Pension Protection Act of 2006
Summary for Defined Benefit ("DB") Plans

You have no doubt already heard about the extensive changes affecting defined benefit plan funding, as well as the changes impacting "hybrid" plans. Below is a brief summary of several below-the-radar but more immediate issues relating to pension plans.

1. **Survivor Annuity Option**: Most defined benefit and money purchase plans may need to add a 75% surviving spouse option, in addition to a 50% surviving spouse option. *This change would require amendments to the plan document as well as to participant communications, forms, and programming.* Although the change does not take effect until 2008, this requirement may shape decisions to eliminate other benefit forms under the final regulations under Code section 411(d)(6).

2. **Distribution and Consent Notices**: The time period for issuing participant notice and consent forms is extended to 180 days before the annuity starting date (now 90 days). Future Treasury regulations will modify the content of these notices as well. *All defined benefit and money purchase plan documents, SPDs and forms will need to be amended. Plans also will need to discuss the timing and content of all distribution notices with vendors ASAP to ensure that new deadlines are met.*

   The impact of this change on administration is unclear. On the one hand, a longer notice period could give participants more time in which to respond to election/consent notices, leading to fewer expired notices that need to be reissued (and possibly fewer retroactive annuity starting dates). This may be particularly true for notices issued to terminated vested participants turning 65. On the other hand, it could increase the likelihood that a participant's circumstances might change between election and benefit commencement (marriage, divorce, death, compensation increases). This could raise complications (who is the spouse?) and might require a reissued notice (with revised relative value calculations). Plans that allow a participant to elect retirement immediately before the commencement date may see little benefit from this change. This provision is effective for plan years beginning in 2007.

3. **EGTRRA Sunsets**: All benefits provisions enacted in EGTRRA have been made permanent, as the 2010 sunset date has been eliminated. This means that the increased benefit limits under Code section 415(b), the increased pay cap under section 401(a)(17), and the expanded rollover rules are here to stay. *Plan documents and SPDs should be reviewed to remove any references to the 2010 sunset date.* This change also may impact long-term plan design and funding projections.

4. **Pension Benefit Statements**: Benefit statements must be provided to all active, vested participants at least once every three years, and participants can request additional benefit statements annually. The statement must explain any floor-offset or permitted disparity arrangement. It is unclear whether this includes a discussion of other offsets that may apply – such as nonduplication clauses, offsets for foreign

pensions, and offsets for worker's compensation. It also must describe the participant's total benefits accrued as well as the total vested benefits (or the earliest vesting date). Notices can be delivered electronically, but little detail is provided. A penalty may apply to failures to provide timely benefit statements ($100 per day). This provision is effective for plan years beginning in 2007.

5. **<u>Fiduciary Issues</u>**: The Act significantly expands the types of investments available under ERISA, effective immediately. This is super news for fund managers and the financial services industry. Plans can now engage in block trades, cross-trading, and certain transactions with parties in interest, which were previously unavailable. Plan money also may be more welcome in certain hedge funds due to changes in the plan asset rules. Plan fiduciaries should expect to be solicited aggressively with regard to these new investments. *Proceed with caution.*

   Any investment changes under these new rules should be discussed with counsel. *Plan fiduciaries will want counsel to review any new fund documents* (invariably prepared by financial services providers) to ensure adequate protections for the plan. *Counsel also should review trust agreements, investment policy language, investment management agreements and plan documents, to ensure that plan fiduciaries are authorized to engage in these new opportunities.* Advance review can prevent delays when investment managers are pushing to get "in the queue." The provision is effective immediately for new transactions.

6. **<u>Changes in Section 415 Benefit Limitation</u>**: The Act makes two significant changes to the annual benefit limit under section 415(b) of the Code:

   - It modifies the minimum interest rate used to convert benefit forms to an equivalent straight-life annuity for 415(b) purposes. This effectively extends the changes made by the PFEA, with minor change.

   - It includes all years of active service with the employer – not just years of plan participation – for purposes of calculating average compensation for a participant's high three years.

     This will entail operational changes and plan amendments – both for qualified pension plans and for any nonqualified excess plans whose contributions are tied to the 415(b) limit. This provision is effective January 1, 2006, which means that corrections may be necessary for distributions made earlier this year.

7. **<u>Increased Deduction Limitations for Employer Contributions</u>**: Generous increases have been made to the deduction limits for employer contributions. For 2006 and 2007, contributions to single employer plans are deductible up to 150% of a plan's current liability. After 2007, contributions are deductible up to the greater of (1) 150% of target funding liability plus the amount of target funding liability associated with projected future compensation and benefit increases, and (2) the

minimum required contribution for the plan year. In addition, the combined deduction limit for employers making contributions to both DC and DB plans has been essentially repealed for most large employers. These changes should be considered along with the plan funding rule changes in devising contribution strategies for upcoming years.

8. **Distributions During Working Retirement**: Pension plans may now permit actively employed participants who have reached age 62 to begin receiving distributions while continuing to work. A phased retirement program is entirely permissive and seems to offer a number of strategic planning possibilities. For instance, it might be possible to offer this distribution option as a temporary window incentive in order to reduce a funding surplus or to encourage a particular group of retirement-eligible employees to continue working. Since distributions do not have to be made pro rata according to hours worked—as required under existing phased retirement regulations—more flexible options now exist for integrating phased retirement with reductions in pay and work schedule. This provision is effective for plan years beginning in 2007.

9. **Plan termination**: Participants are now entitled to request detailed information about a plan facing a distress or involuntary termination. (This covers the same information shared with the PBGC.) The notice must be provided on short notice - within 15 days of the participant's request - so plans will want to be prepared to respond to these requests. Effective generally for any plan termination initiated after the date of enactment.