# QDIA options for DC plans

Regulations offer plan sponsors significant protection from liability

The Employee Retirement Income Security Act of 1974 (ERISA) governs qualified retirement plans. Among its provisions, it allows plan fiduciaries 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. For example, it applies 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. This paper 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

To be a QDIA, an investment must be either a mutual fund or an 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.



**Lifecycle or target retirement date funds or portfolios.** A diversified fund product or model portfolio can be a QDIA if it 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, 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 strategies (1940-Act funds and collective investment trusts), which fall under the lifecycle or target retirement date QDIA category. The target retirement date is when 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 diversified fund product or model portfolio can be a QDIA if it 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 Multi-Asset Absolute Return Fund, and George Putnam Balanced Fund.*

- **Model portfolios.** A portfolio of funds managed by a qualified "investment manager" under ERISA, such as a registered investment adviser or a bank, can be a QDIA. A plan sponsor, in its capacity as the plan's named fiduciary, can also manage a QDIA. Model portfolios are allocation portfolios comprising funds from a plan's available investment options. They 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. Also, the portfolio constitutes a lifecycle, target retirement date, or risk-appropriate balanced portfolio as described earlier. Putnam offers model portfolios.

- **Managed accounts.** A managed account can be a QDIA when 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. This is possible through investment alternatives available under the plan. The allocation is 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<br><br>Age-based options that adjust risk levels over time | Benchmarks may not be appropriate for a specific fund/strategy | Putnam RetirementReady Funds: mutual funds managed by Putnam Global Asset Allocation team<br><br>Putnam Retirement Advantage Funds are 1940-Act mutual funds, and Putnam Retirement Advantage Trusts are collective investment trusts;* both are managed by Putnam Global Asset Allocation team |
| **Risk-appropriate balanced funds** | Many solutions to match overall participant risk profiles<br><br>Ample performance benchmarks<br><br>Administrative simplicity | Risk level should be appropriate for overall plan demographics<br><br>Static allocation mix makes ongoing education or advice programs especially important | Putnam Dynamic Asset Allocation Conservative, Balanced, and Growth Funds are diversified across major asset classes<br><br>Putnam Multi-Asset Absolute Return Fund seeks positive returns regardless of market conditions<br><br>George Putnam Balanced Fund: A balanced fund with a track record of over 80 years |
| **Model portfolios** | Customized to fit the unique demographics and needs of each plan<br><br>Familiarity of underlying funds<br><br>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<br><br>Ongoing monitoring and management as named plan fiduciary<br><br>No standard benchmark for performance comparison | Putnam Multi-Asset model portfolios offer targeted diversification for investors with a choice of six allocation approaches. Consult your plan provider to learn whether Putnam is available among its model portfolio offerings. |
| **Managed accounts** | Customized to the age and target retirement date of each participant | May involve system implementation costs<br><br>May involve additional charges, paid by either plan sponsor or participant<br><br>No standard benchmark for performance comparison | Putnam offers a choice of seven managed accounts. Consult your plan provider to learn whether Putnam is among the plan's managed account offerings. |

* Putnam Retirement Advantage Trusts are collective investment trusts managed and distributed by Putnam Fiduciary Trust Company, a non-depository New Hampshire trust company. However, they are not FDIC insured. They also are not a deposit or other obligation of, and are not guaranteed by, Putnam Fiduciary Trust Company or any of its affiliates. The trusts 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 trusts 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 for communications and notifications. These rules explain when plan fiduciaries must give certain notices to participants. Fiduciaries must also give fund information to participants, and permit transfers out of QDIAs without restrictions or fees. Fiduciaries must adhere to the other provisions of ERISA Section 404(c), and each plan must continue to offer a broad range of investment alternatives and communicate these options to plan participants. 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: (1) the circumstances for investing a participant's account in a QDIA, including a description of any automatic contribution arrangement; (2) the participant's right to direct the investment of his or her account assets; (3) the QDIA itself; (4) the participant's right to direct assets in the QDIA to any other plan investment alternative, and the associated fees, and possible restrictions; and (5) where participants and beneficiaries can obtain information concerning other investment alternatives under the plan.

**Initial eligibility:** Thirty days after the notice is provided, the safe harbor protection applies to all assets invested in the QDIA. In practice, 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:** Notices are due at least 30 days before the first day of each plan year.

**Ongoing review:** In 2013, the Department of Labor Employee Benefits Security Administration drafted tips to help plan sponsors in the selection and monitoring of their target retirement 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 in the QDIA?
- Does the investment manager include active or passive (index) strategies; relative return or absolute return strategies?
- What programs educate participants?
- Is the investment option portable to a Rollover IRA?
- What are the fees and expenses?

**For target retirement date funds**

- Is the portfolio available as a retail fund or as a collective investment trust?
- What is the glide path for the equity/fixed-income mix? Do participants near retirement have too much equity risk?
- What strategies does the manager employ to dampen volatility and limit drawdowns?
- What strategies, if any, does the manager use 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 the model 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 value of investments in the underlying funds' portfolios may fall or fail to rise over extended periods of time for a variety of reasons, including general economic, political, or financial market conditions; investor sentiment and market perceptions; government actions; geopolitical events or changes; and factors related to a specific issuer, asset class, geography, industry, or sector. These and other factors may lead to increased volatility and reduced liquidity in the underlying funds' portfolio holdings. Growth stocks may be more susceptible to earnings disappointments, and value stocks may fail to rebound. Investments in small and/or midsize companies increase the risk of greater price fluctuations.

Bond investments are subject to interest-rate risk (the risk of bond prices falling if interest rates rise) and credit risk (the risk of an issuer defaulting on interest or principal payments). Default risk is generally higher for non-qualified mortgages. Interest-rate risk is generally greater for longer-term bonds, and credit risk is generally greater for below-investment grade bonds. 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, which means that they may increase in value less than other bonds when interest rates decline and decline in value more than other bonds when interest rates rise. The underlying funds may have to invest the proceeds from prepaid investments, including mortgage and asset backed investments, in other investments with less attractive terms and yields.

International investing involves currency, economic, and political risks. Emerging-market securities carry illiquidity and volatility risks. Active trading strategies may lose money or not earn a return sufficient to cover trading and other costs. REITs are subject to the risk of economic downturns that have an adverse impact on real estate markets. Commodity-linked notes are subject to the same risks as commodities, such as weather, disease, political, tax, and other regulatory developments, and other factors affecting the value of commodities. Risks associated with derivatives include increased investment exposure (which may be considered leverage) and, in the case of over-the-counter instruments, the potential inability to terminate or sell derivatives positions and the potential failure of the other party to the instrument to meet its obligations. Efforts to produce lower volatility returns may not be successful and may make it more difficult at times for the funds to achieve their targeted returns. In addition, under certain market conditions, the funds may accept greater volatility than would typically be the case, in order to seek their targeted returns.

Changes in the financial condition of an issuer or counterparty, changes in specific economic or political conditions that affect a particular type of issuer, and changes in general economic or political conditions can increase the risk of default by an issuer or counterparty, which can affect a security's or instrument's credit quality or value. If the quantitative models or data that are used in managing an underlying fund prove to be incorrect or incomplete, investment decisions made in reliance on the models or data may not produce the desired results and the fund may realize losses. Certain securities in which the fund may invest, including securities issued by certain U.S. government agencies and U.S. government sponsored enterprises, are not guaranteed by the U.S. government or supported by the full faith and credit of the United States.

The principal value of each fund is not guaranteed at any time, including at the target date. There is no guarantee that the funds will provide adequate income at and through an investor's retirement. You can lose money by investing in the funds.

Our investment techniques, analyses, and judgments may not produce the outcome we intend. The investments we select for the fund may not perform as well as other securities that we do not select for the fund. We, or the fund's other service providers, may experience disruptions or operating errors that could have a negative effect on the fund. You can lose money by investing in the fund.

**For the portion invested in Putnam Government Money Market Fund, these risks also apply:** *You can lose money by investing in the fund. Although the fund seeks to preserve the value of your investment at $1.00 per share, it cannot guarantee it will do so. An investment in the fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The fund's sponsor has no legal obligation to provide financial support to the fund, and you should not expect that the sponsor will provide financial support to the fund at any time.*

The values of money market investments usually rise and fall in response to changes in interest rates. Interest-rate risk is generally lowest for investments with short maturities (a significant part of the fund's investments).

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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**Investors should carefully consider the investment objectives, risks, charges, and expenses of a fund before investing. For a prospectus, or a summary prospectus if available, containing this and other information for any Putnam fund or product, call Putnam at 1-800-225-1581 and ask for a prospectus. Please read the prospectus carefully before investing.**

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