The **Pension Protection Act of 2006:**
A summary of pension and savings provisions

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Introduction

At over one thousand pages, the Pension Protection Act of 2006 ("PPA") brings about major changes related to pension plans and savings incentives. While these provisions are the primary focus of the Act, it also addresses other areas, such as tax-exempt organizations.

The PPA addresses both defined benefit and defined contribution plans, and both single-employer and multiemployer plans. The primary objective of the Act is to strengthen the funding of defined benefit pension plans by imposing stricter funding requirements and to encourage greater employee participation in defined contribution plans through automatic enrollment procedures.

The PPA also resolves some long-standing controversies regarding cash balance plans, at least on a prospective basis. Another significant aspect of the PPA is that it makes permanent the many pension and IRA provisions that were enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"). Under EGTRRA, these provisions were set to expire at the end of 2010.

I. Defined Benefit Plans (Single-Employer Plans)

A. Key changes

The key changes brought about by PPA for single-employer defined benefit plans can be summarized as follows:

- The PPA imposes stricter funding requirements than under current law.
- The PPA imposes restrictions on the ability of defined benefit plans to increase benefits, and to make lump-sum distributions to participants.
- The PPA increases the deduction limits for plan contributions in order to reflect the increase in funding requirements.
- The PPA requires that certain rates be used to calculate lump-sum distributions, resulting in lower lump-sum distribution amounts than under current law.

These changes are described in more detail below.

B. Stricter funding requirements

The PPA makes significant changes to funding requirements in order to strengthen the overall funding levels of defined benefit plans. They key funding changes can be summarized as follows:

- Higher funding targets than under current law for all plans
- Even higher funding targets for "at-risk" plans
- More volatility in required funding amounts

Each of the funding changes highlighted above is described in more detail below.

1. Higher funding targets than under current law

The PPA imposes stricter funding requirements than current law, effective for plans years beginning after Dec. 31, 2007.

Current law: Generally, plans must be funded based on a 90% funding target. (The funding target, as used here and throughout this summary, is the ratio of pension plan assets to liabilities.)

PPA: The funding target is increased to 100%. The 100% funding target is phased in over a period of several years, as depicted in the table below:

Year	Funding Target
2008	92%
2009	94%
2010	96%
2011 and beyond	100%

Plans are given a seven-year time period to fund the targeted amount.

Exception: Commercial airlines are given either 10 or 17 years to fund the targeted amount, depending on their specific circumstances.

Any new underfunding that is created in the future, such as from a fall in asset values or an increase in pension promises, must also be funded over a seven-year time period.

2. Even higher funding requirements for certain plans, called "at-risk" plans

Exception: The special rules for "at-risk" plans do not apply if a plan had 500 or fewer participants on each day during the preceding plan year.

To determine whether a plan is an at-risk plan, the plan must first calculate its at-risk liability, as follows:

The at-risk liability calculation assumes that employees eligible to retire in the next 10 years will retire as early as possible and will choose to take the form of benefit under the plan with the highest present value (e.g., a lump sum distribution versus a lifetime pension). This calculation results in a higher liability that the normal liability calculation.

A plan is at risk if its funded percentage (assets divided by liabilities) for the preceding year is:

Less than 70%, using the at-risk liability amount, and
Less than 80%, using the regular liability amount.[1]

The funding target for an at-risk plan is 100% of the at-risk liability amount rather than the regular liability amount, resulting in larger required contributions to the plan. The contributions attributable to the additional liability must be made to the plan over a five-year period.

If, in addition to the current year, the plan was at risk in at least two of the prior five years, then the at-risk liability amount is further increased by 4%, plus $700 per plan participant.

3. More volatility in required funding amounts

As a result of the PPA, employers will find that the amount of required pension plan contributions is more volatile from year to year, and more difficult to project, than under current law. This is brought about due to the PPA's changes in the measurement of pension plan assets and liabilities, effective for plan years beginning after Dec. 31, 2007.

[1] A transition rule reduces the 80% threshold to 65% for 2008, 70% for 2009, and 75% for 2010. Thus, the 80% threshold is not reached until 2011.

Plan asset measurement:

Current law: Measures plan assets at fair market value, but allows averaging over a five-year period to reduce the effect of market fluctuations.

PPA: Reduces the averaging period to two years, and requires that the asset value used in the actuarial valuation be no less than 90%, and no more than 110%, of the current fair market value of the assets.[2] This will result in more volatility in funding requirements, because changes in asset values are taken into account more quickly.

Pension liability measurement:

Current law: The interest rate that is used to calculate a plan's liability is the weighted average of the rates of interest on amounts invested conservatively in long-term investment-grade corporate bonds during the four-year period ending on the last day before the plan year begins.

PPA: Commencing in plan years beginning after Dec. 31, 2007, the discount rate used to calculate the present value of future benefit obligations (i.e., the plan's liabilities) is based on a yield curve that uses three different rates. The three different rates are based on the timing of the plan's benefit payments in the future, as depicted in the following table:

Rates	Benefit Payment Dates
Rate 1	Years 1-5
Rate 2	Years 6-20
Rate 3	Beyond Year 20

The actual rates will be calculated and published by the IRS on a monthly basis. The rates are determined on the basis of a corporate bond yield curve that reflects current market-determined interest rates for the time periods above, averaged over a two-year period.

An employer may elect to use a single blended interest rate for valuing all benefits, rather than the three separate rates described above. The rate must still be based on the yield curve. When an employer makes this election, it can be revoked only with IRS consent.

[2] Under current law, this valuation corridor is 80% to 120%.

Under transition rules, the corporate bond yield curve rates are blended with the rates used under current law in 2008 and 2009, as depicted in the table below:

Year	Weighting Factors	
	Current Law Interest Rate	PPA Interest Rate
2008	66-2/3%	33-1/3%
2009	33-1/3%	66-2/3%
2010 and beyond	N/A	100%

The IRS is directed to prescribe by regulation the mortality tables to be used in making computations under the funding rules. The IRS is required to revise the tables at least every 10 years to reflect the actual experience of pension plans and projected trends.

Finally, the PPA imposes joint and several liability to all members of the employer's controlled group for minimum required contributions. This applies to both single-employer and multiemployer plans.

C. Benefit restrictions

The PPA imposes restrictions on the benefits that can be provided in a defined benefit plan, effective for plans years beginning after Dec. 31, 2007.

Exception: The benefit accrual restrictions do not apply for the first five years that a plan (or a predecessor plan) is in effect.

The restrictions limit the ability of a plan that is not well funded to increase its liabilities. The PPA targets the following specific actions because they increase the plan's liabilities:

- Increases in benefit levels
- Acceleration of vesting
- Provision of special benefits related to a plant shutdown or other unpredictable contingent events[3]
- Paying benefits in the form of a lump-sum distribution versus an annuity
- Purchasing an annuity from an insurance company versus paying the annuity from plan assets

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[3] Unpredictable contingent benefits are benefits that depend on contingencies other than age, service, compensation, death or disability, or that are not reliably and reasonably predictable as determined by the IRS.

The specific restrictions applied to a given plan depend on the plan's funded percentage (i.e., ratio of pension plan assets to liabilities), as depicted in the following table:

Funded Percentage	Benefit Accruals	Plant Shutdown Benefits	Lump Sum Distributions or Purchase of Insurance Company Annuity
80% or higher	No restrictions	No restrictions	No restrictions
Less than 80%, but more than 60%	Benefits may continue to accrue, but the benefit formula may not be increased, and vesting cannot be accelerated.	No restrictions	Permitted, but the amount is limited to 50% of the value of the participant's accrued benefit, with a cap equal to the lump sum equivalent of the maximum pension guaranteed by the PBGC for the participant. The remaining amount is paid as an annuity.
Less than 80% for two years in a row	Same as above	No restrictions	Not permitted
Less than 60%	Benefit accruals must stop (i.e., must be frozen).	Not permitted	Not permitted

An employer may make contributions in an amount sufficient to increase the plan's funded percentage so that the above restrictions do not apply. Alternatively, an employer may provide security in the form of a surety bond, cash, certain U.S. government obligations, or another form that is satisfactory to the IRS and the parties involved.

D. Increase in deduction limits

The PPA increases the deduction limit for plan contributions in order to reflect the higher funding requirements, effective for contributions made after 2007.

For 2006 and 2007, the deduction limit is increased from 100% to 150% of the plan's current liability.

For contributions made after 2007, the deduction limit is the contribution amount that would bring the plan's assets up to the sum of all of the following amounts:

The year's normal cost (generally, the cost of benefits accrued during the year)

The amount necessary to fully fund the plan's funding target as of the beginning of the year

A cushion, which consists of 50% of the unfunded liability, plus additional amounts reflecting projections of the participants' compensation and the statutory compensation limits

In addition, the deduction rules for employers that sponsor a combination of both defined benefit and defined contribution plans are updated.

Current law: The combined deduction limit is the greater of the amount of the required minimum contribution for the defined benefit plan, or 25% of compensation paid to plan participants during the year.

PPA: Contributions to the defined benefit plan are deductible without affecting the combined limit. For the defined contribution plans, only contributions in excess of 6% of compensation count towards the combined limit. These rules go into effect for tax years beginning after Dec. 31, 2005.

E. Lower lump-sum distribution amounts

The PPA requires that certain rates be used to calculate lump-sum distributions, resulting in lower lump-sum distribution amounts than under current law.

Current law: In calculating a lump-sum distribution, the interest rate used is the yield on 30-year Treasury bonds.

PPA: Starting in plan years beginning after Dec. 31, 2007, the three rates described above for funding purposes are used to calculate a lump-sum distribution (except that the rate for the month preceding the distribution is used, rather than a two-year average).

Under the approach prescribed by the PPA, the interest rate that applies depends on how many years in the future a participant's annuity payment would have been made (i.e., normal retirement age). Typically, a higher interest rate applies for payments made further out in the future, resulting in a lower lump-sum distribution amount.

The PPA interest rates are phased in by using a blended rate approach for several years. Under the blended rate approach, a combination of the current law interest rate and the PPA interest rate is used. The weighting factors used to determine the blended rate are depicted in the following table:

Year	Weighting Factors	
	Current Law Interest Rate	PPA Interest Rate
2008	80%	20%
2009	60%	40%
2010	40%	60%
2011	20%	80%
2012 and beyond	100%	0%

The mortality table used to calculate the lump-sum distribution is the same table that is used for funding purposes.

II. Defined Benefit Plans (Multiemployer Plans)

A. Key changes

The key changes brought about by PPA for multiemployer defined benefit plans can be summarized as follows:

- Limited revisions to existing funding rules
- Creation of a temporary set of rules for certain poorly-funded plans

These changes are described in more detail below.

Observation: The funding changes for multiemployer plans are much less extensive than for single-employer plans.

B. Limited revisions to existing funding rules

Current law: New unfunded past service liabilities resulting from plan amendments that improve benefits, as well as changes in actuarial assumptions, are funded over a 30-year period.

PPA: Starting in plan years beginning after Dec. 31, 2007, the funding period for these items is reduced to 15 years. In certain cases, the funding period may be increased to as long as 25 years, with IRS approval.

C. Creation of a temporary set of rules for certain poorly-funded plans

A special set of funding rules applies to seriously underfunded plans. These rules expire at the end of 2014. The rules are depicted in the table below:

Term to Describe Plan	Current Funded Percentage	Special Rules
Endangered	Less than 80% funded, or has accumulated funding deficiency (or projected to have within next 6 years)	Must adopt funding improvement plan designed to eliminate one-third of its underfunding over 10-year period
Seriously endangered	Both conditions above apply to plan (i.e., an 'and' rather than an 'or')	Same funding improvement plan as above, but with more relaxed requirements: plan eliminates one-fifth of underfunding over 15-year period
Critical	Projected to fail to satisfy minimum funding standards or to become insolvent within period of 3-6 years[4]	Must adopt rehabilitation plan to emerge from critical status within 10 years. During first year of critical status, required contribution increased by 5% - increased by 10% in subsequent years (as long as plan remains in critical status)

[4] Additional conditions that are specified in the PPA may cause a plan to be treated as a critical status plan.

Even though these special rules expire at the end of 2014, any funding improvement plan or rehabilitation plan that was put in place prior to the expiration remains in force beyond 2014.

D. Withdrawal liability reforms

In addition, the PPA contains withdrawal liability reforms that are effective immediately. These reforms are very briefly described as follows:

- Repeal of limitation on withdrawal liability in certain cases
- Withdrawal liability continues if work contracted out
- Application of forgiveness rule to plans primarily covering employees in building and construction
- Procedures applicable to disputes involving withdrawal liability

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III. Cash Balance Plans

Background: Cash balance plans have been the subject of a great deal of litigation, focused primarily on whether the conversion of a traditional defined benefit plan to a cash balance plan results in age discrimination.

Key change

Effective for periods beginning on or after June 29, 2005, the PPA sets forth rules whereby cash balance plans will not be treated as age discriminatory. The rules apply on a prospective basis only. Thus, traditional plans that were converted to cash balance plans prior to June 29, 2005 have no assurance as to whether the conversion resulted in age discrimination.

Under the PPA, cash balance plans must meet the following requirements:

Interest credits: The interest rate credited to accounts under the plan must not be less than 0%, and not greater than a market rate of return.

Vesting: The plan must provide for 100% vesting upon the completion of three years of service.

Note: For cash balance plans that were already in effect on June 29, 2005, the interest and vesting rules above do not go into effect until plans years beginning after Dec. 31, 2007.

Conversion from a traditional plan to a cash balance plan:

Participants must continue to accrue benefits immediately after the conversion. This eliminates the so-called "wearaway" approach that was used in some prior conversions, whereby some older participants accrued no benefits for a period of time after the conversion.

If, at the time of the conversion, a participant has met the age, years of service, and other requirements under the plan for an early retirement benefit or a retirement subsidy, then the value of these benefits must be recognized in calculating the participant's benefits under the cash balance plan.

In addition to the age discrimination issue, the PPA resolves another issue that has been the subject of litigation. In the past, some courts have taken the position that a participant's lump-sum distribution must be calculated in a manner that results in a distribution that is greater than the participant's hypothetical account balance (the so-called "whipsaw effect"). The PPA makes it clear that cash balance plans are not required to distribute an amount to a participant that is greater than his or her hypothetical account balance. This rule applies to distributions made after the date of PPA's enactment.

Note: In addition to cash balance plans, the provisions above apply to other types of so-called "hybrid" plans, such as pension equity plans. In a pension equity plan, the participant's benefit is a stated percentage of his or her final pay, multiplied by his or her years of service.

IV. Additional Provisions Applicable to Defined Benefit Plans

The PPA brings about other changes to defined benefit plans, as follows:

- Requires that plans offer an annuity option with a 75% survivor annuity
- Makes changes to the rules regarding the calculation of premiums paid to the Pension Benefit Guaranty Corporation ("PBGC"), resulting in premium increases for some employers
- Allows pension plan distributions during working retirement
- Requires that benefit statements be furnished to plan participants
- Requires the electronic display of Form 5500 information
- Requires that a plan prepare and distribute an annual funding notice
- Expands the availability of excess pension plan assets to fund retiree health benefits

A. New survivor annuity requirement

Current law: Defined benefit and money purchase pension plans must offer an annuity option that includes a 50% survivor annuity.

PPA: In addition to the 50% survivor annuity, plans must offer a 75% survivor annuity. The 75% survivor annuity is required starting with plan years that begin after Dec. 31, 2007.

B. PBGC premium increases

The PPA removes the full funding exemption to the PBGC variable premium requirement. This will cause some plans that have not paid the variable premium in the past to do so.

C. Distributions during working retirement

Current law: Pension plans (both defined benefit plans and money purchase plans) may not make pension distributions to participants who are still working for the employer, unless the participant has reached the plan's normal retirement age (commonly, age 65). This is the case even if the participant is working on only a part-time basis (i.e., a "working retirement").

PPA: Effective for plans years beginning after Dec. 31, 2006, a plan may make distributions to any participant who is at least 62 years of age, even if the participant is still working for the employer.

D. Benefit statements for participants

Starting for plans years beginning after Dec. 31, 2006, the plan administrator must furnish a benefit statement at least once every three years to each participant who has a vested benefit. Alternatively, the plan administrator can notify each participant annually of the availability of a benefit statement and the manner in which the participant can obtain the statement. The law sets forth the requirements for the statement's content.

The Department of Labor is directed to develop a model benefit statement within one year after the PPA's enactment.

This requirement also applies to multiemployer plans, and may have a later effective date for these plans, depending in part on the termination date of the collective bargaining agreement.

E. Electronic display of Form 5500 information

Starting with plan years beginning after Dec. 31, 2007, basic plan information and actuarial information contained in the Form 5500 must be filed in an electronic format that accommodates display on the Internet. The Department of Labor ("DOL") is required to display the information on a website maintained by the DOL. If the employer maintains an Intranet website, then the employer must also display the information on its Intranet. Notably, a summary annual report no longer is required for a defined benefit plan. These provisions also apply to multiemployer plans.

F. Annual funding notice

Starting with plan years beginning after Dec. 31 2007, a plan must prepare and distribute to participants an annual notice with certain information, such as a statement as to the plan's funding target percentage. The notice must be provided within 120 days after the end of the plan year to which it relates. This requirement also applies to multiemployer plans.

G. Expansion of the availability of excess pension plan assets to fund retiree health benefits

Current law: A plan may transfer excess assets once each year to separate accounts within the plan to pay for retiree health benefits. The transfer amount cannot exceed the anticipated cost of retiree medical benefits for the year. Certain additional requirements must be met.

PPA: The PPA expands the availability of this type of transfer by allowing a plan to transfer excess assets to fund estimated retiree medical costs for up to 10 years (i.e., not just one year at a time). The PPA also provides for transfers to fund collectively bargained retiree health benefits under certain circumstances.

Both the current law and the PPA provisions expire at the end of 2013.

V. Combined Defined Benefit/401(k) Plan for Small Employers

The PPA permits certain employers to create a single plan that includes both a defined benefit and 401(k) plan. This provision goes into effect for plan years beginning after Dec. 31, 2009. At the time the plan is created, the employer must have employed an average of at least two, but no more than 500, employees on the business days during the preceding calendar year.

The combined plan has the following characteristics:

The assets are held in a single trust.

The plan is treated as a single plan for purposes of Form 5500 annual reporting.

The assets are clearly identified and allocated to the defined benefit and 401(k) portions of the plan.

The provisions of the Internal Revenue Code and ERISA are applied to the defined benefit and 401(k) portions of the plan in the same manner as if these portions were not in a combined plan.

The defined benefit portion of the plan must provide a benefit that is at least equal to 1% of the participant's final average pay times years of service, with a maximum required benefit of 20% of final average pay. Final average pay is determined based on a period that does not exceed five years. The PPA sets forth an alternative benefit formula that may be used, where each year's benefit accrual is based on the participant's age as of the beginning of the year.

The defined contribution portion of the plan must provide for automatic enrollment at a contribution rate of 4% of pay. The employer must make a matching contribution equal to 50% of the employee's contribution, on the first 4% of pay that the employee contributes to the plan. The matching contribution must be fully vested. The plan is deemed to pass the ADP test, but must pass the regular ACP test for matching contributions.
Both the defined benefit and defined contribution portions of the plan are treating as meeting the top-heavy plan requirements.

VI. Defined Contribution Plans

A. Key changes

The key changes brought about by PPA for defined contribution plans can be summarized as follows:

- Facilitates the use of automatic enrollment in 401(k) plans
- Facilitates the rendering of investment advice to plan participants
- Requires faster vesting of plan contributions
- Directs the Department of Labor to issue regulations regarding default investments
- Requires plans sponsored by publicly-traded employers to provide employees with freedom to invest their plan accounts in assets other than employer stock
- Allows distributions to be made to plan beneficiaries as a result of hardships and unforeseen financial emergencies

These changes, along with other changes, are described in more detail below.

B. Automatic enrollment in 401(k) plans

Background: When a 401(k) plan uses automatic enrollment, an employee is automatically enrolled in the plan, with a prescribed percentage of his or her pay automatically withdrawn for his or her paycheck. If the employee does not wish to participate in the plan, then he or she must affirmatively opt out of the plan. Surveys indicate that participation and contribution rates are significantly higher in plans that use automatic enrollment than in plans that do not use this approach.

Current law: Some employers have implemented automatic enrollment, but many have not done so, due at least in part to concerns about state laws that prohibit automatic deductions from pay.

PPA: Effective immediately, all state laws that prohibit automatic enrollment are preempted by Federal law. In addition, the Department of Labor is directed to issue regulations related to default investments that apply when an employee is automatically enrolled. This opens the way for employers with prior concerns about state laws and fiduciary liability with respect to default investments to implement automatic enrollment.

In addition, for plans years beginning after Dec. 31, 2007, plans that offer automatic enrollment and meet certain requirements are exempt from the usual nondiscrimination tests that apply to employees' elective deferrals and the employer's matching contributions (i.e., the ADP and ACP tests). Those requirements are as follows:

Automatic enrollment percentages: The plan provides for automatic enrollment, using an automatic contribution percentage that falls within the ranges depicted in the table below:

Year	Minimum Automatic Contribution	Maximum Automatic Contribution
First year employee is automatically enrolled in plan	3%	10%
Second year	4%	10%
Third year	5%	10%
Fourth year and beyond	6%	10%

The plan's automatic contribution percentages must be uniformly applied to all eligible employees.

Employer contributions: The employer makes either matching contributions or nonelective contributions on behalf of each non-highly compensated employee to the plan. The amount of these contributions is depicted in the table below:

<table>
<tr><td>Matching contribution</td><td>100% on the first 1% of compensation contributed by the employee, plus

50% on the next 5% of compensation contributed by the employee.

(Thus, a matching contribution is made on the first 6% of compensation.)</td></tr>
<tr><td colspan="2">or</td></tr>
<tr><td>Nonelective contribution</td><td>At least 3% of compensation</td></tr>
</table>

The following additional requirements apply with respect to the above matching contributions and nonelective contributions:

> **Vesting:** Employees with at least two years of service must be 100% vested.
>
> **Withdrawal restrictions:** The contributions are subject to the same withdrawal restrictions that apply to employees' elective deferrals.

A plan which meets the requirements above does not have to pass the nondiscrimination test for elective deferrals (i.e., the ADP test).

A plan which meets the requirements above, and consists solely of the employees' elective deferrals, and either the matching or nonelective contributions described above, is not subject to the top-heavy plan rules.

In addition, a plan that provides matching contributions and meets the above requirements does not have to pass the nondiscrimination test for matching contributions (i.e., the ACP test), as long as the following additional requirements are met:

Matching contributions are not provided for elective deferrals in excess of 6% of compensation.

The rate of matching contribution does not increase as the rate of an employee's elective deferrals increases.

Matching contribution rates for highly compensated employees do not exceed the rates for non-highly compensated employees.

C. Investment advice to plan participants

Current law: Generally, prohibited transaction rules preclude plan fiduciaries from being compensated for giving investment advice to plan participants.

PPA: The PPA creates an exemption from the prohibited transaction rules for certain investment advice provided to retirement plan participants. The exemption is effective for investment advice provided after Dec. 31, 2006.

The exemption allows a party-in-interest to the plan, including the employer and other plan fiduciaries, to:

Provide investment advice to participants,

Execute an investment transaction pursuant to the advice, and

Receive fees in connection with the investment advice or the investment transaction.

The exemption applies to the following types of investment advice:

Advice provided through a computer model, or

Advice provided by an advisor whose compensation does not vary with the investments selected

The computer model must apply generally accepted investment theories, use relevant information about the plan participant, use prescribed objective criteria to provide asset allocations, operate in a manner that is not biased in favor of any investment options offered by the fiduciary adviser or related person, and take into account all investment options offered under the plan. The computer model must be certified by an independent investment expert.

An annual audit of the investment advice arrangement must be conducted by an independent auditor who has appropriate technical training or experience and proficiency.

D. Faster vesting of plan contributions

Current law: Generally, a plan must comply with one of two alternative vesting schedules, as depicted in the table below:

Years of Service	Vesting Percentage
Alternative 1: Cliff Vesting Schedule	
1	0%
2	0%
3	0%
4	0%
5	100%
Alternative 2: Graded Vesting Schedule	
1	0%
2	0%
3	20%
4	40%
5	60%
6	80%
7	100%

PPA: Starting in plan years beginning after Dec. 31, 2006, plans must comply with one of two alternative vesting schedules, which provide faster vesting than under current law. The alternative vesting schedules are depicted in the table below:

Years of Service	Vesting Percentage
Alternative 1: Cliff Vesting Schedule	
1	0%
2	0%
3	100%
Alternative 2: Graded Vesting Schedule	
1	0%
2	20%
3	40%
4	60%
5	80%
6	100%

Note: The new PPA vesting schedules already applies under current law to matching contributions.

E. Regulations regarding default investments

The PPA directs the Department of Labor ("DOL") to issue regulations regarding the investment of a participant's account in a default arrangement if the participant has not made an affirmative election regarding investments. The DOL is directed to issue the regulations within six months of the PPA's enactment.

F. Freedom to invest plan accounts in assets other than employer stock

Exceptions:

These rules do not apply to private companies.

The rules do not apply to employee stock ownership plans ("ESOPs") that have no elective deferrals, after-tax employee contributions, or matching contributions, and do not form part of another qualified plan. Of course, ESOPs remain subject to their own diversification requirements under current law.

The rules also do not apply to one-participant retirement plans.

Due to concerns about high concentrations of employer stock in retirement plans, the PPA requires plans sponsored by publicly-traded employers to provide employees with freedom to invest their plan accounts in assets other than employer stock. These provisions go into effect for plan years beginning after Dec. 31, 2006.

The employees to whom this freedom is given depends on the type of contribution, as depicted in the table below:

Elective deferrals and after-tax employee contributions (i.e., the employee's contributions)	All employees have the freedom to invest their accounts in assets other than employer stock. In other words, the employer cannot mandate that these contributions will be invested in employer stock.
Nonelective employer contributions and matching contributions (i.e., the employer's contributions)	All employees with three years of service have the freedom to invest their accounts in assets other than employer stock. Again, the employer cannot mandate that these contributions will be invested in employer stock.

The employees must be given a choice of at least three investment options, other than employer stock. Each of the alternative investment options must be diversified, and must have materially different risk and return characteristics.

The plan administrator must provide each employee with a notice which describes the importance of diversifying the investment of retirement account assets. The IRS is directed to prepare a model notice within 180 days after the PPA's enactment.

As noted above, these rules are effective for plans years beginning after Dec. 31, 2006. However, under transition rules, the degree of freedom to diversify is phased in over a three-year period. This transition is depicted in the following table:

Plan Year for which Freedom to Diversify Applies	Percentage of Employer Stock for which Freedom to Diversify Required
First year	33%
Second year	66%
Third year and beyond	100%

The transition rules do not apply to employees with who have three years of service and who have attained age 55 by the beginning of the first plan year beginning after Dec. 31, 2005. These employees must be given full freedom to diversify starting in the plan year that begins after Dec. 31, 2006.

G. Benefit statements for plan participants

Effective for plan years beginning after Dec. 31, 2006, the plan administrator must provide a benefit statement each quarter to a participant who has the right to direct the investment of assets in his or her account. If the participant does not have the right to direct investments, then a benefit statement must be provided annually. The law sets forth the requirements for the statement's content. The Department of Labor is directed to develop a model benefit statement within one year after the PPA's enactment.

H. Distributions to plan beneficiaries as a result of hardships and unforeseen financial emergencies

Current law: Distributions from a 401(k) plan, 403(b) annuity, Section 457 plan, and nonqualified deferred compensation plans may be made as a result of a hardship or unforeseeable financial emergency on the part of the plan participant, spouse, or dependent.

PPA: These distributions are expanded, effective immediately, to include hardships and unforeseen financial emergencies of any plan beneficiary, including those who are not a spouse or dependent of the participant. The IRS is directed to issue guidance regarding this within 180 days after the PPA's enactment.

VII. Provisions Applicable to All Qualified Plans

A. PPA plan amendment deadline

Plan amendments to reflect the PPA provisions must be made by the last day of the first plan year that begins on or after Jan. 1, 2009.

B. Direct rollover from a plan to a Roth IRA

Current law: Distributions from qualified plans may not be rolled over into a Roth IRA.

PPA: Distributions made after Dec. 31, 2007 from qualified retirement plans, 403(b) annuities and governmental Section 457 plans be rolled over into a Roth IRA.

The present law rules that apply to rollovers from a traditional IRA to a Roth IRA also apply to the above rollovers. Thus, the amount that is rolled over is included in income, but the 10% early distribution tax does not apply. Similarly, an individual with adjusted gross income of $100,000 or more cannot roll over amounts from a qualified retirement plan into a Roth IRA.

C. Increases in maximum bond amount for some plans

Current law: ERISA requires every plan fiduciary and every person who handles a plan's funds to be bonded. The amount of the bond is fixed annually at no less than 10% of the funds that are handled, with a minimum bond amount of $1,000 and maximum amount of $500,000.

PPA: The PPA increases the maximum bond amount to $1 million for plans that hold employer securities. The increase goes into effect for plan years beginning after Dec. 31, 2007.

D. Exceptions to 10% early withdrawal tax

Current law: A 10% early withdrawal tax applies when an individual receives a distribution from a qualified retirement plan prior to age 59½, death, or disability. Among other exceptions, the tax does not apply to distributions made to an employee who separates from services after age 55, or to distributions that are part of a series of substantially equal periodic payments.

PPA: The PPA expands the exemptions from the 10% early withdrawal tax, as follows:

The tax does not apply to distributions made to a member of a reserve who was called to active duty for a period of more than 179 days, as long as the distribution was made during the period beginning when the individual was called to active duty, and ending at the close of the active duty period. This provision is effective for distributions made after Sept. 11, 2001.

In addition, the tax does not apply to distributions from a government defined benefit pension plan to a public safety employee who separates from service after age 50. This provision is effective for distributions made after the date of PPA's enactment.

VIII. Individual Retirement Accounts

The PPA makes the following changes with respect to IRAs:

It provides for inflation adjustments to be made to the income limits that are used to determine deduction amounts for contributions to traditional IRAs, as well as for determining eligibility to make Roth IRA contributions.

Starting for tax years after 2006, it allows individuals to have a portion of their tax refunds deposited directly into an IRA.

It allows tax-free distributions of up to $100,000 from IRAs for charitable purposes, as long as the individual is at least age 70½. The distributions must be made by Dec. 31, 2007.

IX. Nonqualified Deferred Compensation Plans

Key change

Effective immediately, if certain employers with a defined benefit pension plan set up a rabbi trust or similar arrangement in connection with a nonqualified deferred compensation plan, the compensation will become taxable to the plan participants.

This restriction applies only to the following situations and timeframes:

The plan is in "at-risk" status, as defined in the discussion of funding requirements above.

The employer is in bankruptcy.

The period that begins six months before and ends six months after a defined benefit plan is terminated in an involuntary or distress termination.

This restriction applies only with respect to the following individuals:

The chief executive officer

The four highest compensated officers for the year (other than the CEO)

Individuals subject to Section 16(a) of the Securities Exchange Act of 1934

The restriction also includes the following individuals:

Individuals who are in any of the above categories with respect to any member of the plan sponsor's controlled group

Former employees who were in any of the above categories at the time of termination of employment

As a further deterrent to setting aside assets for nonqualified deferred compensation, a 20% penalty tax is imposed on any tax gross-up paid to an individual by the employer when income inclusion is triggered under this restriction. In addition, the employer may not deduct the gross-up payment.

X. Pension and IRA Provisions under EGTRRA Made Permanent

Background: The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") made a number of changes to laws regarding pensions and IRAs. However, EGTRRA included a "sunset" provision, whereby EGTRRA's provisions expire at the end of 2010.

PPA: The PPA repeals the sunset provision of EGTRRA as applied to its EGTRRA's pension and IRA provisions. These provisions include the following:

- Increases in IRA contribution limits, including the ability to make catch-up contributions
- Increases in the limits on contributions, benefits and compensation under qualified retirement plans, tax-sheltered annuities, and Section 457(b) plans
- Elective deferrals not taken into account for purposes of deduction limits
- Ability to treat 401(k) and 403(b) elective deferrals as after-tax Roth contributions
- Retirement plan catch-up contributions for individuals age 50 and older

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XI. Saver's Credit Made Permanent

Current law: A tax credit is provided for eligible taxpayers who make qualified retirement savings contributions. The amount of the credit depends on the adjusted gross income ("AGI") of the taxpayer, with a maximum credit of $2,000. Eligibility for the credit is determined based on the taxpayer's filing status and income level, as depicted in the table below:

Return Filing Status	Adjusted Gross Income
Married filing jointly	$50,000 or less
Head of household	$37,500 or less
Single	$25,000 or less

The AGI limits above will be indexed for inflation in the future.

The retirement savings contributions that are eligible for the credit include the following:

Elective deferrals to a Section 401(k) plan or 403(b) annuity
457(b) plan for a state or local government
SIMPLE plan
Simplified employee pension plan
Roth IRA
Voluntary after-tax contributions to a qualified retirement plan or 403(b) annuity

PPA: The PPA makes the saver's credit permanent. For tax years beginning after Dec. 31, 2006, an individual may direct that the amount of any refund attributable to the credit be directly deposited by the IRS into a retirement plan (i.e., IRA, qualified retirement plan, 403(b) annuity, or 457(b) governmental plan).