

THE WILLARD
1455 PENNSYLVANIA AVENUE, NW, SUITE 1200
WASHINGTON, DC 20004

TEL 202-347-2230

FAX 202-393-3310 WWW.DAVIS-HARMAN.COM

MEMORANDUM

POST-ELECTION LANDSCAPE FOR RETIREMENT POLICY

**Kent Mason and Derek Dorn
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I. Introduction.

The media have appropriately described November’s federal elections as preserving the balance of power; the President was reelected, while Democrats retained their majority in the Senate and Republicans in the House. But even if control does not shift on swearing-in day in January, the playing field has arguably shifted, especially since the reelected Obama Administration could well feel more empowered in implementing its regulatory agenda.

This Memorandum provides an overview of potential developments in retirement policy. After reviewing the retirement policy process and who the key players will be, we

examine leading opportunities and threats, both with respect to Congress and the Administration, organized by topical area.

At the outset, we offer three contextual observations:

- ◆ *Congress generally does not enact significant retirement-related legislation on a stand-alone basis.* Rather, retirement policy measures tend to be attached to broader bills – typically ones related to tax policy. But retirement measures sometimes find a home in completely unrelated legislative vehicles. For instance, highway legislation enacted this past summer included both significant defined benefit (DB) funding stabilization and PBGC premium increases – not because of a relationship between DB plans and highways, but rather due to revenue needs and policy concerns.
- ◆ *Retirement-related provisions have traditionally advanced on a bipartisan basis.* For instance, the most recent stand-alone retirement policy bill, the Pension Protection Act of 2006, passed 93-5 in the Senate and 270-131 in the House. Recent partisan gridlock might lower expectations for what the incoming Congress might enact.
- ◆ *Regulators will continue to play an active role.* During the Obama Administration’s first term, regulators at the key agencies that shape retirement policy – the Department of the Treasury, the Department of Labor, and the Pension Benefit Guaranty Corporation – maintained an active agenda. We expect this level of activity to continue.

II. Key players.

Within the Administration, retirement policy is driven largely by the Department of Labor (DOL) and its Employee Benefits Security Administration (EBSA); the Department of the Treasury and its Office of Tax Policy; and the Pension Benefit Guaranty Corporation (PBGC).

- ◆ *Department of Labor.* The DOL is led by Secretary Hilda Solis, a former Member of Congress from California. It is unclear if she will remain through a second Obama term. She has generally not been vocal on retirement policy issues (although she has testified before Congress in support of the fiduciary proposal discussed further below). The Assistant Secretary in charge of EBSA is Phyllis Borzi, who is generally expected to remain in office. Ms. Borzi’s Deputy Assistant Secretary, Michael Davis, recently departed the Administration, creating a vacancy.
- ◆ *Department of the Treasury.* It is widely anticipated that Secretary Timothy Geithner will step down early in 2013. Among those rumored to succeed him is Jack Lew, the former Director of the Office of Management and Budget who now serves as White House Chief of Staff. The Assistant Secretary for Tax Policy leads tax policy; in that position, the Senate recently confirmed Mark Mazur, an

economist who previously served as Deputy Assistant Secretary for Tax Analysis. Serving under Mazur is Mark Iwry, the Deputy Assistant Secretary (Tax Policy) for Retirement and Health Policy. While a scholar at Brookings, Iwry developed the Automatic IRA proposal. Under Iwry is George Bostick, who serves as Benefits Tax Counsel. The IRS is the lead enforcement agency. With Commissioner Douglas Shulman having recently stepped aside, Acting Commissioner Steve Miller currently leads the agency. As he was previously in charge of the Tax Exempt and Government Entities division of the IRS, Miller has significant familiarity with qualified plan issues.

- ◆ *Pension Benefit Guaranty Corporation.* PBGC is headed by Josh Gotbaum, whose term will end in 2015.

Within Congress, a handful of committees play a central role in shaping retirement legislation; their chairmen and ranking minority members have a significant role in driving retirement legislation. As we approach the 113th Congress, it appears that leadership on these committees will largely remain the same – with certain notable exceptions.

- ◆ *Senate Finance Committee.* The Senate Finance Committee, whose jurisdiction includes all tax aspects of retirement policy as well as Social Security, will continue to be led by Chairman Max Baucus (D-MT) and Ranking Member Orrin Hatch (R-UT). Chairman Baucus's Senate term expires in 2014; he has not yet announced if he will stand for a seventh term. Sen. Hatch was just re-elected; some expect Hatch to reemerge as a bipartisan dealmaker, which had been his reputation in earlier Congresses (particularly on health care issues).

Several longstanding Committee Members will retire. Sen. Kent Conrad (D-ND) has long been a champion for the life insurance industry. Sen. Jeff Bingaman (D-NM) has taken a significant interest in retirement issues, and is the lead Senate sponsor of both the Automatic IRA Act and the Lifetime Income Disclosure Act (described below). Sen. Olympia Snowe (R-ME) has been a critical swing vote, and Sen. Jon Kyl (R-AZ) has been a leading conservative voice.

Among those reportedly under consideration to join the Committee on the Democratic side are Sen. Michael Bennet (D-CO); Sen. Bob Casey (D-PA), who has been particularly interested in multiemployer plan issues; Sen. Kay Hagan (D-NC); Sen. Amy Klobuchar (D-MN); and Sen. Mark Warner (D-VA), a leader of the "Gang of Eight." We understand that Sens. Klobuchar and Casey may have the inside track, but that if Sen. Bennet accepts the chairmanship of the Democrats' campaign committee, he may leap forward.

On the Republican side, those reportedly under consideration include Sen. Johnny Isakson (R-GA), a longtime advocate of retirement incentives and the lead Republican on the Sense of the Senate Resolution regarding preservation of retirement tax incentives; and Sen. Rob Portman (R-OH), who as a House

- Member joined with now-Sen. Ben Cardin (D-MD), also a Finance Committee member, to enact the retirement plan provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001, which dramatically increased contribution limits, simplified many rules, and enhanced portability.
- ◆ *House Ways and Means Committee.* The Ways and Means Committee, whose retirement policy jurisdiction is generally parallel to that of the Finance Committee, will continue to be led by Chairman Dave Camp (R-MI) and Ranking Member Sandy Levin (D-MI). Subcommittees play a strong role in the House; we anticipate that the Select Revenue Measures Subcommittee (with jurisdiction over revenue measures) will continue to be led by Chairman Pat Tiberi (R-OH) and Ranking Member Richard Neal (D-MA). Four Members will leave the Committee: Rep. Rick Berg (R-ND) and Rep. Shelley Berkley (D-NV), who unsuccessfully ran for the Senate; Rep. Pete Stark (D-CA), who was defeated in his reelection, and Rep. Wally Herger (R-CA), who is retiring. Rumored Republican hopefuls for the Committee include Rep. Tim Griffin (R-AR); Rep. Kristi Noem (R-SD); Rep. Reid Ribble (R-WI); Rep. Todd Rokita (R-IN); and Rep. Tim Scott (R-SC). On the Democratic side, we understand it is most likely that two Members will rejoin the Committee: Rep. Allyson Schwartz (D-PA) and Rep. Chris Van Hollen (D-MA).
 - ◆ *Senate Health, Education, Labor and Pensions Committee.* The “HELP” Committee’s jurisdiction extends to non-tax aspects of retirement plans, including Title I of ERISA. The Committee will continue to be led by Chairman Tom Harkin (D-IA), who has indicated that he plans for retirement issues to figure more prominently in the Committee’s agenda for the 113th Congress. We expect in particular that Harkin will convene hearings on, and ultimately mark up, his Retirement USA Fund proposal (discussed in [section VII](#), below). Because Sen. Mike Enzi (R-WY) is term-limited as the Committee’s Ranking Member, we expect Sen. Lamar Alexander (R-TN) to become the Committee’s lead Republican. Sen. Alexander has not previously been active on retirement policy. The only vacancy is the seat of retiring Sen. Jeff Bingaman (D-NM).
 - ◆ *House Education and the Workforce Committee.* The Education and the Workforce Committee, whose retirement policy jurisdiction is generally parallel to that of the HELP Committee, will continue to be led by Chairman John Kline (R-MN) and Ranking Member George Miller (D-CA). In the retirement policy area, the Committee’s activities in the 112th Congress centered on Department of Labor oversight; we expect this focus to continue into the next Congress, alongside PBGC oversight. While it is unclear if the Committee’s Health, Education, Labor and Pensions Subcommittee will continue to be chaired by Rep. Phil Roe (R-TN), we expect that Rep. Rob Andrews (D-NJ) will continue as the Subcommittee’s ranking Democrat. We anticipate extensive changes in the Committee’s composition, particularly on the Republican side.

- ◆ *Senate Special Committee on Aging.* The Aging Committee does not have any legislative jurisdiction and, as such, does not report legislation to the full Senate. But the Committee has a broad ability to convene hearings and commission studies on any topic related to older Americans. The Committee's current chairman, Sen. Herb Kohl (D-WI), has used this authority to highlight retirement plan issues, including plan fees and target date fund composition. With Kohl's retirement, it is likely that Sen. Bill Nelson (D-FL) will become the chairman. (We expect Sen. Ron Wyden (D-OR), who is ahead of Nelson in succession, to opt instead to become chairman of the Energy and Natural Resources Committee.) And given that its current ranking member, Sen. Bob Corker (R-TN), is expected to assume that role on the Foreign Relations Committee, we anticipate that Sen. Susan Collins (R-ME) or Sen. Mark Kirk (R-IL) will become Aging's next Ranking Member.

III. The fiscal backdrop and tax reform.

For the foreseeable future, the gaping federal budget deficit and tax reform will dominate the attention of Washington's policymakers. Because current entitlement spending and tax policies result in unsustainable structural budget deficits, these two themes are inextricably linked.

On December 31, the tax rates on ordinary income, dividends, capital gains, and estates – first established in 2001 and 2003, and extended in 2010 – are set to expire. So, too, will the payroll tax holiday – which lowered the employee-side contribution by 2% in 2011 and 2012 – lapse. (Many plan sponsors have successfully encouraged participants to use at least part of the payroll tax savings to increase retirement plan elective deferrals.) And in January, dramatic across-the-board spending cuts are slated to take effect.

The nonpartisan Congressional Budget Office anticipates that these changes could trigger another recession and cause unemployment to climb to 9.1%. As such, the “fiscal cliff” creates an imperative for lawmakers to identify revenue offsets. The imperative could well ensnare incentives for retirement plans and IRAs – even if policymakers continue to support the incentives' underlying policy merits. We might also see further PBGC premium increases and/or (revenue-raising) DB funding stabilization measures. It seems likely, but is hardly certain, that action will be taken before December 31. If action is taken, we do not anticipate a “grand bargain” that includes fundamental budget reform. Rather, Congress is more likely to enact a “down payment” that averts the fiscal cliff – and forestalls comprehensive reform until 2013.

A. Structural threats in “fiscal cliff” debate.

During the fiscal cliff debate, there is a real possibility that a compromise could dramatically impact retirement plans, particularly from modifications to tax incentives for retirement savings, changes to DB funding rules, and/or PBGC premium increases. In terms of modifications to incentives, we think any change would be the result of broadly enacted provisions, rather than provisions that solely touch retirement. In particular, we

are concerned about the following threats arising in the fiscal cliff context – or during broader budget and tax reform conversations in 2013.

- ◆ Overall limitations on tax expenditures. To raise revenue, policymakers have been considering across-the-board limitations on a taxpayer's ability to claim tax expenditures – that is, exclusions, credits, and deductions that collectively reduce revenues by more than \$1 trillion annually. In his FY13 budget proposal to Congress, President Obama proposed to cap at 28% the value of a taxpayer's tax expenditures – including the exclusion for employee contributions to defined contribution (DC) plans.¹ The dramatic implications of such a proposal can be illustrated by an example. Assume that an individual in the 35% tax bracket makes a contribution to a 401(k) plan of \$1,000. Under current law, the individual would save \$350 of current taxes (*i.e.*, 35%). Some view the 35% as inequitable, because taxpayers in lower tax brackets receive a smaller tax benefit. The President's proposal seeks to ensure that the individual in this example would only save \$280 of taxes (*i.e.*, 28% of \$1,000).

Another way to conceptualize this proposal is that an individual in the 35% bracket would in effect lose 20% of his or her tax benefit ($35\% - 28\% = 7\%$). Thus, under the analysis set forth above, there would be an element of double taxation: the employee in this example would pay a 7% tax on the \$1,000 contribution and then later could be required to pay a 35% tax again on the \$1,000 when it is distributed. This proposal appears not to apply to Roth contributions, which would make Roth contributions more attractive.

- ◆ Cap certain deductions/exclusions. There has been recent discussion of putting all itemized deductions and possibly other deductions and exclusions in a “bucket” and limiting that bucket to a set dollar figure – such as at the \$17,000 level that Governor Mitt Romney floated during the presidential campaign. Alternatively, the limit could be established as a percentage of income (for instance, former Reagan advisor Martin Feldstein has proposed to limit the amount of tax savings a taxpayer can claim from tax expenditures to no more than 2% of the taxpayer's adjusted gross income). Amounts above the limit would not be available as deductions or exclusions from income. If retirement plan and IRA contributions are placed in that bucket with such a low cap and aggregated with itemized deductions – most significantly, mortgage interest, charitable contributions, and state and local income taxes – the adverse effects on qualified retirement savings could be quite dramatic.
- ◆ Stretch IRAs. It is also possible that the fiscal cliff debate (or, later, tax reform or deficit reduction) could implicate more subtle rules. One area that has been

¹ Earlier versions of this proposal had been limited to itemized deductions and the employment-based health plan exclusion; a job-creation proposal from the White House was the first to sweep in retirement incentives.

targeted by both Democrats and Republicans is the “stretch IRA.”² Required minimum distribution (“RMD”) rules generally require that IRA distributions start shortly after the IRA owner attains age 70½. There are also RMD rules applicable after the death of the IRA owner. Very generally, under current law, if an IRA owner dies, the beneficiary is permitted to draw down the IRA over the beneficiary's life expectancy. This rule allows beneficiaries to “stretch” out the distribution of the IRA assets over too long a period in the view of some in the government. This has led to proposals to modify the rules that permit stretch IRAs. For example, under a proposal that appeared in a recent Senate Finance Committee Chairman’s mark, subject to certain exceptions, IRA beneficiaries would be required to draw down all assets in the IRA within five years.³ The proposal was estimated to raise \$4.64 billion in the 10-year budget window. Finance Committee Republicans opposed the inclusion, arguing that this revenue should finance an extension of current estate tax parameters. Given that the estate tax is part of the fiscal cliff – *i.e.*, absent Congressional action, the 2001 exemption amount and tax rate will take effect on January 1 – there is a real potential that this issue will surface in the fiscal cliff debate.

B. Possible defined benefit pension plan issues for the lame duck session.

Pension issues could well arise during the lame duck session. The two most likely issues are discussed below. Other possibilities are addressed in section V, below, devoted to DB plan issues.

- ◆ *Funding stabilization.* The historically low interest rates created by the efforts of the Federal Reserve Board to stimulate the economy have been causing pension liabilities and funding obligations to be artificially inflated. This in turn has been having an adverse effect on jobs and business investment, since companies were being required to divert enormous resources away from their businesses and into pension plans. Once interest rates return to normal, these amounts will not (in most cases) be needed in the plans. This past summer, Congress included a provision to address this problem in a comprehensive highway bill known as the “Moving Ahead for Progress in the 21st Century” (MAP-21). The provision stabilized pension funding obligations by basing pension funding interest rates to some extent on a 25-year average of interest rates, rather than on the more recent historically low interest rates. The effect of this legislation is phased out gradually over the 2012-2016 period. However, even this short-term stabilization legislation raised approximately \$10 billion over 10 years.

² This issue is discussed here in the context of IRAs. Technically, the issue relates to retirement plans also, but as a practical matter, the issue arises predominantly in the IRA context.

³ The exceptions would, for example, generally preserve current law treatment for spouses, beneficiaries who are not more than 10 years younger than the IRA owner, disabled beneficiaries, and chronically ill beneficiaries. The proposal includes a special rule for beneficiaries who have not attained the age of majority, under which the five-year rule would not apply until the beneficiary reached the age of majority.

There have been no public congressional discussions of making the funding stabilization legislation permanent or of slowing down the phase out. And there were some in the government who had policy concerns about the legislation, making permanence or extension uncertain. Nevertheless, there is a very real possibility that Congress will return to this issue either in the lame duck session and/or in 2013. The fact that such further legislation would both raise revenue and be supported by businesses is helpful, especially at a time when the search for revenue will be intense. In addition, in light of the announced plans of the Federal Reserve Board to continue maintaining low interest rates for the near future, it appears that the artificially low interest rates will continue beyond the phase out of the enacted legislation.

- ◆ *PBGC premiums.* The historically low interest rates have also inflated the value of PBGC's liabilities, creating a record deficit of \$34 billion in 2012. Congress responded to the 2011 deficit by increasing the flat and variable rate premiums this past summer by a total of roughly \$9 billion over 10 years. However, the Administration had proposed raising premiums by \$16 billion. Moreover, the Administration had also proposed that Congress give PBGC the ability to set its own premiums based on the risk posed to the PBGC by the plan and plan sponsor, including consideration of the plan sponsor's financial stability. A recent GAO report also supported changes to the PBGC premium structure "to more fully reflect the risk posed by plans and sponsors to the agency."

There have been no public Congressional discussions of further increases in PBGC premiums, nor have there been discussions of giving PBGC the ability to set its own premiums based on plan and plan sponsor risk factors. But in light of the intense need for revenue in the lame duck session and in 2013, there is a real possibility of further increases in premiums. Since they are deemed "fees" rather than taxes, premium increases are often politically more palatable than tax increases. Further, we expect the Administration to continue to push hard for PBGC to have the ability to set its own premiums. This aspect of the Administration has not attracted significant support on the Hill to date, though of course that could change.

C. Additional threats from tax reform.

Even as policymakers seek a compromise on the immediate challenge of the fiscal cliff, it is widely recognized that the Internal Revenue Code (Code) cannot be rewritten in the few weeks that remain before December 31. Nevertheless, with a general consensus that the tax system needs to be modernized, we anticipate that the 113th Congress will attempt the first comprehensive revisions to the Code since 1986. Such a rewrite could well be facilitated by potential provisions of a fiscal cliff compromise providing a directive to the tax-writing Committees to report a tax reform bill meeting stated parameters and/or providing "fast-track" protections for any such bill that comes to the House or Senate floor.

But despite the general consensus on a need for tax reform, Democrats and Republicans do not agree on details. In particular, Democrats appear more supportive of tax reform as a means of raising revenue, while Republicans are focused more on lowering overall tax rates. But in either context, existing tax incentives that promote saving will be critically reviewed in the 113th Congress. In fact, the Senate and House tax-writing Committees have laid the groundwork in the current Congress, each holding hearings to examine the policy rationale for existing retirement incentives. At the hearings, no Member expressed opposition to the current incentive structure. Meanwhile, broad House-wide support has been evidenced by a bipartisan “Sense of the House” resolution “[e]xpressing the sense of the Congress that our current tax incentives for retirement savings provide important benefits to Americans to help plan for a financially secure retirement.” Introduced by Rep. Richard Neal (D-MA) and Rep. Jim Gerlach (R-PA), the Resolution now has 120 cosponsors, and a Senate companion is slated to be introduced by Sen. Johnny Isakson (R-GA) and Sen. Richard Blumenthal (D-CT).

Nevertheless, even if Members of Congress largely support the existing incentive system on its policy merits, retirement tax preferences could well be threatened by a broader drive to cut back tax expenditures. Both of the leading deficit-reduction commissions – the President’s National Commission on Fiscal Responsibility and Reform (Simpson-Bowles) and the Bipartisan Policy Center’s Debt Reduction Task Force (Domenici-Rivlin) – called for an “end to almost all tax expenditures to offset the costs of the much lower tax rates” in order to “dramatically simplify the tax system and remove tax considerations from private decisions on how to work, invest, and spend, thereby improving economic efficiency and raising living standards.”⁴ Under Congressional “scoring” conventions, tax expenditures for DB and DC plans and individual retirement plans (IRAs) collectively rank second among all tax expenditures, behind only the income exclusion for employer-provided health insurance.⁵ Retirement tax expenditures are estimated to cost the federal government \$788 billion between 2012 and 2016.

Given this high (purported) price tag, retirement incentives will be a ripe target in any effort to broaden the tax base – whether aimed at reducing deficits and/or tax rates. Not surprisingly, then, outside commissions and groups have advanced several proposals to scale back retirement tax expenditures. Besides the overall limitations on tax expenditures and caps on certain deductions or exclusions (discussed above in the context of the fiscal cliff), we note the following options that have been raised:

⁴ This same paradigm – broaden the tax base to finance a rate reduction – was the focus of the 1986 comprehensive tax reform (the nation’s most recent). In fact, 60% of the revenue raised by the 1986 Act resulted from eliminating or reducing tax expenditures.

⁵ Other than in the case of a Roth designation, retirement savings incentives generally provide a deferral of tax on contributed amounts, rather than an outright exclusion. But because the Congressional Joint Committee on Taxation calculates its revenue estimates within a 10-year budget window, participant and account-holders’ payment of tax (upon withdrawal) is often not credited – because withdrawals typically occur more than 10 years after contributions are made. Accordingly, current estimates overstate the size of retirement savings provisions relative to tax expenditures that provide a complete exclusion.

- ◆ Direct reductions of contribution limits. Most frequently discussed is the “20/20” proposal, which was included “illustratively” in both the Bowles-Simpson and Domenici-Rivlin reports. Under this proposal, the total amount of employer and employee contributions to a DC plan on behalf of an employee would be limited to the lesser of (a) \$20,000 or (b) 20% of pay. (In 2013, the limits will be the lesser of \$51,000 or 100% of pay.) It is unclear if IRA contributions would be aggregated with DC contributions for purposes of this limit; DB contributions and benefits are excluded. We note that both commissions had proposed outright *elimination* of nearly all other tax expenditures; those for retirement are among the only ones spared – albeit at a far more modest level.
- ◆ Tax credit in lieu of exclusion/deduction. Today, if an employee in the 35% tax bracket contributes \$1,000 to a 401(k) plan, the employee pays no current income tax on the \$1,000, thus receiving a current tax benefit worth \$350. Another employee in the 25% bracket has a current tax benefit of \$250. Some have argued that this is inequitable, and have called to convert the exclusion into a tax credit. One tax credit proposal would set the credit at 18%. Thus, in the above example, both employees would pay tax on the \$1,000 contributions but would receive a tax credit of \$180, a significant decrease in their current tax benefit.

In addition, when the \$1,000 is subsequently distributed, the \$1,000 would again be taxed – effectively creating an element of double taxation. For example, the employee in the 35% bracket pays a 17% tax on the \$1,000 contribution and later pays a 35%⁶ tax on the distribution of the same \$1,000. (It is unclear how this proposal would apply to Roth contributions.)

Under other possible features of the tax credit proposal supported by some, the tax credit would be deposited directly into a plan or IRA on behalf of the individual and would be “refundable” (so that the deposit is made on behalf of individuals with no tax liability).

While a handful of Democrats appear inclined to support a tax credit approach, it has not gained significant traction on the Hill.

- ◆ Plan consolidation. In the name of simplification, the Simpson-Bowles and Bipartisan Policy Center have revived a proposal from the George W. Bush Administration that would consolidate 401(k), 403(b), and 457 plans (and perhaps SIMPLE plans and SEPs) into a single type of deferred compensation plan with one consistent set of rules. Presumably, consolidation aims more to simplify the tax code than to raise significant revenue. Nevertheless, consolidation could have dramatic implications for public, educational, and small business employers, who would face considerable expenses and burdens in terminating existing plans and establishing new ones. And, of course, such a proposal could threaten the market leadership of providers in niche markets.

⁶ The rate may be higher or lower, depending on income at the time of the withdrawal and the marginal rates in effect.

- ◆ *IRA consolidation.* Along similar lines, we might also see a revival of a proposal from the Bush Administration to consolidate tax-advantaged individual retirement accounts into a single vehicle (which President Bush called a “Retirement Savings Account”). Such a move could be tantamount to eliminating deductible and non-deductible IRAs, essentially making Roth IRAs the sole option (other than for rollovers).
- ◆ *Indirect taxes.* Savings incentives could also be undermined if tax exclusions or deferrals are not counted in applying income phase-outs for other tax incentives or tax rates. For instance, in the health care reform law, a new 3.8% surtax applies to investment income for taxpayers with income over \$200,000 (single) and \$250,000 (married/joint). The law expressly exempts qualified retirement plan distributions from the surtax. But those same distributions are counted as income that can push taxpayers over the \$200,000 or \$250,000 threshold for the surtax. Consequently, in many cases, retirement plan distributions are in effect taxed indirectly, because they result in a greater portion of other investment income being pushed into the surtax.
- ◆ *Indirect limit proposals.* Even if contributions are not directly limited, as under the 20/20 proposal referenced above, we would expect active consideration of other more technical proposals that could have effects similar to a direct limit on contributions. This is an area that bears careful monitoring.

IV. Fiduciary issues.

A. Definition of “fiduciary” for investment advice purposes.

For more than 35 years, the DOL has maintained a consistent definition regarding the extent to which the provision of “investment advice” for a fee will give rise to fiduciary status, and the retirement industry has organized itself around this definition. But in late 2010, DOL proposed to expand the definition dramatically – in a manner that could significantly impair the distribution of retirement products. Extensive expressions of concern – particularly from Democratic Members of Congress – resulted in DOL’s announcement in September 2011 that it would withdraw the proposal. In particular, concerns focused on two points, summarized below.

First, the economic analysis of the costs and benefits of the proposed regulation was incomplete. For example, there was no analysis of the proposal’s effect on IRAs. Second, there was great concern that converting almost all discussions of investments into fiduciary acts would result in a dramatic decrease in the investment information available to participants and IRA owners. In this regard, the concern was not the requirement that advisers act in the sole interests of their clients. Instead, under DOL’s rules, a fiduciary is actually barred altogether (by the prohibited transaction rules) from giving advice where that advice could affect the fiduciary’s compensation. This would mean that the

traditional source of investment information for millions of Americans – the brokerage model – would be eliminated with, in many cases, no source of information to replace it.

DOL's top priority in the retirement area is issuing its repropose definition of a fiduciary. Since the reproposal has not yet been sent to OMB, we would not expect the reproposal to be issued until the spring or summer of 2013. We anticipate that the reproposal will contain an enhanced cost/benefit analysis. We also expect that the reproposal will (1) address many of the concerns that were raised in the comment process and (2) include proposed amendments to existing prohibited transaction exemptions as well as one or more proposed new prohibited transaction exemptions.

But based on informal discussions, there are questions as to whether the combination of the reproposal and the proposed exemptions will be enough to ensure that, for example, the brokerage model will be a permissible means of providing investment information in the absence of dramatic changes in business practices. There are also questions as to whether the reproposal will be modified to permit financial institutions to continue to provide critical assistance to small businesses that want to establish a plan. On the other hand, until we see the reproposal, we cannot say with any certainty whether these concerns will be fully addressed.

Additionally, there is one area where there are indications that the reproposal may be much broader than the original proposal. In the original proposal, the DOL had asked for comments on whether advice regarding distributions and rollovers should be treated as fiduciary advice. It is expected that in general, the DOL will propose that such distribution and rollover advice be treated as fiduciary advice. The question that is unclear is the extent to which the "seller's exception" in the reproposal will apply to prevent the ordinary sale of rollover products and services from being treated as fiduciary advice.

With respect to the distribution area, it is further anticipated that the Government Accountability Office (GAO) will issue a report that identifies possible conflicts of interest with respect to the provision of information regarding rollovers. This report will likely support the DOL's reproposal in this area – and could even lead to legislative and other activity with respect to rollovers.

There is a concern that the new regulation of distribution information will lead to much less information being provided to participants who terminate employment and do not know what to do with their retirement savings. The fear is that the reduction in information will lead to more savings being consumed rather than being rolled over. Until we see the reproposal, we cannot determine if those concerns are valid, but this is a critical issue to monitor.

B. Enhanced fee disclosure.

Service providers began providing fee and service disclosures to plan fiduciaries under DOL's final regulations, as of July 1, 2012. Service providers have been concerned by DOL's suggestion that it may provide additional guidance regarding such disclosures, in

the form of questions and answers. The concern is that the disclosures have been made and the process has gone smoothly for both service providers and plan sponsors. Consequently, addressing gray areas with new guidance could be disruptive. Moreover, it would be more helpful to wait to see how the process works over a two or three year period before considering any further guidance.

DOL is also working on proposed regulations that would require service providers to provide plan sponsors with a summary of the fee and service disclosures, or possibly a roadmap or chart showing the plan sponsor where each type of disclosure is available.

DOL has made clear that the enhanced service provider disclosure, together with enhanced 5500 reporting, will be leveraged by DOL's enforcement arm as part of its ongoing focus on consultant and adviser compensation. We expect that it will become standard for DOL auditors to ask plan sponsors to explain how they determined that compensation paid to service providers is reasonable.

C. Brokerage windows.

We anticipate that DOL may well issue adverse proposed guidance with respect to DC plans that offer a brokerage window but no designated investments.

Under guidance issued in the context of participant fee disclosure, DOL had stated that the failure to designate a "manageable number of investment alternatives" raises questions as to whether the fiduciary has satisfied its obligations under ERISA section 404. Subsequently, DOL deleted this reference, stating instead that the participant disclosure "regulation does not require that a plan have a particular number of [designated investment alternatives], and nothing in [the revised guidance] prohibits the use of a platform or a brokerage window, self-directed brokerage account, or similar plan arrangement in an individual account plan." But DOL suggested additional scrutiny in this area, stating that "a plan fiduciary's failure to designate investment alternatives, for example, to avoid investment disclosures under the regulation, raises questions under ERISA section 404(a)'s statutory duties of prudence and loyalty." DOL indicates that it may explore regulatory changes to address this issue.

D. Target date funds.

We expect the DOL to issue final regulations with respect to required disclosures to participants regarding target date funds. SEC has a parallel proposal that we expect will be finalized around the same time. (Enhanced disclosure on target date funds is an area where the SEC and DOL have been working in a harmonized manner.) The DOL is also working on "tips" for plan fiduciaries with respect to selecting target date funds. There are some concerns that, if the tips are too detailed, they could trigger problems with respect to past and future selections that are prudent but resulted from a selection process that differs from the DOL's tips.

E. Judicial issues.

ERISA litigation continues to be a fertile area for class action plaintiff lawyers. We have seen, and expect to continue to see, DOL filing amicus briefs in these cases on the side of the plaintiffs. More than a dozen “401(k) fee” cases continue to be pending in the federal courts. These cases began several years ago largely as copy-cat cases but plaintiffs have focused their arguments over time. Plaintiffs have had somewhat mixed results. DOL has filed briefs arguing against attempts by defendants to dispose of these cases before expensive discovery. DOL has been particularly skeptical of the “404(c) defense” – namely that plan sponsors should not be liable when participants make their own investment decisions and the fees of the plan and its investments are disclosed. We expect that, as these cases continue to be litigated, courts will provide more guidance on the contours of the fiduciary duty, particularly with regard to the fees of participant-directed plans, and to the duties of a fiduciary in monitoring revenue sharing.

V. DB pension plan issues.

We expect a variety of critical DB pension plan issues to arise in 2013.

A. De-risking.

In recent months, a number of major companies have moved forward with plans to shrink the size of their pension plans. This has been done in two primary ways. First, plans have purchased annuity contracts to satisfy their obligations to certain former employees. Generally, these contracts are distributed to former employees in the context of a termination of a portion of the plan. Second, plans have offered lump-sum distributions to certain former employees.

In some cases, the catalyst for considering these actions was the Administration's proposal to dramatically increase PBGC premiums. If former employees are no longer plan participants because they have received their full benefit in the form of an annuity contract or a lump-sum distribution, the plan does not owe a flat-rate premium with respect to such employees. But in the end, the key drivers for consideration of these de-risking actions were reducing the company's exposure to funding and accounting volatility. Although funding stabilization legislation was quite helpful in addressing funding volatility in the short term, as noted, the effect of the legislation phases out, leaving plan sponsors exposed to volatility and artificially low interest rates in the near future. On the accounting side, for many plan sponsors, pension liability is a very material percentage of the value of the company, leaving the company's balance sheet exposed to material swings based on interest rate volatility (without regard to the success of the business). By shrinking pension plans, companies reduce these effects.

In informal contexts, some policymakers have expressed concern about these de-risking transactions, especially the lump-sum distributions. It is not at all clear whether the Administration or Congress will act in this area, nor is it clear what policymakers would do if it did act. But this is an area that merits close monitoring, including during the lame duck session if Congress addresses funding or PBGC premiums then.

For specific reasons related to the law regarding interest rates, it is expected that the lump-sum approach will not be used as widely in 2013 as it has been in 2012, perhaps reducing the government's concerns and need to act. However, the de-risking approaches have highlighted a key issue that will become more prominent in the near future. Aside from funding stabilization legislation, the legal and accounting framework for pension plans has become increasingly difficult for companies, creating incentives to consider the types of actions described above. Unless the framework for pension plans is changed, there are great risks that the pension plan world will shrink very significantly in the next few years, undermining retirement security and reducing the PBGC's premium base dramatically.

B. 25-year average of interest rates.

The Treasury Department is expected to explore revisiting the methodology used to create the 25-year averages of interest rates used for purposes of funding stabilization, as enacted in MAP-21. This project is quite important, as any material changes resulting from a new methodology could have considerable effects on funding obligations.

C. Accounting reform.

Some point out that if today's interest rates are so artificially low that they should not be used for purposes of calculating funding obligations, then nor should the rates be used for accounting purposes. Under this viewpoint, the accounting rules regarding measuring pension liabilities should be modified in a manner similar to what was done in the funding stabilization legislation. This issue has been raised, but has not generated significant discussion among the regulators or private-sector overseers (the Financial Accounting Standards Board and the Securities and Exchange Commission) to date. This issue bears monitoring in the next year.

D. Testing issue affecting pension plans.

As is commonly known, many companies are moving away from traditional DB pension plans by, for example, closing the plans to new hires or shifting to a hybrid plan (such as a cash balance plan or pension equity plan). In many such cases, the plan sponsor grandfathered some or all existing employees from the change in the DB plan, so that the grandfathered employees continue benefiting under the original plan formula. Over time, these pro-employee grandfather arrangements can cause nondiscrimination testing problems, which can effectively force companies to terminate the grandfather in whole or in part. In other words, because of the testing problem, many companies will, as a practical matter, have little choice but to take the grandfathered employees out of the original pension plan formula and treat them like the new hires.

This is a widespread issue and awareness of it is growing within both the private sector and the government. We may see action in the next year to address the problem.

E. ERISA section 4062(e).

Routine business transactions can trigger large liabilities for pension plan sponsors. Under ERISA section 4062(e), if an employer with a pension plan shuts down operations at a facility, and as a result of that shutdown, more than 20% of the employer's employees who are plan participants are separated from employment, the employer is required to provide the PBGC with short-term security in the form of a bond or escrow amount based on the plan's unfunded termination liability.

PBGC has in the last few years stepped up its enforcement of this ERISA provision in many respects. A key element of the PBGC's approach has been an especially expansive definition of the shutdown concept. For example, under the PBGC's approach, the following would be shutdowns: a sale of a business unit, the movement of an operation to a different site, a temporary shutdown of a facility for repairs, or certain modifications of the ownership of a joint venture.

The following example illustrates PBGC's approach and how it can hurt companies engaging in routine business transactions. For purposes of this example, please assume that the plan has funding liabilities of \$5 billion and assets valued for funding purposes at \$5 billion, so that the plan is 100% funded under the funding rules. Assume, however, that under the assumptions used by PBGC, the plan has a termination liability of \$6 billion, so that the plan has \$1 billion of unfunded termination liability. Assume further that the plan sponsor has 10,000 employees. However, because the plan was frozen 15 years ago, only 400 of those employees are covered by the plan.

Example. The plan sponsor sells a small business unit that includes 25% of the 400 active employees who are participants in the plan (i.e., 100 employee/participants). All employees of the business unit become employed by the buyer, so no one loses his or her job and there is no shutdown of a facility. The PBGC treats the sale of the business unit as a shutdown of a facility. Because more than 20% of the employee/participants terminate employment with the seller in connection with the sale, the ERISA shutdown provision is thus triggered. Thus, the movement of only 1% of the employer's workforce triggers this provision.

Under the PBGC's position, the plan sponsor in this example has a liability of \$250 million (i.e., 25% of the \$1 billion unfunded termination liability). Thus, the plan sponsor must either place \$250 million in escrow for the PBGC for five years (with no interest), post a bond for \$375 million for five years, or agree to other terms prescribed by the PBGC. Generally, the PBGC uses the possibility of this liability to extract material concessions from the plan sponsor regarding waiver of credit balances and/or additional contributions to the plan.

The PBGC has recently announced that it will cease imposing liability under ERISA section 4062(e) on creditworthy companies. Enforcement will also cease with respect to small plans with 100 or fewer participants. It appears that the creditworthiness test will apply to all companies other than those with plans that fall within the small plan

exemption. So PBGC would need to determine the creditworthiness of countless private companies and tax-exempt organizations, using “common financial measures of financial soundness such as credit ratings, credit scores, indebtedness, liquidity, and profitability.”

We can expect PBGC to continue its current enforcement positions regarding ERISA section 4062(e). A number on the Hill are quite concerned about the PBGC’s approach in this regard; whether we will see legislation enacted that clarifies the law in this area is still unclear. We can also expect PBGC to attempt to broaden its use of a creditworthiness test to apply in as many areas as possible.

F. Hybrid plan issues.

Further legislation regarding hybrid plans, such as cash balance plans and pension equity plans, is not expected in the next year (though, of course, things can change). We can, however, expect regulatory guidance on these types of plans, including final regulations under the Pension Protection Act regarding the rule prohibiting hybrid plans from providing interest credits in excess of a market rate. We can also expect guidance on how plans with above market interest crediting rates can reduce those rates without violating the anti-cutback rules. In addition, the government is expected to issue guidance specific to pension equity plans in the next year.

VI. Financial services regulation.

A. Swap issues.

The Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) are expected to continue to address swap issues that have great importance for pension plans, including, for example, the margin requirements for uncleared swaps. In addition, the DOL may be issuing guidance on possible prohibited transaction issues with respect to cleared swaps.

B. Stable value funds.

Under the Dodd-Frank Act of 2010, Congress directed the SEC and CFTC to determine whether stable value contracts should be treated as swaps. In 2013, we expect to see the joint SEC/CFTC study of whether stable value contracts are swaps, and, if so, whether they should be exempted from the Dodd-Frank regulatory structure applicable to swaps. There is some thought that the regulators could conclude that stable value contracts are swaps but should be exempted from the regulatory structure. That would raise questions regarding the effects of treating stable value contracts as swaps. In other words, if stable value contracts are swaps, such contracts could be picked up by cross references in other laws to swaps, and such other laws might not contain a similar exemption for stable value contracts.

C. Money market fund issues.

The money market industry has been engaged for some time in a discussion over the future of money market funds. SEC Chairman Mary Schapiro – who has announced her retirement – was unable to secure a majority of SEC commissioners to vote to propose reforms to build on those implemented in 2010. The Financial Stability Oversight Council has stepped in to propose specific changes to put pressure on the SEC to act. The retirement industry has been engaged in this public policy dialogue, as both DB and DC plans are users of money market funds and the contemplated reforms could have a significant effect on the use of money market funds by retirement savings vehicles. Schapiro’s successor, Elisse Walter, has been a supporter of reform and the general expectation is that this dialogue will continue into 2013.

D. Disclosure to participants by non-ERISA plans.

In October 2011, the SEC issued a no-action letter that made clear that an entity regulated by the securities laws may assist a plan sponsor in preparing the new ERISA-required fee and performance disclosures to participants even through the new disclosures do not match precisely with the SEC’s advertising rules. FINRA provided similar relief to its broker-dealer members. An open issue that could be resolved in 2013 is whether non-ERISA plans, such as non-ERISA 403(b) plans, and governmental 457(b) plans, will receive a similar no-action letter. Many such non-ERISA plans elect to follow the DOL rules in this area. Discussions with SEC staff suggest there may be some resistance to issuing relief to plans not covered by ERISA’s comprehensive fiduciary oversight.

VII. Coverage and adequacy.

In the private retirement plan area, policymakers have long maintained a focus on broadening coverage and addressing adequacy. We can expect this focus to continue, and for several proposals to play a key role.

A. Automatic IRA.

The Automatic IRA concept remains the centerpiece of the President’s retirement policy agenda – as well as the most visible congressional bills focused on coverage. Bills have been introduced in both chambers for the past three Congresses. Increasing retirement plan coverage is a shared goal of both parties, and, as recently as 2007, the Automatic IRA enjoyed bipartisan support. But the proposal has since become identified solely with Democrats.

The bills include three key features: (a) default enrollment at 3%; (b) default use of Roth IRAs; (c) multiple alternatives for selecting an Automatic IRA provider (the House bill would have smaller accounts custodied at Treasury; the Senate bill would result in a request for proposals to service all accounts held by a particular employer).

In the wake of health reform, any mandate has been a non-starter for many congressional Republicans. It is unclear if opposition will wane. We can also expect that the second Obama Administration will increase its efforts to pass Automatic IRA legislation,

potentially in the context of tax reform (when, as discussed above, certain aspects of the existing incentive system could face criticisms on grounds of being insufficiently progressive).

B. State-level plans.

Over the past year, there has been a flurry of bills introduced in state legislatures to create state-managed retirement plans for private-sector workers. Massachusetts is the only state to have enacted a bill creating such a program; the bill authorizes a state-run retirement program for non-profit employers (whether or not Massachusetts-based) with 20 or fewer employees. We understand that Massachusetts currently has submitted its plan for IRS approval.

In 2013, California will be studying a more aggressive approach. At the end of its 2012 legislative session, the California legislature created a state-run mandatory Automatic IRA. Under the program, California employers, except the very smallest, that do not offer a retirement plan would be required to automatically enroll employees in a 3% payroll deduction IRA. The state would hold the funds and provide a guaranteed interest rate announced each year. Before the program can be opened, however, the newly-created board in charge of the program must obtain a ruling from the DOL that the program is not subject to ERISA – a significant hurdle. The California legislature also must enact a second bill approving the program after the costs and financial risks to the state have been studied. If California is successful in getting the program off the ground, other states could follow California’s approach.

C. Retirement USA Funds.

This past summer, Senate HELP Committee Chairman Tom Harkin (D-IA) released a white paper outlining his envisioned Retirement USA Funds. Under his proposal, employers that do not offer a workplace retirement plan with automatic enrollment and a minimum level of employer contributions would have to (1) automatically enroll employees in a Fund at a specified level of contributions, and (2) make a minimum level of employer contributions on behalf of the employees to an employer-sponsored plan, a Fund, or a combination of the two. Employees could opt out of participation in the Fund, and employers could participate in a Fund in addition to maintaining their own plan.

As Sen. Harkin envisions, Funds would be “privately run, licensed, and regulated retirement plans . . . overseen by a board of trustees consisting of qualified employee, retiree, and employer representatives.” The Funds would have professional asset management (rather than participant direction); they would be conservatively invested; and employers would not have any fiduciary responsibilities with respect to choosing a Fund or the operations of the Fund. Benefits would be paid out under rules similar to the pension plan rules, meaning that the default form of distribution would be a qualified joint and survivor annuity; an individual could elect a different annuity form only with spousal consent. If an employee dies before the annuity starting date, the benefit would be payable in the form of a life annuity to the surviving spouse. Lump-sum distributions would not be permitted.

Sen. Harkin has expressed his intention to turn this concept into legislation, which he plans to consider in the HELP Committee in 2013.

D. Multiple employer plans.

Multiple employer plans (MEPs) permit employers to pool contributions in a single plan. For certain purposes – including service calculations, annual independent audit requirements, periodic IRS determination letter filings, and Form 5500 filings – the plan is treated as a single plan. But for certain other purposes, such as coverage and nondiscrimination testing, each participating employer is treated as maintaining a separate plan. MEPs enable small employers to achieve economies of scale and cost efficiencies – and thus can be a particularly effective mechanism to expand coverage.

Under current law, if one or more employers participating in a MEP fail to meet the qualification requirements (*e.g.*, the top-heavy or vesting rules), the entire MEP can be disqualified, adversely affecting the many participating employers that complied with the law. This rule – often called the “one bad apple rule” – adversely affects small businesses’ willingness to participate in MEPs. It is possible that Treasury will fix this problem through the regulatory process. Assuming Treasury chooses not to do so, legislation introduced in the 112th Congress would require the Secretaries of the Treasury and Labor to clarify the extent to which one plan adopter’s violation would create liability for other plan adopters and/or taint qualification of the entire MEP.

Other legislation would confirm the ability of completely unrelated employers to enter into an “open MEP,” without concern that the arrangement would be treated as separate plans under ERISA. The statutory framework creates ambiguity, and the DOL has stated that it does not view ERISA as currently authorizing open MEPs. In DOL’s view, participating employers in a MEP must have a material relationship with each other, separate from maintaining the same plan.

Still other legislation would establish special top-heavy and nondiscrimination safe harbors exclusively available to multiple employer plans consisting only of small employers.

E. Small employer pension plan start-up credit.

Under current law, a small employer can claim a credit for costs incurred in establishing and administering a qualified plan. The credit equals 50% of qualified costs incurred in each of the three years upon plan establishment, up to \$500 per year. It is available only to an employer that (a) has 100 or fewer employees and (b) has not in the past three years established or maintained a qualified plan. Because the limitation has not been indexed for inflation, the credit’s value has eroded since Congress first established it in 2001. Separate from the indexing issue, many have called to increase the credit; in fact, the President’s FY13 budget would raise it to a maximum of \$1,000 per year, for up to four years. Legislation in both chambers would increase the amount to \$1,500 per year.

Some have also discussed the possibility of providing additional tax credits based on the

number of employees enrolled in a plan.

F. Saver's Credit.

There is significant congressional interest, particularly among Democrats, in expanding the Saver's Credit, which provides a tax credit to low and middle income employees who contribute to a plan or IRA. For example, ideas under consideration include:

- ◆ Expand the group of individuals eligible for the tax credit;
- ◆ Expand the amount of the credit, at least for certain individuals;
- ◆ Make the credit refundable (primarily a Democratic proposal); and
- ◆ Require that at least a portion of the credit be directly deposited in a plan or IRA.

Of course, the Saver's Credit could be reduced or even eliminated in tax reform.

G. Qualified Automatic Contribution Arrangement safe harbor.

To encourage 401(k) plans to adopt automatic enrollment, the Pension Protection Act of 2006 created a new nondiscrimination safe harbor, known as a qualified automatic contribution arrangement (or "QACA"). A plan that adopts a QACA is deemed to have satisfied the applicable top-heavy and nondiscrimination requirements. The Code provides that to qualify as a QACA, the elective contribution must constitute a "qualified percentage" of a participant's pay, defined to be met if the percentage is at least 3% for the first plan year beginning when the automatic contribution arrangement is established; at least 4% the subsequent year; at least 5% the year after that; and at least 6% for any subsequent year. While these percentages are minimums, the Code provides that a percentage exceeding 10% will cause a plan not to qualify as a QACA.

Reflecting widely held views, one bill would, for years following the year of the first elective contributions, remove the 10% ceiling on qualified percentages. The bill would also authorize Treasury to prescribe regulations increasing the minimum percentages.

H. SIMPLE IRAs.

The SIMPLE IRA is an inexpensive plan that is well suited to many small businesses, and it has been successful in expanding coverage in that area. Some legislative proposals are structured to build on that success by, for example, (1) increasing the employer contributions permitted to be made to SIMPLE plans and (2) facilitating greater portability to and from SIMPLE IRAs.

I. Other coverage issues.

Many other coverage issues may be addressed, including efforts to (1) enhance coverage of part-time employees, (2) establish low cost government bond accounts (R-Bonds) for small account balances, (3) enhance financial literacy, and (4) permit certain unused amounts in a flexible spending arrangement (which would otherwise be forfeited) to be contributed directly to a retirement plan or IRA.

VIII. Lifetime income.

In recent years, Congress and the regulators have turned their attention to the drawdown challenge – specifically, helping retirees ensure that they do not outlive their retirement assets. Both the Treasury and Labor Departments have been interested in helping the private sector provide more information regarding the distribution phase of retirement plans, and in facilitating participants’ access to lifetime income products. We might anticipate a number of important projects from the agencies in this area.

A. Benefit statements.

On Capitol Hill, the one critical development on the lifetime income agenda was the bipartisan, bicameral introduction of the Lifetime Income Disclosure Act, which would require DC plans subject to ERISA (such as 401(k) plans), on at least an annual basis, to include “annuity equivalents” on benefit statements. An annuity equivalent would be the monthly annuity payment that would be made if the employee’s total account balance were used to buy a life annuity that commenced payments at the plan’s normal retirement age (generally 65).

Despite Congressional interest, we believe it more likely that annuity equivalent requirements will be implemented through regulatory action. The Pension Protection Act of 2006 modified the rules regarding providing benefit statements to participants. The DOL has yet to issue regulations implementing the new requirements – but we expect it to do so in the coming year, and, in doing so, provide safe harbor methods of including income illustrations on DC plan benefit statements. In other words, in addition to setting forth the lump-sum benefit earned by a participant, the statement would also include the amount of annual or monthly lifetime income that is equivalent to the lump-sum amount. But there are several decision points that DOL will need to consider: (a) whether the disclosure would be mandated or rather if DOL will simply facilitate such illustrations by protecting plan sponsors and administrators from liability if they use one of the safe harbors; (b) whether in determining the lifetime income amount, the current account balance will be projected to normal retirement age with expected earnings, expected earnings and expected contributions, or neither; and (c) whether the income illustrations will be based on annuity payouts or installment payouts, or if plans may choose between the two.

Some have proposed broader changes, so that the annuity benefit payable to an individual from Social Security would be included on the benefit statement for one DC plan or IRA with respect to individuals.

B. Annuity selection criteria.

Currently, DOL’s second priority in the lifetime income area is to provide further guidance on the fiduciary standards applicable to a DC plan fiduciary in choosing an annuity provider to provide annuity distributions from the plan. The DOL could also supplement the repropounded fiduciary regulation by providing a counterpart to DOL

Interpretive Bulletin 96-1, providing guidance on the difference between distribution advice and distribution education.

C. Treasury guidance in general.

At this point, we do not have a clear picture of the lifetime income projects that Treasury is working on, aside from (1) finalizing its proposed regulations on longevity insurance and partial annuitization from a DB plan and (2) the project described below regarding guaranteed living withdrawal benefits. However, in light of Treasury's interest in this area and the positive reception given to its helpful guidance issued earlier this year, we anticipate that Treasury will be working on additional projects in the lifetime income area.

D. Portability.

Additionally, we expect policymakers to consider portability-related challenges, which have made some plan sponsors and recordkeepers reluctant to offer in-plan lifetime income options. This issue arises, for example, where a plan that offers in-plan annuities as investments changes annuity providers or switches to a recordkeeper that cannot service the annuity investment. If employees are forced to liquidate their annuity investment, they could lose longevity protection that they have paid for. Accordingly, legislation has been introduced deeming a plan's discontinuation of a lifetime income investment to be a distributable event. As such, participants would become able, up to 90 days before the option is discontinued from the plan, to roll over, via a trustee-to-trustee transfer, the entire amount invested in the product to an IRA that provides equivalent lifetime income protection. The plan can also distribute the annuity contract directly to the participant.

Treasury may also have the power to address the portability issue administratively through an interpretation of the hardship distribution rules.

E. Guaranteed living withdrawal benefits.

Treasury has been studying guaranteed living withdrawal benefits ("GLWBs") with the objective of issuing guidance. The issues being reviewed include: (1) whether the guarantee provided by GLWBs has a value that must be separately recognized as part of a participant's account balance; (2) if so, whether the guarantee is subject to applicable non-forfeiture and anti-cutback rules; (3) the extent to which GLWBs may be subject to the spousal consent rules; and (4) the treatment of the right to the guarantee under the benefits, rights, and features portion of the section 401(a)(4) regulations. The last issue, which applies to all GLWB products, also applies to certain plan uses of other annuity products in the marketplace.

F. Federal annuity insurance.

Some commentators have suggested creating federal insurance to pay annuity and similar benefits in the event that an insurer fails. We are not aware of any congressional proposals in this regard.

IX. Disclosure in general.

A. Electronic delivery.

Allowing the delivery of statements, notices, and disclosures electronically can save plans enormous expenses. But currently, there are no fewer than four separate regulatory standards governing the circumstances under which an employee can be provided with a retirement plan statement, notice, or disclosure in an electronic format. And only one in particular has had great success in achieving material efficiencies and cost savings. For ERISA-required benefit statements, a DOL Field Assistance Bulletin (FAB) authorizes the “post and push” method, whereby plan sponsors can use a continuous access secure website for the posting of retirement plan benefit statements, provided that individuals are notified how to access the website and that they can opt out and receive free paper disclosures instead.

Citing access concerns, the DOL has been reluctant to expand the FAB’s applicability. Participant groups have echoed the DOL; for instance, AARP recently released a survey concluding: “People of all ages prefer to receive retirement plan information on paper.”

We do not anticipate regulatory movement on facilitating greater use of electronic delivery of information to participants. In fact, it is possible that the proposed regulations to be issued by the DOL regarding benefit statements might move in the opposite direction. It is possible that the proposed regulations will supersede the FAB, so that the otherwise applicable DOL rules on electronic delivery would apply to benefit statements. Under those rules, very generally, electronic delivery to a participant is only permitted if the participant consents or the use of electronic communication is an integral part of the participant’s job.

But with Members of Congress showing increased interest in the electronic delivery of ERISA- and Code-required statements, notices, and disclosures, it is possible that there could be legislation addressing the electronic delivery issues. For instance, one bill would harmonize the four existing standards and generally follow the FAB approach.

B. Consolidation of notices.

A related provision in the same bill referenced above directs the Secretaries of Labor and the Treasury to adopt final regulations that allow, but do not require, a plan to consolidate two or more of these notices into a single notice and/or to consolidate such notices with the summary plan description or summary of material modifications. There is increasing concern that the disclosures required to be provided to participants involve significant redundancy. The redundancy and the increased volume of disclosures is actually

undermining effective disclosures as they can lead to participants being overwhelmed with difficult material to read. This, in turn, leads to many participants simply not reading any of it. Congress may review this area to eliminate redundancy so as to enhance the effectiveness of disclosure.

X. Distributions and rollovers.

A. Required Minimum Distributions.

The President's budget proposes to exempt small IRA accounts from required minimum distribution (RMD) requirements. In particular, the Administration proposes to exempt an individual from the RMD requirements if the aggregate value of the individual's IRA and tax-favored retirement plan accumulations does not exceed \$75,000 on the "measurement date" (*i.e.*, beginning of the year in which the individual turns 70½ or, if earlier, the year in which the individual dies); the requirement would phase in ratably for individuals with retirement benefits between \$75,000 and \$85,000. Note that while Roth IRAs are exempt from the pre-death RMD rules, Roth IRA balances would be taken into account in measuring retirement assets against the threshold (but annuitized DB plan payments would not be taken into account). A leading bill on the Hill proposes a similar proposal using a \$100,000 threshold.

Other RMD issues that could arise include (1) the stretch IRA rules (discussed above), (2) Treasury's proposed regulations on longevity insurance (as referenced above), (3) efforts to update the age 70½ trigger date (which was set in 1962, but is expensive to update), and (4) possible regulatory guidance to reduce the current-law adverse treatment of partial annuitization from a DC plan or IRA.

B. Inherited IRAs.

The President's budget also repeats a provision from FY 2012, which would allow a non-spouse beneficiary under a tax-qualified retirement plan or inherited IRA to roll over distributions from the arrangement to a non-spousal inherited IRA within 60 days of the distribution. This contrasts with current law treatment, which permits tax-free rollovers by non-spousal beneficiaries only via a direct rollover or direct trustee-to-trustee transfer (and not using the 60-day rollover opportunity). The provision is intended to address current law's "traps for the unwary" and has no revenue cost.

C. Basis rollover rules.

In 2009, Treasury and the IRS updated the section 402(f) notice, which is the notice required to be provided to individuals receiving an eligible rollover distribution. The new notice took a new and surprising position on the tax treatment of a distribution that includes after-tax contributions (basis) and that is sent to multiple destinations. This guidance was not consistent with how most plan sponsors and service providers had interpreted the rollover rules; under the section 402(f) notice approach, different, and more favorable, tax treatment would apply if a rollover is done indirectly. Treasury and

IRS were asked to clarify their position. Recently Treasury and IRS officials have said that guidance on this issue will be released soon.

D. Loans and leakage.

There is increasing concern about pre-retirement leakage from retirement plans. For example, one leading bill would extend the period during which an employee can repay a plan loan if the plan has terminated or the employee has terminated employment. Currently, many such loans are defaulted, so that the employee pays tax on the outstanding loan and that amount is no longer in a plan or IRA. If the employee can have longer to repay the loan, both results could be avoided in some circumstances.

On the other hand, one Texas-based company has been advocating for legislation that would default certain 401(k) plan participants into purchasing credit insurance to cover the balance of their outstanding 401(k) plan loans in the case of death or disability (but not separation from employment). Payments for this credit insurance would come out of the participant's account each month as the loan is repaid. Many in the service provider and benefits communities have come out in strong opposition to this proposal.

XI. Qualified plan technical guidance.

We expect at least three pieces of significant guidance in 2013 from IRS related to plan document and correction issues. First, IRS has said it is rethinking its "interim" amendment requirement for qualified plans. Currently, plan documents must be amended nearly every year on an "interim" basis to reflect any changes in the Code, the regulations, or any other guidance or rulings. This places a somewhat heavy burden on plan compliance, particularly on individually designed plans. Plans then submit their documents for determination letters based on a five-year "cycle." This system has somewhat smoothed out the IRS workload, but is considered in need of modifications to reduce burdens on plans. Second, IRS will open up a pre-approval program for 403(b) prototype plan documents.

Third, IRS will issue an update to its Employee Plans Compliance Resolution System (EPCRS), which was last revised in 2008. EPCRS is a program that allows qualified plans to correct operational and other errors and avoid disqualifying the plan. This update to EPCRS will likely provide additional correction relief for 403(b) plan document errors, and may include pre-approved corrections for automatic enrollment failures.

Legislation introduced in the 112th Congress, and likely to be reintroduced in the 113th Congress, also would make changes to EPCRS. This legislation would direct IRS to simplify the correction for loan errors, provide for a comprehensive correction program for 403(b) and governmental 457(b) plans, provide for a simplified correction for minimum distribution errors and automatic enrollment errors, and under certain circumstances open the program to IRAs. We expect that some, but not all, of these changes will be included in the EPCRS update.

XII. Multiemployer funding and premium issues.

Many believe that there are serious structural issues that need attention with respect to multiemployer plan issues, including both funding and PBGC-related issues. This document does not attempt to provide a full explanation of these issues. However, we expect the issues to be debated over the next few years (particularly given the sunset of PPA multiemployer rules at the end of 2014), with many in Congress having quite different views on how best to resolve the issues.

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If you have any questions, please do not hesitate to contact any member of the DAVIS & HARMAN LLP benefits practice.

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