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## Changes to Rules Regarding Automatic Enrollment in 401(k) Plans

Since the Pension Protection Act (the "Act") was passed by Congress on August 3, 2006, the Benefits Law Group has issued several News Alerts summarizing the impact that the legislation will have on defined contribution and defined benefit plans. This Alert focuses on changes in rules regarding automatic enrollment and default investment plan design features of 401(k) plans.

The Department of Labor ("DOL") issued a proposed regulation on September 26, 2006, facilitating the adoption of automatic enrollment of participants into employer-sponsored, participant-directed defined contribution plans, by providing relief from liability to fiduciaries that invest assets in qualified default investment alternatives. The DOL's expressed purpose in providing this relief is to trigger a significant increase in plan participation and a jump in the aggregate 401(k) plan account balance by as much as \$90 billion. Another expected consequence of the rule change is the ability of fiduciaries to direct default investment toward higher-return instruments, thus boosting account performance.

Despite the dual benefits of increasing participation in retirement savings plans as well as making it easier for employers to pass nondiscrimination testing because of higher nonHCE participation levels, automatic enrollment in 401(k) plans has not been widely utilized to date because fiduciaries have been exposed to potential liability for investment losses. The Act removes this impediment by providing fiduciaries with relief from liability, and the proposed regulation sets forth the guidelines with which fiduciaries must comply in order to qualify for the safe harbor.

### Safe Harbor

The Act provides a safe harbor for plan fiduciaries that automatically enroll plan participants, so long as participants are able to exercise control over the investment of the assets in the plan accounts. If the participant fails to provide investment direction, the plan fiduciary may invest the assets in a qualified default investment alternative (QDIA). Eligibility for the safe harbor also requires that:

- participants have the opportunity to transfer assets to another available investment alternative without penalty;
- participants be furnished with notice of the investment, at least 30 days prior to the first investment and within at least 30 days of each subsequent plan year;
- any notice provided to the plan relating to the QDIA must also be furnished to the participant;
- the plan must offer a broad range of investment alternatives.

Importantly, the Act does not provide a safe harbor for plan fiduciaries with respect to the prudent selection and monitoring of QDIAs, or from liability that results from a prohibited transaction.

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## Qualified Default Investment Alternatives (QDIAs)

Under the proposed regulation, a fiduciary will be relieved from liability for investments that are made on behalf of a participant in a QDIA. To qualify as a QDIA, the following conditions must be satisfied:

- participant contributions may not be directly invested in employer securities, unless the employer securities were acquired as a matching contribution or at the direction of the plan participant;
- a participant may not be restricted from or penalized for transferring the investment to another investment alternative available under the plan;
- the investment must be managed by an investment manager or a registered investment company;
- investment alternatives must be diversified so as to minimize the risk of large losses;
- the QDIA must be either a life-cycle or targeted-retirement-date fund, a balanced fund, or a professionally managed account.

To take advantage of the relief offered by the proposed regulation in 2007, you will need to act soon. The QDIA safe harbor notice must be sent to your participants by December 1, 2006. For additional information regarding automatic enrollment in 401(k) plans or another aspect of the Pension Protection Act, contact any member of the Holland & Hart Benefits Law Group.



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