



December 22, 2016

Mr. Christopher Spence
Senior Director, Federal Government Relations
TIAA
601 Thirteenth Street, NW
Suite 700 North
Washington, DC 20005

Dear Mr. Spence:

This responds to your request regarding the application of the Employee Retirement Income Security Act of 1974 (ERISA) to TIAA's "Income for Life Custom Portfolios" (ILCP). You state that the ILCP product meets all the conditions of a "qualified default investment alternative" (QDIA) under ERISA section 404(c)(5) and 29 CFR 2550.404c-5, except that the ILCP contains certain liquidity and transferability restrictions attributable to an annuity component that fail the frequency of transfer requirement described in paragraph (c)(5)(i) of the regulation. You believe ILCPs nonetheless should still be appropriate for a plan fiduciary to select as a default investment alternative because the annuity component allows the ILCP to provide in-plan access to an investment with a guaranteed rate of return and guaranteed lifetime income at retirement. You ask whether Title I of ERISA prohibits a plan fiduciary from selecting the ILCP as a default investment alternative for a participant-directed individual account plan.

According to the information you provided, TIAA offers the ILCP as a custom target-date investment model that may be included as a default investment alternative on the investment menu of a participant-directed individual account plan. A customized ILCP is developed for each individual plan through an asset allocation service that uses model portfolios and includes asset allocation and glide path instructions selected and managed, as applicable, in accordance with 29 CFR 2550.404c-5(e)(3). The ILCP, like many traditional target-date funds (TDFs), uses mutual funds as one part of the portfolio. However, unlike traditional TDFs, the ILCP allocates investment funds to a fixed guaranteed annuity (Annuity Sleeve). The Annuity Sleeve provides a guaranteed return element to the portfolio and the option of guaranteed lifetime income as a benefit distribution alternative. The ILCP glide path increases the allocation to fixed-income funds as a participant ages, along with gradual increases to the Annuity Sleeve over time (e.g., 7% at age 45 and 40% at age 65). The percentage allocation to the Annuity Sleeve is capped at 50 percent.¹

¹ You note that individuals who initiate rollovers or trustee-to-trustee transfers from one qualified plan to another plan often provide affirmative investment directions and, therefore, would not be subject to the plan's default investment provisions. If the ILCP is selected as the default investment alternative under a plan, it employs a different strategy when investment directions are not provided in connection with a rollover or transfer, which is designed to ensure that rollover contributions or transfers are not allocated to the Annuity Sleeve without affirmative written consent from the participant.

The Annuity Sleeve in the ILCP is subject to certain liquidity restrictions. Specifically, the ILCP will allow participants to transfer or withdraw from the Annuity Sleeve without restriction for 12 months after the initial investment. After this 12-month period, any funds invested in the Annuity Sleeve of the ILCP would be available for transfer to another investment option only in installments over an 84-month period. All other funds in the ILCP would be liquid and transferable. During this 12-month opt-out period, the plan directly or through TIAA would furnish educational materials periodically to participants defaulted into the ILCP. These materials would explain the features of the ILCP, including the Annuity Sleeve, and the delayed liquidity provision following the initial 12-month opt-out period. After the initial 12-month period, participant education about the ILCP will continue on at least an annual basis.²

The Department's QDIA regulation at 29 CFR 2550.404c-5 establishes conditions under which a participant or beneficiary in a participant-directed individual account plan will be deemed to have exercised control over assets in his or her account when, in the absence of investment directions from the participant or beneficiary, the plan invests all or part of a participant's or beneficiary's account in a QDIA. When a plan complies with the regulation, plan fiduciaries remain responsible for the prudent selection and monitoring of the QDIA, but they are not liable for any loss or by reason of any breach that occurs as a result of an investment in the QDIA. The regulation specifies certain types of investments that may be used as QDIAs under section 404(c)(5) of ERISA. In addition to other requirements, the regulation conditions relief on advance notice to participants and beneficiaries. This notice must describe, among other things, the circumstances under which contributions or other assets will be invested on their behalf in a QDIA, the investment objectives of the QDIA, and the rights of participants and beneficiaries to direct investments out of the QDIA.

Section 2550.404c-5(e)(4)(vi) states that products and portfolios that include annuity purchase rights, investment guarantees, death benefit guarantees, or other features ancillary to the investment fund, product or portfolio may qualify as QDIAs, if the product or portfolio otherwise meets the requirements of the QDIA regulation. One of the conditions for qualifying as a QDIA, however, is that any participant or beneficiary on whose behalf assets are invested, must be able to transfer such assets "in whole or in part" to any other investment alternative available under the plan with a frequency consistent with that afforded participants and beneficiaries who elect to invest in the QDIA, but not less frequently than once within any three month period.³ The ILCP's Annuity Sleeve does not meet this requirement, and, accordingly, the ILCP would not constitute a QDIA.

The QDIA regulation, at 29 CFR 2550.404c-5(a)(2) and 2550.404c-5(f)(4), nevertheless states that the QDIA standards are not intended to be the exclusive means by which a fiduciary might satisfy his or her responsibilities with respect to selection of a default investment for assets in the individual account of a participant or beneficiary. In the Department's view, a fiduciary may be able to conclude, without regard to the fiduciary relief available under ERISA section 404(c)(5)

² We understand that this ongoing education is in addition to any other notice requirements that may apply.

³ See 29 CFR 2550.404c-5(c)(5)(i).

and the regulation, that an investment product or portfolio is a prudent default investment for a plan.⁴

The Department's overarching focus when developing the QDIA regulation, including the types of investment alternatives that could be QDIAs, was on the long-term accumulation of retirement savings as a way to ensure adequate retirement income.⁵ Following the publication of the final rule, a national discussion surfaced around the availability, need for, and importance of lifetime income products and features as a way to protect participants and beneficiaries against the longevity risk of outliving the assets they saved to provide retirement income, the risk of having retirement savings eroded by investment losses, and the risk of declining cognitive abilities that can hamper portfolio management and other financial decision-making skills. The Department, along with the Treasury Department and other stakeholders, identified the need for lifetime income as an important public policy issue and has supported initiatives that could lead to broader use of lifetime income options in defined contribution plans as a supplement to and enhancement of accumulation of retirement savings.⁶

It is the view of the Department that a fiduciary of a participant-directed individual account plan could, consistent with the provisions of Title I of ERISA, prudently select an investment with lifetime income elements as a default investment under the plan if it complies with all the requirements of 29 CFR 2550.404c-5 except for reasonable liquidity and transferability conditions beyond those permitted in paragraph (c)(5)(i) of the regulation. When evaluating whether it is prudent to use this type of investment alternative as a default investment alternative, the fiduciary must engage in an objective, thorough and analytical process that considers all relevant facts and circumstances.⁷ For example, it would be important to evaluate the demographics of the plan and make a considered decision about how the characteristics of the investment alternative align with the needs of plan participants and beneficiaries taking into account, among other things, the nature and duration of the liquidity restrictions, the level of the guarantees of principal and minimum interest rates, any opportunities for the guaranteed minimum interest rates to be supplemented with additional credited amounts, as well as the expected lifetime income to be provided in retirement. As another example, the fiduciary should

⁴ The preamble to the final rule notes that investments in stable value products or funds may be prudent for some participants or beneficiaries even though such investments themselves may not generally constitute QDIAs. *See* 72 Fed. Reg. 60452, 60464. The Department did not intend those examples to be an exclusive list of investments that could be prudent default investment alternatives.

⁵ *See* 72 Fed. Reg. 60452, 60463.

⁶ *See, e.g.,* Testimony of Phyllis C. Borzi, Assistant Secretary of Labor for the Employee Benefits Security Administration to the Senate Special Committee on Aging (June 16, 2010) (at www.dol.gov/ebsa/newsroom/ty061610.html); Joint Notice of the Departments of Labor and Treasury, "Request for Information Regarding Lifetime Income Options for Participants and Beneficiaries in Retirement Plans," 75 Fed. Reg. 5253 (Feb. 2, 2010) (at www.dol.gov/ebsa/regs/cmt-1210-AB33.html); and Information Letter from Phyllis C. Borzi to J. Mark Iwry (Oct. 23, 2014) (whether target date funds invested in unallocated deferred annuity contracts described in IRS Notice 2014-16 could serve as QDIAs) (at www.dol.gov/ebsa/regs/ILs/il102314.html).

⁷ *See* 29 CFR 2550.404a-1 (fiduciary investment duties). *See also* 29 CFR 2550.404a-4 (defined contribution plan safe harbor under section 404(a)(1)(B) for selection of annuity providers and contracts for benefit distributions); Field Assistance Bulletin 2015-02 on fiduciary responsibilities in monitoring and reviewing annuity selections safe harbor (at www.dol.gov/ebsa/regs/fab2015-2.html); and Employee Benefits Security Administration Fact Sheet entitled "Target Date Retirement Funds - Tips for ERISA Plan Fiduciaries" (Feb. 2013) (at www.dol.gov/ebsa/newsroom/fsTDF.html).

also consider whether the costs (including fees and investment expenses) associated with the investment alternative are reasonable in relation to the benefits and administrative services to be provided. Further, because the notice and disclosure provisions in the QDIA regulation were designed for default investments that would be generally liquid and freely transferable, the fiduciary should also consider what additional notice should be provided to participants of the liquidity and transferability restrictions in advance of their becoming applicable as well as the need for more education for affected participants and beneficiaries regarding the features of the investment alternative. Whether the selection of any particular investment alternative, including the ILCP, as a default investment alternative satisfies the fiduciary duties of prudence and loyalty in ERISA section 404(a) with respect to any particular plan would depend on the facts and circumstances.⁸

We hope this information is of assistance to you.

Sincerely,



Louis J. Campagna
Chief, Division of Fiduciary Interpretations
Office of Regulations and Interpretations

⁸ This letter relates solely to the application of the provisions of Title I of ERISA addressed in the letter. It is not determinative of any particular tax treatment under the Internal Revenue Code and does not address any issues arising under any other federal or state laws.