OVERVIEW OF THE
PENSION PROTECTION ACT OF 2006
FOR DEFINED CONTRIBUTION PLANS

Palmieri & Eisenberg
715 Executive Drive
Princeton, NJ 08540
www.p-ebenefitslaw.com

Frank Palmieri, Esq.
Tel: (609) 497-0400
Fax: (609) 497-1163
fpalmieri@p-ebenefitslaw.com

March, 2007

The Pension Protection Act of 2006 (the "Act") is the most comprehensive pension reform legislation in decades. The Act includes the permanent extension of the EGTRRA retirement savings provisions, overhauls pension funding rules, and includes reforms affecting hybrid plans (i.e., cash balance plans) and defined contribution plans, and even effects nonqualified deferred Compensation plans.

This summary is only intended to highlight the most important changes that will impact clients of Palmieri & Eisenberg ("P&E"). We will individually discuss all-important changes with each of our clients.

1. **Highlights**.

   a. **Electronic Display of Form 5500 Information**. The DOL must display annual report information in electronic form within **90** days after receiving it for post-2007 plan years. All employers that maintain an Intranet Web site for the purpose of communicating with employees, and not the public, also have to display the Form 5500 information on that Web site, in accordance with DOL regulations.

   b. **Benefits Statements**. Benefits statements are required: (1) quarterly for participant-directed defined contribution ("DC") plans; (2) annually for other DC plans; and (3) every **3** years for defined benefit ("DB") plans. The DOL must issue model benefit statements that will satisfy this requirement. The legislation allows statements to be delivered by electronic means. This provision is effective for post-2006 plan years.

   c. **Plans with Automatic Enrollment**. The Act clarifies that ERISA **"preempts"** state wage and hour laws that directly or indirectly prohibit automatic enrollment provisions, provided that the plan provides **"notice"** to affected employees within a reasonable period before each year. These rules are effective for plan years beginning in 2008 and later, except the ERISA preemption rule is effective on the enactment date.

   d. **Investment Advice**. The Act contains a prohibited transaction exemption (a "PTE") for advice provided by a **"fiduciary adviser"** under an "eligible investment advice arrangement." An eligible investment advice arrangement

must either: (1) provide that the fees received by the fiduciary adviser do not vary on the basis of which investment options are chosen; or (2) use a computer model under an investment advice program meeting certain conditions. An independent fiduciary would have to approve the arrangement. There will be disclosures to participants regarding the fiduciary adviser's fee arrangement, the adviser's relationship with the development of the computer model, certain performance statistics and other prescribed information. In addition, the plan sponsor is deemed to have "met" its fiduciary duties if the conditions of the exemption are met.

A fiduciary may be: (i) a registered investment adviser under the Investment Advisers Act of 1940; (ii) a bank or similar financial institution, but only if provided through a trust department subject to periodic examination and review by federal or state banking authorities; (iii) an insurance company; (iv) a person registered as a broker or dealer under the 1934 Securities Act; (v) an affiliate of a person described in (i) through (iv); or (vi) an employee, agent, or registered representative of a person described in (i) through (v). The person who develops the computer model also may qualify as a fiduciary adviser. This provision applies to advice rendered after December 31, 2006.

e. **Diversification of Employer Securities**. DC plans **must** permit employees to **"diversify"** out of investments in employer securities if the securities are publicly traded. This will not apply to ESOPs that contain no elective deferrals, and employee voluntary contributions. A plan could require up to **3** years of service before diversification rights would apply to employer matching and profit sharing contributions. This provision is effective starting in 2007. However, for existing plans, the diversification requirement is phased in over a **3**-year period with respect to the portion of the participant's account that would be subject to the diversification election.

f. **Notice of Right to Diversify**. An employee who has a right to diversify out of employer securities must receive **30** days advance notice of such right subject to a **$100**-per-failure penalty. The Treasury is required to issue a Model Notice. This provision is effective for plan years beginning in 2007 or later.

g. **Accelerated Vesting Under DC Plans**. The Act imposes the **6**-year top heavy vesting rules on all DC plan contributions (not just on matching contributions, as was done under EGTRRA), effective for contributions made in plan years beginning in 2007.

h. **Hardships**. The Act requires the Treasury to issue regulations that will permit hardship withdrawals for hardships or unforeseeable emergencies of a person who is the participant's beneficiary under the plan, even if that beneficiary is not the participant's spouse or dependent (such as a domestic partner, parent or sibling).

i. **<u>EPCRS</u>**. Formal authority is given to the IRS to design and modify, and waive income or excise taxes, with respect to the Employee Plans Compliance Resolution System ("EPCRS") Program or any successor program, to ensure that any tax, penalty, or sanction is not excessive and is commensurate with the nature, extent and severity of the failure. The Treasury is instructed to take into account circumstances and concerns that small employer's face. P&E has submitted numerous plans to correct compliance issues under the EPCRS Program. This change can only enhance the use of the Program for administrative errors.

j. **<u>Non-Spouse Rollovers</u>**. A non-spouse beneficiary will permitted to roll over benefits to an IRA so that the IRA could satisfy the minimum distribution requirements rather than the existing plan under which the individual is a beneficiary. This is effective for distributions made after 2006.

2. **<u>401(k) Plan</u>**.

a. **<u>Excess Contributions</u>**. A plan with an "eligible" automatic enrollment arrangement will be allowed to make ADP/ACP refunds up to **6** months after the close of the plan year without a **10%** excise tax on the employer.

b. **<u>Timing of Taxation</u>**. Refunds made within the **2½** month correction period (or **6**-month correction period, in the case of an automatic enrollment arrangement) will be taxed in the year of distribution.

c. **<u>Gap Period Earnings</u>**. The Act eliminates the need to distribute gap period earnings on corrective distributions for all 401(k) plans.

d. **<u>Effective Date</u>**. These rules are generally effective for plan years beginning in 2008.

e. **<u>Automatic Enrollment Safe Harbor</u>**. A 401(k) plan with an automatic enrollment feature will be eligible for safe harbor treatment under the ADP/ACP tests, and will be deemed to satisfy the top heavy requirements, if certain conditions are met. A plan meeting this requirement is a "qualified" automatic contribution arrangement. The requirements for this arrangement are: (1) the automatic enrollment percentage initially must be between **3%** and **10%**, but no less than **4%** in the second year of participation; no less than **5%** in the third year of participation; and no less than **6%** in any subsequent year of participation; (2) the arrangement will not have to apply to employees already participating (or who have elected not to participate); and (3) a match of at least **100%** of the first **1%** deferred and at least **50%** of the next **5%** deferred (<u>i.e.</u>, for a total of **3½%**), or at least a **3%** profit sharing contribution is required. Vesting on contributions will have to be **100%** after no more than **2** years, rather than the immediate vesting rule for other safe harbor 401(k) plans. Certain distribution restrictions will apply to these contributions and an annual notice requirement is included.

f. **Other Automatic Enrollment Rules**. The Act contains special rules concerning a distribution of "erroneous contributions" (i.e., contributions made by automatic enrollment that the employee designates were made erroneously). The employees' election will have to be made within **90** days after the first payroll period when the automatic enrollment took effect and will apply to all elective deferrals made since the automatic enrollment started. The amount distributed will not be included in the discrimination test, will not be subject to the **10%** penalty, and will be treated as compensation. Distributions of erroneous contributions will have to be made by April 15 of the following year.

3. **Miscellaneous ERISA Issues**.

a. **Additional Disclosures**. Certain additional information would be required on the annual Form 5500. It is intended that defined benefit plans will be exempt from the Summary Annual Report ("SAR") requirement, which essentially limits the SAR to DC plans. These rules will take effect for post-2007 years.

b. **Mapping Investment Options**. The Act provides fiduciary relief under Section 404(c) of ERISA during a blackout period if certain conditions are satisfied, prescribed by the DOL. Rules would be provided with respect to the mapping of investments to both new and existing investment options in the case of a change in investments under a participant-directed plan under which participant control is deemed to be retained. This rule is effective for plan years beginning after December 31, 2007.

c. **Investment Safe Harbor**. The Act requires the DOL to issue a fiduciary safe harbor under Section 404(c) of ERISA for the investment of assets in an individual account plan, under which the participant will be deemed to be exercising investment control. The default will apply only where the participant has failed to make an investment election. An **annual notice** will be required to explain the default investment and the circumstances under which it applies. The effective date is for plan years beginning in 2007.

d. **Unemployment**. States would be prohibited from reducing unemployment compensation for pension distributions that are nontaxable because they are rolled over. This is effective on the enactment date.

e. **Saver's Credit**. The Act makes the Saver's Credit permanent and indexes the eligibility level.

f. **Distribution Notice and Consent Rules**. The **90**-day notice period is expanded to **180** days for the Section 402(f) and Qualified Joint and Survivor Annuities rollover notice. This is effective for years beginning in 2007 or later.

g. **<u>Phased Retirement</u>**. A DB plan is permitted to allow for in-service distributions to a participant who has reached age **62**, even if normal retirement age is later than age **62**. This applies to distributions made in plan years beginning in 2007.

h. **<u>Transfers to Fund Retiree Health Benefits</u>**. The Act expands the ability to transfer surplus assets under a DB plan to fund retiree health benefits, pursuant to Section 420 of the Code. This applies to transfers made after date of enactment.

i. **<u>Tax Refunds</u>**. A taxpayer can direct a tax refund to be paid directly into an IRA, for taxable years beginning in 2007.

j. **<u>Tax-Free IRA Distributions for Charitable Giving</u>**. Up to **$100,000** could be distributed tax free from an IRA if it is made to a charitable organization, and the IRA owner is at least **70½** years old. This rule will not apply to distributions from SEP-IRAs or SIMPLE-IRAs. This rule will apply only to distributions in 2006 and 2007.

4. **<u>Plan Amendments</u>**. Amendments will be required by the end of the 2009 plan year, with anti-cutback relief.

This Summary was prepared by the Law Firm of Palmieri & Eisenberg, located in Princeton, New Jersey, for clients and associates of the Firm. This Summary is being provided to help educate clients and employers regarding these new rules. P&E is **not** providing any legal advice to any employers to whom this Summary is provided, as a courtesy. Employers are strongly encouraged to work with their own legal counsel in reviewing these important issues.

Any advice in this summary concerning a federal tax issue is not intended or written to be used, and cannot be used by any taxpayer, for the purpose of avoiding any tax penalties that can be imposed by the Internal Revenue Service, or for promoting, marketing or recommending any tax-related matters addressed herein in accordance with IRS Circular 230.

(C:\WPDocs\Website\2006-Leg.Highlights.Sht)