

## IRS AND DOL ISSUE GUIDANCE ON DEFAULT INVESTMENT OPTIONS INCLUDING AUTO ENROLLMENT PLANS

The Pension Protection Act of 2006 (PPA) contained a number of provisions intended to make the adoption of automatic enrollment features more attractive to the sponsors of 403(b), 401(k) and governmental 457(b) plans. On October 24, 2007 the Department of Labor (DOL) issued a final regulation covering qualified default investment vehicles. The final regulation applies to automatic enrollment plans and to any other defined contribution plan in which plan assets are invested on behalf of participants who fail to give investment instructions. On November 8, 2007, the IRS issued proposed regulations on the PPA's automatic enrollment provisions.

### THE DOL FINAL REGULATION

The DOL regulation is a final regulation on appropriate default investment vehicles, termed Qualified Default Investment Alternatives (QDIAs), for defined contribution retirement plans and will become effective on December 24, 2007. While the regulation is intended to apply to automatic enrollment plans, it also applies to default investments under any participant directed individual account plan (such as the typical 403(b) or qualified defined contribution plan funded with TIAA-CREF contracts) in which participants or beneficiaries fail to give investment instructions. The regulation only applies to plans subject to the Employee Retirement Income Security Act of 1974 ("ERISA").

Under the final regulation, a plan fiduciary will generally not be liable for any investment losses of participants and beneficiaries arising from investments in default funds, if certain conditions are met, including:

- the contributions are invested in a QDIA and
- the plan participant or beneficiary is provided with:
  - 1) an opportunity to provide investment direction and has not done so and
  - 2) written notice concerning the terms and conditions of the QDIA at least 30 days before participation in the plan. An annual notice is also required.

Even if all of the conditions of the regulation are met, however, plan fiduciaries will still remain responsible for the prudent selection and monitoring of the specific investments chosen as their plans' QDIAs. QDIAs under the regulation include:

- lifecycle funds,
- balanced funds and
- managed accounts

The regulation also permits a capital preservation product (such as a money market account) to be used to temporarily hold default investments. Any funds defaulted into these products must, however, be transferred to another QDIA within 120 days of deposit. This applies to allocations made on or after December 24, 2007, the effective date of the regulation.

Under a transition rule, assets defaulted prior to the effective date of the final regulation (Dec. 24, 2007) to certain stable value funds are "grandfathered" for purposes of the limitation on liability. Money market accounts, like the CREF Money Market Account, will not qualify for this grandfathering. The transition rule also does not provide relief for deposit of contributions, even to qualifying stable value funds, made on or after Dec. 24, 2007.

The final DOL QDIA regulation goes into effect on December 24, 2007. As a result, the regulation only offers protection for funds invested in a QDIA on or after December 24, 2007. The regulation does not, however, require compliance—an institution has to follow its requirements only if it wants the protection from fiduciary responsibility described above.



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As a result of the final regulation, institutions that are currently using the CREF Money Market Account as their default option might want to consider replacing it with the TIAA-CREF Lifecycle Funds. Institutions also should consider whether they should move the amounts currently invested in the CREF Money Market Account out of the CREF Money Market Account and into the TIAA-CREF Lifecycle Funds. If they decide to do this, the other conditions of the regulation, including the participant notice provisions, must be followed. Deemed consent can be used for this move, pursuant to the regulation (in other words the notice to participants would say that the participant will be deemed to have consented to moving the money in the CREF Money Market Account to the Lifecycle Funds if the participant does not affirmatively elect otherwise).

### THE IRS REGULATIONS

The IRS regulations are proposed to be effective for plan years beginning on or after January 1, 2008. Although they are proposed regulations, plan administrators may rely on them pending the issuance of final regulations. No provision in the final regulations that is more restrictive than the proposed regulations will be applied retroactively. The proposed regulations cover:

- The PPA's new auto-enrollment nondiscrimination testing safe harbor;
- Voluntary employee withdrawals from auto-enrollment plans during the first ninety (90) days after the start of automatic contributions;
- Participant notices for automatic enrollment plans; and
- Refund of excess contributions and excess aggregate contributions.

**Safe harbor** — The proposed regulations create a design-based safe harbor from certain nondiscrimination testing requirements for 401(k) or matching 403(b) plans that provide automatic contributions at a specified level for all eligible employees who do not elect out of participation and meet certain other requirements. These so-called Qualified Automatic Contribution Arrangements (QACAs) are deemed to automatically satisfy the Actual Deferral Percentage (ADP) test applicable to 401(k) plans and Actual Contribution Percentage test (ACP test, also known as the Matching Test) requirements, applicable to both 401(k) and 403(b) plans. These tests prohibit plans from unduly favoring highly compensated employees.

**Withdrawals** — The regulations permit auto enrollment plans to include a provision permitting employees to opt out of the plan and withdraw defaulted contributions without penalty any time within 90 days of the first automatic contribution made on their behalf on or after the January 1, 2008, the effective date of the proposed regulations.

**Participant notices** — The regulations describe the notices that must be sent to participants in order for the plans to meet the QACA requirements and also the notice requirements to participants for permitting withdrawals of defaulted contributions made in the first 90 days of participation by employees who opt out of participation.

**Refund of excess contributions** — The regulations also include technical changes to the refund of excess contributions and excess aggregate contributions including a provision that will enable qualifying automatic enrollment plans to refund such contributions within 6 months of the end of the plan year without paying an employer excise tax. The excise tax applies to sponsors of other plans if they make the refunds at any time later than 2½ months after the end of the plan year.

The tax information contained herein is not intended to be used, and cannot be used by any taxpayer, for the purpose of avoiding tax penalties that may be imposed on the taxpayer. It was written to support the promotion of the products and services addressed herein. Taxpayers should seek advice based on their own particular circumstances from an independent tax advisor.

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