• Would a different format (grouping and order of sections, use of headings, paragraphing) make the regulation easier to understand? If so, what changes to the format would make the regulation easier to understand?

• What else could we do to make the regulation easier to understand?

IV. Regulatory Flexibility Act Analysis

The Regulatory Flexibility Act (RFA) requires that each Federal agency either certify that a proposed rule would not, if adopted in final form, have a significant impact on a substantial number of small entities or prepare an initial regulatory flexibility analysis (IRFA) of the proposal and publish the analysis for comment. See 5 U.S.C. 603, 605. The proposed rule primarily affects the internal operations of the FDIC, does not impose any obligations or restrictions on depository institutions, including small depository institutions, and does not impact the contracting opportunities of small businesses or SDBs. The FDIC certifies pursuant to 5 U.S.C. 605(b) that this proposed rule, if it is adopted in final form, will not have a significant impact on a substantial number of small entities. Commenters are nevertheless invited to provide the FDIC with any information they may have about the likely quantitative effects of the proposal.

V. Paperwork Reduction Act

The FDIC has determined that this proposed rule does not involve a collection of information pursuant to the provisions of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*).

VI. The Treasury and General Government Appropriations Act, 1999— Assessment of Federal Regulations and Policies on Families

The FDIC has determined that the proposed rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, enacted as part of the Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999 (Pub. L. 105–277, 112 Stat. 2681).

List of Subjects in 12 CFR Part 361

Government contracts, Individuals with disabilities, Lawyers, Legal services, Minority businesses, Reporting and recordkeeping requirements, Women.

For the reasons set forth in the preamble, the Board of Directors of the Federal Deposit Insurance Corporation proposes to amend title 12, chapter III, of the Code of Federal Regulations as follows:

PART 361—MINORITY AND WOMEN OUTREACH PROGRAM CONTRACTING

1. The authority citation for part 361 continues to read as follows:

Authority: 12 U.S.C. 1833e.

2. Revise § 361.3 to read as follows:

§ 361.3 Who may participate in this outreach program?

Any MWOB contractor qualified to provide goods and services to the FDIC.

3. Revise § 361.5 to read as follows:

§ 361.5 What are the FDIC's oversight and monitoring responsibilities in administering this program?

The FDIC Office of Diversity and Economic Opportunity (ODEO) has overall responsibility for nationwide outreach oversight which includes, but is not limited to, the monitoring, review and interpretation of relevant regulations. In addition, the ODEO is responsible for providing the FDIC with technical assistance and guidance to facilitate the identification and solicitation of MWOBs. ODEO shall also collect and analyze data on contracting dollars awarded to MWOBs as provided by the FDIC's Division of Administration.

4. Revise § 361.6 to read as follows:

§ 361.6 What outreach efforts are included in this program?

Outreach includes the identification and solicitation of MWOBs who can provide goods and services to the FDIC and the distribution of information concerning the MWOP. The identification and solicitation of MWOBs for the provision of legal and non-legal services will primarily be accomplished by:

(a) Obtaining lists and directories of MWOBs maintained by other federal, state, and local governmental agencies;

(b) Participating in conventions, seminars and professional meetings comprised of, or attended predominately by MWOBs;

(c) Conducting seminars, meetings, workshops and other various functions to promote the identification and solicitation of MWOBs;

(d) Placing MWOP promotional advertisements in minority- and women-owned media indicating opportunities with the FDIC; and

(e) Monitoring FDIC staff interacting with the contracting community to ensure they are knowledgeable of, and actively promote the MWOP.

By order of the Board of Directors.

Dated at Washington, DC, this 19th day of December 2007.

Federal Deposit Insurance Corporation.

Valerie J. Best,

Assistant Executive Secretary.

[FR Doc. E7–25028 Filed 1–2–08; 8:45 am]

BILLING CODE 6714–01–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–136701–07]

RIN1545–BH04

Diversification Requirements for Certain Defined Contribution Plans

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations under section 401(a)(35) of the Internal Revenue Code (Code) relating to diversification requirements for certain defined contribution plans and to publicly traded employer securities. These regulations will affect administrators of, employers maintaining, participants in, and beneficiaries of defined contribution plans that are invested in employer securities.

DATES: Written or electronic comments and requests for a public hearing must be received by April 2, 2008.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (Reg–136701–07), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (Reg–136701–07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or sent electronically via the Federal eRulemaking Portal at *http://www.regulations.gov* (IRS REG–136701–07).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, R. Lisa Mojiri-Azad or Dana Barry at (202) 622–6060; concerning submission of comments or to request a public hearing, Kelly Banks at (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed regulations under section 401(a)(35) of the Code, which was added by section

901 of the Pension Protection Act of 2006, Public Law 109–280, 120 Stat. 780 (PPA '06).[1]

Section 401(a)(35)(A) provides that a trust which is part of an applicable defined contribution plan is not a qualified trust under section 401(a) unless the plan satisfies the diversification requirements of sections 401(a)(35)(B), (C), and (D). Under section 401(a)(35)(B), each individual must have the right to direct the plan to divest employer securities allocated to the individual's account that are attributable to employee contributions or elective deferrals and to reinvest an equivalent amount in other investment options meeting the requirements of section 401(a)(35)(D).[2]

Under section 401(a)(35)(C), each individual who is a participant who has completed at least three years of service, a beneficiary of a participant who has completed at least three years of service, or a beneficiary of a deceased participant must be permitted to elect to direct the plan to divest employer securities allocated to the individual's account and to reinvest an equivalent amount in other investment options meeting the requirements of section 401(a)(35)(D).

Section 401(a)(35)(D)(i) requires an applicable defined contribution plan to offer individuals not less than three investment options, other than employer securities, to which the individuals may direct the proceeds from the divestment of employer securities, each of which is diversified and has materially different risk and return characteristics.

Under section 401(a)(35)(D)(ii)(I), a plan does not fail to meet the requirements of section 401(a)(35)(D) if it allows individuals to divest employer securities and reinvest the proceeds at periodic, reasonable opportunities occurring no less frequently than quarterly.

Under section 401(a)(35)(D)(ii)(II), a plan is not permitted to impose restrictions or conditions with respect to the investment of employer securities that are not imposed on the investment of other assets of the plan. However, this rule does not apply to restrictions or conditions imposed to comply with securities laws. The Secretary is authorized to issue regulations providing additional exceptions to the requirements of section 401(a)(35)(D)(ii)(II).

An applicable defined contribution plan under section 401(a)(35) is a defined contribution plan that holds any publicly traded employer securities. A publicly traded employer security is defined as an employer security under section 407(d)(1) of the Employee Retirement Income Security Act of 1974, Public Law 93–406, 88 Stat. 829 (ERISA) which is readily tradable on an established securities market. Section 401(a)(35)(F)(i) provides that a plan that does not hold publicly traded employer securities is nevertheless treated as holding publicly traded employer securities if any employer corporation or any member of a controlled group of corporations which includes the employer (determined by applying section 1563(a), except substituting 50 percent for 80 percent) has issued a class of stock that is a publicly traded employer security. However, section 401(a)(35)(F) does not apply to a plan if no employer corporation, or parent corporation (as defined in section 424(e)) of an employer corporation, has issued any publicly traded employer security and no employer or parent corporation has issued any special class of stock which grants particular rights to, or bears particular risks for, the holder or issuer with respect to any corporation described in section 401(a)(35)(F)(i) which has issued any publicly traded employer security.

Section 401(a)(35)(E) provides that section 401(a)(35) does not apply to an employee stock ownership plan within the meaning of section 4975(e)(7) (ESOP) that holds no contributions (or earnings thereunder) that are subject to section 401(k) or (m) (generally relating to elective deferrals and matching and employee after-tax contributions) and the ESOP is a separate plan for purposes of section 414(l) with respect to any other defined benefit plan or defined contribution plan maintained by the same employer or employers. Section 401(a)(35)(E) further provides that section 401(a)(35) does not apply to one-participant retirement plans.

Section 401(a)(35) is generally effective for plan years beginning after December 31, 2006. Section 401(a)(35)(H) generally provides a three year phase-in rule with respect to an individual's right to direct the divestment of employer securities attributable to employer contributions, except with respect to certain participants who have attained age 55. Section 901(c)(2) of PPA '06 includes a special rule for a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers that was ratified on or before August 17, 2006. Under this rule, section 401(a)(35) is not effective until plan years beginning after the earlier of (1) the later of (a) December 31, 2007 or (b) the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after August 17, 2006) or (2) December 31, 2008.

Notice 2006–107 (2006–2 CB 1114 (December 18, 2006)) (see § 601.601(d)(2)(ii)(*b*) of this chapter), includes guidance and transitional rules with respect to the diversification requirements of section 401(a)(35).[3] Notice 2006–107 provides that a plan (and an investment option described in section 401(a)(35)(D)(i)) is not treated as holding employer securities to which section 401(a)(35) applies with respect to any securities held through either an investment company registered under the Investment Company Act of 1940 or a similar pooled investment vehicle that is regulated and subject to periodic examination by a State or Federal agency and with respect to which investment in securities is made both in accordance with the stated investment objectives of the investment vehicle and independent of the employer and any affiliate thereof, but only if the holdings of the investment company or similar investment vehicle are diversified so as to minimize the risk of large losses. Notice 2006–107 also provides that investment options satisfy the requirement that investment options be diversified and have materially different risk and return characteristics under section 401(a)(35)(D)(i) if the investment options satisfy the requirements of section 2550.404c–1(b)(3) of the Department of Labor regulations.

Notice 2006–107 further provides that, for purposes of section 401(a)(35), the date on which a participant completes three years of service occurs immediately after the end of the third

[1] Section 901 of PPA '06 also added a parallel provision at section 204(j) of the Employee Retirement Income Security Act of 1974, Public Law 93–406, 88 Stat. 829 (ERISA). Under section 101 of Reorganization Plan No. 4 of 1978 (43 FR 47713), the Secretary of Treasury has interpretative jurisdiction over the subject matter addressed in these proposed regulations for purposes of section 204(j) of ERISA. Thus, the guidance provided in these proposed regulations with respect to section 401(a)(35) of the Code also applies for purposes of section 204(j) of ERISA.

[2] Section 401(a)(28) provides certain diversification rights to participants in an employee stock ownership plan within the meaning of section 4975(e)(7) (ESOP). Section 401(a)(28)(B) also generally requires that the plan offer at least three alternative investment options. Section 401(a)(28)(B) permits a plan to satisfy these diversification requirements by distributing, within 90 days after the period during which the election may be made, the portion of the participant's account that is subject to section 401(a)(28)(B). Section 401(a)(28)(B) was amended by section 901(a)(2)(A) of PPA '06 not to apply to a plan to which section 401(a)(35) applies.

[3] Notice 2006–107 also includes guidance regarding the related notice requirements of section 101(m) of ERISA, including a model notice.

vesting computation period provided for under the plan that constitutes the completion of a third year of service under section 411(a)(5). For a plan using the elapsed time method of crediting service for vesting purposes (or a plan that provides for immediate vesting without using a vesting computation period or elapsed time method of determining vesting), the date on which a participant completes three years of service is the third anniversary of the participant's date of hire.

Notice 2006–107 includes special rules regarding restrictions or conditions with respect to employer securities under section 401(a)(35)(D)(ii)(II). An impermissible restriction or condition is either a restriction on an individual's right to divest an investment in employer securities that is not imposed on an investment that is not in employer securities or a benefit that is conditioned on an investment in employer securities. Examples of restrictions or conditions that are prohibited by section 401(a)(35)(D)(ii)(II) under Notice 2006–107 include: (1) A plan allows an individual the right to divest employer securities on a quarterly basis but permits divestiture of another investment on a more frequent basis; (2) a plan provides that a participant who divests his or her account of employer securities receives less favorable treatment (such as a lower rate of matching contributions) than a participant whose account remains invested in employer securities; and (3) a plan that provides if a participant divests his or her account balance with respect to investment in a class of employer securities, the participant is not permitted for a period of time to reinvest in that class of securities where that restriction is not imposed on other investments. Notice 2006–107 also provided examples of restrictions or conditions that are not prohibited by section 401(a)(35)(D)(ii)(II): (1) A provision that limits the extent to which an individual's account balance can be invested in employer securities; (2) a provision under which an employer securities fund is closed; (3) a restriction imposed by reason of application of securities laws or a restriction that is reasonably designed to ensure compliance with such laws; (4) an imposition of fees on other investment options under the plan but not on investments in employer securities; and (5) a plan restriction on the availability of otherwise applicable diversification rights under the plan for up to 90 days following an initial public offering of the employer's stock.

Notice 2006–107 provides certain transition rules. For example, for the period prior to January 1, 2008, a plan does not impose a restriction or condition prohibited by section 401(a)(35)(D)(ii)(II) merely because the plan, as in effect on December 18, 2006, (1) does not impose an otherwise applicable restriction on a stable value fund or (2) allows individuals the right to divest employer securities on a periodic basis (at least quarterly), but permits divestiture of another investment on a more frequent basis, provided that the other investment is not a generally available investment.

Explanation of Provisions

Overview

The proposed regulations would provide guidance with respect to the requirements of section 401(a)(35) that incorporate much of the guidance provided under Notice 2006–107. The regulations would clarify the scope of the rule in section 401(a)(35)(D)(ii)(II) that generally prohibits restrictions and conditions on investment in employer securities, but would specifically permit certain restrictions and conditions on such investment that are consistent with the statute, and would also define when employer securities are publicly traded on an established securities market under section 401(a)(35)(D).

Basic Diversification Rights

The proposed regulations incorporate the guidance on the basic diversification rights of section 401(a)(35) that is contained in Notice 2006–107. Thus, if an applicable defined contribution plan holds employee contributions (including rollover contributions) or elective deferrals with respect to an individual that are invested in employer securities, the plan must provide that the individual is given the opportunity to divest the employer securities and reinvest an equivalent amount in another investment. These rights must be provided to each participant, to each alternate payee who has an account under the plan, and to each beneficiary of a deceased participant.

If employer contributions (other than elective deferrals) are invested in employer securities under the plan, the divestment right must be provided to each participant who has completed at least three years of service, to each alternate payee who has an account under the plan with respect to a participant who has at least three years of service, and to each beneficiary of a deceased participant (regardless of whether the participant had completed at least three years of service). For this purpose, the regulations would provide that a participant has completed three years of service on the last day of the vesting computation period as determined under the plan that constitutes the completion of the third year of service (or the third anniversary of hire for a plan that either uses the elapsed time method or that does not define the vesting computation period because the plan provides for full and immediate vesting).

The regulations would require a plan to provide individuals who have section 401(a)(35) diversification rights the opportunity to divest the employer securities and reinvest an equivalent amount in another investment at least quarterly. The individuals must be permitted to select among no less than three investment options, each of which is diversified and has materially different risk and return characteristics. For this purpose, investment options that constitute a broad range of investment alternatives within the meaning of Department of Labor Regulations section 2550.404c-1(b)(3) are treated as being diversified and having materially different risk and return characteristics.

Plans Subject to Section 401(a)(35)

Under the proposed regulations, a defined contribution plan, which holds publicly traded employer securities (referred to as an applicable defined contribution plan), is subject to the diversification requirements of section 401(a)(35), unless it is exempted under section 401(a)(35)(E) as a stand-alone ESOP or as a one-participant retirement plan. For this purpose, an employer security is defined by reference to section 407(d)(1) of ERISA.

Under section 401(a)(35)(G)(v), an employer security is a publicly traded employer security if it is readily tradable on an established securities market. The regulations would provide separate rules for securities traded on domestic securities exchanges and foreign securities exchanges.

If a security is traded on a securities exchange that is registered under section 6 of the Securities Exchange Act of 1934, then the security would be deemed to be readily tradable on an established securities market. This definition is consistent with the definition of publicly traded found in § 54.4975–7(b)(1)(iv), but deletes the reference to a system sponsored by the National Association of Securities Dealers (NASDAQ) registered under section 15A(b) of the Act (15 U.S.C. 78o) because NASDAQ is now registered as

a securities exchange under section 6 of the Securities Exchange Act of 1934. Thus, if a security is not traded on a national securities exchange that is registered under section 6 of the Securities Exchange Act of 1934, then the security would not be publicly traded for purposes of section 401(a)(35) (unless it is traded on a foreign securities exchange and has a ''ready market'' as described in the next paragraph). This would apply to U.S. securities that are only traded on the ''Over-The-Counter Bulletin Board'' and the ''pink sheets.''

Under the proposed regulations, if a security is not listed on a securities exchange that is registered under section 6 of the Securities Exchange Act of 1934, but is traded on a foreign national securities exchange that is officially recognized, sanctioned, or supervised by a governmental authority, then under the proposed regulations, the security would be traded on an established securities market. The proposed regulations would provide that such a security is readily tradable if the security is deemed by the Securities and Exchange Commission (SEC) as having a ''ready market'' under SEC Rule 15c3–1 (17 CFR 240.15c3–1).[4]

The proposed regulations would reflect section 401(a)(35)(F), which, subject to certain exceptions, treats a plan holding employer securities that are not publicly traded as nonetheless subject to the rules of section 401(a)(35) if any employer sponsoring the plan, or any member of the controlled group of corporations (determined by applying section 1563(a), except substituting 50 percent for 80 percent) has issued a class of stock which is publicly traded (as defined above).

Section 401(a)(35)(E)(ii) provides that an ESOP that is a separate plan holding no contributions that are subject to section 401(k) or section 401(m) is not an applicable defined contribution plan. (As noted earlier in this preamble, such a plan is subject to the diversification requirements of section 401(a)(28)(B).) The proposed regulations would clarify that a plan does not lose this exemption merely because it receives rollover contributions of amounts from another plan that are held in a separate account, even if those amounts were attributable to contributions that were subject to section 401(k) or 401(m) in the other plan. In addition, the proposed regulations would reflect the exemption for one-participant retirement plans under section 401(a)(35)(E)(iv).

[4] Under the current SEC rules, a security is deemed to have a ready market if it is included on the FTSE Group (FTSE) World Index.

Notice 2006–107 provides that employer securities held by an investment company registered under the Investment Company Act of 1940 or similar pooled investment vehicle are not treated as being held by the plan. Some comments on Notice 2006–107 had recommended a broader rule, under which a commingled fund that holds employer securities and other securities would not be treated as holding employer securities that are subject to the section 401(a)(35) diversification requirement. The proposed regulations would not adopt this broad exemption from the diversification rules.

The proposed regulations, however, clarify the types of pooled investment vehicles that are exempt from the diversification requirements. Under the proposed regulations, in order to be exempt from the diversification requirements, the pooled investment vehicle must be a common or collective trust fund or pooled investment fund maintained by a bank or trust company supervised by a State or Federal agency, a pooled investment fund of an insurance company that is qualified to do business in a State, or an investment fund designated by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin. As under Notice 2006–107, the regulations would include the requirement that in order to be exempt from the diversification requirements the pooled investment fund that holds the employer securities must have stated investment objectives and the investment must be independent of the employer and any affiliate thereof. The proposed regulations would add a percentage limitation rule to ensure that the investment in the employer securities through a pooled fund is not an attempt to evade the rules of section 401(a)(35). Under this rule, if the employer securities held by such fund is more than 10 percent of the total value of all of the fund's investment, then the fund is not considered to be independent of the employer.

Prohibition on Restrictions or Conditions

The proposed regulations would provide that the section 401(a)(35)(D)(ii)(II) prohibition on restrictions or conditions with respect to the investment of employer securities which are not imposed on the investment of other assets of the plans applies to a direct or indirect restriction on an individual's rights to divest an investment in employer securities that is not imposed on an investment that is not employer securities as well as a direct or indirect benefit that is conditioned on investment in employer securities. However, like Notice 2006–107, the regulations would not apply this prohibition to restrictions that are imposed by reason of the application of securities laws and in certain other situations described below.

Like Notice 2006–107, the proposed regulations would allow a plan to impose a restriction on divestiture that is reasonably designed to comply with securities law, even if the restriction is broader than the minimum restriction needed to comply with securities laws. The proposed regulations incorporate the example of such a restriction from Notice 2006–107. This is merely an example and broader restrictions on divestiture are permitted, provided they are reasonably designed to comply with securities law. For example, in some smaller entities a broad restriction allowing divestiture to occur only once a quarter might be a restriction that is reasonably designed to comply with securities law.

Notice 2006–107 includes a rule that permits a plan to restrict the otherwise applicable diversification rights under section 401(a)(35) for a period of up to 90 days following an initial public offering of the employer's stock. The proposed regulations would extend this rule to apply to the first 90 days after the plan becomes an applicable defined contribution plan. This could happen, for example, when some other entity in the controlled group first issues stock which is publicly traded or when a stand-alone ESOP first provides for contributions that are subject to section 401(k) or section 401(m).

Notice 2006–107 permits a plan to impose a restriction on an investment in employer securities that is not imposed on a stable value fund. The proposed regulations extend this rule to a fund that is similar to a stable value fund. Specifically, the proposed regulations would provide that in the case of a plan that has several investment funds, including a fund invested in employer securities, a fund which is a stable value or similar fund, and other funds which are not invested in employer securities, the plan does not impose a restriction prohibited under section 401(a)(35)(D)(ii)(II) merely because the plan permits transfers to be made into the stable value or similar fund more frequently than into the fund invested in employer securities (assuming the plan does not impose a restriction on transfers to or from the employer securities fund that it does not impose with respect to the other funds).

While the proposed regulations would generally prohibit indirect restrictions

on an individual's exercise of diversification rights (such as a plan provision that limits the right of an individual who diversifies out of employer securities by providing that such a participant is not permitted to reinvest in employer securities for a period of time), the rules would permit certain indirect restrictions, as well as certain indirect benefits that are conditioned on investment in employer securities. Under the proposed regulations, a plan would be permitted to limit the extent to which an individual's account balance can be invested in employer securities. For example, a plan would not be treated as imposing a restriction that violates section 401(a)(35)(D)(ii)(II) merely because the plan prohibits a participant from investing additional amounts in employer securities if more than 10 percent of that participant's account balance is (or would be after the change) invested in employer securities. In addition, an applicable defined contribution plan does not violate a prohibition against reinvestment in employer securities if the plan has terminated any further investment in employer securities.

The proposed regulations would provide that a plan is not providing an indirect benefit that is conditioned on investment in employer securities merely because the plan imposes fees on other investment options that are not imposed on the investment in employer securities. In addition, a plan is not providing a restriction on the right to divest an investment in employer securities merely because the plan imposes a reasonable fee for the divestment of employer securities.

The proposed regulations would permit a restriction on the frequency of investment elections that was not in Notice 2006–107. Under this rule, a plan would be permitted to impose reasonable restrictions on the timing and number of investment elections that an individual can make to invest in employer securities, provided that the restrictions are designed to limit short-term trading in the employer securities. For example, a fund could limit the purchase of employer securities if there has been a sale within a short period of time, such as 7 days. The regulations, however, would not permit a plan to limit an individual's right to divest employer securities.

Proposed Effective Date

Section 401(a)(35) is applicable to plan years beginning on or after January 1, 2007, subject to certain deferred effective dates and transition rules. The proposed regulations would provide guidance on these effective dates and transition rules. In particular, the regulations would provide that a plan is eligible for the deferred effective date applicable to collectively bargained plans only if at least 25 percent of the participants in the plan are members of collective bargaining units for which the contributions under the plan are specified under a collective bargaining agreement.

The regulations under section 401(a)(35) are proposed to be effective for plan years beginning on or after January 1, 2009. Until the regulations go into effect, Notice 2006–107 will continue to apply. For this purpose, the transitional relief provided for the period prior to January 1, 2008, in paragraph 4 of Section III.D. of Notice 2006–107 will continue to apply after 2007 until the regulations go into effect.[5] In addition, plans are also permitted to apply the proposed regulations for plan years before the regulations go into effect.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because § 1.401(a)(35)–1 would not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (one signed and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and the Treasury Department specifically request comments on the clarity of the proposed regulations and how they can be made easier to understand.

In particular, the IRS and the Treasury Department request comments on whether the determination of when an employer security is readily tradable on an established securities market under these proposed regulations should also be applied for purposes of determining whether an employer security is readily tradable on an established securities market in applying other provisions relating to qualified plans, given that the same words used in interrelated provisions of the Code are presumed to have the same meaning. These interrelated provisions include section 401(a)(28)(C) (requiring the use of an independent appraiser for valuation of employer securities that are not readily tradable on an established securities market), section 409(h)(1)(B) (relating to put options for employer securities that are not readily tradable on an established market), the definition of employer securities under section 409(l)(1) (including regulations under section 4975), and the special rules under section 1042 (providing nonrecognition treatment for certain sales to an ESOP).

All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person who timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place of the public hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these regulations are Dana A. Barry and Lisa Mojiri-Azad, Office of Division Counsel/ Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury participated in the development of these regulations.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.401(a)(35)–1 is also issued under 26 U.S.C. 401(a)(35).* * *

Par. 2. Section 1.401(a)(35)–1 is added to read as follows:

[5] The Treasury and IRS are issuing a notice to reflect this extension. The notice is expected to be published as Notice 2008–7 in the 2008–3 issue of the IRB on january 22, 2008 (see § 601.601(d)(2)(ii)(*b*) of this chapter).

§ 1.401(a)(35)–1 Diversification Requirements for Certain Defined Contribution Plans.

(a) *General rule*—(1) *Diversification requirements.* Section 401(a)(35) imposes diversification requirements on applicable defined contribution plans. A trust that is part of an applicable defined contribution plan is not a qualified trust under section 401(a) unless the plan—

(i) Satisfies the diversification election requirements for elective deferrals and employee contributions set forth in paragraph (b) of this section;

(ii) Satisfies the diversification election requirements for employer nonelective contributions set forth in paragraph (c) of this section;

(iii) Satisfies the investment option requirement set forth in paragraph (d) of this section; and

(iv) Does not apply any restrictions or conditions on investments in employer securities that violate the requirements of paragraph (e) of this section.

(2) *Definitions, effective dates, and transition rules.* The definitions of applicable defined contribution plan, employer security, parent corporation, and publicly traded are set forth in paragraph (f) of this section. Effective/applicability dates and transition rules are set forth in paragraph (g) of this section.

(b) *Diversification requirements for elective deferrals and employee contributions invested in employer securities*—(1) *General rule.* With respect to any individual described in paragraph (b)(2) of this section, if any portion of the individual's account under an applicable defined contribution plan attributable to elective deferrals (as described in section 402(g)(3)(A)), after-tax employee contributions, or rollover contributions is invested in employer securities, then the plan satisfies the requirements of this paragraph (b) if the individual may elect to divest those employer securities and reinvest an equivalent amount in other investment options. The plan may limit the time for divestment and reinvestment to periodic, reasonable opportunities occurring no less frequently than quarterly.

(2) *Applicable individual with respect to elective deferrals and employee contributions.* An individual is described in this paragraph (b)(2) if the individual is—

(i) A participant;

(ii) An alternate payee who has an account under the plan; or

(iii) A beneficiary of a deceased participant.

(c) *Diversification requirements for employer nonelective contributions invested in employer securities*—(1) *General rule.* With respect to any individual described in paragraph (c)(2) of this section, if a portion of the individual's account under an applicable defined contribution plan attributable to employer nonelective contributions, other than elective deferrals, is invested in employer securities, then the plan satisfies the requirements of this paragraph (c) if the individual may elect to divest those employer securities and reinvest an equivalent amount in other investment options. The plan may limit the time for divestment and reinvestment to periodic, reasonable opportunities occurring no less frequently than quarterly.

(2) *Applicable individual with respect to employer nonelective contributions.* An individual is described in this paragraph (c)(2) if the individual is—

(i) A participant who has completed at least three years of service;

(ii) An alternate payee who has an account under the plan with respect to a participant who has completed at least three years of service; or

(iii) A beneficiary of a deceased participant.

(3) *Completion of 3 years of service.* For purposes of paragraph (c)(2) of this section, a participant completes three years of service on the last day of the vesting computation period provided for under the plan that constitutes the completion of the third year of service under section 411(a)(5). However, for a plan that uses the elapsed time method of crediting service for vesting purposes (or a plan that provides for immediate vesting without using a vesting computation period or the elapsed time method of determining vesting), a participant completes three years of service on the day immediately preceding the third anniversary of the participant's date of hire.

(d) *Investment option.* An applicable defined contribution plan must offer not less than three investment options, other than employer securities, to which an individual who has the right to divest under paragraph (b)(1) or (c)(1) of this section may direct the proceeds from the divestment of employer securities. Each of the three investment options must be diversified and have materially different risk and return characteristics. For this purpose, investment options that constitute a broad range of investment alternatives within the meaning of Department of Labor Regulation section 2550.404c–1(b)(3) are treated as being diversified and having materially different risk and return characteristics.

(e) *Restrictions or conditions on investments in employer securities*—(1) *Impermissible restrictions or conditions*—(i) *General rule.* Except as provided in paragraph (e)(2) of this section, an applicable defined contribution plan violates the requirements of this paragraph (e) if the plan imposes restrictions or conditions with respect to the investment of employer securities that are not imposed on the investment of other assets of the plan. A restriction or condition with respect to employer securities means—

(A) A restriction on an individual's right to divest an investment in employer securities that is not imposed on an investment that is not employer securities; and

(B) A benefit that is conditioned on investment in employer securities.

(ii) *Indirect restrictions or conditions.* Except as provided in paragraph (e)(3) of this section, a plan violates the requirements of this paragraph (e) if the plan imposes a restriction or condition in paragraph (e)(1)(i)(A) or (B) of this section either directly or indirectly. For example, a plan imposes an indirect restriction on an individual's right to divest an investment in employer securities if the plan provides that a participant who divests his or her account balance with respect to investment in employer securities is not permitted for a period of time thereafter to reinvest in employer securities.

(2) *Permitted restrictions or conditions*—(i) *In general.* An applicable defined contribution plan does not violate the requirements of this paragraph (e) merely because it imposes a restriction or a condition set forth in paragraph (e)(2)(ii) or (e)(2)(iii) of this section.

(ii) *Securities laws.* A plan is permitted to impose a restriction or condition on the divestiture of employer securities that is either required in order to ensure compliance with applicable securities laws or is reasonably designed to ensure compliance with applicable securities laws. For example, it is permissible for a plan to limit divestiture rights for participants who are subject to section 16(b) of the Securities Exchange Act of 1934 to a reasonable period (such as 3 to 12 days) following publication of the employer's quarterly earnings statements because it is reasonably designed to ensure compliance with Rule 10b–5 of the Securities and Exchange Commission.

(iii) *Deferred application of the diversification requirements.* An applicable defined contribution plan is permitted to restrict the application of the diversification requirements of

section 401(a)(35) and this section for up to 90 days after the plan becomes an applicable defined contribution plan (for example, the date on which the employer securities held under the plan become publicly traded).

(3) *Permitted indirect restrictions or conditions*—(i) *In general.* An applicable defined contribution plan does not violate the requirements of this paragraph (e) merely because it imposes an indirect restriction or condition set forth in paragraphs (e)(3)(ii) through (e)(3)(v) of this section.

(ii) *Limitation on investment in employer securities.* The plan is permitted to limit the extent to which an individual's account balance can be invested in employer securities, provided the limitation applies without regard to a prior exercise of rights to divest employer securities. For example, a plan does not impose a restriction that violates this paragraph (e) merely because the plan prohibits a participant from investing additional amounts in employer securities if more than 10 percent of that participant's account balance is invested in employer securities.

(iii) *Trading frequency.* A plan is permitted to impose reasonable restrictions on the timing and number of investment elections that an individual can make to invest in employer securities, provided that the restrictions are designed to limit short-term trading in the employer securities. For example, a plan could provide that a participant may not elect to invest in employer securities if the employee has elected to divest employer securities within a short period of time, such as seven days.

(iv) *Frozen funds.* A plan is permitted to prohibit any further investment in employer securities.

(v) *Fees.* The plan has not provided an indirect benefit that is conditioned on investment in employer securities merely because the plan imposes fees on other investment options that are not imposed on the investment in employer securities. In addition, the plan has not provided a restriction on the right to divest an investment in employer securities merely because the plan imposes a reasonable fee for the divestment of employer securities.

(vi) *Transfers to stable value fund.* In the case of a plan that has several investment funds, including one or more funds invested in employer securities, a fund which is a stable value or similar fund, and other funds which are not invested in employer securities, the plan does not impose a restriction prohibited under this paragraph (e) merely because the plan permits transfers to be made into the stable value or similar fund more frequently than other funds (including funds invested in employer securities).

(f) *Definitions*—(1) *Application of definitions.* This paragraph (f) contains definitions that are applicable for purposes of this section.

(2) *Applicable defined contribution plan*—(i) *General rule.* Except as provided in this paragraph (f)(2), an applicable defined contribution plan means any defined contribution plan which holds employer securities that are publicly traded. See paragraph (f)(2)(iv) of this section for a special rule that treats certain plans that hold employer securities that are not publicly traded as applicable defined contribution plans and paragraph (f)(3)(ii) of this section for a special rule that treats certain plans as not holding publicly traded employer securities for purposes of this section.

(ii) *Exception for certain ESOPs.* An employee stock ownership plan (ESOP), as defined in section 4975(e)(7), is not an applicable defined contribution plan if the plan is a separate plan for purposes of section 414(l) with respect to any other defined benefit plan or defined contribution plan maintained by the same employer or employers and holds no contributions (or earnings thereunder) that are (or were ever) subject to section 401(k) or 401(m). Thus, an employee stock ownership plan is an applicable defined contribution plan if that ESOP is a portion of a larger plan (whether or not that larger plan includes contributions that are subject to section 401(k) or 401(m)). For purposes of this paragraph (f)(2)(ii), a plan is not considered to hold amounts ever subject to section 401(k) or 401(m) merely because the plan holds amounts attributable to rollover amounts in a separate account that were previously subject to section 401(k) or 401(m).

(iii) *Exception for one-participant plans.* A one-participant plan, as defined in section 401(a)(35)(E)(iv), is not an applicable defined contribution plan.

(iv) *Certain defined contribution plans treated as holding publicly traded employer securities*—(A) *General rule.* A defined contribution plan holding employer securities that are not publicly traded is treated as an applicable defined contribution plan if any employer maintaining the plan or any member of a controlled group of corporations that includes such employer has issued a class of stock which is publicly traded. For purposes of this paragraph (f)(2)(iv), a controlled group of corporation has the meaning given such term by section 1563(a), except that ''50 percent'' is substituted for ''80 percent'' each place it appears.

(B) *Exception for certain plans.* Paragraph (f)(2)(iv)(A) of this section does not apply to a plan if—

(*1*) No employer maintaining the plan (or a parent corporation with respect to such employer) has issued stock that is publicly traded; and

(*2*) No employer maintaining the plan (or parent corporation with respect to such employer) has issued any special class of stock which grants to the holder or issuer particular rights, or bears particular risks for the holder or issuer, with respect to any employer maintaining the plan (or any member of a controlled group of corporations that includes such employer) which has issued any stock that is publicly traded.

(3) *Employer security*—(i) *General rule.* Employer security has the meaning given such term by section 407(d)(1) of the Employee Retirement Income Security Act of 1974, as amended.

(ii) *Certain defined contribution plans or investment funds not treated as holding employer securities*—(A) *Exception for certain flow-through investments.* Subject to paragraph (f)(3)(ii)(B) and (C) of this section, a plan (and an investment option described in paragraph (d) of this section) is not treated as holding employer securities for purposes of this section to the extent the employer securities are held indirectly through—

(*1*) An investment company registered under the Investment Company Act of 1940;

(*2*) A common or collective trust fund or pooled investment fund maintained by a bank or trust company supervised by a State or a Federal agency;

(*3*) A pooled investment fund of an insurance company that is qualified to do business in a State; or

(*4*) Any other investment fund designated by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin.

(B) *Investment must be independent.* The exception set forth in paragraph (f)(3)(ii)(A) of this section applies only if the investment in the employer securities are held in a fund under which—

(*1*) There are stated investment objectives of the fund; and

(*2*) The investment is independent of the employer and any affiliate thereof.

(C) *Percentage limitation rule.* For purposes of paragraph (f)(3)(ii)(B)(*2*) of this section, an investment in employer securities in a fund is considered to be independent of the employer and any affiliate thereof only if the aggregate value of the employer securities held in

the fund is not in excess of 10 percent of the total value of all of the fund's investments.

(4) *Parent corporation.* Parent corporation has the meaning given such term by section 424(e).

(5) *Publicly traded*—(i) *In general.* A security is publicly traded if it is readily tradable on an established securities market.

(ii) *Established securities market.* For purposes of this paragraph (f)(5), a security is traded on an established securities market if—

(A) The security is traded on a national securities exchange that is registered under section 6 of the Securities and Exchange Act of 1934 (15 U.S.C. 78f); or

(B) The security is traded on a foreign national securities exchange that is officially recognized, sanctioned, or supervised by a governmental authority.

(iii) *Readily tradable.* For purposes of this paragraph (f)(5), except as provided by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin, a security is readily tradable if—

(A) The security is traded on a securities exchange that is described in paragraph (f)(5)(ii)(A) of this section; or

(B) The security is traded on a securities exchange that is described in paragraph (f)(5)(ii)(B) of this section and the security is deemed by the Securities and Exchange Commission (SEC) as having a ''ready market'' under SEC Rule 15c3–1 (17 CFR 240.15c3–1).

(g) *Effective date and transition rules*—(1) *Statutory effective date*—(i) *General rule.* Except as otherwise provided in this paragraph (g), section 401(a)(35) is effective for plan years beginning after December 31, 2006.

(ii) *Collectively bargained plans*—(A) *Delayed effective date.* In the case of a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers ratified on or before August 17, 2006, section 401(a)(35) is effective for plan years beginning after the earlier of

(*1*) the later of—

(*i*) December 31, 2007; or

(*ii*) the date on which the last such collective bargaining agreement terminates (determined without regard to any extension thereof); or

(*2*) December 31, 2008.

(B) *Definition of collectively bargained plans.* For purposes of this paragraph (g)(1)(ii), in the case of a plan for which one or more collective bargaining agreements apply to some, but not all, of the plan participants, the plan is considered a collectively bargained plan if at least 25 percent of the participants in the plan are members of collective bargaining units for which the contributions under the plan are specified under a collective bargaining agreement.

(iii) *Special rule for certain employer securities held in an ESOP.* Section 901(c)(3)(A) and (B) of the Pension Protection Act of 2006, Public Law 109–280, 120 Stat. 780 (PPA '06), provides a special effective date for an employee stock ownership plan that holds a class of preferred stock with a guaranteed minimum value, as described in that section.

(2) *Statutory transition rules*—(i) *General rule.* Pursuant to section 401(a)(35)(H), in the case of the portion of an account to which paragraph (c) of this section applies and that consists of employer securities acquired in a plan year beginning before January 1, 2007, the requirements of paragraph (c) of this section only apply to the applicable percentage of such securities.

(ii) *Applicable percentage*—(A) *Phase-in percentage.* For purposes of this paragraph (g)(2), the applicable percentage is determined as follows—

Plan year to which paragraph (c) of this section applies:	The applicable percentage is:
1st	33
2nd	66
3rd and following	100

(B) *Special rule.* For a plan described in paragraph (g)(1)(iii) of this section for which the special effective date under section 901(c)(3) of PPA '06 applies, the applicable percentage under this paragraph (g)(2)(ii) is determined without regard to the delayed effective date in section 901(c)(3)(A) and (B) of PPA '06.

(iii) *Nonapplication for participants age 55 with three years of service.* Paragraph (g)(2)(i) of this section does not apply to an individual who is a participant who attained age 55 and had completed at least three years of service (as defined in paragraph (c)(3) of this section) before the first day of the first plan year beginning after December 31, 2005.

(iv) *Separate application by class of securities.* This paragraph (g)(2) applies separately with respect to each class of securities.

(3) *Regulatory effective date.* This section is effective for plan years beginning on or after January 1, 2009.

Linda E. Stiff,

Deputy Commissioner for Services and Enforcement.

[FR Doc. E7–25533 Filed 1–2–08; 8:45 am]

BILLING CODE 4830–01–P

DEPARTMENT OF VETERANS AFFAIRS

38 CFR Part 4

RIN 2900–AM55

Schedule for Rating Disabilities; Evaluation of Scars

AGENCY: Department of Veterans Affairs.

ACTION: Proposed rule.

SUMMARY: This document proposes to amend the Department of Veterans Affairs (VA) Schedule for Rating Disabilities by revising that portion of the Schedule that addresses the Skin, so that it more clearly reflects our policies concerning the evaluation of scars.

DATES: Comments must be received on or before February 4, 2008.

ADDRESSES: Written comments may be submitted through *www.Regulations.gov*; by mail or hand-delivery to the Director, Regulations Management (00REG), Department of Veterans Affairs, 810 Vermont Ave., NW., Room 1068, Washington, DC 20420; or by fax to (202) 273–9026. Comments should indicate that they are submitted in response to RIN 2900-AM55 ''Schedule for Rating Disabilities; Evaluation of Scars.'' Copies of comments received will be available for public inspection in the Office of Regulation Policy and Management, Room 1063B, between the hours of 8 a.m. and 4:30 p.m. Monday through Friday (except holidays). Please call (202) 461–4902 for an appointment. (This is not a toll-free number.) In addition, during the comment period, comments may be viewed online through the Federal Docket Management System (FDMS) at *www.Regulations.gov*.

FOR FURTHER INFORMATION CONTACT: Maya Ferrandino, Regulations Staff (211D), Compensation and Pension Service, Veterans Benefits Administration, Department of Veterans Affairs, 810 Vermont Avenue, NW., Washington, DC 20420, (727) 319–5847. (This is not a toll-free number.)

SUPPLEMENTARY INFORMATION: This document proposes to amend the Department of Veterans Affairs (VA) Schedule for Rating Disabilities (38 CFR part 4) by revising the portions of § 4.118, the Skin, that address scars. A prior proposed rulemaking addressing the evaluation of scars was published in the **Federal Register** (67 FR 65915) on October 29, 2002, but it was subsequently withdrawn as VA determined that the proposed amendments did not accomplish the stated purpose or intended effect. The