

IRS Issues Final Regulations on Employer Stock Diversification Requirements for Defined Contribution Plans

The Pension Protection Act of 2006 requires defined contribution plans (other than certain employee stock ownership plans (ESOPs)) to permit participants to diversify their investments in employer securities if those securities or other securities of the employer or any member of the employer's controlled group are readily tradable on an established securities market. These requirements are effective for plan years beginning after December 31, 2006 (i.e., January 1, 2007 for calendar year plans) and apply to investments in employer securities that are attributable to (i) any employee pre-tax (e.g., 401(k) elective deferrals) or after-tax contributions, or (ii) employer contributions (e.g., matching or nonelective contributions) for participants who have at least three (3) years of service.

The IRS proposed regulations explaining these requirements in January 2008. You can read our summary of those proposed regulations by clicking on the following link: [IRS Issues Proposed Regulations on Employer Stock Diversification Requirements for Defined Contribution Plans](#).

The IRS has now finalized those regulations with relatively few modifications. As was the case with the proposed regulations, the provisions of greatest interest to most plan sponsors are those that address prohibited or permitted restrictions on divestitures from or reinvestments in employer securities. Here are some of the significant changes from the 2008 proposals.

- As provided by the proposed regulations, prohibition on reinvestment in a frozen employer stock fund is permitted. The final regulations add that this restriction remains available, even if the plan allows reinvestment in employer securities of dividends paid on employer securities in a frozen fund.
- An employer securities fund under a leveraged ESOP may be treated as frozen, even if employer securities that are released from a suspense account are used as matching contributions and allocated to participants' accounts, so long as the suspense account securities were acquired before January 1, 2007, with an exempt loan that has not been refinanced after the end of the last plan year beginning before January 1, 2007.
- The proposed regulations allowed more frequent transfers into a stable value fund than into an employer securities fund. The final regulations expand this exception to permit more frequent transfers out of a stable value fund, as well.
- Transfers out of a qualified default investment alternative (QDIA) may be permitted more frequently than transfers out of an employer securities fund. This accommodates the requirement under DOL regulations for QDIAs that mandates the availability of transfers out of a QDIA without penalty or other restriction during the first 90 days of a defaulted investment.

If you have questions or would like additional information about diversification requirements for defined contribution plan investments in employer securities, please feel free to contact Brian Dougherty at (215) 587-5919 or bdougherty@postschell.com.

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