

Educating the Investor

Lifecycle Funds as A Default Investment Require Education on the Part of Company and Employee

BY BILL HASTIE

Since coming on the scene more than 30 years ago, the 401(k) plan has become the retirement plan of choice for most produce-related companies. The primary benefit of the 401(k) plan, some say, is that it gives the plan participant the ability and responsibility of directing their retirement investments as they see fit. The primary weakness of the plan, others say, is that in giving plan participants this ability and responsibility of directing their plan investments, it puts the success of one's future retirement income in the hands of people who otherwise may never invest on their own. Recognizing this dilemma, most 401(k) plans provide default investment options for plan participants who have the opportunity to direct their plan investments but fail or choose not to do so. Plan fiduciaries (trustees, etc.) are required to use independent discretion and judgment as how to best invest these assets.

In most cases a money market account or fixed rate fund was selected as a plan's default investment option. Since the plan fiduciary, rather than the participant, the fiduciary was then held responsible for prudently selecting and monitoring whatever default investment option he or she had selected. What's more, the



Department of Labor recently indicated that for the purposes of long-term retirement investing, a money market account and fixed rate fund may not be appropriate investment options. As a result, many plan sponsors expressed concern about the liability of selection and monitoring of previously acceptable default investment options now being viewed as inappropriate.

A key aspect of the Pension Protection Act (PPA) passed in August 2006, was to improve the default investment options available to participants and to provide some level of legal protection for plan fiduciaries selecting the default investment options. This Act added §404(c)(5)

to ERISA which provides a plan fiduciary safe harbor protection when a participant has the opportunity to direct their plan investments and fail to do so, and the participant is invested in a qualified default investment alternative (QDIA).

It is beyond the scope of this article to address all of the reporting and disclosure requirements of the new QDIAs, but rather to address issues that arise from utilizing one of the more popular QDIA options – the lifecycle or age-based investment funds. In the generic sense, lifecycle funds are a series of mutual funds whose allocation of stocks and bonds are based on the participant's current age and length of time to retirement, generally assumed to be at age 67 – the younger the participant (thus the more time they have until retirement), the greater the allocation to stocks in the lifecycle fund and therefore the more aggressive (i.e., risky) the fund. Over time, as the participant comes closer to retirement age, the fund systematically adjusts its allocation away from stocks and toward bonds, making the fund increasingly less risky.

Produce and produce-related companies in the Salinas Valley tend to have many default invested participants, and the challenge this often creates for the

younger participant who is default invested is that they can go from investing in a money market account into a lifecycle fund which would typically be quite aggressive given their young age and time to retirement. In a normal investment market cycle this may not have raised too many eyebrows, but given that the Department of Labor issued the final QDIA regulations effective December 24, 2007, one needs to consider the market environment which closely followed that date to recognize the challenge that may have been created. In the month of January 2008 alone, the Standard & Poors

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500 Index, a commonly-used barometer of the U.S. stock market, declined 6%. So the participant who was previously default invested in a stable money market account may now be invested in an aggressive lifecycle fund. As a result, they see their retirement savings subjected to this highly volatile stock market environment we are now experiencing.

The best course of action is communication with the default invested plan participant. The Department of Labor required a transition notice be sent to each participant describing how plan investments would be invested (in the QDIA) as of a certain date should they continue not to make a specific investment selection, including QDIA performance, expenses, etc. There is also an annual notification requirement of this information. But notifications aside, plan fiduciaries are often recommended to have their plan investment advisors meet with their default invested participants and address the QDIA options and

any concerns or confusion the participant may have. Plan participants need not be savvy investors, but they should always have available a reliable source of investment education and guidance.

With additional investment education and guidance, the plan participant who was previously default invested may now be able to make an investment election which may better fit their goals, objectives and risk tolerance – not one

that is simply based on their current and projected retirement age. While the intent of the PPA action to better position 401(k) plan participants for long-term investing is certainly good, plan sponsors are advised to take a pro-active stance in providing quality and on-going investment education and guidance to all plan participants. **ce**



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