Federal Legislative & Regulatory Report

Nationwide Retirement Solutions
On Your Side

March 2010

Inside this issue

I. Washington Update

While health care reform and the economy (jobs) continue to be top priorities for the Obama Administration and Congress, there has been some recent legislative and regulatory activity on retirement- and benefit-related topics that may be of interest to public sector employers.

Roth 401(k) and Roth 457 Proposals

On Friday March 5, the Senate adopted a substitute amendment to H.R. 4213 by unanimous consent that included provisions relating to Roth 401(k) account conversions and the establishment of Roth 457 accounts, which would put these plans on par with current Roth 401(k) and 403(b) accounts. In regard to Roth 401(k) accounts, the amendment would allow distributable 401(k) account balances to be converted to Roth accounts within the 401(k) plan. Under current law, the conversion to a Roth account can only be made via Roth IRAs. The provision to permit the conversion to a Roth 401(k) account is to retain assets within an employer plan, which is often a better option for employees. This also is being considered to allow employees to take advantage of a new Roth conversion rule for 2010 only that allows federal income tax due as a result of the conversion to be split between 2011 and 2012. Both the Roth 401(k) conversion provision and the Roth 457 account option are seen as revenue generators in this bill. Although they generate federal budget revenue, it remains unclear whether the House will accept this amendment.

Small Business Add Value for Employees Act

On March 3, Representatives Ron Kind (D-WI) and Dave Reichert (R-WA) introduced the Small Businesses Add Value for Employees (SAVE) Act. Although this proposal pertains to retirement plans subject to the Employee Retirement Income Security Act (ERISA), some of its provisions may indirectly impact retirement plans of public sector employers.

This bill's primary purpose is to provide more savings opportunities for employees of small businesses by making certain changes to SIMPLE IRAs and SIMPLE 401(k) plans. A second goal, however, is to help employees better understand how accumulated assets can be used for income in retirement by requiring plans to provide an illustration of lifetime monthly income based on current account balances. This illustration is required to be provided at least once per year.

Temporary Extension Act of 2010

On March 2, 2010, President Obama signed the Temporary Extension Act of 2010 (H.R. 4691). This Act provides short-term extensions of certain federal subsidies that were expiring, including those pertaining to unemployment compensation and the continuation of health insurance payments under the Consolidated Omnibus Budget Reconciliation Act (COBRA). This extension is for one month only, through the end of March, and intended to give the Senate more time to consider a proposal to provide subsidies through the end of the year to workers who have been involuntarily terminated.

Proposed Investment Advice Regulations

The Employee Benefits Security Administration (EBSA) of the Department of Labor (DOL) recently released proposed regulations entitled "Investment Advice—Participants and Beneficiaries." These rules replace proposed regulations that were previously issued by the Bush Administration and pertain to investment advice within retirement plans subject to ERISA.

Go to Section III of this report for a discussion of the new DOL proposed investment advice regulations.

EBRI 2010 Retirement Confidence Survey Report Released

The Employee Benefit Research Institute (EBRI) recently released its report on the findings from the 2010 Retirement Confidence Survey. This is the 20th annual survey that EBRI has conducted and, after two years of record low retirement confidence levels being reported, it appears that they are beginning to stabilize. Only 16% of workers state they are very confident about having sufficient money for a comfortable retirement, compared to 13% in 2009.
The EBRI report can be found here:
www.ebri.org/publications/ib/index.cfm?fa=ibDisp&content_id=4488.

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II. IRS: Health Benefits for Retiree's Domestic Partner Usually Taxable

In a recent private letter (PLR 201003007, 4 pages, 47 KB) ruling involving a county and two labor unions representing county employees, the Internal Revenue Service concluded that health benefits provided to retirees, their spouses and tax dependents are generally not taxable – but health benefits provided to domestic partners may be taxable.

Facts

Unions A and B, representing County employees, established a Trust to pre-fund retiree health benefits during employment. Under the plan, the Trust provides reimbursement payments to eligible retired employees, their spouses, tax dependents and domestic partners only for the cost of post retirement medical expenses or health insurance premiums listed in section 213(d) of the Internal Revenue Code. The Unions' memo of understanding (MOU) with the County requires:

- Participation in the plan to be mandatory. Employees are not permitted to elect into or out of the plan;
- Mandatory pre-tax contributions for each participant as well as mandatory contributions of a uniform percentage of accrued sick leave and vacation pay at the time of retirement; and
- Employees cannot make an election with respect to contributions or accrued leave.

In addition to retirees, their spouses and dependents, the plan provides benefits to domestic partners. Contributions made for coverage of non-spouse or non-dependent domestic partners are taxable. The value of benefit provided to such a domestic partner is included in the employee's gross income in the tax year when the benefits are earned, not when the benefits are received. Amounts to be included in the employee's gross income will be determined using a calculation with reasonable actuarial assumptions. The value of coverage for a non-dependent domestic partner will be included in the employee's gross income during a taxable year if the employee is expected to have a domestic partner upon eligibility for benefits under the plan.

In this PLR, the IRS concluded:

- Mandatory pre-tax contributions and mandatory contributions of accrued leave to the Trust that are used exclusively to pay for the accident or health coverage of eligible retired employees, their spouses, and tax dependents (as defined under the Code) are excluded from the gross income of eligible retirees, their spouses and dependents, but
- The Trust will include the fair market value of the coverage in the gross income of the employee for individuals covered under the Trust who do not qualify as a spouse, or tax dependent under Federal law.

The PLR did not express an opinion on the classification of the Trust for federal tax purposes or any other provisions of the Tax Code than those specifically addressed in the PLR. The PLR notes the IRS will not issue a ruling on whether a self-insured medical reimbursement plan satisfies the non-discrimination rules applicable to accident and health plans. This ruling is directed only to the taxpayer requesting it and may not be cited as precedent.

Reference Material

IRS Private Letter Ruling 201003007
www.irs.gov/pub/irs-wd/1003007.pdf (4 pages, 47 KB)

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III. DOL Releases New Proposed Investment Advice Regulation

The Pension Protection Act of 2006 created a new statutory exemption to the ERISA prohibited transaction rules for investment advice in participant-directed defined contribution plans and IRA owners. This exemption is intended to increase access to investment advice to participants. The Department of Labor (DOL), responsible for implementing the PPA statutory prohibited transaction exemption, estimates that regulatory impact of the exemption will affect 16,000 investment advisory firms, including broker-dealers.

Under the PPA statutory prohibited transaction exemption, investment advice may be provided to participants by either "fiduciary advisers":

- Using a computer model that is certified as unbiased, by an independent expert, or
- Who are compensated on a "level-fee" basis and whose fees do not vary based on investments selected by the participant.

Prohibited Transaction Exemption

A prohibited transaction exemption (PTE) allows plan fiduciaries to engage in transactions that would otherwise be prohibited under ERISA such as providing investment advice for a fee. PTEs may be statutory under the Code and ERISA, or granted by the DOL as class or individual exemptions.

The investment advice arrangement must be authorized by a plan fiduciary other than the person offering the advice arrangement, any person providing designated investment options under the plan or any affiliate of either group. A plan fiduciary must also establish qualifications and a selection process for the investment expert who will certify the computer model. Investment advice disclosures must be provided to participants or IRA accountholders. They are not required to implement the advice they receive from the fiduciary adviser. The new regulation also contains a non-mandatory model disclosure form in the Appendix that may be used to satisfy the regulation's participant disclosure requirements.

Early last year, the DOL finalized its proposed investment advice rule. The final rule included a class exemption that provided alternative conditions for granting prohibited transaction relief for investment advice. It would have allowed advisers to give investment advice outside of the level fee arrangement if the adviser gave the participant computer-generated advice first. The final rule was later withdrawn after numerous commentators questioned the ability of the class exemption to lessen the potential for adviser conflicts of interest, tainted advice and self-dealing.

Late last month the DOL published a new proposed investment regulation generally tracks the withdrawn final rule, but does not contain the controversial class exemption. It does include several additional clarifications. In the preamble to the revised proposed regulation, the DOL stresses that the new proposed rule:

1. Does not invalidate or affect prior DOL regulations, exemptions, interpretive or other investment advice guidance addressing prohibited transactions for providing investments advice.
2. Does not require the plan fiduciary or any other party to offer investment advice to participants.

The Computer Model

Among other requirements, the computer model must be designed and operated to:

- Apply generally accepted investment theories that take into account historic risks and returns of different asset classes over time, investment management and other fees and expenses, and may include other considerations;
- Consider all options under the plan except for qualifying employer securities, annuities/annuity options and investment funds based on a defined time horizons such as retirement age or life expectancy; and
- Avoid recommendations that inappropriately favor investment options offered by the adviser or anyone with a material affiliation or material contractual relationship with the adviser or generate greater income for the adviser than other options.

The new proposed rule clarifies that computer models must be designed and operated to avoid recommendation that inappropriately distinguish among investment options within a single investment class based on a factor that cannot be reasonably expected to continue into in the future. Differences between investment options within a single investment class – such as fees, expenses or management style – are likely to continue into the future and are appropriate criteria for asset allocation, while differences in historical performance are less likely to continue into the future and may not be appropriate for asset allocation. Asset classes however, may be distinguished from one another based on the differences in their historical risk and return characteristics.

Before the computer model may be used for providing investment advice, the fiduciary adviser must obtain a written and signed certification from an "eligible investment expert" that the computer model is unbiased, and meets the requirements of the new proposed rule. An "eligible investment expert" is defined as someone who has the appropriate technical training or experience and proficiency to analyze, to determine and certify whether the computer model meets the requirements of the regulation. The expert must not have any material affiliation or contractual relationship with the adviser or any of the fiduciary adviser's employees, agents or registered representatives.

If the computer model is modified in any way after certification, the fiduciary adviser must obtain a new certification from an eligible investment expert that the model as modified meets the requirement of the proposed regulation.

The Level Fee Arrangement

Under a level fee arrangement a fiduciary adviser (including its employees) cannot receive compensation from affiliates based on the adviser's recommendations, even though affiliates may receive variable compensation based on the investment options selected by the participant.

The new regulation clarifies that receipt by a fiduciary adviser of any payment from any party, including an affiliate of the fiduciary adviser that is based in whole or in part on investments selected by the participant or beneficiaries would not meet the requirements of the statutory exemption. This limitation applies both to the organization retained to provide advice and to any of its employees, agents or registered representatives. Thus, even though an affiliate of a fiduciary adviser may receive fees that vary depending on investment options selected by participants and beneficiaries, the fiduciary adviser cannot receive any financial or economic incentive from the affiliate or any other party. Likewise, the fiduciary adviser cannot provide economic incentives to any individual employer to favor certain investments.

Additional Requirements

- The investment advice arrangement is subject to an annual independent audit. The auditor must be independent from the investment advice provider and have the necessary training or experience and proficiency to audit the arrangement.
- The auditor must verify compliance with the regulation and issue a report of its findings within 60 days following the completion of the audit to the fiduciary adviser and to each fiduciary who authorizes the investment advice arrangement.
- Fiduciary advisers relying on the exemption for a computer model or level fee advice arrangement are subject to a 6 year recordkeeping requirement.

Effective Date and Comment Period

The regulation becomes effective 60 days publication in the Federal Register as a final regulation.

The DOL is especially interested is receiving comments on a number of specific questions listed in the new proposed regulation. Comments must be submitted no later than May 5, 2010.

Public comments can be submitted electronically by email to e-ORI@dol.gov or by using the Federal eRulemaking portal at www.regulations.gov. All comments will be available to the public, without charge, online at www.regulations.gov and www.dol.gov/ebsa, and at the EBSA Public Disclosure Room.

Reference Material

Proposed rule
www.dol.gov/federalregister/HtmlDisplay.aspx?DocId=23559&AgencyId=8&DocumentType=1 (11 pages, 88 KB)

Fact Sheet
www.dol.gov/ebsa/newsroom/fsinvestmentadvice.html (3 pages, 54 KB)

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IV. DOL Clarifies Prior Guidance for Private Sector 403(b) Plans

Beginning with the 2009 plan year, Title I 403(b) plans will be subject to the full financial reporting requirements, including the independent audit requirement, that apply to ERISA 401(k) plans and other qualified plans. Prior to the 2009 plan year, ERISA 403(b) plans filed simplified 5500s and were exempt from the independent audit requirement for large plans (plans with 100 or more participants).

Some private sector 403(b) plans may be able to meet the requirements of the ERISA safe harbor and avoid the reporting and disclosure requirements of Title I of ERISA. Private sector 403(b) plans that cannot meet the ERISA safe harbor requirements must file an annual full informational Form 5500, starting with the 2009 plan year.

Since the IRS issued the final 403(b) regulations in 2007, the DOL has issued three Field Advisory Bulletins (FABs): FAB 2007-2, 2009-2 and now FAB 2010-01.

Among other things, FAB 2007-2 explained a private sector 403((b) plan could stay within the ERISA safe harbor and still comply with the IRS final regulation if:

- The plan contains only voluntary contributions;
- The employer offers a reasonable selection of providers and products to give the participant a reasonable choice;
- The plan does not have employer matching or non-elective contributions, or contributions conditioned on an employee's making elective deferrals to the 403(b) plan;
- All rights under the plan's funding contracts are enforceable by the employee, not the employer, even if the plan is funded with a group contract; and
- The employer (plan sponsor) does not make any discretionary decisions about the plan such as loan and hardship determinations.

What is a 403(b) Plan?

A 403(b) plan is a retirement plan for employees of public schools, 501(c) tax exempt organizations and self-employed ministers that are funded with annuity contracts or custodial accounts purchased by an employer. A 403(b) plan may be either an ERISA or non-ERISA plan. Governmental plans, non-electing church plans and private sector plans with no active employer involvement are not subject to Title I of ERISA.

The determination that a plan meets the 403(b) safe harbor requirements is based on a facts and circumstance determination.

FAB 2009-2 provided guidance on how plan administrators could meet the new ERISA reporting and disclosure requirements beginning with the 2009 plan year. This FAB explains that plan administrators can be relieved from the administrative burden and expense of collecting and including financial report information on certain individual annuity contracts and mutual fund custodial accounts of current and former employees on their 2009 Form 5500. According to FAB 2009-2, pre-2009 individual contracts/accounts can be ignored for purposes of 5500 reporting if:

- Employer has made a good faith effort to obtain this information,
- Employer ceased making contributions to these contracts and accounts prior to January 1, 2009,
- Rights under contracts are enforceable by employees, and

- The employees are 100% vested in their contracts.

A number of questions remained about the scope of 5500 relief provided in FAB 2009-2, and the ERISA safe harbor. To address these questions, the DOL issued, in a Q & A format, FAB 2010-01, which is summarized below.

FAB 2010-01

Annual Reporting Issues	
Plan assets *Q 3, 6 and 9*	Annuity and custodial accounts that meet the requirements of FAB 2009-2 are not considered plan assets and may be disregarded for purposes of the 5500 reporting requirements. These contracts/accounts may be excluded from comparative financial statements in the plan's annual report even if the plan administrator knows of and can identify the contracts.
Final Contributions for 2008 made in 2009 *Q 13*	The relief in FAB 2009-2 applies to employers that ceased making contributions to the contract or account before January 1, 2009. FAB 2010-01 clarifies that final contributions to the contract or account attributable to 2008 that were not deposited until 2009 will not be treated as continuing contributions after January 1, 2009.
Continuing Reporting Relief for Large and Small Plans *Q 5*	Annual reporting relief under FAB 2009-2 applies to both large and small plans and extends beyond the 2009 plan year. It also applies to determining the number of participants in the plan for reporting purposes and if the plan has to submit a report from an independent qualified public accountant report as part of its Form 5500. Employees whose only assets in the plan are contracts or accounts that meet the conditions of FAB 2009-2 and who are not eligible to make salary reduction contributions are not counted as participants for 5500 purposes.
Loan Repayments *Q 2*	Ongoing loan repayments the employer forwards to the contract/account vendor would be treated like employee salary deferrals, giving the employer an ongoing role with the contract/account and making the plan ineligible for the relief provided in FAB 2009-2. But, the annual reporting relief in FAB 2009-2 could apply if employees make loan repayments in 2009 directly to the contract or custodial account providers.
DOL Safe Harbor Arrangements	
Availability of Optional Features *Q 14*	A safe harbor plan may have optional features such as loan and hardship distributions available if the 403(b) provider (contractor) is responsible for making any discretionary determinations for administering these provisions.
Hiring a TPA to Make Discretionary Determinations *Q 15*	The employer's selection of a TPA for this purpose would be inconsistent with the DOL safe harbor. To stay within the safe harbor, documents should describe the employer's limited role and allocate discretionary determinations to the annuity provider or other responsible third party. The employer may also limit the providers it will make available in its safe harbor arrangement to providers whose 403(b) contracts or accounts or other governing documents prepared by the provider state that the provider or another appropriate TPA is responsible for discretionary decisions related to loans and hardships. In other words, if the employer hires a TPA for the purpose of making discretionary determinations, the plan falls out of the safe harbor, but if the annuity contractor/mutual fund provider hires a TPA to the make discretionary determinations the plan will not fall outside of the safe harbor.

Choice of Investment Providers and Investment Products *Q 16*	To meet the safe harbor requirements, employers must offer a choice of more than one 403(b) contractor and more than one investment product so that participants will have a reasonable choice of both products and contractors. An employer, however, may be limited to one provider if employees are allowed to transfer or exchange their interest to another 403(b) provider. An employer may also have only one contractor offering a wide variety of investment products that would give participants a reasonable choice if the employer can demonstrate that increased administrative burdens and costs would be enough to make the employer stop collecting and remitting deferral contributions to any 403(b) contractor. When the employer limits the availability of providers in a safe harbor arrangement, limitations on costs or assessments associated with an employee's ability to transfer or exchange contributions to another provider's contract or account must be fully disclosed before employees decide to participate in the plan.
Discontinuing Remitting Salary Deferrals to a Provider That Does Not Comply with the 403(B) Code Requirements *Q 17*	An employer may discontinue letting a provider from offer products to participants if it is necessary to maintain tax code compliance. Including such provisions in the plan/arrangement will not take it out of the safe harbor.
Changing 403(b) Providers and Unilaterally Moving Employee Funds From One Provider Contract to Another *Q 18*	To stay within the safe harbor an employer cannot unilaterally move employee funds from one provider to the contracts or accounts of another provider, like they can in 401(k) and qualified plans.

Reference Material

FAB 2010-1
www.dol.gov/ebsa/regs/fab2010-1.html (3 pages, 57 KB)

FAB 2009-2
http://www.dol.gov/ebsa/regs/fab2009-2.html (22 pages, 197 KB)

FAB 2007-2
http://www.dol.gov/ebsa/regs/fab2007-2.html (6 pages, 91 KB)

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V. 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

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