CASE OF THE WEEK

What is the maximum equity exposure allowed in TDFs as QDIAs?

ERISA Consultants at the Learning Center Resource Desk, which is available through Columbia Threadneedle Investments, regularly receive calls from financial advisors on a broad array of technical topics related to IRAs and qualified retirement plans.

A recent call with an advisor in West Virginia is representative of a common inquiry regarding custom target date funds (TDFs) as qualified default investment alternatives (QDIAs). The advisor asked:

"Does the Department of Labor (DOL) provide guidance on the maximum equity exposure allowed in TDFs that qualify as QDIAs?"

- In the QDIA context, the Department of Labor (DOL) regulations defines a TDF as the following:

  > An investment fund product or model portfolio that applies generally accepted investment theories, is diversified so as to minimize the risk of large losses and that is designed to provide varying degrees of long-term appreciation and capital preservation **through a mix of equity and fixed income exposures** based on the participant's age, target retirement date (such as normal retirement age under the plan) or life expectancy. Such products and portfolios change their asset allocations and associated risk levels over time with the objective of becoming more conservative (i.e., decreasing risk of losses) with increasing age. Asset allocation decisions for such products and portfolios are not required to take into account risk tolerances, investments or other preferences of an individual participant.

- As the highlighted text points out, there must be a mix of equity and fixed income exposure. Therefore, an investment fund or product with zero fixed income (or, alternatively, zero equity) would not qualify as a QDIA. This stance is further supported in Field Assistance Bulletin (FAB) 2008-3, Q&A 14.

  > Each of the QDIA categories … requires that the investment fund product, model portfolio, or investment management service be "diversified so as to minimize the risk of large losses" and be designed to provide varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures. In the preamble to the QDIA regulation, the [DOL] explains that it did not intend to include funds, products, or services with no fixed income exposure. Although an investment option with no fixed income component may be appropriate for certain individuals actively directing their own investments, the [DOL] determined that a QDIA should have some fixed income exposure. Similarly, a fund, product, or service with no equity exposure cannot qualify as a QDIA …"

- Unfortunately, the QDIA regulations do not establish minimum fixed income or equity exposures necessary to satisfy the requirement for a mix within a QDIA. According to Q&A 14 of FAB 2008-3, the DOL continues to believe that such a determination is best left to the discretion of the individuals or entities tasked with assessing the appropriateness of a particular QDIA for a plan. The DOL does not plan to provide further guidance on the issue.

Conclusion

A TDF may be considered a QDIA for a plan if, among other things, it provides varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures based on the participant's age, target retirement date or life expectancy. An investment fund or product with zero fixed

income (or zero equity) would not qualify as a QDIA. The QDIA regulations do not establish minimum fixed income or equity exposures necessary to satisfy the requirement for a mix within a QDIA. That determination is left to those determining what is appropriate for the plan.

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