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Employee Benefits Briefing

A bulletin designed to keep clients and other friends informed on employee benefits law matters

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The Pension Protection Act and Investment Advice to Plan Participants—A Step Forward

The Department of Labor (DOL) has issued a Field Assistance Bulletin (No. 2007-1) providing some initial guidance on implementing the investment advice provisions of the Pension Protection Act of 2006 (PPA).

Many, if not most, individual account plan participants need professional investment advice. Almost every study and survey confirms that fact. But two issues have blocked an effective solution to the problem. First, plan sponsors themselves want to be protected from fiduciary liability if they secure such advice for participants. Second, participants need advisers who do not have a conflict of interest in providing the investment advice.

Prior to the PPA, the DOL had taken several steps to allow investment advice to be provided to plan participants. Now the PPA has established a clear structure for making investment advice more available. The PPA provides a fiduciary "safe harbor" for providing investment advice under an "eligible investment advice arrangement." (ERISA sections 408(b)(14) and 408(g))

An "eligible investment advice arrangement" can be in the form of: (a) a *level-fee* arrangement where the adviser receives the same fee regardless of the advice given to an individual or (b) a *computer model* advice program where the computer model has been determined to be unbiased. As of this date, no computer model has been approved by the DOL.

The DOL Field Assistance Bulletin responds to some initial questions received by the DOL in this area. First, fiduciary advisers wanted assurance regarding the fees of their affiliates. Would those fees be permitted to vary? The DOL's response is that only the fees of the fiduciary adviser cannot vary. An affiliate of the fiduciary adviser may have varying fees as long as the affiliate itself is not providing investment advice.

The DOL also answered two related questions: First, what is the extent of plan sponsor fiduciary responsibility in connection with implementing these arrangements? As anticipated, the DOL's position is that the plan sponsor (or other responsible plan fiduciary) implementing an "eligible investment advice arrangement" retains fiduciary liability as to the prudent selection and monitoring of the fiduciary advisers.

Second, questions were raised about whether the DOL's prior advice in this area was still valid. Some believe the prior advice may be easier to comply with than the PPA provisions. The DOL confirmed that its pre-PPA advice continues to be valid. Specifically, the advice the DOL gave previously in this area (e.g., Interpretive Bulletin 96-1 explaining the difference between investment advice and general educational information and various advisory opinions) may still be relied on.

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IRS Issues Guidance on Pension Protection Act Provisions

The Internal Revenue Service has recently issued Notice 2007-7 providing guidance on certain provisions of the Pension Protection Act of 2006 (PPA). The guidance is set up in the form of questions and answers and primarily relates to distributions. Some of the more significant PPA provisions covered in Notice 2007-7 are summarized below.

Vesting of Nonelective Contributions

The PPA requires accelerated vesting for future employer contributions to defined contribution plans. For employer contributions made for plan years beginning after December 31, 2006, either those employer contributions must be fully vested upon a participant's completion of three years of service, or the plan must provide for a graded vesting schedule in which a participant is at least 20 percent vested in such contributions after two years of service and 20 percent for each year thereafter, resulting in 100 percent vesting after six years.

Notice 2007-7 clarifies that the new vesting requirement applies only to contributions made for plan years beginning in 2007; therefore, contributions made for the 2006 and earlier plan years are not subject to the new accelerated vesting requirement. However, most plan sponsors will likely conclude that it would be impracticable to maintain two separate vesting schedules and will apply the new schedule to all contributions.

Hardship Distributions

The PPA expanded the hardship distribution rules to permit plans to allow a participant to take a hardship distribution due to a hardship event that affected the participant's beneficiary, even if the individual is not the participant's spouse or dependent. The new rules apply as of August 17, 2006.

Notice 2007-7 provides that a 401(k) plan or 403(b) plan may permit hardship distributions for a primary beneficiary's medical, tuition or funeral expenses. The guidance clarifies that a "primary beneficiary" for this purpose means an individual who is named as a beneficiary under the plan. Further, 457(b) plans and deferred compensation plans subject to Code section 409A may treat a primary beneficiary the same as the participant's spouse or dependent for purposes of determining whether the participant has incurred an unforeseeable financial emergency.

Rollovers for Nonspouse Beneficiaries

The PPA amended the rollover rules to allow a nonspouse beneficiary under an employer plan to make a direct rollover of all or part of a distribution from the deceased participant's account into an IRA. The IRA receiving such rollover must be treated as an inherited IRA with more restrictive distribution rules than a regular IRA. If the participant dies before his or her required beginning date, the nonspouse beneficiary may directly roll over the entire benefit within one year of the year of the participant's death and receive payment over the beneficiary's life expectancy. These new rules may be applied for distributions made after December 31, 2006.

Notice 2007-7 clarifies that this is an optional provision for plans and that qualified plans, 403(b) plans, and eligible section 457(b) plans must be amended by the end of the 2009 plan year if such direct rollovers into an IRA are to be allowed. Further, the guidance provides that a distribution to a nonspouse beneficiary is not subject to the direct rollover requirements, the special tax notice requirements or the mandatory withholding requirements.

Code Section 415 Limits on Lump Sum Distributions

Section 415(b) of the Internal Revenue Code of 1986 sets forth limitations on benefits payable by a defined benefit plan. For a lump sum distribution paid out from a defined benefit plan, an actuarial adjustment must be made for purposes of determining whether the Code section 415(b) limits have been satisfied. This adjustment must be made using prescribed actuarial assumptions. The PPA amended the Code section 415(b) limitations by retroactively increasing to 5.5 percent the interest rate used in computing the limit on lump sum distributions and as a result lowered the permissible maximum amount of the lump sum.

Because this change was made effective for distributions starting on January 1, 2006 even though the PPA was not signed into law until August 17, 2006, some distributions made in 2006 may have exceeded the Code section 415(b) limitations as amended by the PPA. In response, the guidance sets forth three methods plans may use to correct excess distribution violations that may have occurred in 2006. One option provides for the issuance by the plan of two Form 1099-Rs (one for the adjusted amount and the other for the excess amount) without an obligation to seek reimbursement of the excess amount.

Notice 2007-7 also provides that the new changes to Code section 415(b) apply to distributions made in plan years beginning after December 31, 2005 but do not apply to plans terminated on or prior to August 17, 2006. Further, a plan may be amended retroactively to comply with these changes without violating the anti-cutback rules of Code section 411(d)(6) if the amendment is adopted by the end of the 2009 plan year and the plan is operated in accordance with the new rules as of the first date the amendment is effective.

Notice and Consent Period for Distributions

The PPA amended the rules regarding notices that must be provided to participants in connection with distributions. The PPA expanded the period for furnishing the distribution notices to the participant from 90 days to 180 days before the annuity starting date. Also, the description of a participant's right to defer a distribution must also include a description of the consequences of failing to defer receipt of a distribution. The new rules apply for plan years beginning after December 31, 2006.

Notice 2007-7 clarifies that these new rules apply for notices issued starting in the 2007 plan year and that until regulations on these new rules are issued, plan sponsors should make a reasonable attempt to comply. To assist plan sponsors in satisfying the reasonable attempt requirement, Notice 2007-7 provides a safe harbor in the form of a checklist that sets forth elements that should be covered in the notice.

If you have any questions or wish to discuss this topic further, please contact Jonathan E. Hyun at 312-609-7791, jhyun@vedderprice.com, Paul F. Russell at 312-609-7740, prussell@vedderprice.com or any member of the Employee Benefits Group.

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