Qualified Default Investment Alternative (QDIA)

Background

The use of automatic enrollment for employee 401(k) plans will best serve the retirement needs of workers who do not take charge of their own pension investments. For the plan sponsor, the QDIA provides an increased protection from fiduciary liability. This mandate does not, however, supply specific investment products; the QDIA outlines the actions for investing participant contributions.

QDIA Options

There are four types of QDIA paths described by the Department of Labor (DOL):

1. Mixed investments that take into account the individual's age or date of retirement. This could be a life-cycle or a targeted-retirement-date fund.

2. A service that assigns contributions among options of an existing plan to provide asset mixes that take into account the individual's age or date of retirement. This could be a professionally-managed account.

3. A mix of investments taking into account the characteristics of the entire group of employees instead of an individual. This could be a balanced fund.

4. A capitol preservation product that is in effect for the first 120 days of participation. This would be a viable option for plan sponsors wanting to simplify administration in the event that workers end participation prior to incurring an additional tax.

Taking Action

When offering a QDIA to employees, the first step to consider is picking the best plan to fit the worker demographic. This may involve a plan fiduciary analyzing which QDIA option would be most prudent for the plan. The investment option chosen should best represent the financial needs and goals of the working demographic. For example, consider the age of the employee population; this can be an indicator of the most sensible investment type and whether long-term or short-term investment is most desirable.

Following the selection of a plan, evaluate its existing default option. Determine whether or not it meets the requirements and regulations of a QDIA as set by the DOL. If it does, proceed by notarizing participants of the QDIA option. If it does not meet the DOL's requirements, identify a new plan that does.
After ensuring that the selected plan is QDIA compliant and it is in the best interest of the employee population, implement the plan and notarize participants of their new plan option (employees still maintain the right to opt out of the QDIA plan). This notice must be completed at least 30 days in advance of the date of the plan eligibility or any first investment in the QDIA; it should contain a detailed description of the new offered plan, an explanation of the rights of the participants, the plan's objectives and functions, the risk and returns characteristics and the fees involved. Additional notices must be issued annually. To register the plan, complete the necessary QDIA authorization documents with the plan provider.

10 Step Plan for Implementing a QDIA

1. Review the IRS's regulations on Qualified Automatic Contribution Arrangements (QACA) and eligible automatic contribution arrangements (EACA), and the Labor Department's regulations on qualified default investment alternatives (QDIA).

2. Determine if automatic enrollment or the "safe harbor" automatic enrollment makes sense for the plan by contacting a professional service provider. The service provider will analyze the demographic of the employee base to establish that a QDIA is a prudent option.

3. If the plan allows for interactive contributions (i.e. online or phone service), determine what type of contribution will be withheld on behalf of the employee.

4. Select a QDIA for automatic enrollment contributions by discussing the QDIA rules with the investment advisor and selecting an option that meets the requirements.

5. Determine the process for handling annual automatic enrollment increases. This process should be documented to alleviate fiduciary liability.

6. Determine at what point to amend the plan (whether for compliance with changing DOL mandates, or to best serve the participants' investment needs).

7. Notarize (Automatic Enrollment Notice or Qualified Default Investment Notice are generally provided by the investment advisor) employees at least 30 days before enrollment and then annually thereafter.

8. Automatically enroll employees at a uniform percentage of at least 3% of their pay.

9. Deposit and invest the automatic enrollment contributions in the qualified default investment plan.

10. Make changes to election levels when the next annual change is due.

The aforementioned information is not intended to be tax or legal advice and should only be used for informational purposes. Any actions taken by plan sponsors or their financial advisors based on this outline are the sole responsibility of said sponsors and their advisors.

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