ONE LESS FURROWED BROW FOR 401K PLAN SPONSORS

There was a sneak preview of the Dept of Labor's preliminary guidance on setting up 401k default investment options. These situations occur when 401k participants fail to select an investment option for their 401k contributions or a 401k default fund is used in 401k plans with automatic enrollment features.

Currently, 401k plan sponsors are rethinking their default fund decisions because they are concerned about the risk associated with their fiduciary responsibility and about the risk of the earnings performance of the default investments of those participants who failed to choose any.

When a participant fails to make a choice, the default fund is the choice made for them by the plan's fiduciaries. And because the participant is NOT making the decision when a default investment is used, the plan fiduciaries are responsible to prudently invest their funds.

Many plan sponsors feel that their decision on the default investment is protected by the safe harbor exemption of Internal Revenue Code Section 404c. Section 404c provides an exemption to plan sponsors from liability for investment decisions when participants are given the choice to choose their own investments. Section 404c transfers liability to plan participants for their choices of investment options. Here, sponsors believe that by not making an active choice, the participant has decided to take the default investment.

And if the default investment is a Stable Value or Money Market Fund, the participant does not loose any of his principal. Plan sponsors feel that the participant's funds are not at risk and so neither are they.

Because the participant is not making the decision when a default investment is used, there is no 404c defense for plan fiduciaries. Also, sponsors are required by ERISA to invest with a reasoned, thoughtful process for evaluating risk and returns and for providing investment options that are diversified and prudent.

Under the forthcoming guidance -- which, said a Dept of Labor law specialist in the Office of Regulations and Interpretations, is subject to change – 401k fiduciaries are given a safe harbor on 401k investment management decisions and any breach that is "the direct and necessary result of investing a participant or beneficiary's account" in a default investment. Investment managers and advisers, on the other hand, are solely responsible for any decisions they make with regard to the 401k investments or any resulting losses and do not get that kind of relief.

In order to qualify for that 401k safe harbor, however, 401k fiduciaries must allow participants:

- the opportunity to move their investments into an alternate account
- provide advance notice of the default investment and
- invest the assets in a certain kind of qualified default investment.

Moreover, that choice, which can be a lifecycle fund or a managed account, among others, must limit the presence of employer stock in the portfolio, as well as allow funds to be transferred out of the default.

The 401k fiduciary responsibility associated with selecting funds for the default investment options in a 401k plan has now been tempered with this new preliminary safe harbor.

One less furrowed brow for 401k plan sponsors.