

# The Pension Protection Act

A checklist for action this year. **By Susan Rosenbleeth, Principal, Buck Consultants**

A piece of legislation as far ranging as the Pension Protection Act (PPA) demands in-depth ongoing analysis of the enacted provisions and the supporting regulations and notices that the departments of Labor and Treasury will issue in the coming months. However, some of the provisions related to defined contribution (DC) plans are effective as of the first plan year following December 31 of this year; other provisions went into effect on August 17, the date of enactment. Thus, calendar-

year DC plan sponsors should evaluate the effect of these provisions on their plans' operations and be prepared to implement any changes that may be needed before January 1, 2007; in some cases in time for notices that must be issued by December 1, 2006.

In the chart below, items listed in the Things to Consider column identify those PPA provisions that may require DC plan sponsors' attention sooner rather than later. **HRO**

PPA Provision	Summary of Provision	Things to Consider	
<b>Encouraging Retirement Savings</b>			
Preemption of state wage and garnishment laws. Effective Aug. 17, 2006	PPA provides an exemption from state laws that prohibit automatic enrollment—effective on the date of enactment.	If your plan currently has an automatic enrollment feature, this provision will relieve any compliance and admin concerns related to state prohibitions.	
EGTRRA Provisions Made Permanent Effective Aug. 17, 2006	EGTRRA's original expiration date of December 31, 2010 for certain benefit limits and other plan provisions was repealed, making those provisions permanent that were enacted as part of EGTRRA. Most EGTRRA plan provisions have become fairly institutionalized, resulting in many plan sponsors correctly seeing this provision as positive but of limited immediate consequence. However, the elimination of EGTRRA's sunset provision opens some new opportunities. For instance, some plan sponsors may have delayed implementing a Roth 401(k) plan because of this provision's pending sunset date.	With final regulations on Roth 401(k)s available and assurance that the provision will not sunset, sponsors may want to evaluate this plan design option.	
	<b>Topic EGTRRA Provision/Limit</b>		
	Roth Contributions	Deferrals to 401(k) and 403(b) plans can be designated as after-tax Roth contributions.	Long-range tax planning related to the permanence of the ESOP dividend deductions should be reviewed.
	ESOP Dividend Deductions	Tax deduction permitted for ESOP dividends that participants can elect to reinvest.	Communicate Savers' Credit to eligible participants.
Savers' Credit	The Savers' Credit on qualified retirement savings contributions for individuals with certain AGI limits becomes permanent and the limits will be indexed for inflation (beginning in 2007).		
Required Vesting for Non-matching Contributions  Effective for plan years beginning after December 31, 2006 <sup>1</sup>	Employer non-matching contributions, such as profit-sharing contributions, must be 100 percent vested after three years of service or 20 percent vested per year over 2 to 6 years of service. Applies to plan participants with as little as an hour of service after the effective date. Can be applied only to post-2006 contributions, although pre-2007 service must count toward vesting.	Evaluate: Design options and adopt one of the alternative vesting schedules for non-matching contributions. Calculate potential cost increase associated with decreased forfeitures.	
<b>Investment Advice and Diversification</b>			
Eligible Investment Advice Arrangement  Effective for advice provided on or after January 1, 2007	Prohibited transaction exemption (PTE) covers fiduciary advisors who provide investment advice to plan participants under an "eligible investment advice arrangement." The fiduciary advisor is a plan fiduciary and is a registered investment advisor, bank, insurance company, or broker-dealer and its employees and representatives. The following restrictions apply: —Fees must be reasonable and cannot vary by investment option chosen, or advice must be based on a computer model certified by an independent eligible investment expert (to be defined in forthcoming DOL rules). The arrangement must be authorized by an independent plan fiduciary, audited annually, and fully disclosed in writing prior to participant use. —Plan sponsors are not responsible for monitoring the specific advice given to participants but remain liable for the prudent selection and periodic review of fiduciary advisors.	Many open questions need to be addressed by the DOL, but plan sponsors should identify potential fiduciary advisors and adopt selection and evaluation processes that will qualify for the protections provided by the PTE.	

Investment Advice and Diversification		
<p><b>Mandatory Diversification of Employer Stock Funds</b></p> <p>Effective first day of plan year beginning after December 31, 2006<sup>2</sup></p>	<p>Plans that hold sponsor's publicly traded stock must permit participants to diversify:</p> <ul style="list-style-type: none"> <li>• 100 percent of participant contributions</li> <li>• Post-2006 employer contributions                             <ul style="list-style-type: none"> <li>—100 percent after three years of service</li> <li>—100 percent immediately if surviving beneficiary</li> </ul> </li> <li>• Pre-2007 employer contributions                             <ul style="list-style-type: none"> <li>—100 percent if age 55 with at least three years of service by the start of the first plan year beginning after December 31, 2005</li> <li>—33 percent, 66 percent, 100 percent during three years for all other participants with at least three years of service</li> </ul> </li> </ul> <p>Stand-alone ESOPs with no employee or matching contributions and one-participant plans are exempt.</p> <p>Diversification must be permitted quarterly at a minimum and at least as frequently as other investment changes are allowed (daily for most plans) unless securities law provides otherwise.</p> <p>At least three other investment options with materially different risk and return characteristics must be offered.</p> <p>Diversification notice is required 30 days in advance of eligibility to diversify. Treasury is required to issue a model notice. Notice failures may result in a penalty of \$100 a day per failure.</p>	<p>If plan includes a KSOP or a company stock investment fund, evaluate the plan's diversification rights in relation to the new requirements. If changes are required, develop an implementation strategy and the necessary communications.</p>
Participant Disclosures		
<p><b>Benefit (Account) Statements</b></p> <p>Effective for plan years beginning after December 31, 2006</p>	<p>DC plan benefit statements must be furnished in writing or electronically to participants at least quarterly, if investments are participant-directed; or annually if not; and to other beneficiaries upon request. Statements must include total benefit amounts, vested amount or future dates of vesting, value of each investment fund held by the participant, explanation of investment limitations or restrictions, and a statement about the importance of diversification and reference to the DOL website. DOL will issue a model statement within 180 days of enactment, which plan sponsors may modify.</p>	<p>DC plan sponsors should review the contents of benefit statements against these requirements and the DOL model statement, when available. Most statements will need to add information about diversification, risk and refer participants to the DOL Web site.</p>
<p><b>Distribution Notices</b></p> <p>Effective for plan years beginning after December 31, 2006</p>	<p>Rollover, general consent, and QJSA notices must be issued 180 (currently 90) to 30 days before distribution commences. The notice must explain the participant's rollover options and the tax consequences of failure to roll over in a timely manner.</p>	<p>Review administrative practices to determine impact of the expanded notice period.</p>
Withdrawals and Distributions		
<p><b>Special Distribution Option for Reservists</b></p> <p>Effective for distributions after September 11, 2001</p>	<p>Eligible reservists* may take distributions of elective deferrals while on active duty:</p> <ul style="list-style-type: none"> <li>• Restrictions on plan distributions do not apply</li> <li>• 10 percent excise tax on early withdrawals does not apply</li> <li>• Withdrawn amounts may be re-contributed to an IRA over two-year period after active duty ends</li> </ul> <p><small>* Eligible reservists are those called to active duty after September 11, 2001 and before December 31, 2007 and who serve in excess of 179 days.</small></p>	<p>Evaluate whether to allow distributions for employees on active duty. Anticipate contact from prior employees who want to refile prior year tax returns and/or re-contribute distributions to an IRA.</p>
<p><b>Expanded Rollover Opportunities</b></p> <p>Effective January 1, 2007</p>	<ul style="list-style-type: none"> <li>• After-tax contributions can be rolled over between different types of employer retirement plans.</li> <li>• Direct rollovers by non-spouse beneficiaries permitted for distributions after December 31, 2006, but only to an IRA. The rollover will be treated as one made to an inherited IRA.</li> </ul>	<p>Revise plan documentation and distribution forms to:</p> <ul style="list-style-type: none"> <li>— Explain and permit non-spousal rollovers</li> <li>— Reflect expanded rollovers of after-tax contributions</li> </ul>
<p><b>Annuity Contracts</b></p> <p>Effective August 17, 2006</p>	<p>Selection of a provider to underwrite annuity contracts as a form of distribution will be subject to current fiduciary standards for prudent selection and will not be subject to the "safest available annuity" rule of IB 95-1. DOL directed to issue final regulations within one year of enactment.</p>	<p>If your plan offers annuity distributions, revise processes if needed. Evaluate the pros and cons of offering an annuity distribution option if one is not currently provided.</p>
Compliance and Reporting		
<p><b>EPCRS</b></p> <p>Effective August 17, 2006</p>	<p>The IRS has been granted greater authority to provide means to correct plan administration and compliance failures in the EPCRS process, especially with respect to small plans.</p>	<p>The IRS emphasizes having processes and procedures in place to utilize EPCRS. Review documented procedures against plan document and administrative practices.</p>

<sup>1</sup> For collectively bargained plans ratified before August 17, 2006, the effective date is the earlier of (1) the later of the date the last collective bargaining agreement expires without regard to extensions made on or after August 17, 2006 or January 1, 2007, or (2) January 1, 2009. For leveraged ESOPs with an outstanding loan as of September 26, 2005, the effective date is the earlier of the date the loan is fully repaid or was (as of September 26, 2005) scheduled to be repaid.

<sup>2</sup> For collectively bargained plans ratified on or before August 17, 2006, the effective date is the earlier of (1) the later of December 31, 2007, or the date the collective bargaining agreement terminates without regard to extensions made on or after August 17, 2006, or (2) December 31, 2008. The effective date for ESOPs holding certain preferred shares with guaranteed minimums is plan years beginning after the earlier of December 31, 2007, or the first date when the fair market value of the securities is not less than the guaranteed minimum value.