



## NEW NOTICE AND DIVERSIFICATION REQUIREMENTS FOR 401(K) PLANS

by Allison M. Grimm

### Does Your 401(k) Plan Allow Investments in Employer Securities?

If your 401(k) Plan allows investments in employer securities, then you need to know about the recent passage of the Pension Protection Act of 2006 ("PPA"). The PPA includes a provision that imposes certain diversification requirements upon 401(k) and other defined contribution plans that allow investments in employer securities.

### Important Date and Deadline —

**January 1, 2007:** Effective date for two action items: (1) compliance with the diversification rules and (2) issuance of a required notice to participants (notice must be sent **before** January 1, 2007).

### Diversification Rules.

Effective for the first plan year beginning after December 31, 2006, a plan that allows investments in employer securities must provide all participants the right to diversify the portions of their plan accounts that are invested in "publicly traded employer securities." The right must be provided immediately for any accounts that contain participant contributions (whether pre-tax or after-tax). For accounts that contain employer contributions (matching or profit-sharing contributions), the right must be provided no later than the time when the participant completes three years of service. The new diversification rule is effective as of January 1,

2007 for new contributions, but allows a three-year phase-in for employer securities acquired before January 1, 2007.

### Notice Requirement.

The PPA also requires plan sponsors to provide participants with a notice that informs participants of their right to diversify their investments in employer securities and explaining the benefits of diversification of investments. The PPA authorized the Secretary of the Treasury to issue a model notice that could be used for this purpose.

On November 30, 2006, the Internal Revenue Service (IRS) issued Notice 2006-107, providing a model notice and clarifying that plans with plan years beginning on January 1, 2007 or February 1, 2007 must provide the notice **before** January 1, 2007. The IRS explained in Notice 2006-107 that the model notice would need to be revised for plans that do not currently place restrictions on the ability of participants to diversify their investments in employer securities since the model presumes that the plan to which it relates will have to be amended to comply with the new diversification rules. In other words, if a plan currently allows investments in employer securities, but places no restrictions on a participant's ability to move into and out of employer securities as an investment vehicle, that plan must issue a notice to its participants informing them of the PPA diversification requirements even though the plan already complies with those requirements.

Attached as Exhibit A to this legal advisory is the model notice issued by the IRS. Attached as Exhibit B to this legal advisory is a revised notice created by us to address plans that do not currently restrict participants' rights to diversify their investments in employer securities.

## What are the Adverse Consequences for Failure to Provide the Notice?

Failure to provide the required notice may result in a penalty of up to \$100 per day from the date of the failure.

We suggest that all plan sponsors whose plans allow investments in employer securities **immediately** contact their plan administrator and/or plan document provider to develop a notice to be sent out to plan participants before January 1, 2007. Exhibits A and B to this legal advisory may serve as a starting point for this process.

---

**Allison Grimm** and **Howard Williams** are our attorneys who are experienced in qualified plan matters. They will be happy to discuss the PPA diversification and notice issues with you.

## CONTACT INFORMATION

Allison M. Grimm  
(336) 271-3109 (Direct Dial)  
agrimm@brookspierce.com

Howard L. Williams  
(336) 271-3123 (Direct Dial)  
hwilliams@brookspierce.com

## BROOKS, PIERCE, McLENDON, HUMPHREY & LEONARD, LLP

Post Office Box 26000  
Greensboro, NC 27420  
(336) 373-8850

Post Office Box 1800  
Raleigh, NC 27602  
(919) 839-0300

WWW.BROOKSPIERCE.COM

Greensboro, NC • Raleigh, NC

---

*Brooks, Pierce, McLendon, Humphrey & Leonard, LLP is a business law firm providing comprehensive strategic counsel and innovative solutions to its clients. The information contained in this bulletin is not legal advice and does not create an attorney-client relationship between the reader and Brooks, Pierce, McLendon, Humphrey & Leonard, LLP.*

# EXHIBIT A

## Notice of Your Rights Concerning Employer Securities

This notice informs you of an important change in Federal law that provides specific rights concerning investments in employer securities (company stock). Because you may now or in the future have investments in company stock under the [*insert name of plan*], you should take the time to read this notice carefully.

### SECTION 1. Your Rights Concerning Employer Securities

For plan years beginning after December 31, 2006, the Plan must allow you to elect to move any portion of your account that is invested in company stock from that investment into other investment alternatives under the Plan. This right extends to all of the company stock held under the Plan, except that it does not apply to your account balance attributable to [*identify any accounts to which the rights apply only after three years of service*] until you have three years of service. [*Insert description of any advance **notice** requirement before a **diversification** election becomes effective .*] You may contact the person identified below for specific information regarding this new right, including how to make this election. In deciding whether to exercise this right, you will want to give careful consideration to the information below that describes the importance of diversification. All of the investment options under the Plan are available to you if you decide to diversify out of company stock.

### SECTION 2. The Importance of Diversifying Your Retirement Savings

To help achieve long-term retirement security, you should give careful consideration to the benefits of a well-balanced and diversified investment portfolio. Spreading your assets among different types of investments can help you achieve a favorable rate of return, while minimizing your overall risk of losing money. This is because market or other economic conditions that cause one category of assets, or one particular security, to perform very well often cause another asset category, or another particular security, to perform poorly. If you invest more than 20% of your retirement savings in any one company or industry, your savings may not be properly diversified. Although diversification is not a guarantee against loss, it is an effective strategy to help you manage investment risk.

In deciding how to invest your retirement savings, you should take into account all of your assets, including any retirement savings outside of the Plan. No single approach is right for everyone because, among other factors, individuals have different financial goals, different time horizons for meeting their goals, and different tolerances for risk. Therefore, you should carefully consider the rights described in this notice and how these rights affect the amount of money that you invest in company stock through the Plan.

It is also important to periodically review your investment portfolio, your investment objectives, and the investment options under the Plan to help ensure that your retirement savings will meet your retirement goals.

### SECTION 3. For More Information

If you have any questions about your rights under this new law, including how to make this election, contact [*enter name and contact information*].

## **EXHIBIT B**

### **Notice of Your Rights Concerning Employer Securities**

This notice is required by law and informs you of an important change in Federal law that provides specific rights concerning investments in employer securities (company stock). Because you may now or in the future have investments in company stock under the *[insert name of plan]*, you should take the time to read this notice carefully. Please note that the Plan already complies with the new law (and did so before the new law was enacted). Nevertheless, we are required to provide to you this notice of the new law and to explain the importance of diversification.

#### **SECTION 1. Your Rights Concerning Employer Securities**

For plan years beginning after December 31, 2006, the Plan must allow you to elect to move any portion of your account that is invested in company stock from that investment into other investment alternatives under the Plan. This right extends to all of the company stock held under the Plan. You may contact the person identified below for specific information regarding this right, including how to make this election. In deciding whether to exercise this right, you will want to give careful consideration to the information below that describes the importance of diversification. All of the investment options under the Plan are available to you if you decide to diversify out of company stock.

#### **SECTION 2. The Importance of Diversifying Your Retirement Savings**

To help achieve long-term retirement security, you should give careful consideration to the benefits of a well-balanced and diversified investment portfolio. Spreading your assets among different types of investments can help you achieve a favorable rate of return, while minimizing your overall risk of losing money. This is because market or other economic conditions that cause one category of assets, or one particular security, to perform very well often cause another asset category, or another particular security, to perform poorly. If you invest more than 20% of your retirement savings in any one company or industry, your savings may not be properly diversified. Although diversification is not a guarantee against loss, it is an effective strategy to help you manage investment risk.

In deciding how to invest your retirement savings, you should take into account all of your assets, including any retirement savings outside of the Plan. No single approach is right for everyone because, among other factors, individuals have different financial goals, different time horizons for meeting their goals, and different tolerances for risk. Therefore, you should carefully consider the rights described in this notice and how these rights affect the amount of money that you invest in company stock through the Plan.

It is also important to periodically review your investment portfolio, your investment objectives, and the investment options under the Plan to help ensure that your retirement savings will meet your retirement goals.

#### **SECTION 3. For More Information**

If you have any questions about your rights under this new law, including how to make this election, contact *[enter name and contact information]*.

**BROOKS PIERCE**

BROOKS, PIERCE, MCLENDON, HUMPHREY & LEONARD, LLP  
Attorneys at Law