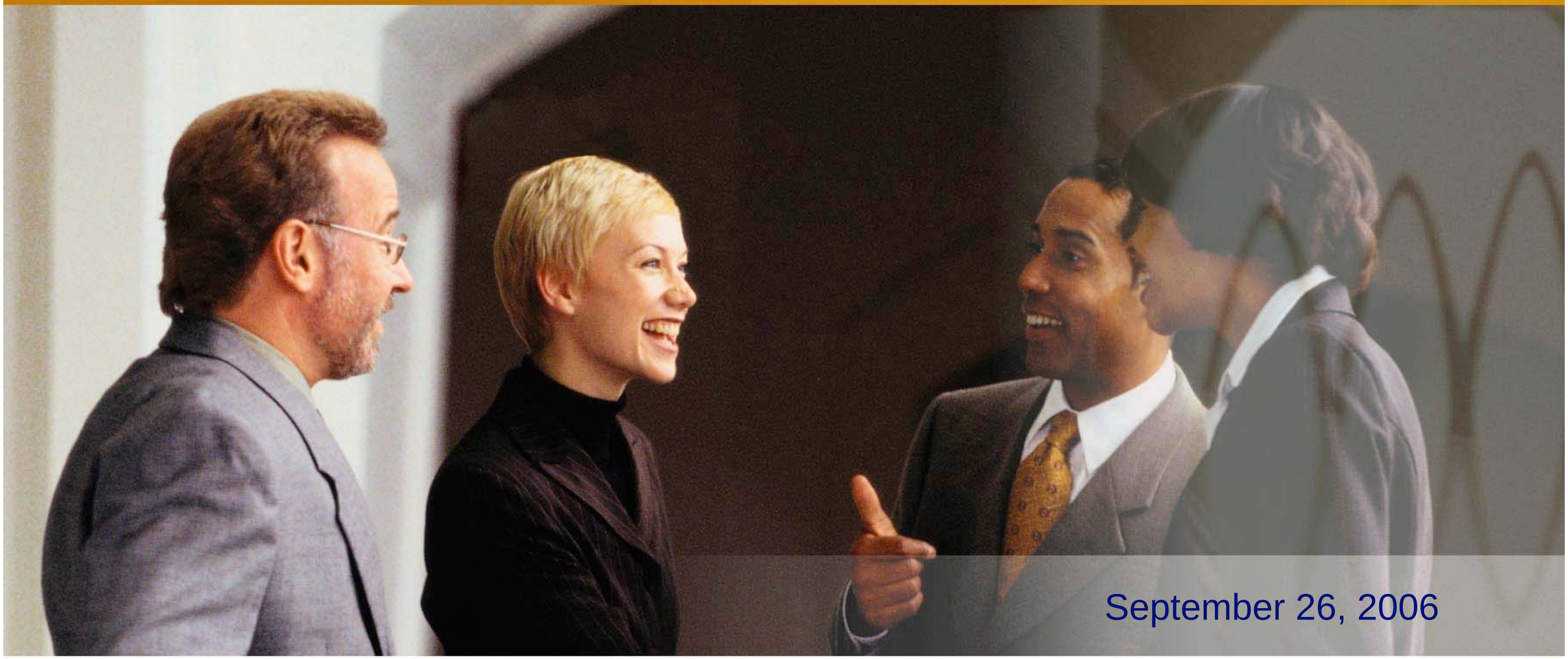
Pension Protection Act of 2006

Defined Contribution Plans



September 26, 2006

A MILLIMAN GLOBAL FIRM

Milliman

Consultants and Actuaries

Doug Conkel, Rhonda Migdail, Randy Mitchell

Circular 230 Disclosure

The following disclosure is provided in accordance with the Internal Revenue Service’s Circular 230 (21 CFR Part 10). This communication is not intended to constitute tax advice to any specific taxpayer or for any specific situation. Any tax advice contained in this communication is intended to be preliminary, for discussion purposes only, and not final. Any such advice is not intended to be used for marketing, promoting or recommending any transaction or for the use of any person in connection with the preparation of any tax return. Accordingly, this advice is not intended or written to be used, and it cannot be used, by any person for the purpose of avoiding tax penalties that may be imposed on such person.

CAVEAT

Information contained in and presented through this material is intended to provide a general understanding of the topics included, based on our understanding of applicable laws. Application to specific situations may involve additional laws and issues beyond the scope of the material presented here. This presentation is not intended nor should be construed nor used as legal advice, investment advice, tax advice, or any other professional service.

Defined Contribution Plan Provisions

1. Diversification Requirements
2. Default Investment Protection
3. Mapping Protection
4. Investment Advice Exemption
5. Automatic Enrollment Plans
6. EGTRRA Permanence
7. Periodic Benefit Statements
8. Miscellaneous Provisions

1. Diversification Requirements

1. Diversification Requirements

Requirements of the Law...

- Effective generally for plan years beginning in 2007
  - Special effective date for plans subject to a collective bargaining agreement
- There is a 3-year transition rule for employer contributions invested in employer securities prior to the effective date of this rule
  - 1st year: *33%*
  - 2nd year: *66%*
  - 3rd year: *100%*
- Transition rule does not apply to participants who by the beginning of the 2006 plan year had 3 years of service and are age 55

1. Diversification Requirements

Requirements of the Law...

New Qualification Requirement

- A participant (or certain beneficiaries) in a defined contribution plan that holds publicly-traded employer securities must have the right to diversify his/her account(s) invested in employer stock
  - Elective deferrals and after-tax employee contributions invested in employer securities may be diversified immediately
  - A participant (or beneficiary) with 3 years of service must be permitted to diversify nonelective employer contributions and employer matching contributions

    NOTE: This is not a 3-year rolling requirement
- Eligible individuals must be provided the right to diversify these investments at least quarterly

1. Diversification Requirements

Requirements of the Law...

Exceptions

- Exempt from the diversification requirements
  - Privately held companies
  - Stand-alone ESOPs that do not hold contributions (or earnings) subject to special nondiscrimination tests that apply to elective deferrals, employee contributions (i.e. after-tax contributions) or matching contributions
  - One-participant plans

1. Diversification Requirements

Requirements of the Law...

Investment Alternatives

- Individual must be provided a choice of at least 3 investment options (other than employer securities, of course), each of which is diversified and has materially different risk and return characteristics

1. Diversification Requirements

Requirements of the Law...

Notice to Participants

- No later than 30 days prior to the first date that participants are eligible to exercise their diversification rights, they must be provided notice
- Notice must contain their right to diversify as well as a description of the importance of diversification
- Failure to provide notice = penalty of up to $100 per day per person
- Treasury to issue model notice within 180 days of enactment

1. Diversification Requirements

Client Considerations...

- Phase in or not?
  - Impact on stock value
  - Thinly traded stock issues
  - Phase in rules only apply to stock investments before the 2007 plan year.
- Notice requirement (30 days before participant is eligible to diversify)
  - IRS model notice not due until mid-February 2007
  - First required notice due December 1 for calendar year plans
- Diversification rules may dilute the benefits of stock based investments.

2. Default Investment Protection

2. Default Investment Protection

Requirements of the Law...

- Effective date
  - Plan years beginning after December 31, 2006
- Expands ERISA 404(c) fiduciary protection
  - Treats participant as having exercised control under ERISA 404(c) when the plan includes certain default investment arrangements
  - DOL to issue final regulations by mid-February 2007
  - Not limited to auto contribution/auto-enrollment arrangements

2. Default Investment Protection

Requirements of the Law...

- Requirements for expanded fiduciary protection
  - Investments chosen in accordance with DOL regulations
    - Regulations to provide guidance on appropriateness of designating certain investments as "default investments" that use a mix of investments and asset classes consistent with "long-term capital appreciation or long-term capital preservation, or both"
    - Regulations to be issued within six months of date of enactment (DOL proposed regulations to be published in Fed. Reg. tomorrow)
  - Plan gives participant notice
    - Reasonable period before each plan year
    - Explains participant's right to choose among investments
    - States how account will be invested

2. Default Investment Protection

Client Considerations...

- Does not remove sponsor's fiduciary duty in choosing investments
- DOL proposed regulations offer principles about acceptable asset mixes, not list safe harbor funds.
  - Acceptable options include:
    - Target date funds
    - Life style funds
    - Balanced options
    - Professionally managed accounts
- Sponsors should be prepared to review their existing default option once the DOL regulations are published.

3. Mapping Protection

3. Mapping Protection

Requirements of the Law...

- Applicable generally to plan years beginning in 2008 with special rule for plans subject to collective bargaining agreements

- Clarifies that ERISA 404(c) fiduciary safe harbor applies to a change in investment options where
  - The new options are reasonably similar in characteristics, including risk and rate of return to the prior options

    and

  - Certain notice is provided to participants and beneficiaries within a particular timeframe

    and

  - Participant's investment immediately prior to change was participant's exercise of control over account and participant did not provide affirmative instructions to plan contrary to proposed reinvestment

3. Mapping Protection

Requirements of the Law...

- Notice to participants
  - To be provided in writing within 30 to 60 days prior to effective date of change in investments
  - Must include
    - Information comparing existing and new investment options
    - Explanation that in absence of new directions, account will be invested in new options with characteristics reasonably similar to existing options

3. Mapping Protection

Client Considerations...

- Provides a little more protection to employers when they need (or choose) to change available investment options
- Does not address non-similar funds
- Comparative “Information” not defined

4. Investment Advice Exemption

4. Investment Advice Exemption

Requirements of the Law...

- Effective date
  - Applicable to investment advice offered after 2006
- Statutory exemption for
  - Providing investment advice to participants
  - Investment transactions pursuant to the advice
  - Direct/indirect receipt of fees or other compensation in connection with such activities
- Allows brokerage firms, banks, insurance companies and registered advisors who administer plan or act as trustee to become “fiduciary advisors”

4. Investment Advice Exemption

Requirements of the Law...

- Two ways to qualify as an "eligible investment advice arrangement"
  - ***First***, fees unrelated to participant investment choices
    - Available to qualified retirement plans and IRAs
  - ***Second***, investment advice arrangement uses a computer model under an investment advice program
    - Available initially only to qualified retirement plans, DOL to study feasibility of extending to IRAs, to be completed by December 2007
      - If feasible exemption extended; if not, DOL to issue new class exemption for IRA advice

4. Investment Advice Exemption

Requirements of the Law...

- Computer model requirements
  - An eligible investment expert must initially certify computer model meets parameters
    - Recertification required for “material” changes
  - Parameters include
    - Uses generally accepted investment theories
    - Utilizes participant information (e.g., age life expectancy, retirement age, risk tolerance, other assets)
    - Does not favor investments offered by fiduciary advisor
    - Takes into account all investment options offered

4. Investment Advice Exemption

Requirements of the Law...

- Requirements
  - Arrangement expressly authorized by an unrelated plan fiduciary (for defined contribution plans only)
  - Independent audit report
    - For qualified plans: annually
    - For IRAs: per DOL guidance
  - Advance written notice to participants
  - Fiduciary advisor must provide securities disclosures
  - Transactions must occur at participant's direction
  - "Reasonable" compensation to fiduciary advisor
  - Transaction terms must be as favorable to plan as an "arm's-length transaction"
  - Maintenance of records for 6 years and updating of information to participant by fiduciary advisor

4. Investment Advice Exemption

Requirements of the Law...

- Written notice describes
  - Role of any party related to financial advisor in development of investment advice program and selection of available options
  - Past performance and historical rates of return
  - Fees or other compensation related to advice received by fiduciary advisor
  - Manner in which participant or beneficiary information will be used or disclosed
  - Types of services provided by fiduciary advisor
  - Advisor acting as fiduciary
  - Participant may arrange for other investment advice

4. Investment Advice Exemption

Client Considerations...

- What is the impact of this provision on DOL Advisory Opinion 2001-09A (SunAmerica)?
  - Unlike the ***SunAmerica*** Advisory Opinion, PPA imposes some additional conditions. For example,
    - PPA looks at ***all of the plan's investment options***
    - Advice may be limited to discretionary advice whereas the DOL opinion appeared to contemplate both discretionary and nondiscretionary investment advice
  - Some question continuing validity of ***SunAmerica***
    - ***BUT NOTE,*** Senator Enzi (Chair, Senate HELP Committee) indicated in August 3, 2006 Congressional Record that PPA "***does not alter the current or future…[r]ather, the legislation builds upon these advisory opinions…***"
  - ***We will have to wait and see…***

5. Automatic Enrollment Plans

5. Automatic Enrollment Plans

What is an Eligible Automatic Contribution Arrangement

- Eligible Automatic Contribution Arrangements
  - Provides for deferrals to be made automatically unless the participant elects to opt out or defer at another rate.
  - Absent participant direction, automatic deferrals are invested according to default investment guidelines issued by the DOL
  - Advance notice of the automatic deferral arrangements provided to all affected participants
  - Applies to 401(k), 403(b) and 457 plans.

5. Automatic Enrollment Plans

Applies to all Eligible Automatic Enrollment Arrangements

- State law preemption (effective immediately?)
- Return of “erroneous automatic contribution” (effective for plan years beginning in 2008)
  - Employee must request within 90 days from the first paycheck to which automatic deductions applied.
- Excess contribution return extended to 6 months for automatic plans (vs. 2_ months for non-auto enroll)
  - Doesn’t have to be a safe harbor plan
  - Note – refunds made within due date (2 _ or 6 months) taxed in year of receipt.

5. Automatic Enrollment Plans

Requirements of the Law...

- State Law Preemption Requirements
  - Participant must have right to change percentage or to elect out
  - Contributions invested in accordance with DOL regulations
  - Advance notice requirement satisfied
    - Explanation of right to change percentage or to opt out
    - Participant has reasonable period of time after receiving notice to make such election
    - Explanation of default investments
    - If notice not provided, ERISA penalty of up to $1,100 per day applies

5. Automatic Enrollment Plans

Requirements of the Law...

- Return of contributions
  - Effective date
    - Plan years beginning after December 31, 2007
  - Plan may allow employees to elect to receive an "erroneous automatic contribution" within 90 days of date first automatic contribution was made
    - Return of contributions and earnings
    - Ordinary income in year amount returned
    - 10% early withdrawal penalty does not apply
  - Matching contributions generally forfeited

5. Automatic Enrollment Plans

Requirements of the Law...

- 6 months to refund
  - Excess contributions return extended to 6 months after end of plan year
    - 10% excise tax does not apply
    - Taxable income in year distributed

5. Automatic Enrollment Plans

New Safe Harbor Plan

- New safe harbor plan
  - Effective date
    - Plan years beginning after December 31, 2007
  - Referred to as " Qualified Automatic Contribution Arrangements"

5. Automatic Enrollment Plans

New Safe Harbor Plan

- New safe harbor plan requirements
  - General Requirements
    - All participants included, except those with previous election
    - Employee and employer contribution requirements
    - Notice to eligible participants
    - Participants afforded reasonable period after receiving notice to elect different amount or to opt out
  - Notice
    - Provided a "reasonable period" before start of plan year
    - Explains the automatic contribution feature and options
    - Identifies default investment options

5. Automatic Enrollment Plans

New Safe Harbor Plan

- Exempt from ADP, ACP and Top-heavy requires
  - Default deferral elections
    - Minimum default: 3% in Year 1
    - Increasing by 1% each year thereafter up to a 6% deferral rate
    - Automatic increases may not exceed 10% automatic
  - Employer Contribution requirements
    - Match 100% of first 1% deferred, then 50% on the next 5% deferred (3.5% of pay). Must be available to all NHCEs. Other conditions apply for ACP.

      or
    - A 3% nonelective contribution made to all NHCEs eligible to participate, regardless of whether the participant makes a contribution to the plan of at least 3%
    - Employer contributions must be 100% vested after 2 years of service
    - Distribution of employer contributions limited to 401(k) restrictions

5. Automatic Enrollment Plans

Client Considerations...

- Traditional safe harbor match is 4% of pay vs. QACA safe harbor match is 3.5% of pay?
- Traditional safe harbor 100% immediate vesting vs. QACA requires 100% vesting in 2 years.
  - Is the safe harbor necessary for an automatic enrollment plan?
  - Which safe harbor will cost more?
- Automatic enrollment plans will continue to grow in popularity.
  - Clients can phase in the safe harbor rules over time (e.g.)
    1. Auto enroll new employees – yr 1
    2. Auto enroll all employees – yr 2 (not required for safe harbor)
    3. Auto increases – yr 3
- Notice requirements

6. EGTRRA Permanence

6. EGTRRA Permanence

Requirements of the Law...

- Provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 that were to sunset as of December 31, 2010 have been made permanent by PPA effective immediately
- Among the provisions that are now made permanent
  - Increased limits on contributions to qualified retirement plans, 403(b) tax-sheltered annuities and 457(b) deferred compensation arrangements
  - Catch-up contributions for those 50 and older
  - Availability of Roth 401(k) and Roth 403(b) plans
  - Increased compensation limits taken into account in determining benefits under qualified plans
  - Simplification of the top-heavy rules

6. EGTRRA Permanence

Requirements of the Law...

- Expansion of rollover opportunities, including for after-tax contributions
- Repeal of the “multiple use” test for 401(k) deferrals and contributions subject to IRC 401(m)
- Repeal of the “same desk” rule
- Increase in compensation-related limit for the maximum annual contributions to a defined contribution plan
- Modified deductions for employer contributions to qualified plans, including the exclusion of 401(k) plan deferrals
- Expanded requirements for notification of benefit accrual reduction amendments
- Faster vesting schedule for employer matching contributions
- Ability to reinvest ESOP dividend without loss of dividend deductions
- Automatic rollovers of certain mandatory distributions

6. EGTRRA Permanence

Client Considerations...

- Clients may now choose to adopt certain features under EGTRRA
  - Roth contributions

7. Periodic Benefit Statements

7. Periodic Benefit Statements

Requirements of the Law...

- Effective, generally, for plan years beginning in 2007, with a special effective date for plans subject to a CBA
- Defined contribution plan participants must be provided a benefit statement at least once a year if they do not have the right to direct the investments in their accounts
- Defined contribution plan participants or beneficiary who have the right to direct the investment of assets in their accounts must be provided a ***quarterly*** benefit statement
- Beneficiaries not described above must be provided a benefit statement upon request

7. Periodic Benefit Statements

Requirements of the Law...

- Must include the following information
  - Total benefits accrued and vested benefits
  - An explanation of any permitted disparity or floor-offset arrangement
  - The value of investments, including employer securities
  - Where participant has right to direct investments, and any limitations on those rights
  - An explanation of the importance of a diversified and well-balanced investment portfolio, including a statement about the risk of holding more than 20% of a portfolio in the security of one entity

    and
  - A notice directing the participant or beneficiary to the DOL website for sources of information on individual investing and diversification
- PPA direct DOL to issue model statement

7. Periodic Benefit Statements

Client Considerations...

- Model statement from DOL not due until August 17, 2007.
- Most defined contribution plans probably meet the timing requirements for participant statements
- Additional notice language will have to accompany each statement
  - Additional notice requirements may contribute to information overload.
  - Will participants read the notices?

8. Miscellaneous Provisions

H I G H L I G H T S

8. Miscellaneous Provisions

- Faster vesting of employer nonelective contributions
  - 3-year cliff vesting

    or
  - 2-year (20%) to 6-year graded vesting schedule
  - Generally effective for plan years after 2006 for employees with at least 1 hour of service after the effective date
  - Client considerations
    - What cost impact will this have
    - Decide to apply faster vesting to prior contributions or only future contributions

8. Miscellaneous Provisions

- Within 180 days after enactment, Treasury to expand hardship distribution rules for certain beneficiaries

- Permits rollover to an IRA by nonspouse beneficiaries *(effective for distributions after December 31, 2006)*

  - *Client considerations – might inform non-spouse beneficiaries of this new law in case they want to delay a distribution until January 1, 2007.*

- Permits distributions from qualified retirement plans, 403(b) tax-sheltered annuities and governmental 457 plans to be rolled over to a Roth IRA *(effective for distributions after December 31, 2007)*

8. Miscellaneous Provisions

- Permits direct payment of tax refund to an IRA *(effective for taxable years beginning after December 31, 2006)*

- Permits penalty-free withdrawals to certain reservists *(effective for those called to active duty for at least 179 days after 9/11/2001 and before 12/31/2007)* and to certain public safety employees *(effective after date of enactment)*

8. Miscellaneous Provisions

- Form 5500
  - Effective date
    - Plan years beginning after December 31, 2007
  - Certain plan information included in the Form 5500 to be filed with DOL in an electronic format to accommodate Internet display
    - Information will be displayed within 90 days after filing on DOL Internet website
    - Also will need to be displayed on any plan sponsor Intranet website in accordance with regulations
- PPA amendments generally required by last day of 2009 plan year.
  - Governmental plans have 2 additional years.

8. Other Milliman Webinars

- Milliman Update on Pension Reform for Defined Benefit Plans – September 27th at 3:00 ET
- Milliman Update on Pension Reform for Multi-Employer Plans – September 28th at 3:00 ET

Questions?