

LEGISLATIVE UPDATE:

THE PENSION PROTECTION ACT OF 2006

The Act has wide-ranging impact in the retirement plan area. There are provisions imposing funding reforms for defined benefit pension plans, promoting “cash balance” retirement plans, liberalizing the Roth IRA rules, adding IRA “rollover” options, and making “permanent” the various increases in contribution limits provided by the Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”).

We feel that the following new requirements are most likely to impact the greatest number of qualified retirement plan sponsors (most of these changes are effective for non-collectively bargained plans as of the first plan year beginning after December 31, 2006, so for calendar year plans, they apply as of January 1, 2007).

Benefit Statements

All individual account plans (profit sharing and Section 401(k) plans) will be required to provide participants benefit statements at least annually, and plans which permit participant investment direction (including Section 403(b) plans of tax-exempt organizations) must do so on a quarterly basis. Sponsors of defined benefit plans will have to provide participant statements at least once every three years and more frequently on request. Under current law, participants are entitled to benefit statements only if they request them in writing. The new benefit statements will be required to state the participant’s total accrued benefit, the vested portion of such benefits, an explanation of any “permitted disparity” affecting benefit allocations, an explanation of any applicable limitations and restrictions on the right of participants to direct their investments, an explanation of the importance for retirement planning of well-balanced and diversified investments, and a notice directing participants to a Department of Labor (DOL) web site for sources of investment information. The Act requires the DOL to issue model statements of the required explanatory material, but those model statements are not due until August 16, 2007.

Comment: Sponsors of individual account plans that permit participant investment direction need to work with their third party administrators and other service providers to be in a position to provide the required disclosures by the first quarter of the 2007 plan year.

Participant Notices

The Special Tax Notice that generally advises participants in pay status of the tax effect of the various distribution options they may elect will have to be revised to include a statement warning participants of the consequences of “failing to defer” receipt of a distribution by transfer to an IRA or otherwise. Those consequences include income tax on the amounts not rolled over into an IRA within 60 days plus a 10% early distribution penalty for benefit recipients under age 59½. For participants with vested benefits in excess of \$5,000, a retirement plan cannot make a current distribution of benefits without the participant’s written consent. Under current law, such

consent is not valid unless it is responsive to a written explanation of (1) the material features and relative values of the optional forms of benefits, (2) the participant's right to defer receipt of the distribution to the plan's normal retirement age or to have the distribution transferred directly to another qualified plan or to an IRA, and (3) the rules concerning taxation of a benefit distribution. Under current law, this explanation must be given no less than 30 and no more than 90 days before the distribution begins. Under the Act, the maximum period during which participants may consider their distribution elections is extended from 90 to 180 days, so that the written explanation of distribution options must be given no less than 30 days and no more than 180 days before distributions begin.

Comment: The Special Tax Notice and participant benefit election forms need to be revised for distributions after December 31, 2006.

Accelerated Vesting

All employer contributions to defined contribution retirement plans will be subject to new rules that require full vesting at least as fast as provided under two alternate schedules (plans can choose either 100 percent "cliff" vesting after three years of service or graduated vesting at 20 percent per year over years of service two through six). This will require conforming amendments to many defined contribution plans. Vesting rules for defined benefit plans are not changed by the Act.

Annual Reports

Additional information must be included in plan annual reports including, in the case of defined benefit pension plans, additional information on the plan's funding status. At the same time, defined benefit plans will no longer be required to provide participants with "summary annual reports." One-participant plans with assets that do not exceed \$250,000 will no longer have to file annual reports, and simplified reporting requirements will be provided for certain plans with fewer than 25 participants. At the same time, the annual report requirements applicable to qualified retirement plans, as modified by the Act, are extended to the Section 403(b) plans of tax-exempt organizations. For the 2008 plan year, basic plan information and actuarial information included in the annual report for defined benefit plans must be filed with the DOL in an electronic format that accommodates display of this information by the DOL on the internet.

Investment Advice

In an effort to promote the use of investment advisers who will meet personally with participants to assist them with investment decisions relating to their directed retirement accounts (including IRAs), the Act provides an exemption from the prohibited transaction rules of ERISA and the Internal Revenue Code for "eligible investment advice arrangements." Eligible investment advice arrangements are written agreements between a "fiduciary adviser" and an employer or other plan fiduciary that (1) authorize the arrangement, (2) contain an acknowledgment of fiduciary status by the "fiduciary adviser," and (3) provide for "objective"

advice by requiring the adviser to either give advice based on a computer model or charge a flat fee not tied in any way to the recommended investment. Only an investment adviser registered under the Investment Advisers Act of 1940, a bank, an insurance company, or a broker or dealer registered under the Securities Exchange Act of 1934 (and their properly authorized employees) can act as a “fiduciary adviser,” and there are associated participant disclosure requirements.

Comment: Defined contribution plans with fiduciary advisers will be subject to an annual audit by an independent auditor, which will be burdensome for smaller plans not otherwise required to have an annual plan audit. Most of these smaller plans will take a pass on providing “fiduciary advisers” for plan participants.

Joint and Survivor Annuity Option

Defined benefit plans and defined contribution plans subject to the joint and survivor annuity rules will have to make available an additional benefit option (the “qualified optional survivor annuity”), which is an equivalent value joint annuity with a survivor annuity payable in an amount equal to 75 percent of the benefit payable while the retiree and the beneficiary are both alive. This change is effective for the 2008 plan year for non-collective bargaining plans, and will require a plan amendment for almost every defined benefit plan.

Phased Retirement

Under current law, a defined benefit or “money purchase pension plan” is prohibited from providing distributions to participants before they attain the plan’s normal retirement age unless they have separated from employment. Under the Act, new rules allow defined benefit plans to be amended to permit in-service distributions to participants age 62 and older.

Automatic Section 401(k) Enrollment

Starting with the 2008 plan year, Section 401(k) plans have an extra incentive to provide “automatic enrollment,” or a plan provision requiring eligible employees to have elective contributions made on their behalf from their compensation unless they affirmatively elect to contribute at another rate or they elect not to participate at all. A plan offering a “qualified automatic rollover feature” will be deemed to satisfy the anti-discrimination tests applicable both the deferral contributions and related matching or nonelective employer contributions *and*, if the plan consists solely of contributions pursuant to a “qualified automatic rollover feature,” it will not be subject to the top-heavy rules. Under a qualified automatic rollover feature, the eligible employee is treated as making an elective contribution of between three and ten percent of compensation (the exact percentage is designated within that range for all participants) unless the employee elects otherwise. The employer is also required to make either matching contributions that satisfy minimum requirements or nonelective contributions equal to three percent of the compensation of each nonhighly compensated eligible employee. Any such employer contributions must vest over an accelerated schedule so that participants with two years of service are 100 percent vested.

Comment: Current Section 401(k) regulations already permit the use of the automatic enrollment feature without special contribution limits, additional employer contributions or accelerated vesting. Most employers will consider current options before turning to the “qualified automatic rollover feature.”

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