



Deadline for Participant Diversification Requirements

Insights

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Under the Pension Protection Act ("Act") of 2006, defined contribution plans that offer publicly traded employer stock as an investment option must now satisfy new diversification requirements. In order to inform participants of their diversification rights, ERISA now requires that participants receive a written notice of their right to divest employer stock. For calendar year plans, the new participant notice must be distributed by December 2, 2006, and the new diversification rights must be offered effective as of January 1, 2007.

Prior to the Act, it was common for plans to require participants to remain invested in employer stock or, alternatively, to hold employer stock for a predetermined period (e.g., two years). Under the Act, plans must now permit participants to more readily diversify their investments out of employer stock.

Diversification Rights

With respect to employee contributions and elective deferrals, participants must be granted the ability to diversify the investment of these account balances out of employer stock (on the same terms and conditions applicable to other investment election changes). This new diversification right applies to existing account balances as well as new contributions, and it must be offered no less than quarterly. A plan will not satisfy the diversification requirement, however, unless the plan also offers at least three alternative investment options, each with different risk and return characteristics.

With respect to employer contributions (e.g., matching or profit-sharing contributions), the diversification rights are required to be offered once the participant has completed three years of service. The Act provides for this rule to be phased in over three years for amounts contributed in plan years prior to 2007. However, for participants who reached age 55 before the first plan year beginning after December 31, 2005, full diversification rights must be offered beginning in 2007.

New Notice Requirements

Each participant affected by the new rule must receive a notice of his or her diversification rights at least 30 days before the first date the participant is eligible to diversify. For calendar year plans, the notice must be provided by December 2, 2006. The notice must explain the diversification rights, as well as the importance of diversifying the investment of retirement account assets. Electronic delivery of the notice is permitted and the Secretary of the Treasury has been directed to provide a

delivery of the notice is permitted, and the Secretary of the Treasury has been directed to provide a model notice (although it is not expected that a model notice will be available until early 2007). The fact that the Secretary has not issued a model notice does not excuse a plan from providing the notice, and the failure to provide the notice can result in penalties.

For calendar year plans, the deadline for implementing the new diversification rights is fast approaching, and employers must act quickly to determine the manner in which their plans will comply. While the Act permits a phased-in approach with respect to employer contributions, employers may find this approach to be administratively burdensome. Accordingly, employers should evaluate and consider whether a permissible alternative approach is more desirable.

For more information, contact a member of the Employee Benefits Practice Group.