

Preliminary assessment of the

Impact of the 2006 Pension Protection Act on Defined Contribution Plans

How the 2006 Pension Protection Act will affect
Employees, Plan Sponsors, Providers and Advisors
who rely on 401(k) and other defined contribution
plans.

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IMPACT OF 2006 PENSION PROTECTION ACT

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INTRODUCTION

On August 3rd, 2006 Congress passed the 2006 Pension Protection Act that will overcome the hurdles to retirement security that were built into the 1974 ERISA and subsequent regulation. The new legislation will increase the number of DC plans and participation rates, but more importantly it will raise contribution levels and create more rational investment behavior by participants.

Most provisions of the 2006 Act focus on Defined Benefit plans but this focus makes it more costly to offer and maintain these plans. Additionally, congress has created a clear path for employers to transition from these traditional pension plan obligations into defined contribution cash balance plans. These changes as well as the relaxed fiduciary responsibility for defined contribution plans will cause a boom in new DC plans.

Participation rates will increase over time from the 70% rates for mature plans that has been the experience of the last ten years to an estimated 95% through the introduction of the automatic enrollment. The new legislation abandons the practice of trying to convince employees to join the plan through a series of costly meetings and expensive materials. Instead employees are automatically enrolled and may opt out, if desired. History has shown that only 5% do actually opt out.

Contribution levels that have averaged approximately 5% for more than two decades will increase over time to levels approaching 10%. The automatic enrollment provision has set 10% as the implied benchmark and introduced minimum contribution levels. These minimum contribution level start at 3% and will gradually force participants that now contribute under 6% to increase contributions up to 6%.

Investor behavior is improved by delivering explicit advice to plan participants. Participants were left to fend for themselves in the past. They could hire and pay their own advisor or use complex financial planning tool to assess how plan balances and contributions should be allocated. This ineffective system is replaced by meaningful default investments and personal advice delivered by the plan provider or independent advisor that is paid by the plan itself.

These reforms are expected to greatly increase the number of plans, improve employee savings as well as improve the profits of providers and advisors. Employers benefit directly from reduced fiduciary responsibility and increased employee productivity (spending less time learning about investing and managing their plans).

SHIFT IN FOCUS

The 2006 Pension Protection Act represents a radical shift from the core tenets of the 1974 ERISA law as it related to defined contribution plans.

The underlying belief of the 1974 law and the regulations that followed, was that employees would make good decisions regarding their retirement if they were properly educated, informed and given reasonable choices. This belief has proved to be untrue as evidenced by low contribution levels and poor investment choices that employees have made. The motivation for reform was further stimulated by the success of industry initiated automatic enrollment and personal advice initiatives.

The need for the person-to-person advice and automatic enrollment has been motivated by:

- ✓ Failure of current system of education and communication to enable participants to accumulate and confidently manage their retirement assets.
- ✓ Low usage of online tools that provide financial planning, retirement planning, etc.
- ✓ Ambiguity about where the fiduciary responsibility lies for automatic enrollment, education, planning tools, investment guidance and advice provided to participants a (some providers explicitly accept while others explicitly deny responsibility).
- ✓ Conflict of interest in providers who provide education and advice that may be tainted since it benefits the provider directly.

Congress has now turned away from the education/information approach to a default/advise approach consisting of:

- Requiring employees to opt out of retirement plans with pre-defined defaults instead of requiring them to opt in and make complex investment selections.
- Automatically increasing contribution levels unless employees choose to opt out of the increases.
- Permitting plan providers to deliver personal advice as long as an audited computer model is used to drive recommendations.
- Prescribing standards for the selection and review of independent advisors and explicitly permitting compensation from plan assets.
- Shifting the fiduciary responsibility for the advice provided from the plan sponsor to the advisor.

This major change in focus away from education/information towards default/advise will materially increase plan assets and change the relationships between plan sponsors, providers and advisors.

WHAT IF?

The 2006 Pension Protection Act has great virtues, but there are also several potential areas of risk and exposure to undesirable outcomes. The major areas of concern for defined contribution plans are that:

- **Regulators impose excessive restrictions and reporting requirements.** These will make it unattractive for employees, employers, providers and fiduciary advisers to take advantage of the features contained in the Act. The low participation that would result means that the benefits of the Act to improve the retirement security of millions of workers will be lost.
- **Employees disregard disclosures of conflicts of interest and act on tainted advice from fiduciary advisers.** Reliance on employees to read disclosures and make prudent decisions is highly questionable. It is unlikely that employees will take the time to read and assess the disclosure but instead will assume that the employer has properly vetted the fiduciary adviser. Employees exercising this judgment could face losses from acting on tainted advice.
- **Employers select fiduciary advisers without the proper due diligence to identify a history of poor client service and regulatory infractions.** Since the employer has the fiduciary duty and employees will rely on the employers' choice, steps must be taken to vet fiduciary advisers. Employers will have no defense if advice arrangements are made without a thorough background check on the fiduciary advisers.
- **Providers act as fiduciary advisers and limit investment lineup to their own funds that may have higher costs.** While the Act has explicit provision to prevent a provider from giving favorable treatment to its own products within the fund lineup, it is silent on the composition of the lineup. The use of independent and unaffiliated plan advisors is needed to protect against this possibility.
- **Independent fiduciary advisers receive compensation from providers in exchange for recommending their products.** The Act requires that compensation arrangements that are the norm today be disclosed to employees and employers. Since this disclosure will be commonplace, they cannot be relied on to call attention to an improper financial arrangement. Improper arrangements between independent advisers and providers will only be detected through proper due diligence.

THE NEW LANDSCAPE

The 2006 Pension Protection Act redefines the defined contribution landscape in revolutionary ways. The following summary highlights some of the major changes.

EMPLOYEES AND PARTICIPANTS

The employee will no longer have to struggle with decisions about how much to contribute and where to put the money or where to get help when it is needed. They will not have to attend enrollment meetings or read the pounds of paper they receive about investment selection.

In the long term, they will undoubtedly have a more secure retirement.

EMPLOYER AND PLAN SPONSOR

Employees will no longer complain about not being able to figure out what investment choices to make and lose productivity while struggling to make the right decisions.

As a plan sponsor, employers will be able to pass the responsibility for oversight of plan investments on to fiduciary advisers.

These benefits do require the employer to take on the responsibility for selecting, reviewing and paying the fiduciary adviser. Payments are made from plan assets so there should be little or effect on costs.

PROVIDERS

Providers realize cost savings from discontinued enrollment and education programs as well as lowered need to support employees who will turn to fiduciary advisers for assistance.

The increased contribution levels and automatic increases will accelerate asset growth in assets. Revenues are also increased by the use of default investments that have higher management fees.

An entirely new revenue stream is created for providers that elect to act as fiduciary advisers. In addition to direct compensation for this service, providers have greater influence over the fund lineup and can reduce the use of outside funds.

ADVISOR

The newly created role of fiduciary adviser opens opportunities for thousands of financial professionals. In addition to direct compensation, fiduciary advisers have the inside track to expand the relationship with a participant into capturing assets from the entire family and friends.

SUMMARY OF DC FEATURES IN THE 2006 PENSION PROTECTION ACT

AUTOMATIC ENROLLMENT (EFFECTIVE 12/31/2007)

The inclusion of automatic enrollment with increases eliminates the concern that plan sponsors could incur a liability for withholding from employees' pay without the employee's explicit permission.

The following requirements apply to automatic enrollment arrangements (Note 1):

- Each employee eligible to participate in the arrangement is treated as having elected to have the employer make elective contributions in an amount equal to a qualified percentage of compensation.
- Qualified percentage is not contributed if the employee makes an affirmative election to:
 - Not have such contributions made, or
 - Make elective contributions at a level other than the qualified percentage
- The qualified percentage is applied uniformly, does not exceed 10 percent, and is at least 3%, 4%, 5% and 6% in the first and subsequent years, respectively.
- The automatic enrollment may be applied without taking into account any employee who:
 - Was eligible to participate in the arrangement (or a predecessor arrangement) immediately before the date on which such arrangement becomes a qualified automatic contribution arrangement.
 - Had an election in effect on such date either to participate in the arrangement or to not participate in the arrangement.

Each employee who is eligible to participate in the arrangement receives written notice of the employee's rights and obligations under the arrangement which (Note 2):

- Is sufficiently accurate and comprehensive to apprise the employee of such rights and obligations, and
- Is written in a manner calculated to be understood by the average employee to whom the arrangement applies.

Employees who do not make an investment election are put into a default investment that include a mix of asset classes consistent with capital preservation or long-term capital appreciation, or a blend of both. (Note 3).

COMPUTER MODELED ADVICE (EFFECTIVE 12/31/2006)

Providers, including record keeping platforms, investment managers and others can act as fiduciary advisers, explicitly advising plan participants on the allocation of their 401(k) and other investments.

Prerequisites for the provider to act as a fiduciary adviser are (Note 4):

- The only investment advice provided is the advice generated by a computer model created by an independent outside firm.
- The computer model must meet a set of minimum standards and must be certified annually by an independent expert, other than the creator.
- Any transaction (change) occurs solely at the direction of the participant or beneficiary.
- The plan sponsor expressly authorizes the advisory arrangement.
- An independent audit is conducted annually of the arrangement and a written report is issued.
- Fiduciary adviser makes regular disclosures to every participant regarding affiliations and contractual relationships, past fund performance, fees and compensation, privacy policy and scope of services offered.
- Disclosures must be made in a manner calculated to be understood by the average plan participant.
- Fiduciary adviser must explicitly acknowledge that he/she is acting as a fiduciary of the plan in connection with the provision of the advice.
- Compensation received by the fiduciary adviser or affiliates must be reasonable and at least as favorable to the plan as an arm's length transaction would be. Compensation may be made from plan assets.

INDEPENDENT ADVICE (EFFECTIVE 12/31/2006)

Advisors that have no affiliation or contractual relationships with a provider may act as a fiduciary adviser, without the requirements of using a computer model and the need to certify the model annually.

Prerequisites for an unaffiliated advisor to act as a fiduciary adviser are (Note 4):

- Fees do not vary based on the investment option selected.
- The plan sponsor expressly authorizes the advisory arrangement.
- An independent audit is conducted annually of the arrangement and a written report is issued.

- Fiduciary adviser makes regular disclosures to every participant regarding affiliations and contractual relationships, past fund performance, fees and compensation, privacy policy and scope of services offered.
- Disclosures must be made in a manner calculated to be understood by the average plan participant.
- Fiduciary adviser must explicitly acknowledge that he/she is acting as a fiduciary of the plan in connection with the provision of the advice.
- Compensation received by the fiduciary adviser or affiliates must be reasonable and at least as favorable to the plan as an arm's length transaction would be. Compensation may be made from plan assets.

FIDUCIARY PROTECTION

Plan sponsors are protected from fiduciary liability for investment decisions of individual employees when a fiduciary adviser is engaged. Neither is there any requirement for the plan sponsor to monitor the advice given by the fiduciary adviser. This relief makes it very likely that fiduciary advisers will be engaged by virtually all plans.

Plan sponsors must meet requirements to secure the fiduciary protection offered by this legislation (Note 4):

- The fiduciary adviser must be prudently selected and periodically reviewed.
- Written acknowledgment must be provided by the fiduciary adviser that the fiduciary adviser is a fiduciary of the plan with respect to the provision of the advice.
- Fiduciary advisor fees must be reasonable.

COMPANY STOCK (EFFECTIVE 1/1/2007)

Participants must have flexibility to divest employer securities from their defined contribution plans (Note 5):

- Plans that contain company stock must offer not less than 3 additional investment options, each of which is diversified and has materially different risk and return characteristics.
- Participants may not be prevented from divesting company stock that is purchased with employee contributions and reinvesting the proceeds into other investment options in the plan.
- Participants with more than three years of service may not be prevented from divesting employer contributed company stock and reinvesting the proceeds into other investment options in the plan.

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- These requirements are phased in over three years for company stock that exists in accounts at 1/1/2007. A specified percentage of existing company stock must meet requirements (applicable percentage) each year. The applicable percentage for year 1 is 33%, year 2 is 66% and year 3 and beyond is 100%.

FEATURES MADE PERMANENT (EFFECTIVE IMMEDIATELY)

Provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001, including Roth 401(k), higher plan limits and catch-up contributions that were temporary are now made permanent by the 2006 Pension Protection Act. (Note 6).

IMPACT ON EMPLOYEES

Employee Perspective		
Employee is automatically enrolled and contributions increased but may opt out. Employee may choose to use a person-to-person advisor provided by the employer.		
Area Affected	Current Practice	New Practice
Enrollment Kits	Used to encourage participation, maximize contribution and start education.	The need for enrollment materials is eliminated by automatic enrollment. Fiduciary adviser maximizes contribution and recommends investment choices.
Enrollment Meetings	Used to encourage participation, maximize contribution and start education.	The need for enrollment meetings is eliminated by automatic enrollment. Fiduciary adviser maximizes contribution and recommends investment choices.
Education Programs	Enable employee to manage his/her plan.	Fiduciary adviser takes on this responsibility.
Employee Communications	Inform participants about the status plan and any changes.	Fiduciary adviser must also be kept informed.
Rollover and In-force Distribution	Open to external solicitation.	Bundled with services provided by fiduciary adviser which extends beyond current employment.
Call Center	Available only for administrative tasks.	Call center can advise participants if provider acts as fiduciary adviser using computer modeled advice.
Deferral Rates	Employee must determine adequate rate.	Automatic enrollment determines minimum rates. Employee can opt out. Fiduciary adviser makes recommendations to employee on deferral rate.
Investment selection	Employee must determine selection.	Fiduciary adviser makes recommendation to participant.

IMPACT ON EMPLOYERS

Employer Perspective		
<p>Employers are likely to seize the opportunity to escape the fiduciary liability as well as answer employee concerns about the difficulty in managing their plans.</p> <p>Employers will also be advised that employees will realize greater returns and enjoy more secure retirements.</p>		
Area Affected	Current Practice	New Practice
Fiduciary Responsibility	Employer has no definitive way to avoid fiduciary responsibility and must rely on the ambiguous current rules.	New legislation prescribes explicit transfer of fiduciary liability from employer to fiduciary adviser if the employer meets the standards for selection and periodic review.
Compliance Testing	Testing failure are avoided through continuous education and enrollment programs.	Automatic enrollment with automatic increases, avoids the problem in plans where this is a concern. Any education that is needed becomes the responsibility of the fiduciary adviser.
Liability Insurance	Fiduciary liability insurance is not readily available and most policies do not include this coverage.	Relief from fiduciary liability removes the risk of having an uninsured liability.
Conversion	The decision to change provider rests with the sponsor and the at times with employees.	When part of the fiduciary liability rests with the fiduciary adviser, changing of providers will also require the approval of the fiduciary adviser.
Investment Lineup	The employer, often with the support of a financial advisor, defines investment lineup.	Since the fiduciary adviser now has the fiduciary responsibility, the investment lineup must be approved by that fiduciary adviser.

Employer Perspective

Employers are likely to seize the opportunity to escape the fiduciary liability as well as answer employee concerns about the difficulty in managing their plans.

Employers will also be advised that employees will realize greater returns and enjoy more secure retirements.

Area Affected	Current Practice	New Practice
Poor Investment Results	The employer has the responsibility for monitoring investment results, often with the support of an advisor.	By assuming the fiduciary liability, the fiduciary adviser must also assume the responsibility for monitoring performance.
Conflicts of Interest	The employer has “prudent person” duties to monitor conflicts of interest.	Conflicts of interest are permitted and must be disclosed to plan sponsor and to participants.
Plan Costs	As they exist today.	Employer will incur the added cost of the fiduciary adviser compensation, which may be taken from plan assets. Presumably forfeitures and credits will be used before withdrawing funds from participant accounts.
Employee Productivity	Productivity is lost in time spent in enrollment meetings, decision making on investment selection, reviewing enrollment kits and managing employee’s own account.	Productivity gains are immediately realized from automatic enrollment, annual contribution increases, default investments and the availability of a fiduciary adviser to guide employees’ decisions.

IMPACT ON PROVIDERS

Provider Perspective (Record keeper, Investment Manager and TPA)		
<p>Automatic enrollment, automatic increases, profitable defaults and personal advice will increase plan contributions, plan assets and revenues. The larger number of small accounts from automatic enrollment may reduce profit margins in the short run but the cost reductions in enrollment and education will usually offset this reduction.</p>		
Area Affected	Current Practice	New Practice
Fiduciary Responsibility	Provider has no precise definition where fiduciary responsibility begins and ends and must rely on the opinion of counsel.	Provider liability is assumed only if provider chooses to act as a fiduciary adviser. New legislation prescribes explicit transfer of fiduciary liability from employer to fiduciary adviser if the employer meets certain standards.
Investment Lineup	The employer, often with the support of a financial advisor, defines investment lineup.	Since the fiduciary adviser now has the fiduciary responsibility, the investment lineup must be approved by that fiduciary adviser.
Poor Investment Results	The employer has the responsibility for monitoring investment results, often with the support of an advisor.	By assuming the fiduciary liability, the fiduciary adviser must also assume the responsibility for monitoring performance.
Conflicts of Interest	The employer has “prudent person” duties to monitor conflicts of interest.	Conflicts of interest are permitted and must be disclosed to plan sponsor and to participants.
Plan Costs	As they exist today	Provider recognizes cost savings from elimination of high cost enrollment kits and meetings.

Provider Perspective (Record keeper, Investment Manager and TPA)		
Automatic enrollment, automatic increases, profitable defaults and personal advice will increase plan contributions, plan assets and revenues. The larger number of small accounts from automatic enrollment may reduce profit margins in the short run but the cost reductions in enrollment and education will usually offset this reduction.		
Area Affected	Current Practice	New Practice
Sales & Marketing	Sales and marketing is based on investments available, employer services and employee programs.	If provider takes on the responsibility as fiduciary adviser, service to employees becomes part of that duty. Alternatively, providers must work with unaffiliated fiduciary advisers to support employees.
Alliances	Alliances exist among “sellers”, investment only and record keeping providers and TPA’s.	Alliances with fiduciary advisers become critical for plans that elect to use independent advisers. These alliances are less relevant for providers that elect to become fiduciary advisers.
Competitive Strategies	Services are most often packaged and funded by providers.	The requirement to disclose conflicts of interest through affiliations or contracts combined with the explicit ability to compensate fiduciary advisers from plan assets will discourage provider funded services.
Advisor Relationship	Providers and advisors co-exist in the advisor channel but advisors are not a factor in the direct channel.	Nothing in the Act defines plan level advisors activities so the only effect is expected to be conflicts with the fiduciary adviser when these roles are held by different individuals.
Open Architecture	Offered as the market demands but majority of flow is to “house brand”.	Providers that act as fiduciary advisers will control the asset flow by defining the investment lineup. When an independent fiduciary adviser is used, the use of the “house brand” will decline.

Provider Perspective (Record keeper, Investment Manager and TPA)		
Automatic enrollment, automatic increases, profitable defaults and personal advice will increase plan contributions, plan assets and revenues. The larger number of small accounts from automatic enrollment may reduce profit margins in the short run but the cost reductions in enrollment and education will usually offset this reduction.		
Area Affected	Current Practice	New Practice
Online Advice	Experience very low usage.	Demand is lowered further as most employees will opt for the person-to-person fiduciary adviser.
Enrollment Kits	Provide comprehensive kit to all plans	Need is eliminated by automatic enrollment. Person-to-person fiduciary adviser maximizes contributions.
Enrollment Meetings	May be done by advisor or provider.	The need for meetings is eliminated.
Education Programs	Offered by provider.	Any education needed becomes the responsibility of the fiduciary adviser.
Employee Communications	Offered by provider.	Employee communications becomes the responsibility of the fiduciary adviser.
Rollover and In-force Distribution	Open to external solicitation.	Fiduciary adviser has unobstructed path to rollovers which could be moved away from provider, depending on the advisers' preference.
Call Center	Available only for administrative tasks.	Call center can advise participants if provider acts as fiduciary adviser using computer modeled advice.
Compliance Testing	Testing failures are avoided through continuous education and enrollment programs.	Automatic enrollment with automatic increases, avoids the problem in plans where this is a concern. Any education that is needed becomes the responsibility of the fiduciary adviser.

Provider Perspective
(Record keeper, Investment Manager and TPA)

Automatic enrollment, automatic increases, profitable defaults and personal advice will increase plan contributions, plan assets and revenues. The larger number of small accounts from automatic enrollment may reduce profit margins in the short run but the cost reductions in enrollment and education will usually offset this reduction.

Area Affected	Current Practice	New Practice
Conversion	The decision to change provider rests with the sponsor and at times with employees.	When part of the fiduciary liability rests with the fiduciary adviser, changing of providers will also require the approval of the fiduciary adviser.

IMPACT ON ADVISOR

Independent Advisor Perspective		
<p>The act empowers the fiduciary adviser to build a far-reaching relationship with employees that transcend the 401(k) plan and extends to the employee's family. Advisers must, however, directly accept the fiduciary responsibility for the advice they give.</p>		
Area Affected	Current Practice	New Practice
Fiduciary Responsibility	Advisor may or may not have fiduciary responsibility, sometimes designated as a "co-fiduciary"	New legislation prescribes explicit transfer of fiduciary liability from employer to fiduciary adviser if the employer meets certain standards.
Compensation	12b-1 Fees or plan sponsors pay advisors directly.	Legislation provides for plan to pay fiduciary advisers fees. This would presumably come from forfeitures and credits and not from participant accounts.
Rollover and In-force Distribution	Open to external solicitation.	Fiduciary adviser has unobstructed path to rollovers which could be moved away from provider, depending on who the adviser is.
Investment Lineup	The employer, often with the support of an advisor, defines investment lineup.	Since the fiduciary adviser now has the fiduciary responsibility, the investment lineup must be approved by that fiduciary adviser.
Poor Investment Results	The employer has the responsibility for monitoring investment results, often with the support of an advisor.	By assuming the fiduciary liability, the fiduciary adviser must also assume the responsibility for monitoring performance.
Conflicts of Interest	The employer has "prudent person" duties to monitor conflicts of interest.	Conflicts of interest are permitted and must be disclosed to plan sponsor and to participants.

Independent Advisor Perspective

The act empowers the fiduciary adviser to build a far-reaching relationship with employees that transcend the 401(k) plan and extends to the employee's family.

Advisers must, however, directly accept the fiduciary responsibility for the advice they give.

Area Affected	Current Practice	New Practice
Provider Relationship	Providers occasionally pass leads to advisors.	Providers will introduce independent fiduciary advisers only when provider chooses not to assume that role. The non-fiduciary providers will create a demand for qualified fiduciary advisers. Providers are expected to form informal alliances with independent advisers to meet this demand.
Enrollment Meetings	May be done by advisor or provider.	The need for meetings is eliminated.
Education Programs	Offered by provider.	Any education needed becomes the responsibility of the fiduciary adviser.
Conversion	The decision to change provider rests with the sponsor and at times with employees.	When part of the fiduciary liability rests with the fiduciary adviser, changing of providers will also require the approval of the fiduciary adviser.

REFERENCES

The following notes contain the language in the 2006 Pension Protection Act that is referenced in this report.

NOTE 1 -AUTOMATIC DEFERRAL

`(C) AUTOMATIC DEFERRAL-

`(i) IN GENERAL- The requirements of this subparagraph are met if, under the arrangement, each employee eligible to participate in the arrangement is treated as having elected to have the employer make elective contributions in an amount equal to a qualified percentage of compensation.

`(ii) ELECTION OUT- The election treated as having been made under clause (i) shall cease to apply with respect to any employee if such employee makes an affirmative election--

`(I) to not have such contributions made, or

`(II) to make elective contributions at a level specified in such affirmative election.

`(iii) QUALIFIED PERCENTAGE- For purposes of this subparagraph, the term `qualified percentage' means, with respect to any employee, any percentage determined under the arrangement if such percentage is applied uniformly, does not exceed 10 percent, and is at least--

`(I) 3 percent during the period ending on the last day of the first plan year which begins after the date on which the first elective contribution described in clause (i) is made with respect to such employee,

`(II) 4 percent during the first plan year following the plan year described in subclause (I),

`(III) 5 percent during the second plan year following the plan year described in subclause (I), and

`(IV) 6 percent during any subsequent plan year.

`(iv) AUTOMATIC DEFERRAL FOR CURRENT EMPLOYEES NOT REQUIRED- Clause (i) may be applied without taking into account any employee who--

`(I) was eligible to participate in the arrangement (or a predecessor arrangement) immediately before the date on which such arrangement becomes a qualified automatic contribution arrangement (determined after application of this clause), and

`(II) had an election in effect on such date either to participate in the arrangement or to not participate in the arrangement.

NOTE 2 -AUTOMATIC DEFERRAL NOTICES

` (i) IN GENERAL- The requirements of this subparagraph are met if, within a reasonable period before each plan year, each employee eligible to participate in the arrangement for such year receives written notice of the employee's rights and obligations under the arrangement which--

` (I) is sufficiently accurate and comprehensive to apprise the employee of such rights and obligations, and

` (II) is written in a manner calculated to be understood by the average employee to whom the arrangement applies.

` (ii) TIMING AND CONTENT REQUIREMENTS- A notice shall not be treated as meeting the requirements of clause (i) with respect to an employee unless--

` (I) the notice explains the employee's right under the arrangement to elect not to have elective contributions made on the employee's behalf (or to elect to have such contributions made at a different percentage),

` (II) in the case of an arrangement under which the employee may elect among 2 or more investment options, the notice explains how contributions made under the arrangement will be invested in the absence of any investment election by the employee, and

` (III) the employee has a reasonable period of time after receipt of the notice described in subclauses (I) and (II) and before the first elective contribution is made to make either such election.'

NOTE 3 -DEFAULT INVESTMENT

SEC. 624. TREATMENT OF INVESTMENT OF ASSETS BY PLAN WHERE PARTICIPANT FAILS TO EXERCISE INVESTMENT ELECTION.

(a) In General- Section 404(c) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1104(c)), as amended by section 622, is amended by adding at the end the following new paragraph:

` (5) DEFAULT INVESTMENT ARRANGEMENTS-

` (A) IN GENERAL- For purposes of paragraph (1), a participant in an individual account plan meeting the notice requirements of subparagraph (B) shall be treated as exercising control over the assets in the account with respect to the amount of contributions and earnings which, in the absence of an investment election by the participant, are invested by the plan in accordance with regulations prescribed by the Secretary. The regulations under this subparagraph shall provide guidance on the appropriateness of designating default investments that include a mix of asset classes consistent with capital preservation or long-term capital appreciation, or a blend of both.

`(B) NOTICE REQUIREMENTS-

`(i) IN GENERAL- The requirements of this subparagraph are met if each participant--

`(I) receives, within a reasonable period of time before each plan year, a notice explaining the employee's right under the plan to designate how contributions and earnings will be invested and explaining how, in the absence of any investment election by the participant, such contributions and earnings will be invested, and

`(II) has a reasonable period of time after receipt of such notice and before the beginning of the plan year to make such designation.

`(ii) FORM OF NOTICE- The requirements of clauses (i) and (ii) of section 401(k)(12)(D) of the Internal Revenue Code of 1986 shall apply with respect to the notices described in this subparagraph.'

(b) Effective Date-

(1) IN GENERAL- The amendments made by this section shall apply to plan years beginning after December 31, 2006.

(2) REGULATIONS- Final regulations under section 404(c)(5)(A) of the Employee Retirement Income Security Act of 1974 (as added by this section) shall be issued no later than 6 months after the date of the enactment of this Act.

NOTE 4 -FIDUCIARY ADVISER REQUIREMENTS

- `(g) Provision of Investment Advice to Participant and Beneficiaries-
 - `(1) IN GENERAL- The prohibitions provided in section 406 shall not apply to transactions described in subsection (b)(14) if the investment advice provided by a fiduciary adviser is provided under an eligible investment advice arrangement.
 - `(2) ELIGIBLE INVESTMENT ADVICE ARRANGEMENT- For purposes of this subsection, the term `eligible investment advice arrangement' means an arrangement--
 - `(A) which either--
 - `(i) provides that any fees (including any commission or other compensation) received by the fiduciary adviser for investment advice or with respect to the sale, holding, or acquisition of any security or other property for purposes of investment of plan assets do not vary depending on the basis of any investment option selected, or
 - `(ii) uses a computer model under an investment advice program meeting the requirements of paragraph (3) in connection with the provision of investment advice by a fiduciary adviser to a participant or beneficiary, and
 - `(B) with respect to which the requirements of paragraph (4), (5), (6), (7), (8), and (9) are met.
 - `(3) INVESTMENT ADVICE PROGRAM USING COMPUTER MODEL-
 - `(A) IN GENERAL- An investment advice program meets the requirements of this paragraph if the requirements of subparagraphs (B), (C), and (D) are met.
 - `(B) COMPUTER MODEL- The requirements of this subparagraph are met if the investment advice provided under the investment advice program is provided pursuant to a computer model that--
 - `(i) applies generally accepted investment theories that take into account the historic returns of different asset classes over defined periods of time,
 - `(ii) utilizes relevant information about the participant, which may include age, life expectancy, retirement age, risk tolerance, other assets or sources of income, and preferences as to certain types of investments,
 - `(iii) utilizes prescribed objective criteria to provide asset allocation portfolios comprised of investment options available under the plan,
 - `(iv) operates in a manner that is not biased in favor of investments offered by the fiduciary adviser or a person with a material affiliation or contractual relationship with the fiduciary adviser, and

`(v) takes into account all investment options under the plan in specifying how a participant's account balance should be invested and is not inappropriately weighted with respect to any investment option.

`(C) CERTIFICATION-

`(i) IN GENERAL- The requirements of this subparagraph are met with respect to any investment advice program if an eligible investment expert certifies, prior to the utilization of the computer model and in accordance with rules prescribed by the Secretary, that the computer model meets the requirements of subparagraph (B).

`(ii) RENEWAL OF CERTIFICATIONS- If, as determined under regulations prescribed by the Secretary, there are material modifications to a computer model, the requirements of this subparagraph are met only if a certification described in clause (i) is obtained with respect to the computer model as so modified.

`(iii) ELIGIBLE INVESTMENT EXPERT- The term `eligible investment expert' means any person--

`(I) which meets such requirements as the Secretary may provide, and

`(II) does not bear any material affiliation or contractual relationship with any investment adviser or a related person thereof (or any employee, agent, or registered representative of the investment adviser or related person).

`(D) EXCLUSIVITY OF RECOMMENDATION- The requirements of this subparagraph are met with respect to any investment advice program if--

`(i) the only investment advice provided under the program is the advice generated by the computer model described in subparagraph (B), and

`(ii) any transaction described in subsection (b)(14)(B)(ii) occurs solely at the direction of the participant or beneficiary.

Nothing in the preceding sentence shall preclude the participant or beneficiary from requesting investment advice other than that described in subparagraph (A), but only if such request has not been solicited by any person connected with carrying out the arrangement.

`(4) EXPRESS AUTHORIZATION BY SEPARATE FIDUCIARY- The requirements of this paragraph are met with respect to an arrangement if the arrangement is expressly authorized by a plan fiduciary other than the person offering the investment advice program, any person providing investment options under the plan, or any affiliate of either.

`(5) ANNUAL AUDIT- The requirements of this paragraph are met if an independent auditor, who has appropriate technical training or experience and proficiency and so represents in writing--

` (A) conducts an annual audit of the arrangement for compliance with the requirements of this subsection, and

` (B) following completion of the annual audit, issues a written report to the fiduciary who authorized use of the arrangement which presents its specific findings regarding compliance of the arrangement with the requirements of this subsection.

For purposes of this paragraph, an auditor is considered independent if it is not related to the person offering the arrangement to the plan and is not related to any person providing investment options under the plan.

` (6) DISCLOSURE- The requirements of this paragraph are met if--

` (A) the fiduciary adviser provides to a participant or a beneficiary before the initial provision of the investment advice with regard to any security or other property offered as an investment option, a written notification (which may consist of notification by means of electronic communication)--

` (i) of the role of any party that has a material affiliation or contractual relationship with the financial adviser in the development of the investment advice program and in the selection of investment options available under the plan,

` (ii) of the past performance and historical rates of return of the investment options available under the plan,

` (iii) of all fees or other compensation relating to the advice that the fiduciary adviser or any affiliate thereof is to receive (including compensation provided by any third party) in connection with the provision of the advice or in connection with the sale, acquisition, or holding of the security or other property,

` (iv) of any material affiliation or contractual relationship of the fiduciary adviser or affiliates thereof in the security or other property,

` (v) the manner, and under what circumstances, any participant or beneficiary information provided under the arrangement will be used or disclosed,

` (vi) of the types of services provided by the fiduciary adviser in connection with the provision of investment advice by the fiduciary adviser,

` (vii) that the adviser is acting as a fiduciary of the plan in connection with the provision of the advice, and

` (viii) that a recipient of the advice may separately arrange for the provision of advice by another adviser, that could have no material affiliation with and receive no fees or other compensation in connection with the security or other property, and

` (B) at all times during the provision of advisory services to the participant or beneficiary, the fiduciary adviser--

` (i) maintains the information described in subparagraph (A) in accurate form and in the manner described in paragraph (8),

` (ii) provides, without charge, accurate information to the recipient of the advice no less frequently than annually,

` (iii) provides, without charge, accurate information to the recipient of the advice upon request of the recipient, and

` (iv) provides, without charge, accurate information to the recipient of the advice concerning any material change to the information required to be provided to the recipient of the advice at a time reasonably contemporaneous to the change in information.

` (7) OTHER CONDITIONS- The requirements of this paragraph are met if--

` (A) the fiduciary adviser provides appropriate disclosure, in connection with the sale, acquisition, or holding of the security or other property, in accordance with all applicable securities laws,

` (B) the sale, acquisition, or holding occurs solely at the direction of the recipient of the advice,

` (C) the compensation received by the fiduciary adviser and affiliates thereof in connection with the sale, acquisition, or holding of the security or other property is reasonable, and

` (D) the terms of the sale, acquisition, or holding of the security or other property are at least as favorable to the plan as an arm's length transaction would be.

` (8) STANDARDS FOR PRESENTATION OF INFORMATION-

` (A) IN GENERAL- The requirements of this paragraph are met if the notification required to be provided to participants and beneficiaries under paragraph (6)(A) is written in a clear and conspicuous manner and in a manner calculated to be understood by the average plan participant and is sufficiently accurate and comprehensive to reasonably apprise such participants and beneficiaries of the information required to be provided in the notification.

` (B) MODEL FORM FOR DISCLOSURE OF FEES AND OTHER COMPENSATION- The Secretary shall issue a model form for the disclosure of fees and other compensation required in paragraph (6)(A)(iii) which meets the requirements of subparagraph (A).

` (9) MAINTENANCE FOR 6 YEARS OF EVIDENCE OF COMPLIANCE- The requirements of this paragraph are met if a fiduciary adviser who has provided advice referred to in paragraph (1) maintains, for a period of not less than 6 years after the provision of the advice, any records necessary for determining whether the requirements of the preceding provisions of this subsection and of subsection (b)(14) have been met. A transaction prohibited under section 406 shall not be considered to have occurred solely because the records are lost or destroyed prior to the end of the 6-year period due to circumstances beyond the control of the fiduciary adviser.

` (10) EXEMPTION FOR PLAN SPONSOR AND CERTAIN OTHER FIDUCIARIES-

` (A) IN GENERAL- Subject to subparagraph (B), a plan sponsor or other person who is a fiduciary (other than a fiduciary adviser) shall not be treated as failing to meet the requirements of this part solely by reason of the provision of investment advice referred to in section 3(21)(A)(ii) (or solely by reason of contracting for or otherwise arranging for the provision of the advice), if--

` (i) the advice is provided by a fiduciary adviser pursuant to an eligible investment advice arrangement between the plan sponsor or other fiduciary and the fiduciary adviser for the provision by the fiduciary adviser of investment advice referred to in such section,

` (ii) the terms of the eligible investment advice arrangement require compliance by the fiduciary adviser with the requirements of this subsection, and

` (iii) the terms of the eligible investment advice arrangement include a written acknowledgment by the fiduciary adviser that the fiduciary adviser is a fiduciary of the plan with respect to the provision of the advice.

` (B) CONTINUED DUTY OF PRUDENT SELECTION OF ADVISER AND PERIODIC REVIEW-

Nothing in subparagraph (A) shall be construed to exempt a plan sponsor or other person who is a fiduciary from any requirement of this part for the prudent selection and periodic review of a fiduciary adviser with whom the plan sponsor or other person enters into an eligible investment advice arrangement for the provision of investment advice referred to in section 3(21)(A)(ii). The plan sponsor or other person who is a fiduciary has no duty under this part to monitor the specific investment advice given by the fiduciary adviser to any particular recipient of the advice.

` (C) AVAILABILITY OF PLAN ASSETS FOR PAYMENT FOR ADVICE- Nothing in this part shall be construed to preclude the use of plan assets to pay for reasonable expenses in providing investment advice referred to in section 3(21)(A)(ii).

` (11) DEFINITIONS- For purposes of this subsection and subsection (b)(14)--

` (A) FIDUCIARY ADVISER- The term `fiduciary adviser' means, with respect to a plan, a person who is a fiduciary of the plan by reason of the provision of investment advice referred to in section 3(21)(A)(ii) by the person to the participant or beneficiary of the plan and who is--

` (i) registered as an investment adviser under the Investment Advisers Act of 1940 (15 U.S.C. 80b-1 et seq.) or under the laws of the State in which the fiduciary maintains its principal office and place of business,

` (ii) a bank or similar financial institution referred to in section 408(b)(4) or a savings association (as defined in section 3(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(1))), but only if the advice is provided through a trust department of the bank or similar financial institution or savings association which is subject to periodic examination and review by Federal or State banking authorities,

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- ` (iii) an insurance company qualified to do business under the laws of a State,
- ` (iv) a person registered as a broker or dealer under the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.),
- ` (v) an affiliate of a person described in any of clauses (i) through (iv), or
- ` (vi) an employee, agent, or registered representative of a person described in clauses (i) through (v) who satisfies the requirements of applicable insurance, banking, and securities laws relating to the provision of the advice.

For purposes of this part, a person who develops the computer model described in paragraph (3)(B) or markets the investment advice program or computer model shall be treated as a person who is a fiduciary of the plan by reason of the provision of investment advice referred to in section 3(21)(A)(ii) to the participant or beneficiary and shall be treated as a fiduciary adviser for purposes of this subsection and subsection (b)(14), except that the Secretary may prescribe rules under which only 1 fiduciary adviser may elect to be treated as a fiduciary with respect to the plan.

` (B) **AFFILIATE**- The term `affiliate' of another entity means an affiliated person of the entity (as defined in section 2(a)(3) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(3))).

` (C) **REGISTERED REPRESENTATIVE**- The term `registered representative' of another entity means a person described in section 3(a)(18) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(18)) (substituting the entity for the broker or dealer referred to in such section) or a person described in section 202(a)(17) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(17)) (substituting the entity for the investment adviser referred to in such section).`

(3) **EFFECTIVE DATE**- The amendments made by this subsection shall apply with respect to advice referred to in section 3(21)(A)(ii) of the Employee Retirement Income Security Act of 1974 provided after December 31, 2006.

NOTE 5 -COMPANY STOCK

` (35) DIVERSIFICATION REQUIREMENTS FOR CERTAIN DEFINED CONTRIBUTION PLANS-

` (A) IN GENERAL- A trust which is part of an applicable defined contribution plan shall not be treated as a qualified trust unless the plan meets the diversification requirements of subparagraphs (B), (C), and (D).

` (B) EMPLOYEE CONTRIBUTIONS AND ELECTIVE DEFERRALS INVESTED IN EMPLOYER SECURITIES- In the case of the portion of an applicable individual's account attributable to employee contributions and elective deferrals which is invested in employer securities, a plan meets the requirements of this subparagraph if the applicable individual may elect to direct the plan to divest any such securities and to reinvest an equivalent amount in other investment options meeting the requirements of subparagraph (D).

` (C) EMPLOYER CONTRIBUTIONS INVESTED IN EMPLOYER SECURITIES- In the case of the portion of the account attributable to employer contributions other than elective deferrals which is invested in employer securities, a plan meets the requirements of this subparagraph if each applicable individual who--

` (i) is a participant who has completed at least 3 years of service, or

` (ii) is a beneficiary of a participant described in clause (i) or of a deceased participant,

may elect to direct the plan to divest any such securities and to reinvest an equivalent amount in other investment options meeting the requirements of subparagraph (D).

` (D) INVESTMENT OPTIONS-

` (i) IN GENERAL- The requirements of this subparagraph are met if the plan offers not less than 3 investment options, other than employer securities, to which an applicable individual may direct the proceeds from the divestment of employer securities pursuant to this paragraph, each of which is diversified and has materially different risk and return characteristics.

` (ii) TREATMENT OF CERTAIN RESTRICTIONS AND CONDITIONS-

` (I) TIME FOR MAKING INVESTMENT CHOICES- A plan shall not be treated as failing to meet the requirements of this subparagraph merely because the plan limits the time for divestment and reinvestment to periodic, reasonable opportunities occurring no less frequently than quarterly.

(II) CERTAIN RESTRICTIONS AND CONDITIONS NOT ALLOWED- Except as provided in regulations, a plan shall not meet the requirements of this subparagraph if the plan imposes restrictions or conditions with respect to the investment of employer securities which are not imposed on the investment of other assets of the plan. This subclause shall not apply to any restrictions or conditions imposed by reason of the application of securities laws.

NOTE 6 -FEATURES MADE PERMANENT

SEC. 811. PENSIONS AND INDIVIDUAL RETIREMENT ARRANGEMENT PROVISIONS OF ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001 MADE PERMANENT.

Title IX of the Economic Growth and Tax Relief Reconciliation Act of 2001 shall not apply to the provisions of, and amendments made by, subtitles A through F of title VI of such Act (relating to pension and individual retirement arrangement provisions).