

employment & employee benefits developments special report: the pension protection act of 2006 — fall 2006

A landmark in pension legislation, the Pension Protection Act of 2006 (“PPA”) was enacted on August 17, 2006. The PPA overhauls many benefits-related provisions of the Internal Revenue Code and the Employee Retirement Income Security Act of 1974 (“ERISA”). Among other things, the PPA significantly changes the funding requirements for defined benefit pension plans, imposes potentially heavy new financial obligations on employers contributing to multiemployer pension plans, removes barriers to automatic enrollment programs, changes important aspects of plan administration for many 401(k) and other defined contribution plans and makes sweeping changes to the plan asset rules affecting investment funds. In this newsletter, we provide coverage of the PPA’s most noteworthy provisions.



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PPA’s Comprehensive Changes for 401(k) Plans

The PPA introduces new rules for 401(k) plans and other defined contribution plans, generally making it easier for employers to enroll employees in such plans automatically. The new legislation encourages employers to make more diverse default investment elections on behalf of participants. Qualified “investment advisors” will now be allowed to provide investment advice to plan participants if certain requirements are met. The PPA accelerates vesting of employer profit sharing and other nonelective contributions and requires greater diversification of plans that hold publicly traded employer securities.

Automatic Enrollment

Traditionally, 401(k) plans and 403(b) plans were designed to require new employees to sign up to participate. Approximately a third of eligible workers do not participate in their employer sponsored plans. In order to combat low rates of participation, the PPA encourages (but does not require) automatic enrollment of employees. Employers may automatically enroll employees at specified contribution levels, unless the employee elects not to enroll or to have contributions made at a different level. Employers may either follow the safe-harbor rules below or can offer automatic enrollment without following the safe-harbor as long as the annual notice and default investment provisions are followed.

New Nondiscrimination Safe Harbor: Effective for years beginning after December 31, 2007, employers may take advantage of a new safe harbor for nondiscrimination testing of 401(k) and 403(b) plans by adopting a qualified automatic enrollment feature (“QAEF”) that meets the following conditions.

Employee Contributions: Under the QAEF, each eligible employee is treated as having elected to make deferrals at a uniform percentage set by the employer, which cannot exceed 10 percent of compensation and must satisfy the following minimums: 3 percent of compensation for the first year, 4 percent during the second year, 5 percent during the third year, and 6 percent during the fourth year and thereafter. This feature makes it easier for companies over time to automatically increase the percentage of an employee’s salary that is invested in his or her account. Automatic deferrals cease if the employee opts out or affirmatively chooses a different deferral percentage.

Employer Contributions: The new rules also encourage companies to meet certain minimum requirements for matching employer contributions. The employer must provide either (i) a minimum matching contribution that matches the first 1 percent of compensation on a dollar-for-dollar basis and contribute fifty cents for each additional dollar up to 6 percent or (2) a minimum non-elective employer contribution equal at least 3 percent of an employee's compensation.

Vesting: Under the QAEF, employer contributions must be 100 percent vested after two years of service.

Notice to Employees. Each employee must be given a notice that explains (1) the employee's right to elect not to have automatic contributions made on his or her behalf or to elect to have contributions made in an amount other than the uniform percentage set by the employer, (2) the right to make investment elections, and (3) how contributions made under the automatic enrollment arrangement will be invested in the absence of any investment election by the employee. Employees must be given a reasonable period of time after they receive the notice and before the first contribution in which they can make an election with respect to contributions and investments.

New Withdrawal Option: Plans may be designed to provide that if a participant opts out of automatic enrollment within 90 days of the first automatic contribution, he or she may withdraw enrollment contributions and earnings without being subject to the penalty tax for early distributions prior to age 59 1/2.

Preemption of State Law. Effective immediately, Congress settled that state laws that would directly or indirectly prohibit or restrict an automatic enrollment arrangement (e.g., state laws limiting an employer's right to take deductions from an employee's wages) are preempted, provided a specified annual notice is given.

Default Investment Options

Effective for plan years beginning after December 31, 2006, the PPA extends protection under Section 404(c) of ERISA to plans that use automatic enrollment features. Generally, plan fiduciaries are not held responsible for results of investment decisions made by participants, provided the Department of Labor regulations are met. Previously, ERISA Section 404(c) did not afford relief if the participant failed to make an affirmative investment decision. The PPA makes a safe harbor available for plans that implement a safe harbor default investment fund for participants who fail to make an investment decision provided that participants receive an annual notice detailing their rights and obligations under the default arrangement. This notice must include the participant's right to specifically elect to exercise control over the assets in his or her account and an explanation of how contributions made under the arrangement will be invested in the absence of any investment election by the plan participant. The participant must have a reasonable period of time after receipt of the notice and before the assets are first invested to make such an election.

On September 27, 2006, the Department of Labor issued regulations that define the safe harbor qualified default investment alternative ("QDIA"). The regulations permit employers to designate more broadly diversified default

investments rather than the stable value fund. The types of investments that qualify as a QDIA include lifecycle and target maturity funds, balanced funds and professional managed accounts. Once the regulations are finalized, plan sponsors will be able to designate such funds rather than fixed income funds without concern about potential fiduciary liability.

Investment Advice to 401(k) Participants

Effective for advice provided after December 31, 2006, the PPA relaxes rules that have hindered 401(k) plan sponsors from offering specific investment advice services to plan participants. The PPA allows "fiduciary advisors" to provide investment advice and receive fees for such advice through an "eligible investment advice arrangement."

In order to allay fears that investment advice may be in fiduciary advisors' self-interest, an eligible investment advice arrangement must either provide that fees for investment advice do not vary with different investment options (referred to as a level or flat fee arrangement) or use an unbiased computer model in connection with providing investment advice. Procedures and requirements relating to the use of a computer model are set out in the PPA.

Before it sends out its first investment advice, and annually thereafter, the fiduciary advisor must provide participants with a written notice that contains information including a disclosure of fees and other compensation related to such advice and a description of past performance and historical rates of return. The DOL is mandated to issue a model notice.

The eligible investment advice arrangement must be expressly authorized by a plan fiduciary other than the person offering the investment advice program, a person providing investment options under the plan or an affiliate of either. An independent auditor must review the arrangement annually for compliance. Plan fiduciaries will continue to be subject to ERISA's fiduciary and prudence requirements regarding the selection and monitoring of the investment advisors.

Accelerated Vesting of Employer Nonelective Contributions

The PPA requires that, effective for plan years beginning after December 31, 2006, all employer profit sharing and other nonelective contributions must be 100 percent vested after three years of service or must vest at the rate of 20 percent for each year of service, beginning with a participant's second year of service and ending with 100 percent after six years of service. This is the same vesting requirement that currently applies to matching contributions. Thus, the PPA prohibits five-year cliff and seven-year graded vesting schedules for a participant's employer-provided benefit. In applying the new rules, employers can choose to apply the new faster vesting schedule to all contributions in the participant's account or only to contributions made after January 1, 2007. Collectively bargained plans may have later effective dates.

Diversification of Company Stock

The PPA requires defined contribution plans holding employer stock to let employees invest their employee contributions in alternative investments. Participants with at least three years of service must be allowed to diversify their employer contributions as well. Plans must offer a choice of at least three investment options, other than

employer securities, to which investments can be directed. For company stock acquired with employer contributions before the effective date of this provision (plan years beginning after December 31, 2006), the diversification requirement phases in over three years. These requirements do not apply to an ESOP that does not hold employee or matching contributions and is a separate plan from all other qualified retirement plans of an employer.

PPA Overhauls Funding Requirements for Defined Benefit Pension Plans

The Pension Protection Act of 2006 (the "PPA") overhauls the funding rules governing single-employer defined benefit pension plans. The changes increase annual funding costs for employers because they will have to fund plans more rapidly. Among other things, the new law also introduces new actuarial assumptions, tighter smoothing methods, shorter amortization periods, expanded notice and disclosure requirements, and increased deduction limits. Here are the key provisions of the new rules, most of which will take effect for the 2008 plan year.

Funding Rules. The PPA increases the funding target for single-employer defined benefit pension plans from 90 percent to 100 percent of the plan's present value of all accrued benefit liabilities. This change requires employers to make additional contributions to plans. The new funding target will be phased in over four years. Plan sponsors should determine whether additional contributions are required so that plan assets meet the new thresholds.

Shorter Amortization Periods. If a plan is underfunded, the PPA requires an employer to make a contribution to the plan to correct the shortfall over seven years, rather than the current 30-year period.

Actuarial Assumptions. Defined benefit plans may offer lump sum distributions as a payment option instead of annuity distributions, and many plans require lump sum distributions for small benefits. One of the central underpinnings of pension funding reform is selecting an appropriate interest rate to calculate the lump sum amount. (If the interest rate is too low, the plan's liabilities are overstated; conversely, if the rate is too high, the liabilities are understated.) The PPA adopted a "modified yield curve" approach to determining the interest rate for measuring pension liabilities. This approach is based on the 24-month average yield curve for the top three grades of corporate bonds. While the current method uses a single interest rate for calculating a pension plan's liabilities, the PPA requires employers to use different rates for participants of different ages, depending on when benefits are expected to be paid. The modified yield curve approach will be phased in over three years beginning in 2008. The PPA also requires employers to value pension liabilities using a mortality table prescribed by the IRS, which will be updated every 10 years. It is anticipated that the Treasury will adopt the mortality tables proposed in December 2005.

Asset Valuation. The PPA changes the rules for valuation of plan assets for purposes of determining a plan's funded

Expanded Hardship Distributions

Effective immediately, the PPA expands the availability of distributions on account of financial hardship to any beneficiary of a participant, which may include a domestic partner or other person who is not a dependent within the meaning of the Internal Revenue Code. •

status. Currently, the law allows employers to use a "smoothing" method (i.e., averaging method) to value plan assets over a five-year period rather than using the current fair market value. To combat problems of underfunded plans, the PPA restricts plans' ability to utilize asset smoothing. The PPA permits employers to use, at most, a two-year average for calculating the value of plan assets. The new rules will not only reduce the effect of market fluctuations, but also provide less flexibility than current rules. Plan sponsors should review their investment policies and asset allocations to reduce asset volatility.

Credit Balances Limited. Credit balances generally occur if a plan sponsor contributes more than the minimum required contribution for a plan year. Prior to the PPA, such credit balances could be used to reduce the minimum required contribution for the year. To improve a plan's financial disclosures, the PPA imposes a new set of rules to address credit balances, which is one of the most complex aspects of the new funding requirements. If a plan is less than 80 percent funded for the preceding plan year, the employer may not subtract credit balances from the asset calculation to offset minimum required contributions for the year. The Treasury is to provide much-needed guidance.

At-Risk Plans. The PPA imposes new accelerated funding requirements on certain underfunded plans — i.e., those plans that are "at risk." A plan will be deemed "at risk" if its funded ratio is less than 80 percent using standard actuarial assumptions and less than 70 percent funded using worse-case scenario — or "at-risk" — assumptions (i.e., assuming employees take the most expensive benefits and retire as early as possible). If a plan is "at risk," it will be subject to additional actuarial assumptions that result in increased funding targets. Plans with 500 or fewer participants are exempt from the at-risk rules.

Benefit Restrictions for Underfunded Plans. Plans that are "at risk" (less than 80 percent funded) will face significant plan design restrictions. For example, employers of such underfunded plans are prohibited from amending the plans to increase benefits, establishing new benefits, changing the rate of benefit accruals or improving the plan's vesting schedule. Lump sum distributions are also limited, and — in certain circumstances — prohibited. If a plan falls to less than 60 percent funded, plan benefits are frozen and distributions are further limited.

Higher Deductions for Employer Contributions. The PPA adopts new limits on the maximum deductible contributions for employers with single-employer defined benefit plans

and relaxes the combined deductible limit for employers with defined benefit and defined contribution plans. This will allow employers to make larger contributions in profitable years. This provision applies for contributions for taxable years beginning January 1, 2008. For 2006 and 2007, however, the deduction limit has been increased from 100 percent to 150 percent of current liability.

PBGC Variable Rate Premiums. The PPA extends prior variable-rate premium rules for plans with a funding shortfall. Such plans will continue to pay a variable rate premium of \$9 for each \$1,000 of underfunding. The PPA eliminates the full-funding exception from variable rate premiums. The PPA makes permanent the premium to be paid by certain terminated plans transferring their liabilities to the PBGC. This premium is \$1,250 per participant per year for three years.

Expanded Disclosure and Reporting. The PPA creates new disclosure and reporting obligations for defined benefit pension plans, including a requirement that plans provide an annual funding notice within 120 days after the end of the plan year to participants, beneficiaries and the PBGC. This new notice is first required for plan years beginning in 2008. The new notice will replace the Summary Annual Report (SAR), but will compel more disclosure than previously required. The Department of Labor will publish

a model notice. Violations of the new notice requirements will result in significant penalties. In addition, for plan years beginning in 2008, the IRS Form 5500 must provide the plan's funded percentage. Basic plan and actuarial information from the Form 5500 will be displayed on the DOL's web site and the plan sponsor's private web or intranet site.

Limitations on Deferred Compensation. Prior to the PPA, defined benefit plan sponsors that also sponsored a nonqualified deferred compensation plan were able to set aside amounts to fund the nonqualified deferred compensation without regard to the funding status of the defined benefit plan. Under the PPA, however, when a defined benefit pension plan is at risk or the sponsoring employer is in bankruptcy, the employer is prohibited from setting aside or reserving amounts for nonqualified deferred compensation. If this rule is violated, the employee will be subject to an additional 20 percent tax and interest under Code Section 409A. This provision is effective immediately.

Although many of the new rules under the PPA are not effective until 2008, plan sponsors of single-employer defined benefit pension plans will want to begin planning immediately for changes for possible increases in contributions, new or expanded disclosure requirements, and other potential impacts. •

PPA Eases the 25 Percent Plan Asset Rule

For investment funds, one of the PPA's most important changes is that it narrows the situations in which the fund would be subject to the ERISA fiduciary rules and prohibited transaction restrictions. Previously, funds were subject to those rules and restrictions if 25 percent or more of the value of any class of equity interests was held by "benefit plan investors." Those investors included foreign pension plans, U.S. state and local government pension plans, and church plans, as well as ERISA-covered plans and IRAs. Now only the last two categories — ERISA-covered plans and IRAs — are defined as "benefit plan investors."

In addition, a fund of funds now counts toward the 25 percent threshold of the underlying fund only if more than 25 percent of any class of equity in the fund of funds is held by ERISA-covered plans and IRAs — and only in the proportion that such investors constitute of the fund of funds' total value. Formerly, an underlying fund would count a fund of funds as 100 percent owned by benefit plan investor money if more than 25 percent of any class of equity in the fund of funds met that description.

For more information, please go to: <http://www.srz.com/publications/publicationsDetail.aspx?publicationId=1558>.

PPA Validates Cash Balance and Hybrid Plans

The Pension Protection Act ("PPA") of 2006 and the Seventh Circuit's decision in *Cooper v. IBM Personal Pension Plan* validate cash balance and other hybrid plans. As a result, employers will have greater flexibility in designing retirement plans.

A cash balance plan, like other hybrid plans, is a type of defined benefit pension plan that resembles a defined contribution plan because benefits are expressed by reference to a hypothetical account balance for individual participants. Cash balance plans are attractive to many employers because they allow employers to maintain control over how assets are invested, bear the risk and

reward of their own investment strategies and have increased funding flexibility as contributions are based on actuarial valuations and reduce operating costs.

Cash balance plans came under attack in the late 1990s as a form of unlawful age discrimination. The courts have been divided on the issues. In 1999, the Internal Revenue Service responded to the charges of age discrimination by suspending the issuance of determination letters for cash balance plans that converted from traditional defined benefit plans and by beginning a study of cash balance plans. As a result of the controversy, employers' use of cash balance and other hybrid plans came to a halt.

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The PPA has resolved the controversy, lifting the cloud of uncertainty that has hovered over cash balance plans for the last decade. The PPA sanctions cash balance and other hybrid plans under ERISA, the Internal Revenue Code and the Age Discrimination in Employment Act. Prospectively, cash balance plans are protected against legal challenges including age-discrimination claims provided that the vesting schedules and interest crediting rates meet certain conditions. The PPA also establishes rules governing cash balance conversions from traditional defined benefit pension plans. Plan conversions that took place prior to June 29, 2005, however, are not afforded this protection.

In a related development, the Seventh Circuit Court of Appeals published its long-awaited decision in *Cooper v. IBM Personal Pension Plan* on August 7, 2006. That court, reversing the prominent decision by the Southern District of Illinois, held that cash balance plans do not discriminate against older workers in violation of ERISA. The circuit court opined that IBM's cash balance plan is age-neutral on its face, because there is no age-based difference in the amounts imputed to an older employee's and a younger employee's hypothetical accounts. The court explained that the differences in pension benefits in IBM's plan "are a function of differing years of service, salary history, or the years the balance has been allowed to compound," and not age. The Court observed that it is "essential to separate *age discrimination* from other characteristics that may be correlated with age."

While the PPA and the Seventh Circuit's decision generally validate the legality of cash balance plans, age discrimination claims may continue with respect to plans in existence before June 29, 2005. In addition, the Seventh Circuit's decision is not binding on New York's Second Circuit Court of Appeals, which has not yet addressed the issue. Further, plan sponsors should note that the Equal Employment Opportunity Commission is currently proposing revisions to its age discrimination regulations to clarify that employers are not barred from favoring older workers over younger ones, pursuant to a 2004 U.S. Supreme Court decision. Accordingly, plan sponsors and fiduciaries should review, with the assistance of counsel, any existing cash balance and other hybrid plans and may wish to create new ones. •

PPA's New Rules for Financially Troubled Multiemployer Pension Plans

The Pension Protection Act of 2006 (the "PPA") generally preserves the funding rules for multiemployer pension plans but it introduces dramatic new rules for financially troubled plans.

Classification of Financially Troubled Plans. The PPA requires a multiemployer pension plan's actuary to provide an annual certification of the plan's funded status and whether the plan is in "endangered" or "critical" status (as defined below) within 90 days after the start of each plan year. If the actuary determines that the plan falls into one of these categories, the plan must provide notice of that status to the participants, beneficiaries, contributing employers, the PBGC, Secretary of the Treasury and the Secretary of Labor within 30 days of the actuarial certification. If a multiemployer plan is in "endangered" or "critical" status, the plan sponsor must adopt a 10-year corrective program containing financial targets to improve the plan's status. The corrective program must be adopted within 240 days of the actuarial certification. The plan sponsor (i.e., the trustees) must propose options to the bargaining parties, such as reducing future benefit accruals and increasing contributions. If the bargaining parties cannot agree on a rehabilitation plan, future benefit accruals must be reduced (with advance notice to participants) on the earlier of (i) impasse as determined by the Secretary of Labor and (ii) within 180 days after the current collective bargaining agreement expires.

A plan will generally be deemed to be in "critical" status if (i) it is less than 65 percent funded and plan assets plus contributions for the current plan year and each of the six succeeding plan years are less than the benefits and administrative expenses projected to be payable during the current plan year and the next six years, or (ii) it will experience a funding deficiency in the current year or in the next three years (or four years if less than 65 percent funded). A plan is in "endangered" status generally if it is not in "critical" status but is less than 80 percent funded

or if it has or is projected to have an accumulated funding deficiency in the current or any of the six succeeding plan years. These rules apply for plan years beginning in 2008.

Penalties. Most of the obligations imposed on plan sponsors of financially troubled plans are associated with a \$1,100 per day penalty for noncompliance. In some instances, an excise tax may also be imposed. Contributing employers to a critical status plan are subject to an automatic surcharge of 10 percent of required contributions (5 percent in the first plan year of critical status) until a collective bargaining agreement is adopted that includes terms consistent with the corrective program. Plan sponsors should contact their fiduciary insurance carriers regarding whether coverage is available for the new penalties.

Expanded Disclosure and Reporting. The PPA expands the information that multiemployer plans must provide. An annual funding notice (for which the Department of Labor will publish a model) must be sent out within 120 days after the end of the plan year to participants, beneficiaries, bargaining parties, and the PBGC. Form 5500 will be changed to required additional information (e.g., critical/endangered status, summary of corrective program, withdrawal liability estimates, assets and liabilities of merged plans). Instead of summary annual reports (which will no longer be required), the summary of plan information must be provided to each union and contributing employer within 30 days of filing Form 5500 with significantly more disclosures. In addition, plans will have to provide certain materials (e.g., financial reports, actuarial reports, and withdrawal liability estimates) to contributing employers and participants upon request. Failure to meet these notice requirements can result in significant monetary penalties.

Reduced Amortization Period. The PPA would require amortization of new plan liabilities due to benefit increases

and changes in actuarial assumptions over 15 years, rather than the current 30 years. Multiemployer plans will have to be funded more quickly under the new rules.

Increased Maximum Deductible Contributions. The PPA increases the maximum deductible limit from 100 percent to 140 percent of current liability.

Withdrawal Liability. The PPA clarifies that a partial withdrawal is triggered if an employer ceases to have an obligation to contribute under one or more collective bargaining agreements but contracts out such work to an entity or entities owned or controlled by the employer. •

Roth Contributions Permitted for 401(k) and 403(b) Plans

Because Congress has made Roth 401(k) and 403(b) plans permanent, employers may now wish to consider amending their 401(k) and 403(b) plans to offer a Roth Contribution feature. Unlike traditional 401(k) or 403(b) plan contributions, Roth Contributions are made with after-tax dollars. The principal advantage of a Roth Contribution is that it results in tax-free earnings on the contributions made to the account. Although a participant pays taxes on the contributions made into the Roth account, all of the funds distributed (contributions plus earnings) are made on a tax-free basis. In a regular 401(k) or 403(b) account, the contributions and earnings are only tax-deferred and are subject to income tax at distribution.

Side-By-Side Comparison of Contributions

	401(k) and 403(b) Contributions	Roth Contributions
Eligibility	All participants can make contributions.	All participants can make Roth Contributions, unlike Roth IRAs, which have income limits of \$110,000 for single individuals and \$160,000 for married couples
Taxation of Contributions	Contributions are made with pre-tax dollars	Contributions are made with after-tax dollars
Contribution Limit	\$15,000 in 2006 (\$20,000 for age 50 or older); \$15,500 in 2007 (\$20,500 for age 50 or older)	Same limit as 401(k) and 403(b) contributions
Taxation of Earnings	Appreciation is tax-deferred	Appreciation is tax-free, subject to the five-year hold requirement
Taxation of Distributions	Contributions and earnings are taxed as ordinary income upon distribution	Contributions and earnings are tax-free if the distribution meets the five-year hold requirement

Roth Contributions — The Basic Rules

A participant's contribution to the plan must meet three requirements to be treated as a Roth Contribution:

- The participant must irrevocably designate the contribution as a "Roth Contribution" when it is made.
- At the time of contribution, the employer must treat the contribution as wages includible in the participant's gross income and subject to withholding requirements.
- The plan must maintain Roth Contributions in a separate account until distribution to the participant.

Participants can designate part or all of a 401(k) or 403(b) contribution as a Roth Contribution. The total amount contributed in any one year cannot exceed the applicable contribution limit, which is \$15,000 in 2006 (\$15,500 in 2007) or for participants age 50 or older, \$20,000 in 2006 (\$20,500 in 2007).

If a participant designates his or her elective deferral as a Roth Contribution, the amount of that contribution will be included in participant's gross income at the time of deferral. However, the Roth Contribution (and any appreciation) will be excluded from the participant's gross income when it is distributed to the participant, provided that the distribution is not made within five years of a participant's commencement of Roth Contributions (the five-year holding period). Plan sponsors will have to track the five-year holding period because if distributions are made before the end of that period, the distributions will be subject to income tax.

Although there are significant differences in a plan's treatment of Roth Contributions and 401(k)/403(b) contributions, many rules apply to both Roth Contributions and 401(k)/403(b) contributions. Participants must always be 100 percent vested in their Roth Contributions because they are elective deferrals. Roth Contributions are subject to the same distribution rules, which prohibit distributions before attainment of age 59 1/2, death, disability, hardship or termination of employment and which require distributions to commence no later than age 70 1/2. In addition, Roth Contributions

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are treated the same as 401(k)/403(b) contributions for purposes of nondiscrimination testing. This means that, when conducting ADP testing, Roth Contributions will be combined with 401(k)/403(b) contributions to determine whether the plan satisfies certain nondiscrimination tests.

Who benefits from Roth Contributions?

Advantages of Roth Contributions	Disadvantages of Roth Contributions
<ul style="list-style-type: none"> Participants who expect higher tax rates at retirement may find the tax-free nature of Roth Contributions to be more valuable than the tax deduction to the participant at the time of deferral. 	<ul style="list-style-type: none"> Participants who expect to be in a lower tax bracket at retirement may benefit from making regular 401(k)/403(b) contributions to defer taxation until then.
<ul style="list-style-type: none"> Participants who expect their income to increase over their career may find that contributing to a Roth account today to be advantageous while in a lower tax bracket. 	<ul style="list-style-type: none"> Participants do not receive a tax deduction for Roth Contributions.
<ul style="list-style-type: none"> Roth Contributions can be rolled over to Roth IRAs, which are not subject to minimum required distributions. This strategy can create a longer tax shelter for estate planning purposes. 	<ul style="list-style-type: none"> Participants on a limited budget may not be able to defer as much into the plan with Roth Contributions as 401(k)/403(b) contributions because Roth Contributions are first treated as wages subject to applicable withholding requirements. As a result, participants must use more income to fund a Roth Contribution than a regular 401(k)/403(b) contribution.

If you are interested in adding Roth Contributions to your existing 401(k) or 403(b) plan or would like to create a new plan that permits 401(k) or 403(b) contributions and Roth Contributions, you will need to amend your plan document. The IRS has issued a sample plan amendment that will work as a snap-on and allow plans to make Roth Contributions. Employers have until the end of 2006 to adopt a plan amendment allowing for contributions during 2006. In addition, you will need to take the following steps: amend your summary plan description, obtain new election forms so that participants can specify whether their deferrals are regular 401(k)/403(b) contributions or Roth Contributions, modify existing record keeping and payroll systems to separately account for Roth Contributions and communicate effectively the new benefit to employees. •

Other Notable PPA Provisions

Benefit Statements

Effective for plan years beginning after December 31, 2006, the PPA expands the disclosure requirements for qualified plans. For defined contribution plans, quarterly statements are required for participant-directed plans and annual statements are required for participants who do not direct their investments. Benefit statements must indicate the total account balance, the amount vested and information about the investments, including an explanation of portfolio diversification, a discussion of the inherent risk of holding more than 20 percent of the portfolio in a single security and a statement that additional information is available on the DOL website. The DOL has been directed to issue one or more model benefit statements that will satisfy these requirements. For defined benefit plans, plan administrators are required either to furnish a benefit statement at least once every three years to each participant who has a vested accrued benefit under the plan and who is employed by the employer at the time the benefit statements are furnished to participants or to furnish at least annually to each participant notice of the availability of a benefit statement and the manner in which the participant can obtain it (this annual notice may be included with other communications to the participant). Collectively bargained plans have later effective dates.

Qualified Joint and Survivor Annuities

Currently, qualified pension plans and certain defined contribution plans (such as money purchase pension plans) are required to offer a qualified joint and survivor annuity that is not less than 50% and not more than 100 percent of the benefit payable to the participant. The PPA requires that effective for plan years beginning after 2007,

such plans also provide benefits in the form of a qualified optional survivor annuity to provide greater flexibility to participants and their spouses. Under the new rules, plans that currently provide only a joint and 50 percent survivor annuity must be amended to add a survivor annuity of at least 75 percent. Further, if the plan's joint and survivor annuity is 75 percent or more, the plan must be amended to add a joint and 50 percent survivor annuity. In addition, effective in 2007, the spousal waiver period has also been amended from 90 days to 180 days before the annuity starting date.

Rollovers by Non-Spouse Beneficiaries

Effective for distributions after December 31, 2006, the PPA allows non-spouse beneficiaries who inherit assets from qualified plans, 403(b) plans and 457(b) plans to directly roll over those amounts to another qualified plan in which the individual is a participant or to his or her own IRA. Prior to the PPA, only spouses could effect rollovers of inherited assets.

EGTRRA Changes Become Permanent

The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") included a "sunset" provision specifying that the act's provisions would expire at the end of 2010. The PPA repeals the temporary nature of these provisions and makes them permanent. Among the EGTRRA provisions made permanent are the catch-up contributions for participants aged 50 and older, expanded rollover opportunities, faster vesting schedules for matching contributions and the availability of Roth 401(k) and 403(b) plans (see page 6 for more information on Roth 401(k) and 403(b) plans). •

employment & employee benefits developments

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