



Many Happy Returns

Through QDIAs, it is win-win for sponsors and participants

Participants in 401(k) plans need to make three fundamental decisions: Should I participate? How much should I defer? And how should I invest? This article focuses on the last question; more specifically, it looks at one way to dramatically improve 401(k) participant investment returns.

The investment provisions of the Employee Retirement Income Security Act (ERISA) are based on generally accepted investment principles, such as modern portfolio theory. Applied at the participant level, that means the law assumes that participants will be invested in portfolios. In other words, participants are expected to either select among the plan's investments to craft portfolios in their accounts or, alternatively, to select professionally designed portfolios such as target-date funds. Unfortunately, most participants don't know how to construct portfolios or don't realize the importance of balanced portfolio investing. Fortunately, ERISA provides in 404(c) that, if plans satisfy the 404(c) conditions, fiduciaries will not be liable for imprudent investment decisions by participants. However, in my experience, many plans don't satisfy those conditions. In these cases, fiduciaries should protect against possible claims by helping participants improve their investing.

And, even if a plan satisfies 404(c), giving fiduciaries a defense against claims for losses due to imprudent participant investing, there is an important reason for improving participant investing: to help participants reach their retirement goals.

Historically, when plans switched providers, most opted to "map" participants into the investments on the new platform. When mapping, fiduciaries select investments from the new provider that are similar to those at the old provider and then move participants' accounts to the similar investments in direct proportion to their old investments. There is a fiduciary safe harbor for mapping, but only if the new investments are reasonably similar and if a plan satisfied all of the 404(c) conditions immediately before the mapping. In addition, the plan must give participants an opportunity to direct their investments on the new platform prior to the conversion. In other words, plans that want fiduciary protection cannot simply move the money from the old investments to the new investments without giving participants the opportunity, in advance, to pick their own on the new platform.

A better alternative to mapping: Fiduciaries should consider moving participants into a qualified default investment alterna-

tive (QDIA). If a plan gives participants the opportunity to direct their investments on the new platform prior to the conversion, and if the QDIA regulation requirements are satisfied (such as notice and information), the fiduciaries will benefit from the QDIA safe harbor for the participants who don't direct their investments and are defaulted into the QDIA.

How successful are conversion defaults? Several major service providers have encouraged plan sponsors to use the QDIA process for conversions, and one has been doing it long enough that it has accumulated data on the results.

	UPON CONVERSION	18 MONTHS LATER
% of assets in QDIAs	79%	72%
% of participants: 100% QDIAs	81%	76%

Source: A national recordkeeper

As the data show, on conversion, 79% of the assets were invested in QDIAs, and 81% of the participants were invested 100% in QDIAs. After 18 months, 76% were still invested 100% in QDIAs. That 5% "slippage" could have been due to such factors as participants directing new deferrals into other investments and/or participants moving part of their accounts into other investments. But the bottom line is that fiduciaries have the satisfaction of knowing that approximately 80% of their participants are well-invested, and that they have a fiduciary safe harbor to participant investing.

This is one of those cases when the interests of plan sponsors, committee members and participants are aligned, and they can be served in a manner that is both legally protected and practically effective.

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