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U.S. District Court Finds No Fiduciary Breach for Change in Qualified Default Investment Alternative

April 29, 2011

The U.S. District Court in the Western District of Kentucky recently ruled in favor of plan fiduciaries that adopted a qualified default investment alternative (QDIA) for an employer's tax-qualified retirement plans. In *Bidwell v. University Medical Center, Inc.*, No. 3:10-cv-00005-TBR (W.D. Ky. Apr. 17, 2011), the court ruled that a plan administrator did not breach its fiduciary duties when it did the following:

- Changed the plans' default investment fund from a conservative stable value fund focused on capital preservation to a comparatively more aggressive "life cycle" fund invested in a mixture of equity and fixed income investments.
- Automatically transferred amounts held in the stable value fund to the life cycle fund for participants who did not make a different election.

Due to the timing of the transfer (July 2008) and prevailing market conditions, some plan participants incurred significant investment losses as a result of the increased equity investment exposure in the life cycle fund. Despite these investment losses, the court determined that the plan fiduciaries complied with the QDIA safe harbor established pursuant to the Pension Protection Act of 2006 (PPA) and, as such, were not liable for the investment losses.

Background on QDIA

The QDIA safe harbor was enacted as part of PPA to provide plan fiduciaries with the opportunity to preserve the relief available under Section 404(c) of the Employee Retirement Income Security Act of 1974, as amended (ERISA), for participant-directed investments. Section 404(c) provides that the fiduciary of an individual account plan (like a 401(k) or 403(b) plan) will not be responsible for investment losses stemming from a participant's investment election so long as certain procedural requirements are satisfied (e.g., the participant receives adequate and timely information about plan investments, the participant has an opportunity to make investment elections at least quarterly). Before PPA, according to the U.S. Department of Labor (DOL), Section 404(c) relief applied only to "affirmative" investment elections and was not available for "negative" election situations where a participant's account was defaulted into a particular investment if the participant failed to make a timely investment election.

Under PPA and the DOL's enabling QDIA regulations, plan fiduciaries now can obtain and preserve Section 404(c) relief even in situations where a participant fails to make an affirmative election and the participant's account is defaulted into a particular investment alternative. To qualify for the QDIA safe harbor, a plan must satisfy certain procedural requirements (e.g., provide at least 30 days' advance notice, provide information about election procedures) and offer a default investment alternative (i.e. , a target date or life cycle fund, a balanced fund, or an actively managed alternative with similar investment aims) that is recognized by the QDIA regulations. Stable value funds generally are not recognized as QDIAs for future contributions, but the regulations contain a narrow exception granting QDIA status to certain stable value funds for amounts contributed to such funds before 2008.[1]

Factual Background of Bidwell Case

The plaintiffs in this case were two University Medical Center, Inc. (UMC) employees who participated in UMC's tax-qualified retirement plan and 403(b) plan (the UMC Plans). The plaintiffs elected to invest their entire plan accounts in the Lincoln Retirement Services Company, LLC (Lincoln) stable value fund, which was offered as an investment alternative in the UMC Plans. Although the plaintiffs made an affirmative election to invest their accounts in the Lincoln stable value fund, the Lincoln stable value fund also served as the UMC Plans' default investment fund for participants who failed to make an affirmative investment election.

Following the issuance of the QDIA safe-harbor regulations in late 2007, UMC decided to change the UMC Plans' default investment alternative from the Lincoln stable value fund to the Lincoln life cycle fund. As part of this decision, UMC elected not only to make the Lincoln life cycle fund the default investment fund for amounts contributed to the UMC Plans in the future, but also decided to transfer all amounts already invested in the Lincoln stable value fund to the Lincoln life cycle fund. UMC made this decision (1) despite the exception in the QDIA regulations that would have permitted the UMC Plans to preserve the Lincoln stable value fund as the QDIA for amounts defaulted into the fund before 2008, and (2) even though UMC could not tell which participants (like the plaintiffs) previously had made an affirmative election to invest their accounts in the Lincoln stable value fund.

In June 2008, UMC notified all participants (including the plaintiffs) about the changes and informed them that all amounts in the Lincoln stable value fund would be reinvested in the Lincoln life cycle fund unless the affected participants specifically elected otherwise. The plaintiffs claimed they never received the notices. Following the end of the required 30-day notice period, in July 2008, UMC transferred all of the amounts in the Lincoln stable value fund to the Lincoln life cycle fund. The plaintiffs claimed that they learned of the change only after receiving their quarterly statements in October 2008 (which reflected significant investment losses because of the ongoing market conditions) and immediately switched their investments back to the Lincoln stable value fund. Plaintiffs then filed suit against the UMC Plans and the plan fiduciaries alleging that the fiduciaries breached their duties under ERISA by transferring their accounts to the Lincoln life cycle fund.

1. A more detailed description of the QDIA safe harbor and the related regulation is set forth in our November 20, 2007 LawFlash, "Qualified Default Investment Alternatives for Participant-Directed Individual Account Plans," available online at http://www.morganlewis.com/pubs/EB_QualifiedDefaultInvest_LF_20nov07.pdf.

The District Court's Decision

In a very favorable ruling in support of QDIAs, the court ruled that neither UMC nor Lincoln was liable for a breach of fiduciary duty. Dealing with Lincoln first, the court concluded that Lincoln was not a fiduciary of the UMC Plans. The court then ruled that, while UMC was acting in a fiduciary capacity, UMC complied with the QDIA safe harbor and, as such, did not breach its fiduciary duties under ERISA. In reaching this conclusion, the court made several favorable determinations:

- The court concluded that UMC's notice to UMC Plan participants (including plaintiffs) satisfied the notice requirements in the QDIA regulations.
- The plaintiffs' argument that UMC's actions contradicted the terms of the UMC Plans' summary plan descriptions (SPDs) was rejected. The SPDs indicated that once a participant made an affirmative investment election, that original election would control until a new election was made. The court noted that while there were some inconsistencies between the SPDs, the plan document, and the QDIA notice, language in the governing plan documents and the SPDs gave UMC the necessary authority and discretion to alter the plaintiffs' prior investment elections.
- UMC was entitled to the QDIA relief even though it chose not to preserve the Lincoln stable value fund as the QDIA for amounts contributed before 2008 as otherwise permitted by the QDIA regulations. The court noted that while the QDIA regulations permit this, the choice was UMC's.
- UMC was entitled to the QDIA relief even though it transferred the accounts of participants (like the plaintiffs) who previously made an affirmative election to invest in the Lincoln stable value fund. The court reasoned that by giving notice and providing participants with an opportunity to opt out, UMC could make the change even for participants who previously made an affirmative election to invest their accounts in the Lincoln stable value fund.

Practical Considerations

This case is a positive decision for plan sponsors and fiduciaries, but developments in this area of the law bear watching. Many plans went through a similar QDIA implementation process in 2008 and 2009 following the release of DOL's QDIA regulations. In addition, the emphasis on QDIAs and the related administrative processes will only grow as more and more plan sponsors shift to participant-directed defined contribution retirement plans as their primary (or only) retirement plan. These plans increasingly contain design features (e.g., auto-enrollment provisions) that create default investment situations where the plan's QDIA comes into play. The district court in *Bidwell* reached a very favorable conclusion regarding the scope and effect of a QDIA, and favorably interpreted provisions in the various plan documents, SPDs, and other communications. As such, it is recommended that plan sponsors and fiduciaries review and evaluate their plans' QDIAs and related documents and administrative processes to confirm compliance with the QDIA requirements.

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