



Pension Reform Legislation—Status Update

The "Pension Reform Bill" (HR 2830) is the key piece of legislation that is currently sitting in conference committee on Capitol Hill. If and when passed, this legislation will drive major changes in the way we do business in the retirement space. With two similar but separate versions of the bill (House and Senate) being amalgamated into one broad sweeping bill, it is important to understand the implications of the likely outcome. This document will provide the reader with a snapshot of where the Retirement Learning Center sees the provisions of this legislation landing, and outlines some of the key impacts it will have.

The Bill

Although the bill seems to be stuck in a congressional quagmire at present, it has taken on a "must-pass" status. Additional (nonrelated) provisions are being added to the bill (e.g., estate tax cuts), which indicates to us that Congress is expecting passage, and is "tagging on" extra initiatives to ride along with this legislation through eventual enactment. The recent predication from Congress pegs the bill's passage for August – but with four previous deadlines missed, and time still left on the '06 congressional clock in the fall – there is a possibility we may see this deadline slip by as well.

The Issues

The passage of the bill will hinge on decisions made with respect to Defined Benefit (DB) plan issues such as plan funding status, funding rules for commercial airlines, cash-balance plan conversions, and solvency of the PBGC (Pension Benefit Guarantee Corporation, the insurer of pension plans here in the U.S.). The debate is focused primarily on whether to mandate increased funding and force plan terminations, or ease funding and risk further plan failures.

DC Insights

While passage of the bill will be driven by the DB issues – and the outcome will be materially meaningful to the 29 million Americans who still have pension benefits today – a decidedly different set of legislative issues, currently included in the bill as well, will have a major impact on the Defined Contribution (DC) side of the retirement equation.

The two versions of the bill (from the House and Senate) are similar in the key areas that need to be addressed in DC plans. The primary focus being to address

- participation rates (which are too low),
- contribution rates (which are too low), and
- fiduciary liability for plan sponsors (which is too confusing).

Some of the specific concepts that are being hammered out include

- making auto enrollment a standard, and eliminating fiduciary risk associated with offering it;
- addressing “advice” as a necessary standard for participants;
- requiring employee “feedback” on the plan; and
- providing fiduciary relief for plan sponsors through a “qualified investment advisor” or the “fiduciary advisor.”

The Debate

The big debate in the DC section of the bill is over the topic of how investment “advice” is delivered to participants who are able to self-direct the investment of their plan assets. This is a major issue because the person or entity that ultimately delivers advice to participants assumes the role of a fiduciary in the plan, and reduces the fiduciary liability of the plan sponsor with respect to decisions made by participants based on the investment advice given.

In the House version, effectively, the plan provider (e.g., Fidelity), as the “fiduciary advisor,” would be allowed to advise participants on how to invest plan assets– and would not be forced to avoid investment vehicles upon which the provider earns a profit. This, in essence, would constitute a repeal of what now is considered a prohibited transaction - legalizing transactions that would allow a fiduciary to earn profits from investment vehicles that the fiduciary delivers explicit advice on.

Moreover, some commentators in the industry have interpreted the House version to imply that the fiduciary advisor would now be in a position to establish the investment line up for the plan as the investment fiduciary, and take on full fiduciary liability for investment decisions. This point is unclear at this time. However, the provision, as currently written, does not exempt a plan sponsor from the fiduciary responsibility for the prudent selection and periodic review of the fiduciary advisor.

In the Senate version, the plan sponsor would have to name a “Qualified Investment Advisor” who would deliver investment-related advice to plan participants. A Qualified Investment Adviser would be deemed to be a plan fiduciary, and would assume liability for any investment losses to participants that resulted from any investment advice provided. The plan sponsor would simply have to “monitor” the Qualified Investment Advisor according to safe harbor provisions as outlined in the bill. The Senate version does not include a prohibited transaction exemption for the Qualified Investment Advisor. Therefore, the advisor would have to be considered independent.

If the House version passes – we would expect to see current plan providers ramp up their ability to deliver advice to participants, and emphasize the reduction in fiduciary liability for plan sponsor as part of their “turnkey retirement solution.” Plan providers would also have a new found major advantage in being able to attract and retain rollovers as part of this outcome.

If the Senate version passes, we would expect to see a new wave of financial advisors who, heretofore, had not participated in the retirement space, and who now would have a major opportunity to deliver “participant advice” to plan participants – much in the same way they do for their traditional retail clients. Financial advisory firms would be forced to either step up to a fiduciary role and deliver investment

advice – or forfeit any potential participation in the retirement space (and likely forfeit any material opportunity to win plan rollovers as a consequence).

The Expectation

It is impossible to predict which version or amalgamation of versions will emerge. We do, however, expect a bill to pass, possibly by August 2006, which will bring with it more changes in how firms conduct business in the retirement space than we have seen in some time.