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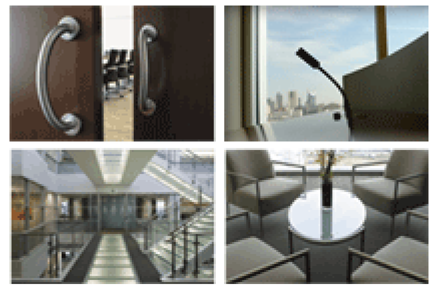

Pension Protection Act of 2006: New Participant Notices for Defined Contribution Plans Required by December 2, 2006

By B. David Joffe & Charles M. Cain II

The Pension Protection Act of 2006 (the "Act") requires sponsors of defined contribution plans[1] with certain investment and enrollment features to provide up to three new participant notices this year. **For calendar-year plans, these new notices should be provided to plan participants by December 2, 2006.** As described below, the new notices are: (1) a default investment notice, for plans with a "qualified default investment alternative"; (2) a diversification notice, for plans with a publicly traded employer securities investment option; and (3) an automatic enrollment notice, for plans with automatic enrollment features.

Whether any or all of the new notices are required for a particular defined contribution plan depends on the investment options and/or automatic enrollment features triggering each notice requirement. Despite the impending deadline, model notices and final regulations have not yet been issued. However, affected plan sponsors may develop their own good-faith participant notices.

Default Investment Option Notice

For plans that include a default investment option for those assets over which participants do not make affirmative investment elections, the Act provides additional fiduciary protection, with regard to investment losses, if the default option is a "qualified default investment alternative" ("QDIA"). Absent investment directions from the participant, the participant will be deemed to have exercised control over the assets if they are invested in a type of default investment permitted under Department of Labor ("DOL") regulations and the plan provides the required notice to participants.

The DOL has issued proposed regulations that set forth the requirements for QDIAs. The regulations give the following examples as types of investments that would generally meet the requirements:

- a "life-style" or "targeted-retirement-date" fund;
- a "balanced" fund that includes equity and fixed income allocations; or
- a "managed account" that includes equity and fixed income allocations based on age, target retirement date, or life expectancy.

However, it is important to note that these regulations are only proposed and cannot be relied upon. The DOL has indicated informally that comments on the proposed regulations have requested that QDIA investments be expanded to include stable-value funds, asset allocation models, annuities, guaranteed investments, and other types of funds.

Generally, for a plan to take advantage of the additional fiduciary protection, the Act requires that an annual notice be received at least 30 days in advance of each plan year. For calendar-year plans, the initial notice must be received by December 2, 2006. According to the proposed regulations, the notice must include, among other things a description of the circumstances under which assets will be invested in the QDIA; information regarding the fees, expenses, investment objectives, and risk/return characteristics, of the QDIA; a description of the participant's right to direct investments under the plan; and a description of how and where the participant can obtain information regarding other investment options in the plan.

The QDIA requirements are strictly optional. Plan fiduciaries may continue to rely on the prudent fiduciary rules with respect to default investments, rather than using a QDIA. However, if a plan already uses an investment option that would likely qualify as a QDIA, the plan fiduciaries may benefit from providing the notice. Even if the plan does not provide for a QDIA (for example, it uses a money-market fund, which seems unlikely to qualify as a QDIA even if the types of permitted investments are expanded), it may still be advisable to notify participants of the default investment alternative, if for no other reason than to remind participants of their right to diversify their investments away from the default option. However, plan sponsors who do not already have a default investment that would qualify as a QDIA may want to wait until final regulations are issued before changing their default investment option because, again, the regulations are not final and the DOL has signaled, informally, that the types of permitted investment options may be expanded when final regulations are released.

Employer Securities Diversification Notice

For plans that include publicly traded employer securities as an investment option (excluding stand-alone ESOPs), the Act generally requires that plan participants be given the option to divest employer securities in their account, at least quarterly, and offer at least three other diversified investment options in which the proceeds may be reinvested. However, for plans that generally allow daily investment elections, such plans must permit diversification daily. This diversification requirement applies to existing accounts as well as new contributions. Also, employees who have completed three years of service must be allowed to diversify matching and nonelective employer contributions, subject to a special phase-in rule. In addition, the plan cannot impose restrictions on employer securities investment or diversification that are not imposed on other plan investments, although there is an exception for restrictions or conditions imposed under the securities laws.

Participants must be provided notice of their right of diversification at least 30 days before an "applicable individual" is eligible to exercise the right of diversification. For most plans, the requirements will take effect for 2007 (2008 for certain ESOPs). Therefore, for calendar-year plans to which the new requirements apply, the deadline to provide the new notice is December 2, 2006, and it would be advisable to insure receipt by such date. The notice must include a statement of the participants' rights to diversify assets held in employer securities into other investments and a statement describing the importance of diversifying the investments of retirement accounts.

The Act directed the Internal Revenue Service to issue a model diversification notice, but it has not yet been issued. Employers would be well-advised to develop good-faith notices for this purpose. In addition to the initial notice, Plan administrators should provide the notice to new enrollees at least 30 days prior to enrollment. Once regulations are issued, there may be further guidance on when the notice must be provided. **Failure to provide the notice can result in penalties of up to $110 a day per participant.**

Automatic Enrollment Notice

If a plan has an automatic enrollment feature, employee deferral contributions are made at a certain percentage of compensation unless the participant affirmatively elects to receive cash instead. Effective immediately, the Act amends ERISA to preempt any state laws, such as wage deduction or garnishment laws, that could interfere with automatic enrollment arrangements. To qualify for this protection, the plan must provide a notice to participants within a reasonable period before the beginning of each plan year. Therefore, as with the other notices described above, the notice should be provided by December 2, 2006, and it would be advisable to insure receipt by such date. The notice must explain the employee's right to opt out of the automatic enrollment feature and explain how contributions under the arrangement will be invested if no investment election is made. In 2008, the Act also introduces a new "safe harbor" design that can be used by plans with automatic enrollment arrangements.

[1] Including profit-sharing plans, both with and without 401(k) options, and money purchase pension plans.

If you would like assistance in preparing the new notices or have any questions about the new notice requirements, please contact one of the attorneys on the Boult Cummings Employee Benefits and Executive Compensation Team listed below:

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