



March 16, 2007

Via Electronic Filing

CC:PA:LPD:DRU (Notice 2006-107)
Room 5203
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20044

Re: Notice on Diversification Requirements for Qualified Defined Contribution Plans Holding Publicly Traded Employer Securities

Dear Sir or Madam:

The American Benefits Council (Council) appreciates the opportunity to comment on the transitional guidance provided in Notice 2006-107, *Diversification Requirements for Qualified Defined Contribution Plans Holding Publicly Traded Employer Securities*, and topics that should be addressed in the upcoming proposed regulations on the same subject. The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

The Council recognizes the significant workload placed upon the Internal Revenue Service (Service) and the U.S. Treasury Department (Treasury) by the enactment of the Pension Protection Act (PPA) and applauds the Service and Treasury for providing significant transition guidance on the new diversification requirement in an expedited manner. This has been very helpful to plan sponsors who were required to meet new statutory requirements as of the first of the year.

Despite the helpful pronouncement, there are still many unanswered questions relating to the application of this new requirement. Plan sponsors have been forced to make reasonable interpretations of the new requirement, based on the statute and the transition guidance, and it does not seem appropriate to punish plan sponsors for making reasonable interpretations in order to operate their plans. Therefore, first and foremost, the Council requests that pending the issuance of regulations on the employer stock diversification provisions of the

PPA, employers be permitted to rely on a good faith interpretation of the statutory provisions for any issues for which clear and complete direction was not provided in the transition guidance.

In addition to the good faith compliance issue, the Council requests that the Service and Treasury address the following issues in upcoming regulatory guidance. We recognize that the notice issues generally fall under the jurisdiction of the Department of Labor but include them in this letter since there will likely be discussion and coordination between the two agencies.

Notice Issues

Notice Recipients. The proposed guidance should clarify who must receive the diversification notice. First, the notice requirement should not apply to any participant who does not have any employer securities in his or her account and who does not have any right to invest in employer securities. (This could arise, for example, where an employer securities fund in a plan has been closed to new participants; the new participants should not be required to receive a notice.) Second, these proposals should spell out that diversification information included in benefit statements is sufficient to meet both the benefit statement and separate diversification notice requirements for participants in plans previously structured in a way that complies with the new rules (as indicated in the separate transition guidance for benefit statements).

30-Day Notice Exceptions. An exception to the 30-day rule for situations where 30-day advance notice is not possible should also be provided. For example, 30-day notice is not possible where (i) employees are immediately eligible to participate, or (ii) the beneficiary “inherits” the diversification rights upon the death of the participant. In such cases, notices should be treated as in compliance with the law if they are provided within an administratively reasonable period after the commencement of employment or death, as applicable. For this purpose, if there is a reasonable delay attributable to difficulty finding a beneficiary, this should be taken into account in determining what is an “administratively reasonable period.”

Earlier Diversification. The public policy behind requiring employer stock diversification encourages plan sponsors to allow participants to diversify out of employer stock at an earlier date than required by the statute. Plans that provide diversification rights at an earlier date should be allowed flexibility in the timing of the notice. Guidance should specify that the notice rule does not apply to such earlier date, but rather a notice 30 days before the legally required diversification date. Thus, penalties would not apply unless the plan administrator fails to provide a notice by the date 30 days before the legally required diversification date. On a different point with respect to the same fact pattern, it should be

clarified that if a plan administrator does provide a notice in connection with the earlier date when diversification rights are first given, no additional notice need be provided later when the statutory rules take effect.

Providing the Notice. The Council also requests the proposal allow the notice to be incorporated in the plan's summary plan description (SPD) and that electronic delivery be permitted under the rules of Treas. Reg. Section 1.401(a)-21.

Diversification Rules

Vesting. The Council requests clarification on the interaction of the vesting provisions (completed three years of service) with the timing of the diversification rights. For example, if a participant completes three years of service during the 2007 plan year, should the participant be immediately eligible to diversify one third of the employer securities acquired before the 2007 plan year and attributable to employer contributions? Or is it sufficient for the plan to provide the right as of the first day of the next quarter?

Limits on Participant Direction. If a plan does not allow participants to direct investments at all, the new diversification rule should not apply, since it is premised on participant direction.

In addition, if a plan provides less than three options for participant-directed investments (for example, two diversified options), the new rules should be satisfied if the plan makes those two options available. The three-option rule should be limited to plans with at least three such diversified options that are otherwise available to participants.

A contrary rule would have disruptive and unintended consequences. For example, multiemployer defined contribution plans often do not permit participants to direct investments. The plan, as the fiduciary directs, may invest in a diversified group of securities, including the securities of one or more participating employers. It is hard to imagine that the diversification rules should apply to such plans.

An exemption could be limited to multiemployer plans in these circumstances. A better solution is a more generic rule for plans that do not permit participants to direct investments. The rule described at the outset of the discussion -- making the diversification rule inapplicable to plans that do not permit participants to direct investments -- would address that need. It could also apply to profit-sharing and stock bonus plans that invest in employer stock and do not permit participant investment direction.

Comparative Restrictions and Transition Rule. The transition guidance provides that restrictions on investing (or reinvesting) in employer securities are treated as prohibited restrictions if not imposed on other plan assets. The Council continues to believe that the guidance should permit reasonable restrictions on investing or reinvesting in employer securities since the legislation encouraged diversification and facilitating investment in employer securities. If the proposed regulations continue to provide this prohibition, at least five exceptions should be made.

First, some employer securities, while publicly traded, are so thinly traded that employee transactions within a qualified retirement plan can cause significant swings in the securities' price. Employer plan sponsors should be permitted to place restrictions discouraging rapid trading resulting in some employees benefiting from short-term price swings (at other employees' expense) without being required to place the same restrictions on other plan assets not subject to such manipulation.

Second, and closely related, some plans will have a delay in processing the sale of employer securities held in shares because the securities have to be sold on the open market. Such limitations are necessary and should not be prohibited.

Third, it is common for various plan investment options to have different trading restrictions, such as regarding trade frequency and/or redemption fees (often imposed by the investments themselves). In such cases, it will be difficult to compare the restrictions on employer securities with those on "other assets of the plan". The law should permit any reasonable determination of the least restrictive alternative investment that can be applied to the employer stock investments. In addition, many plans that have redemption fees on investments other than the employer stock fund may not feel it is appropriate to apply a redemption fee to sales of employer securities. Instead, to address the problems with rapid trading, the plan may restrict reinvestment in employer securities following a sale. The diversification rules should not "woodenly" prohibit this type of reasonable approach to applying equivalent trading restrictions on the employer stock fund. We urge you to permit alternative means of curbing rapid trading as being equivalent for purposes of the rule prohibiting restrictions on employer securities that are not imposed on other plan assets.

Fourth, many plans offer brokerage windows and have trading restrictions on all of the underlying (non-brokerage window) funds that are not applied to the brokerage window. For example, a plan may only permit 20 trades per year within the core funds but trades within the brokerage window are unlimited. This is clearly not the type of arrangement that Congress intended to regulate. Generally, a very small percentage of plan participants access brokerage

windows. If the number of participants using a brokerage window is de minimis, it would be inappropriate to let the open nature of those windows affect the vast majority investing in the plan's main menu of funds. In other words, many employers have a legitimate interest in restricting rapid trading among funds, but at the same time want to permit more trading flexibility to the very few who elect to use a brokerage window. This fact pattern was clearly not what Congress intended to prohibit.

Fifth, while the Council appreciates the flexibility provided by the transition rule in Notice 2006-107 that permits plans to continue applying restrictions to employer stock investments that do not apply to stable value funds [or investments not generally available (e.g., limited to a fixed class of participants)], the Council respectfully requests that this transition rule be made permanent and clarified to include funds similar to stable value funds such as fixed income and short-term bond funds. Plans need to have one fund that permits employees to move assets in and out quickly or participants could be permitted to sell the employer securities but have no place to invest the proceeds.

Permissible Securities Law Restrictions. The notice appears to allow a broad interpretation of a permissible securities law restriction by approving “a restriction reasonably designed to ensure compliance” with securities laws but providing an example limited to actual securities law. The proposed regulation should indicate that the restriction is not required by securities law so long as it is reasonably designed to ensure compliance. Some examples not strictly limited to actual securities law would be helpful. For example, companies may broadly prohibit trading of company stock prior to (and immediately after) the release of earnings. This prudent measure should not be prohibited by regulations. Other restrictions imposed solely on certain top employees should also be permitted. For example, in certain contexts (such as a private company going public), certain top employees are often required to retain their company stock for a certain period of time.

Index Fund Exception. The notice clearly provides an exception to the diversification rules for index-type funds and similar investment products. The Council believes that an investment in employer securities in an employer’s defined contribution plan should be considered to be “made...independent of the employer and any affiliate” if the securities are held either in (i) a registered mutual fund, including one for which the employer or any affiliate acts as investment adviser, or (ii) an unregistered commingled fund, subject to regulation by federal or state agencies, including one for which the employer or any affiliate acts as investment adviser or trustee, if in either case the investment objective of the fund is to meet or exceed the performance of an index developed and maintained by an unrelated third party (such as Standard & Poor’s), such employer securities are a constituent of such index, and the employer securities

will be held in the fund in accordance with their weighting in such index. It does not make sense to require companies to engage a third party to manage an index fund merely because that fund happens to include the stock of the plan sponsor. Such an interpretation of the law would not enhance the ability of the companies' employees to diversify employer stock holdings within the plan and likely will increase the cost of that investment alternative to employees.

ESOP Spin-off. If a plan contains assets attributable to contributions subject to section 401(k) or (m) (which may or may not be part of an ESOP) as well as an ESOP attributable to nonelective employer contributions, the regulations should clarify that the latter part of the plan can be spun off and subsequently covered by this ESOP exemption. In the case of post-effective date spin-offs, the exemption would apply prospectively as of the date of the spin-off.

Spin-off to Unrelated Company. The regulations should clarify that if, in the context of a corporate transaction, a portion of a plan containing employer securities is spun off to an unrelated company, the securities do not retain their character as employer securities in the context of the new plan sponsor.

Clarification of Phase-in. A three-year phase-in is needed in the case of a private company that goes public or in other situations where the diversification rules suddenly apply to a plan that was previously exempt. In addition, employer securities held in a suspense account as of 12/31/06 (in the case of a calendar year plan), should be treated as acquired before the effective date so that the transition phase-in rule applies to securities released in 2007 and/or 2008. The transition phase-in rule should also apply to employer securities contributed during the 2007 plan year but attributable to the 2006 plan year.

Elimination of Distribution Options. Some plans complied with Code section 401(a)(28) (previous diversification requirements) by offering distribution options. Any such plans that will now be subject to the new diversification rules appear to be permitted to eliminate such distribution options under PPA Section 1107 (absent Treasury guidance to the contrary). Confirmation of this in the proposed regulations would be helpful. Alternatively, elimination of the distribution options could be permitted under Code section 411(d)(6)(C) and ERISA section 204(g)(3).

Collectively Bargained Plans. Historically, "collective bargaining effective dates" have consistently applied to plans where participants covered by a collectively bargained agreement constitute at least 25 percent of plan participants. In addition, plans can be aggregated for purposes of this test if they have "essentially the same" benefits and contributions. See, e.g., House Conference Report for ERISA at 267 (referring to Ways and Means Report at 51-52); General Explanation of TEFRA at 290-91; IRS Notice 88-98; PLRs 9610025, 8618042. This

25 percent rule should apply for purposes of the effective dates of the PPA diversification provisions.

Restrictions or Conditions Not Prohibited. The notice provides a couple of examples of restrictions or conditions that are not prohibited provided the limitations apply without regard to a prior exercise of rights to divest employer securities (not more than 10 percent of an account balance invested in employer securities; an employer stock fund closed to new investments). The proposed regulations should clarify that restrictions on reinvestment in employer stock are permitted so long as no employee contributions can be invested in employer stock even though employer contributions may be invested in employer stock (or employer stock may be released from suspension upon the repayment of a loan). The Council believes this is a reasonable restriction and a fairly common arrangement. If Treasury and the Service determine such a restriction unreasonable, the Council again urges employers be permitted to rely on a good faith interpretation of the statutory provisions (to allow such a restriction) for the period prior to a period ending 60 days after the issuance of the proposed regulations.

Multiple Stock Funds. The proposed regulations should also clarify that plans are permitted to restrict reinvestments in only one employer stock fund when a plan contains more than one employer stock fund, provided that the stock contained in each fund has the same characteristics except for differences in the cost basis to the trust.

Again, we appreciate the opportunity to comment on these employer stock diversification issues. We believe that the American Benefits Council offers an important and unique perspective of the employer sponsors of retirement plans and we would be pleased to make this perspective and additional information available to the Service. If this would be helpful, please call me at 202-289-6700.

Sincerely,

A handwritten signature in black ink, appearing to read "Jan Jacobson", written in a cursive style.

Jan M. Jacobson
Director, Retirement Policy