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ERISA ALERT

TO: CLIENTS AND COLLEAGUES
DATE: APRIL 2008
RE: TWO NEW LAWS FOR YOUR ATTENTION NOW

This Alert addresses two matters requiring your attention. These matters arise under the Pension Protection Act of 2006, and are first effective in 2008. You may need to revise your plan's operations without delay, if you have not done so.

The first matter relates to the prudent investment of retirement plan assets held in plan default funds (that is, regarding the investment of plan accounts over which participants have not provided investment elections). The second relates to a form of benefit payment that must be made available to participants of certain retirement plans.

A. DEFAULT INVESTMENT ALTERNATIVES

Summary. This Alert first discusses the recent Department of Labor ("DOL") final regulations on qualified default investment alternatives ("QDIAs"). The new regulations are effective now and warrant your review *if and only if* your plan allows participants to invest their plan accounts. The new rules do not affect defined benefit plans nor other plans whose assets are invested by plan trustees and not the plan's participants. The new rules provide an opportunity for employers, plan trustees, and others to increase the level of protection from liabilities relating to plan default investments. It may be necessary to change the plan default investments that are in place.

Please contact your plan investment provider to ascertain the steps that have been taken to ensure you are afforded the protections available through these new rules. You should then share such information with your benefits counsel to ensure compliance.

Background. Plan fiduciaries are liable for plan losses resulting from fiduciary breaches. Plan fiduciaries generally include employers, plan trustees and individuals exercising discretion over plan matters. Fiduciary breaches include the failure to act with the care, skill, prudence, and diligence under the circumstances that a prudent person acting in a like capacity and familiar with such matters would use. This standard of care extends to a plan fiduciary's selection of plan investments (and resulting losses or insufficient gains). Plan fiduciaries are responsible for plan investments and are personally exposed to liabilities resulting from investment losses (and perhaps liabilities associated with alleged inadequate gains). Section 404(c) of the Employee Retirement Income Security Act ("ERISA"), if complied with, provides protection to plan fiduciaries resulting from investment losses when participants or beneficiaries exercise control over the assets in their individual plan accounts (that is, losses resulting from a participant's self-direction of his or her investments). New ERISA

Section 404(c)(5) (which was added by the Pension Protection Act), and the new DOL regulations issued thereunder, expand such protections and provide that plan fiduciaries may be protected from liability for investment losses even in the absence of participant affirmative investment elections, if the plan complies with certain notice requirements and invests the participants' accounts in a default investment consistent with DOL regulations.

Plans have long invested such accounts in default funds; however, the liability for losses or insufficient gains has rested on the plan's fiduciaries. The new regulations provide the same protections for default accounts that are available if the participant were actively investing such accounts. Fiduciaries should take advantage of the increased protection afforded by the new regulations.

New Rules and Conditions. The new regulations provide relief from liability from investment losses if six conditions are met, as follows:

1. Assets are invested in a QDIA (defined below).
2. The participant had the opportunity, but failed to direct the investment of his or her account.
3. The participant whose account is invested in a QDIA is provided with a notice that sets forth specified content and is furnished within certain timeframes.
4. Investment materials relating to the QDIA are provided to the participant (e.g., account statements, prospectuses, proxy voting materials, etc.).
5. The participant is provided with the opportunity (no less than once every three months) to transfer his or her QDIA account to another investment alternative under the plan without financial penalty.
6. The plan offers a broad range of investment alternatives.

“What is a QDIA?” In general, QDIAs are professionally managed investment products that are intended to minimize the risk of loss, but also to provide varying degrees of appreciation. They generally fall into one of three categories described as follows:

1. Life-Cycle/Targeted Retirement Date Fund – Mix of equity and fixed income based on a participant's age, target retirement date, or life expectancy.
2. Balanced Fund – Mix of equity and fixed income based on a level of risk appropriate for participants of the plan as a whole.
3. Managed Account – Similar to life-cycle funds, except more individually tailored.

With limited exceptions, QDIAs do not include capital preservation funds, such as money market or stable value type funds, which are traditionally the kinds of funds many plans utilize as their default funds. Also, fiduciaries must still exercise an appropriate ERISA standard of care in selecting and monitoring a QDIA.

The regulations are intended in part to work in conjunction with the new rules expanding the availability of automatic enrollment (which will presumably result in an increased number of participants who fail to direct their own investments). However, the use of QDIAs is not exclusive to automatic enrollment. QDIAs may be used with any participant-directed account plan where participants fail to direct their own investments. In fact, the plan at issue need not be a “Section 404(c) plan” in order to take advantage of the QDIA protections. Also, investment in a QDIA is not the exclusive means by which fiduciaries may protect themselves from potential liabilities associated with a participant’s failure to exercise control over his or her own account and resulting investment losses.

B. NEW FORM OF BENEFIT PAYMENT

Summary. If your plan offers a joint and survivor annuity form of payment, your plan payment options made available to your participants must be revised now.

Discussion. Certain 401(k), profit sharing, pension and other qualified retirement plans are required to allow benefits to be paid in the form of annuities to participants and their spouses. Most always, in operation, the participant and the participant’s spouse waive the annuity (called a “qualified joint and survivor annuity”) in favor of a lump sum payment or rollover, but nonetheless participants and their spouses have the very important right to receive payment in an annuity form over their joint lifetimes. Many newer plans, but certainly not all of them, and particularly newer Section 401(k) plans that did not receive a transfer of benefits from another plan, are not required to offer the annuity. To determine whether your plan offers annuity payments, your plan document must specifically be checked, and double checked, because the provisions sometimes are not apparent.

If your plan is one of these plans that must offer annuity payments (and thus requires the spouse’s signature to waive the annuity), then effective currently for most plans a new type of annuity must be offered to the participant and spouse. The new type of annuity simply increases or decreases, as the case may be, the payment that is made to the spouse if the spouse survives the participant. In other words, the annuity choices you must now make available to the participant and spouse over their joint lifetimes will be a bit different than the annuity choices offered previously.

To determine whether you must adjust your form of payment, we recommend you immediately check with your plan recordkeeper and ERISA counsel. If the new provision applies, your benefit payment form likely must be modified to add the new type of annuity (called a “qualified optional survivor annuity”). Your plan document also will need to be amended; however, the deadline for that amendment has been delayed under the Pension Protection Act and is not imminent.

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The above introduces the new QDIA and annuity rules. The actual regulations and law are more detailed and complex. For more information, please contact Jeffery Mandell or John Hughes.

This Alert is intended to provide general information only and does not provide legal advice. The application of ERISA laws can be complex. For information regarding the impact of these developments under your particular facts and circumstances, please call us.