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PAY ATTENTION TO PENSION PROTECTION

The Pension Protection Act of 2006 was signed into law on Aug. 17, 2006. At a whopping 900-plus pages, the Act makes significant changes to the Code and ERISA. Although the Act has been widely publicized in its efforts to reform pension plans, much of it impacts defined contribution plans such as 401(k)s, 403(b)s and 457 plans, as well as IRAs. Below is a summary of some of the key provisions impacting defined contribution plans and IRAs.

EGTRRA permanency. The 2006 law made permanent many of the provisions of EGTRRA 2001 which were scheduled to expire in 2010. These include increased IRA and 401(k) contribution and deduction limits, age 50 and over catch-up contributions, Roth-type contributions to 401(k)s and 403(b)s, and more favorable rollover and vesting rules.

Investment advice. The Act provides fiduciary relief to plan fiduciaries. A prohibited transaction exemption is included for the provision of investment advice to plan participants. The exemption applies if the advice arrangement between the plan fiduciary and the investment adviser meets numerous requirements. It applies to flat fees and to advice using a computer model. Plan fiduciaries continue to have the fiduciary duty to prudently select and monitor the investment options as well as the investment adviser. Also, the fiduciary relief available under the exemption only applies to advice provided to participants, not to plan-level investment advice provided to the fiduciary by an investment adviser or manager.

Automatic enrollment 401(k) safe harbor. Under current law, employers can design 401(k) plans to include automatic enrollment provisions (also called negative elections). These provisions enable them to withhold a certain amount from an employee's pay as a salary deferral unless the employee affirmatively elects not to contribute to the plan. The employee must be notified in advance. Plans containing automatic enrollment provisions are still subject to the ADP/ACP test and top-heavy rules. Effective for plan years beginning on or after Jan. 1, 2008, if this provision meets the new law requirements as a "qualified automatic contribution arrangement," the plan will satisfy the ADP/ACP test and the top-heavy rules. The plan must contain provisions regarding the minimum and maximum deferral amounts allowed, employee notice requirements, and mandatory employer contributions and vesting.

Default investment safe harbor. The Act requires the DOL to make a change to ERISA Section 404(c) that will provide plan fiduciaries protection for certain types of default investments. Currently, ERISA Section 404(c) provides relief to plan fiduciaries of participant-

directed plans if participants direct their investments. It also provides relief if the plan satisfies certain design and disclosure requirements. However, if participants do not make investment selections, plan fiduciaries remain responsible for the investment of those participant accounts. The procedure often used is to invest those accounts in a default investment. Usually, the default investment has the lowest volatility of investment options and is designed for principal preservation. That, however, may not be the most prudent investment choice for a participant who has decades until retirement. It is anticipated that the new Section 404(c) default investment requirements will allow for the use of asset allocation funds and models that take into account risk tolerance and estimated years to retirement.

Electronic display of Form 5500s. For plan years beginning in 2008, the Form 5500 must be provided electronically so that some information can be displayed by the Department of Labor (DOL) on the Internet. Plan sponsors who maintain intranet sites must also display the information on the sponsor's intranet site.

Benefit statement requirements. Currently, ERISA generally requires that defined benefit and defined contribution plans provide participants benefit statements upon request, but not more than once per year. In the case of participant-directed plans intending to qualify for fiduciary relief under Section 404(c) benefit statements must be provided automatically and, generally, at least quarterly. Beginning for 2007 plan years, participant-directed plans must provide participants and beneficiaries benefit statements at least quarterly. The statement must contain information regarding the importance of diversifying plan investments and a message that refers the participant to a DOL Web site with information on investing. Employer-directed defined contribution plans must provide participants and beneficiaries benefit statements annually.

Individual Retirement Accounts (IRAs). The Act makes a number of changes impacting IRAs.

- Indexing traditional and Roth IRA contribution limits. Beginning in 2007, the income limits for traditional and Roth IRA contributions will be indexed for inflation (rounded to the nearest $1,000).
- Direct deposit of tax refunds to IRAs. Beginning with the 2007 tax year, taxpayers may elect to direct deposit all or a portion of their tax refunds to an IRA of the taxpayer or spouse of the taxpayer in the case of a joint return. Previously, taxpayers only had the ability to elect direct deposit of their refunds to checking or savings accounts. This provision does not modify the rules relating to the timing and deductibility of IRA contributions or any other rules relating to IRAs.
- Direct rollover to Roth IRAs. For distributions made in plan years beginning on or after Jan. 1, 2008, participants in qualified retirement plans, 403(b) plans and governmental 457 plans will be able to roll over distributions directly from those plans into Roth IRAs, subject to current law.
- Tax-free distributions from IRAs for charitable purposes. For the 2006 and 2007 tax

years only, IRA owners who are age 70½ and older can make distributions from traditional IRAs of up to $100,000 to tax-exempt charities.

Just as ERISA changed the retirement landscape for millions of workers over 30 years ago, so too does the Pension Protection Act change the landscape of existing laws affecting the private retirement system.