August 14, 2006

Pension Protection Act - Automatic Enrollment And Fiduciary Provisions

Holland & Hart is the largest law firm in the Rocky Mountains, providing a complete range of legal services to a diverse group of commercial and individual clients.

The firm offers an extensive network of legal talent and resources equipped to assist businesses in every stage of development, and in all facets of the law.

For more information, visit the Holland & Hart web site at www.hollandhart.com.

Just when you thought it was safe to go back in the water, Congress has passed another major piece of legislation that will have significant impact on retirement plans. The Pension Protection Act (H.R. 4) was passed on August 3, 2006, and President Bush is expected to sign it into law.

The Pension Protection Act covers a massive amount of territory in over 900 pages. In order to reduce it to manageable parts, the Benefits Law Group plans to issue four News Alerts summarizing the features that are most likely to be relevant to employers and their retirement plans. This first News Alert highlights the automatic enrollment and fiduciary provisions of the Pension Protection Act. We anticipate the second News Alert will cover remaining defined contribution plan topics, followed by two News Alerts addressing provisions of the Act that affect defined benefit plans.

Most of the provisions are effective for plan years beginning in 2008 and later. Consequently, the Act states that plans must be formally amended to include any and all necessary Pension Protection Act provisions by December 31, 2009 (for calendar year plans).

<u>Automatic Enrollment</u>

Automatic enrollment (sometimes called "negative deferral elections") has been a part of the 401(k) landscape since 2000, when the IRS issued guidance permitting employers to make default deferral elections of 3% for new employees. Since that time, the IRS has issued additional guidance making clear that automatic enrollment could be applied to existing employees, and that the default percentage could be more than 3%.

In addition to the social policy issue of encouraging private retirement savings, automatic enrollment is attractive to employers because it can be effective in boosting nonHCE participation levels, making it easier to pass nondiscrimination testing. Nevertheless, many employers were reluctant to implement it. The Pension Protection Act contains many provisions clearly intended to encourage even more plans to automatically enroll participants.

- The Act removes any concern that state garnishment laws might prohibit automatic enrollment by creating a clear exemption in ERISA permitting it. This provision is effective immediately.
- The Act provides relief for fiduciaries who must select the default investment for automatic enrollment.
- As an incentive to implement automatic enrollment, the Act will allow automatic enrollment plans that meet certain basic requirements up to 180 days after the end of the plan year to return excess 401(k) deferrals to HCEs (compared to the current rule of 2 ½ months).

- A new type of ADP/ACP safe harbor is created for plans that include a "qualified" automatic enrollment arrangement. To take advantage of this safe harbor:
    - The plan must automatically enroll all participants who have not made a written election in the past to participate or not to participate.
    - The initial enrollment percentage must be at least 3-10%, and must gradually increase (if necessary) until a contribution rate of 6% in the fourth year of automatic participation.
    - The employer must match 100% of the first 1% of pay deferred, and 50% of the next 5%, to a maximum of 3 ½ %. Alternatively, the employer may make a 3% nonelective contribution to all eligible employees. This employer contribution must be 100% vested after two years.

Investment Advice

All plans that permit participants to direct the investment of their own accounts provide some measure of investment education so that participants can make informed investment decisions. But only a limited number of those plans take the next step of offering investment advice. Many have pointed to the lack of investment advice as a cause of low participation (employees are reluctant to contribute without more assistance in making investment decisions).

ERISA provides that anyone who provides investment advice to participants for a fee is a fiduciary to the plan, which means that the prohibited transaction (self-dealing) rules of ERISA apply to investment advisors. This was perceived as one of the barriers to plans offering investment advice. To alleviate this concern (and continuing the theme of encouraging private retirement savings), the Pension Protection Act creates a new statutory prohibited transaction exemption called an "eligible investment advice arrangement."

An eligible investment advice arrangement must either use an objective computer model of investment alternatives, or the arrangement must not permit the investment adviser's compensation to vary with the investments selected. In either circumstance, an independent fiduciary must approve of the eligible investment advice arrangement.

This provision has an effective date of January 1, 2007, so plans that want to implement an eligible investment advice arrangement will need to act soon.

Default Investment Selection

ERISA section 404(c) provides limited protection to fiduciaries where participants are allowed to direct their own investments. Fiduciaries have historically been on thin ice, however, where participants fail to make affirmative elections. The Pension Protection Act directs the Department of Labor to issue regulations in the next six months that will extend 404(c) protection to the fiduciary's selection of default investments.

This provision is scheduled to take effect January 1, 2007, so plans will want to be poised to take whatever actions are necessary after the DOL issues regulations.

If you have any questions about these or any other provisions of the Pension Protection Act, the Benefits Law Group would be happy to help.

HOLLAND&HART. BENEFITS LAW GROUP

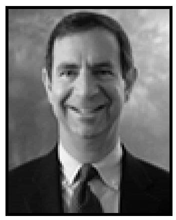
News Alert

Jane Francis
jfrancis@hollandhart.com
(303) 295-8599
Denver

Irene Gallagher
igallagher@hollandhart.com
(303) 295-8270
Denver
(208) 383-3957
Boise

Rebecca Hudson
rhudson@hollandhart.com
(303) 295-8005
Denver

Elizabeth Nedrow
enedrow@hollandhart.com
(406) 252-2166
Billings



Sheldon Smith
ssmith@hollandhart.com
(303) 295-8540
Denver

Leslie Thomson
lthomson@hollandhart.com
(406) 252-2166
Billings

For questions regarding this Alert, please contact
Beth Nedrow, Holland & Hart LLP, 401 North 31st Street, Suite 1500, Billings MT 59101
Phone: 406-252-2166 | enedrow@hollandhart.com