Morgan Lewis

alert

employee benefits lawflash

July 27, 2012

Qualified Default Investment Alternative Safe Harbor Upheld

Sixth Circuit finds that plan fiduciaries did not breach their duties when participants' investments were transferred to the plan's default fund without their explicit consent.

The U.S. Court of Appeals for the Sixth Circuit affirmed that a Section 403(b) plan administrator did not breach its fiduciary duty to plan participants when it changed the plan's default investment fund and automatically transferred participants' investments to the new default fund without first receiving actual investment elections from the participants.[1] In *Bidwell*, the Sixth Circuit upheld the U.S. District Court for the Western District of Kentucky's April 17, 2011, decision that the Department of Labor's (DOL's) Qualified Default Investment Alternative (QDIA) safe harbor protected a plan fiduciary from liability stemming from losses suffered following a transfer of participant accounts to the plan-selected default investment vehicle, provided adequate notice and other procedural requirements were satisfied.

Background on QDIA

The QDIA safe harbor was enacted as part of the Pension Protection Act of 2006 (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 (e.g., 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. Under the DOL's enabling QDIA regulations, plan fiduciaries can preserve Section 404(c)'s safe harbor 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 and offer a default investment alternative that is recognized by the QDIA regulations.

Factual Background and the District Court's Decision

Following the issuance of the QDIA safe harbor regulations in 2008, the University Medical Center, Inc. (UMC), changed the default investment in its 403(b) plans from the Lincoln stable value fund to the comparatively more aggressive Lincoln Retirement Services life cycle fund. In making this change, UMC decided to transfer all amounts already invested in the Lincoln stable value fund to the Lincoln life cycle fund. Because UMC did not have records distinguishing between participants who had elected to participate in the stable value fund and participants who had simply been placed there by default, UMC sent notice to all plan participants that their investments in the stable value fund would be transferred to the life cycle fund unless they elected otherwise.

The plaintiffs were participants who had affirmatively elected to invest in the stable value fund. The plaintiffs claimed that they never received notice of the transfer, and that, as a result, their investments were transferred to the life cycle fund without their knowledge, resulting in significant losses while invested there. The plaintiffs filed suit, alleging that UMC and Lincoln, as fiduciaries, breached their duties under ERISA by transferring their accounts to the life cycle fund involuntarily.

---

1. *Bidwell v. Univ. Med. Ctr., Inc.*, No. 11-5493 (6th Cir. June 29, 2012), *available at* http://www.ca6.uscourts.gov/opinions.pdf/12a0203p-06.pdf.

© 2012 Morgan, Lewis & Bockius LLP

In a ruling supporting QDIAs, the district court held that neither UMC nor Lincoln was liable for a breach of fiduciary duty.[2] The court concluded that Lincoln was not a fiduciary of the UMC 403(b) plans, and that while UMC was acting in a fiduciary capacity, it complied with the QDIA safe harbor and, therefore, did not breach its fiduciary duties under ERISA. Notably, the district court found that UMC's notice to participants satisfied the QDIA notice requirements, and that following the participants' failure to opt out of the transfer, UMC operated within the scope of the QDIA regulations in transferring the participant accounts to the new default investment. The district court also rejected the plaintiffs' argument that UMC's actions contradicted the terms of the UMC plans' summary plan descriptions (SPDs), finding that despite inconsistencies among the SPDs, the plan document, and the QDIA notice, the language in the governing plan documents and the SPDs gave UMC the necessary authority and discretion to alter the plaintiffs' prior investment elections.

The Sixth Circuit Affirms

On appeal to the Sixth Circuit, the plaintiffs argued that the QDIA safe harbor provision does not insulate UMC as a plan fiduciary against claims by participants who had affirmatively elected the stable value fund as their investment choice because the safe harbor provision covers only employer-selected, not employee-selected, investment vehicles.[3] The Sixth Circuit rejected this argument, noting that in adopting the final QDIA regulation, the DOL explicitly stated that "the final regulation applies to situations beyond automatic enrollment," including "[w]henever a participant or beneficiary has the opportunity to direct the investment of assets in his or her account, but does not direct the investment of such assets," provided that the other safe harbor provisions are satisfied. The court went on to hold that the "DOL was clear also that the 'opportunity to direct investment' includes the scenario where a plan administrator requests participants who previously had elected a particular investment vehicle to confirm whether they wish for their funds to remain in that investment vehicle." Deferring to the DOL's reasonable interpretation of its own regulation, the Sixth Circuit rejected the plaintiffs' claim.

The plaintiffs further argued that UMC's transfer of their investments was (i) outside the scope of the DOL's QDIA regulations and (ii) a breach of the terms of the UMC 403(b) plans. With respect to the first argument, the court noted that the plain language of the DOL QDIA regulation extends to acts of a fiduciary in transferring funds from an investment vehicle to a QDIA and, in fact, covers such scenarios in its illustrative examples. With respect to the second argument, the court affirmed the district court's conclusion that the transfer was authorized under the powers granted to the plan administrator through the plan's terms.

Although the plaintiffs did not appear to specifically raise this issue, the Sixth Circuit also evaluated whether UMC complied with the QDIA notice requirements. The court held that while UMC could have demanded more proof of delivery (e.g., individual delivery confirmation), UMC's notice via first-class mail was "reasonably calculated to ensure actual receipt" and thus complied with the QDIA notice requirements.

Implications

The Sixth Circuit's affirmation in *Bidwell* is a positive outcome for plan sponsors and fiduciaries. It is another reminder, however, that plan sponsors and fiduciaries should take steps to ensure that their QDIAs, plan terms, and design features relating to default investments and transfer of investments, as well as related administrative and notice processes, comply with the DOL's QDIA requirements.

Contacts

If you have any questions or would like more information on the issues discussed in this LawFlash, please contact any of the following Morgan Lewis attorneys:

---

2. A more detailed description of the district court decision may be found in our April 29, 2011, LawFlash, "U.S. District Court Finds No Fiduciary Breach for Change in Qualified Default Investment Alternative," available at http://www.morganlewis.com/pubs/EB_LF_NoFiduciaryBreachForChange_29april11.pdf.

3. The plaintiffs waived appeal of the district court's decision in favor of Lincoln by failing to raise arguments regarding Lincoln upon appeal.

© 2012 Morgan, Lewis & Bockius LLP

Chicago

Brian D. Hector	312.324.1160	bhector@morganlewis.com
Marla J. Kreindler	312.324.1114	mkreindler@morganlewis.com
Julie Stapel	312.324.1113	jstapel@morganlewis.com

New York

Craig A. Bitman	212.309.7190	cbitman@morganlewis.com

Philadelphia

Robert L. Abramowitz	215.963.4811	rabramowitz@morganlewis.com
Brian J. Dougherty	215.963.4812	bdougherty@morganlewis.com
I. Lee Falk	215.963.5616	ilfalk@morganlewis.com
Vivian S. McCardell	215.963.5810	vmccardell@morganlewis.com
Steven D. Spencer	215.963.5714	sspencer@morganlewis.com

Pittsburgh

Lisa H. Barton	412.560.3375	lbarton@morganlewis.com
John G. Ferreira	412.560.3350	jferreira@morganlewis.com
Lauren B. Licastro	412.560.3383	llicastro@morganlewis.com
R. Randall Tracht	412.560.3352	rtracht@morganlewis.com

Washington, D.C.

Althea R. Day	202.739.5366	aday@morganlewis.com
David R. Fuller	202.739.5990	dfuller@morganlewis.com
Mary B. (Handy) Hevener	202.739.5982	mhevener@morganlewis.com
Gregory L. Needles	202.739.5448	gneedles@morganlewis.com

About Morgan, Lewis & Bockius LLP

With 24 offices across the United States, Europe, and Asia, Morgan Lewis provides comprehensive litigation, corporate, transactional, regulatory, intellectual property, and labor and employment legal services to clients of all sizes—from globally established industry leaders to just-conceived start-ups. Our international team of lawyers, patent agents, benefits advisers, regulatory scientists, and other specialists—more than 1,600 legal professionals total—serves clients from locations in Almaty, Beijing, Boston, Brussels, Chicago, Dallas, Frankfurt, Harrisburg, Houston, Irvine, London, Los Angeles, Miami, Moscow, New York, Palo Alto, Paris, Philadelphia, Pittsburgh, Princeton, San Francisco, Tokyo, Washington, D.C., and Wilmington. For more information about Morgan Lewis or its practices, please visit us online at www.morganlewis.com.

IRS Circular 230 Disclosure

To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing, or recommending to another party any transaction or matter addressed herein. For information about why we are required to include this legend, please see http://www.morganlewis.com/circular230.

This LawFlash is provided as a general informational service to clients and friends of Morgan, Lewis & Bockius LLP. It should not be construed as, and does not constitute, legal advice on any specific matter, nor does this message create an attorney-client relationship. These materials may be considered **Attorney Advertising** in some states. Please note that the prior results discussed in the material do not guarantee similar outcomes. Links provided from outside sources are subject to expiration or change. © 2012 Morgan, Lewis & Bockius LLP. All Rights Reserved.