

October 2007

Department of Labor Issues Regulation for DC Plans on Default Investment Options

On Wednesday, October 24, the U.S. Department of Labor (DOL) issued its final regulation regarding qualified default investment alternatives (QDIA) in defined contribution plans.

This regulation is a non-exclusive safe-harbor designed to assist employers in selecting default investments that best serve the retirement needs of workers who have had an opportunity to direct their plan investments but do not actually do so.

"The significance of this decision can not be understated – it will prompt the most dramatic shift in employer-sponsored retirement plans in decades," says Matt Smith, Managing Director, Russell Retirement Services. "And it will leave companies of all sizes with a lot of questions to answer, a range of options to choose from, and a big transition to make."

OVERVIEW OF FINAL REGULATION

The final regulation provides the following conditions that must be satisfied in order to obtain safe harbor relief from liability for certain investment related losses associated with QDIA:

- Assets must be invested in a qualified default investment alternative, as defined by the regulation.
- Participants and beneficiaries must have been given an opportunity to provide investment direction, but have not done so.
- An initial notice must be given to participants and beneficiaries in accordance with prescribed time periods and annually thereafter. The rule describes the information that must be included in the notice.
- Material, such as investment prospectuses, must be furnished to participants and beneficiaries who invest in the QDIA. These investors must also be informed about where to obtain other applicable information, such as a mutual fund's statement of additional information.
- Participants and beneficiaries whose contributions are defaulted into a QDIA must, at least quarterly, have the opportunity to direct those defaulted investments out of a QDIA without penalty.
- A participant or beneficiary who opts out cannot be subjected to restrictions, fees or expenses (including surrender charges), liquidation or exchange fees and similar expenses charged in connection with the liquidation or transfer of a QDIA. Fees and expenses related to the ongoing management of a QDIA (e.g. 12b-1 fees) are permissible.
- The plan must offer a "broad range of investment alternatives" as defined in the DOL's regulation under section 404(c) of ERISA.

WHAT IS A QUALIFIED DEFAULT INVESTMENT ALTERNATIVE?

- A properly constructed mix of investments that takes into account a participant's age or retirement date (such as a lifecycle or target date fund);
- A properly constructed mix of investments that takes into account the characteristics of the group of employees as a whole, rather than each individual (for example, a balanced fund);

- An investment management service that allocates contributions among existing plan options to provide an asset mix that takes into account a participant's age or retirement date (such as a professionally managed account);
- A capital preservation product for only the first 120 days following a participant's first elective contribution to a plan (an option for plan sponsors wishing to simplify administration if workers opt-out of participation before incurring an additional tax).

OTHER KEY PROVISIONS TO KEEP IN MIND

- **QDIA structures** – The final regulation clarifies that a QDIA may be offered through a variable annuity or similar types of contracts.
- **"Grandfathering" of stable value default investments** – In light of the fact that some plan sponsors adopted stable value products as their default investments prior to the passage of the Pension Protection Act and the DOL's final rule, the rule "grandfathers" investments in these products existing as of December 24, 2007. Investments in these products made on or after December 24, 2007, will not be a QDIA.
- **ERISA protection for automatic enrollment** – The DOL's final regulation supersedes any state law that would prohibit or restrict automatic contribution arrangements, regardless of whether such automatic contribution arrangements qualify for safe harbor.

HOW SOON WILL PLAN SPONSORS NEED TO OFFER A SUITABLE DEFAULT OPTION?

This regulation will take effect on December 24, 2007.

It's important for plan sponsors to understand this new regulation. You may want to work with legal counsel to assess specific implications for your defined contribution plan.

For additional information please contact Phil Enochs, Russell's Director of Institutional Defined Contribution Services, at 866-306-9939.

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