BACKGROUND INFORMATION RELATING TO THE INVESTMENT OF RETIREMENT PLAN ASSETS IN EMPLOYER STOCK

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JOINT COMMITTEE ON TAXATION

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INTRODUCTION

Recent events have focused public attention on issues related to the investment of qualified retirement plan assets in employer stock, including the potential effect on retirement security and the need for plan participants to understand sound investment practices. This document,[1] prepared by the staff of the Joint Committee on Taxation, provides background material relating to these issues.

This document contains the answers to frequently asked questions related to qualified retirement plans and the investment of plan assets in employer stock, data on the most common types of qualified retirement plans, and a summary of current legislative proposals.

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[1] This document may be cited as follows: Joint Committee on Taxation, *Background Information Relating to the Investment of Retirement Plan Assets in Employer Stock* (JCX-1-02), February 11, 2002.

I. QUESTIONS AND ANSWERS RELATING TO EMPLOYER-SPONSORED RETIREMENT PLANS

A. General Questions and Answers Relating to Employer-Sponsored Retirement Plans

1. Is an employer required to offer retirement plan coverage to its employees?

No, an employer is not required to offer retirement plan coverage to its employees. The employer generally decides whether to offer a retirement plan to its employees and, if it does, has the ability to set many plan terms, including the level of benefits. In the case of employees covered by a collective bargaining agreement, retirement benefits are subject to the bargaining process. Thus, the retirement plans and benefits available to employees vary from employer to employer.

2. What types of retirement plan arrangements are available to employees?

There are two broad types of retirement arrangements that an employer may provide: qualified retirement plans and nonqualified deferred compensation plans or arrangements. A qualified retirement plan is a plan that meets requirements set forth in the Internal Revenue Code of 1986 (the "Internal Revenue Code") (see Q&A A.3., below). Qualified plans are also subject to regulation under the Employee Retirement Income Security Act of 1974 ("ERISA"). In contrast to qualified plans, nonqualified plans are subject to relatively few restrictions under the Internal Revenue Code. In addition, if a nonqualified plan is limited to a select group of management or highly compensated employees, it is generally not subject to ERISA. Under ERISA, such a plan is referred to as a "top-hat" plan.

3. What is a qualified retirement plan?

A qualified retirement plan is a plan that meets requirements set forth in the Internal Revenue Code. In order to provide an incentive to employers to offer qualified plans, the Internal Revenue Code provides favorable tax treatment to such plans. If the Internal Revenue Code's qualification requirements are satisfied, the employer is entitled to a current deduction for plan contributions (within limits) and employees are not taxed on plan benefits until received.

There are two general types of qualified retirement plans, defined contribution plans and defined benefit plans.

4. What is a defined contribution plan (or individual account plan)?

A defined contribution plan is an employer-sponsored retirement plan that provides an individual account for each participant. The participant's benefits are based solely on the participant's account balance, which consists of contributions to the account and adjustments to reflect earnings and losses. Depending on the design of the plan, contributions may consist of pre-tax or after-tax employee contributions, employer matching contributions (i.e., employer contributions that are made only if an employee makes contributions to a plan), and other employer contributions. Under ERISA, a defined contribution plan is also referred to as an individual account plan.

Particular types of defined contribution plans include profit-sharing plans, stock bonus plans, employee stock ownership plans ("ESOPs") (see Q&A A.9., below), 401(k) plans (see Q&A A.10., below), and money purchase pension plans. The legal requirements applicable to each type of plan differ somewhat.

5. What is a defined benefit plan?

A defined benefit plan specifies a formula under which a participant's retirement benefits are determined, usually based on compensation and years of service. The plan does not maintain individual participant accounts or earmark plan assets for particular participants. Employer contributions to a defined benefit plan are subject to minimum funding requirements to ensure that plan assets are sufficient to pay the benefits under the plan. Defined benefit plan benefits are insured by the Pension Benefit Guaranty Corporation (see Q&A B.6., below).

6. What is a hybrid plan?

A hybrid plan is a plan that has features of both a defined benefit plan and a defined contribution plan. For example, a cash balance plan is a hybrid plan. Technically, a cash balance plan is a defined benefit plan; however, plan benefits are defined by reference to a hypothetical account balance.

7. What laws govern employer-sponsored retirement plans?

The Internal Revenue Code and ERISA both regulate qualified retirement plans. Nonqualified retirement plans or deferred compensation arrangements are not subject to the Internal Revenue Code's qualification requirements. In addition, if such plans are available only to a select group of management or highly compensated employees, they are also not subject to ERISA.

Some of the provisions of the Internal Revenue Code and ERISA applicable to qualified retirement plans are identical or very similar. For example, both the Internal Revenue Code and ERISA impose minimum participation and vesting requirements.

In addition, the Internal Revenue Code contains requirements not included in ERISA, such as nondiscrimination rules that are designed to ensure that the plan governs a broad group of employees. The Internal Revenue Code also limits the amount of contributions (including employee contributions) and benefits that can be provided under a qualified plan.

Similarly, ERISA contains provisions that are not included in the Internal Revenue Code. For example, ERISA contains basic fiduciary standards that apply to retirement plan fiduciaries.

8. How are the rules relating to qualified retirement plans enforced?

The qualification requirements under the Internal Revenue Code are enforced by the IRS. If a plan fails to meet the qualification requirements, then the favorable tax treatment for such plans may be denied; that is, the employer may lose tax deductions and employees may have current income taxation. As a practical matter, the IRS rarely disqualifies a plan. Instead, the

IRS may impose sanctions short of disqualification and require the employer to correct any violation of the qualification rules.

Certain of the Internal Revenue Code rules relating to qualified plans are enforced through an excise tax rather than through disqualification. For example, a failure to satisfy the minimum funding requirements for defined benefit plans (see Q&A A.5., above) does not result in disqualification of the plan. Instead, an excise tax is imposed on the employer.

Employees do not have a right to sue to enforce the Internal Revenue Code's requirements.

ERISA's requirements generally may be enforced through administrative actions by the Department of Labor or by lawsuits brought by plan participants, the Department of Labor, or plan fiduciaries.

9. What is an ESOP?

An ESOP (i.e., an employee stock ownership plan) is a defined contribution plan that is designated as an ESOP and is designed to invest primarily in stock of the employer. An ESOP can be an entire plan or it can be only a component of a larger defined contribution plan. ESOPs are subject to additional requirements that do not apply to other plans that hold employer stock. For example, voting rights must generally be passed through to ESOP participants, employees must generally have the right to receive benefits in the form of stock, and certain ESOP participants must be given the right to diversify a portion of their plan benefits.

In addition, certain benefits are available to ESOPs that are not available to other types of qualified plans that hold employer stock. For example, an ESOP may be "leveraged," i.e., stock held in an ESOP may be purchased with loan proceeds. In a leveraged ESOP, the ESOP typically borrows from a financial institution. The loan is typically guaranteed by the employer and the employer stock is generally pledged as security for the loan. Contributions to the plan are used to repay the loan. The employer stock is held in a suspense account and released to participants' accounts as the loan is repaid.

Special tax benefits also apply to ESOPs. For example, the employer may deduct dividends paid on stock held by an ESOP if the dividends are used to repay a loan, are distributed to plan participants, or if they are reinvested in the ESOP by plan participants.

10. What is a 401(k) plan?

A 401(k) plan technically is not a separate type of plan, but is a profit-sharing or stock bonus plan that contains a "qualified cash or deferred arrangement." Under a qualified cash or deferred arrangement, plan participants may elect to contribute a part of their current compensation, on a pre-tax basis, to the plan. Such contributions are commonly referred to as "elective contributions" or "elective deferrals." A plan that contains such an arrangement is commonly referred to as a "401(k) plan" or more simply a "K plan" after section 401(k) of the Internal Revenue Code, which governs such arrangements. The Federal Thrift Savings Plan is an example of a 401(k) plan. Special rules apply to 401(k) plans, including special nondiscrimination requirements and lower limits on the amount an employee can elect to contribute.

To encourage employees to participate in a 401(k) plan, many employers provide matching contributions. For example, a plan could provide that the employer will make matching contributions equal to 50 percent of the employees' elective contributions, up to a maximum of 3 percent of compensation. Employers are not required to offer a match. Many employers provide a match because doing so makes it easier for the plan to satisfy applicable nondiscrimination rules.

In addition to or in lieu of matching contributions, some employers make "qualified nonelective contributions" for employees participating in a 401(k) plan. Like matching contributions, such contributions may make it easier for plans to satisfy the applicable nondiscrimination rules. "Qualified nonelective contributions" are contributions that are made by the employer without regard to whether the employee makes elective contributions, that are 100 percent vested, and that meet certain other requirements.

Matching contributions and qualified nonelective contributions can be made to the same plan that contains the 401(k) cash or deferred arrangement or to another plan of the employer.

B. Questions and Answers Relating to Investment of Qualified Retirement Plan Assets

1. Who makes investment decisions with respect to qualified retirement plan assets?

ERISA requires that retirement plan documents designate who is responsible for investment of plan assets. In the case of defined benefit plans, the plan trustee or other designated fiduciary makes investment decisions, unless authority to manage the investments is delegated to one or more investment managers.

In the case of individual account plans, a plan may permit participants or beneficiaries to make investment decisions with respect to their individual accounts. It is common for 401(k) plans to provide participants with investment authority with respect to their own elective contributions.

2. What is a plan fiduciary?

ERISA generally provides that a person is a plan fiduciary to the extent the fiduciary exercises any discretionary authority or control over management of the plan or exercises authority or control over management or disposition of its assets, renders investment advice for a fee or other compensation, or has any discretionary authority or responsibility in the administration of the plan.

The employer and officers or directors of the employer are only fiduciaries of a plan to the extent they meet ERISA's definition of a plan fiduciary. Such persons often are not fiduciaries with respect to a plan because they do not have authority or exercise authority with respect to fiduciary functions.

3. What is the responsibility of a plan fiduciary with respect to investment decisions made by the fiduciary?

ERISA contains general fiduciary standards that apply to all fiduciary actions, including investment decisions made by fiduciaries. ERISA requires that a plan fiduciary must discharge its duties solely in the interests of participants and beneficiaries and:

- for the exclusive purpose of providing benefits to plan participants and beneficiaries and defraying reasonable expenses of plan administration;
- with the care, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
- by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and
- in accordance with plan documents insofar as they are consistent with ERISA.

Certain defined contribution plans are not subject to the diversification requirement or the general prudence requirement (to the extent that it requires diversification) with respect to investments in employer stock. See Q&A C.3., below.

A plan fiduciary that breaches its fiduciary duties is personally liable under ERISA to the plan for any losses resulting from such breach.

In addition, the Internal Revenue Code provides that a qualified retirement plan must prohibit the diversion of assets for purposes other than the exclusive benefit of employees and their beneficiaries (the "exclusive benefit rule"). Plan investment decisions made by plan fiduciaries may in some cases violate the exclusive benefit rule; however, not all fiduciary violations relating to plan investments are violations of the exclusive benefit rule.

4. Who is responsible for investment decisions made by plan participants?

Under a safe harbor rule, ERISA fiduciary liability does not apply to investment decisions made by plan participants if plan participants control the investment of their individual accounts. Many employers design plans to meet the safe harbor in order to minimize fiduciary responsibilities. If the safe harbor applies, a plan fiduciary may be liable for the investment alternatives made available, but not for the specific investment decisions made by participants. This includes investments in employer stock made at the direction of the participant. Failure to satisfy the safe harbor rule means that plan fiduciaries may be held liable for the investment decisions of participants. This safe harbor is commonly referred to as the "404(c) safe harbor" because it is contained in section 404(c) of ERISA.

In order for the safe harbor to apply:

- the plan must provide at least three different investment options, each of which is diversified and has materially different risk and return characteristics;
- the plan must allow participants to give investment instructions with respect to each investment option under the plan with a frequency that is appropriate in light of the reasonably expected market volatility of the investment option (the general volatility rule);
- at a minimum, participants must be allowed to give investment instructions at least every three months with respect to least three of the investment options, and those investment options must constitute a broad range of options (the three-month minimum rule);
- participants must be provided with detailed information about the investment options, information regarding fees, investment instructions and limitations, and copies of financial data and prospectuses; and
- specific requirements must be satisfied with respect to investments in employer stock to ensure that employees' buying, selling, and voting decisions are confidential and free from employer influence.

In addition, the safe harbor applies only with respect to a transaction where a participant exercises independent control in fact with respect to the assets in his or her account. Whether a participant has exercised independent control in fact with respect to a transaction depends on the facts and circumstances of the particular case. However, a participant's exercise of control is not independent in fact if:

- the participant is subjected to improper influence by a plan fiduciary or the employer with respect to the transaction;
- a plan fiduciary has concealed material nonpublic facts regarding the investment from the participant, unless the disclosure of the information by the plan fiduciary to the participant would violate other law not preempted by ERISA; or
- the participant is legally incompetent and the responsible plan fiduciary accepts the participant's instructions knowing this.

5. How often must a plan permit participants to change investment decisions?

If the ERISA 404(c) safe harbor is being relied upon, then participants must be permitted to change investment decisions in a manner consistent with that safe harbor. Unless the ERISA 404(c) safe harbor is being relied upon, there are no specific rules regarding how often a plan must permit participants to change investments.

As a practical matter, timeframes for permitting participants to change investments are determined by the plan and are often tied to the plan's administrative systems, including the frequency with which plan assets are valued. In addition, the plan will generally specify when a participant's investment directions will be executed. For example, a transfer from one investment to another may be made on the first day of the month after the month in which the participant requested the transfer.

6. Who bears the risk of investment loss in a qualified retirement plan?

In a defined benefit plan, investment risk is generally on the employer. The Internal Revenue Code and ERISA both impose minimum funding requirements on the employer with respect to defined benefit plans to help ensure that plan assets are sufficient to provide promised benefits. If the plan suffers investment losses, then the employer may be required to increase plan contributions. In addition, benefits under defined benefit plans are guaranteed (within limits) by the Pension Benefit Guaranty Corporation (the "PBGC"). In the event a plan terminates with assets insufficient to pay promised benefits, the PBGC will pay benefits up to the maximum guaranteed amount. For 2002, the maximum guaranteed benefit for an individual retiring at age 65 is $3,579.55 per month, or $42,954.60 per year.

In a defined contribution plan, the benefit the participant is entitled to is the account balance. Thus, the plan participant bears the risk of investment losses, regardless of whether investment decisions are made by the participant or a plan fiduciary. Defined contribution plans are not guaranteed by the PBGC.

7. Are there any restrictions on the type of investments that can be made with qualified retirement plan assets?

Subject to two exceptions, the Internal Revenue Code and ERISA do not contain any specific rules as to what types of investments are appropriate (or inappropriate) for retirement plan investments. Rather, ERISA's fiduciary standards govern whether investment decisions by plan fiduciaries are appropriate.

ERISA limits the amount of employer stock that can be held by certain types of plans (see Q&A C.3., below). In addition, both the Internal Revenue Code and ERISA contain prohibited transaction rules that prohibit plan fiduciaries and other persons with a close relationship to a plan from engaging in transactions with the plan. These rules are not targeted toward particular types of investments, but rather seek to prevent self-dealing transactions.

C. Questions and Answers Relating to Investment of Qualified Retirement Plan Assets in Employer Stock

1. What kinds of plans can invest in employer stock?

The assets of either a defined contribution plan or a defined benefit plan may be invested in employer stock. However, the rules relating to such investments differ for defined benefit plans and defined contribution plans.

2. What kind of employer stock can be held by a qualified retirement plan?

ERISA generally does not limit the type of employer stock that may be held by a qualified retirement plan. The Internal Revenue Code specifies the type of employer stock that may be held by an ESOP.

Under ERISA, a qualified retirement plan may hold only a "qualifying employer security." Any stock issued by the employer or an affiliate of the employer is a qualifying employer security. In the case of a defined benefit plan (and money purchase pension plans other than certain pre-ERISA plans), in order for stock to be a qualifying employer security, the plan cannot hold more than 25 percent of the aggregate amount of the issued and outstanding stock of the same class, and at least 50 percent of the aggregate amount of that stock must be held by persons independent of the issuer.

Under ERISA, qualifying employer securities also include certain publicly traded partnership interests and certain marketable obligations (i.e., a bond, debenture, note, certificate or other evidence of indebtedness).

For purposes of ESOP investments, employer stock (referred to as "employer securities" or a "qualifying employer security") is defined in the Internal Revenue Code to mean only:

(1) publicly traded common stock of the employer or a member of the same controlled group;

(2) if there is no such publicly traded common stock, common stock of the employer (or member of the same controlled group) that has both voting power and dividend rights at least as great as any other class of common stock; or

(3) noncallable preferred stock that is convertible into common stock described in (1) or (2) and that meets certain requirements. In some cases, an employer may design a class of preferred stock that meets these requirements and that is held only by the ESOP.

3. Is there any limit on the amount of employer stock that a plan can hold?

ERISA prohibits defined benefit plans (and money purchase pension plans other than pre-ERISA plans) from acquiring employer stock if, after the acquisition, more than 10 percent of the assets of the plan would be invested in employer stock.

Most defined contribution plans, such as profit-sharing plans, stock bonus plans, pre-ERISA money purchase plans, 401(k) plans and ESOPs, generally are not subject to this 10-percent limitation. Plans that are not subject to the 10-percent limitation are referred to in ERISA as "eligible individual account plans." As discussed in Q&A C.4., below, the 10-percent limitation may apply to some 401(k) plans in which participants do not have investment discretion. There is no limit on the amount that an employee can choose voluntarily to invest in employer stock in an eligible individual account plan.

4. Can employees' contributions to a section 401(k) plan be invested in employer stock without the participants' consent?

If the plan is an ESOP, then there is no limit on the amount of an employee's contributions that can be required to be invested in employer stock without the participant's consent.

If the plan is not an ESOP and the plan provides for investment in employer stock other than by participant choice, then the 10-percent limit on investment of plan assets in employer stock applies to employee contributions (and earnings) as if they were a separate plan. That is, the portion of such a plan that consists of employee elective 401(k) contributions (and earnings) is subject to the 10-percent limitation.

This restriction does not apply if: (1) the amount of 401(k) contributions required to be invested in employer stock does not exceed more than one percent of any employee's compensation; (2) the fair market value of all individual account plans maintained by the employer is no more than 10 percent of the fair market value of all retirement plans of the employer; or (3) as noted above, the plan is an ESOP.

5. Can a plan require that certain assets be invested in employer securities with no opportunity to change investments?

A plan can generally require that some or all plan contributions must be invested in employer stock, with no opportunity to change investments, and some plans do. For example, an ESOP, by its nature, is designed to invest primarily in employer stock. Many 401(k) plans provide that the employer match is invested in employer stock. Some plans do not allow participants to elect an investment option other than employer stock. Such a plan feature is sometimes referred to as a "lockdown."

In the case of an ESOP, the Internal Revenue Code imposes a diversification requirement under which an ESOP participant who is age 55 and has 10 years of plan participation must be permitted to diversify the investment of the participant's account. The participant must be given a period each year for six years in which to diversify up to 25 percent (or 50 percent in the last year) of the participant's account, reduced by the portion of the account diversified in prior years. As an alternative to providing diversified investment options in the plan, the plan can provide for the portion of the participant's account that is subject to the diversification requirement to be distributed to the participant.

This requirement does not apply to plans other than ESOPs. Thus, for example, suppose an ESOP provides that the employer will match employees' 401(k) contributions and that the match will be invested solely in employer securities. The plan may, but is not required to, provide diversification opportunities.

II. DATA RELATING TO QUALIFIED RETIREMENT PLANS

1. What percentage of the labor force participates in an employer-sponsored qualified retirement plan?

The recent U.S. Department of Labor National Compensation Survey found that in 1999, 48 percent of private sector employees participated in employer-sponsored qualified retirement plans. The survey found that, among full-time employees, participation was 56 percent. Participation rates are higher among public sector employees. The Bureau of Census's Current Population Survey found that, in 1997, 87 percent of State and local government employees and 88 percent of Federal government employees participated in an employer-sponsored retirement plan.

2. What percentage of the private labor force participates in defined contribution plans and what percentage of the labor force participates in defined benefit plans?

The National Compensation Survey found that, in 1999, among full-time employees in the private sector, 42 percent participated in an employer-sponsored defined contribution plan and 25 percent participated in an employer-sponsored defined benefit plan. Some employees participated in both.

3. Is participation in employer-sponsored qualified retirement plans roughly the same across different sectors of the economy?

No. Participation varies with firm size and industry. Figure 1 and Figure 2 below present some of the findings of the 1999 National Compensation Survey and some of the variability of employee participation in employer-sponsored qualified retirement plans by industry and firm size.

Figure 1

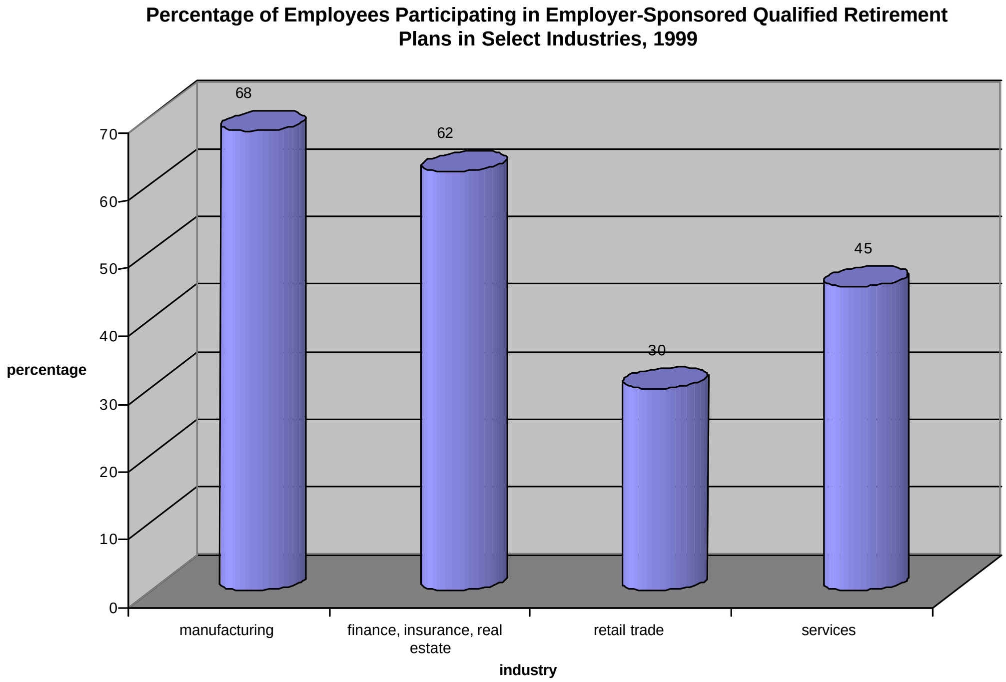
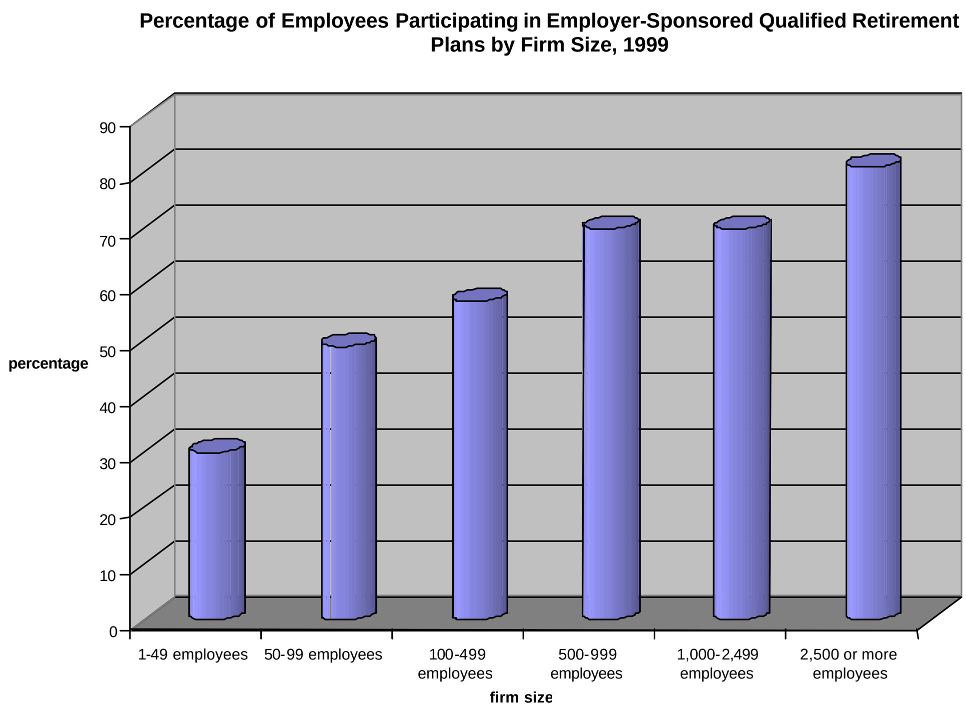


Figure 2



Source: Bureau of Labor Statistics, National Compensation Survey, "Employee Benefits in Private Industry, 1999."

4. What percentage of private sector workers participating in a qualified retirement plan are only in a defined contribution plan?

In 1997, about 54 percent of workers in the private sector who participated in a qualified retirement plan were covered only by a defined contribution plan, 32 percent were covered by both a defined benefit plan and a defined contribution plan, and 14 percent were covered only by a defined benefit plan.

5. What percentage of 401(k) enrollees worked for private firms sponsoring only 401(k) plans?

In 1997, an estimated 49 percent of private sector 401(k) enrollees worked for private firms sponsoring only 401(k) plans, an increase from 46 percent in 1996 and 44 percent in 1995.

6. How have the types of qualified retirement plans that private sector employees participate in changed over time?

Figures 3 through 6 below provide a historical perspective on the growth of private sector defined contribution plans, particularly 401(k) plans, relative to defined benefit plans. The data presented in these figures are from data based on Form 5500 filings. As illustrated in the figures below, the number of defined contribution plans and active participants in those plans have increased over time, while the number of defined benefit plans and active participants in those plans has decreased. Further, the growth in defined contribution plans resulted from a large increase in 401(k) plans and participants, which offset a decrease in the number of non-401(k) defined contribution plans and participants that occurred over much of this period.

Figure 3

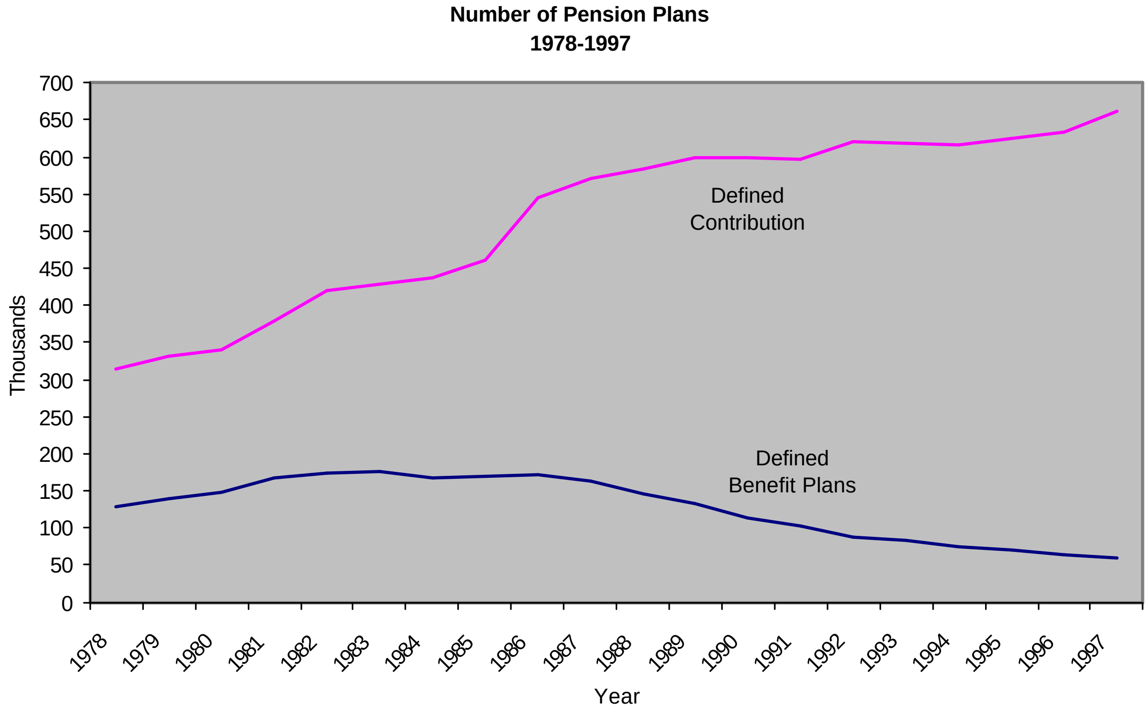


Figure 4

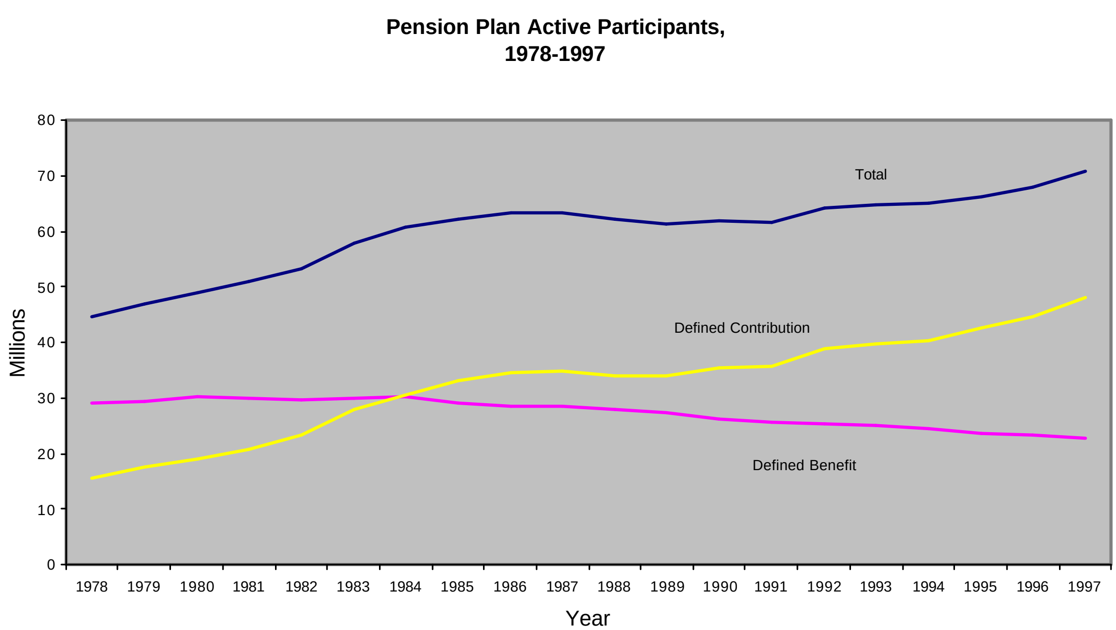


Figure 5

Number of Defined Contribution Plans
1984-1997

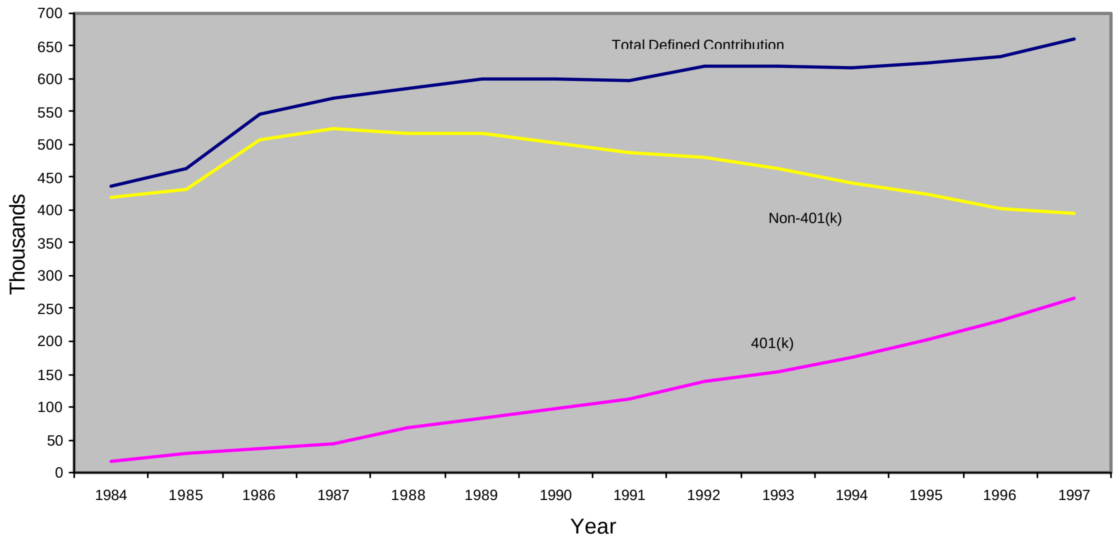
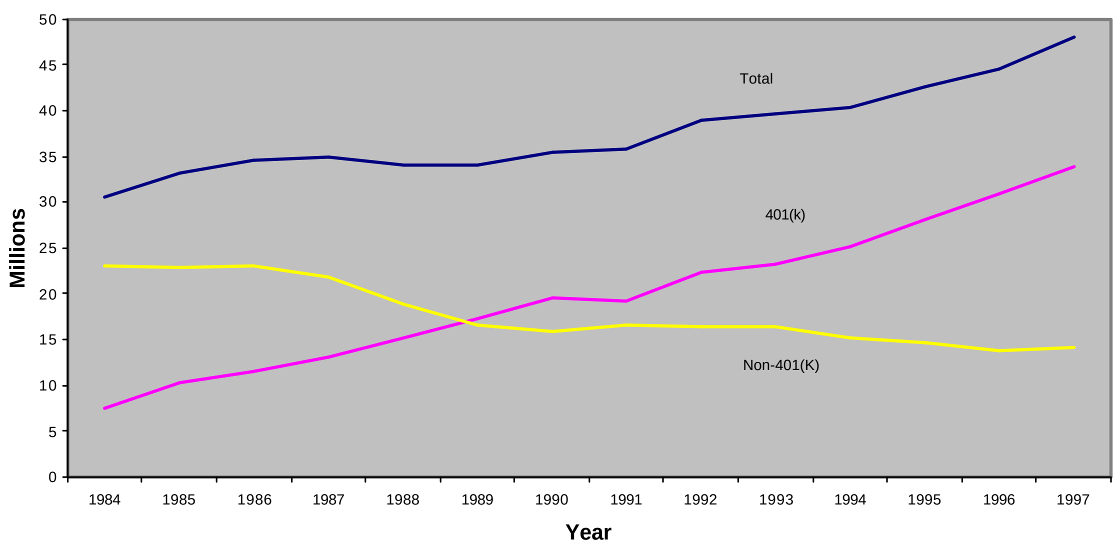


Figure 6

Active Participants in Defined Contribution Plans
1984-1997



Source for Figures 3 through 6: United States Department of Labor, Pension and Welfare Benefits Administration. Abstract of 1997 Form 5500 Annual Reports. Private Pension Plan Bulletin No. 10, Winter 2001.

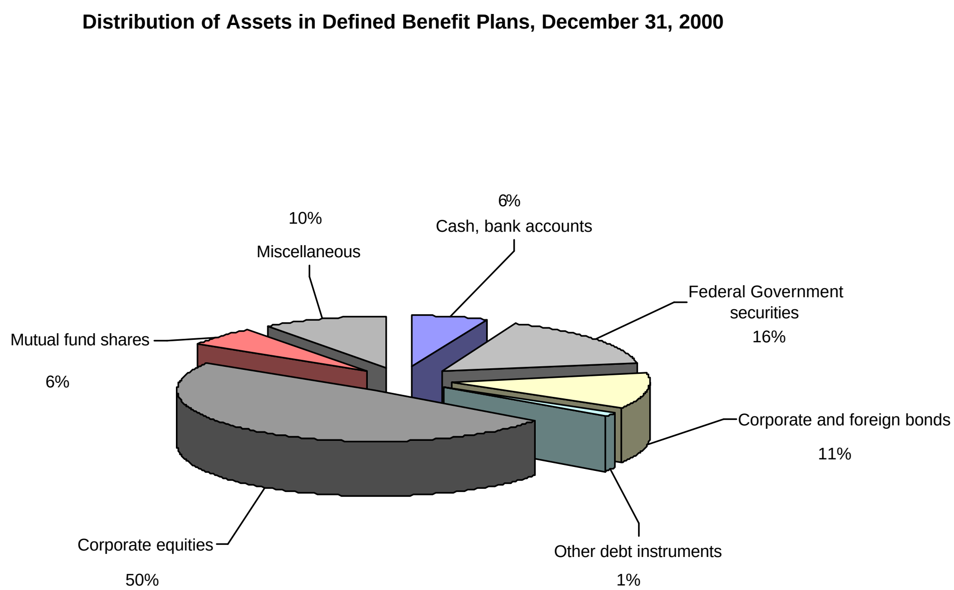
7. How much money is held in employer-sponsored qualified retirement plans?

As of December 31, 2000, data from the Federal Reserve Board of Governors showed that defined benefit plans held assets valued at $2.06 trillion and defined contribution plans held assets valued at $2.53 trillion. In addition, individuals held assets valued at $2.65 trillion in IRAs and Keogh accounts (i.e., qualified retirement plans for self-employed individuals).[2]

8. How are qualified retirement plan assets invested?

Figure 7 and Figure 8 below present estimates of the Federal Reserve Board of Governors of the distribution of defined benefit plan and defined contribution plan assets among different types of investments as of December 31, 2000.

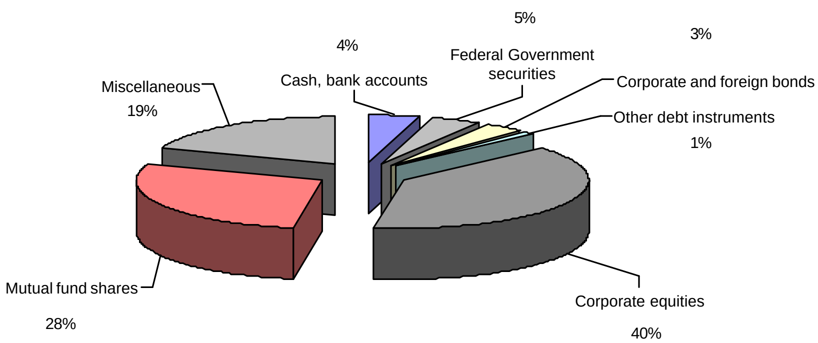
Figure 7



[2] Board of Governors, United States Federal Reserve System, *Flow of Funds,* December 7, 2001.

Figure 8

Distribution of Assets in Defined Contribution Plans, December 31, 2000



Source for Figures 7 and 8: Board of Governors, Federal Reserve System, *Flow of Funds*, December 7, 2001.

III. SUMMARY OF LEGISLATIVE PROPOSALS RELATING TO INVESTMENT OF DEFINED CONTRIBUTION PLAN ASSETS IN EMPLOYER STOCK

A. Proposals Relating to the Investment of Retirement Plan Assets

1. The Administration's Proposal[3]

- The proposal would permit 401(k) plan participants to sell employer stock and diversify into other investments after three years of plan participation.
- The proposal would require participants to be provided with quarterly benefit statements about their individual accounts.
- The proposal would require that participants be given 30 days notice before a blackout period begins. A "blackout period" would be a period when participants cannot control the investment of their individual accounts because of administrative changes, such as a change in plan features or plan administrator.
- The safe harbor that relieves a fiduciary from liability for investment decisions made by participants would not apply during a blackout period.
- The proposal would preclude company executives from selling their stock during a blackout period.
- The proposal would encourage employers to make investment advice available to participants and allow financial advisors to offer investment advice if agreeing to act solely in the interests of the participants.[4]

2. H.R. 3463, the Pension Protection Act (Rep. Deutsch and others)

- The bill would amend the definition of a qualified cash-or-deferred arrangement under section 401(k) of the Internal Revenue Code to add requirements related to the acquisition, holding, and divestment of employer stock.
- Employee contributions under a 401(k) plan could not be used to acquire employer stock if the acquisition would cause more than 10 percent of the fair market value of the portion of a participant's account attributable to employee contributions to consist of employer stock.
- The fair market value of employer stock held in a participant's account as of December 31 of any year could not exceed 10 percent of the fair market value of the portion of the account attributable to employee contributions.
- A participant would have to be permitted to direct the plan to divest the participant's account of employer stock that had been in the account for three years.

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[3] A detailed description of the Administration's proposal has not yet been released.

[4] The Administration has expressed support for H.R. 2269, the Retirement Security Advice Act of 2001, discussed below.

- These requirements would apply to plans on and after the date of enactment; however, employer stock held by a plan on the date of enactment would not be subject to the holding requirement.

3. H.R. 3509, the Retirement Account Protection Account of 2001 (Rep. Bentsen)

- The bill would amend the fiduciary duty provisions of ERISA to impose restrictions on "lockdowns." Accordingly, failure to comply with the lockdown requirements would be a violation of the ERISA fiduciary duty rules.
- A "lockdown" would mean any suspension of a participant's ability to transfer the participant's vested account balance out of employer stock to another investment available under the plan, but would not include a permanent limitation that applies to employer contributions invested in employer stock or a reasonable restriction on the frequency on transfers as permitted under regulations.
- A lockdown could not be imposed with respect to a participant's vested account balance unless an exemption were obtained from the Secretary of Labor and participants were given at least 60 days advance notice.
- Various notice and other procedural requirements would apply to the exemption process.
- If a plan failed to provide for compliance with the lockdown requirements, plan assets invested in employer stock would be subject to the ERISA requirements of diversification and prudence that apply to investments generally (that is, the exception to these requirements for investment in employer stock would not apply).
- The bill would also require the Secretary of Labor, in consultation with the Secretary of the Treasury and the Securities and Exchange Commission, to undertake a study relating to the investment of defined contribution plan assets in employer stock, to be submitted to Congress within 180 days after the date of enactment.
- The provisions of the bill would be effective generally for plan years beginning on or after January 1, 2002, with a delayed effective date for plans maintained pursuant to a collective bargaining agreement. A plan would not have to be amended before January 1, 2004, to comply with the bill, provided it is operated in accordance with the bill and is amended retroactively to the effective date.

4. H.R. 3622, the Emergency Worker and Investor Protection Act of 2002 (Rep. Rangel and others)

- The bill would apply the 20-percent excise tax on golden parachute payments to any amount realized by a corporate insider (within the meaning of securities laws) from a sale or exchange of stock that occurs while the corporation (or any other entity consolidated with the corporation for securities reporting purposes) maintains a "transfer-restricted 401(k) plan."
- A "transfer-restricted 401(k) plan" would mean, with respect to any period, a qualified cash-or-deferred arrangement if, during the period, any participant is not able freely to sell employer stock that is held in the participant's account and that is attributable to employee contributions, employer contributions, or earnings.

- The provision would apply to sales or exchanges of stock that occur during the six-month period beginning on the date of enactment.
- Another provision of the bill (unrelated to retirement plans) would amend the deduction rules of the Internal Revenue Code to deny a deduction for payments on certain corporate debt instruments, effective for debt instruments issued after the date of enactment.

5. H.R. 3623, the Employee Savings Protection Act of 2002 (Rep. Bentsen)

- The bill would provide that certain knowing misrepresentations by a fiduciary of a plan that included a qualified cash or deferred arrangement would constitute a breach of fiduciary duty under ERISA, and that the safe harbor that relieves a fiduciary from liability for investment decisions made by participants would not apply if such misrepresentations were made.
- The provision would apply to a knowing misrepresentation relating to the present or expected value of employer stock (1) that were made at a time reasonably contemporaneous with a period when a participant makes investment decisions with respect to his or her account or (2) that could be reasonably perceived as likely to induce investment decisions by a participant with respect to his or her account.
- The provision would apply to misrepresentations made on or after January 1, 2000.
- The bill would also amend the rules for priority claims under the Bankruptcy Code to add a priority for unsecured claims based on the knowing misrepresentation provision of ERISA, effective for bankruptcy cases commenced on or after January 1, 2000.

6. H.R. 3640, the Pension Protection and Diversification Act of 2002 (Rep. Pascrell)

- The provisions of H.R. 3640 are similar to the provisions of S. 1838, described below.

7. H.R. 3642, the 401(k) Pension Right to Know Act of 2002 (Rep. Bonior)

- The bill would amend the fiduciary duty provisions of ERISA to require an employer sponsoring a 401(k) plan to provide semiannual written notice to participants regarding the financial health of the employer and advising participants of the importance of diversifying the investment of their accounts and the risk of holding securities of any one entity, including employer stock.
- A failure to satisfy these requirements would be treated as a failure to fulfill ERISA fiduciary duties and the safe harbor that relieves a fiduciary from liability for investment decisions made by participants would not apply.
- The bill would require the first written notice pursuant to the bill to be issued within 30 days of the first day of the first plan year beginning after 60 days after the date of enactment.

8. H.R. 3657, the Employee Pension Freedom Act of 2002 (Rep. George Miller and others)

Benefit statements

- The bill would amend the reporting provisions of ERISA to require the administrator of a plan to provide periodic benefit statements and other information to plan participants.
- In the case of a single-employer plan, benefit statements would have to be provided at least every three years to defined benefit plan participants age 35 or older and at least annually to defined contribution plan participants. In the case of a multiemployer plan, a benefit statement would have to be provided at the request of a participant, but not more frequently than annually.
- The Secretary of Labor would be required to develop a model benefit statement that would provide certain information, including information about the investment of plan assets.
- In the case of a benefit distribution from a plan, on written request of the participant, the plan administrator would have to provide a worksheet explaining the calculation of the benefit amount, any documents relating to the calculation, and other information as prescribed by the Secretary. The information would be required to be provided in a form expected to be understood by the average participant.

Participant-directed investments

- Several provisions of the bill would amend the fiduciary duty provisions of ERISA to add new requirements related to participants' right to direct investments under a defined contribution plan.
- The employer and plan administrator would have a fiduciary duty to ensure that, in connection with investments made at the direction of the participant, each participant were provided with all material information that would generally be required to be disclosed by the employer to investors under securities laws. The provision of misleading information by the employer or plan administrator would be a violation of this requirement. Failure to comply with this requirement could make the employer or plan administrator subject to a civil penalty.
- The plan would be required to provide that a participant had the right to allocate the vested portion of his or her account balance that consisted of publicly-traded employer securities to any investment option under the plan. Application of a penalty or restriction based on age or service in connection with the exercise of this right generally would be a violation of this requirement. However, in the case of matching contributions under an ESOP, this right could be limited to participants with 10 years of plan participation.
- The provision would not prevent a plan from imposing a limit on what portion of a participant's account could be invested in employer securities.
- The plan administrator would be required to make the allocation to a different investment within 30 days of the participant's election or, if the plan provided for elections during prescribed periods, within 30 days of the end of the period. In addition, at least 30 days before a participant became vested (or completed 10 years

of participation in the case of an ESOP), the plan administrator would be required to notify the participant of the right to diversify the investment of his or her account and the importance of diversification.

- The Secretary of Labor would be required within a year of enactment to recommend legislative changes with respect to defined contribution plans under which participants could direct the investment of assets in their accounts and the assets in the account did not include publicly-traded employer securities.
- The bill would also impose restrictions on “lockdowns.” A “lockdown” would mean a temporary freeze or suspension of a participant’s ability to direct the investment of the assets in his or her account as otherwise generally provided under the plan. A lockdown could not take effect until at least 30 days written notice were provided to participants and could not continue for more than 10 consecutive business days. Subject to regulations, an exception would be provided in the case of an emergency.

<u>Vesting of employer contributions</u>

- The bill would amend the vesting provisions under ERISA for defined contribution plans so that the portion of a participant’s account balance attributable to employer contributions would be vested after one year of service.

<u>Other changes</u>

- The trust requirements under ERISA would be amended to provide that, in the case of a single-employer defined contribution plan that included employee contributions, at the request of a majority of the plan participants, the assets of the plan would be required to be held in trust by a board that included trustees representing on an equal basis the interests of the employer and the interests of the participants (with a neutral party as a tie breaker). The provision would include rules for the designation or selection of the trustees to represent participants’ interests.
- The bonding provision of ERISA would be amended to require that each fiduciary of a defined contribution plan be bonded or insured in an amount sufficient to cover financial losses due to any failure to satisfy the fiduciary requirements under ERISA.
- Fiduciary liability under ERISA would be extended to any person who, with notice of the facts constituting a breach of fiduciary duty by a plan fiduciary, participated in or undertook to conceal the breach. In addition, any person liable for a breach of fiduciary duty would be liable to plan participants directly.
- The civil enforcement provision of ERISA would be amended to expand the types of relief available in an action brought by a plan participant or fiduciary or the Secretary of Labor and to prevent the waiver of ERISA rights.
- A new Office of Pension Participant Advocacy would be established in the Department of Labor to handle issues and provide reports on retirement plans and plan participants.
- The Pension Benefit Guaranty Corporation would be required to undertake a study relating to the establishment of an insurance system for defined contribution plans and to report thereon within three years.

Effective date

- The provisions of the bill would be effective generally for plan years beginning on or after January 1, 2003, with a delayed effective date for plans maintained pursuant to a collective bargaining agreement. A plan could be amended retroactively to comply with the bill, provided it is operated in accordance with the bill as of the effective date and the amendment is retroactive to the effective date.

9. H.R. 3669, the Employee Retirement Savings Bill of Rights (Reps. Portman and Cardin)

Diversification requirement

- The bill would add a new diversification requirement under the Internal Revenue Code for qualified defined contribution plans holding publicly-traded employer stock.
- Under the diversification requirement, a participant could elect at least quarterly to have a certain percentage of the portion of his or her account attributable to elective deferrals transferred from employer stock and reinvested in any of at least three other investment options. The percentage would generally be phased in as follows: 20 percent for 2003, 40 percent for 2004, 60 percent for 2005, 80 percent for 2006, and 100 percent for 2007 and thereafter.
- A similar diversification requirement would apply with respect to the portion of a participant's account attributable to employer contributions invested in employer stock if the participant had at least five years of service (or three years of service in the case of employer matching contributions).
- The diversification requirement applicable to ESOPs under present law would not apply with respect to publicly traded employer stock. However, the diversification percentages under the new requirement would be coordinated the percentages applicable under present law.
- The definition of an ESOP would be amended to provide that a plan would not fail to be treated as an ESOP merely because the plan provided for the new diversification rights (or greater rights) or because participants exercised such rights.
- The new requirement would apply to plan years beginning after December 31, 2002, with an exception for certain grandfathered ESOPs.

Notice of investment principles

- The bill would amend the Internal Revenue Code to apply a new investment notice requirement in the case of a qualified retirement plan or annuity, a tax-sheltered annuity, a simplified employee pension, a SIMPLE plan, or an eligible deferred compensation plan of a governmental employer that permitted participants to direct the investment of their accounts or under which benefits depended on hypothetical investments directed by participants.
- On enrollment in the plan and at least annually thereafter, participants would have to be provided with written notice of generally accepted investment principles, including principles of risk management and diversification.
- The notice would be required to be written in a manner expected to be understood by the average participant and could be provided electronically. The Secretary of the

Treasury, in consultation with the Secretary of Labor, would be required to issue a model notice.

- The employer (or the plan in the case of a multiemployer plan) would be subject to an excise tax of $100 for a failure to provide the notice to an individual unless reasonable diligence to meet the notice requirement were exercised and notice were provided within 30 days of when the failure was discovered.
- The excise tax would be subject to an overall annual limitation of $500,000 if reasonable diligence to meet the notice requirement were exercised. The excise tax could also be waived if the failure were due to reasonable cause.
- The new requirement would be effective 60 days after the adoption of rules or other guidance (including the model notice) to implement the notice requirement. Such rules or other guidance would be required to be issued within 120 days after the date of enactment.

<u>Notice of transaction restriction periods</u>

- The bill would amend the Internal Revenue Code to apply another new notice requirement in the case of a qualified retirement plan or annuity, a tax-sheltered annuity, or an eligible deferred compensation plan of a governmental employer that maintained accounts for participants or under which benefits depended on hypothetical investments directed by participants.
- At least 21 days before the beginning of a "transaction restriction period," written notice of the transaction restriction period, and the effect thereof, would have to be provided to participants to whom the transaction restriction period applied, as well as any employee organization representing them. In the case of a transaction restriction period in connection with the disposition of substantially all of the stock of a subsidiary or the assets of a trade or business, notice generally would be required at least 21 days before the disposition.
- The notice would be required to be written in a manner expected to be understood by the average participant and could be provided electronically.
- A "transaction restriction period" would mean a temporary or indefinite period of at least three consecutive business days during which an individual's right to direct investments or obtains loans or distributions from the plan were substantially reduced. For this purpose, rights would be treated as substantially reduced with respect to directing investments out of employer stock if rights were significantly restricted for at least three consecutive business days.
- The employer (or the plan in the case of a multiemployer plan) would be subject to an excise tax of $100 for a failure to provide the notice to an individual unless reasonable diligence to meet the notice requirement were exercised and notice were provided as soon as reasonably practicable after the failure was discovered.
- The excise tax would be subject to an overall annual limitation of $500,000 if reasonable diligence to meet the notice requirements were exercised. The excise tax could also be waived if the failure were due to reasonable cause.
- The new requirement would apply to transaction restriction periods beginning after 60 days after the issuance of guidance to implement the notice requirement. Such guidance would be required to be issued within 60 days after the date of enactment.

Qualified retirement planning services

- The bill would expand the present-law exclusion for employer-provided qualified retirement planning services to allow employees to choose whether to receive qualified retirement planning services or other taxable compensation.
- The exclusion would be available to highly compensated employees only if a choice were available on substantially the same terms to all employees normally provided education and information on the qualified employer plan.
- The expanded exclusion would apply to years beginning after December 31, 2002.

10. H.R. 3677, the Safeguarding America's Retirement Act of 2002 (Rep. English)

- The bill would amend the ERISA provisions relating to investments in employer stock or real property to add new rules relating to the investment of 401(k) plan assets in employer stock.
- Assets attributable to employee contributions could be invested in employer stock only to the extent elected by the participant.
- In the case of a participant with less than three years of plan participation, no more than 20 percent of the participant's account attributable to employee contributions could be invested in employer stock.
- In the case of a participant with three or more years of plan participation, no more than 20 percent of the participant's entire vested account could be invested in employer stock.
- If any portion of a participant's vested account attributable to employee contributions were invested in employer stock, the participant would have to be given the opportunity at least quarterly to direct a transfer to another investment option.
- No "lockdown" could be imposed with respect to a participant's vested benefit. A "lockdown" would mean any temporary lockdown, blackout, freeze, suspension, or similar limitation on an opportunity otherwise generally available to a participant under the plan to transfer any of his or her vested account from investment in employer stock to another investment option under the plan. Lockdown would not include any reasonable restriction on the frequency of transfers between investment options.
- The bill would amend the enforcement provisions of ERISA to add criminal and civil penalties for violations of these requirements.
- The provisions of the bill would be effective generally for plan years beginning on or after January 1, 2003, with a delayed effective date for plans maintained pursuant to a collective bargaining agreement. A plan would not have to be amended before January 1, 2005, to comply with the bill, provided it is operated in accordance with the bill and is amended retroactively to the effective date.

11. H.R. 3692, the Pension Protection and Diversification Act of 2002 (Rep. Jackson-Lee)

- The provisions of H.R. 3692 are similar to the provisions of S. 1838, described below.

12. S. 1838, the Pension Protection and Diversification Act of 2001 (Sens. Boxer and Corzine)

Investment in employer stock or real property

- The bill would amend the ERISA provisions relating to investments in employer stock or real property to add requirements related to the acquisition, holding, and divestment of employer stock or real property in a defined contribution plan, other than an ESOP.
- The plan could not acquire employer stock or real property if the acquisition would cause more than 20 percent of the fair market value of a participant's account to consist of employer stock and real property.
- The fair market value of employer stock and real property held in a participant's account as of the last day of any calendar quarter could not exceed 20 percent of the fair market value of the account. Stock and real property allocated to the participant's account before the effective date would not cause the holding requirement to be violated.
- A fully vested participant would have to be permitted to direct the plan to divest the participant's account of employer stock or real property that had been in the participant's account for 90 days and reinvest an equivalent amount in other assets.
- Regulations would provide for notice to a participant if employer stock or real property had to be sold to comply with the holding requirement and for a reasonable period in which to sell employer stock or real property to comply with the holding or divestment requirement. Regulations could also waive the holding requirement where market fluctuation caused the value of employer stock or real property to exceed 20 percent of the account balance by only a de minimis amount.
- Failure to meet the acquisition, holding, or divestment requirement would mean that the plan could not acquire employer stock or real property if the acquisition would cause more than 10 percent of the fair market value of the plan's assets to consist of employer stock. This restriction would apply to the plan's assets as a whole rather than the assets in individual participants' accounts.

ESOP diversification requirements

- The present-law diversification requirements under the Internal Revenue Code would apply to any ESOP participant who were at least age 35 and had at least 5 years of plan participation.
- If the plan provided for distributions as an alternative to diversified investments, a distribution to a participant under age 55 would have to be made by direct rollover to another retirement plan or account.

Deductions

- In the case of employer matching contributions made to a defined contribution plan (other than an ESOP) in the form of employer stock, the employer's deduction would be limited to 50 percent of the amount that would otherwise be allowable.

Effective date

- The provisions of the bill would apply to years beginning on or after December 31, 2002, with a delayed effective date for plans maintained pursuant to a collective bargaining agreement.

13. S. 1919, the Retirement Security Protection Act of 2002 (Sen. Wellstone)

Investment in employer stock or real property

- The bill would amend the ERISA provisions relating to investments in employer stock or real property to add new requirements related to such investments by an "applicable individual account plan."
- An "applicable individual account plan" would mean a defined contribution plan, other than a multiemployer plan or an ESOP that (1) is maintained by an employer that has not issued any publicly traded stock or (2) holds employer stock that possesses more than 50 percent of the voting rights of all classes of employer stock or 50 percent of the value of all classes of employer stock.
- An applicable individual account plan could not acquire employer stock or real property after December 31, 2003, if the acquisition would cause a participant's "employer asset percentage" to exceed 20 percent. In addition, if, as of December 31, 2003, a participant's employer asset percentage exceeded 20 percent, the participant would have to reallocate assets to the extent needed to reduce his or her employer asset percentage to 20 percent or less by December 31, 2007.
- A participant's "employer asset percentage" would mean the ratio of (1) the fair market value of all employer stock or real property in the participant's accounts under all applicable individual account plans maintained by the employer, to (2) the sum of the fair market value of all assets in the participant's accounts under all applicable individual account plans maintained by the employer plus the present value of the participant's accrued benefits under all defined benefit plans maintained by the employer. A participant's employer asset percentage would be determined each time the assets in a participant's account were valued and at least annually.
- An exception to the 20-percent limitation would generally apply if the applicable individual account plan did not exceed the "employer asset limitation."
- Under the "employer asset limitation," the ratio of (1) the fair market value of all employer stock and real property held by all applicable individual account plans maintained by the employer, to (2) the fair market value of all assets held by all applicable individual account plans and all defined benefit plans maintained by the employer could not exceed 15 percent. For this purpose, only plans covering the same or substantially all of the same employees or group of employees as the applicable individual account plan could be taken into account.
- Regulations would provide for a reasonable period in which to sell employer stock or real property to comply with these requirements. Regulations could also waive these requirements or provide an extension of time for compliance if a failure to comply were inadvertent or attributable to a merger or acquisition or were otherwise appropriate.

- Failure to meet these requirements would mean that an applicable individual account plan could not acquire employer stock or real property if the acquisition would cause more than 10 percent of the fair market value of the plan's assets to consist of employer stock or real property.
- The bill would also require the Secretary of Labor, jointly with the Secretary of the Treasury, to undertake a study as to the application of these requirements to ESOPs that provide only for employer nonelective contributions.
- The bill would also amend the fiduciary duty provisions of ERISA to prohibit a defined contribution plan from requiring that a participant invest his or her contributions (including elective deferrals) in employer stock or real property.

Participant-directed investments

- Several provisions of the bill would amend the fiduciary duty provisions of ERISA to add new requirements related to participants' right to direct investments under a defined contribution plan.
- The employer and plan administrator would have a fiduciary duty to ensure that, in connection with investments made at the direction of the participant, each participant were provided with all material information that would generally be required to be disclosed by the employer to investors under securities laws. The provision of misleading information by the employer or plan administrator would be a violation of this requirement. Failure to comply with this requirement could make the employer or plan administrator subject to a civil penalty.
- The plan would be required to provide that, after one year of service (or 10 years of participation in the case of nonelective employer contributions to an ESOP), a participant has the right to reinvest any employer contribution of employer stock or real property in any other investment option under the plan. This requirement would apply only if the employer had issued publicly traded stock.
- The plan administrator would be required to effectuate any reinvestment of employer contributions elected by a participant within 30 days or, if the plan provided for elections during prescribed periods, within 30 days of the end of the period. In addition, at least 30 days before a participant completed one year of service (or 10 years of participation in the case of nonelective employer contributions to an ESOP), the plan administrator would be required to notify the participant of the right to reinvest the employer contributions and the importance of diversification.
- An ESOP would not be treated as failing any requirement to maintain a minimum percentage of its assets in employer stock solely by reason of a participant's election to reinvest employer stock in other assets.
- The Secretary of Labor would be required within a year of enactment to recommend legislative changes with respect to defined contribution plans under which participants may direct the investment of assets in their accounts and the assets in the account include employer stock that is not publicly traded.
- The bill would also impose restrictions on "lockdowns" in the case of a defined contribution plan that provided for investment in employer stock or real property. A "lockdown" would mean a temporary freeze or suspension of a participant's ability to

direct the investment of the assets in his or her account as otherwise generally provided under the plan.

- A lockdown could not be take effect until at least 30 days written notice were provided to participants and could not continue for more than 10 consecutive business days. Subject to regulations, an exception would be provided in the case of an emergency.
- In addition, a plan fiduciary that breached its fiduciary duty in the implementation of a lockdown would be liable for any loss resulting from a participant's inability to exercise control over employer stock or real property in his or her account by reason of the lockdown.
- The bill would also amend ERISA to prohibit directors, officers, and principal stockholders of the employer from selling employer stock during a lockdown period.

<u>Other changes</u>

- The annual reporting provisions of ERISA would be amended to provide that a public accountant examining a plan's financial records and statements would not be treated as independent if the accountant (or the accountant's firm) were employed by or performed compensated services for the employer maintaining the plan.
- The fiduciary liability and enforcement provisions of ERISA would be amended to expand the types of relief available in an action brought by a plan participant or fiduciary or the Secretary of Labor, to prevent the waiver of ERISA rights, and to provide additional protections against interference with participants' rights.
- The bill also contains provisions relating to the following, which are similar to the provisions of H.R. 3657, described above: (1) a requirement that participants be provided with periodic benefit statements, (2) a requirement that the board of trustees represent the interests of the employer and participants on an equal basis, (3) new bonding and insurance requirements, (4) new fiduciary liability for any person involved in the concealment of a breach of fiduciary duty, (5) the establishment of a new Office of Pension Participant Advocacy in the Department of Labor, and (6) a study by the Pension Benefit Guaranty Corporation relating to the establishment of an insurance system for defined contribution plans.

<u>Effective date</u>

- The provisions of the bill would be effective generally for plan years beginning on or after January 1, 2003, with a delayed effective date for plans maintained pursuant to a collective bargaining agreement. A plan could be amended retroactively to comply with the bill, provided it is operated in accordance with the bill as of the effective date and the amendment is retroactive to the effective date.

14. S. 1921, the Pension Plan Protection Act (Sens. Hutchison, Lott, and Craig)

Diversification requirement for applicable defined contribution plans

- The bill would amend the Internal Revenue Code to add new qualification requirements relating to diversification of assets in the case of an "applicable defined contribution plan."
- An "applicable defined contribution plan" would mean a defined contribution plan, other than an ESOP that provided only for employer nonelective contributions. (The ESOP diversification requirements under present law would no longer apply to an ESOP that is an applicable defined contribution plan.)
- The plan would have to provide participants with at least four different investment options, including three that do not involve employer stock or real property.
- The plan would have to provide that no employee contributions (including elective deferrals) could be required to be invested in employer stock or employer real property.
- A fully vested participant would have to be permitted to direct the plan to divest the participant's account of employer stock or real property that had been in the participant's account for 90 days and reinvest an equivalent amount in other assets. Regulations would provide for a reasonable period in which to sell employer stock or real property to comply with this requirement.
- The bill would amend the fiduciary duty provisions of ERISA to add similar requirements.

Benefit statements

- The plan administrator of an applicable defined contribution plan would be required to provide quarterly statements to participants about their accounts, including the fair market value of the assets in each investment option and the percentage of the account invested in each option. Regulations could provide an exception for plans with fewer than 100 participants.
- If more than 25 percent of the fair market value of a participant's account consisted of employer stock, the plan administrator would have to provide a separate notice of that percentage and a reminder of the need for diversification and a recommendation that the participant seek investment advice.
- The notices would be required to be written in a manner expected to be understood by the average plan participant.
- The employer (or the plan in the case of a multiemployer plan) would be subject to an excise tax in the case of a failure to provide the required benefit statements. In general, the excise tax would be $100 a day (subject to an overall limitation) until the notice were provided or the failure otherwise corrected.
- The bill would amend the provisions of ERISA dealing with the furnishing of information to participants to add similar requirements for quarterly benefit statements.

Blackouts

- A “blackout” would mean any temporary blackout, lockdown, suspension, or similar limitation within the control of the employer or the plan administrator with respect to a participant’s ability to transfer any of his or her vested benefit from investment in employer stock to another investment option under the plan. A blackout would not include any permanent limitation that applied only to benefits attributable to employer contributions or any reasonable restriction on the frequency of transfers between investment options.
- An applicable defined contribution plan would be required to provide that a blackout could not take effect until at least 30 days written notice had been provided to participants.
- The employer (or the plan in the case of a multiemployer plan) would be subject to an excise tax in the case of a failure to provide the required blackout notice. In general, the excise tax would be $100 a day (subject to an overall limitation) until the notice were provided or the failure otherwise corrected.
- The bill would also amend the fiduciary duty provisions of ERISA to apply similar blackout restrictions. In addition, a plan fiduciary that breached its fiduciary duty with respect to the imposition of a blackout or a participant’s ability to exercise control over assets during the blackout would be liable for any loss during the blackout from the investment of the participant’s assets in employer stock or real property.
- The bill would also amend the Securities Exchange Act to prohibit a beneficial owner, director or officer of the employer from selling employer stock during a blackout period.

Other provisions

- The bill also contains investment advice provisions similar to those contained in H.R. 2269, described below.
- The bill would also require the Secretary of Labor, in consultation with the Secretary of the Treasury and the Securities and Exchange Commission, to undertake a study relating to the investment of defined contribution plan assets in stock or other securities, to be submitted to Congress within 180 days after the date of enactment.
- The bill would also amend the Securities Exchange Act to limit a public accountant’s ability to provide auditing services and other services for the same entity.

Effective date

- The provisions of the bill would be effective generally for plan years beginning on or after January 1, 2002, with a delayed effective date for plans maintained pursuant to a collective bargaining agreement. A plan could be amended retroactively to comply with the bill, provided it is operated in accordance with the bill as of the effective date and the amendment is retroactive to the effective date.

B. Proposals Relating to Investment Advice

1. H.R. 2269, the Retirement Security Advice Act of 2001 (passed by the House on November 15, 2001)

- The bill would amend the prohibited transaction rules under ERISA and the Internal Revenue Code to provide an exemption for (1) the provision of investment advice to the plan or plan participants with respect to the investment of plan assets, (2) the sale, acquisition or holding of investments pursuant to the advice, and (3) the receipt of fees for the advice or the investments.
- The exemption would apply to plans under which the investment of plan assets is subject to the direction of plan participants and to investments made solely at the direction of the recipient of the investment advice.
- The exemption would apply to an investment advisor who is a "fiduciary advisor," defined as a person who is a fiduciary of the plan by reason of the provision of investment advice and who is also (1) a registered investment adviser, (2) a bank, (3) an insurance company, (4) a registered broker or dealer, or (5) an affiliate, employee, agent, or registered representative of such an entity.
- The investment advisor would have to provide a plain-language notice that includes information about (1) fees to be received by the advisor in connection with the advice or the investments, (2) the types of services provided by the advisor, (3) any limitations on the scope of the investment advice, and (4) any connection between the advisor and the investments. The investment advisor would also have to acknowledge its status as a fiduciary of the plan.
- The notice would have to be provided at the time of the initial investment advice and at least annually after. This notice would be in addition to notices required under other laws, such as securities laws.
- Any fees received by the investment advisor would have to be reasonable, and the terms of any investments would have to be at least as favorable as an arm's length transaction would be.
- If the requirements for the exemption were met, the employer (or other fiduciary) would not be responsible under ERISA for the investment advice provided by the fiduciary advisor. The employer or other fiduciary would continue to bear fiduciary responsibility for selecting and monitoring the fiduciary advisor.
- The bill would also amend ERISA to clarify that plan assets may be used to pay reasonable expenses for investment advice.
- The bill would apply to advice provided on or after January 1, 2002.

2. S. 1677, the Independent Investment Advice Act of 2001 (Sens. Bingaman and Collins)

- The bill would amend ERISA by adding specific rules dealing with the provision of investment advice to plan participants.
- The proposal would apply to a defined contribution plan that permits participants to exercise investment control over the assets in their accounts and to investment advice provided to participants by a qualified investment advisor.

- A “qualified investment advisor,” would be defined as a person who is a plan fiduciary by reason of providing investment advice and who is also (1) a registered investment adviser, (2) a bank, (3) an insurance company, or (4) a comparably qualified entity under criteria to be established by the Secretary of Labor. Similar requirements would apply to any individual who provided investment advice to participants on behalf of the investment advisor (such as an employee thereof).
- In designating an investment advisor, the employer or other fiduciary would be required to review (1) the contract for investment advice services, (2) the fees to be received by the investment advisor, and (3) documentation that the investment advisor is a qualified investment advisor. The employer or other fiduciary would also make a determination that there is no material reason not to engage the investment advisor.
- Before designating the investment advisor and at least annually thereafter, the employer or other fiduciary would be required to obtain written verification that the investment advisor (1) is a qualified investment advisor, (2) acknowledges its status as a plan fiduciary that is solely responsible for the investment advice it provides, (3) has reviewed the plan document (including investment options) and determined that it can provide investment advice to participants without violating the prohibited transaction rules, and (4) has sufficient insurance to cover claims by participants.
- If questions were raised about the investment advisor’s qualified status or about the quality of its services, the employer or other fiduciary would be required to determine within 30 days whether to continue the investment advisor’s services.
- An employer or other fiduciary that complied with the requirements for designating and monitoring an investment advisor would be deemed to have satisfied its fiduciary duty in the prudent selection and review of an investment advisor and would not bear fiduciary liability for any loss or breach resulting from the investment advice.
- The bill would also amend ERISA to provide that amounts recovered by the plan for a breach of fiduciary duty by a qualified investment advisor would benefit the accounts of the plan participants affected by the breach.
- The bill would apply with respect to investment advisors designated on or after the date of enactment.