

KEY PROVISIONS OF THE PENSION PROTECTION ACT OF 2006

Provision	Description	Effective Date/Comments
Funding of Single Employer Defined Benefit Pension Plans		
Interest Rate for Determining Plan Liabilities for 2006 and 2007	<p>Current law requires the use of the 30-year Treasury bond rate for determining pension plan liabilities. Temporary relief enacted in 2004 allowed plan sponsors to use a long-term corporate bond rate (which was higher than the 30-year Treasury rate, resulting in lower liability estimates for 2004 and 2005). The Act extends use of the long-term corporate bond rate for 2006 and 2007.</p>	<p>January 1, 2006. Use of the 30-year Treasury rate for calculating required contributions for 2006 likely caused some plan sponsors subject to the quarterly contribution requirements to contribute more than they were required to contribute on April 15 and July 15. This can be "made up" with lower contributions the rest of the year.</p>
Minimum Funding Standards – Determining Assets and Liabilities	<p>The Act substantially modifies the basic plan funding rules. Key changes from current law include:</p> <ul style="list-style-type: none"> • Plan liabilities will be determined using a three-segment corporate bond yield curve. The yield is based on a 24-month average of the top three grades of corporate bonds. • Certain large plans may petition the IRS to use plan-specific mortality tables in certain circumstances. • Generally fair market value is to be used when valuing plan assets, but "smoothing" of asset gains and losses is allowed if: (i) restricted to asset averaging over 	<p>Generally becomes effective for plan years beginning on or after January 1, 2008. The modified yield curve is phased in over three years beginning in 2008 (unless a plan opts to forego the phase-in).</p>

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	<p>24 months and (ii) the result is limited to between 90% and 110% of the fair market value of plan assets as of the valuation date.</p> <ul style="list-style-type: none"> Plans must use the first day of the plan year as the valuation date (plans with fewer than 100 participants are exempt from this rule) 	
Minimum Contributions	<p>The employer generally must contribute an amount sufficient to cover the plan's normal cost for the year (<i>i.e.</i>, generally, the benefit accruals for the year) and an amount sufficient to amortize the plan's underfunding over a 7-year period.</p> <p>Generally, a plan may have a funding standard account "credit balance" that it may elect to use to satisfy its minimum funding requirements. However, for plans that are less than 80% funded, credit balances may not be used to satisfy minimum funding requirements.</p>	Phased in beginning in 2008.
"At Risk" Plans	<p>Plans that are "at-risk" are subject to certain required actuarial assumptions and additional funding requirements. A plan generally is at-risk if, in the prior year, it is less than 80% funded under the basic rules and less than 70% funded using special (and very conservative) rules. Plans with fewer than 500 participants (determined by aggregating all defined benefit plans (other than multiemployer plans) maintained by the employer's controlled group) are</p>	Generally phased in beginning in 2008.

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	exempt from the at risk rules.	
Funding-Based Benefit Limitations	<p>In addition to increased funding requirements, plans that are at-risk are subject to other limitations affecting distribution options, accruals and amendments (unless additional security is given).</p> <p>In particular: (i) plans that are less than 60% funded generally may not pay lump sums, (ii) lump sums under plans that are between 60% and 80% funded generally are limited to the lesser of the participant's PBGC-guaranteed benefit or 50% of the lump sum the participant otherwise would receive, (iii) shutdown benefits and benefits for other unpredictable contingent events are restricted if the plan is less than 60% funded, (iv) benefit accruals under plans that are less than 60% funded generally must be frozen, and (v) plan amendments increasing benefits generally are prohibited if the plan is less than 80% funded (or would be less than 80% funded taking into account the amendment).</p> <p>A single-employer plan generally may not pay lump sums if the plan is in bankruptcy unless the plan is 100% funded.</p>	Plan years beginning in 2008.
Deduction Limitation for Defined Benefit Plans	Increased to the year's normal cost plus the amount needed to satisfy the plan's funding target for the plan year under the Act. In addition, employers may contribute and deduct a "cushion" of up to 50% of the	Plan years beginning after December 31, 2007.

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	<p>funding target plus additional amounts reflecting projections for salary increases.</p> <p>Plans with 100 or fewer participants may not take any benefit increases adopted in the prior two years into account.</p>	
Combined Plan Deduction	<p>The deduction for annual contributions to the combined defined benefit and defined contribution plans of an employer generally is limited to 25% of the total compensation paid to plan participants. The Act will exclude defined benefit plans subject to Title IV of ERISA from the calculation.</p> <p>In addition, only employer contributions to a defined contribution plan that exceed 6% of participant compensation are subject to the deduction limit.</p>	Plan years beginning after December 31, 2007.
Multiemployer Plan Funding		
Funding Rules	<p>The funding rules applicable to multiemployer plans are substantially revised. Key changes include:</p> <ul style="list-style-type: none"> • In general, the amortization schedule for funding is reduced from 30 years to 15 years. • Plans that are funded below 80% generally are considered to be in "endangered" status. A plan in endangered status must adopt a rehabilitation plan. • Plans that are less than 65% funded and meet 	Generally effective for plan years beginning in 2008. The rules generally sunset in 2017.

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	<p>certain other tests are in "critical status." Plans in critical status must adopt a funding improvement plan. Plans in this status may reduce or eliminate early retirement subsidies for active participants.</p> <ul style="list-style-type: none"> Plans must certify whether they are in "endangered" or "critical" status annually and, if in such status, must certify whether progress is being made under its rehabilitation or funding improvement plan. 	
Benefits Under Defined Benefit Plans		
Interest Rate for Determining Lump Sums	A version of the 30-year corporate bond yield curve must be used to determine minimum lump sum distributions under defined benefit pension plans. Current law generally requires the use of the 30-year Treasury bond rate.	Phased in using 20% increments beginning in 2008, and the rate is fully phased in by 2012.
Valuing Lump Sum Distributions for Purposes of Code Section 415	Code section 415(b), which limits the benefit payable under a defined benefit pension plan, is expressed in the form of annual annuity payments. Lump sum distributions must be "converted" for purposes of determining the limitation for that form of benefit. Under current law, the 30-year Treasury bond rate generally is used. The Act changes this rate to the greatest of (i) 5.5%, (ii) 105% of the 30-year Treasury bond rate, or (iii) the rate specified under the plan.	Effective with distributions made in years beginning after December 31, 2005.

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PBGC-Related Provisions		
Variable Premiums	Currently, plans that satisfy the "full funding limitation" are exempt from PBGC variable premiums even if the plans are underfunded. (Under the rules, a plan that is underfunded still can have hit the full funding limit.) The Act eliminates the full funding limit exception, so all underfunded plans will be subject to variable premiums.	Plan years beginning after 2007.
Bankruptcy Provisions	If an underfunded plan is terminated during the bankruptcy process, (i) the bankruptcy filing date determines the maximum PBGC benefit guarantee, and (ii) assets are allocated as of that date under section 4044 of ERISA.	Effective with bankruptcies initiated on or after 30 days of the Act's date of enactment.
Missing Participants	The PBGC missing participant program is extended to cover terminating multiemployer plans, small professional plans not subject to ERISA, and defined contribution plans.	Effective upon issuance of final regulations.
Disclosure Requirements		
Defined Benefit Plan Funding Notice	The administrator of a plan subject to Title IV of ERISA must provide an annual funding notice to the PBGC, participants, beneficiaries and labor unions setting forth information regarding the plan's funded status. Multiemployer plans must also send the notice to contributing employers. The notice must be provided within 120 days after the end of the plan year (unless the plan has 100 or fewer participants).	Plan years beginning after December 31, 2007.
Periodic Benefit Statements	Administrators of defined	Plan years beginning after

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	contribution plans generally must provide benefit statements annually. If participants direct the investments in their accounts, statements must be provided quarterly. Administrators of defined benefit plans generally must provide such a statement every three years.	December 31, 2006.
Notice of Freedom to Divest Employer Securities	Plan participants generally must be permitted to divest employer securities held under a defined contribution plan after three years of plan participation. Notice must be provided at least 30 days before the right to divest attaches to the participant.	Plan years beginning after December 31, 2006.
Fiduciary and Prohibited Transaction Rules		
Investment Advice to Participants in Defined Contribution Plans	The Act provides a prohibited transaction exemption to allow qualified fiduciary advisers to offer personal investment advice to participants in defined contribution plans and IRAs. The advice must be provided through an arrangement that either: (i) is based on computer models meeting certain conditions, or (ii) provides that the adviser's compensation may not vary based on the investments selected. Various disclosure requirements also apply. The plan sponsor generally is protected against liability to participants in connection with such advice.	Advice provided after December 31, 2006.
Modification of "Significant" Participation Test	The Act modifies the "significant" participation test (commonly referred to as the "25% test") that is applicable in determining whether assets held by an investment fund are ERISA "plan assets." Only ERISA-	Transactions occurring after enactment of the Act.

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	<p>covered plans, IRAs and other plans subject to section 4975 of the Code, and entities that hold plan assets by virtue of a plan's investment in such fund will be "benefit plan investors" taken into account in the numerator of the 25% test. The Act also provides that only the proportional part of the equity owned by benefit plan investors is treated as plan assets.</p>	
<p>Prohibited Transaction Exemptions Relating to Financial Investments</p>	<p>The Act includes prohibited transaction exemptions for:</p> <ul style="list-style-type: none"> • Certain transactions involving the sale, exchange or leasing or property, extension of credit, or transfer of plan assets between a plan and a plan service provider that is a "party in interest" (other than certain persons who may have discretionary control over the assets involved in the transaction or render investment advice for a fee with respect to those assets). • Certain block trades involving at least 10,000 shares or securities with a market value of at least \$200,000. • Certain cross-trades involving plans with assets of at least \$100 million managed by the same account manager. • Certain foreign exchange transactions between a 	<p>Transactions occurring after enactment of the Act.</p>

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	<p>plan and a bank or a broker-dealer.</p> <ul style="list-style-type: none"> • Certain transactions involving the sale of securities or other property using electronic communications networks. • Certain otherwise prohibited transactions incurred in connection with the acquisition, holding or disposition of any security or commodity (other than a transaction involving the acquisition or sale of employer securities or employer real property between a plan and the plan sponsor) that are corrected within 14 days of discovery (or when they should have been discovered). 	
Changes Applicable to Defined Contribution Plans		
<p>Investment of Assets Where Participant Fails to Exercise Investment Election</p>	<p>The Act amends section 404(c) of ERISA (which generally insulates fiduciaries from liability for losses caused by plan participants' investment elections if various requirements are met) to also apply where the participant fails to make an investment election. There is a participant notice requirement, and the default investment must be in accordance with Labor Department regulations (and the Department is directed to provide that such investments include a mix of asset classes consistent with long-term capital preservation or long-term capital</p>	<p>Plan years beginning after December 31, 2006. The Labor Department is directed to issue final regulations with respect to this section not later than six months after enactment of the Act.</p> <p>The Labor Department has been working on regulations addressing this issue for quite some time, and was expected to issue proposed regulations this summer, so it can be expected that regulations will be issued fairly quickly.</p>

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Increase in Diversification Rights	<p>Since 1998, plans generally have not been permitted to require participants to invest their own contributions in employer securities. The Act extends this provision to employer contributions. Participants must be permitted to diversify out of employer securities after they have been in the plan for three years. This rule applies only to plans with publicly-traded employer securities. The rules do not apply to ESOPs that do not have elective, employee or matching contributions and one-participant plans.</p>	<p>Plan years beginning after December 31, 2006 (subject to a limited exception to the extent the plan covers collectively bargained employees, in which case the effective date may be as late as plan years beginning after December 31, 2008 in certain cases).</p> <p>Existing plans may phase in diversification over three years.</p>
Automatic Enrollment in 401(k) Plans	<p>In order to encourage automatic enrollment in 401(k) plans via "negative elections" (<i>i.e.</i>, employee deferrals are made unless the employee affirmatively "opts out"), the Act provides various protections to employers. The Act requires that enrollment be accompanied by a notice explaining the participant's right to elect out of the plan or to change the rate of contribution, the time periods for making elections, and how contributions will be invested in the absence of a participant election. The Labor Department is directed to establish safe harbor investment guidelines for employees who do not make affirmative investment elections. In addition, the Act also clarifies that ERISA preempts any state laws that would require employee consent to payroll withholding.</p> <p>The Act also includes an optional</p>	<p>Plan years beginning after December 31, 2007 (except that the preemption of state laws is effective upon enactment).</p> <p>Employers that use the current ADP/ACP safe harbor (which will remain available) may want to consider the automatic enrollment safe harbor as an alternative. There are two advantages. First, the current safe harbor requires matching contributions that can be up to 4% of compensation. Second, that safe harbor requires immediate vesting of all employer safe harbor contributions, so short-service employees do not forfeit any portion of the matching contributions upon termination of employment. The downside is that more employees may end up receiving the match as a result of automatic enrollment, possibly offsetting some or all of these savings.</p>

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	<p>"safe harbor" that results in automatic passage of the "ADP" and "ACP" nondiscrimination tests. The safe harbor applies if there is a minimum match of 100% of elective deferrals up to 1% of compensation, plus 50% of elective deferrals between 1% and 6% of compensation. Thus, the maximum match is 3-1/2% of compensation. Alternatively, a 3% nonelective contribution may be made on behalf of all participants. A plan qualifies for this safe harbor only if the contribution rate for automatic enrollees is at least 3% during the first year of participation, 4% during the second, 5% during the third, and 6% thereafter. In addition, the plan may specify a higher percentage, up to 10%. Matching contributions must be 100% vested after two years of service.</p>	
<p>Faster Vesting of Employer Contributions</p>	<p>Under current law, employer contributions (other than matching contributions) must vest at least as fast as five-year "cliff" vesting or under a seven-year "graded" vesting schedule. The Act modifies these rules to three-year cliff vesting or six-year graded vesting (the same treatment currently applicable to employer matching contributions).</p>	<p>Plan years beginning after December 31, 2006 (with potentially delayed effectiveness for collectively bargained employees to as late as 2009).</p>
<p>Provisions Applicable to Distributions from Qualified Plans</p>		
<p>Direct Rollovers from Retirement Plans to Roth IRAs</p>	<p>Individuals with adjusted gross incomes of less than \$100,000 may directly roll over distributions to Roth IRAs. The distribution from the qualified plan would be subject to ordinary income tax, but earnings of the</p>	<p>Effective with distributions after December 31, 2007.</p>

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	IRA would be tax-free. The 10% early withdrawal penalty tax under Code section 72(t) does not apply to such rollovers.	
Elimination of 10% Penalty Tax for Military Personnel	Code section 72(t) generally imposes a 10% penalty tax on distributions taken from tax-qualified retirement plans before age 59-1/2 (subject to certain exceptions). The Act eliminates the application of this rule to distributions to participants called to active military duty for at least 179 days. In addition, the amount withdrawn by the participant may be repaid within two years after the later of the end of service or enactment of the Act.	Applies to individuals called to active duty between September 11, 2001 and December 31, 2007, and applies to all distributions made after September 11, 2001.
Modification of 401(k) Hardship Withdrawal "Safe Harbor"	The regulations under Code section 401(k) include a "safe harbor" for hardship withdrawals by participants. The Act directs the IRS to revise the regulations to provide that an event that would be a hardship if incurred by the participant's spouse or dependents will also constitute a hardship if incurred by the participant's beneficiary.	Following issuance of final IRS regulations.
Rollovers by Nonspouses	Spousal death beneficiaries may "roll over" eligible rollover distributions (<i>i.e.</i> , most lump sum distributions) to an IRA or another retirement plan. The Act extends this right to nonspouse beneficiaries.	Effective with distributions made after December 31, 2006. This will require plan administrators to modify the eligible rollover distribution notice that must be provided to participants and beneficiaries.
Distributions During Working Retirement	Defined benefit plans generally may not make in-service distributions until the employee attains normal retirement age (generally age 65). The Act permits in-service distributions	Effective with distributions in plan years beginning after December 31, 2006.

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	beginning at age 62.	
Additional QJSA Option	<p>Most plans subject to the Code's annuity rules (generally defined benefit plans and money purchase pension plans) must provide a "qualified joint and survivor annuity" (or "QJSA") as the normal form of benefit for married participants that applies unless waived without spousal consent.</p> <p>The Act requires a plan to offer a 75% survivor annuity option if the QJSA has a survivor percentage that is less than 75% and a 50% annuity option if the survivor percentage is greater than or equal to 75%.</p>	Plan years beginning after December 31, 2007 (with potentially delayed effectiveness for collectively bargained plans to as late as 2009). This will require revision of plan distribution forms for plans that do not already offer such an option.
Notice and Consent Period	Generally, election of a form of benefit other than a QJSA (for plans subject to the QJSA rules as described above) may be made no earlier than 90 days before the annuity starting date. The Act extends this to 180 days before the annuity starting date.	Plan years beginning after December 31, 2006. This will require revision of plan distribution forms.
Executive Compensation		
Section 409A – Restrictions on Non-Qualified Deferred Compensation Plans	The Act amends Code section 409A to accelerate taxation (and impose a 20% additional tax on the employee) in the event benefits are "funded" (through a "rabbi" trust or otherwise) if (or if a plan provision provides for such funding) the employer or a member of its controlled group (i) is bankrupt while it sponsors a defined benefit plan, (ii) sponsors an "at risk" defined benefit plan (e.g., less than 80% funded), or (iii) terminates a defined benefit plan in a "distress" termination in bankruptcy (in which case the	Upon enactment of the Act. However, because the pension plan "at risk" rules do not become effective until 2008, that portion of the rule effectively does not apply until then.

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	<p>funding restriction applies for six months before and six months after the distress termination). This restriction only applies to "covered employees" (generally senior executives of public companies and retired participants who previously were senior executives).</p> <p>The Act also attempts to deter "gross-ups" of any tax liability triggered by this provision by denying the employer a tax deduction for the cost of the gross-up.</p>	
EGTRRA Provisions		
Permanency of EGTRRA	<p>The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") increased a number of the dollar limits applicable to tax-qualified retirement plans, including the compensation limit (currently \$220,000), the limit on employee elective deferrals (currently \$15,000), the introduction of "catch-up" contributions for employees age 50 and older (currently \$5,000), and the total limit on annual contributions to a defined contribution plan (currently the lesser of \$44,000 or 100% of compensation). In addition, "Roth" 401(k) contributions were created by EGTRRA. However, these provisions were scheduled to "sunset" at year-end 2010. The Act eliminates the sunset and makes the provisions permanent.</p>	Upon enactment of the Act.
Safe Harbor for "Cash Balance" and Other "Hybrid" Pension Plans		
Cash Balance Plan Safe Harbor	Numerous plaintiffs have sued regarding whether cash balance	Generally, applies to periods beginning on or after June 29,

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	<p>and other hybrid pension plans satisfy the Code's and ERISA's age discrimination and benefit accrual rules. Because these rules were originally drafted with only "traditional" plan designs in mind, their application to cash balance plans is unclear.</p> <p>The Act adds a safe harbor for cash balance/hybrid plans. However, the rules are prospective only, and the Act states that no inference should be drawn as to the legality of such plan designs or the manner in which such plans were "converted" from prior designs satisfies the age discrimination rules. Under the Act, a plan will not be age discriminatory if, under the plan design, a participant's accrued benefit would be equal to or greater than that of any "similarly situated" younger participant. There is a safe harbor that applies only if specified rules regarding interest crediting and vesting of benefits are met. The vesting requirement is full vesting after three years of service. Since most defined benefit plans require five years of service for vesting, this would require amendment of most plans. The Act also addresses the age discrimination issues raised by plan conversions that occur after enactment of the Act.</p> <p>The Act also addresses the "whipsaw" issue. A number of courts have held that cash balance plans that use a higher interest rate for interest crediting purposes than the rate used for determining lump sum benefits under defined benefit plans may</p>	<p>2005.</p> <p>Amendments regarding the calculation of lump sums are effective with respect to distributions made after the date of the Act's enactment.</p> <p>For plans in existence on June 29, 2005, certain vesting and interest credit requirements may become effective for years beginning after December 31, 2007.</p> <p>A key risk with the Act in this regard is that the "safe harbors" may become the de facto rules, and any employer operating outside the safe harbors will be taking on additional risk.</p>

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	<p>not treat participants' account balances as the lump sum benefit. The Act provides that the lump sum may be the account balance if certain requirements are satisfied.</p>	