age clusters of your employee population as a whole.

**Q: Does QDIA fiduciary protection apply to participant assets invested in stable value funds before the rules took effect?**

**A:** Under a “grandfather” provision, assets invested in stable value funds before Dec. 24, 2007, can remain invested in stable value funds and receive QDIA fiduciary protection.

**Why Are Lifecycle Funds Gaining Momentum?**

**Lifecycle or target-retirement-date funds take the concept of “automating” employee decisions one step further by:**

- Providing appropriate asset class allocations for participants when they are automatically enrolled in the plan, based on a participant’s retirement date.
- Providing participants with age-appropriate – but different – asset allocations in five, 10 and 20 years after enrollment or at retirement.
- Adjusting asset allocations over time to become more conservative.

**Q: What role do plan sponsors play in selecting QDIAs?**

**A:** Plan sponsors are responsible for prudent selection of appropriate QDIAs for their plan, as well as for monitoring QDIAs. The plan sponsor should also be able to demonstrate the due diligence process followed when selecting QDIAs.

**Q: How do plan sponsors determine what type of QDIA is appropriate?**

**A:** Plan sponsors must consider either the age of individual participants or the average age of the group of participants. The most appropriate type of QDIA depends on income and age clusters in the employee population as a whole.

**Q: How many QDIAs should a plan sponsor designate?**

**A:** A plan sponsor can select one QDIA based on the average age of all participants or designate several QDIAs. A participant who fails to make investment elections would default into the QDIA most appropriate for his or her age.

**Q: Are costs and fees important in QDIA selection?**

**A:** DOL regulations specify that costs and fees should be an important consideration in the selection of QDIAs.

**Q: Who manages QDIAs?**

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

**Q: How can plan sponsors receive safe harbor relief from QDIAs?**

**A:** Plan sponsors can receive safe harbor relief from fiduciary liability for default investment outcomes when default investments are one of the four approved QDIA types discussed above and meet the following criteria:

- 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 in the QDIA and 30 days prior to every plan year thereafter.
- All material – such as investment prospectuses and other notices – provided to the plan for the QDIA must be provided to participants and beneficiaries.
- Participants and beneficiaries must have the opportunity to direct investments out of a QDIA as frequently as from other plan investments, but at least quarterly.
- The plan may not impose financial penalties or otherwise restrict the ability of a participant or beneficiary to transfer the investment from the QDIA to any other investment alternative available under the plan.
- The plan must offer a “broad range of investment alternatives” as defined in the DOL’s regulation under section 404(c) of ERISA.

QDIAs include the potential for asset class diversification, which can help manage inflation, diversification and investment risks.

**Q. What is the requirement for notifying participants about the QDIA?**

**A:** To receive fiduciary relief, plan sponsors must provide a notice to all eligible participants at least 30 days before eligibility or before any QDIA investment on behalf of a participant or beneficiary. While the DOL has not specifically stated how often this notice must be provided, an annual notice is a conservative approach.

**Q. How does the participant notification requirement affect plans that have immediate eligibility or an eligibility service requirement of fewer than 30 days?**

**A:** The DOL has stated that plans with automatic enrollment that allow participants to withdraw automatic contributions within 90 days may provide notice as late as the date the employee becomes eligible. Plans with immediate eligibility but not automatic enrollment must comply with the 30-day notice to receive fiduciary relief.

**Q: What information must the participant notice include?**

**A:** Regulations require that both the initial and annual notice provide the following information:

- A description of the circumstances when assets will be invested in the QDIA, the automatic deferral percentage and the participant's right to change that percentage
- A statement of the participant's right to affirmatively direct investments
- An explanation of the rights of participants and beneficiaries to direct the investment of their assets
- A description of the QDIA, including investment objectives, risk and return characteristics (if applicable), fees and expenses
- A description of the rights of participants and beneficiaries to direct QDIA assets to another investment alternative under the plan, including a description of applicable restrictions, fees or expenses associated with a transfer
- Referral to sources of additional information about QDIAs offered under the plan

**Q: How do QDIAs help with risk management?**

**A:** With the exception of the stable value fund, QDIAs include the potential for asset class diversification, which can help manage inflation, diversification and investment risks.

**Q: Can QDIAs invest participant contributions in employer stock?**

**A:** QDIAs are not permitted to invest in or hold employer stock, except when it is held or acquired by a registered investment company that is independent of the plan sponsor or when it is acquired as a matching contribution.

**Next step?**

Please review with your financial advisor, plan consultant and/or legal counsel to determine whether a QDIA is appropriate for your plan or whether a current default investment in your plan complies with QDIA regulations.

**Consider the investment objectives, risks and charges and expenses carefully. For this and other information about AIM funds, obtain a prospectus from your financial advisor and read it carefully before investing.**

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## Supplemental Information

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