



CHANGES IN RULES FOR RETIREMENT PLANS

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For several years, Congress has worked on improving the laws governing retirement plans sponsored by employers, attempting to encourage employers to maintain such plans and to protect the employees enrolled in such plans. In August 2006, the Pension Protection Act of 2006 (PPA), the culmination of this initiative, became law. The PPA made several changes to the laws governing retirement plans, including defined contribution plans – profit-sharing and 401(k) plans. Following is an overview of some of the more important provisions that affect these plans:

Encouraging Automatic Enrollment in 401(k) Plans. One concern of Congress was the failure of many employees to elect to participate in employer-sponsored plans. In order to encourage employers to adopt 401(k) plans with automatic enrollment (*i.e.*, employee deferrals are made unless the employee affirmatively “opts out”), the PPA provides various protections to employers, including clarifying that ERISA preempts any state laws that would require employee consent to payroll withholding. The employer will be required to give an annual notice to employees explaining the employees’ right to elect out of the plan.

An optional non-discrimination safe harbor for automatic enrollment plans, effective for plan years beginning after 2007, will require that the automatic deferral percentage be at least 3% in the first year of participation, increasing each year to 6% in the fourth year and thereafter. The employer must match at least 100% of the first 1%, and at least 50% of the next 5%, of employee deferrals or must make a 3% non-elective contribution. Employer contributions under automatic enrollment plans must be fully vested after two years of service.

Providing Employees with Investment Advice. Many employers maintain plans under which employees are responsible for choosing how to invest the funds. Employers and their advisers have been reluctant to provide individual investment advice to employees for fear of incurring liability if the investments do not perform well. To address this problem, the PPA includes a new prohibited transaction exemption that will allow “qualified fiduciary advisers” to offer personal investment advice to plan participants. This provision is effective starting January 1, 2007. A qualified fiduciary adviser (*e.g.*, a registered bank, investment company, broker-dealer, or insurance company) may provide investment advice if either (i) its recommendations are based on a computer model certified by an independent third party or (ii) its compensation is not based on the investments selected. Various disclosure requirements also apply. The plan sponsor (typically the employer) is generally protected against liability to participants in connection with such advice.

Default Investment and Reallocation Safe Harbors. Another problem faced by employer-plan sponsors is the failure of employees to select investments. One approach has been for the plan sponsor to designate a “default” investment, but the potential liability for losses in an employee account often result in the default investment’s being one of the more conservative choices, which may not be appropriate for all employees. To address this issue, the PPA amended ERISA Section 404(c) so that it will insulate fiduciaries from liability for losses caused by a plan sponsor’s investment decisions when a participant fails to make an investment election, if certain conditions are met. The Department of Labor is required to provide guidance on how plan sponsors can satisfy their fiduciary responsibilities for the

investment of assets where the participant has not made any investment choices.

Changes in Accelerated Vesting Requirements for Employer Contributions. Effective for plan years beginning in 2007 and later, all employer contributions (not just matching contributions) must vest at least as rapidly as either three-year “cliff” vesting or a six year “graded” vesting schedule.

Benefit Statements. Beginning with the first plan year after 2006, periodic benefit statements must be given to participants on a specific schedule. Pending issuance of further guidance, delivery of the statement will be deemed timely if it is provided not later than 45 days following the “applicable time period.” The “applicable time period” is a specified period for which the statement is required. For example, for a participant-directed calendar year plan, the applicable time period is each calendar quarter, and the first statement would have to be provided by May 15, 2007 (45 days following the quarter ending March 31, 2007). For a participant-directed fiscal year plan with a June 30 plan year, the statement would need to be provided no later than November 14, 2007 (45 days following the quarter ending September 30, 2007, the first applicable time period). For a non-participant-directed calendar year plan with an annual reporting period, the deadline for providing the statement for the 2007 calendar year would be February 14, 2008.

Certain Prior Laws Become Permanent. The PPA eliminated the sunset provisions of pension-related portions of the Economic Growth & Tax Relief Reconciliation Act of 2001 (EGTRRA). These provisions significantly simplified the portability, plan design, and administrative rules, increased contribution limits for most types of retirement accounts, including the catch-up provisions for employees age 50 and older, and established Roth 401(k) contributions. These provisions were scheduled to expire in 2010.

Increased Options for Participants. The PPA also provides several new options to plan participants and their beneficiaries:

Distributions Prior to Retirement. Pension plans may provide for distributions to an employee who has attained age 62 and who is not separated from employment at the time of the distribution.

Rollovers Directly into a Roth IRA. After December 31, 2007, participants of 401(k) plans, 403(b) plans, tax-sheltered annuities, governmental 457 plans, and other qualified trusts may roll over plan assets directly to a Roth IRA. The rollover is not tax free. The limitations applicable to rollovers of traditional IRAs to Roth IRAs also apply.

Rollovers by Nonspouse Beneficiaries. After December 31, 2006, a nonspouse beneficiary may roll over a qualified plan account (e.g., 401(k) account) upon the death of the participant to an inherited IRA and take distributions from the account over his or her lifetime. The beneficiary will avoid tax on the rollover and will be taxed only when the assets are withdrawn. This rule applies only to direct rollovers.

Tax-Free IRA Distributions to Charities. Individuals age 70½ or older may distribute up to \$100,000 of their IRA account assets to charitable organizations (excluding private foundations) in 2006 and 2007 without recognizing income and without taking a charitable deduction. This distribution qualifies as a required minimum distribution.

Investments in Employer Stock. Some qualified plans require that a portion of a participant’s account be invested in the employer’s publicly-traded stock. The PPA allows a participant (or the participant’s beneficiary) to divest any employer stock in which the participant’s employee contributions and elective deferrals are invested. In addition, a participant who has completed at least three years of service may divest a portion of the employer contributions invested in employer stock.

This is only a summary of various provisions of the PPA. Regulations containing additional specific requirements and guidance for implementing these changes are due from the Internal Revenue Service and Department of Labor early in 2007. If you are interested in a more complete summary of the key provisions of the PPA, the American Society of Pension Professionals and Actuaries has posted an excellent explanation at http://www.asppa.org/government/ASPPA_HR_4_Summary_Final.pdf.