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Articles in this Edition

RECENT LEGISLATIVE ACTIVITY

Congressional Committees Hear Testimony on 401(k) Fees; Neal Introduces New Legislation

401(k) fees have been a hot topic across the board in recent weeks. First, a recent House of Representatives Ways and Means Committee (Committee) hearing was held discussing the appropriateness of 401(k) plan fees. For the purposes of the hearing, Ways and Means Chairman Charles Rangel (D-NY) asked Representative Jim McDermott (D-WA) to preside over the session. Rangel and McDermott both expressed concern that excessive fees may be compromising retirement savings and suggested the importance of more transparency in fee disclosure. Ranking Republican committee member Jim McCrery (R-LA) also expressed support for enhanced disclosure, but warned against the unintended consequences of increased costs to plans and participants.

Several panel discussions were held during the course of the hearing. The first panel consisted of government witnesses:

- The Honorable Bradford P. Campbell, Assistant Secretary of Labor for the Employee Benefits Security Administration, U.S. Department of Labor (DOL), said that the DOL's ongoing plan fee projects are "a top priority" for the department and noted that the Form 5500 project should be finalized in the next several weeks (discussed in later sections of this Issue). He also indicated that a project related to service providers is drafted and currently in the government review stage (now in the Office of Management and Budget), while the participant disclosure project is expected to be released as a proposed regulation during the first months of 2008.
- W. Thomas Reeder, Esq., Benefits Tax Counsel for the Office of Tax Policy at the U.S. Department of the Treasury described Treasury efforts to address 401(k) issues related to the tax code. Reeder also warned that "legislation in this area could disrupt the Labor Department's significant ongoing efforts to require enhanced disclosures of plan fees and costs," while expressing concern that increased disclosure could impair or mislead participants.
- Andrew J. Donohue, Director of the Division of Investment Management at the U.S. Securities and Exchange Commission (SEC), described the agency's mutual fund disclosure initiative, which favors clear, concise, meaningful disclosure of relevant information (such as the fund's investment strategies, risks and total costs) to investors. He indicated his department has been working with DOL to determine how the mutual fund procedure could dovetail with potential defined contribution plan disclosures.
- Barbara D. Bovbjerg, Director of Education, Workforce, and Income Security Issues at the U.S. Government Accountability Office, discussed what information participants should receive (such as direct expenses that are charged to accounts and benchmarks for comparing plan options) and the responsibilities of plan fiduciaries.

The question-and-answer period for this panel centered primarily on the necessity of legislative action, considering the imminent release of proposed DOL regulations. The

DOL, United States Treasury (Treasury) and SEC officials asserted that they possessed statutory authority to issue comprehensive rules, while Bovbjerg strongly recommended statutory changes. Some Committee members also asked whether the cost of "bundled" retirement products should be broken down into smaller components, to which the panelists generally replied that the component prices are irrelevant as long as the fiduciaries can judge the appropriateness of the services for the total cost. Along these lines, Rep. Richard Neal (D-MA) promoted his Defined Contribution Plan Fee Transparency Act (H.R. 3765), which would, among other provisions, divide charges for bundles services into three broad categories (discussed later in this section).

Rep. Earl Pomeroy (D-ND) took his opportunity during the question-and-answer period to ask about regulations related to defined benefit pension plans under the Pension Protection Act – generally the responsibility of the Treasury – and noted the importance of his legislation, cosponsored with fellow committee member Eric Cantor (R-VA), to delay by one year the effective date of certain provisions of the Pension Protection Act of 2006 (PPA) (H.R. 3868).

The second panel addressed various industry organizations. During the question-and-answer period for this panel, committee members once again asked about the authority of regulatory agencies to provide disclosure rules and the appropriateness of bundled services for plan sponsors.

The third and final panel addressed public plans and participant groups. The brief question-and-answer period after the third panel again touched on the use of bundled services, as well as the use of independent financial consultants for selecting plan services and the provision of objective advice to participants.

The Senate Special Aging Committee (Special Committee) also recently held a hearing on 401(k) fees. Special Committee Chairman Herb Kohl (D-WI) announced in his opening statement that he, along with Senator Tom Harkin (D-IA), would soon be introducing the Defined Contribution Fee Disclosure Act, legislation to achieve "complete transparency" of plan fees. Bill text and other details have not yet been released, but Kohl described the bill by saying that it would foster competition between pension managers and expand choices and options for participants. Ranking Special Committee Republican Gordon Smith (R-OR), in his opening statement, noted Americans' historically low savings rate and acknowledged that additional disclosures may carry burdens and costs for plan sponsors and participants.

As was true at the House Ways and Means Committee hearing, three panel discussions ensued.

The first panel consisted of government witnesses and discussions were held regarding what information would be most useful to participants (such as direct expenses that are charged to accounts and benchmarks for comparing plan options) and how that information should be disclosed (through brief, simple language and layout). The DOL once again described their ongoing plan fee projects as "a top priority" for the department and also indicated that the Form 5500 project should be finalized in the near future. The service provider project is drafted and currently in the internal review stage. The participant disclosure project is expected to be released as a proposed regulation during the first months of 2008. During the question-and-answer period, both government witnesses invoked "plan fiduciary responsibility" for estimating fees and ensuring that they are reasonable.

In early October, the House of Representatives Education and Labor Committee (Labor Committee) held a hearing on the Fair Disclosure for Retirement Security Act (H.R. 3185), the 401(k) fee disclosure bill introduced by Labor Committee Chairman George Miller (D-CA).

At the Labor Committee hearing, testimony was heard from several benefits trade organizations, which shared in common certain key principles intended to guide 401(k) fee legislation:

- Disclosure should contain key information important to participants, generally including, for example, the investment objectives, risk level, fees, and historical returns of investment options. Undue emphasis on fees will only mislead participants by elevating fees above other equally or more important factors.

- The disclosure needs to be short, simple, and easy to understand. Examples or estimates based on prior year data may be helpful.

- Reform of existing rules regarding electronic communication is needed to facilitate less expensive, more efficient forms of communication, including the use of internet and intranet postings.

- Fee information should be provided upon enrollment and updated annually. Any legislation should be coordinated with the existing benefit statement requirements.

- Fee disclosure should be disclosed in the manner in which fees are charged and should not force an artificial or overly granular breakdown of information.

- Where disclosure of exact dollar amounts would be costly, the use of estimates or examples based on prior year data should be permitted.

- Plan fiduciaries should retain flexibility to determine the format for disclosure based on the nature, expectations, and other attributes of their workforce.

- Fee disclosure should be disclosed in the manner in which fees are charged.

- Service providers should be required to disclose what services are included in the "bundle" and what services can be purchased separately by the plan fiduciary.

During the course of the hearing, the committee heard testimony from a number of witnesses, including Bradford P. Campbell, Assistant Secretary of Labor at the DOL Employee Benefits Security Administration. His testimony provided some detail on the DOL initiatives and expressed the department's concern with some provisions of H.R. 3185, including the scope of the bill's disclosure requirements, the mandated investment options and the provision of "services" to small employers.

Other witnesses appeared representing public and private employers, service providers and plan participants. During the question and answer period, Miller questioned the assertions of some witnesses that the disclosures required under the bill would be excessive and unhelpful. Ranking minority member Buck McKeon (R-CA) stressed the importance of "rate of return" in evaluating plan funds.

Miller may now schedule a mark-up of H.R. 3185, or he may collect additional testimony in further hearings.

As previously noted, another defined contribution plan fee bill was introduced in early October by Rep. Neal (D-MA), a member of the House Ways and Means Committee. The Defined Contribution Plan Fee Transparency Act would amend the Internal Revenue Code (Code) to require certain disclosures to plan participants and impose taxes for failure to comply. The bill would apply to all tax-preferred, participant-directed defined contribution plans, including 401(k) plans, 403(b) plans and governmental 457(b) plans. An official summary of the bill is available.

Specifically, the bill requires employers to provide employees with disclosures regarding plan investments and fees at enrollment and annually. The enrollment notice would disclose the key characteristics of each investment option – including risk and return characteristics and any applicable fees – among other traits. Accompanying the disclosure would be a statement that participants should not select investments based solely on fees but based on careful consideration of a range of factors. The annual notice would provide participants with information about the investments selected and the fees applicable to their accounts. This annual notice would describe and detail the participant's investment choices, as well as any asset-based or other fee charges to the account, but would not require actual dollar figures for fees assessed other than for participant-initiated transactions such as plan loans. The DOL would be called upon to develop model notices and regulations for automatic enrollment and electronic communication. Failure to comply would result in a tax of $100 per day per failure with annual exposure capped at $500,000.

With regard to disclosures by plan service providers, the legislation would require them to provide various fee information to plan administrators in advance of a contract for plan services. Providers would be required to give the employer an estimate of total fees and a detailed and itemized list of all the services to be provided under the contract. Multiple bundled services would need to be separated into three categories: (1) investment management, (2) administration and recordkeeping, and (3) fees paid to intermediaries or other third parties. Estimates can be used to make a reasonable allocation between categories. Revenue sharing would also need to be disclosed, but payments to affiliates are not required to be disclosed because members of a controlled group are treated as a single service provider. The detailed disclosure statement would need to be provided to employers every year and after any material modification to the contract. Employers would be required to make the notice available to participants. Failure to provide the proper notice to plan administrators would result in a tax of $1,000 a day per failure with annual exposure capped at $1,000,000.

Fee disclosures to participants and plan administrators can be done as dollar amounts, as a percentage of assets or a combination of both. Both the $100 per day and $1,000 per day penalties can be avoided for inadvertent failures that occur despite reasonable diligence, if the failures are corrected within 90 days of knowledge of the failure. Treasury can also waive part or all of the tax. The bill also promotes electronic delivery of notices by directing Treasury to (1) allow the notices to be provided electronically and

(2) issue regulations that permit plan administrators to notify participants of the availability of the notices and to make those disclosures available through new technology.

The legislation reflects concerns that the participant disclosure required by the Fair Disclosure for Retirement Security Act (H.R. 3185) is too granular to be useful to participants and raises significant compliance and liability issues.

House Committees Approve COBRA Coverage Expansion, Enhancement of TAA Tax Credit and Legislation Barring Sexual Orientation Employment Discrimination
The House of Representatives continued to be busy in October.

Two House of Representatives committees focused on the expansion of COBRA coverage when they recently approved legislation to expand COBRA coverage and a federal health care tax credit for employees whose jobs have been lost due to the effects of import competition or shifts in production to other countries.

In mid-October the Labor Committee approved the Early Warning and Health Care for Workers Affected by Globalization Act (H.R. 3796), which significantly expands the COBRA coverage period for individuals who are eligible for trade adjustment assistance (TAA) due to a job loss resulting from adverse trade-related conditions specified in the Trade Act of 2002. Currently, individuals whose jobs are lost due to a qualified trade-related reason may elect COBRA coverage for up to 18 months (or 36 months for qualified dependents that experience a second qualifying event) as long as the individual elects COBRA within six months of termination. Under the provisions approved by the Labor Committee, employers must provide employees with 90 days advance notice of a job loss due to a plant closure or other workforce reduction related to global trade. Individuals who have attained age 55 or have completed 10 years of service with the employer as of the date of termination would be entitled to remain on COBRA coverage until the earlier of becoming eligible for benefits under Medicare or under another group health plan (unless the employer's plan is terminated or the individual fails to pay premiums). The new extended COBRA coverage period would not apply to other individuals who qualify for TAA, but these individuals would remain qualified for the current 18-month COBRA period (or 36 months for qualified dependents who experience a second qualifying event). The provisions in the Labor Committee-approved bill would be effective for plan years beginning on or after January 1, 2008.

In late October the House Ways and Means Committee approved the Trade and Globalization Assistance Act (H.R. 3920) which increases from 65 percent to 85 percent the health care tax credit for health insurance premiums paid by individuals who are eligible for TAA. The increased tax credit would be available for qualified individuals to receive retroactively to their date of separation from employment, beginning January 1, 2008. The legislation also permits qualifying family members of a TAA recipient to continue to receive the tax credit for an additional 36 months after the TAA recipient becomes entitled to Medicare or in the event of the divorce or death of the TAA recipient.

Additional analysis is available on the American Benefit Council's (Council) summary of the COBRA coverage period and health tax credit changes approved by the two House committees. The two bills are next expected to be considered by the House Rules

Committee and merged before they are brought to a vote before the full House of Representatives later this year.

Last, the Labor Committee also approved by a vote of 27 to 21 the Employment Non-Discrimination Act (H.R. 3685); a bill to bar employment discrimination on the basis of an individual's "actual or perceived sexual orientation." In addition to applying to hiring, firing and other employment practices, the legislation prohibits sexual orientation discrimination related to "compensation, terms, conditions, or privileges of employment." However, the legislation also includes a clarification on its applicability to employee benefits which states that "nothing in this act shall be construed to require a covered entity to treat a couple who are not married, including a same-sex couple who are not married, in the same manner as the covered entity treats a married couple for purposes of employee benefits." The clarification appears to be intended to limit the application of the legislation to employment practices other than those related to employee benefits. The legislation to determine if the measure might still have implications for employer-sponsored plans is currently being examined.

Premium Assistance Provisions of CHIP Legislation Pose Administrative Burden for Employer-Sponsored Plans

The premium assistance provisions of the Children's Health Insurance Program (CHIP) Reauthorization Act (H.R. 976), vetoed by President Bush on October 3, included new and administratively burdensome enrollment, notice and disclosure requirements that would have directly affected employers who sponsor health benefits coverage.

Improvement of the special enrollment, notice, disclosure and effective date provisions is being sought for these provisions should they be retained in any CHIP legislation that Congress approves.

Title III of H.R. 976 is intended to reduce barriers for states that elect to provide premium assistance subsidies for qualified employer coverage for children who are eligible for child health assistance. These provisions allow states an option for providing premium assistance where the employer contributes at least 40 percent toward the cost of coverage. States would be required to provide certain outreach, education and enrollment assistance for families of children likely to be eligible for premium assistance programs.

Section 311 of Title III seeks to coordinate premium assistance with private coverage by amending special enrollment rules under ERISA, the Code and the Public Health Service Act to require group health plans and insurers to permit children to enroll in private coverage outside open enrollment periods if they lose Medicaid or CHIP coverage, or become newly eligible for premium assistance. The provision also requires employers who sponsor group health plans to provide employees with notice regarding potential opportunities for premium assistance under state programs. Administrators of group health plans would be required to disclose certain information about their benefits coverage to states (upon their request) so that states could determine whether to provide premium assistance.

Rangel Unveils Tax Bill Including Revenue-Raising Deferred Compensation Provisions

House Ways and Means Committee Chairman Charles Rangel also recently unveiled the Tax Reduction and Reform Act, a sweeping tax reform bill. As has been reported in the mainstream media, the legislation seeks to provide income tax relief for lower and middle-class workers through permanent repeal of the alternative minimum tax (AMT) and other individual tax changes. These "individual tax reforms" include a number of revenue-raising provisions that address nonqualified deferred compensation and could affect retirement plans. Among these key provisions:

- Taxation of "carried interest" (income to fund managers derived from the profits of the investment partnership) as ordinary income: the bill would prevent investment fund managers – hedge fund managers, in particular – from paying taxes at capital gains rates on investment management services income received as carried interest in an investment fund. Instead, the standard income tax would apply to these amounts. The bill would continue to tax carried interest at capital gain tax rates only to the extent that it reflects a reasonable return on invested capital. Policymakers have been urged to carefully consider whether any increase in the tax liability of private equity managers could be passed on to pension fund investors. The Government Accountability Office is currently developing a report on hedge funds and pension plans, but final publication is not expected before the end of the year.

- Current inclusion of deferred compensation paid by offshore hedge funds to investment managers: the bill would prevent hedge fund managers from using offshore entities to defer taxes on compensation received for providing investment services. Under the bill, such managers would be required to take this deferred compensation into account as it accrues. This provision is similar to the Offshore Deferred Compensation Reform Act, introduced recently by Senator John Kerry (D-MA) and Representative Rahm Emanuel (D-IL) and discussed later in this Benefits Insider. While this provision is intended to focus on egregious situations in which hedge fund managers are avoiding taxation, it also presents problems for multinational companies that currently use offshore vehicles to create equitable benefit programs for employees across borders.

- Modification of unrelated business income tax rules for certain investment partnerships: the bill would allow pension plans, universities and other tax-exempt entities to directly invest onshore in hedge funds and other investment funds without incurring unrelated business income tax (UBIT). This would eliminate the current-law incentive for pension plans, universities and other tax exempt entities to invest in hedge funds and other investment funds through offshore corporations.

There is also a provision in the bill that would extend the tax penalties on employer-sponsored group health plans for failure to comply with the current law mental health parity requirements. This is likely a placeholder provision since it would not be needed if Congress enacts permanent mental health parity legislation (currently pending in both the House and the Senate). If no new parity law is enacted, the provision in this tax measure would extend the enforcement provisions of current law by another year, as has been the practice for several years.

An official summary of the bill is available. Further analysis will be required to determine whether there are additional implications for retirement, health and/or nonqualified deferred compensation plans. A "tax extenders" package (legislation addressing expiring tax provisions) could also be a vehicle for benefits-related provisions at the end of the year.

End-Stage Renal Disease Provision in SCHIP Bill Opposed

The Employers' Coalition on Medicare (ECOM) recently held a briefing at the U.S. Capitol to highlight concerns about a provision in Section 703 of H.R. 3162, the House of Representatives bill to reauthorize the State Children's Health Insurance Program (SCHIP), which would require employers with 100 or more workers to be the primary payers for coverage for individuals with end-stage renal disease (ESRD) for up to 42 months. Currently, employer plans are required to cover individuals with ESRD for an initial three month waiting period after a patient is diagnosed with this condition, plus an additional 30 months after the waiting period. After the initial 33-month period, Medicare becomes the primary payer for individuals with end-stage renal disease. ESRD is the only disease that Medicare covers for individuals regardless of their age.

The 12-month extension for ESRD coverage by employer-sponsored plans is opposed by the Employers' Coalition on Medicare, the American Association of Kidney Patients, the Service Employees International Union and the United Auto Workers. The provision is estimated to save Medicare $1.2 billion over a ten year period, but would likely cost employer-sponsored health plans considerably more than the amount Medicare would save because commercial payment rates for this service are often two to three times higher than the rate Medicare sets for itself for payment for ESRD treatment.

During the recent briefing, opponents of the additional 12-month Medicare cost shift for ESRD coverage by employer-sponsored health plans were joined by Senator Debbie Stabenow (D-MI) who said that it was critically important that Medicare not make it even more difficult for employers to provide health coverage to their employees and retirees by shifting more of Medicare's costs to private employers. Stabenow also stated that it was important for Medicare to improve the quality of care for ESRD patients who have higher mortality rate and lower average life expectancy than individuals with the same condition living in other countries.

Legislation to Delay PPA Funding Rules Introduced

As previously referenced in this issue, Representatives Earl Pomeroy (D-ND) and Eric Cantor (R-VA) recently introduced legislation to delay the effective date of certain provisions of the Pension Protection Act of 2006 (PPA), currently set at January 1, 2008. The newly introduced legislation would delay the effective date by one year to January 1, 2009, assuming that guidance is provided by the U.S. Treasury and Labor departments by June 30, 2008. If such guidance is not provided by June 30, 2008, the legislation would not go into effect until the January 1 *after* guidance is provided by June 30 of the applicable year.

Specifically, the legislation would change the effective date in the following sections of the PPA:

- 101(d), 102(c). 107(e), 111(b), and 112(b) (minimum funding standards);
- 103(c) and 113(b) (benefit limitations and at-risk rules);
- 104(b) (multiple employer plans of certain cooperatives);
- 105(b) (PBGC settlement plans);
- 106(b) (government contractors);
- 115(a), 115(b)(3) and 115(e)(2) (interstate bus company);
- 302(c) (lump sum interest rates);
- 401(a)(2) (PBGC premiums);
- 402(b)(1) (commercial airlines);
- 505(c) (4010 filings); and
- 809(b) (deduction limit for multiemployer plans).

The bill also lists sections of ERISA and the Code that are affected by the change in effective date that include (but are not limited to) provisions on minimum funding, lump sum calculations, credit balances, and use of the yield curve.

The bill would delay the effective date for certain portions of the PPA for at least one year and includes automatic further delays if certain guidance is not issued by June 30 of the preceding year (by June 30, 2008 for a January 1, 2009 effective date). The automatic further delay would kick in if final regulations in the following sections of ERISA and the Code are not issued by the preceding June 30:

- ERISA 206(g) and Code Section 436 (benefit limitations);
- ERISA 303(f) and Code Section 430(f) (pre-funding and standard carryover balance, previously known as credit balances);
- ERISA 303(g)(3) and Code Section 430(g)(3) (valuation, two-year averaging, 90-100 percent corridor);
- ERISA 303(h)(2) and 430(h)(2) (yield curve);
- ERISA 303(h)(3) and Code Section 430 (h)(3) (mortality tables);
- ERISA 303(i)(4)(A)(ii) and 430(i)(4)(A)(ii) (the 70 percent portion of at-risk test); and
- ERISA 303(j)(3)(A) and 430 (j)(3)(A) (quarterly contributions).

This legislation had been recommended by employers and plan sponsors primarily because of the lack of regulatory guidance necessary to implement provisions of the PPA.

The next steps on the bill remain unclear, however. The measure falls under the jurisdiction of the House Education and Labor and Ways and Means committees, but may also be considered as part of an end-of-year "omnibus" bill with other unresolved items. It is also possible that the House could approve the measure by "unanimous consent" without formal committee action. There is not yet a Senate companion to the bill.

Bill Introduced to Limit Deferral for Offshore Fund Managers

Senator John Kerry (D-MA) and Representative Rahm Emanuel (D-IL) recently introduced the Offshore Deferred Compensation Reform Act, which would eliminate the ability of U.S. taxpayers to defer nonqualified deferred compensation in offshore accounts.

Under the bill, nonqualified deferred compensation paid by a foreign corporation generally would be considered taxable income when there is no substantial risk of forfeiture to the compensation. A foreign corporation can be exempt from the law if substantially all of its income is effectively connected with the conduct of a trade or business in the U.S. or if it is subject to a tax treaty with the U.S. and a deduction is allowed for compensation under rules that are substantially similar to the way in which the U.S. provides deductions for compensation. The legislation would apply to amounts deferred in taxable years beginning after December 31, 2007.

Mental Health Parity Legislation Passes House Committee

Both the House of Representatives Energy and Commerce Committee (Commerce Committee) and its Health Subcommittee recently approved the Paul Wellstone Mental Health and Addiction Equity Act (H.R. 1424). During its session, the Commerce Committee defeated a substitute amendment that would have incorporated language from the Senate-passed Mental Health Parity Act (S. 558).

As previously reported, there are serious concerns with H.R. 1424, which:

- Includes a broad mandate that employers and health plans must cover all mental health conditions and substance abuse disorders in the most recent diagnostic and statistical manual (DSM-IV), if a plan covers any mental health benefits at all;
- Broadly expands the ability of states to establish new remedies for plan participants in insured health plans that would apply only to mental health coverage under their plan; and
- Fails to fully protect the medical management practices of plans which are needed to ensure that plans only cover services determined to be medically necessary and appropriate.

In approving H.R. 1424, the Commerce Committee agreed to some minor changes to the legislation, which had been approved by the panel's Health Subcommittee on October 10. It included technical corrections as well as provisions extending the legislation's application to emergency care, clarifying that the bill mandates coverage of all conditions listed in the DSM-IV and updating the effective date with respect to the bill's exemption when costs of compliance would exceed a certain threshold. The chairman's mark also includes a provision stating that the bill does not preclude medical management of mental health or substance abuse benefits, as long as any medical management tools are based on "valid medical evidence."

Side-by-side charts comparing the two bills in their entirety are available, along with a chart illustrating the key differences between them.

An amendment substituting the language of S. 558 was offered and defeated. The panel also defeated a pair of amendments by the committee Republicans – one accelerating the bill's cost exemption and one allowing insurers to offer health insurance options without a mental health component.

H.R. 1424 has already been approved by the House Ways and Means Committee and the House Education and Labor Committee, and will now be sent to the full House for consideration. With 272 cosponsors, the legislation is almost certain to be approved and the differences between H.R. 1424 and S. 558 would need to be reconciled in a conference committee. However, another possible avenue that could be open to the Democratic House leadership would allow them to avoid a conference and attach H.R. 1424 to an end-of-year "omnibus" bill with other miscellaneous legislation and brought before the Senate under a separate process.

Hybrid Plan/Backloading Update: New Letter Sent to Treasury

Treasury and the Internal Revenue Service (IRS) are examining their position on the application of the backloading rules to hybrid pension plan conversions. The Treasury's standing position on the backloading rules precludes the use of "greater-of" transition formulas, in which participants receive the greater of the benefits calculated under the traditional plan formula or benefits calculated under the hybrid formula. Left to stand, this interpretation could also negatively affect "greater-of" formulas in other contexts (such as traditional plans with a minimum benefit, or plans that provide the greater of the buyer's plan formula or the seller's plan formula immediately following a corporate acquisition).

The business community continues to encourage legislators to write to Treasury urging a reconsideration of its position. In early October, 24 members of the House of Representatives signed on to a letter to Treasury and IRS stating that "The [IRS's] position is not consistent with Congressional intent, present law, or the best interests of participants, employers, and plans. We urge you to quickly reverse this position." Among the signers was Rep. Howard "Buck" McKeon (R-CA), ranking Republican member of the House Education and Labor Committee.

This letter follows similar letters from the Senate Health, Education, Labor and Pensions (HELP) and Finance Committees, the House Ways and Means Committee, various Senators and a collection of Senators and House members. Treasury has already responded to the Senate HELP and Finance Committees indicating that Treasury will issue guidance on the matter by the end of this year or earlier and will not take any adverse actions on determination letter applications for cash balance plan conversions in the meantime.

The exact timing of guidance on the Treasury and IRS position is uncertain and the extent to which relief will be provided is unclear. There is concern as to whether the solution will be broad enough to sufficiently address the application of all "greater of" formulas.

A number of summaries have been completed regarding this issue, including employer group letters to Congress and the policy document "Effect of IRS Backloading Interpretation on Both Hybrid and Traditional Plans."

RECENT REGULATORY ACTIVITY

DOL Releases Final QDIA Regulations

The DOL EBSA recently released its final regulations on Qualified Default Investment Alternatives (QDIA) under participant-directed individual account plans. The regulation implements provisions of the PPA that provide relief to plan fiduciaries who invest the assets of participants who do not provide investment direction (such as automatically enrolled workers) in QDIAs. The final regulation was expected to be published in the Federal Register on October 24 and would be effective 60 days from the date of publication. The DOL also released a fact sheet on the guidance. Proposed regulations had been issued on September 26, 2006.

The final regulations do not include stable value funds in the list of QDIAs but does "grandfather" amounts already invested in stable value funds if the employer used a stable value fund as its default some time prior to the effective date of the regulations. Employers in this situation will not need to move any of the monies defaulted into stable value funds prior to the effective date of the regulations to qualify for the fiduciary relief. In addition, prospectively a capital preservation product such as a stable value fund can be used for the first 120 days of participation by an eligible employee (treated as a QDIA fund for the first 120 days of eligibility).

Under the final regulations, a QDIA must either be managed by an investment manager, plan trustee, or plan sponsor who is a named fiduciary, or be an investment company registered under the Investment Company Act of 1940. This is a change from the proposed regulations that were more restrictive and would have precluded plan sponsor-managed QDIAs.

Like the proposed regulations, the final regulations do not identify specific investment products as QDIAs but instead describe the type of investment and list examples. Also like the proposed regulations, the final regulations' description examples include (1) life-cycle or targeted-retirement-date funds, (2) managed accounts, and (3) balanced funds.

The final regulations clarify that a QDIA may be offered through a variable annuity contract or other pooled investment funds and also provides that ERISA supersedes any State law that would prohibit or restrict automatic contribution arrangements, regardless of whether such automatic contribution arrangements qualify for the safe harbor.

As in the proposed regulations, the plan fiduciaries remain responsible for the prudent selection and monitoring of the QDIA but the DOL clarified that fiduciaries will not face potential liability for choosing between the types of QDIAs. The final regulations provide the following conditions that must be satisfied in order to obtain safe harbor relief from fiduciary liability for investment outcomes:

1. Assets must be invested in a qualified default investment alternative (QDIA).

2. Participants or beneficiaries must have had the opportunity to direct the investment but did not direct the investment.

3. Participants or beneficiaries must receive both an initial notice and an annual notice. The DOL modified the requirement that the initial notice be provided 30 days prior to the initial investment by (1) measuring the 30-day advance notice requirement from the date of plan eligibility (or at least 30 days before the first investment in the QDIA), and (2) allowing notice on or before the date of plan eligibility, provided the participant has the opportunity to make a permissible withdrawal (as determined under Code Section 414(w)). The final regulations eliminate the possibility of including required notices in the Summary Plan Description or Summary of Material Modifications but do allow coupling the QDIA notice with Qualified Automatic Contribution Arrangement notices (automatic enrollment safe harbor).

4. Any material on the QDIA provided to the plan (e.g., prospectuses, proxy voting materials) must be provided to the participant or beneficiary.

5. Participants or beneficiaries defaulted into QDIAs must be afforded the opportunity to transfer to other investments without financial penalty as often as participants who elect to invest in the QDIA, but no less often than once within any three-month period. The final regulations make clear that during the first 90-day period following the participant's first "elective" contribution, any transfer or permitted withdrawal cannot be subject to any restrictions, fees or expenses (except those fees and expenses that are charged on an ongoing basis for the investment itself, such as investment management and similar fees, and are not imposed, or do not vary, based on a participant's or beneficiary's decision to withdraw or transfer). This provision would prevent the imposition of a redemption fee, surrender charge, etc. but only for that first 90-day period. Following the 90-day period, participants defaulted into the QDIA cannot be subject to restrictions, fees or penalties that do not apply to participants and beneficiaries who elected to invest in the QDIA.

6. The plan must offer a "broad range of investment alternatives" as defined in the DOL's 404(c) regulation.

IRS Provides One-Year Extension and Further Guidance on 409A

Final IRS regulations regarding Internal Revenue Code Section 409A, originally published by the IRS on April 17, 2007, set forth the rules for nonqualified deferred compensation under the IRC, including deferral elections and distributions. Under those final regulations, compliance was required as of December 31, 2007. The IRS later issued Notice 2007-78 effectively providing relief in relatively few cases, by providing an extension of the deadline to December 31, 2008.

The IRS has since issued Notice 2007-86, providing a one-year extension for compliance with IRC Section 409A, the tax code section governing nonqualified deferred compensation. Notice 2007-86 generally extends the transitional period for compliance with the requirements for deferral elections and payment timing under Section 409A.

The notice also confirms that the Treasury and IRS expect to issue guidance regarding a correction program as soon as possible.

The IRS then followed up with Notice 2007-89, providing interim guidance for employers and payers under Section 409A for calendar year 2007. The guidance sets forth the rules for reporting and withholding, including interim rules on how to calculate the amount of taxable income under 409A.

Treasury, IRS Guidance for Non-spouse Beneficiary Rollovers

In early October, Treasury and the IRS released 2007 interim and discretionary amendments, including a change to the rules governing non-spouse beneficiary rollovers under the PPA.

Under the PPA, non-spouse beneficiaries are allowed to roll-over amounts received from qualified plans to IRAs, but IRS Notice 2007-7 stated that retirement plans could consider such rollovers optional — that is, plans would not be required to offer such rollovers for qualified plans to IRA's for non-spouse beneficiaries. This will change, however, if the pending technical corrections legislation (H.R. 3361/S. 1974) is enacted.

The interim and discretionary amendment guidance reverses this ruling, asserting that non-spouse beneficiary rollovers will be a required plan provision for plan years beginning on or after January 1, 2008. This change conforms to the Pension Protection Technical Corrections Act introduced in the House of Representatives (H.R. 3361) and the Senate (S. 1974).

Regulatory Agencies Announce Cost of Living Adjustments for 2008 Tax Year

The IRS recently released IRS Revenue Procedure 2007-66 announcing the inflation adjustments applicable to dollar limitations for Tax Year 2008. Section 415 of the Code provides for dollar limitations on benefits and contributions under qualified retirement plans. In most cases, hikes in the cost-of-living index and scheduled increases (through the EGTRRA tax relief act of 2001) have triggered increased limits. However, the limits on maximum elective deferrals and catch-up contributions will remain at the 2007 levels. Key adjustments are listed in the table below:

	2007	**2008**
Maximum annual pension benefit [415(b)] (The limit applied is actually the lesser of the dollar limit or 100 percent of the participant's average compensation (generally the high three consecutive years of service))	$180,000	$185,000
Defined contribution maximum deferral [415(c)]	45,000	46,000
Maximum elective deferral [401(k) and 403(b)]	15,500	15,500
Maximum catch-up contribution for those age 50 and over [414(v)]	5,000	5,000
Qualified plan compensation limit [401(a)(17)]	225,000	230,000

Highly compensated threshold [414(q)]	100,000	105,000

In related regulatory news, the Social Security Administration has announced that Monthly Social Security and Supplemental Security Income benefits will also increase 2.3 percent in 2008. Additionally, the maximum amount of earnings subject to the Social Security tax (taxable maximum) will increase to $102,000 from $97,500. The SSA released a fact sheet on the announced adjustments.

DOL Releases Advance Copies of 2007 Form 5500, Guidance on Timing of Individual Benefit Statements

The DOL, in conjunction with the IRS and the PBGC, has released advance informational copies of the 2007 Form 5500 Annual Return/Report for employee benefit plans and instructions for completing the form. Form 5500 is used by pension plans annually to report the financial conditions, investments and operations of the plan.

According to the DOL news release, significant changes to the form include:

- A new simplified reporting option for eligible plans with fewer than 25 participants required by the PPA.
- Revised Schedule B instructions to reflect the updated mortality tables and the list of codes used for valuation purposes, as well as for calculating current liability for plan years beginning on or after January 1, 2007.
- Instructions that caution certain filers that, due to form changes required by the PPA that will appear in the 2008 Form 5500, they will have to wait for the 2008 forms rather than using the 2007 forms if they must file a 2008 short plan year report.

The new release does not reflect changes to the Form 5500 proposed by DOL in the proposed revisions and proposed regulations issued in July 2006. Rather, this release represents the typical annual update of Form 5500 instructions. DOL is expected to finalize the proposed changes, which would be effective for the 2009 plan year, within the next few weeks. Some changes from the earlier proposals are expected.

The DOL's Employee Benefits Security Administration recently released Field Assistance Bulletin (FAB) 2007-03, providing guidance on the timeframe for furnishing pension benefit statements by certain individual account plans. Under the guidance, plan administrators of individual account plans that do not provide for participant direction of investments will, in the absence of further guidance, be deemed in good faith compliance with the law if benefit statements are furnished to participants and beneficiaries on or before the date the Form 5500 annual return/report is filed by plans, but not later than the last date on which the plan administrator is required to file the report, including any extensions. This bulletin revises the guidance set forth in FAB 2006-03 bulletin that would have required statements to be provided within 45 days after the end of the plan year.

IRS Releases PPA Guidance on Yield Curve and its Rates

On October 9, Treasury and the IRS issued Notice 2007-81, providing guidance on the corporate bond yield curve and the segment rates required to calculate funding requirements and lump sum distributions under the new defined benefit pension plan funding rules as enacted by the PPA. The notice also outlines the methodology used by Treasury in producing the yield curve.

On October 10, the Internal Revenue Service issued Notice 2007-82, containing the corporate bond weighted average interest rate update for purposes of calculating current liability and required contributions for pension plans under the IRC, in compliance with the PPA. This update provides interest rate calculations for October 2007.

Plan sponsors have been anxiously awaiting this guidance, which is needed to calculate the value of lump sum and other similar distribution types. These calculations must be reflected in distribution notices for plan year 2008 distributions (notices are required 30 to 180 days prior to commencement of payment(s) and many plans would normally send the notice around October 1 for a January 1, 2008 annuity starting date). Under the PPA, Treasury is required to produce a yield curve for investment-quality corporate debt that private pension plans must use to calculate their funding obligations and lump-sum payments to retirees for plan years beginning after December 31, 2007.

Notice 2007-81 also provides the full yield curve and various segment rates for August 2007 and historical segment rates starting in September of 2005. Each month, IRS will publish a standard notice containing updated monthly yields along with the additional rates required under the provisions of PPA. The initial yield curve, as well as monthly updates, will also be posted on the IRS Web site and on Treasury's Economic Policy Web page.

Opponents of the yield curve concept during the PPA legislative debate argued that it makes the applicable interest rate far less predictable and will not have a materially beneficial effect as compared to the application of the long-term corporate bond rate. A four-year weighted average of the long-term corporate bond rate was instead recommended.

DOL Issues Guidance on "Safest Available Annuity"

The DOL recently issued an interim final rule and proposed regulations on the fiduciary standards that govern the selection of an annuity as an optional form of distribution from a defined contribution plan under ERISA. The guidance was required under a provision in the PPA directing the Secretary of Labor to clarify that the selection of an annuity contract as an optional form of distribution in a defined contribution plan is not subject to the fiduciary standards of DOL Interpretive Bulletin 95-1. Interpretive Bulletin 95-1 generally requires that a plan fiduciary select only the "safest available annuity" and consider numerous aspects of the issuer's financial condition, including, among others, the issuer's investment portfolio, the level of the issuer's surplus and capital, and indications of the issuer's exposure to liability. This heightened standard of fiduciary responsibility may have been a significant barrier to the inclusion of annuity forms of distribution in defined contribution plans, such as 401(k) plans. The interim final rule amends Interpretive Bulletin 95-1 to provide that it only applies to annuity contracts that are distributed from defined benefit plans.

The proposed regulations provide a safe harbor under which a plan fiduciary is considered to act prudently in selecting an annuity as a distribution option under a defined contribution plan, if the fiduciary appropriately:

- Engages in an "objective, thorough and analytical search" for an annuity provider;
- Determines whether he or she has the "expertise or knowledge to meaningfully evaluate" the annuity provider and, if not, obtains the advice of a qualified independent expert;
- Considers information to assess the ability of the annuity provider to make all future payments under the annuity contract (and to provide any other applicable services under the contract);
- Considers the cost of the annuity contract in light of the benefits and services provided;
- Concludes that, at the time of selection, the provider is financially able to make all future required payments and the cost of the contract is reasonable;
- Periodically reviews his or her conclusions with regard to the selection; and
- Considers any other information he or she knows or should know would be relevant to an evaluation. The regulations also require, among other things, review of the issuer's level of capital, surplus and reserves available to make payments under the contract as well as state guarantees, ratings by insurance rating services, and the role of separate accounts under the contract.

The interim final rule is effective November 13, 2007, while the general fiduciary standards under the proposed regulations will apply to annuity distribution options in defined contribution plans from November 13, 2007 until 60 days after final regulations are issued.

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