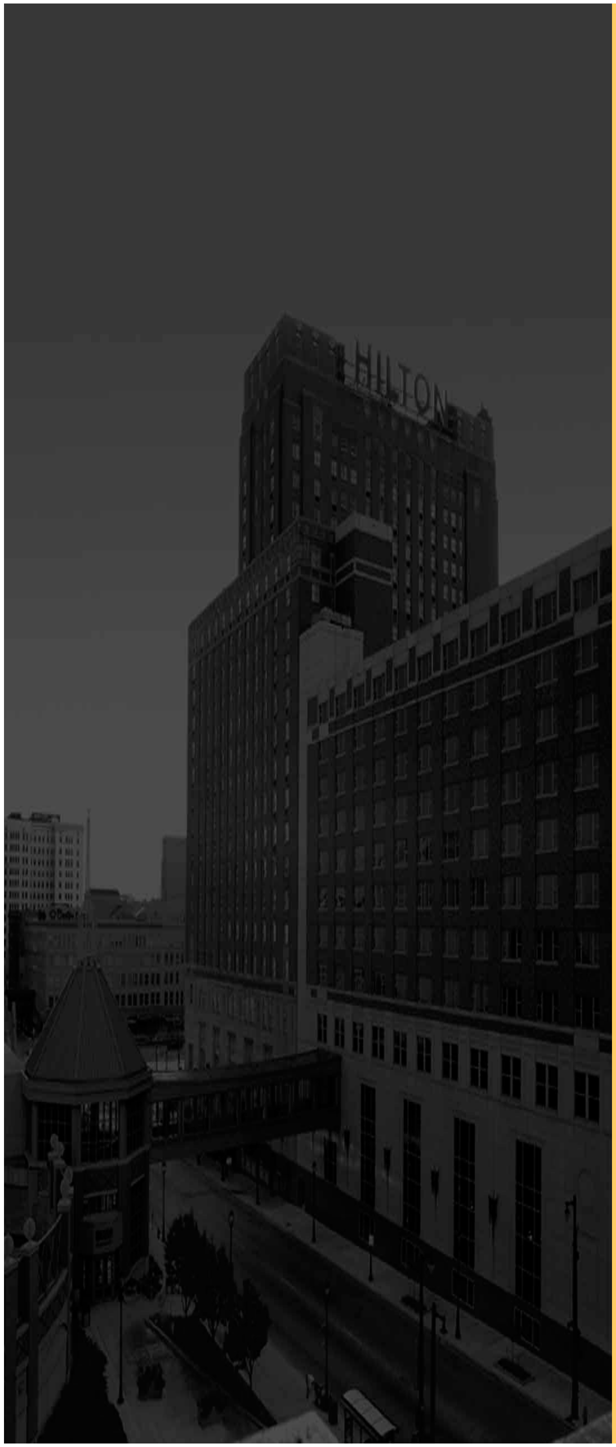

The Schilffarth – Schnoll Group of RBC Dain Rauscher

- 1st Annual
- Institutional Investment Forum

- November 14 – 15, 2006

Need Based … Future Focus

The Changes in ERISA Legislation

Moderator: **Howard M. Schnoll, CPA**
Senior Vice President
The Schilffarth – Schnoll Group of RBC Dain Rauscher

Speaker: **John E. Donahue**
Shareholder, Employee Benefits Practice Group
Godfrey & Kahn S.C.

Pension Protection Act of 2006 (PPA)

- Enacted on August 17, 2006
- Funding of defined benefit (DB) plans was primary focus, but there are many other changes
- Some retroactive and immediate changes, but most have deferred effective dates

Defined Benefit Plans

- Most provisions do not apply until 2008 or later, but the exceptions include
  - Higher deduction limits for 2006
  - Authorization of cash balance and other hybrid plan designs after 6/29/05
- Single employer plan changes include
  - New funding standards with accelerated funding requirements for "at-risk" plans
  - Asset "smoothing" reduced to two years
  - "At-risk" status will trigger benefit restrictions and a prohibition against funding deferred compensation for key employees

Defined Benefit Plans *(cont.)*

- Beginning in 2008, a multiemployer plan will have to
  - Amortize liability changes over no more than 15 years
  - Satisfy tests to avoid "endangered," "seriously endangered" or "critical" status
  - Adopt a "funding improvement plan" if it becomes endangered or seriously endangered
  - Adopt a rehabilitation plan if its status is certified as critical

Defined Contribution (DC) Plan Changes

Selected changes include

- Faster vesting
- Automatic enrollment in 401(k) plans
- Investment advice for participants
- Diversification for publicly traded employer stock
- Default investments
- Other fiduciary matters
- Distributions and rollovers
- EGTRRA permanency

Faster Vesting in DC Plans

- PPA extends 2001 changes for matching contribution accounts to all employer contribution accounts
  - 100% vesting at three years of service
  - 20% per year of service beginning with second year
- Generally effective for plan year beginning in 2007, but exceptions for
  - Leveraged ESOPs with loans outstanding 9/26/05
  - Collectively bargained plans
- Plan may require an hour of service after new law first applies

Automatic Enrollment in 401(k) Plans

- Most effective way to encourage savings
- Authorized by IRS but employers remained concerned about
  - Conflicting state payroll laws
  - Liability for default investment selections
- PPA addressed both issues
  - Immediate preemption of state laws affecting automatic enrollment
  - Default investments can qualify for “404(c) protection” in 2007

Automatic Enrollment in 401(k) Plans *(cont.)*

- Beginning in 2008 PPA will provide additional incentives for automatic enrollment
  - For "automatic contribution arrangements"
    - 90-day period for withdrawal of unintended deferrals
    - Administrators will have 3½ additional months to make corrective distributions without penalty
    - Corrective distributions will be taxed when received
  - Additional ADP/ACP safe harbor for "qualified automatic contribution arrangements"
    - Waivable enrollment at deferral of 3% or more, increasing over 3 years to 6% or more (but not more than 10%)
    - 3% nonelective contribution or a matching contribution up to 3.5% (100% of first 1% plus 50% of the next 5%)
    - 2-year cliff vesting for these required employer contributions

Investment Advice

- Beginning in 2007, a new prohibited transaction exemption will allow "fiduciary advisers" to provide advice on their own funds
  - Limited to advice for participants and beneficiaries (not plan level advice)
  - "Fiduciary advisers" include registered investment advisers, banks, insurance companies, broker/dealers, their affiliates and their eligible employees
  - To qualify as an "eligible investment advice arrangement," one of two models must be followed

Investment Advice *(cont.)*

- Two alternatives will be available to plans
  - Fee leveling—fiduciary adviser’s fees don’t vary with investment selection
    - Possible distinction between individual adviser and his or her employer
  - Computer model—advice is determined by computer model accounting for all plan options
    - No bias in favor of adviser’s products
    - Annual certification by independent investment expert
    - Participant may still request other advice, but the permitted scope of response is uncertain

Investment Advice *(cont.)*

- Both alternatives require
  - Authorization by an independent plan fiduciary
  - Extensive disclosures
  - An independent audit for compliance
- The plan sponsor does not have to monitor specific advice, but remains liable for initial selection and periodic review of the fiduciary adviser
- The computer model alternative will not be available for IRAs, at least initially

Diversification From Employer Stock

- Participants must be able to diversify out of publicly traded employer stock
  - At all times for elective deferrals and other employee contributions
  - After three years of service for employer contributions
- Exceptions
  - Stand-alone ESOPs, but not KSOPs
  - Three-year phase-in for employer contributions invested in employer stock as of 12/31/06
    - Except for participants who attained age 55 and completed three years of service before the 2006 plan year

Diversification From Employer Stock *(cont.)*

- A plan must offer at least three investment alternatives with differing risk-return profiles
- Generally effective for 2007 plan years
  - Delays for collectively bargained plans
- Required notice due 30 days in advance of right to diversify
  - First notices due by 12/2/06
  - Applies even if plans have never restricted diversification

Default Investments

- Beginning in 2007 "404(c) protection" can extend to a plan's default investment(s) if
  - The selection complies with Labor Department regulations
  - The participant has made no investment election, and
  - The participant must have received reasonable notice
- DOL must issue final regulations by 2/17/07

Default Investments *(cont.)*

- Proposed regulations were issued on 9/27/06
  - Three types of "qualified default investment alternatives"
    - A life cycle or targeted retirement date fund
    - A balanced fund
    - An investment management service arrangement
  - A participant must be able to transfer out of the default investment
    - Without penalty
    - At least quarterly
    - To at least three diversified options with differing risk-return characteristics
- Beginning in 2008, similar protection will be available for "mapping" and "blackouts"

Other Fiduciary Matters

- Prohibited transaction exemptions
  - New statutory exemptions for transactions with service providers who are not fiduciaries
    - Key requirement is "adequate consideration"
      - Plan receives no less than adequate consideration
      - Plan pays no more than adequate consideration
    - Exemptions for
      - Cross trading for large plans ($100 million or more)
      - Foreign exchange transactions
      - Block trades
      - Trades using regulated electronic communication trading systems

Other Fiduciary Matters *(cont.)*

- New 14-day correction period for prohibited trades that do not involve
  - Employer securities
  - Self-dealing
- DC plans no longer need to purchase the "safest available annuity," just a prudent one
- These changes became effective 8/18/06

Distributions and Rollovers

- Tax-free IRA donations during 2006 and 2007
  - IRA owner must be 70½
  - Maximum of $100,000 per year
  - Payments must be directly to charities, not private foundations or donor-advised funds
- After 2006 a nonspouse beneficiary <u>may</u> be allowed to elect a direct rollover from a plan to an "inherited IRA"

Distributions and Rollovers *(cont.)*

- After 2006 the nontaxable portions of most distributions from qualified plans can be rolled over to other plans or 403(b) annuities
  - Must be a trustee-to-trustee transfer
  - The recipient must provide for separate accounting
- After 2006 pension plans may permit in-service distributions at or after age 62

Distributions and Rollovers *(cont.)*

- By 2/13/07 IRS must change most of its rules to recognize hardships of beneficiaries
  - Changes will be optional for plans

EGTRRA Permanency

- PPA makes permanent the qualified plan and IRA enhancements enacted in 2001 that were to expire 12/31/10
  - Increased limits on employer and employee contributions
  - "Catch-up" contributions by those 50 or older
  - Roth deferrals under 401(k) and 403(b) plans
  - Repeal of coordination requirements for 457(b) plans