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SUMMARY OF THE PENSION PROTECTION ACT OF 2006

TABLE OF CONTENTS

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The Pension Protection Act of 2006, P.L. 109-280, (the "PPA") signed by President Bush on August 17, 2006, makes substantial changes to ERISA regarding pension plan funding and other pension plan rules, and is arguably the most significant pension plan legislation since the enactment of ERISA in 1974. This memo summarizes the significant provisions of the PPA.

I. REFORM OF FUNDING RULES

A. Minimum Funding Rules

Replaces Old Rules. The PPA replaces the current funding rules of Internal Revenue Code § 412 and ERISA § 302 et seq. applicable to defined benefit plans, including the current minimum funding standards Code § 412(b), the additional deficit reduction contribution requirements § 412(*l*), and the numerous alternative actuarial cost funding methods § 412(c)(5). These changes are generally effective for plan years beginning after December 31, 2007. PPA §§ 201(d), 202(f), 211(b) & 212(e).

Single Funding Obligation. The new law, which would take effect for plan years beginning in 2008, imposes a single structure that requires any "funding shortfall" to be amortized over a seven-year period. For plans with a funding shortfall the minimum required contributions will be equal to the sum of (i) the "target normal cost" for the current year, i.e., the present value of the benefits expected to accrue during the plan year, including as a result of salary increases § 430(b), plus (ii) the "shortfall amortization charge," i.e., the amortization of the funding shortfall over a seven-year period § 430(c). Code § 430(a)(1). ("Funding shortfall" is the excess of the funding target over the plan assets. "Funding target" is the present value of benefit liabilities accrued to date.) In addition, a charge for any funding waivers granted by the IRS must be amortized over five years. If there is no funding shortfall, the employer only has to contribute the target normal cost. § 430(a)(2). Some plans may utilize a transition rule for determining the funding shortfall amortization bases for 2008 through 2010.

There are exception for airlines, which can amortize a plan's unfunded liability over 17 years, and defense contractors, which have a delayed effective date.

There is transition relief under which there would be no shortfall amortization charge in 2008 if the plan is 92% funded, in 2009 if 94% funded and in 2010 if 96% funded.

At Risk Plans. If a plan is "at risk" (generally if less than 80% funded), there will be accelerated funding requirements. A plan is "at risk" if it has over 500 participants, and the value of plan assets for the preceding year is less than 80% of the funding target and less than 70% of the at risk funding target. At risk funding target is determined based on assumptions that participants eligible to retire in the next 10 years will do so at the earliest possible time and that all participants will elect the most valuable form of payment. At risk plans have accelerated funding obligations. § 430(i) The 80% funding target and at risk funding rules are phased in.

Smoothing of Asset Valuations. A plan may determine the value of plan assets by averaging fair market values, but the averaging period may not exceed 24 months (rather than 5 years), and the resulting value must be between 90% and 110% of fair market value (instead of 80%-120%). § 430(g)(3).

Consequences of New Funding Rules. Some companies may want to increase funding currently in order to avoid the funding shortfall amortization payments. The new funding laws will require underfunded plans to contribute substantially more than under current rules. Also, because of reduced smoothing, the contributions will vary more from year to year. Some have argued that increased funding obligations of the PPA will be the nail in the coffin for defined benefit plans, because of the more onerous funding minimums, interest rate restrictions and restrictions on smoothing.

B. Interest and Mortality Assumptions for Funding and Other Purposes

Interest and Mortality Assumptions for Funding Purposes. Effective for plan years beginning in 2008, the interest rate to be used in determining plan liabilities generally must be one of three interest rates (rate segment yield curves) that the IRS will issue (based on corporate bond rates): short term (for benefits payable within 5 years), mid term (for benefits payable in 5-20 years), and long term (for benefits payable in more than 20 years), averaged over a 24 month period. § 430(h)(2). For purposes of determining the minimum required contribution, a plan sponsor may instead elect to use interest rates under the corporate bond yield curve without averaging. For 2006 and 2007, the PPA extends the use of the corporate bond rate rather than the 30-year Treasury rate. Mortality assumptions will be developed by the IRS, based on RP-2000 rather than GAM 1983, and there will be an alternative mortality table for disabled participants. Large plans may request to use plan-specific mortality tables. § 430(h)(3).

Interest Rate and Mortality Assumptions for Determining Lump-Sum Distributions. For purposes of determining the actuarial value of lump-sum distributions from defined benefit plans under Code § 417(e)(3), plans must use the same three interest rates (short term, mid term and long term) used for funding purposes, except that it is not averaged over 24 months, and must also use the same mortality table as for funding purposes. Code § 417(e)(3). This is effective for plan years beginning in 2008, but the new interest rate is phased in over five years. PPA § 302(c). These rates may produce lower regulatory floors for lump-sum cashouts, particularly for younger workers - Milliman memo pg. 4-5.

Interest Rate for Applying 415 Benefit Limits to Lump Sums. The interest rate assumption used in applying the Code § 415(b) benefit limits is the greater of (i) 5.5%, (ii) 105% of the interest rate under Code § 417(e), or (iii) the plan's rate. Code § 415(b)(2)(E). This is similar, but not identical, to the rate provided under the Pension Funding Equity Act of 2004. This is effective for distributions made in years beginning in 2006. PPA § 303(B). Plans that already paid out lump sums in 2006 may have paid out greater amounts than the 5.5% rate under the PPA, and if relief is not granted employers may need to seek to recover any excess amounts paid.

C. Benefit Limits for Severely Underfunded Plans

The PPA adds limits on benefits in Code § 436 and ERISA § 206(g) for severely underfunded pension plans, effective for plan years beginning in 2008 (or 2010 for collectively bargained plans).

Lump-Sum Restrictions for Severely Underfunded Plans. If a plan is less than 60% funded (i.e., the "adjusted funding target attainment percentage" as defined in Code § 436(b); ERISA § 206(g) is less than 60%), or if the plan is less than 100% funded and the employer is in bankruptcy, a plan may not make lump-sum payments or other accelerated forms of distribution, and may only make distributions that do not exceed the monthly single life annuity payable under the plan. Code § 436(d); ERISA § 206(g)(3). If a plan is at least 60% but less than 80% funded, lump-sum payments are limited to the lesser of 50% of the amount that could be paid without restriction or the present value of the participant's PBGC guaranteed benefits. Code § 436(d)(3); ERISA § 206(g)(3)(C).

Requirement of Freeze or Restriction on Increased Benefits for Severely Underfunded Plans. If a plan is less than 60% funded, benefit accruals must be frozen, unless it is in the first five years of plan's existence or the employer makes additional corresponding contributions. Code § 436(e); ERISA § 206(g)(4). If a plan is (or would become) less than 80% funded, the plan may not be amended to increase benefits, unless it is in the first five years of the plan's existence or the employer makes corresponding contributions to the plan. Code § 436(c); ERISA § 206(g)(2).

Shutdown Restrictions for Severely Underfunded Plans. If a plan is less than 60% funded, the plan cannot provide for shutdown benefits or other unpredictable contingent benefits, unless the employer makes a corresponding contribution to the plan. Code § 436(b); ERISA § 206(g)(1).

Notice to Participants. Notices to participants are required under ERISA § 101(j) if less than 60% funded regarding restrictions on shutdown benefits, restrictions on lump sum distributions and requirement for freeze.

D. Restriction on Funding Nonqualified Deferred Compensation Plan if Have Severely Underfunded or Terminated Plan

The PPA adds Code § 409A(b)(3), which provides that if the employer or controlled group member (i) has an "at risk" plan (see above), (ii) is in bankruptcy, or (iii) has within six months terminated a pension plan in a distress termination, then assets may not be set aside in a trust (rabbi or secular) to pay nonqualified deferred compensation of executives without adverse tax consequences. Code § 409A(b)(3). If assets are set aside in the trust for executives under such circumstances, they will be considered immediately taxable to the participants (if vested) and will be subject to an additional 20% tax and interest penalties. Id. If there are gross-ups to cover such penalties of the executives, such gross-ups will be nondeductible and will be subject to income tax and 20% tax and interest penalties. § 409A(b)(3)(C). These provisions are effective August 17, 2006. PPA § 116(c).

E. Funding Rules for Multiemployer Plans

Funding Rules for Multiemployer Plans. For multiemployer pension plans, the PPA generally retains the existing funding rules, but with certain significant changes. The amortization period for most charges is reduced from 30 to 15 years (although extensions can be applied for). Code § 431; ERISA § 304. "Endangered" or "critical" multiemployer plans are subject to new funding rules that would require improvement of the plan's funding over a 10-15 year period. Generally, "endangered" plans are plans that are less than 80% funded or projected to have an accumulated funding deficiency in the next six years, and "critical" plans are plans that are less than 65% funded or projected to have an accumulated funding deficiency in the next three years. Critical plans are permitted to cutback certain benefits and impose a 5% charge on employer contributions, and they are also subject to an excise tax. Code § 432; ERISA § 305; Code § 4971(g).

Withdrawal Liability Reforms. There are certain changes to ERISA's multiemployer plan withdrawal liability rules. PPA § 204. The limits on unfunded vested benefits in the case of sale of substantially all of the assets are modified, for sales occurring after 2006. ERISA § 4225(a). The PPA provides that a partial withdrawal will occur where work is contracted out to other controlled group entities that are not part of the union. ERISA § 4205(b)(2). The PPA also changes the withdrawal liability payment rules in cases where the plan alleges a transaction was undertaken to evade or avoid withdrawal liability, whereby payment can be deferred if an appeal of the plan sponsor's determination of liability is pending. ERISA § 4221(g).

II. INCREASE IN DEDUCTION LIMIT FOR DEFINED BENEFIT PLAN CONTRIBUTIONS

Previously the employer deduction for contributions to defined benefit plans was generally limited to the excess of current liability over plan assets. Any contribution in excess of the contribution limit is nondeductible and subject to a 10% excise tax.

The PPA § 801 provides that for the 2006 and 2007 taxable years the maximum deductible amount is increased to 150% of the excess of current liability over plan assets.

Beginning in 2008 taxable years, the PPA § 801 provides that the deductible limit for single-employer plans is the excess of the plan's funding target (which is the present value of benefit liabilities accrued to date) over the plan assets, plus the plan's target normal cost (cost of benefits accrued), plus a cushion amount (which is 50% of the funding target plus amounts reflecting increases in compensation). Code § 404(o).

For multiemployer plans the maximum deductible amount is 140% of the excess of current liability over the plan assets. PPA § 802 Code § 404(a)(1)(D).

The PPA § 801 amends the combined defined benefit/defined contribution plan limit of Code § 404(a)(7) so that defined benefit plans subject to Title IV are deductible without affecting the combined limit, effective for taxable years after 2005. Code § 404(a)(7)(C)(iv).

III. PBGC GUARANTEE AND RELATED PROVISIONS

A. PBGC Premiums

Beginning in 2008, the interest rate for calculating unfunded vested benefits for purposes of the variable rate premium of ERISA § 4006 will be based on the three-segment yield curve used for funding purposes (but without 24-month averaging). ERISA § 4006(a)(3)(E)(iv). (Note that the flat-rate premium was increased to $30 by the Deficit Reduction Act of 2005.) The full-funding exception to variable rate premiums is eliminated. Repeal of old ERISA § 4006(a)(3)(E). The termination premium put in by the Deficit Reduction Act of 2005 (of $1,250 per participant for three years for certain distress terminations) is made permanent. ERISA § 4006(a)(7). Variable rate premiums is limited for plans with 25 or fewer employees. ERISA § 4006(a)(3)(H). These changes may cause increased premiums.

B. Limitation on Guarantee of PBGC Shutdown Benefits

The PPA amends ERISA § 4022(b) to provide that the five-year phase-in of the PBGC guarantee for increases of benefits by plan amendment will also apply to plant shutdown and other contingent events benefits (even though not provided under plan amendment). This is effective for events occurring after July 26, 2005. PPA § 403(b).

C. Termination of Plan in Bankruptcy

The PPA amends ERISA to provide that if a pension plan is terminated during bankruptcy, the bankruptcy filing date is treated as the termination date for purposes of the guaranteed benefit rules of ERISA § 4022 and the asset allocation rules of ERISA § 4044. ERISA §§ 4022(g) and 4044(e). This is effective for bankruptcy filings on or after September 16, 2006. PPA § 404(c).

D. Treatment of Plans Where Cessation or Change in Membership of Controlled Group

The PPA amends ERISA § 4041(b)(5) to provide that where a plan is spun off, the allocation of assets and liabilities need not use the PBGC termination assumptions and can use the plan's interest rate for determining the allocation of assets and liabilities among participants under § 4041. This is effective for transactions entered into after August 17, 2006. PPA § 409(b).

E. Missing Participants

The PPA provides for extension of ERISA § 4050 missing participant procedures for terminating plans to multiemployer plans, and on a voluntary basis to defined contribution plans, effective on issuance of final regulations implementing the provisions. PPA § 410.

IV. REPORTING AND DISCLOSURE

A. Defined Benefit Plan Funding Notice

The PPA adds new ERISA § 101(f) requiring annual funding notices for all single-employer and multiemployer defined benefit plans no later than 120 days after the end of the plan year (or in the case of small plans with 100 or fewer participants by the filing of the Form 5500). The notice must be sent to the PBGC, participants and beneficiaries, unions and contributing employers, and they must contain detailed information about the funding status and whether the plan is in endangered or critical status. These provisions are effective for the 2008 plan year. PPA § 501(d). The funding notice under ERISA § 4011 for plans with variable rate premiums and the summary annual reports due 60 days after the Form 5500 due date would no longer be required for defined benefit plans.

B. Access to Multiemployer Plan Information on Request

A participant or contributing employer can request copies of actuarial reports or financial reports of multiemployer plans (which must be provided within 30 days) under ERISA § 101(k), added by the PPA. In addition contributing employer can request an estimate of potential withdrawal liability (which must be provided within 180 days) under ERISA § 101(l) as added by the PPA. The provisions are effective for plan years beginning in 2008. PPA § 502(d).

C. Additional Form 5500 Information

The PPA imposes some additional information on annual reports (5500s) for single-employer defined benefit plans (e.g., regarding funded status of merged plans) and significant additional information for multiemployer defined benefit plans. ERISA § 103(f). The PPA also requires a multiemployer plan to provide to each contributing employer and employee organization a summary of the additional PPA-required information within 30 days after the 5500 is due. ERISA § 104(d). The DOL is directed to provide additional guidance and a model form. These provisions are effective for 2008 plan years. PPA § 503(f).

D. Electronic Display of 5500

Form 5500 information shall be filed in electronic format (in accordance with regulations) and posted by the DOL within 30 days, and such information is also to be displayed on the company intranet. ERISA § 104(b)(5). This is effective for plan years beginning in 2008. PPA § 504(b).

E. Expansion of ERISA § 4010 Reporting Obligation

ERISA § 4010 requires filing of financial and actuarial information for the controlled group if the unfunded vested benefits exceed $50 million. The PPA expands this obligation to where the plans are funded (funding target attainment percentage) by less than 80% regardless of the dollar size of the underfunding. ERISA § 4010(b)(1). This is effective for years beginning in 2008. PPA § 505(c).

F. Disclosure of Distress or Involuntary Terminations to Participants

Under the PPA, sponsors of pension plans in a distress or involuntary termination will have to provide participants with information it files with the PBGC within 15 days of such filing. ERISA § 4041(c)(2)(d) & (c)(3). This is effective for notices to terminate after August 17, 2006. PPA § 506(c).

G. Requirements to Furnish Periodic Benefits Statements

ERISA previously only required benefit statements to be provided on request. The PPA amends ERISA § 105 to provide that benefit statements must be furnished to participants of participant-directed defined contribution plans at least quarterly, to participants of other defined contribution plans annually, and to participants of defined benefit plans once every three years (or for defined benefit plans an annual notice of how to obtain benefit statements). ERISA § 105. The DOL is to issue model notices. PPA § 508(b). The provision is effective for plan years after 2006 (with a delay for collectively bargained plans). PPA § 508(c).

H. Blackout Notices

The PPA amends ERISA § 101(i)(8)(B) so that the requirement of notices of blackouts of self-directed plans will not apply to one-participant or partner-only plans. PPA § 509.

V. INVESTMENT ADVICE, PROHIBITED TRANSACTIONS AND FIDUCIARY RULES

A. Investment Advice

The PPA amends ERISA and the Code to provide for a prohibited transaction exemption for a "fiduciary advisor" to provide investment advice to participants of participant-directed defined contribution plans through an "eligible investment advice arrangement." ERISA § 408(b)(14); Code § 4975(d)(17). "Eligible investment advice arrangements" must either (a) provide that fees received do not vary on the basis of the investments chosen, or (b) that the advisor uses a computer model that meets certain requirements (e.g., computer model must provide generally accepted investment theories, use relevant information about participants, use prescribed objective criteria, not favor investment options of the advisor, take into account all of the investment options of the plan, etc., similar to the requirements in DOL Adv. Op. 2001-09A). ERISA § 408(g); Code § 4975(f)(8). A "fiduciary advisor" is a registered investment advisor, bank, insurance company, registered broker dealer or an affiliate or employee of any of the above. Id. There must be an annual audit of the investment advice, the advisor must give prior notice on an annual basis, an independent fiduciary must approve the arrangement and certain other requirements apply. The DOL is to study the feasibility of allowing a computer model to broad options available to IRAs. These provisions are effective for investment advice provided after 2006.

B. Prohibited Transaction Exemptions Relating to Financial Investments

Expanded Service Provider Exemption. The PPA § 611(d) provides that if a person is a party-in-interest solely by reason of providing services to the plan, and is not an investment advisor to the plan, then transactions under ERISA § 406(a)(i)(A), (B) or (D) (sale, exchange, lease or loan, but not sale of employer securities or self-dealing) are not prohibited as long as the plan pays no more (or receives no less) than adequate consideration. ERISA § 408(b)(17); Code § 4975(d)(20).

Exemption for Block Trades. The PPA § 611(a) provides a prohibited transaction exemption for certain "block trade" transactions allocated between two or more client accounts of a fiduciary, with block trades defined as blocks of at least 10,000 shares with market value of at least $200,000. ERISA § 408(b)(15); Code § 4975(d)(18).

Exemption for Electronic Communication Network Trades. The PPA § 611(c) provides for a prohibited transaction exemption for the purchase and sale of securities on regulated electronic communication networks. ERISA § 408(b)(16); Code § 4975(d)(19).

Exemption for Foreign Exchange Transactions. The PPA § 611(e) provides a prohibited transaction exemption for foreign exchange transactions between a bank or broker-dealer (or affiliate) and a plan, if the transaction is arm's-length, the exchange rate is not more than 3% off of the interbank bid and ask rate, and the bank or broker-dealer is not an investment advisor for the transaction. ERISA § 408(b)(18); Code § 4975(d)(21. This exemption is more broad than Prohibited Transaction Class Exemption 94-20.

ERISA Look-Through Plan Asset Rule. Under the Department of Labor look-through rule (DOL Reg. § 2510.3-101(a)), when benefit plan investors hold nonpublicly-traded equity of an entity, the assets of the entity are plan assets, unless (i) the entity is an operating company (or VCOC) or (ii) equity participation of the "benefit plan investors" is not significant (less than 25%). The PPA § 611(f) adds ERISA § 3(42) to provide that "benefit plan investors" only includes employee benefit plans subject to ERISA, or plans subject to Code § 4975 (e.g., IRAs), but it would not include other non-ERISA plans such as governmental plans or foreign plans. Thus, many more funds will be able to rely on the 25% test.

ERISA § 3(42), added by the PPA, also provides relief for funds which invest in other funds, so-called "funds of funds," by specifying that an entity shall be considered to hold plan assets only to the extent of the percentage of equity interest held by benefit plan investors. Thus, if a fund of funds has 30% of its assets held by benefit plan investors, and the fund of funds invests $10 million in an underlying fund, only $3 million of the assets invested in the underlying fund would be considered plan assets for purposes of the underlying fund meeting the 25% test.

Exemption for Cross-Trading. The PPA § 611(g) adds a prohibited transaction exemption for trades between a plan and another account managed by the same investment manager (cross-trading) if certain requirements are met, including: (i) each plan participating has assets of at least $100 million; (ii) the transaction is a cash payment for securities for which market quotations are readily available; (iii) the transaction is at the independent current market price; (iv) no brokerage fee (other than customary transfer fees) is paid; (v) an independent fiduciary for the plan(s) authorizes the cross-trade after receiving separate disclosure of the conditions of the cross-trade; (vi) the investment manager provides a quarterly report to the independent fiduciary; etc. ERISA § 408(b)(19); Code § 4975(d)(22).

Effective Date. The above provisions are effective for transactions occurring after August 17, 2006. PPA § 611(h).

C. Correction Period for Prohibited Transactions Involving Securities and Commodities

The PPA § 612 adds a prohibited transaction exemption for prohibited sales of a security or commodity if corrected within 14 days of when the party in interest discovers or should have discovered that it was a prohibited transaction. However, this exemption does not apply to transactions between a plan and plan sponsor of employer securities or employer real property. ERISA § 408(b)(20); Code §§ 4975(d)(23) & 4975(f)(11). This is effective for transactions discovered after August 17, 2006.

D. Mapping Investment Options

ERISA § 404(c) provides relief from fiduciary liability for investment choices of participants in participant-directed account plans (e.g., typical 401(k) plans with choice of mutual funds). The PPA § 621 amends § 404(c) to extend this relief to the mapping of investment options where new investment options replace old ones, provided: (i) proper notice is given, (ii) the participant has not given instructions to the contrary, and (iii) the participant had chosen the original investment option. ERISA § 404(c)(4).

The PPA also amends § 404(c) to state that the fiduciary relief does not apply in a blackout period where the participants' choices are frozen, unless the blackout requirements of ERISA (e.g., § 101(i)) are complied with. ERISA § 404(c)(1). These provisions are effective for plan years beginning in 2008 (with further extension for collectively bargained plans). PPA § 621(b).

E. Bonding

Bonding Relief for Brokers and Dealers. The PPA § 611(b) provides that, effective for plan years beginning after August 17, 2006, the ERISA bonding requirement is not required of registered brokers or dealers subject to the bonding requirements of a self-regulatory organization. ERISA § 412(a)(6).

Increase in Bonding Requirement. The PPA § 622 provides that the maximum bond amount that fiduciaries, and other who handle plan assets need to have, which is generally $500,000, is increased to $1 million if the plan holds employer securities. ERISA § 412(a). This is effective for plan years beginning in 2008. PPA § 622(b)

F. 404(c) Protection for Default Investment

As discussed above, ERISA § 404(c) provides relief from fiduciary liability for self-directed investments. The PPA § 624 adds ERISA § 404(c)(5) to extend this protection to situations where the participant does not make an investment choice and the plan sponsor makes a default investment in accordance with DOL regulations (to be issued within six months), provided notice of the participant's rights are given and the participant has a reasonable period of time after receipt of the notice to make such election. This is effective for plan years beginning in 2007. PPA § 624.

G. Clarification Regarding Safest Available Annuity

DOL Interpretive Bulletin 95-1 requires a fiduciary to choose the safest available annuity. The PPA § 624 directs the DOL to issue regulations within one year to clarify that the selection of an annuity contract as an optional form of distribution from a defined contribution plan is not subject to the safest available annuity requirement and is subject to all otherwise applicable fiduciary standards.

VI. CASH BALANCE PLANS AND BENEFIT ACCRUAL STANDARDS

A. New Rules Relating to Cash Balance and Other Hybrid Plans

Litigation Relating to Age Discrimination of Hybrid Plans. The issue of age discrimination for hybrid plans such as cash balance plans (where benefits are determined by reference to a hypothetical account balance with pay credits and fixed interest credits) and pension equity plans (where benefits are described as a percentage of final average pay with the percentage determined on the basis of points received for each year of service), and whether it violates the continued accrual requirement of Code § 411(b)(1)(H) (that the rate of accrual may not be reduced because of age), has been the subject of much litigation.

General Age Discrimination Rules Under the PPA. The PPA § 701 provides that a plan is not age-discriminatory (i.e., it does not fail the § 411(b)(1)(H) continued accrual requirement) if the participant's accrued benefit as of any date is at least as great as similarly situated younger participants. Code § 411(b)(5)(A)(i). "Similarly situated" means participants that are similar in every respect (period of service, compensation, etc.) except for age. Code § 411(b)(5)(A)(ii). Accrued benefit for the above purposes can be calculated on the basis of an annuity at normal retirement age, the hypothetical account balance (e.g., for cash balance plans), or the current value of employees' final average pay (e.g., for pension equity plans). Code § 411(b)(5)(A)(iv).

A plan is not age discriminatory solely because it provides for (i) offsets of benefits, (ii) disparity in contributions and benefits if § 401(*l*) is met, or (iii) indexing of accrued benefits. Code § 411(b)(5)(C), (D) & (E).

Rules for Applicable Defined Benefit Plans. A hybrid plan -- which is referred to as an "applicable defined benefit plan" and defined in § 411(a)(13)(C) as a defined benefit plan where the accrued benefit is calculated as the balance of a hypothetical account (cash balance plan) or as an accumulated percentage of the participant's final average compensation (pension equity plan) -- is not inherently age discriminatory if the interest credits are not greater than a market rate of return, and interest credits cannot result in a negative return. Code § 411(b)(5)(B)(i).

In addition, applicable defined benefit plans must be fully vested after three years of service. Code § 411(a)(13)(B).

Other Provisions. The PPA prohibits wear-away of accrued benefits if a conversion to the hybrid plan occurs after June 29, 2005. Code § 411(b)(5)(B)(ii) & (iii).

The PPA eliminates the whipsaw issue (discrepancy between minimum lump-sum and hypothetical account balance) by allowing the present value of accrued benefits to equal the hypothetical account balance or accumulated percentage of final average pay. Code § 411(a)(13).

Effective Date. The above provisions apply to periods on or after June 29, 2005, but vesting and interest credit requirements do not apply to plans in existence on June 29, 2005 until the 2008 plan year. PPA § 701(e).

No Inference as to Existing Plans. The PPA specifically provides in § 701(d) that the above changes do not create an inference as to the status of plans prior to June 29, 2006.

B. Regulations Relating to Hybrid Plans in Mergers & Acquisitions

The PPA instructs the IRS to issue regulations within 12 months regarding application of the above rules where the conversion of a plan to a cash balance or other hybrid plan is made with respect to those who become employees pursuant to a merger and acquisition. PPA § 702.

VII. ROLLOVERS, CONTRIBUTIONS AND OTHER PENSION RELATED PROVISIONS

A. EGTRRA Pension and IRA Provisions Made Permanent

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) made a number of changes to tax laws, relating to retirement plans and IRAs, such as increasing benefit and contribution limits, catch up contributions, deemed IRAs in 401(k) plans, increased rollover availability, deduction for ESOP dividend reinvestment, etc. These provisions were scheduled to sunset after 2010. The PPA § 811 makes the EGTRRA changes permanent.

B. Rollover of After-Tax Amounts

The PPA § 822 provides that after-tax contributions can be rolled over between qualified plans and 403(b) plans, effective for 2007 taxable years. Code § 402(c)(2).

C. Rollovers Directly from Retirement Plans to Roth IRAs

Previously, a rollover could be made to a qualified plan to an IRA, and could then be rolled over from an IRA to a Roth IRA (subject to income tax and $100,000 AGI limit, but no 10% early withdrawal tax). The PPA § 824 provides that, effective for distributions after 2007, amounts can be rolled over directly from a qualified plan to a Roth IRA (subject to the income tax and $100,000 AGI limit). Code §§ 408A(d)(3) and 408A(e).

D. Hardships for Nonspouse Beneficiaries

The PPA § 826 directs the Treasury to issue regulations within 180 days expanding the hardship distribution rules of Code § 401(k)(2)(B)(i)(IV) to hardships of nonspouse beneficiaries, and to provide similar rules for unforeseen emergencies under Code § 409A(2).

E. Qualified Reservists

The PPA § 827 allows distributions of reservists called for active duty of at least 179 days between 9/11/01 and 12/31/07 to be exempt from the Code § 72(t) early distribution 10% tax and allows distributions to be recontributed to an IRA (without regard to the issued dollar limits that apply to IRA contributions) within the later of two years after end of active service or Aug. 17, 2006. Code § 72(t)(2)(G).

F. Rollovers by Nonspouse Beneficiaries

The PPA § 829 amends the rollover rules to provide that even a nonspouse beneficiary of a plan or IRA may roll-over those amounts to an IRA and treat the distribution as an inherited IRA (allowing distributions over the life of the beneficiary rather than within five years). Code § 402(c)(11). This is effective for distributions after 2006. PPA § 829(b).

G. Additional IRA Catch-up Contribution for Enron and Certain Other Bankruptcies

The PPA § 831 allows certain IRA catch-up contributions in 2007-2009 where the employer is bankrupt, the officers are indicted, and at least 50% of the match to the 401(k) plan is in employer stock. Code § 219(b)(5)(C).

H. Average Compensation for 415(b) Limits

The PPA § 832 provides that effective from 2006 plan years, average compensation for Code § 415(b) defined benefit limit includes compensation while working for the employer even when not a participant. Code § 415(b)(3).

I. Inflation Adjustments for IRA Gross Income Limits

The PPA §833 provides for inflation indexing (to the nearest $1,000) of adjusted gross income limits for IRAs. Code § 219(g)(8).

J. Transfer of Surplus Pension Assets for Future Retiree Health Costs

Code § 420 allows transfers of excess pension plan assets from a defined benefit plan to a retiree health plan but not in excess of the retiree health costs for the year. The PPA § 841 allows transfers of excess assets (excess of value of assets over 120% of the plan's current liability) to fund future retiree health costs if certain conditions, are met, effective for transfers made after the 2006 taxable year Code § 420(f). It also allows transfer of excess assets from multiemployer pension plans to fund retiree health if certain requirements are met. Id.

K. Corporate Owned Life Insurance

The PPA § 863 provides that the employer is taxed on the proceeds of corporate owned life insurance (COLI) unless the insured was an employee within 12 months of death or was a highly-compensated employee when the policy was issued, or in certain other cases. Code § 101(j).

VIII. INCREASE IN RETIREMENT PLAN DIVERSIFICATION AND PARTICIPATION

A. Diversification Out of Employer Stock Fund for 401(k) Plan

The PPA § 901 imposes new diversification requirements for employer stock funds of 401(k) plans, pursuant to which for employee deferrals immediate option to diversify out of the employer stock fund (to at least three investment alternatives) is required, and for employer match and qualified nonelective contributions diversification is required if the participant has three years of service. Code § 401(k)(35); ERISA § 204(j). For the first three years in which the diversification rules apply, the diversification requirement is phased in over three years. This requirement would also apply to an ESOP that has a 401(k) or 401(m) feature (KSOPs). These provisions are effective for 2007 plan years. The PPA § 507 also imposes a 30-day advance notice requirement for the diversification rights (apparently for any plans with publicly traded securities), effective for 2007 plan years. ERISA § 101(m).

B. Automatic Enrollment for 401(k) Plan

Encouragement of Automatic Enrollment by Free ADP/ACP Pass. The PPA § 902 encourages automatic enrollment (also referred to as negative elections) in 401(k) plans by providing that qualified automatic enrollment arrangements are deemed to meet the ADP and ACP non-discrimination tests (as well as avoiding the top-heavy rules). Code §§ 401(k)(13) and 416(g)(4).

Requirements for Qualified Automatic Enrollment Arrangement. Automatic enrollment arrangements are qualified if they meet the following: (i) the plan must provide that unless otherwise elected the employee is treated as electing elective deferrals of not more than 10% and not less than 3% the first year, 4% the second year, 5% the third year and 6% the fourth year; (ii) the plan must either satisfy a matching contribution requirement of 100% of the first 1% and 50% of the next 5%, or make a 3% nonelective contribution for all non-highly compensated employees (and such match or nonelective contribution must vest within two years); and (iii) notice of the arrangement, the ability to opt-out, and how amounts will be invested must be given to each eligible employee. Code §§ 401(k)(13)(C), (D) and (E).

Ability to Withdraw Automatic Contributions Within 90 Days. The PPA provides that any automatic contribution arrangements (even if not qualified under the above § 401(k)(13) rules) may be withdrawn by an employee within 90 days if he/she elects to treat it as erroneous, and such amount is taxed as ordinary compensation and is not subject to an early withdrawal penalty. Code § 414(w).

Distribution of Excess Contributions Within Six Months. For automatic contribution arrangements, excess contributions (over ADP amount) or excess aggregate contributions (over ACP amount) can be distributed within six months after the plan year (instead of 2½ months) without an excise tax. Code § 4979(f).

Preemption of State Law for Automatic Contribution Arrangements. The PPA amends ERISA § 514 to provide that ERISA will preempt state laws that would directly or indirectly restrict automatic contribution arrangements (such as state laws that require authorization in writing to deduct from payroll). Code § 514(e).

Effective Date. These provisions (except for preemption) are effective for years after 2007. PPA § 902(g).

C. New Combined Defined Benefit/401(k) Plan

The PPA § 903 allows a small employer (with 500 or less employees) to establish a combined defined benefit – 401(k) plan (a so-called DB/K plan) in a single trust if it meets certain requirements. Code § 414(x); ERISA § 210(e). Each component is subject to its respective Code and ERISA requirements. The defined benefit component must provide benefits of at least 1% of final average pay times years of service up to 20% (or if a cash balance plus a percentage of compensation (2, 4, 6 or 8%) based on age. Code § 414(x)(2)(B); ERISA § 210(e)(2)(B). The 401(k) component must have automatic enrollment (with a 4% automatic rate), and the employer must match 50% of the first 4% deferred. Code §§ 414(x)(2)(C) and 414(x)(5); ERISA §§ 210(e)(2)(C) and 210(e)(4). The match must be immediately vested, and the defined benefit and the nonelective contribution to the 401(k) component must be vested within three years. Code § 414(x)(2)(D); ERISA § 210(e)(2)(D). The ADP nondiscrimination test is deemed to be met. Code § 414(x)(3); ERISA § 210(e)(3). The plan is deemed to not be top-heavy. Code § 414(x)(4). All contributions, benefits and features must be provided uniformly to all participants. Code § 414(x)(2)(E); ERISA § 210(e)(2)(E). A single 5500 is filed. Code § 414(x)(6)(B); ERISA § 210(e)(5)(B). The PBGC guarantee will apply to the defined benefit component. The provisions are effective for the 2010 plan year. PPA § 903(c).

D. Faster Vesting of Employer Nonelective Contributions

The PPA § 904 amends the Code § 411(a)(2)(B) and ERISA § 203(a)(2)(B) to provide that the accelerated vesting of 3 year cliff or 2-6 year graded vesting that previously applied only to matching contributions under EGTRRA now applies to all employer contributions to defined contribution plans, effective for the 2007 plan year (or later for collectively bargained plans or leveraged ESOPs). The 5 year cliff, 3-7 year graded vesting still applies to defined benefit plans.

E. Distributions During Working Retirement

To facilitate phased retirements, the PPA § 905 allows distributions from pension plans (defined benefit or money purchase pension plans) at age 62 even prior to normal retirement age and prior to termination of employment, effective for 2007 plan years. Code § 401(a)(36); ERISA § 3(2)(A).

IX. SPOUSAL PENSION PROTECTION

A. Regulations on Time and Order of QDRO

The DOL is directed to issue regulations within one year to clarify that a domestic relations order will not fail to be a QDRO solely because of the time it is issued (e.g., even if issued after employer's 18-month determination period) or solely because it is issued after, or amends another QDRO. PPA § 1001.

B. Additional Survivor Annuity Option

The PPA § 1004 provides that an additional optional survivor annuity must be offered that at the direction of the participant would allow a "qualified optional survivor benefit", which is 75% of the participant's annuity where the QJSA is less than 75%, and which is 50% where the QJSA is 75% or more. Code §§ 417(a)(1)(A)(ii) & 417(g); ERISA §§ 205(c)(1)(A)(ii) & 205(d)(2). A plan amendment under this provision will not violate the anticutback rule unless it eliminates a subsidized QJSA. Legislative History. These provisions are effective for 2008 plan years (or later for collectively bargained plans). PPA § 1004(c).

X. ADMINISTRATIVE PROVISIONS

A. Employee Plan Compliance Resolution System

The PPA § 1101 clarifies that the IRS has full authority to establish and implement the Employee Plans Compliance Resolution System (EPCRS) (see, e.g., Rev. Proc. 2006-27) or any other corrective policy waiving excise taxes, and the IRS is directed to give attention to expanding the EPCRS.

B. Notice and Consent Regarding Distributions Up to 120 Days Prior to Distribution

The PPA § 1102 provides that the requirement for QJSA notice and consent that was 30 to 90 days prior to annuity starting date is changed to 30 to 120 days prior to annuity starting date. Code § 417(a)(6)(A); ERISA § 205(c)(7)(A). The DOL is directed to modify regulations under § 402(f) (rollover notice), 411(a)(11) (involuntary cashout) and 417 (QJSA) to be 30 to 120 prior to distribution. The statutory and regulatory changes are to be effective for 2007 plan years. PPA § 1102.

C. Reporting Simplification

Under the PPA § 1103, the Treasury is directed to eliminate Form 5500 filing requirements for one-participant plans with assets not exceeding $250,000 (currently limit is $100,000), effective for 2008 plan years, and to provide simplified reporting for certain plans with fewer than 25 participants, effective Aug. 17, 2006.

D. Unemployment Compensation for Pension Rollovers

The PPA § 1105 provides that there can be no reduction in unemployment compensation (for FUTA) as a result of pension rollovers, effective Aug. 17. 2006. Code § 3304(a).

E. Revised Multiemployer Elections

The PPA § 1106 allows multiemployer plans that were treated as single-employer plans before the Multiple Employer Pension Protection Act of 1980 a one-time election to be treated as multiemployer plans, effective Aug. 17, 2006. Code § 414(f)(6); ERISA § 3(37)(G).

F. Provisions Relating to Plan Amendments

The PPA § 1107 provides plans with protection from the anticutback rules for amendments to comply with the PPA and related regulations, if the amendment is made by the last day of the plan year beginning in 2009.