

Federal Legislative & Regulatory

Report



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April 2009

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I. Washington Update

When Congress returns from its two-week recess, the Obama Administration and legislators are expected to continue to focus on the economic recovery and budget proposals. Although not an immediate priority, retirement plan issues will likely see renewed attention from legislators over the next few months.

Budget Resolutions

On April 2, the House and Senate approved separate fiscal year 2010 Budget Resolutions. These non-binding resolutions establish a framework for enacting President Obama's policy initiatives. The Senate Budget Resolution includes provisions that could affect employee benefits, including expansion of the Saver's Credit and a mandate for employers that do not offer a retirement plan to automatically enroll employees into an individual retirement account. The House Budget Resolution establishes a deficit-neutral reserve fund to provide for certain tax relief. Although specific details are not included, the resolution specifies that this reserve fund

could facilitate “individual tax relief supporting working families, higher education, and raising participation in retirement savings vehicles, among other purposes. It could also accommodate tax relief and investment incentives for businesses, states, or communities.”

A Congressional conference committee will resolve the differences between the two separate budget resolutions and a single compromise resolution is expected to be approved later this month. Although a budget resolution does not have the force of law, it provides an indication of legislation that may be proposed later this year.

The Savings for American Families’ Future Act of 2009

On April 3, Representative Earl Pomeroy (D-ND) introduced legislation to enhance the current Saver’s Credit. This federal tax credit of up to \$1,000 encourages low- and moderate-income families and individuals to save for retirement in an individual retirement account (IRA) or employer-sponsored 401(k), 403(b) or 457 plan.

The changes that would be made to the Saver’s credit by *The Savings for American Families’ Future Act* include:

- Make the Saver’s Credit refundable – even those not subject to federal income tax would be eligible for the credit.
- Require that the credit be paid directly into the taxpayer’s retirement accounts.
- Expand eligibility requirements to cover more families and individuals by increasing the adjusted gross income limit for the full credit to \$32,500 for individuals and \$65,000 for joint incomes. A phase out range is provided for those earning slightly above these limits.
- Increase the maximum amount of the taxpayer’s contribution by \$100 for an individual (from \$500) and \$200 for joint incomes (from \$1,000) each year until 2020, with additional increases based on inflation after this date.
- Outline how the Saver’s Credit interacts with the annual retirement plan and IRA contribution limits and retirement account nondiscrimination testing of employee elective deferrals.

More information about this bill can be found here:

www.pomeroy.house.gov/index.asp?Type=B_PR&SEC={820ACC56-0438-4323-9649-1F5FC2D3C563}&DE={3FB9693C-C7BE-4985-85E3-1AF1F09C0263}

Taxpayer Certainty and Relief Act of 2009

On March 26, Senate Finance Committee Chair Max Baucus (D-MT) introduced the *Taxpayer Certainty and Relief Act of 2009* (S. 722) to amend the Internal Revenue Code of 1986. This bill would permanently extend certain provisions of the tax cuts for low- and middle-income taxpayers instituted by the Bush Administration in 2001 and 2003, preventing them from expiring at the end of 2010. Under this bill, the current tax rates for individuals in the 10%, 15%, 25% and 28% tax brackets would continue while the top two tax brackets would revert to pre-2001 levels in 2011.

Other provisions of this bill include indexing the alternative minimum tax exemption for inflation and permanently freezing the 15 percent middle-income taxpayer rate on capital gains from the sale of stocks and other assets. Those in the highest income-tax brackets would pay a

capital gains tax rate of 20 percent starting in 2011. More information about this bill can be found here at www.govtrack.us/congress/bill.xpd?bill=s111-722.

Savings Recovery Act

A group of House Republicans, called the *House GOP's Solutions Group for Savings Restoration*, recently introduced the *Savings Recovery Act*. The bill proposes:

- Increasing retirement contribution and catch-up limits for individuals and families
- Providing cuts in the capital gains and dividend tax rates
- Doubling the earnings limit for retirees receiving Social Security benefits
- Extending the Saver's Credit to include contributions made to 529 college savings accounts
- Providing a three-year extension to the current suspension of the required minimum distribution (RMD) rules

Information about this Republican proposal can be found at <http://republicanleader.house.gov/News/DocumentSingle.aspx?DocumentID=115658>.

The group, led by the House Minority Leader John Boehner (R-OH), was formed to put forth alternate solutions to those being introduced by the Obama Administration and the Democratic majority.

Investment Advice Hearing

On March 24, the House Education and Labor Subcommittee on Health, Employment, Labor and Pensions, chaired by Representative Rob Andrews (D-NJ), held a hearing entitled "*Retirement Security: The Importance of an Independent Investment Advisor*."

This hearing explored investment advice in defined contribution plans and the final regulations released during the Bush Administration that are currently on hold. Representative Andrews noted that this hearing would be the first in a series held by this subcommittee on defined contribution plan issues.

Temporary Money Market Funds Guarantee Program Extended

On March 31, 2009, the Department of Treasury announced they are extending the temporary Money Market Funds Guarantee Program that was scheduled to expire on April 30, 2009. This extension will provide coverage to certain shareholder investments in participating money market funds through September 18, 2009.

Only money market funds already participating in this program are eligible for the extension, under certain conditions, and it only covers investors who were participating in these funds as of the close of business on September 19, 2008 up to the amount invested at that time.

Information about this extension can be found at www.ustreas.gov/press/releases/tg76.htm.

Tax Reform Panel

On March 25, the White House announced the establishment of a new tax reform panel, led by former Federal Reserve Chairman Paul Volcker. This group is charged with studying options for reforming the U.S. tax code that includes:

- Simplifying the tax code
- Eliminating tax loopholes
- Reducing corporate welfare

The panel has been asked to submit a report, with recommendations, to the Obama Administrations by December 4. Although proposals for sweeping changes to the tax system are not anticipated, some of the resulting recommendations may be included in President Obama's fiscal year 2011 budget proposal, which will be released in February 2010.

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II. Beware When Applying Exception to Early Distribution Tax

A recent U. S. Tax Court case, [Bailey v. Commissioner of the Internal Revenue Service](#), illustrates how a little knowledge can be dangerous or as in this case, costly unless that knowledge is applied correctly. The Bailey case addresses the misapplication of one exception to the 10% additional tax on early distributions.

Background

In 2005, Jennifer Bailey, a 30 year old participant in her employer's 401(k) plan, requested and received a distribution from the plan. She and her husband filed a joint federal income tax return for 2005 that included her plan distribution in their gross income. The Baileys, however, neglected to report in their return that they were subject to the 10% additional tax on the distribution from Jennifer's 401(k) plan.

The IRS notified them that they were subject to the 10% additional tax on the plan distribution. Instead of paying the additional tax and penalties, the Baileys argued in Tax Court the distribution was not subject to the additional tax because they had used Jennifer's plan distribution towards the purchase of their first home – an exemption under IRC §72(t). Apparently, they were unaware the first time homebuyer exception to the additional tax applies only to distributions from IRAs (individual retirement accounts or annuities) and not distributions from an employer-sponsored retirement plan.

The Court declared a retirement plan described in 401(a) and (k) is not an IRA under the IRC and found the Baileys were subject to the 10% additional tax on the 401(k) distribution because their arguments were without merit, irrelevant and/or moot.

To understand how the exceptions to this tax apply, we provide on the next two pages a table summarizing the exceptions to the 10% early distribution tax.

About the Early Distribution Tax

The additional early distribution tax applied on amounts distributed to individuals under age 59½ from certain employer-sponsored retirement plans and IRAs. There are a number of exceptions to this tax but not all of these exceptions apply to all types of retirement plans.

Primary Exceptions to Retirement Plan Early Distribution Tax

| Exceptions under IRC §72(t) for distributions which are: | IRAs including deemed IRAs | 401(a), 403(b) plans and governmental 457 plan rollover accounts holding roll-ins from non-457 plans |
|------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------|
| Made on or after employer attains age 59½ | √ | √ |
| Made to employee after separation from service after attainment of age 55 (age 50 for public safety employees in governmental defined benefit plans) | | √ Requires termination of employment |
| Made to a beneficiary after death of employee | √ | √ |
| Qualified Reservist | √ | √ Does not apply to distributions from 457 plan accounts |
| Attributable to an employee's total and permanent disability | √ | √ |
| Made as qualified first-time home-buyer distributions | √ | |
| Made for qualified higher education expenses | √ | |
| Made to unemployed individuals for qualified health insurance premiums | √ | |
| Refunds of Economic Stimulus payment directly deposited into IRA | √ | |
| Conversions from traditional IRA / or SIMPLE IRA to a Roth IRA | √ | |
| Made to employee for unreimbursed medical expenses up to minus 7.5% of adjusted gross income | | √ |
| Seizures by IRS for Tax Levy on qualified plan | √ | √ |
| Substantial equal periodic payments made at least annually based on life expectancy | √ Payments must be made until age 59½ or for 5 years whichever is longer. Separation from service is not required. | √ Payments must be made until age 59½ or for 5 years whichever is longer and individual must be separated from service. |
| QDRO payments to an alternate payee | | √ |

Tip: Click on underlined words to go to the topic being discussed.

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Information presented in this newsletter was current and accurate as of the date of publication. This information is of a general and informational nature and is NOT INTENDED TO CONSTITUTE LEGAL 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. Plan Sponsors are urged to consult their own counsel regarding this information.

| Exceptions under IRC §72(t) for distributions which are: | IRAs including deemed IRAs | 401(a), 403(b) plans and governmental 457 plan rollover accounts holding roll-ins from non-457 plans |
|---------------------------------------------------------------------------------------------------|----------------------------|------------------------------------------------------------------------------------------------------|
| Qualified disaster recovery distributions or qualified disaster recovery assistance distributions | √ | √ |
| Rollover from a 401(a), 403(b) or governmental 457(b) plan to a Roth IRA | | √ |

Nationwide Comment: Participants need to be careful about applying exceptions to the 10% excise tax on early distributions from retirement plans. They risk underpayment of federal income taxes which usually results in additional taxes and penalties. If an exception applies, it must be reported on IRS Form 5329 and filed with the individual's federal income tax return.

Reference Material

www.ustaxcourt.gov/InOpHistoric/Ba2iley.SUM.WPD.pdf

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III. Retirees Could Be Underwithholding for 2009 Income Taxes

The [American Recovery and Reinvestment Act of 2009](#) (ARRA) provides workers with a tax credit on their earned income. This "Making Work Pay Tax Credit" gives employees, self-employed individuals, and individuals receiving nontaxable combat pay a refundable credit up to \$400 (\$800 if married and filing jointly). The credit phases out when modified adjusted gross income is more than \$75,000 (\$150,000 for joint married filers). Although non-working retirees are not eligible for this credit, those receiving Social Security benefits will receive a one-time payment of \$250 from Social Security as part of the ARRA stimulus package.

In the meantime, to give workers and retirees more immediate disposable income, the IRS has released new income tax withholding tables to be used for income tax withholding through December, 2009. These new tables lower withholding on both worker earned income and pension payments but does not change tax liability.

Included with the new tax withholding tables is a notice employers can use to inform employees they may need to adjust their current withholding if they have more than one job or are married with a combined income that puts them in a higher tax bracket.

To ensure the correct amount is being withheld, taxpayers may use the applicable worksheets found in IRS [Publication 919](#). If withholding needs to be changed, workers may file a revised Form W-4 with their employer.

One of the consequences of using the new lower withholding tables for pension payments is that non-working retirees could face unexpected tax liability because of insufficient withholding on their pension checks. They may want to check their current withholding to determine if they are withholding enough using the applicable worksheets in Publication 919.

Key provision for government retirees

Government retirees who did not receive an economic recovery payment from Social Security, Supplemental Social Security Railroad Retirement, and veterans' disability or pension benefits may want to review Worksheet 12 in Publication 919. These government retirees may be eligible for a refundable credit of \$250 or \$500 if the retiree and spouse are government retirees filing joint returns.

Reference Material

Social Security One-Time Payment for 2009: www.socialsecurity.gov/pubs/10519.html

Tax Withholding for 2009: www.irs.gov

In the Search Box select either:

[Pub 919](#) – How Do I Adjust My Withholding for 2009?

[Pub 15-T](#) – New Wage Withholding and Advance Earned Income Credit Payment Tables

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IV. Plan Loans to Be Exempt from Truth in Lending Disclosures

The Truth in Lending Act (TILA) disclosure rules under the Federal Reserve Board's Regulation Z, apply to various forms of consumer credit. The rules required this disclosure of loans made to participants from employer-sponsored retirement plan if the plans has made in excess or 25 participant loans secured by the participant's account balance or more than 5 loans secured by a dwelling in the current or prior calendar year.

Effective July 1, 2010, the Federal Reserve Board (the Board), using its authority to exempt transactions from TILA disclosures it determines are unnecessary, has amended Regulation Z to exempt participant loans from employer sponsored retirement plans from the TILA disclosure rules. This exemption applies to all ERISA and non ERISA qualified plans and 403(b) plans as well as governmental 457(b) plans provided that the loans are made from fully vested accounts and are made in compliance with the Internal Revenue Code. Plans that permit loans up to \$10,000 disregarding the participant's vested account balance will still need to provide TILA disclosures.

The Board concluded these disclosures are not necessary for participant loans from employer-sponsored retirement plan because:

- The consumer's (participant's) interest and principal payments on a loan from a retirement plan are reinvested in the consumer's own account;
- There is no third party creditor imposing finance charge on the consumer, and
- The costs of a loan taken for example from a 401(k) plan are not comparable to the costs of a third party loan product because the consumer pays the interest on the 401(k) plan to him/herself instead of to a third party.

What is TILA?

The Congress enacted the Truth in Lending Act (TILA) to enhance and strengthen economic stability and competition among consumer credit providers by:

1. Helping consumers compare credit terms in the marketplace and avoid uniformed use of credit, and
2. Protecting consumers against inaccurate and unfair billing and credit card practices.

Reference Material

<http://edocket.access.gpo.gov/2009/pdf/E8-31185.pdf> – See pages 5244, 5262-3 and 5399 for provisions covering loans from employer-sponsored retirement plan

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V. IRS Issues Guidance for COBRA Premium Reduction Payments

The Consolidated Omnibus Budget Reconciliation Act (COBRA), of 1985, gives employees who lose their jobs and health coverage the opportunity to continue group health coverage, up to 18 months after termination, for themselves, their spouses and dependents.

COBRA continuation coverage:

- Does not apply to employers who do not offer group health plans.
- Generally covers group health plans maintained by private-sector employers with 20 or more employees, employee organizations, or state and local governments
- Applies to voluntary or involuntary termination of employment, for reasons other than gross misconduct, or a reduction in the number of hours of employment

COBRA participants usually pay 100% of the COBRA premiums. To help individuals who have lost their jobs pay their COBRA premiums, the American Recovery and Reinvestment Act of 2009 (ARRA) temporarily reduces the amount of COBRA premiums eligible individuals have to pay because of their own or a family member's involuntary termination from employment between September 1, 2008 and December 31, 2009.

Under ARRA, eligible individuals, referred to as "assistance eligible individuals" (AEIs) who have elected COBRA coverage pay only 35% of the full COBRA premiums for up to 9 months. The amount of the premium reduction is excluded from an individual's gross income. Employers pay the remaining 65% of the COBRA premium for the AEI. Once the AEI has paid the 35% of the COBRA premium, the employer, plan administrator or insurer is reimbursed for its share of the COBRA premium as a credit against payroll liabilities. For this purpose payroll taxes are defined as the employee and employer share of FICA taxes.

The COBRA premium reduction provisions apply to all group health plans sponsored by private-sector employers or employee organizations (unions) subject to the COBRA rules under the Employee Retirement Income Security Act of 1974 (ERISA). They also apply to plans sponsored by State or local governments subject to the continuation provisions under the Public Health Service Act, and plans in the Federal Employee Health Benefits Program (FEHBP). The premium reduction is also available for group health insurance that is required by State law to provide comparable continuation coverage (such as "mini-COBRA").

In March 2009, the IRS issued [Notice 2009-27](#) consisting of 58 questions and answers to help employers, administrators and insurers in implementing the COBRA premium reduction. The following summary outlines the major provisions found in this guidance.

Involuntary Termination of Employment

To apply the new COBRA premium reduction rules it is important to understand the meaning of "involuntary termination of employment" in the context of the ARRA.

According to IRS [Notice 2009-27](#), an involuntary termination employment, based on all the facts and circumstances, is an employee's severance from employment because of an employer's unilateral authority to terminate the employment where the employee was willing and able to continue performing services for the employer. The Notice provides examples of involuntary termination of employment that could include:

- An employer's failure to renew a contract at the time the contract expires, if the employee is able and willing to execute a new contract with terms and conditions similar to those in the expiring contract.
- An employee-initiated termination from employment for good reason because of an employer action that causes material negative change in the employment relationship for the employee which could include a material change in the employee's geographic location of employment.
- A reduction in hours to zero such as a furlough, layoff or other suspension of employment that result in the loss of health coverage.
- A termination elected by an employee in return for a severance package (a buy-out) where the employer indicates that after the offer period for the severance package, a certain number of remaining employees in the employee's group will be terminated.
- An employer's action to end an individual's employment while the individual is absent from work because of illness or disability.
- A lockout initiated by an employer.

This IRS Notice also provides examples of what may not be an involuntary termination of employment such as:

- Involuntary termination of health coverage for a reason other than involuntary termination of employment.
- A reduction in hours unless hours are reduced to zero.
- Retirement, unless facts and circumstance indicate that absent retirement, the employer would have terminated the employee's services.
- Termination for cause due to gross misconduct of the employee (under Federal COBRA).
- A work stoppage as a result of a strike by employees or their representatives.
- Another qualifying event such as divorce, or loss of dependent status.
- An employee's death or absence from work due to disability.

Eligibility

Only AEs, are eligible for the COBRA continuation premium reduction. An AE is generally someone who:

- Is a qualified beneficiary as the result of an involuntary termination during the period between September 1, 2008 and December 31, 2009.
- Is eligible for COBRA continuation coverage at any time during that period and coverage.

The Notice confirms that an individual may become an AE more than once and is eligible for up to 9 months of premium reduction for each involuntary termination. The premium reduction applies as of the first period of coverage beginning on or after February 17, 2009.

Calculation of Premium Reduction

The premium used to determine the 35% share that must be paid by or on behalf of an AEI is the cost that would be charged for someone who is not an AEI. If the AEI is required to pay 102% of the COBRA continuation premium, the AEI is required to pay, under Federal COBRA, rules, 35% of the 102% applicable premium. If the maximum premium is less than 102%, for example because of an employer pays part of the premium, the AEI would pay 35% of the AEI's share of the premium.

Coverage Eligible for Premium Reduction

The premium reduction is available for COBRA continuation coverage under any group health plan, except a flexible spending arrangement (FSA) offered through a cafeteria plan including vision only coverage and mini med plans whether or not the employer pays for a portion of the costs for active employees. The premium reduction for COBRA may also apply to an HRA, but is not available for continuation coverage for non health benefits such as group life insurance.

Retiree health coverage may also be eligible for the COBRA premium reduction if the retiree coverage does not differ substantially from that of active employees. Retiree health coverage may still be eligible for the ARRA premium reduction provided the charge to retirees does not exceed the maximum amount permitted under Federal COBRA.

Duration of Premium Reduction Period

The premium reduction occurs as of the first period of coverage beginning on or after February 17, 2009 and does not apply to premiums paid before then. The COBRA premium reduction period ends the earlier of:

- The first date the AEI becomes eligible for coverage under another group health plan that is not an FSA or limited care coverage plan;
- The first date the AEI becomes eligible for Medicare coverage;
- The date that is nine months after the first day of the first month for which the premium reduction applies; or
- The date the individual ceases to be eligible for COBRA continuation coverage premium.

An AEI must notify the group health plan of eligibility for the other coverage. Otherwise the AEI will be subject to a penalty tax of 110% of the premium reduction he/she should not have received.

Extended Election Period

Individuals, who were offered Federal COBRA continuation coverage as a result of an involuntary termination of employment that occurred at any time from September 1, 2008 through February 16, 2009, and who declined to take it at that time, or elected COBRA and later discontinued it, may have another opportunity to elect coverage and pay a reduced premium.

Individuals eligible for the extended COBRA election period must receive a notice informing them of this opportunity by April 18, 2009. Individuals have 60 days after the notice is provided to elect COBRA. This special election period does not extend the period of COBRA continuation coverage beyond the original maximum period (generally 18 months from the date of the

employee's involuntary termination). COBRA coverage elected in this special election period begins with the first period of coverage beginning on or after February 17, 2009.

This extended election period does not apply to State continuation coverage requirements.

Recapture of Premium Assistance

If an AEI's modified adjusted gross income exceeds \$145,000 for single taxpayers (\$290,000 for married taxpayers filing jointly) the amount of the premium reduction is recaptured as an increase in the individual's Federal income tax liability. The recapture is phased in for individuals with modified adjusted gross income in excess of \$125,000 (\$250,000 for married filing jointly).

A health plan, however, cannot refuse to provide premium reduction even if the individual's income is high enough for the recapture of the premiums to apply. A high income AEI may make a permanent election to waive the COBRA premium reduction.

Notice Requirements

Employers subject to COBRA or similar health care continuation laws must notify all individuals entitled to elect COBRA continuation coverage between September 1, 2008 and December 31, 2009 of their rights and obligations under the ARRA. The notice must include:

- The forms necessary for establishing eligibility for the premium reduction;
- Contact information for the plan administrator or other person maintaining relevant information in connection with the premium reduction;
- A description of the second election period (if applicable to the individual);
- A description of the requirement that the Assistance Eligible Individual notify the plan when he/she becomes eligible for coverage under another group health plan or Medicare and the penalty for failing to do so;
- A description of the right to receive the premium reduction and the conditions for entitlement; and
- If offered by the employer, a description of the option to enroll in a different coverage option available under the plan.

The Department of Labor has provided on its website several model notices for employers to use.

Reference Material

IRS Notice 2009-27 – <http://www.irs.gov/pub/irs-drop/n-09-27.pdf>

COBRA Premium Reduction Information from the DOL – www.dol.gov/ebsa/faqs/faq-cobra-premiumreductionEE.html

COBRA Model Notices – www.dol.gov/ebsa/COBRAModelnotice.html

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VI. Keeping watch

You can find the most recent information on issues affecting governmental defined contribution plans, plan sponsors and plan participants on the Employer page of our plan Web site, NRSforu.com. In addition, we report guidance on legislative and regulatory activity relevant to government sector defined contribution plans through:

- *Federal Legislative and Regulatory Report* — distributed monthly and posted on the Legislative / Regulatory tab on the Employer section of NRSforu.com. It's available online and for download.
- *Plan Sponsor Alerts* — published as needed to announce breaking news, and distributed by e-mail and posted in the Plan Sponsor Corner of NRSforu.com.

About this report

JOANN ALBRECHT, CPC, QPA, Plan Technical Consultant, our resident expert on legislative and regulatory issues, prepares this report. As a leading member of the Nationwide Legislative Task Force, she identifies how federal actions may affect your plan and its participants.

Albrecht is a member of American Society of Pension Professionals and Actuaries (ASPPA), currently serving on its Government Affairs Committee, is immediate past chair of the ASPPA Tax Exempt and Government Plans Subcommittee and is a subject matter expert (SME) for the ASPPA Education and Examinations Committee. She is a current contributor to Aspen Publisher's "457 Answer Book."

BOB BEASLEY, CRC, CIC, Communications Consultant, edits it. Beasley brings 19 years of financial services communications experience to your plan. He helped prepare the *457 Guidebook* and *Fiduciary Fundamentals*, edited countless newsletters and plan sponsor communications, and in 2001 authored "What you should know about the Economic Growth and Tax Relief Reconciliation Act of 2001."

Beasley serves on the Education and Communication Committee for the Profit Sharing / 401k Council of America and is a member of the National Association of Governmental Defined Contribution Administrators.

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