

## **Comments on Proposed Regulations under Code §401(a)(35) – Diversification Requirements for Qualified Defined Contribution Plans Holding Publicly Traded Employer Securities**

**April 2, 2008**

**Department of the Treasury  
Internal Revenue Service  
26 CFR Part 1  
[Reg-136701-07]**

The American Society of Pension Professionals & Actuaries (ASPPA) appreciates this opportunity to comment on Proposed Regulations §1.401(a)(35)-1, which provide guidance on diversification requirements for qualified defined contribution plans holding publicly traded employer securities, under Internal Revenue Code (Code) §401(a)(35), added by §901 of the Pension Protection Act of 2006.

ASPPA is a national organization of more than 6,000 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines, including consultants, administrators, actuaries, accountants and attorneys. Our large and broad-based membership gives ASPPA unique insight into current practical applications of ERISA and qualified retirement plans, with a particular focus on the issues faced by small- to medium-sized employers. ASPPA's membership is diverse but united by a common dedication to the employer-sponsored retirement plan system.

The Proposed Regulations provide welcome guidance for practitioners who must implement and administer the new diversification requirements. ASPPA, however, requests further clarification with respect to the two issues discussed below. Further clarification will allow plan sponsors to operate affected plans in full compliance with the diversification requirements.

### **Discussion of Issues**

#### **A. Spin-off ESOPs**

Code §401(a)(35)(E) provides an exception from the diversification requirements for ESOPs that are separate plans for purposes of Code §414(l) and do not hold any contributions that are subject to Code §401(k) or (m). Plans that include an ESOP component and Code §401(k)/(m) components are commonly referred to as "KSOPs." KSOPs must comply with diversification

requirements for all employer stock held by the plan, including stock held under the ESOP portion of the plan.

Some KSOP sponsors may not wish to be subject to the diversification requirements for employer stock held in the ESOP portion of the plan. One suggested approach to achieving this result is to spin off the ESOP portion of the plan to create two separate plans. The sponsor will then have an ESOP, which will not hold any contributions that are subject to Code §401(k)/(m), and a 401(k)/(m) plan.

The Proposed Regulations do not specifically address whether the diversification requirements, once applicable to a plan, would no longer apply if the plan subsequently meets the ESOP exception in Code §401(a)(35)(E). We understand that the IRS has informally acknowledged that, following a spin-off of the ESOP portion of a KSOP, the ESOP would no longer be subject to the diversification requirements of Code §401(a)(35), based on the exception in subsection (E).

*ASPPA recommends* that the Final Regulations clarify that the diversification requirements would no longer apply to an ESOP that is spun off from a KSOP provided the resulting ESOP meets the exception in Code §401(a)(35)(E) [*i.e.*, as long as the ESOP does not hold any contributions that are subject to Code §401(k)/(m)]. In addition, the Final Regulations should clarify that diversification rights are not Code §411(d)(6) protected benefits [this would be consistent with Regulations §1.411(d)-4 A-1(d)(4)].

## **B. Employer Matching Contributions – Restrictions on Reinvestment in Employer Stock Following Diversification**

Some defined contribution plans provide for employer matching contributions to be made in stock. These plans generally permit a participant to diversify his or her account by directing that shares of employer stock be sold and the proceeds invested in other plan investment options. A number of plans provide that once a participant has elected to diversify his or her account out of employer stock, the participant cannot later elect to reinvest any portion of the account balance in employer stock.

Proposed Regulations §1.401(a)(35)-1(e) provides that a plan may not impose restrictions on a participant's right to divest an investment in employer securities that are not imposed on other investment options. It appears that the Proposed Regulations could be interpreted to prohibit a plan from barring participants from reinvesting in employer stock after an election to divest is made, in the scenario described above, to the extent that there are no similar restrictions on other plan investment options.

We believe that the Proposed Regulations are overly restrictive in this situation. An employer that elects to make matching contributions in employer stock should be encouraged to provide participants with an opportunity to diversify out of the investment in employer stock. However, where the plan does not permit participants to elect to invest any other portion of their accounts in employer stock, we do not believe the employer should be required to provide an election to reinvest in employer stock once a participant has elected to divest.

**ASPPA recommends** that the Final Regulations be modified to include a specific exception under §1.401(a)(35)-1(e) to provide that a plan that provides matching contributions in employer stock and does not permit participants to invest any other portion of their accounts in employer stock may also provide that once a participant elects to divest the employer stock, he or she may not later elect to reinvest in employer stock. Treasury has broad authority to provide exceptions to the reinvestment requirement and this is an appropriate situation to use that authority.

We thank you for your time and consideration of these issues.



These comments were prepared by the IRS Subcommittee of the ASPPA Government Affairs Committee and were principally authored by Jim Paul, APM, and Subcommittee Chair. Please contact us if you have questions or if we can provide further information or clarification.

Sincerely,

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