

# Legislation Made Real

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## Monitoring What Matters

The flurry of legislative and regulatory activity that began in 2006 has carried over into 2007. Here's what Nationwide® is keeping an eye on.

### **PENSION PROTECTION ACT OF 2006**

The Health, Employment, Labor and Pensions (HELP) subcommittee in the House held a hearing on May 3, 2007, to examine the implementation of the Pension Protection Act (PPA) and any unintended consequences that may have arisen from its passage.

This committee is responsible for reviewing ERISA plans. They're expected to focus on defined benefit plan provisions, such as the airlines' exceptions. However, certain defined contribution plan issues will likely be examined, as well.

### **401(k) PLAN FEES**

As we mentioned in our last newsletter, we're closely monitoring the Congressional hearings on 401(k) plan fees.

Hearings on the subject began in March. There was agreement that 401(k) fee disclosure needs improvement. However, no decision was reached on how much

disclosure is needed and how to present it so that it's easy to understand for both plan sponsors and participants.

Both the Securities Exchange Commission (SEC) and the U.S. Department of Labor (DOL) are also working diligently on rules and regulations related to fee disclosures. We'll keep you updated as we learn more.

### **OTHER REGULATORY ACTIVITY**

We're expecting the IRS to issue final 403(b) regulations by the end of June and the DOL to release final regulations on default investment options by late summer.

Our legal and compliance staffs will work to review the requirements. We'll share the potential business impacts of the final regulations with you.

Finally, as indicated in our last newsletter, we plan to support automatic enrollment features, including default investment options, early next year. We'll continue to keep you advised on developments.

We hope you find this information useful. As always, we appreciate the opportunity to serve you.

#### **This issue focuses on:**

- **Prohibited Transaction Exemption Rules for "Fiduciary Advisers"**
- **Terminating DC Plans: What to do with Vested Balances Over \$5,000**
- **Plans With Last-day Requirements**



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# Prohibited Transaction Exemption Rules for “Fiduciary Advisers”

In recent years, defined contribution plan participants have been requesting investment advice. However, plan service providers and sponsors have been reluctant to make such advice available because of concerns about fiduciary liability. The Pension Protection Act of 2006 (PPA) permits retirement plan service providers who offer investments to participant directed plans (“fiduciary advisers”) to provide investment advice and, if warranted, to recommend their own funds without violating fiduciary rules.

In general, PPA grants a prohibited transaction exemption for investment advice provided by fiduciary advisers after Dec. 31, 2006, under an “eligible investment advice arrangement” (EIAA). To qualify for this relief, an EIAA must meet certain conditions. *Either* the fiduciary adviser’s fees must be “neutral” (meaning that the fees the adviser receives are the same, regardless of which investment options a participant selects after receiving advice) *or* the adviser must use an unbiased computer model, certified by an independent expert, to create a recommended portfolio for a participant’s consideration. (Note that those offering the computer model will now be deemed to be plan fiduciaries as well.)

## NOTICE REQUIREMENT AND OTHER PPA RULES

Before investment advice may be given, the fiduciary adviser must provide the participant with a written or electronic notice that contains specific information, including:

- The role of any related party in developing the advice program or selecting plan investment options
- The past performance and rates of return for each of the plan’s investment options
- A disclosure of any fees or other compensation to be received by the fiduciary adviser

The fiduciary adviser must also maintain records demonstrating compliance with the various rules for fiduciary advisers for six years.

Beginning in 2007, EIAs will have to undergo a *new* annual independent compliance audit. This requirement, which is unrelated to the Form 5500 independent audit, mandates that an audit report be provided to the plan fiduciary that authorized the EIAA.

Plan assets may be used to pay reasonable expenses involved in providing investment advice under these rules.

## GUIDANCE FROM THE DOL

The DOL recently issued FAB 2007-1, which addresses three issues involving EIAs. The DOL issues this guidance for the benefit and use of DOL staff, especially field examiners. This guidance is not officially binding on plan sponsors or participants, but provides useful information and unofficial guidance to them. According to this FAB:

1. DOL guidance on investment advice issued before PPA continues to apply.
2. The same standards of fiduciary care and prudence that applied before PPA also apply when using an EIAA — with additional requirements. Plan fiduciaries have a duty to prudently select and periodically monitor the advisory program, but not the specific advice given to a particular participant. As long as these guidelines are followed, the fiduciary is not responsible for the advice provided by the fiduciary adviser. The FAB provides a process for the prudent selection and monitoring of fiduciary advisers.
3. The investment advice exemption applies only to investment advice provided by a fiduciary adviser under an EIAA and not to affiliates of that fiduciary adviser. The DOL’s view is that Congress did not intend for the neutral fee requirement to extend to the affiliate of a fiduciary adviser — unless the affiliate also provides investment advice. For example, if a participant chooses to invest in an affiliate of a fiduciary adviser, *and the fiduciary adviser has not provided investment advice about the affiliate*, then the fees charged by the affiliate do not have to meet the neutral fee requirement.

The DOL further clarifies that PPA also permits employees, agents, or registered representatives of fiduciary advisers who provide investment advice in their capacity as employees, agents, or registered representatives to qualify as fiduciary advisers, provided they satisfy the relevant advice requirements of applicable insurance, banking, and securities laws. Thus, both the individuals and the entity they work for are

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## Prohibited Transaction Exemption Rules for “Fiduciary Advisers” *(continued)*

fiduciary advisers. Employers should expect that this exemption will prompt more investment providers to step into the role of fiduciary adviser than had previously been the case.

***Nationwide comments: In December 2006, the DOL issued a Request for Information asking the public for comments on the computer model requirements. The DOL asked that comments be provided by Jan. 30, 2007. To date, the DOL has not yet issued regulations, so there are still many questions surrounding the use of the computer model.***

***Also, an eligible investment advice arrangement is not equivalent to a managed account arrangement offered by many plans. In an eligible investment advice arrangement, the participant still directly controls his or her account, and may accept or reject the advice provided by the fiduciary adviser. In a managed account arrangement, such as RIA Managed Account Services, a registered investment adviser directly controls the participant’s account without any action required on the part of the participant.***

### Fiduciary Adviser

For Pension Protection Act of 2006 (PPA) purposes, a fiduciary adviser is a person who is a plan fiduciary because he or she provides investment advice to plan participants or beneficiaries. In addition, the fiduciary adviser must be one of the following:

1. Registered as an investment adviser under the Investment Advisers Act of 1940 or under the laws of the state in which it maintains its principal office and place of business.
2. A bank or similar financial institution or savings association, but only if the advice is provided through a trust department that is subject to periodic examination and review by federal or state banking authorities.
3. An insurance company qualified to do business under the laws of a state.

4. A person registered as a broker or dealer under the Securities Exchange Act of 1934.
5. An affiliate of a person or entity in numbers one through four.
6. An employee, agent, or registered representative of a person or entity in numbers one through five who satisfies the requirements of applicable insurance, banking, and securities laws relating to the provision of investment advice.

A person who develops a computer model or markets an investment advice program or computer model will also be treated as a plan fiduciary because he or she is providing participants or beneficiaries with investment advice and is a fiduciary adviser.

## Terminating DC Plans: What to do with Vested Balances Over \$5,000

When a plan is terminating, the IRS generally requires all plan assets to be distributed within one year of the termination date (Rev. Rul. 89-87). But getting consent from each and every participant can present challenges.

### **DISTRIBUTION WITHOUT CONSENT**

In the case of a terminated defined contribution (DC) plan, distributions may be made without the participant’s consent — even if the participant’s vested balance is over \$5,000 as allowed by Treas. Reg. 1.411(a)-11(e) — provided that:

- The plan does not offer an annuity option as a form of payout
- The plan is not a money purchase or target benefit plan
- The employer has no other plan (with the exception of an ESOP)
- If the employer belongs to a controlled group, no other employer in the group has another plan (with the exception of an ESOP)

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## Terminating DC Plans: What to do with Vested Balances Over \$5,000 *(continued)*

- Every reasonable effort has been made to locate the participant, including the use of the DOL's missing participant rules

### REQUIRED SEARCH METHODS

The DOL provides four mandatory methods for finding missing plan participants. They are all efficient and relatively inexpensive. (NOTE: Each subsequent step is required *only if* the prior step was not successful.) The methods are:

1. *Send certified mail to the participant's address.* Assuming the address on record is correct, this is an easy and cost effective way to locate a participant.
2. *Review related plan records.* An employer must search its other retirement and employee benefit and health plans for more up-to-date address information. If privacy issues arise (a common concern with health plans), a letter may be forwarded from the qualified plan to the employee requesting that he or she contact the retirement plan administrator.
3. *Contact the participant's designated beneficiary.*
4. *Use either the IRS's or Social Security Administration's letter forwarding services.* Both agencies have published guidelines explaining their services. They are also available on their respective websites: [www.irs.gov](http://www.irs.gov) and [www.ssa.gov](http://www.ssa.gov).

### CHANGES PENDING

For now, if every effort has been taken to locate the participant, but all efforts have failed, the assets should be directly rolled into an IRA under the automatic rollover rules. We say "for now" because PPA permits terminating qualified DC plans to send the missing participant's assets to the Pension Benefit Guaranty Corporation (PBGC) to be handled under its missing participant program. However, this has been delayed pending regulations from the PBGC establishing applicable rules and procedures.

The DOL issued guidance amending the missing participant rules and the DC orphan plan rules to incorporate the changes from The Pension Protection Act of 2006 (PPA) in the Feb. 15, 2007 Federal Register.

***The four search methods to locate lost participants described above for terminating plans can also be used by existing plans.***

## Plans With Last-day Requirements

For plans that have a last-day requirement, what happens when the last day of the plan year falls on a weekend, as happened with Dec. 31 in both 2005 and 2006? Is the last business day of the year treated as the last day of the plan year? According to the IRS, the answer is "Generally, yes." This issue was addressed, along with similar situations, at the 2005 ASPPA National Conference.

### EMPLOYMENT IS A "RELATIONSHIP"

The IRS guidance started with this rule of thumb: Being "employed" on the last day of the year is not necessarily the same as "working" on the last day of the year. The IRS indicated that employment is a "relationship" with the employer. For example, if you are on vacation, you are still employed by the firm, even if you may not be actually working there during the vacation time period.

### PLAN YEAR ENDS ON A WEEKEND OR HOLIDAY

If the last day of a plan year falls on a Saturday, Sunday, or holiday, and a participant is considered an "employee" on the last *business* day of the plan year, then the participant is considered "employed" on the last day of the plan year.

For example, a retirement plan requires participants to be employed on the last day of the plan year to receive an allocation of employer contributions. In 2005, Dec. 31 fell on a Saturday. If the company usually conducts business from Monday to Friday only, and an employee's last day of work in 2005 was Friday, Dec. 30, the employee is deemed to have satisfied the last-day requirement.

The same holds true for any other type of allocation with a last-day requirement, such as the top-heavy

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## Plans With Last-day Requirements *(continued)*

contribution. However, if someone were actually terminated from employment on Dec. 30, then the employment relationship ceased *before* the last day of the year, and the ex-employee would not be entitled to an allocation.

**Caveat:** The termination of a large group of employees at year-end might trigger a possible partial termination or cause a plan to fail coverage testing, thus requiring the sponsor to increase vesting or provide allocations to the affected group.

This rule also applies to off-calendar-year plans. For example, assume the last day of the plan year for an off-calendar-year plan is Sept. 30. If Sept. 30 falls on a Saturday, and an employee works on Friday, Sept. 29, the employee is deemed to be employed on the last day of the plan year.

### UNUSED VACATION TIME

Can unused vacation time be added to an employee's termination date to extend his or her employment beyond the last day of the plan year? No. According to the IRS, unused vacation time *may not be added* to an employee's termination date in order to reach the end of the plan year.

*Example:* An employee with two weeks of unused vacation time terminates employment on Dec. 23, 2005, and the last day of the plan year is Dec. 31. The employee is not permitted to add the two weeks of unused

vacation time to the Dec. 23 termination date. Therefore, the employee is not considered to be employed on the last day of the plan year.

### FIRM IS ON VACATION WHEN PLAN YEAR ENDS

A company sponsors a retirement plan with a Dec. 31 year-end. It also regularly closes for a company-wide winter holiday the last week of December and the first week of January. In 2005, the vacation ran from Dec. 24, 2005, to Jan. 8, 2006. Were employees who worked on Dec. 23 considered employed on Dec. 31, the last day of the plan year? The IRS says "Yes." Because this was a company-wide vacation, anyone who did not terminate or resign before Dec. 31 was considered employed on the last day.

Seasonal employees were not addressed in the IRS discussion of this matter. Industry standards may have a bearing on the answer to this question.

***This information is of a general and informational nature and is NOT INTENDED TO CONSTITUTE LEGAL, TAX OR INVESTMENT ADVICE. Rather, it is provided as a means to inform you of current information about legislative, regulatory changes, and other information of interest. The information is based on current interpretations of the law and is not guaranteed. Neither the company nor its representatives give legal or tax advice. Please consult your attorney or tax advisor for answers to specific questions.***

## Questions?

**If you're a plan administrator, call your account manager at 1-800-548-6436.**

**If you're an investment professional, call your internal retirement plan consultant at 1-800-626-3112, option 1.**

**If you're a plan sponsor, call your plan administrator or investment professional.**



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