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Key Provisions of HR 4 Pension Protection Act of 2006

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Edited by the ASPPA asap Committee

On August 3, 2006, the Senate passed HR 4, the Pension Protection Act of 2006, by a vote of 93 to 5. The Senate passage of the most comprehensive pension reform legislation in decades comes on the heels of House passage on July 28, 2006. The pension bill will now go to President Bush for signature. Most importantly, the legislation includes the permanent extension of the EGTRRA retirement savings provisions, which is a huge victory. The legislation also overhauls pension funding rules, and includes reforms affecting hybrid plans, defined contribution plans, and nonqualified deferred compensation. ASPPA's Government Affairs Committee (GAC) was able to obtain a number of modifications to certain provisions in the bill, including several important small business exceptions to the new DB funding requirements.

ASPPA is providing you a detailed summary of the preliminary review of the 907-page HR 4 (see www.asppa.org/government/gacpdf/HWC_373_xml.pdf). At this time, legislative history is not available.

I. EGTRRA Permanency

Section 811 of the bill would make permanent the EGTRRA provisions relating to pensions and IRAs, and Section 812 of the bill would make the Saver's Credit under IRC §25B permanent.

II. Minimum Funding Standards

The bill replaces the minimum funding standard account rule and the deficit reduction contribution for certain plans with a single minimum funding calculation. The general effective date is for the 2008 plan year, but there are transition rules. The ERISA rules are addressed in sections 101-107 of the bill, and the corresponding tax code provisions in sections 111-116 of the bill.

Basic minimum funding contribution. The amount is the sum of: (1) the target normal cost (present value of benefits expected to be accrued in the current year, including an increase in benefits attributable to services performed in prior years by reason of an increase in compensation during the current plan year), plus (2) shortfall amortization charge (determined over a seven-year period, but phased in through 2011), plus (3) waiver amortization charge, if any (over five years). If there is no funding shortfall for the year (*i.e.*, plan assets, reduced by any credit balances, equals or exceeds the funding target for the year), the minimum contribution is the target normal cost for the plan year reduced by such excess (but not below zero). IRC §412 would refer to the new IRC §430, the minimum required contribution calculation.

Interest rate assumptions. Current liability is determined using three segments (0-5 years, more than 5 years up to 15 years, over 15 years), phased in over three years beginning in 2007 (unless the employer foregoes the phase-in) based on a yield curve that is derived from a two-year weighted average of interest rates on investment-grade corporate bonds.

- **Extension of PFEA.** The Pension Funding Equity Act (PFEA) rates would be extended through the 2006 and 2007 plan years for purposes of the interest rate permissible range and the current liability calculation. See Section 301 of the bill, amending IRC §412(b)(5)(B)(ii)(II) and IRC §412 (l)(7)(C)(i)(IV), and the corresponding ERISA sections (see *ASPPA asap 04-20 and 04-21*).

Mortality table. Tables are to be prescribed by the Treasury for both healthy and

disabled participants. Large plans may petition the IRS to use a plan-specific mortality table pursuant to certain restrictions and demonstrations.

At-risk plans. Additional required actuarial assumptions, resulting in increased funding targets, would apply to at-risk plans, including the assumption that employees within ten years of retirement will retire at the earliest possible time, and that employees are assumed to elect the most valuable payment option. An additional loading factor would apply to plans that are in at-risk status for at least two of the last four years. A "70/80" at-risk funding target would be triggered if, at the prior valuation date, plan liabilities were both (i) less than 80% funded (without regard to at-risk liabilities) and (ii) less than 70% funded using the at-risk liabilities and subtracting the credit balance. The 80% test is phased in using 65% in 2008, 70% in 2009, 75% in 2010 and 80% for 2011, and thereafter. This legislation would exempt from the at-risk funding requirements plans with 500 or fewer participants on every day of the preceding year (treating all defined benefit plans of an employer as a single plan). ASPPA's Government Affairs Committee (GAC) worked with Congress to obtain this exemption.

Valuation date. The first day of the plan year would have to be used, except for small plans (a small plan is one with 100 or fewer participants). This small plan rule is another issue advocated by ASPPA GAC.

Valuation of plan assets. Generally, fair market value is to be used, but certain smoothing is allowed over a period not to exceed 24 months. Smoothing cannot result in a value that is more than 110% or less than 90% of the current value of assets.

Credit balances. Generally, the plan would retain credit balances in two pieces—a carryover balance from 2007 and a pre-funding balance from contributions in excess of funding rules in 2008 and later plan years. The plan may elect to use its credit balance to satisfy a minimum funding obligation only if the assets are at least 80% funded (from the prior valuation date) based on the pre-funding balance, but not carryover balance. Credit balances would reflect the investment performance of plan assets and would be subtracted from assets for most determinations under the bill.

Contribution deadlines/quarterly contributions. The due date for a required contribution is 8½ months after the close of the plan year (but adjusted for interest if made after the valuation date for the plan year). Quarterly contributions are required if there was a funding shortfall in the prior year. See IRC §430(j), which would replace present-law IRC §412(m). Plans with 100 or fewer participants are not subject to the quarterly contribution requirement.

Funding-based benefit limitations. New ERISA §206(g) and IRC §436 would impose the following suspensions and restrictions on plan amendments, accruals or distribution options, applicable to single-employer defined benefit plans. See sections 103 and 113 of the bill.

- **Shutdown benefits (applies only to plans funded below a 60% level).** Shutdown benefits and other unpredictable contingent benefits would be restricted if the plan is below a 60% funding level, unless the employer makes a prescribed additional contribution. The PBGC guarantee for such benefits would be phased in over a five-year period commencing when the event occurs. This is not applicable for the first five years of a plan's existence.
- **Restrictions on benefit increases (applies to plans funded below an 80% level).** The bill would not allow a plan amendment that increases plan benefits if the plan is below an 80% funding level, unless the employer makes a prescribed additional contribution. An amendment is subject to this rule if it increases benefit liabilities due to an increase in benefits, the addition of new benefits, a change in the rate of benefit accrual or a change in the rate at which benefits become vested. This is not applicable for the first five years of a plan's existence.
- **Restrictions on accelerated distributions and lump sum payments (applies only to plans funded below a 60% level).** The bill prohibits distributions in excess of the monthly life annuity payable under the plan when the plan's funding level is less than 60%. This also applies if the

employer is in bankruptcy unless the plan is 100% funded. The employer could put up security to permit larger distributions to be made. Plans less than 60% funded may not pay lump sums.

- **Restrictions on accelerated distributions and lump sum payments** (applies only to plans funded above a 60% level, but below an 80% level). A limited payout, rather than a prohibition on any distribution in excess of the monthly life annuity is allowed if a plan's funding level is above 60%, but below 80%. The employer could put up security to permit larger distributions to be made. Plans at least 60% but less than 80% funded can make lump sum payments limited to the lesser of (i) 50% of the amount that would have been paid without restriction; and (ii) the present value of the participant's PBGC benefit.
- **Cessation of future accruals** (applies to plans funded below a 60% level). A plan would have to cease further accruals if funding falls below 60%, with an exception during the first five years of a plan's existence, or if the employer makes an additional contribution prescribed by the statute.
- **Notice to participants**. ERISA §101(j) would require notice to participants on the restrictions regarding shutdown benefits or accelerated distributions, as described above. This notice also would be required when future accruals cease under the rules described above. The notice is required within 30 days following the plan being subject to any of these restrictions. This is enforceable through the penalties under ERISA §502(c)(4).
- **Effective date**. These rules are generally effective in 2008, but not before 2010 for collectively bargained plans.

Restrictions on non-qualified deferred compensation plans. Adverse tax consequences would result if amounts are set aside for nonqualified deferred compensation when a defined benefit plan is in at-risk status (e.g., less than 80% funded), the employer is in bankruptcy for the 12-month period that begins six months before a distress termination date. New IRC §409A(b)(3). See Section 116 of the bill.

Multiemployer plans. Significant changes would be made to the funding rules for these plans as well. Some of the funding changes for multiemployer plans would sunset at the end of 2014 (for plan years beginning after December 31, 2014). See Title II of the bill.

Joint and several liability. This is retained for controlled group members. IRC §412(b).

Waivers. The IRS retains the right to grant waivers in IRC §412(c), but not more than three in any 15-year period (five out of 15 for multiemployer plans). The IRS may require the employer to put up security. The Treasury is required to consult with the PBGC before issuing a waiver.

Retroactive reduction of benefits. The exception currently under IRC §412(c)(8) would be moved to IRC §412(d).

Fully insured exception retained. IRC §412(i) would be retained, but moved to IRC §412(e)(3).

III. Lump Sum Distributions

Minimum lump sums under IRC §417(e). The bill would replace the current rules under IRC §417(e) (which uses 30-year Treasury rates) under the three-segment approach described above in the minimum funding rules, with a phase-in of 20% a year from 2008-2012 (current rules remain in effect for 2006 and 2007).

Interest rate assumption for IRC §415 lump sums. The bill would adopt the PFEA rule with a twist: the interest rate used would be the greatest of: (1) 5.5%; (2) the rate that would provide a benefit of not more than 105% of the benefit that would be provided if the IRC §417(e)(3) rate were used; or (3) the plan's rate.

Note: This is effective in 2006.

- **Technical correction or administrative relief needed.** Since this provision is effective in 2006, there is the possibility that a plan has already paid out benefits during 2006 before the enactment of this change. Current law reverted back to the use of the greater of the 417(e)(3) rate or the plan rate to calculate the maximum lump sum. If the lump sum paid out were greater than what the new limitation would provide, relief is needed so that the plan is deemed to satisfy IRC §415. If the plan paid less, the plan should have the *option of*: (1) paying the greater amount or (2) limiting the effective date of the higher limitation to distributions made after the enactment date (or some later transition date perhaps). Considering the recent low 30-year Treasury rates, the 5.5% rate would probably apply for most 2006 distributions made before the enactment of this legislation; so it is very possible some plans paid a greater amount based on the 30-year Treasury rate. ASPPA GAC will likely need to seek relief on this from the Treasury.

IV. PBGC Rules

Flat rate premium. HR 4 makes no changes to the PBGC flat rate premium. The Deficit Reduction Act of 2005 already increased the per-participant flat-rate premium to \$30 for single-employer plans and to \$8 for multiemployer plans.

Variable rate premium. The rules for 2004 and 2005 would continue for 2006 and 2007 and then be amended to reflect the interest rates in the new funding rules. In addition, for employers with 25 or fewer employees, a \$5 cap would apply to the variable premium. See Section 405 of the bill, creating new ERISA §4006(a)(3)(H), effective for post-2006 plan years. The full funding limitation exemption is repealed. The variable rate premium must be computed using the three-segment yield curve beginning in 2008; risk-based premium is based on unfunded vested benefits.

Surcharge premium made permanent. The bill makes permanent the surcharge premium of \$1,250 per participant for certain distress terminations [see ERISA §4006(a)(7), as added by the Deficit Reduction Act of 2005, which was to expire in 2010]. See Section 401 of the bill.

Bankruptcy. The bankruptcy petition filing date will be substituted for the termination date in order to apply certain guaranteed benefit rules under ERISA §4022 and asset allocation rules under ERISA §4044, if the bankruptcy case is not dismissed as of the actual plan termination date. Effective 30 days after enactment. See Section 404 of the bill.

Interest on overpayment of premiums. Section 406 of the bill would authorize the PBGC to pay interest on overpayment of premiums, effective upon enactment.

Substantial owners. The bill would modify ERISA §4022(b)(5) to apply the phase-in rule to majority owners, rather than substantial owners, and accelerate the phase-in period to ten years. See Section 407 of the bill.

Director of the PBGC. The director would become a presidential appointment, subject to confirmation by both the Senate Committee on Finance and Senate Committee on Health, Education, Labor and Pensions. See Section 411 of the bill.

V. Benefit Accruals Under Hybrid Plans

The rules described below are found in Section 701 of the bill.

Age discrimination. The law would clarify that all defined benefit plans (including cash balance and pension equity plans) are not inherently age discriminatory as long as benefits are fully vested after three years of service and interest credits do not exceed a market rate of return. The bill further provides that the age discrimination test is met if a participant's accrued benefit is not less than the accrued benefit of any similarly situated younger employee. "Similarly situated" means that the participants are identical in every respect (*e.g.*, period of service, compensation, position, date of hire, work history), except age. The accrued benefit can be tested on the basis of an annuity payable at normal retirement age, a *hypothetical account balance* (*e.g.*, cash balance plan), or the current value of the accumulated percentage of the employee's final average pay (*e.g.*, a PEP plan). See Section 701 of the bill. No definition of a cash balance plan is provided with respect to the application of this rule, except any interest credited by a plan must be no more than a market rate of interest, effective for

plan years beginning in 2008 or later (unless the employer elects to apply earlier). Corresponding amendments are made to the Age Discrimination in Employment Act (ADEA).

Conversions. The bill would prohibit wear away of pre-conversion accrued benefits if the conversion occurs after June 29, 2005. No inference is to be drawn with respect to earlier conversions.

Whipsaw. The bill would eliminate the “whipsaw” problem by allowing the lump sum distribution from a hybrid plan to be equal to the hypothetical account balance (e.g., cash balance

plan) or the accumulated percentage of final average pay (e.g., PEP plan). This is effective for distributions made after the date of enactment.

Vesting. Hybrid plans (i.e., benefits based on a hypothetical account or as an accumulated percentage of final average pay) would have to have full vesting in no more than three years of service. This is effective for plan years beginning in 2008 or later, unless the employer elects earlier application.

No inference as to prior years. The bill’s provision is prospective only and would provide no clarification of the legal status of hybrid plans for past years. This, in effect, will leave unresolved the age discrimination and whipsaw issues under prior law.

VI. Deduction Limits

Contributions to DB plans. Beginning in 2008, the maximum deductible contribution would equal (i) the target normal cost; plus (ii) 150% of the applicable funding target; plus (iii) an allowance for future pay or benefit increases; minus (iv) assets. For 2006 and 2007, the deduction limit would be raised to 150% of current liability minus plan assets. The bill allows expected compensation and benefit increases to be taken into account in calculating the limit. If the plan is covered by the PBGC, the actuary may also project increases in the compensation dollar amount under IRC §401(a)(17). For plans with 100 or fewer participants, benefit increases due to amendments adopted within the past two years cannot be taken into account.

The bill also repeals the alternative maximum deductible contribution determined using an interest rate of 90-105% of a four-year weighted average 30-year Treasury rate. Contributions in excess of this limit are subject to a 10% excise tax. See new IRC §404(o), as added by Section 801 of the bill.

Combined limit under IRC §404(a)(7). The limit under IRC §404(a)(7) would be determined without regard to all DB plans that are covered by the PBGC. See Section 801 of the bill. In addition, only employer contributions [other than 401(k) contributions] to a DC plan that *exceed 6% of participant compensation* would be subject to the limit. Elective deferrals would continue to be disregarded from the deduction limits. See Section 803 of the bill.

- **Excise tax.** The excise tax under IRC §4972 would not apply to DC contributions that are nondeductible solely because of 404(a)(7), but only to the extent such contributions are matching contributions made by the employer.

Multiemployer plans. Section 802 of the bill increases the deduction limit for multiemployer plans, effective in post-2007 years.

Effective date. This is effective for plan years beginning in 2008 or later. For the 2006 and 2007 plan years, the maximum DB deduction is increased to 150% of current liability. In addition, the higher 404(a)(7) limit, except for the disregarding of PBGC-covered plans, is effective for post-2005 years.

VII. 401(k) Plans

Excess contributions. A plan with an “eligible” automatic enrollment arrangement would be allowed to make ADP/ACP refunds up to six months after the close of the plan year without a 10% excise tax on the employer. The automatic enrollment arrangement would not have to be a “qualified” automatic enrollment arrangement (i.e., the safe harbor arrangement described below). See Section 902 of the bill.

- **Timing of taxation.** Refunds made within the 2½ month correction period (or six-month correction period, in the case of an automatic enrollment

arrangement) would be taxed in the year of distribution. See Section 902 of the bill.

- **Gap period earnings.** The bill eliminates the need to distribute gap period earnings on corrective distributions for all 401(k) plans. This provision was successfully expanded from a previous version of the bill thanks to ASPPA GAC. See Section 902(e) of the bill.
- **Effective date.** These rules are effective for plan years beginning in 2008 and later.

Automatic enrollment safe harbor. A 401(k) plan with an automatic enrollment feature would be eligible for safe harbor treatment under the ADP/ACP tests, and would be deemed to meet 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 would 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, or at least a 3% nonelective contribution would have to be provided. Vesting on contributions would have to be 100% after no more than two years, rather than the immediate vesting rule for other safe harbor 401(k) plans. The distribution restrictions under IRC §401(k)(2) would apply to these contributions. An annual notice requirement is included. See Section 902 of the bill.

Other automatic enrollment rules. The bill 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 would have to be made within 90 days after the first payroll period when the automatic enrollment took effect and would apply to all elective deferrals made since the automatic enrollment started. The amount distributed would not be included in the discrimination test, would not be subject to the 10% penalty, and would be treated as compensation. Distributions of erroneous contributions would have to be made by April 15 of the following year. The bill clarifies that ERISA preempts state 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. (For the first time, this preemption would be conditioned upon an annual notice requirement). These rules are effective for plan years beginning in 2008 and later, except the ERISA preemption rule is effective on the enactment date. See Section 902 of the bill.

DB(k). An "eligible combined plan" would be permitted to contain a 401(k) component and a DB component. Each component would be subject to its respective rules under the tax code and ERISA. This plan design would be limited to employers with no more than 500 employees. The plan would be subject to a single Form 5500 filing requirement and it would be deemed *not to be top heavy*. The DB component will have to be either a 1% of final average pay formula for up to 20 years of service, or a cash balance formula that increases with the participant's age. This provision is another that ASPPA GAC was able to obtain. The 401(k) component would have to include an automatic enrollment feature (using 4% as the automatic enrollment rate), and provide for a fully vested match of 50% on the first 4% deferred. Nonelective contributions would be permitted. All employer-derived benefits under the DB component and nonelective contributions under the DC component would have to be vested after no more than three years of service, and 100% vesting would have to apply to matching contributions. Nondiscrimination and coverage testing would have to be satisfied without regard to contributions or benefits under another plan and without regard to permitted disparity. The ADP/ACP test would be deemed satisfied. In the case of a cash balance arrangement, it would also have to meet the vesting requirements in IRC §411(a)(13)(B) and the interest credit rules in IRC §411(b)(5)(B)(i), as added by Section 701 of the bill. (See part V of this summary.) This provision is not effective until plan years beginning in 2010 or later due to revenue considerations. The legislation, as drafted, does not allow for a DB plan and 401(k) plan to constitute a single plan and trust unless they utilize the safe harbors described above. Since this provision is not effective until 2010, ASPPA GAC will be working to clarify this language.

Matching contributions consisting of employer stock by employers that go bankrupt. Affected employees would have the right to make additional IRA contributions of three times the normal deduction limit if they were receiving matching contributions (in an amount at least equal to 50% of the employee's contribution) in the form of employer securities within the six-month period before the employer goes into bankruptcy and the employer is subject to indictment or conviction resulting from business transactions related to the bankruptcy. These "catch up" IRA contributions could be made only in 2007, 2008 and 2009. See Section 831 of the bill, which adds IRC §219(b)(5)(C).

VIII. Spousal Protection

QDROs. The DOL would be required to issue regulations to clarify that an order does not fail to be a QDRO merely because of the time it is issued, or that it modifies a prior order or QDRO. See Section 1001 of the bill.

QJSA options. The bill would require a plan to offer a 75% survivor annuity option if the QJSA has a survivor percentage less than 75%, and a 50% survivor annuity option if the QJSA has a survivor percentage that is greater than 75%. Effective for plan years beginning in 2008 or later (delayed effective date for collectively bargained plan). See Section 1004 of the bill.

IX. Portability

Missing participants under terminated plans. The PBGC's missing participant program (ERISA §4050) would be extended to multiemployer plans and to plans not covered by the PBGC (including terminated DC plans and terminated DB plans maintained by professional corporations with 25 or fewer plan participants). The administrators of these plans would not be required to participate in the missing participant program, but would have the option to do so. See Section 410 of the bill.

Direct rollovers into Roth IRAs. Under Section 824 of the bill, plan distributions could be rolled over directly to Roth IRAs (with the taxable portion of the rollover amount taxed at the time of the rollover). These would be subject to the Roth IRA conversion rules (*i.e.*, no more than \$100,000 adjusted gross income). This is effective in 2008.

Non-spouse rollovers. A non-spouse beneficiary would be 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. See Section 829 of the bill, adding new IRC §402(c)(11).

After-tax amounts. The bill would expand the portability of after-tax amounts, allowing such rollovers between different types of employer-sponsored plans [*e.g.*, qualified plan to 403(b) plan, or vice versa]. This also should apply to the issue of rolling over designated Roth accounts under qualified plans into 403(b) plans, and vice versa. See Section 822 of the bill, effective after 2006.

Accelerated vesting under DC plans. Section 904 of the bill would impose the 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 or later (for employees who have at least one hour of service after the effective date). A later effective date applies to collectively bargained plans.

Permissive service credits. The rules regarding permissive service credits under state and local governmental plans would be expanded under Section 821 of the bill, including the ability to purchase additional credits for years where service credit already has been given. In addition, the trustee-to-trustee transfer rules under IRC §403(b)(13)(A) and IRC §457(e)(17)(A) are expanded by eliminating the restrictions under IRC §415(n)(3)(B). More flexibility is provided with respect to prior educational service that is treated as permissive service credit for purposes of buying credit. The amendments are treated as if they were part of the Taxpayer Relief Act of 1997, or of EGTRRA, depending on the law to which the rule relates.

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. See Section 1105 of the bill.

X. Reporting and Disclosure

DB funding notice. An annual funding notice would be required of all single-employer DB plans, along the lines of the current rules for multiemployer plans, starting with the 2008 plan year. The notice would have to be furnished no later than 120 days after the end of the plan year to which the notice relates. Small plans (100 or fewer participants) would furnish the notice coincident with the filing of the annual report (Form 5500), as advocated for by ASPPA GAC. The ERISA §4011 notice would be repealed for post-2006 plan years. See amended ERISA §101(f) in Section 501 of the bill.

Additional disclosures. Certain additional information would be required on the annual report (Form 5500), pursuant to new ERISA §103(f). Although not drafted correctly, it is intended that defined benefit plans subject to ERISA §101(f) [the bill incorrectly cites ERISA §103(f)] would be exempt from the Summary Annual Report (SAR) requirement, which essentially limits the SAR to DC plans. Summary plan information, however, would be required of multiemployer DB plans within 30 days after the Form 5500 deadline. These rules would take effect for post-2007 years. See Section 503 of the bill.

Electronic display of Form 5500 information. The DOL would have to display annual report information in electronic form within 90 days after receiving it, effective in post-2007 plan years. Also, companies that maintain an Intranet Web site maintained for the purpose of communicating with employees, and not the public, would have to display the Form 5500 information on that Web site, in accordance with DOL regulations. This provision modifies a more troublesome requirement for a general Web site posting, thanks to the efforts of ASPPA GAC. See Section 504 of the bill.

ERISA §4010 reporting. Rather than requiring the filing of ERISA §4010 information if the aggregate unfunded vested benefits exceed \$50 million, ERISA §4010(b)(1) is amended to require this filing of financial and actuarial information for any PBGC-covered plan that has a funding percentage of less than 80%, starting with the 2008 plan year. ASPPA GAC is aware that this is a significant change that will affect many small plans. See Section 505 of the bill.

Distress and involuntary terminations. In the case of a distress termination under ERISA §4041(c), or involuntary termination under ERISA §4042, the plan administrator or plan sponsor would have to furnish participants the information provided to the PBGC (subject to confidentiality limitations) within 15 days of the filing. It would apply to notices of intent to terminate, or involuntary termination determinations, issued after the enactment date. See Section 506 of the bill.

Notice of right to diversify. Pursuant to new ERISA §101(m), an employee who has a right to diversify out of employer securities, in accordance with ERISA §204(j), would have to receive 30 days advance notice of such right. The Treasury is required to issue a model notice. This is effective for plan years beginning in 2007 or later. See the discussion of diversification rights in Section XII of this summary. See Section 507 of the bill.

Benefits statements. Benefits statements would be required: (1) quarterly for participant-directed DC plans; (2) annually for DC plans; and (3) every three years for DB plans. The DOL must issue model benefit statements that will satisfy this requirement. The legislation allows statements to be delivered by electronic means. It remains to be seen how this impacts the DOL's current regulations on electronic communications. This is effective in post-2006 plan years (delayed effective date for collectively bargained plans). See Section 508 of the bill.

Blackout notices. The bill adds an exception to the notice requirement for one-participant plans (including plans that cover the spouse of the owner), and plans that cover only partners in a partnership (or only partners and their spouses). This is effective as if it were originally part of Sarbanes-Oxley. See Section 509 of the bill.

Form 5500-EZ. The bill would exempt filing for one-participant plans with assets not in excess of \$250,000 (rather than the present-law \$100,000 threshold). This is effective for plan years beginning in 2007 or later. See Section 1103 of the bill.

Simplified Form 5500 for smaller plans. A simplified Form 5500 would have to be available for plans with 25 or fewer participants, if the plan meets coverage without being combined with another plan, and no related group members or leased employees are covered by the plan. This is effective for plan years beginning in 2007 or later. See Section 1103 of the bill.

XI. Investment Advice and Other Prohibited Transaction Exemptions

Investment advice. Section 601 of the bill contains a prohibited transaction exemption for advice provided by a “fiduciary adviser” under an “eligible investment advice arrangement.” See new ERISA §408(b)(14) and IRC §4975(f) (8). 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 (which are modeled after the DOL’s advisory opinion to SunAmerica). An independent fiduciary would have to approve the arrangement. There would 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 under Part 4 of Title I of ERISA if the conditions of the exemption are met.

- This provision incorporates aspects of both the original House and Senate versions, with a more limited scope on the prohibited transaction exemption, but with fiduciary relief for the plan sponsor.
- **Definition of fiduciary adviser.** A fiduciary may be: (1) a registered investment adviser under the Investment Advisers Act of 1940; (2) 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; (3) an insurance company; (4) a person registered as a broker or dealer under the 1934 Securities Act; (5) an affiliate of a person described in (1) through (4); or (6) an employee, agent, or registered representative of a person described in (1) through (5). The person who develops the computer model also may qualify as a fiduciary adviser.
- **Restriction of exemption for IRAs.** Investment advisors for IRAs would not be eligible to use the computer model exception, only the fee arrangement exception for an eligible investment advice arrangement. The DOL and the Treasury, however, would conduct a feasibility study to determine if a computer model exists that could allow IRAs to use that exception. If it is determined that the requisite computer model does not exist, the DOL must issue a class exemption for IRAs that will allow for investment advice to be rendered along the lines of the computer model exemption.
- **Effective date.** This is for advice rendered after December 31, 2006.
Other prohibited transaction exemptions.
- **Transactions with service providers.** This bill offers relief in that a transaction between a plan and a party-in-interest, who is not a fiduciary, is not a prohibited transaction [under ERISA §406(a)(1)(A), (B) and (D) (*i.e.*, sale or exchange, lease, loan or use of plan assets)] so long as the plan receives no less than, or pays no more than, adequate consideration for the transaction. See Section 611(d) of the bill.
- **Block trades.** Section 611 of the bill would create exemptions for certain “block trades” (any trade of at least 10,000 shares or a fair market value of at least \$200,000), which will be allocated among two or more client accounts of a fiduciary.
- **Electronic communication networks.** An exemption is provided for certain transactions on electronic communication networks. See Section 611(c) of the bill.
- **Foreign exchange transactions.** An exemption is provided in Section 611 (e) of the bill for certain foreign exchange transactions.

- **Cross-trading.** An exemption for certain cross-trading transactions is provided in Section 611(g) of the bill.
- **Special correction period.** A prohibited transaction involving securities or commodities would be exempt if the correction is completed within 14 days after the fiduciary discovers (or should have discovered) that the transaction was prohibited. This prohibited transaction exemption does not apply to transactions involving employer securities. It also does not apply if, at the time of the transaction, the fiduciary or other party-in-interest (or any person knowingly participating in the transaction) knew (or should have known) that the transaction was prohibited. See Section 612 of the bill.
- **Effective date.** The new exemptions would be effective for transactions occurring after the enactment date. The correction period exemption applies to prohibited transactions that the fiduciary discovers (or should have discovered), *after the date of enactment*.

XII. Miscellaneous ERISA Issues

Bonding. Bonding relief is provided in Section 611(b) of the bill for any entity that is registered as a broker or dealer and is subject to the fidelity bond requirements of a self-regulatory organization. In addition, Section 622 of the bill increases the maximum bond amount to \$1 million for a plan that holds employer securities, effective for post-2007 plan years.

Plan asset definition. Section 611(f) of the bill would add ERISA §3(42) to adopt the DOL's 25% threshold for "benefit plan investors" to determine if the underlying assets of an entity are plan assets (for purposes of being subject to Title I of ERISA), immediately after the most recent acquisition of an equity interest in the entity. "Benefit plan investors" would be employee benefit plans subject to Part 4 of ERISA and IRC §4975 of the Code (under this definition, certain interests held by entities that are similar to plans, such as foreign or governmental plans, would be precluded when determining whether the 25% threshold is met).

Mapping investment options. The bill would provide fiduciary relief under ERISA §404(c) during a blackout period if certain conditions, as prescribed by the DOL, are satisfied. 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 is effective for plan years beginning after December 31, 2007 (with a delay for collectively bargained plans). See Section 621 of the bill.

Investment safe harbor. Section 624 of the bill would require the DOL to issue a fiduciary safe harbor under ERISA §404(c) for the investment of assets in an individual account plan, under which the participant would be deemed to be exercising investment control. The default would apply only where the participant has failed to make an investment election. An annual notice would be required to explain the default investment and the circumstances under which it would apply. The effective date is for plan years beginning in 2007 or later.

Safest annuity rule. Section 625 of the bill requires the DOL to issue regulations under which the selection of an annuity contract as an optional form of distribution under a DC plan: (1) is not subject to the DOL's "safest annuity" rule and (2) is subject to all otherwise applicable fiduciary standards. This is effective on the date of enactment.

Diversification of employer securities investments. A DC plan would have to permit employees to diversify out of investments in employer securities if the securities are publicly traded. This would not apply to ESOPs that contain no elective deferrals, employee contributions and matching contributions, and would not apply to one-participant plans. A plan could require up to three years of service before diversification rights would apply to employer matching and nonelective contributions. See Section 901 of the bill. This would be effective starting in 2007, except that, for existing plans, the diversification requirement would be phased in over a three-year period with respect to the portion of the participant's account that would be subject to the diversification election. Participants would have to receive 30 days advance notice of the diversification right (\$100-per-failure penalty). See

Section 507 of the bill.

Coercive interference with ERISA rights. The bill would increase penalties to \$100,000 and imprisonment up to ten years for willful acts of coercive interference. This is effective for violations occurring on or after the enactment date. See Section 623 of the bill.

Indian tribal governments. The bill would clarify that a plan is treated as a governmental plan if it is maintained by an Indian tribal government, a subdivision, agency or instrumentality of such government. Also, all of the participants must be employees whose services are substantially in the performance of essential governmental functions, but not in the performance of commercial activities (whether or not it is an essential government function). This is effective for plan years beginning on or after the enactment date. See Section 906 of the bill.

XIII. Miscellaneous Qualification and Tax Issues

IRC §415(b) limit. In a DB plan, average compensation may be calculated by taking into account years of service for which the employee was *not* an active participant in the plan. See IRC §415(b)(3), as amended by Section 832 of the bill. This would continue the rule in the current regulations that the Treasury had proposed to reverse. This is effective for post-2005 years. Also, for church plans, the compensation limit under IRC §415(b)(1)(B) would apply only to highly compensated employees. See Section 867 of the bill. Inclusion of this provision was in response to a last-minute lobbying effort by ASPPA GAC.

Saver's Credit. Section 833 of the bill amends IRC §25B to subject the income levels to indexing. Also, Section 812 of the bill makes the Saver's Credit permanent.

Distribution notice and consent rules. The 90-day notice period would be expanded to 180 days under Section 1102 of the bill. This is applicable to notice and consent requirements under IRC §402(f) (rollover notice), IRC §411(a)(11) (general consent rules) and IRC §417 (QJSA). This is effective for years beginning in 2007 or later.

Phased retirement. A DB plan will be 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 or later. See Section 905 of the bill.

Minimum distributions. Governmental plans would be subject to a good faith standard under Section 823 of the bill, and the Treasury is directed to issue regulations to this effect. The House's bill summary indicates this is intended to apply retroactively.

Hardships. The bill would require the Treasury to issue regulations that would 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. See Section 826 of the bill.

EPCRS. Formal authority is given to the IRS to design and modify, and waive income or excise taxes, with respect to the EPCRS 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. See Section 1101 of the bill.

Qualified reservists. Under the bill, IRAs and 401(k) plans would be able to make distributions to "qualified reservists" called up to active duty for a minimum period. A 10% premature distribution penalty would not apply and a two-year rollover rule would apply following the end of the active duty period. This provision applies only if the reservist is called up between September 11, 2001, and before December 31, 2007, for more than 179 days. See Section 827 of the bill.

Public safety employees. Public safety employees would be exempt from the 10% premature distribution penalty for distributions made after a separation from service that occurs on or after age 50 (rather than 55, as under current law). See Section 828 of the bill. This is effective for distributions made after enactment date. In addition, retired public safety employees could apply distributions from governmental plans to the purchase of health or long-term care insurance and exclude such distributions from gross income (up to \$3,000 per year). This is

effective for distributions in 2007 or later. See Section 845 of the bill.

Nondiscrimination testing for governmental plans. All governmental plans (including federal plans) would be exempt from nondiscrimination testing (only state or local governmental plans are exempt under current law). This is effective for years beginning after enactment date. See Section 861 of the bill.

Unrelated Business Taxable Income (UBTI). IRC §514(c)(9) is amended to extend application of the UBTI exemption for certain leveraged real estate investments to retirement income accounts described under IRC §403(b)(9) (available only to churches). See Section 866 of the bill.

Transfers to fund retiree health benefits. The bill would expand the ability to transfer surplus assets under a DB plan to fund retiree health benefits, pursuant to IRC §420. This applies to transfers made after date of enactment. See Section 841 of the bill.

Tax refunds. A taxpayer could direct a tax refund to be paid directly into an IRA, for taxable years beginning in 2007 or later. See Section 830 of the bill.

IRA limits. The gross income levels for IRA deductions and for Roth IRA contribution limits are made subject to indexing. See Section 833 of the bill.

Tax-free IRA distributions for charitable giving. 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 would not apply to distributions from SEP-IRAs or SIMPLE-IRAs. This would apply only to distributions in 2006 and 2007. See Section 1201 of the bill.

XIV. Plan Amendments

Amendments would be required by the end of the 2009 plan year, with anti-cutback relief. Governmental plans would have an additional two years to amend. See Section 1107 of the bill.