

Uncovering Planning Opportunities in the Pension Protection Act of 2006

The Pension Protection Act of 2006 (PPA), signed by President Bush on Aug. 17, 2006, contains opportunities for offering investment advice and diversification for pension plans. My prior column discussed the plan's charitable giving provisions; this column addresses two important provisions for financial advisors: investment advice and diversification.

Investment Advice

This good planning tool is for fiduciaries, such as banks, insurance companies, broker dealers, registered investment advisors, and their employees and representatives. The PPA amended ERISA and the Internal Revenue Code to relieve fiduciary liability and prohibited transaction restrictions for plan sponsors and fiduciaries who appoint qualified "fiduciary advisors" for defined contribution plans. If statutory requirements are met, sponsors and fiduciaries are not liable for advice from fiduciary advisors for investment performance based on that advice. Now, employers can arrange for needed investment advice for employee participants.

Concerns about fiduciary liability generally discouraged employers from providing investment advice. Subject to conflict of interest protections, the new prohibited transaction exemption modifies fiduciary rules to allow employers to offer advice from neutral third parties. Qualified "fiduciary advisors" are allowed to offer individualized investment advice to help employees manage their 401(k) plans, IRAs and other plans.

The fiduciary advisor may be affiliated with the investment funds offered in a 401(k) plan, but will have to meet disclosure, qualification and other self-dealing safeguards. In addition, if these conditions are met, employers or plan sponsors will not be obligated to monitor specific advice given to any particular participant or beneficiary, although they will retain responsibility for prudently selecting and monitoring advice providers.

Fiduciary advisors providing investment advice under an "eligible investment advice arrangement" may provide individualized investment advice to 401(k) plan participants. Such arrangement means (1) portfolio recommendations are generated for a participant based on an unbiased computer model "certified and audited" by an independent third party, or (2) fiduciary advisors provide investment advice services by charging a flat fee that does not vary depending on investment chosen by the participant.

The unbiased computer model must (1) apply generally accepted investment theories using relevant individualized participant information (retirement age, life expectancy, risk tolerance), (2) not be biased in favor of investments offered by the advisor or its affiliates, and (3) take into account all invest-



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ment options available under the plan.

An independent auditor (i.e., unrelated to the advisor or any provider of investment options under the plan) must certify annually that the model is appropriate, advice is given pursuant to the computer model and all transactions must result solely from participant decisions.

- Before investment advice is given, the advisor must provide notice to participants that discloses, among other things:
 - ✓ the role of all parties involved in developing the program or selecting investment options under the plan
 - ✓ that the financial advisor is a fiduciary
 - ✓ past performance of the investment options
 - ✓ any fees or other compensation received by the fiduciary advisor
 - ✓ how any participant information will be used and
 - ✓ that participants may arrange for their own advice from another advisor.
- In addition, the information must be written clearly so it is easily understood by participants and beneficiaries; the Department of Labor will issue a model form of disclosures.
- Compensation received by the fiduciary advisor or its affiliates in connection with an investment transaction must be reasonable, and the terms of the transaction must be at least as favorable as an arms-length transaction.

Although certain requirements apply, this change will encourage employers to furnish investment information to plan participants, and it is effective for advice provided after Dec. 31, 2006.

Diversification

Pension plans holding employer stock must allow participants to diversify away from employer securities. For employee contributions, diversification must be available at any time. For employer contributions, diversification must be available

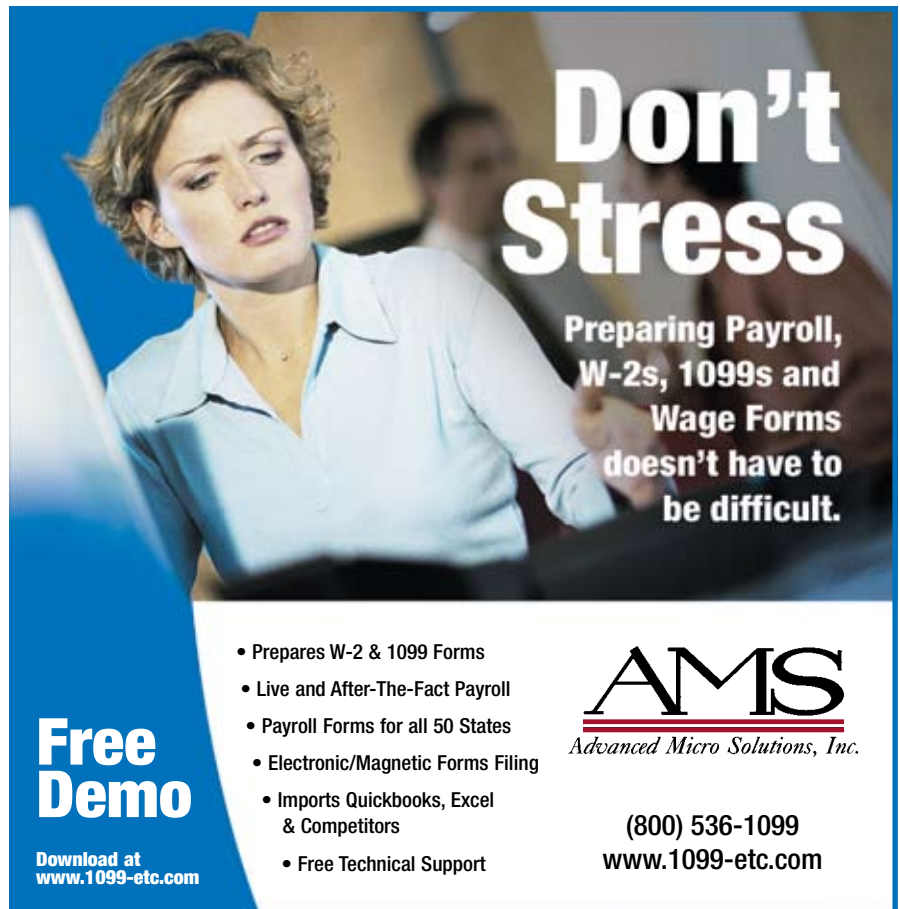
to those with three or more years of service. Plans must provide at least three diversified investment options other than employer securities or employer real property.

Another requirement is that diversification notices must be given no later than 30 days before the effective date of any new diversification right. These rules do not apply to employee stock ownership plans (ESOPs), and are effective for plan years beginning after Dec. 31, 2006, but phased in over three years.

A Final Word

With Social Security on thin ice, retirement savings inadequate and defined benefit pensions vastly underfunded, the PPA can help millions of baby boomers, their children and grandchildren build a more solid foundation for retirement security.

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