QDIA options for DC plans

Regulations offer plan sponsors significant protection from liability

The Employee Retirement Income Security Act of 1974 (ERISA) provides retirement plan fiduciaries with important protections from liability for assets invested in a "qualified default investment alternative" (QDIA) on behalf of participants that have not made an investment election. This protection can apply to a number of different situations including to new participants in an automatic contribution arrangement and to participants following the change in a plan investment option.

At Putnam, we offer a number of products that plan fiduciaries can consider using as QDIAs for participant-directed defined contribution plans. The following is a brief summary of the key provisions of the U.S. Department of Labor (DOL) regulations governing QDIAs, along with a description of Putnam funds that can serve as QDIAs. For more information about the regulations or which investment arrangement may be best for your plan, you should consult your financial representative or retirement plan counsel.

Qualified default investment alternatives

For an investment alternative to qualify as a QDIA, it must either be a mutual fund or another type of investment fund or portfolio of funds that is managed by 1) a qualified "investment manager" as defined under ERISA section 3(38); 2) a trustee of the plan; or 3) the plan sponsor who is a named fiduciary. Second, the investment must fall under one of three categories designed to provide long-term appreciation and capital preservation through a mix of equity and fixed-income investments: a stand-alone fund, a portfolio of funds, or a fund of funds can qualify.

Specifically, QDIAs can be:

- **Lifecycle or target retirement date funds or portfolios.** A QDIA can be a diversified fund product or model portfolio 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, or life expectancy. Such products change their asset allocations and associated risk levels over time with the objective of becoming more conservative with increasing age. Putnam offers *Putnam RetirementReady® Funds* and *Putnam Retirement Advantage Funds,* which fall under the lifecycle or target retirement date QDIA category. Target retirement date is the date at which the participant anticipates to begin withdrawing assets, typically at retirement. The principal value of the funds is not guaranteed at any time, including the target date.

- **Risk-appropriate balanced funds or portfolios.** A QDIA can be a diversified fund product or model portfolio that is designed to provide long-term appreciation and capital preservation through a mix of equity and fixed-income exposures consistent with a target level of risk that is appropriate for participants of the plan as a whole. Plan fiduciaries considering this type of QDIA need to determine the risk level that is appropriate for their plans' participant base. Putnam makes available the following funds that include a mix of equity and fixed-income exposures that may be appropriate based upon a plan's determined risk level: *Putnam Dynamic Asset Allocation Funds, Putnam Absolute Return 500 Fund®,* and *George Putnam Balanced Fund.*

- **Model Portfolios.** As mentioned previously, a QDIA can be a portfolio of funds managed by a qualified "investment manager" under ERISA, such as a registered investment advisor or a bank. A plan sponsor, in its capacity as the plan's named fiduciary, can also manage a QDIA. In this category, Putnam offers Model Portfolios for Putnam-administered plans. Model Portfolios are allocation portfolios made up of funds from a

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plan's available investment options that allow participants to quickly and easily diversify their accounts among the funds in the portfolio. Model Portfolios can serve as QDIAs where the plan sponsor as a named fiduciary selects and monitors the funds and allocations within the portfolio, and the portfolio constitutes a lifecycle, target retirement date, or risk-appropriate balanced portfolio as described earlier. Putnam can also offer you access to fiduciary services to help you manage this responsibility.

- **Managed accounts.** A QDIA can be a managed account in which a fiduciary, applying generally accepted investment theories, allocates the assets of a participant's individual account to achieve varying degrees of long-term appreciation potential and capital preservation through a mix of equity and fixed-income exposures offered through investment alternatives available under the plan, based on the participant's age, target retirement date (such as normal retirement age under the plan), or life expectancy.

Qualified default investment alternatives and Putnam solutions

QDIA	Advantages	Considerations	Putnam solutions
Lifecycle or target retirement date funds	Effortless, dynamic allocation for participants Age-based options that adjust risk levels over time	Benchmarks may not be appropriate for a specific fund/strategy	Putnam RetirementReady Funds: portfolios managed by Putnam Asset Allocation team Putnam Retirement Advantage Funds*: collective investment trusts managed by Putnam Asset Allocation team
Risk-appropriate balanced funds	Many solutions to match overall participant risk profiles Ample performance benchmarks Administrative simplicity	Risk level should be appropriate for overall plan demographics Static allocation mix makes ongoing education or advice programs especially important	Putnam Dynamic Asset Allocation Conservative, Balanced, and Growth Funds diversified across major asset classes Putnam Absolute Return 500 Fund seeks positive returns regardless of market conditions George Putnam Balanced Fund: A balanced fund with a track record of over 75 years
Putnam Model Portfolios	Customized to fit the unique demographics and needs of each plan Familiarity of underlying funds Includes funds from plan's lineup based on the investment policy statement	Must constitute a lifecycle, target retirement date, or risk-appropriate balanced investment portfolio Ongoing monitoring and management as named plan fiduciary No standard benchmark for performance comparison	Model Portfolios: Age-based or risk-based models that include multiple fund families
Managed accounts	Customized to the age and target retirement date of each participant	May involve system implementation costs May involve additional charges, paid by either plan sponsor or participant No standard benchmark for performance comparison	Various options

* Retirement Advantage Funds are collective trusts managed and distributed by Putnam Fiduciary Trust Company, a non-depository New Hampshire trust company. However, they are not FDIC insured, and are not a deposit or other obligation of, and are not guaranteed by, Putnam Fiduciary Trust Company or any of its affiliates. The funds are not mutual funds registered under the Investment Company Act of 1940, and their units are not registered under the Securities Act of 1933. The funds are only available for investment by eligible, qualified retirement plan trusts, as defined in the declaration of trust and participation agreement.

Putting QDIAs into operation

To ensure fiduciary protection for the QDIA, the regulations include additional requirements regarding communications and notifications. These rules generally require plan fiduciaries to provide certain notices to participants within specified time frames, provide participants with fund information, and permit transfers out of QDIAs without restrictions or fees. Of course, the other provisions of ERISA Section 404(c) must be satisfied, and each plan must continue to offer a broad range of investment alternatives and communicate these options to plan participants. In addition, plan fiduciaries still have the obligation to prudently select and monitor a QDIA. Sponsors of defined contribution plans who intend to comply with the QDIA rules must provide participants with a notice describing five items: 1) the circumstances under which a participant's account will be invested in a QDIA, including a description of any automatic contribution arrangement; 2) an explanation of the participant's right to direct the investment of his or her account assets; 3) a description of the QDIA; 4) a description of the participant's right to direct investment of assets invested in the QDIA to any other plan investment alternative, including any applicable fees and/or restrictions; and 5) an explanation of where participants and beneficiaries can obtain information concerning other investment alternatives under the plan. Putnam can assist in helping clients identify default participants on the recordkeeping system.

Initial eligibility: Thirty days after the notice is provided, the safe harbor protection applies to all assets invested in the QDIA. In practice, for comprehensive QDIA protection, the notice should be provided at least 30 days before a participant is first eligible to participate in the plan, or at least 30 days before contributions are first invested in the QDIA.

Annually: A notice must be provided at least 30 days before the first day of each plan year.

At Putnam, we are committed to explaining ERISA and the applicable regulations to plan sponsors and to helping them meet the requirements. The regulations give sponsors a great opportunity to gain fiduciary protection while offering attractive investment alternatives for plan participants.

Ongoing review: In 2013, the Department of Labor Employee Benefits Security Administration drafted target-date tips to help plan sponsors in the selection and monitoring of their target-date funds. For more information, go to **www.dol.gov/ebsa/pdf/fsTDF.pdf**

Key questions to ask your plan provider when choosing a QDIA

For all investments

- What asset classes are included or excluded?
- Does the investment manager include active management or passive management (index funds) strategies; relative return or absolute return strategies?
- What type of supporting participant education programs are available?
- Is the investment option portable to a Rollover IRA?
- What are the investment option's fees and expenses?

For target retirement date funds

- Is the portfolio available as a retail fund or collective/institutional trust?
- What is the glide path for equity/fixed-income mix, particularly for allocations of participants at or near retirement?
- What strategies does the manager employ to dampen volatility and limit drawdowns?
- How is the fund managed to perform in periods of market volatility?
- Are custom target date model portfolios available?

For Model Portfolios

- Who is the fiduciary for the asset allocation models and underlying investment selection?
- What is the process for investment review and replacement?
- Will performance for the combined model be displayed?
- Is there a cost to implement and manage on an ongoing basis?

For managed accounts

- Who is the fiduciary for the investment selection?
- What is the process for investment review and replacement?
- Is there a cost to implement at the plan level, and what is the cost for participants?

Consider these risks before investing: Our allocation of assets among permitted asset categories may hurt performance. The prices of stocks and bonds in the funds' portfolio may fall or fail to rise over extended periods of time for a variety of reasons, including both general financial market conditions and factors related to a specific issuer or industry. Our active trading strategy may lose money or not earn a return sufficient to cover associated trading and other costs. Our use of leverage obtained through derivatives increases these risks by increasing investment exposure. Bond investments are subject to interest-rate risk, which means the prices of the funds' bond investments are likely to fall if interest rates rise. Bond investments also are subject to credit risk, which is the risk that the issuer of the bond may default on payment of interest or principal. Interest-rate risk is generally greater for longer-term bonds, and credit risk is generally greater for below-investment-grade bonds, which may be considered speculative. Unlike bonds, funds that invest in bonds have ongoing fees and expenses. Lower-rated bonds may offer higher yields in return for more risk. Funds that invest in government securities are not guaranteed. Mortgage-backed securities are subject to prepayment risk. International investing involves certain risks, such as currency fluctuations, economic instability, and political developments. Additional risks may be associated with emerging-market securities, including illiquidity and volatility. The use of derivatives involves additional risks, such as the potential inability to terminate or sell derivatives positions and the potential failure of the other party to the instrument to meet its obligations. The funds may not achieve their goal, and they are not intended to be a complete investment program. The funds' effort to produce lower-volatility returns may not be successful and may make it more difficult at times for the funds to achieve their targeted return. In addition, under certain market conditions, the funds may accept greater volatility than would typically be the case, in order to seek their targeted return. REITs involve the risks of real estate investing, including declining property values. Commodities involve the risks of changes in market, political, regulatory, and natural conditions. Investments in small and/or midsize companies increase the risk of greater price fluctuations. Growth stocks may be more susceptible to earnings disappointments, and value stocks may fail to rebound. You can lose money by investing in a mutual fund. Additional risks are listed in the funds' prospectus.

This information is not meant as tax or legal advice. You should consult with the appropriate tax or legal professional before making any investment decisions.

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