August 8, 2006

SUMMARY COMPARISON AND ANALYSIS OF CURRENT LAW WITH THE FIDUCIARY AND PROHIBITED TRANSACTION PROVISIONS OF THE PENSION PROTECTION ACT (H.R. 4) [1]

Contents

1 H.R. 4 was passed by the House of Representatives on July 28, 2006 and the Senate on August 3, 2006.

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CURRENT LAW	PENSION PROTECTION ACT OF 2006	ANALYSIS	EFFECTIVE DATE
PROHIBITED TRANSACTION EXEMPTIONS			
<u>Block Trading</u>: ERISA section 406(a) currently prohibits purchase and sale transactions between a plan and a party in interest (e.g. service provider or fiduciary and certain affiliates) absent an exemption. Section 4975 of the Code imposes excise tax liability in the case of prohibited transactions involving qualified pension plans, IRAs, and certain other accounts. Where a manager wishes to aggregate the trades of multiple clients in a single "block" with a single counterparty, one or more plans may not be able to participate if the counterparty is a party in interest with respect to the plan(s). ERISA section 406(b)(2) may also be implicated where a fiduciary allocates among one or more ERISA plan clients securities purchased in a single block based on an average price.	**<u>Block Trading (Act § 611(a))</u>**: The PPA adds **ERISA § 408(b)(15)** which provides an exemption from the prohibitions of section 406 for the purchase or sale of securities between a plan and a party in interest (other than a fiduciary) in a block trade (<u>i.e</u>., a trade that will be allocated among 2 or more client accounts of a fiduciary) provided – 1. the trade involves at least 10,000 shares or a market value of $200,000, 2. the terms of the transaction, including the price, are at least as favorable to the plan as an arm's length transaction, 3. the plan's interest (together with other plans maintained by the same sponsor) in the block trade accounts for no more than 10% of the block trade, 4. the compensation associated with the trade is no greater than in an arms' length transaction with an unrelated party. A parallel exemption is provided under new Code § 4975(d)(18).	The new exemption may not be available where the counterparty in the block trade is a plan fiduciary. It is possible that a technical correction or DOL guidance will confirm that the exemption would be available for transactions with a fiduciary so long as the fiduciary does not have discretion over the assets involved in the transaction. It had been hoped that the exemption would provide relief in certain situations not covered by the QPAM exemption (PTE 84-14), such as where an affiliate of the counterparty has the ability to appoint the investment manager on behalf of the plan. However, given the fact that the exemption does not cover transactions with parties-in-interest that are fiduciaries, it is unlikely to extend to these transactions, unless DOL interprets the exemption to apply to transactions with parties in interest who do not act as fiduciaries in the transactions at issue. The new exemption provides to individual separate accounts the same type of access to block trades that is currently enjoyed by bank commingled funds and pooled separate accounts under PTEs 90-1 and 91-38. The new exemption does not appear to address the potential 406(b)(2) issue (discussed in the current law section).	Applies to transactions occurring after the date of the Act's enactment.

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PROHIBITED TRANSACTION EXEMPTIONS			
<u>Electronic or Alternative Trading Systems</u>: ERISA section 406(a) prohibits, in the absence of an exemption (e.g. QPAM), a purchase or sales of securities between a plan and a party in interest through an alternative trading network under circumstances where the transaction is not deemed a "blind transaction." (See Adv. Op. 2004-05A indicating that certain trading systems are "blind transactions" and not prohibited transactions.) ERISA section 406(b) prohibits a fiduciary manager from exercising his authority to utilize a trading network or system in which it has an ownership interest or from which it receives a fee for plan transactions.	**<u>Electronic or Alternative Trading Systems (Act § 611(c))</u>:** The PPA adds new **ERISA § 408(b)(16)** which provides an exemption from the prohibitions of section 406 for the purchase or sale of securities or other property (as determined by DOL) between a plan and a party in interest via an exchange, electronic communication network, alternative trading system, or similar regulated trading venue ("trading system") if -- 1. the transaction is effected under rules designed to match purchases and sales at the best price available through the trading system in accordance with applicable governmental rules <u>OR</u> the identity of the parties is not taken into account in the trade execution, 2. the price and compensation are not greater than that associated with an arm's-length transaction, 3. the transaction through the trading system is effected at the best price available, 4. if the party in interest is an owner of the trading system, an independent fiduciary authorizes the use of the trading system (Note that at one point in the legislative process, DOL proposed this condition relating to the ownership of the trading system, but its language stated "if the fiduciary or the party in interest" is an owner of the trading system), and 5. the plan fiduciary is provided notice at least 30 days before the initial transaction executed through the system. A parallel exemption is provided under new Code § 4975(d)(19).	The exemption provides relief from the prohibitions of section 406(a) for "non-blind" party-in-interest transactions effected through the trading system. Unless DOL interprets the exemption to apply only to the prohibitions of section 406(a) and not potential 406(b) violations, this exemption may also provide relief for - • principal transactions between a plan and the plan fiduciary causing the transaction through the trading system, and • transactions through a trading system in which the manager has an interest or through which the manager receives a fee. This exemption may not cover inadvertent cross trades through a trading system (i.e., a trade between two of the manager's clients) because the client plans will not likely be parties in interest with respect to each other. DOL is to issue regulations applying the exemption to transactions involving "property" other than securities. According to the Joint Committee on Taxation Technical Explanation, the exemption should also be available for futures contracts and currency trades.	Applies to transactions occurring after the date of the Act's enactment.

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PROHIBITED TRANSACTION EXEMPTIONS			
<u>Foreign Exchange Transactions</u>: ERISA section 406(a)(1)(A) and (D) prohibit foreign exchange ("FX") transactions between a plan and a party in interest. Existing class exemptions, PTEs 94-20 and 98-54, permit plans to engage in FX transactions with parties in interest (other than the fiduciary with discretion over the securities or FX transaction), if a direction (individual or standing) from a fiduciary independent of the counterparty is obtained. ERISA section 406(b) prohibits a plan fiduciary from causing a plan to engage in an FX transaction with a counterparty affiliated with the fiduciary. There is no current relief for these transactions.	**<u>Foreign Exchange Transactions (Act § 611(e))</u>:** The PPA adds new **ERISA** § **408(b)(18)** which provides an exemption from the prohibitions of section 406 for FX transactions between a plan and a party in interest bank, broker-dealer or affiliate (including a fiduciary) if – 1. the transaction is in connection with the purchase, sale or holding of securities or other investment asset (other than an FX transaction unrelated to investment of securities or other assets), 2. at the time of the transaction, the terms of the transaction are not less favorable to the plan than the terms generally available in comparable arms'-length transactions between unrelated parties, or the terms afforded by the bank or broker in comparable arm's length FX transactions involving unrelated parties, 3. the exchange rate may not deviate by more or less than 3% from the interbank bid/asked rate displayed by an independent service at the time of the transaction for comparable transactions, and 4. the bank or broker-dealer (or any affiliate) does not have investment discretion or provide advice with respect to the transaction. A parallel exemption is provided under new Code § 4975(d)(21).	Many FX transactions are principal transactions with the plan's trustee or custodian (or an affiliate). The procedures under the current class exemptions requiring direction of an investment manager unaffiliated with the plan are unwieldy. The new exemption will eliminate the need for individualized or standing directions, provided the trustee/custodian is able to implement and finds acceptable the interbank rate standard. The exemption does not provide relief for FX transactions between the plan and the fiduciary who has discretion over the assets in the transaction. Thus, managers of bank collective funds and transition mangers will still be unable to effect FX through the bank. Some have questioned whether a transaction of less than $1 million could be deemed "comparable" under condition #2 because intrabank transactions are usually not less than $1 million.	Applies to transactions occurring after the date of the Act's enactment.

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PROHIBITED TRANSACTION EXEMPTIONS			
<u>Transactions with Service Providers</u>: ERISA prohibits most transactions between a plan and a party in interest. A "party in interest" includes a plan fiduciary, service provider, employer, union and certain affiliates of these entities. ERISA § 3(14). Although section 408(b) contains an exemption for the provision of services to a plan by a party in interest, current law prohibits other transactions between a plan and its party in interest service providers (including purchases, sales, leases, loans and exchanges) unless another exemption applies.	**<u>Exemption for Transactions with Party-in-Interest Service Providers (Act § 611(d))</u>:** The PPA adds **ERISA § 408(b)(17)** which provides an exemption from the prohibitions of section 406 for transactions described in sections 406(a)(1)(A), (B) and (D) (sales, exchanges, leases, loans, uses and transfers between a plan and those entities that are parties in interest solely by reason of providing services to a plan (or because of a relationship to a service provider) if the plan pays no more (or receives no less) than "adequate consideration". The exemption does not apply to transactions between a plan and a fiduciary with respect to the assets involved in the transaction (or an affiliate of such a fiduciary). "Adequate consideration" is defined as follows – 1. For securities traded on such an exchange: the prevailing price on a national securities exchange, 2. For other securities for which there is a generally recognized market: the current bid and asked prices quoted by persons independent of the issuer and the party in interest, or 3. For all other assets: the fair market value of the asset as determined in good faith by a fiduciary. A parallel exemption is provided under new Code § 4975(d)(20).	This is a broad exemption covering 406(a) transactions that meet a single condition -- that the plan receive no less, or pay no more, than "adequate consideration." The language of the amendment is awkwardly drafted, raising the following issue: is the exemption is available for a transaction with a fiduciary service provider that does not have discretion with respect to the assets involved in the transaction? We think this is the better reading, but the exemption might be read to be limited to parties in interest that have no fiduciary relationship to the plan. This could narrow the exemption significantly. The exemption does not provide any relief from the prohibitions of ERISA section 406(b), so will not cover a transaction if the plan's fiduciary has an interest in the service provider that could affect the fiduciary's exercise of its best judgment (such as an ownership interest or profits interest). The exemption's "adequate consideration" condition may be difficult to determine with respect to non-sale transactions, such as a loan.	Applies to transactions occurring after the date of the Act's enactment.

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PROHIBITED TRANSACTION EXEMPTIONS			
<u>Cross Trading:</u> ERISA § 406(b)(2) currently prohibits an investment manager or other fiduciary from causing a client plan to engage in a direct purchase or sale of securities with another client of the manager, even though such a "cross trade" may result in cost savings for both clients. DOL has issued class exemptions to permit under certain conditions "agency" cross trades (where the manager has discretion only on one side of the transaction) and "passive" cross trades (where the portfolio composition is determined by an external index or fixed computer model). <u>See</u> PTEs 86-128 and 2002-12.	**<u>Cross Trading (Act § 611(g)):</u>** The PPA adds **ERISA § 408(b)(19)** which provides an exemption from the prohibitions of section 406 for any transaction described in sections 406(a)(1)(A) and 406(b)(2) involving the purchase and sale of a security between a plan and any account managed by the same investment manager, if — 1. the transaction is a cash-only purchase or sale of a security for which market quotations are readily available; 2. the transaction is effected at the market price as determined under SEC Rule 17a-7(b) applicable to mutual funds; 3. no brokerage commission or other fee (except customary and disclosed transfer fees) is paid in connection with the transaction; 4. for each plan engaged in the transaction, a fiduciary independent of the manager receives written disclosures of the conditions under which cross trades may occur, and provides advance written approval (both the disclosures and approval must be in a document separate from any management agreement); 5. each affected plan or master trust must have assets in excess of $100 million; 6. the manager must provide detailed quarterly reports of all cross trades to the plan fiduciary; 7. the manager's fee schedule or other services must not be contingent on the ability to cross trade; 8. the manager must adopt written cross-trading policies and procedures; and 9. the manager must designate an individual responsible for	The new exemption will have utility primarily for large separately-managed accounts. Unlike the new service provider exemption, the conditions of the cross-trade exemption may be burdensome. The new exemption's restriction on conditioning fees or services on the ability to engage in cross trading (#7) arguably eliminates the ability to offer fee incentives (other than the direct cost savings of avoiding commissions or market impact). The exemption's prohibition on commissions may rule out the common use of "brokered" cross trades at discounted commission rates. It is not clear whether the restriction is intended to prohibit all commissions or merely those paid to the manager or its affiliates. The exemption's "penalties of perjury" compliance audit (condition #9) is a condition not found in most prohibited transaction exemptions and may present compliance challenges. Given these additional burdens and uncertainties, the exemption is not likely to alter reliance on existing class exemptions for passive or agency cross trades, but will add an additional tool for discretionary managers, particularly those who also manage mutual fund assets.	Effective for transactions occurring after the date of the Act's enactment. DOL is required to issue regulations within 180 days regarding the content of managers' written cross-trading policies and procedures. A manager that engages in cross trading in the interim presumably will do so at risk that its policies and procedures will later be determined insufficient.

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	compliance reviews and who will prepare an annual compliance report for clients signed under penalties of perjury (the report must also remind clients of their right to terminate participation). A parallel exemption is provided under new Code § 4975(d)(22). (The Code does not contain a 406(b)(2)-type prohibition.)		
BONDING RELIEF			
Bonding: ERISA section 412 requires plan fiduciaries and other persons who "handle" assets of employee benefit plans to be bonded against losses to the plan from acts of fraud or dishonesty. Each plan must be covered for 10% of the amount of plan assets handled, up to $500,000. Banks and insurance companies supervised or examined by Federal or State authorities generally are exempt. Current law does not exempt registered broker-dealers or registered investment advisers from the bonding requirement.	**Persons Required to Be Bonded (Act § 611(b)):** The PPA adds **ERISA § 412(a)(2)** which extends the bonding exemption to registered broker-dealers subject to fidelity bond requirements of a self-regulatory organization. Banks and insurance companies remain exempted from the bonding requirement. **Bond Amount (Act § 622)**: The PPA amends **ERISA § 412(a)** to increase the maximum required bond amount from $500,000 to $1,000,000 for plans that hold employer securities.	H.R. 2830 would have included a bonding exemption for registered investment advisers and affiliates of broker-dealers under certain conditions. However, the final PPA only provides relief to registered broker-dealers. Even at the current maximum bond amount of $500,000, large investment managers find it difficult to get the required bonds. Doubling the maximum bonding requirement to $1 million will exacerbate this significant problem.	The broker-dealer exemption applies to plan years beginning after the date of the Act's enactment. The increase in the bond amount will apply to plan years beginning after December 31, 2007.

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DEFINITION OF "PLAN ASSETS"			
<u>Significant Participation Test</u>: The "significant participation test" under DOL's plan asset regulation provides that a non-publicly traded investment entity (e.g., a limited partnership, LLC or trust) is treated as holding "plan assets" if participation by "benefit plan investors" is significant — that is, benefit plan investors own 25 or more of any class of the fund's equity interests. If a fund holds plan assets, the fund must be managed to comply with ERISA's prohibited transaction rules and other fiduciary requirements. The plan asset regulation currently defines a "benefit plan investor" as any employee benefit plan, including an ERISA plan, a non-ERISA governmental or foreign plan, an individual retirement account (IRA) or other arrangement subject to Code section 4975, and an entity that holds plan assets by reason of a plan's investment. DOL's current position is that, if any fund holds plan assets (because benefit plan investors hold 25% or more of its equity interests), that entity's entire investment in another entity must be treated as the investment by a "benefit plan investor." For example, if Fund A holds plan assets and invests in Fund B, Fund B must treat Fund A's entire investment as an investment by	**<u>Plan Assets Definition (Act § 611(f))</u>:** The PPA adds **ERISA § 3(42)** which provides that the term "plan assets" will mean, generally, plan assets as defined by regulations issued by the Secretary of Labor, but specifies that such regulations shall provide that an entity shall not be treated as holding plan assets if less than 25% of the total value of each equity class is held by benefit plan investors. The amendment narrows the definition of "benefit plan investor" to include only: 1. Plans covered by ERISA, 2. IRAs or other arrangements subject to Code section 4975, and 3. Those entities whose assets include plan assets by reason of a plan's investment in the entity. Non-ERISA plans such as governmental, church and foreign benefit plans are effectively excluded from the definition of "benefit plan investor." In another change, the PPA provides that an investment entity is deemed to hold plan assets only to the extent of the percentage of the entity owned by benefit plan investors. For example, if 50% of Fund A's equity interests are held by benefit plan investors, only 50% of Fund A's investment in Fund B must be counted as an investment by a benefit plan investor in Fund B's calculations under the significant participation test. The 25% threshold under the significant participation test was not changed by the Act.	The new "benefit plan investor" definition means that governmental and foreign plans will no longer be counted in determining whether benefit plan investor participation in a private investment fund is "significant." This should expand ERISA plan investment opportunities in non-plan asset vehicles. The "to the extent" change will facilitate ERISA plan investments through "funds of funds," which may offer more diverse investments in alternative asset classes. Investment managers sought a change to the Manager Disregard Rule that would clarify that only those interests <u>owned</u> by the manager must be disregarded. HR 2830 contained this language but it did not make it into the final PPA, leaving the issue as to whether interests <u>controlled</u> but not owned by the manager must be disregarded. Some suggest that, notwithstanding new section 3(42), DOL should retain discretion to issue regulations that increase the 25% threshold (but could not decrease the threshold). The amendment made by the PPA gives DOL legislative authority to issue regulations defining when an entity holds "plan assets" – authority which DOL did not have under prior law. Current DOL "plan asset" regulations are interpretative rules only.	Applies to transactions occurring after the date of the Act's enactment.

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DEFINITION OF "PLAN ASSETS"			
a benefit plan investor, even if only 50% of A's equity interests are owned by benefit plan investors. In calculating the percentage of equity interests owned by benefit plan investors, any equity interest "held" by a person who has discretionary authority with respect to the assets of the entity (or who provides investment advice with respect to such assets) must be disregarded (e.g., subtracted from the denominator) (the "Manager Disregard Rule").		It may be possible to argue, based on the language of the new section 3(42), that DOL regulations may not impose "plan assets" status on any entity in which benefit plan investors hold less than 25% of the interests, including, for example, pooled separate accounts and collective investment funds.	
CORRECTION OF PROHIBITED TRANSACTION			
Excise Taxes on Prohibited Transactions: ERISA currently prohibits purchases and sales between a plan a party in interest. In the case of a securities transaction, a prohibited transaction is deemed to occur once the transaction has settled. Currently, there is no relief from ERISA's prohibited transaction provisions, or from the imposition of excise taxes under the Code, even if an inadvertent prohibited transaction is ultimately corrected.	**Exemption for Corrected Party-in-Interest Transactions (Act § 612)):** The PPA adds **ERISA § 408(b)(20)** which provides an exemption from the prohibitions of section 406(a) in connection with the acquisition, holding, or disposition of any security or commodity, if the transaction is corrected within 14 days of the date that the fiduciary discovers (or reasonably should have discovered) the fact that the transaction was prohibited. The exemption would not apply to: 1. a transaction between the plan and plan sponsor involving employer securities or real property, or 2. a transaction that the fiduciary or party in interest knew or reasonably should have known was prohibited at the time	Significantly, the exemption permits correction within a 14-day window from *the date the transaction is discovered (or reasonably should have been discovered).* The Senate version of the exemption would have required correction within 14 days of the transaction itself. Undoubetedly, the issue will arise as to when and whether a prohibited transaction "reasonably should have been discovered."	Applies to any transaction fiduciary discover (or should have discovered) is a prohibited transaction after the date of the Act's enacted.

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CORRECTION OF PROHIBITED TRANSACTION			
	it occurred. To "correct" means: 1. to undo the transaction to the extent possible and in any case to make good to the plan any losses resulting from the transaction, and 2. to restore to the plan any profits made through the use of the plan assets. A parallel exemption is provided under new section 4975(d)(23). If a transaction is covered by the new exemption, no excise tax shall be assessed, and if assessed, the tax shall be abated.		

INVESTMENT ADVICE (ACT §601)			
Investment Advice Issues: The provision of investment advice for a fee to plan sponsor or to participants in a participant-directed plan is a fiduciary act. Generally, an investment adviser that provides advice to invest in specific securities or vehicles that pay additional fees to the adviser or the adviser's affiliate could violate ERISA's self-dealing restrictions. DOL has issued several older class exemptions that may provide relief for such transactions. See PTEs 75-1, 77-4, 84-24, 86-128. DOL more recently has indicated a prohibited transaction will not occur if an adviser levels or offsets all of his fees such that the adviser has no financial interest in a transaction. See DOL Adv. Ops.	**Exemption for Fiduciary Advisers (Act § 601)**: In General: The Amendment provides an exemption for the provision of advice to participants and receipt of fees from such advice by a "fiduciary advisor." The exemption does not apply to "plan level" advice – i.e., advice to plan fiduciaries who are selecting investment options, or any plans other than participant directed plans. Fiduciary adviser is defined broadly to include banks, insurance companies, broker dealers, registered investment advisers, all of their affiliates, and all of their employees, representatives and agents. The exemption includes significant conditions. Most importantly, advice must be given pursuant to an "eligible investment advice arrangement" ("Eligible Arrangement"). To be an Eligible	General The final agreement significantly reduces the usefulness of the broad exemption originally passed by the House. If narrowly interpreted, the exemption may not provide much more flexibility than the fee leveling and independent computer modeling options available under current law and, in fact, the adviser would be required to comply with significant new audit and disclosure conditions. There are two issues which DOL could interpret favorably that would enhance the utility of the exemption: Fee leveling: It may be possible to read the fee leveling condition as only requiring fee neutrality for	Applies to advice provided after December 31, 2006.

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INVESTMENT ADVICE (ACT §601)			
97-154 (Frost Bank), 2005-10A (Country Bank). Alternatively, the adviser must use, and not deviate from, an independently developed computer model that provides the investment recommendations. DOL Adv. Op. 2001-09 (Sun America). Plan sponsors that hire investment advisers have a fiduciary responsibility to prudently select and monitor the adviser. In addition, under ERISA section 405, a sponsor could be liable for the fiduciary breaches of advisers they have hired under certain circumstances.	Arrangement, either: 1. any fees received by the adviser must not vary on the basis of investment options selected or 2. the adviser must use a computer model. The computer model must be objective and must be certified by an eligible investment expert at the time it is initially used and then again if later modified. The independent expert must have no material relationship with the adviser. A myriad of additional conditions apply, including comprehensive disclosures of fees and affiliations that must be given before the time of the advice and regularly updated. Advisers must obtain an annual audit from an independent auditor regarding compliance with the exemption. Plan sponsors are given some relief from the specific advice provided by advisers, but they must prudently select and monitor advisers as they currently must do for investment managers. <u>IRAs</u> The exemption includes the same conditions in ERISA section 406 and Code section 4975. However, the exemption includes a special rule that directs the DOL to study whether computer models are feasible for IRAs. In particular, DOL must determine if computer models can take into account the full range of investments available in IRAs, including individual bonds and equities. DOL must issue a report to Congress and if it determines a	the individual adviser providing the advice, as opposed to requiring comprehensive fee neutrality for the adviser's employer and affiliates. If DOL (or Congress) provided such a clarification, this condition would make more sense because an exemption would still be needed because an employer's financial interests are usually imputed to an individual acting on the employer's behalf. <u>Computer Model</u>: The exemption includes a provision requiring that advice be given at the direction of the participant. However, it further indicates that nothing precludes individuals from requesting advice other than that provided under the computer model provided that the request is not "solicited." It is not clear whether this provision (1) requires "rerunning" and following the model in order for the adviser to respond to the participant's request, or, (2) provides exemptive relief for deviating from the model in response to such a request. It is also unclear if advisory materials could in any way publicize this option without running afoul of the "no solicitation" rule. <u>IRAs</u>: It is possible that DOL could issue a very helpful exemption for IRAs under this provision. However, there is no set time frame for the issuance of the DOL exemption and there could be a strong effort by opponents to an IRA exemption to prove that computer models can cover all individual securities. Moreover, DOL is required to continuously review	 The provision relating to the DOL study is effective on the date of the Act's enactment.

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INVESTMENT ADVICE (ACT §601)			
	computer model is not feasible it must issue a class exemption for IRAs that follows the statutory exemption, but without the computer model requirement. If DOL initially finds that computer models are not feasible for IRAs, any person may later ask DOL to review that finding based on new information and DOL must respond within 90 days of such request. If DOL then makes a finding that computer models are feasible, then the exemption is revoked within 2 years.	future requests and subsequently revoke the exemption if it revises its initial finding, which creates uncertainty for those seeking to rely on a DOL exemption.	
DEFAULT INVESTMENTS & AUTO ENROLLMENT			
ERISA § 404(c) – Default Investment Options: Under ERISA, the investment of plan assets is generally a "fiduciary" act. Under ERISA a fiduciary must, among other things, act for the exclusive benefit of participants and act with care, skill and prudence. Under ERISA section 404(c), provided certain requirements are met, plan fiduciaries are relieved of liability for losses that result from a participant's exercise of control over his or her plan account balance. It is DOL's view that 404(c) relief is not available in the absence of a participant's affirmative investment direction, including where a participant's account is invested "by default" in an investment option.	**Default Investment (Act § 624)**: A new **ERISA § 404(c)(5)** is added to extend protection to fiduciaries of plans that provide for the investment of the participant account balances in the absence of an affirmative investment election in "default investments." To obtain relief, the plan must comply with new DOL regulations and provide notice to participants. DOL must issue regulations on the appropriateness of designating certain investments as "default investments" that would permit the use of a mix of investments and asset classes consistent with long-term capital appreciation or capital preservation, or a blend of both. Annual notice must be provided to participants explaining the employee's right to designate investments under the plan and how a participant's account balance will be invested in the absence of an affirmative investment election.	This section 404(c) amendment will encourage employers to offer automatic enrollment programs since they will be able to obtain liability relief. Providing relief for both capital preservation and accumulation vehicles will provide needed flexibility. As with any relief under section 404(c), plan fiduciaries will still be liable for prudently selecting and monitoring the default vehicles. One limit is that the amendment only applies to section 404(c) plans, and many individual account plans may not qualify as section 404(c) plans. DOL has already drafted proposed regulations for default investment programs, pending at OMB. Apparently, the scope of the pending DOL regulation is broader as it is issued under section 404(a), so it may be available to non-section 404(c) plans. One key issue is how DOL will revise its proposed regulations in light of this change.	Effective for years beginning after December 31, 2007.

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DEFAULT INVESTMENTS & AUTO ENROLLMENT			
	The participant must be given a reasonable amount of time after receipt of the notice, and before the beginning of the plan year, to affirmatively designate investments under the plan.	Interestingly, the notice to participants is annual and no notice is required at the time of the actual enrollment and default election.	
Preemption of State Law for Auto Enrollment: ERISA section 514 broadly preempts any state law that relates to a plan. Various state laws may restrict a plan's enrollment procedures, including state requirements for affirmative or written authorization for payroll deductions, or limits on overall payroll deductions for employee benefit plan contributions relative to an employee's total wages. DOL has issued several advisory opinions indicating that such laws, even state criminal laws, are preempted by ERISA. See DOL Adv. Ops. 96-01A; 94-27A.	**Preemption (Act § 902(f))**: ERISA's preemption provision is amended to provide that any state law restricting the inclusion of an "automatic contribution arrangement" would be preempted. An automatic contribution arrangement is limited to arrangements under which contributions are made in accordance with the default investment arrangements that are added to section 404(c)(5). As a condition of obtaining preemption, the administrator must provide an annual notice to participants describing the arrangement.	This provision will provide some new certainty regarding automatic enrollment arrangements. Several aspects of the preemption relief that are noteworthy. The provision might be interpreted to narrow current law since DOL has issued numerous favorable opinions of the subject under the more general preemption rules of section 514(a). Moreover, the relief is available only for section 404(c) plans. There may be a negative inference created for non-section 404(c) plans, including many health and welfare plans that have automatic enrollment features, since those plans have previously relied on the general preemption rules under section 514(a). Notices required under this provision must be coordinated with the notice required under the new default investment rules in section 404(c)(5).	Effective on the date of the Act's enactment.

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MAPPING (ACT § 621(a)(2))			
Mapping: ERISA section 404(c) provides that if a participant is permitted to direct his own investments under the plan, plan fiduciaries will generally not be liable for losses that result from the participant's direction.	**Mapping (Act § 621(a)(2)):** ERISA section 404(c) is amended in two respects. First, fiduciaries are provided with 404(c) relief during a blackout period if they authorized and implemented the blackout period consistent with the "requirements of this title." In addition, ERISA section 404(c)(4) would be added to provide generally that, if certain requirements are met, section 404(c)	Providing "mapping" relief is also a favorable change. Important changes were made in conference that allow administrators to "synch" the existing blackout notice with this mapping notice and provide relief for any mapping circumstances whether or not a blackout period is entered into. However, requiring mapping to	Applies for plan year beginning after 12/31/07.

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MAPPING (ACT § 621(a)(2))			
Under 404(c), the plan fiduciary must provide a broad range of investment options, consisting of at least three diversified investment options. Failure to prudently choose these investment options may result in personal liability on the part of the fiduciary under 404(a). DOL currently takes the position that section 404(c) is not available to a fiduciary either (1) during a blackout period or (2) when participant account balances are "mapped" to new options without an affirmative participant direction. Section 101(i) of ERISA requires administrators to provide advance notice of a "blackout period." Generally, the notice must be provided at least 30 days in advance. A "blackout period is defined as a period of 3 or more consecutive days in which individual account participants may not direct trades, obtain loans or obtain distributions.	relief would be available for mapping that constitutes a "qualified change in investment options." A "qualified change in investment options" must meet the following requirements: 1. The participant's account is reallocated among one or more new investment options which have characteristics relating to risk and rate of return are reasonably similar to the existing investment options immediately before the change; 2. Notice must be sent at least 30 days and no more than 60 days before the effective date of the change, explaining how the account will be invested in the absence of affirmative directions and including information comparing the new and existing options; 3. The participant must not have provided affirmative investment instructions contrary to the change before the effective date of such change; and 4. The investments of the participant or beneficiary in effect immediately before the change must have been the product of the exercise of control by the participant or beneficiary.	similar risk and return vehicles is quite problematic. In many circumstances there may be no similar fund or there will be uncertainty as to whether funds are similar enough (e.g., a GIC vs. a money market fund).	<u>Special CBA rule</u>: Plan Years beginning on the earlier of (A) the later of 12/31/08 or the termination of the CBA, or (B) 12/31/09.
EMPLOYER STOCK			
<u>Divestment of Employer Securities:</u> Under the Code, an employee stock ownership plan ("ESOP"), which is designed to invest primarily in employer securities, must permit a participant who has attained age 55 with at least 10 years of participation to diversify his or her account into	**<u>Divestment of Employer Securities (Act § 901)</u>**: The PPA amends ERISA and the Code are amended to add new **ERISA § 204(j)** and **Code § 401(a)(35)**, which generally provide that defined contribution plans are required to permit participants to diversify amounts invested in employer securities. The time at which the new diversification rights are triggered depends upon	Currently, ERISA section 407, dealing with limitations on acquisition and holding of employer securities, allows a plan to require that employees invest up to 1% of their elective deferrals in employer securities. This seems at odds with the diversification requirements	<u>Generally</u>: Applies to plan years beginning after 12/31/2006.

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assets other than employer securities. Eligible individual account plans generally are not subject to restrictions on the amount that may be invested in employer securities, and fiduciaries generally will not be deemed to violate ERISA's diversification requirements with respect to qualifying employer securities held by such plans.	the type of contribution invested in employer securities: 1. In the case of elective deferrals under a qualified cash or deferred arrangement and employee after-tax contributions that are invested in employer securities, each "applicable individual" (i.e., a plan participant, and any beneficiary who has an account under the plan with respect to which the beneficiary is entitled to exercise the rights of the participant) must be permitted to direct that such amounts be transferred into alternative investments. 2. With respect to nonelective employer contributions and employer matching contributions that are invested in employer securities, a participant with at least three years of vesting service, a beneficiary of such participant, or the beneficiary of a deceased participant, must be permitted to direct that such amounts be transferred into alternative investments. A transition rule would apply to employer securities held in accounts of participants acquired in a plan year beginning before January 1, 2006. Under the transition rule, the divestment opportunities would apply to 33% of each class of employer securities held in a participant's account during the first year of the transition, 66% during the second year of the transition, and 100% during the final year of the transition. No transition period would apply for participants aged 55 and over who completed three years of services before the first plan year beginning after December 31, 2005. Plans subject to the diversification rules are required to give	added to ERISA section 204(j) under the PPA. Current regulations under ERISA section 404(c) include a "general volatility rule" applicable to all plan investment options, including employer stock alternatives, which provides that a plan will not meet the requirements of ERISA section 404(c) if it does not allow participants to give investment instructions "with a frequency which is appropriate in light of the market volatility to which the investment alternative may reasonably be expected to be subject." Thus, even though the PPA allows for quarterly trading out of an employer stock alternative, a plan may not meet the requirements of ERISA section 404(c) if it only allows for quarterly trading out of the employer stock alternative.	Special CBA Rule: Applies on the earlier of: (1) 12/31/07, or the date on which the last CBA terminates (without regard to extensions), or (2) 12/31/2008. Special ESOP Rule: the earlier of: (1) 12/31/07, or (2) the first date on which the fair market value of employer securities exceeds the guaranteed minimum value specified by the plan. 3-Year Transition Rule: Special transition rule applies to nonelective

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	applicable individuals a choice of at least three investment options—other than employer securities—each of which is diversified and has materially different risk and return characteristics. Plans must offer applicable individuals the opportunity to request diversification from employer securities with the same frequency as the opportunity to make other investment changes, and such opportunity must be offered at least quarterly. Plans may not impose restrictions or conditions with respect to investment of employer securities that are not imposed on the investment of other assets (other than as required by securities laws). For example, a plan may not provide lower rates of employer matching contributions with respect to participants who divest their accounts of employer securities. Plan administrators must provide participants with written notice of diversification rights at least 30-days prior to such rights being triggered (the disclosure obligations is discussed below).		employer contributions and employer matching contributions invested in employer securities in plan years beginning before January 1, 2007.
	<u>Notice to Participants Regarding the Right to Divest Employer Securities (Act § 507)</u>: The PPA adds a new **ERISA § 101(m)**, which requires a plan administrator to notify each individual account plan participant of his or her right to sell employer securities at least 30 days before the participant is eligible to sell such securities. The notice must also describe the importance of diversifying retirement account assets.	If a participant's ability to divest from employer securities is triggered at different times due to the manner in which employer securities were acquired, <u>e.g</u>., elective deferrals versus non-elective employer contributions or employer matching contributions, separate notices must be provided.	<u>Notice</u>: Applies to plan years beginning after December 31, 2006.

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	The notice must be written in a manner calculated to be understood by the average participant, and may be delivered in written, electronic, or other appropriate form to the extent such form is reasonably accessible to the applicable individual. Also amended is **ERISA §502(a)(7)**, to allow the Secretary of Labor to assess a civil penalty upon the plan administrator of up to $110 per day, for failure to provide the required notice in a timely manner.	The Treasury Department is required to issue a model notice within 180 days of the enactment of the legislation.	
Benefit Statements: ERISA currently requires pension plans to provide certain benefits statements to participants "upon request." Specifically, section 105(a) of ERISA requires pension plans to provide a statement of a participant or beneficiary's accrued and vested benefits (or the date benefits will become vested) upon written request. Plans are not required to provide this statement more frequently than once per year. Plans to which more than one unaffiliated employer contributes (e.g., multiemployer plans) are not currently subject to this requirement under section 105(d). Plans wishing to qualify for the fiduciary relief provided by ERISA section 404(c) are required to provide, upon request, information concerning the value of shares or units in the investment options held in a participant or beneficiary's account under the plan.	**Periodic Benefit Statements (Act § 508):** The PPA amends **ERISA § 105(a)** to require periodic benefit statements to individual account plan and defined benefit plan participants, including a notice regarding account diversification. Certain pension plans must provide benefit statements automatically, rather than solely upon request. Individual account plans must furnish quarterly statements to participants and beneficiaries who have the right to direct the investment of their accounts, annual statements to participants and beneficiaries who have plan accounts that they do not have the right to direct, and upon request to other beneficiaries. Defined benefit plans would be required to provide benefit statements every three years to vested participants who are current employees, or an annual explanation of how to obtain a benefit statement. Other participants and beneficiaries could obtain statements from a defined benefit plan upon request. Benefit statements could be provided in written or electronic form, and would be required to provide a statement of both		Applies to plan years beginning after December 31, 2006. For collectively bargained plans, the amendments apply to plan years beginning after December 31, 2007 or December 31, 2008, depending on the expiration date of the latest collective bargaining agreement under which the plan is

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	accrued and vested benefits (or the date on which benefits become vested) and an explanation of the impact of any permitted disparity or floor-offset arrangements. For individual account plans, statements would generally be required to include the value of each investment option to which the participant's account has been allocated, and if a participant has the right to direct the investment of his account, an explanation of any limitations on the right to direct account balances, the importance of a diversified portfolio, and notice that the DOL website contains information on investing and diversification. Participants and beneficiaries would not be entitled to more than one benefit statement in any 12-month period. The PPA removes section 105(d) from ERISA. Accordingly, plans maintained by multiple employers are now subject to benefit statement requirements to the same extent as their single employer counterparts. The PPA directs the DOL to develop a model benefit statement within one year of enactment and permits interim final rules.		maintained.
MISCELLANEOUS			
Missing Participants: Under current ERISA § 4050 and PBGC regulations, when a plan participant in a terminating single-employer DB plan cannot be located, the plan administrator may purchase an annuity for the missing participant or pay the funds to the PBGC. Before turning assets over to the PBGC, the plan administrator must conduct a diligent	**Missing Participants (Act § 410):** The PPA amends **ERISA § 4050** to direct the PBGC to issue regulations including multi-employer plans in the PBGC's missing participant program. Thus, like terminating single employer DB plan, terminating multi-employer plans must either purchase an annuity for the missing participant or pay the funds to the PBGC. The PPA also amends ERISA § 4050 to provide that certain other terminating plans may, in accordance with PBGC regulations, transfer	Without further guidance from the DOL, it may be difficult for plan fiduciaries of terminating defined contribution plans to utilize the PBGC missing participant program. The PPA does not provide any relief from ERISA's fiduciary liability provisions for the transfer of assets to the PBGC. ERISA section 404(c)(3) provides that a	Effective for distributions made after final regulations implementing the provisions are issued.

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search for missing plan participants. DOL takes the position that plan fiduciaries have a duty to attempt to locate missing participants. DOL Info. Ltr. to W. Strauss (Aug. 25, 1986), DOL also views the choice of a distribution option for missing participants in a terminating defined contribution plan as a fiduciary decision and has identified establishing an IRA as the preferred distribution option. DOL FAB 2004-02 (Sept. 30, 2004).	missing participants' benefits to the PBGC. Plans included in the permissive PBGC missing participant program include: 1. defined contribution plans 2. defined benefit pension plans with no more than 25 active employees maintained by a professional service corporation, and 3. the portion of defined benefit pension plans that provide benefits based upon the separate accounts of participants. Once assets are transferred to the PBGC, the PBGC becomes responsible for paying each located plan participant either a single lump-sum (plus interest) or a payment in another form specified by the PBGC's regulations. The regulations may also require plan administrators transferring missing participant assets to provide the PBGC with information about the benefits due to the plan's missing participants.	fiduciary shall not be liable for losses suffered by a participant account transferred to an IRA in accordance with DOL regulations. DOL regulations shield plan fiduciaries from ERISA liability for the selection of an IRA provider and the investment of IRA funds in the case of IRA rollovers. Without similar liability protections, plan fiduciaries may not be as willing to turn missing participant assets over to the PBGC. Depending on the regulations adopted by the PBGC, this informational requirement could apply even where the plan administrator does not elect to transfer participant assets to the PBGC. For instance, where a plan administrator opens a bank account for a missing participant, the plan administrator may still have to provide the PBGC with information	
<u>Coercive Interference with Participant Rights under ERISA Section 511</u>: Section 511 provides that it is unlawful to coerce or intimidate any participant through the use of fraud, force, violence or the threat thereof for the purpose of interfering with or preventing the exercise of the participant's right under the plan, Title I, section 3001 or the WPPDA. A violation of Section 511 results in a fine of $10,000 and or imprisonment of up to one year.	**<u>Increased Interference Penalties (§ 623</u>**): The penalty for violation of section 511 was increased to $100,000 and imprisonment of no more than 10 years.		Applies to violations occurring on or after the date of Act's enactment.