Significant Retirement Plan Provisions in New Pension Law: This memorandum summarizes key provisions of that Act affecting retirement plans and deferred compensation. The Act also contains a number of provisions addressing charitable giving which are not discussed herein. Among other measures, the Act:

- establishes new reporting and disclosure rules for both single employer and multiemployer plans;
- sets new standards for cash balance plans, including limits on wearaway provisions for new plans, and requirements for interest crediting and vesting for all plans effective in 2008, with no inference language governing current cash balance plans;
- provides special rules for plans that allow investment in company stock, including a requirement that participants be allowed to divest their accounts of company stock after 3 years (certain of these rules do not apply to ESOPS);
- makes permanent certain EGTRRA provisions, such as the limits on elective contributions and allowance of catch up contributions;
- establishes a safe harbor for nondiscrimination testing for 401(k) plans that provide for automatic enrollment of participants and meet certain other requirements;
- requires faster vesting for certain employer contributions to defined contribution plans.
- creates prohibited transaction exemptions for certain investment advice arrangements;
- provides a variety of special withdrawal and distribution rules for certain military and government employees; and
- changes a number of IRA and qualified plan rollover rules.

These changes are discussed in more detail below.

PROVISIONS AFFECTING DEFINED BENEFIT PLANS

New Funding Standards. The Act provides for enhanced funding standards for defined benefit pension plans. Generally, employers will be required to make sufficient contributions to the plan so as to meet a 100% funding target and erase funding shortfalls over 7 years. These rules become effective generally in 2008.

Actuarial Assumptions and Lump Sum Calculations. The Act establishes a permanent interest rate based on a modified three-segment "yield curve" based on corporate-bond yields. The yield curve is phased in over a 5-year period. The Act also prescribes required mortality tables, except in certain cases where the IRS approves a different table. A modified corporate bond rate (for the month before the date of distribution or such other date as prescribed by Treasury) would be used to convert annuity benefits to lump sums. For 2006 and 2007, the temporary use of the long-term corporate bond rate will continue as a substitute for the currently required 30-year Treasury rate. A special temporary rule applies in circumstances where the maximum benefit a participant may receive under the Code (measured as an annuity) is converted to a lump sum.

Credit Balances. Employers cannot generally use credit balances when determining the plan's level of funding or "at- risk" status, although the "carryover" balance reflecting credit balances as of 2006 may be used to reduce the minimum required contribution if the plan's "funding target attainment percentage" is at least 80%.

Accelerated Contributions for At-Risk Plans. The Act redefines "at-risk" plans and requires accelerated funding of those plans. The test for at-risk plans is phased in over 5 years.

Prohibitions on Benefit Enhancements. If plans are underfunded, limits are placed on increasing benefits (if funded below 80%) or providing shutdown benefits (if funded below 60%).

Rabbi Trusts and Section 409A Rules for Employers with At-Risk Plans. Employers with at-risk plans may not set aside funds in a rabbi trust or other deferred compensation funds to pay for nonqualified deferred compensation. They are also prohibited from deducting the value of any gross-up of 409A penalties incurred because of this rule.

Special Rules for Airlines, Defense Contractors and Others. Airlines, defense contractors and certain other entities have some special rules and additional time to meet certain of the obligations set forth in the Act.

Multiemployer Plan Rules. New reporting, disclosure and withdrawal liability rules will apply to multiemployer plans, as well as new funding standards and benefit restrictions for multiemployer plans that are funded at less than 65%.

PBGC Premiums. The temporary method for calculating PBGC variable premiums is extended through 2007. The temporary termination premium (established in 2005) is made permanent, and the full funding exemption to the variable rate premium is eliminated. The Act provides for a termination premium of $1,250 per participant if a plan sponsor terminates its pension plan upon entering bankruptcy (the premium would be paid when the company emerges from bankruptcy). New reduced premiums apply to employers with very small plans (fewer than 25 employees).

New Disclosure Rules for Pension Plans. Both single and multiemployer plans will be required to include more detailed information in the Forms 5500. Forms 4010 (information on reportable events filed with the PBGC) will be made available to the public. A special funding notice for participants will be required, and the summary annual report (SAR) will be eliminated.

Phased Retirement. Section 905 of the Act would allow payments from the plan to begin at age 62, even if the employee is still working.

RULES FOR HYBRID (CASH BALANCE) PLANS

Age Discrimination. Title VII of the Act provides rules that deem a cash balance plan to meet the Internal Revenue Code and ADEA age discrimination standards if it meets certain vesting (3 years) and interest crediting rules (market rates, negative returns cannot reduce account below contribution level). These rules generally apply beginning in 2008 to current plans with a delayed effective date for collectively bargained plans.

Whipsaw Eliminated and No Wearaway. The "whipsaw" is eliminated for plans that meet the vesting and interest crediting rules described above. For new plans established after July 29, 2006, the wearaway of benefits that a participant has earned at the time of plan conversion is prohibited; a plan must provide that accrued benefits are no less than the sum of the accrued benefit for service before conversion and the accrued benefit after.

No Inference Language. The Act contains no inference language with respect to practices of plans established prior to the effective date.

Mergers and Acquisitions. Special rules apply to cash balance plans involved in mergers and acquisitions.

ENHANCED RETIREMENT SAVINGS AND DEFINED CONTRIBUTION PLANS

EGTRRA. The EGTRRA contribution limits, including the increased 401(k) limits and catch up contributions, will be made permanent.

Saver's Credit. Effective for taxable years beginning after 2006, the Saver's Credit – a nonrefundable credit for up to $2,000 of qualified retirement savings contributions dependent on the adjusted gross income of the taxpayer – is made permanent.

Automatic Contribution Arrangements. An automatic contribution arrangement that meets certain requirements is treated as meeting the nondiscrimination rules for 401(k) plans and matching contributions and as meeting top-heavy rules. The automatic enrollment arrangement must provide for automatic elective contributions not exceeding 10% of compensation and at least 3% the first year of participation, 4% in the second year, 5% in the third year and 6% in each year thereafter. Employers must match 100% of the first 1% of pay contributed, plus 50% of the next 5%. The matches must be 100% vested after 2 years. The Act also preempts state laws that would prohibit or restrict automatic contribution arrangements.

Erroneous Automatic Elective Contributions. Erroneous automatic elective contributions

not exceeding $500, distributed before April 15 of the year following the contribution, and that meet certain other criteria, are treated as compensation to the employee and are not subject to the 10% early withdrawal tax or to the otherwise applicable nondiscrimination rules. Distributions of such contributions must include any earnings.

Faster Vesting Requirements for Nonelective Contributions. Nonelective contributions to a defined contribution plan must vest at least as rapidly as 100% after 3 years or 20% per year after 2 years. (This rule now applies to matching contributions.) This is effective after 2006 with a delayed effective date for collectively bargained plans.

Rollover of After-Tax Amounts to 403(b) Contracts. Such rollovers currently prohibited; they would be allowed effective after 2006.

Direct Rollovers From Retirement Plans to Roth IRAs. Effective for distributions made after 2007, eligible taxpayers may roll distributions from qualified retirement plans, tax-sheltered annuities, and governmental 457 plans to a Roth IRA (treated as a Roth IRA conversion and subject to eligibility for such a conversion).

Penalty Free Withdrawals For Individuals Called to Active Duty for At Least 179 days. Effective for distributions after September 11, 2001, plans are allowed to make qualified reservist distributions (10 % early withdrawal tax does not apply). A qualified reservist distribution is made (1) from an IRA or elective deferrals from a 401(k) plan or similar arrangement, (2) to a member of the reserves who, after September 11, 2001, and before September 12, 2007, is called to active duty for a period in excess of 179 days or an indefinite period, and (3) during the period beginning on the date the individual was called to active duty and ending at the close of the active duty. The amount of a qualified reservist distribution may be recontributed to the IRA within 2 years after the end of the active period and no deduction is allowed for such contributions.

IRAs. This legislation provides some new rules for IRAs:

- Individuals are allowed to direct that a refund be deposited in an IRA effective for taxable years beginning after 2006

- Effective for distributions made after December 31, 2006, a nonspouse beneficiary of a qualified retirement plan, governmental Section 457 plan, or tax-sheltered annuity can roll his or her interest over to an IRA, which is subject to the minimum distribution rules applicable to benefits payable after an employee's death.

Modification of Rules Governing Hardships and Unforeseen Financial Emergencies. The Treasury Secretary must revise the rules (within 180 days of the date of enactment) for determining financial hardship or unforeseeable emergency to include a financial hardship or unforeseeable emergency of a person who is the participant's beneficiary under the plan.

PROVISIONS RELATING TO PLAN AMENDMENTS

General Provisions. Effective as of the date of enactment, Section 1107 of the Act (1) provides that subject to certain requirements, conforming plan amendments made pursuant to the Act can be made by the end of the 2009 plan year; and (2) allows anticutback relief for such amendments, except as provided by the Secretary of Treasury.

DIVERSIFICATION RIGHTS AND OTHER PARTICIPANT PROTECTIONS UNDER DEFINED CONTRIBUTION PLANS

Defined Contribution Plans Required to Provide Employees With Ability to Divest Employer Stock. A defined contribution plan holding publicly traded employer securities must permit participants to diversify amounts invested in employer securities or real property. This does not apply to an ESOP containing no elective deferrals, employee contributions or matching contributions and not forming a part of another plan, or to a one-participant retirement plan. This provision requires immediate diversification rights for elective deferral and employee contribution amounts and diversification rights after 3 years of service for employer nonelective and matching contributions. It would generally apply for plan years beginning after December 31, 2006, with a 2-year phase-in rule and a delayed effective date for collectively bargained plans and ESOPs holding certain preferred stock on September 17, 2003. Additionally,

- A plan administrator must provide a participant with notice and certain other information no later than 30 days before the participant has the right to diversify.

- A plan administrator of a defined contribution plan is required to provide quarterly benefit statements to participants with a right to direct the investment of their accounts as well as annual benefit statements to other participants. A plan administrator of a defined benefit plan must provide vested active participants with statements every 3 years (or to notify such participants annually that benefit statements are available).

FIDUCIARY PROVISIONS

Investment Advice. The Act provides a prohibited transaction exemption for purchases and sales, extensions of credit and the receipt of fees in connection with a qualified investment advice program. Such a program is either based on a computer model that is certified by an independent party or has a fee structure which does not vary with the investments made. The Act requires the DOL to conduct a feasibility study on the use of computer models in connection with investment advice for IRAs. If the models are not deemed to be feasible, the Act instructs the Department of Labor to issue an exemption similar to that provided in the Act.

Prohibited Transaction Relief. The Act provides an exemption for certain transactions involving block trading, regulated electronic communications networks, foreign exchange transactions, and cross trading, and for certain transactions between a plan and a service provider who is not exercising authority or control with respect to such transactions.

Definition of Plan Assets. The Act modifies the definition of "plan assets" under current Department of Labor regulations, by eliminating foreign and governmental plans in determining whether a pooled investment fund holds "plan assets. The 25% threshold is not changed.

Correction of Inadvertent Transactions. If a prohibited transaction occurs in connection with the acquisition or any holding any security or commodity, and is corrected within 14 days of discovery (or the date it should have been discovered), no excise taxes will be due. Certain additional requirements must be met for this relief to apply (i.e., it does not apply to employer securities or employer real property or to self-dealing transactions).

Maximum Amount of Fiduciary Bond. Effective for plan years beginning after December 31, 2007, the Act raises the maximum amount of fiduciary bond required under ERISA to $1 million in the case of a plan that holds employer securities.

Other Bonding Relief. The Act would modify the bonding requirements to eliminate duplicative fidelity bonding coverage for registered broker-dealers, who must carry bonding coverage under rules imposed by self-regulatory organizations.

Increase in Penalties for Coercive Interference with Exercise of ERISA Rights. These penalties are increased from a maximum of $10,000 and 1 year in prison to $100,000 and 3 years in prison.

Treatment of Investment of Assets by Plan Where No Election Exercised. Employers have some fiduciary protections where participants self-direct their accounts, and those protections are extended in circumstances where the participant does not make an investment choice and the plan sponsor makes a default investment consistent with Department of Labor regulations (to be issued within 6 months of enactment). This will be effective for plan years after 2006. Notice of the participant's rights and obligations under the arrangement must be provided for this treatment to apply.

Fiduciary Liability During Blackout Periods. Fiduciary protections for self-directed plans are eliminated during blackout periods during which a participant's ability to change investments is restricted. This provision applies in 2008 (2010 for collectively bargained plans). Blackout notices will not be required for one-person plans.

PROVISIONS RELATING TO SPOUSAL PENSION PROTECTION

Regulations on Time and Order of Issuance of Domestic Relations Orders. The Act requires the Secretary of Labor to issue regulations (within one year after the date of enactment) to clarify that a domestic relations order otherwise meeting qualified domestics relations order (QDRO) requirements does not fail to be a QDRO solely because of the time it is issued or because it is issued after or revises another domestic relations order or QDRO.

Entitlement of Divorced Spouses to Railroad Retirement Annuities. Effective one year after the date of enactment, the Act eliminates the requirement that a railroad employee actually receive railroad retirement benefits for a former spouse to receive Tier I or Tier II benefits awarded under a State divorce court decision. Additionally, a former spouse does not lose eligibility for Tier II benefits upon death of the employee.

Requirement for Additional Survivor Annuity Option. Section 1004 of the Act requires that defined benefit pension plans and money purchase pension plans offer benefits in the form of an optional survivor annuity (i.e., an annuity for the life of the participant with a survivor annuity for the life of the spouse of the applicable percentage of the amount payable during the joint lives of the participant and spouse). The applicable percentage is (1) 75% if the qualified joint and survivor annuity (QJSA) under the plan provides a survivor annuity of less than 75% and (2) 50% if the QJSA provides a survivor annuity of more than 75%. This would be effective for plan years beginning after December 31, 2007, with a delayed effective date for collectively bargained plans.

PROVISIONS TO ENHANCE HEALTH CARE AFFORDABILITY

Treatment of Annuity or Life Insurance Contracts with a Long Term-Care Insurance Feature. This provision provides for tax rules applicable to long-term care insurance that is provided by a rider on or as part of an annuity contract, and modifies the tax rules applicable to long-term care insurance coverage provided by a rider on or as part of a life insurance contract.

Transfers of Excess Defined Benefit Assets for Retiree Health. The Act liberalizes the Section 420 (retiree health account) rules to permit plans with assets in excess of 120% of current liability to fund retiree health liabilities, subject to certain conditions.

Distributions From Government Retirement Plans for Health and Long-Term Care Insurance for Public Safety Officers. Distributions from a governmental plan to pay for health or qualified long-term care insurance premiums of a retired public safety officer (individuals serving a public agency as a law enforcement officer, firefighter, chaplain, or member of a rescue squad or ambulance crew) are excludable from gross income, up to a maximum of $3,000 per year. The premium must be paid directly to the insurer.

ADDITIONAL PROVISIONS

The following are some additional provisions of interest:

- **EPCRS.** The Act clarifies the IRS's authority with respect to Employee Plans Compliance Resolution System ("EPCRS") and provides issues to be considered in updating and improving EPCRS.

- **Distribution and Joint & Survivor Notices.** Effective for years beginning after December 31, 2006, the Act increases the period in which certain distribution notices can be provided to employees (the Treasury Secretary will modify the notice and consent regulations to require certain information to be included in a distribution notice).

- **Corporate-Owned Life Insurance.** The Act creates certain requirements (e.g., notice and consent of the insureds) in order for a holder of employer-owned insurance policies to exclude amounts exceeding premiums from income under Section 101 of the Code, and also establishes new reporting requirements for such arrangements.

- **Permissive Service Credit and Minimum Distribution Rules for Certain Government Arrangements.** Section 821 of the Act amends Section 415(n) to allow the purchase of service credit with respect to certain periods during which the employee has not performed services. Section 823 of the Act requires the Secretary of the Treasury to issue regulations allowing government plans to use a "good faith interpretation" of the minimum distribution rules of Section 401(a)(9).