



August 2006

Special Report to Clients

The Pension Protection Act of 2006

On August 17, 2006, the President signed the Pension Protection Act of 2006 (PPA) into law. PPA was passed by the U. S. Senate on August 3, 2006, and the U. S. House of Representatives on July 28, 2006. This landmark pension legislation fundamentally changes the funding rules for single employer defined benefit plans and makes extensive changes to other rules governing multiemployer pension plans, hybrid pension plans, and defined contribution retirement plans. It also includes a limited number of provisions that affect nonqualified deferred compensation benefits and health care. Some of the more significant changes are briefly summarized in the following two paragraphs.

PPA replaces the funding requirements for defined benefit pension plans by subjecting defined benefit plans to a 100% of current liability funding target, requiring more funding of “at-risk” defined benefit plans, and imposing new benefit limits on underfunded defined benefit plans. PPA also changes the premiums that the sponsors of underfunded defined benefit plans must pay to the Pension Benefit Guaranty Corporation (PBGC). In addition, PPA clarifies the legal standing of cash balance and other hybrid pension plans by making it clear that, at least prospectively, plans complying with the PPA rules do not discriminate on the basis of age.

PPA also extends certain tax incentives for retirement savings, modifies tax provisions relating to spending for health care, establishes a safe harbor for employers to provide investment advice to help employees manage their 401(k) plan accounts, and provides a safe harbor for automatic enrollment of employees in 401(k) plans. Furthermore, PPA provides for modifications to the plan asset rules that determine when participant contributions become assets of a plan, and to the prohibited transaction rules, which prohibit a wide range of transactions between a plan and a party in interest unless an exemption applies. PPA also requires more disclosure to participants about how their retirement plans are performing.

In this Special Report, Hewitt Associates provides detailed coverage of PPA’s most significant provisions affecting single employer defined benefit pension plans, multiemployer defined benefit pension plans, defined contribution retirement plans, nonqualified deferred compensation benefits, and health care.

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Table of Contents	Page
Single Employer Defined Benefit Plans: Minimum and Maximum Funding Requirements	1
<i>Minimum Funding Requirements—General</i>	1
<i>Liability Underlying Funding Calculations</i>	2
<i>Funding Shortfall</i>	2
<i>Amortization of Funding Shortfalls</i>	2
<i>Interest Rate to Value Liabilities</i>	3
<i>Mortality Table and Other Assumptions</i>	4
<i>At-Risk Plans and At-Risk Liability</i>	4
<i>Actuarial Value of Assets</i>	5
<i>Valuation Date</i>	6
<i>Credit Balances</i>	6
<i>Quarterly Contributions</i>	7
<i>Maximum Deductible Limit</i>	7
<i>Delayed Effective Dates</i>	8
Single Employer Defined Benefit Plans: Funding-Based Benefit Restrictions	9
<i>Funding-Based Benefit Limitations—General Rules</i>	9
<i>Use of Credit Balances</i>	10
<i>Limitations on Plan Amendments Increasing Benefits</i>	10
<i>Limitations on Lump Sum Payments (and Other Accelerated Benefit Distributions)</i>	11
<i>Benefit Freezes</i>	11
<i>Shutdown and Other Unpredictable Contingent Event Benefits</i>	12
<i>Presumption as to Funded Status</i>	12
Funding Rules for Multiemployer Defined Benefit Plans and Related Provisions	13
<i>General Funding Rules for Multiemployer Plans</i>	13
<i>Additional Funding Rules for Plans in Endangered or Critical Status</i>	13
<i>Changes to Withdrawal Liability Rules</i>	15
<i>New Notice and Disclosure Requirements</i>	15
Other Defined Benefit Pension Plan Provisions	16
Minimum Lump Sum Benefits	16
Section 415 Limits	17
<i>Application of 415 Limit to Lump Sum Distributions</i>	17
<i>Calculation of Three-Year Highest Average Compensation for 415 Limit Purposes</i>	18
PBGC Guarantee and Related Provisions	19
<i>PBGC Premiums</i>	19
<i>Bankruptcy Premiums</i>	20
<i>Guarantee of Shutdown Benefits</i>	20
<i>Bankruptcy as Termination Date</i>	20
<i>Interest on Overpayments</i>	20

Hybrid Pension Plans	21
<i>Rules Relating to Reduction in Rate of Benefit Accrual: Anti-Age Discrimination</i>	21
<i>Rules Relating to Reduction in Rate of Benefit Accrual: Interest Credits</i>	22
<i>Rules Relating to Reduction in Rate of Benefit Accrual: Conversions to Hybrid Plans</i>	22
<i>Rules for Computing Accrued Benefits by Reference to Hypothetical Account Balance</i>	23
<i>Vesting for Hybrid Plans</i>	23
<i>Definition of Hybrid Plan</i>	23
<i>Effect of New Legislation on Hybrid Plans Existing Before Effective Date</i>	24
<i>Regulations Relating to Mergers and Acquisitions</i>	24
Reporting and Disclosure	25
<i>Defined Benefit Plan Funding Notice</i>	25
<i>Additional Annual Reporting Requirements</i>	26
<i>Electronic Display of Annual Report Information</i>	27
<i>Disclosure of Termination Information to Plan Participants</i>	27
<i>4010 Filings with the PBGC</i>	28
<i>Periodic Pension Benefit Statements</i>	29
<i>Notice and Consent Regarding Distributions</i>	30
Rules Related to Prohibited Transactions and Fiduciary Liability	31
<i>Investment Advice</i>	31
<i>Prohibited Transaction Rules Relating to Financial Investments</i>	32
<i>Correction Period for Prohibited Transactions Involving Securities and Commodities</i>	32
<i>Treatment of Investment of Assets by Plan Where Participant Fails to Exercise</i>	33
<i>Investment Election (Default Investments)</i>	
<i>404(c) Protection for Blackouts</i>	33
<i>Increase in Penalties for Coercive Interference With Exercise of ERISA Rights</i>	34
EGTRRA and Saver's Credit Permanence	35
<i>EGTRRA Permanency</i>	35
<i>Saver's Credit (for Elective Deferrals and IRA Contributions)</i>	35
Diversification and Vesting	36
<i>Diversification Requirements for Defined Contribution Plans</i>	36
<i>Notice of Freedom to Divest Employer Securities</i>	37
<i>Faster Vesting</i>	38
Automatic Enrollment	39
<i>ADP/ACP Safe Harbor for Automatic Enrollment</i>	39
<i>Returns of Automatic Enrollment Contributions</i>	40
<i>Excess Contributions</i>	40
<i>State Law Preemption</i>	40

Distribution, Portability, and Contribution Rules	41
<i>Pension Plan Distributions While Working</i>	41
<i>Rollovers of After-Tax Contributions to 403(b) Plans and Pension Plans</i>	41
<i>Rollovers to Roth IRAs</i>	41
<i>Hardship Withdrawals to Meet the Needs of Family Members</i>	42
<i>Death Benefit Rollovers by Nonspouse Beneficiaries</i>	43
<i>Penalty-Free Withdrawals From Retirement Plans for Individuals Called to Active Duty</i>	43
Spousal Pension Protection	44
<i>Regulations on Time and Order of Issuance of Domestic Relations Orders</i>	44
<i>Requirement for Additional Survivor Annuity Option</i>	44
Other Provisions	45
<i>Nonqualified Deferred Compensation</i>	45
<i>Tax Treatment of Death Proceeds Under COLI Contracts</i>	46
<i>Plan Amendments</i>	46
Health Care	47
<i>Retiree Health: Use of Excess Pension Assets</i>	47
<i>Annuity and Life Insurance Contracts With Long-Term Care Insurance Feature</i>	48

Single Employer Defined Benefit Plans: Minimum and Maximum Funding Requirements

Current Law	PPA	Hewitt Comments
Minimum Funding Requirements—General		
<p>General Rules</p> <ul style="list-style-type: none"> • The Minimum Required Contribution is determined by comparing the results from an ongoing valuation and from the calculation of a Deficit Reduction Contribution (DRC), which is based on Current Liability. The DRC applies to plans that have more than 100 participants (on a controlled group basis) and that have a funded Current Liability ratio under 90% (or 80% if plans satisfy certain Volatility Rules). • Credit balances based on prior year contributions in excess of the Minimum Required Contribution can be used to reduce the amount of the current year contribution. • The Minimum Required Contribution is limited to the amount that liabilities exceed assets (i.e., Full Funding Limit). • Special rules apply to 2004 and 2005 plan years that impact the determination of Current Liability. 	<p>Special Rules for 2006 and 2007</p> <ul style="list-style-type: none"> • The rules that applied to the 2004 and 2005 plan years are generally extended to 2006 and 2007. In particular, the use of the Corporate Bond Rate to calculate Current Liability is continued. <p>2008+</p> <ul style="list-style-type: none"> • Contributions are based on a plan's Funding Target. • The Minimum Required Contribution is the sum of the Target Normal Cost (i.e., value of benefits expected to accrue during the year) plus an amortization of the Funding Shortfall (called the Shortfall Amortization Charge). • Many of the economic assumptions used to calculate the Funding Target either are defined or have specific criteria that must be considered when selecting the assumption. Special assumptions must be used by plans that are in At-Risk Status. • Credit balances attributable to prior year contributions in excess of the Minimum Required Contribution can be used, with some restrictions, to reduce the amount of the current year Minimum Required Contribution. • If the Value of Plan Assets (reduced by all credit balances) exceeds the Funding Target, the Minimum Required Contribution will equal the Target Normal Cost minus the excess (i.e., Full Funding Limit), but no less than \$0. 	<ul style="list-style-type: none"> • The prior set of funding rules is completely replaced, and a single set of rules similar in concept to the Deficit Reduction Contribution is used under PPA. • The PPA Funding Target is similar to Current Liability, as both are based on the value of benefits accrued as of the Valuation Date (in particular, neither amount reflects any projection of pay increases beyond the Valuation Date). • Contribution are still due by 8-1/2 months after the close of a plan year. However, under PPA, all contributions are discounted back to the Valuation Date for purposes of determining if the Minimum Required Contribution was satisfied. • The treatment of credit balances under PPA is one of the more complex aspects of the revised minimum funding requirements.

Current Law	PPA	Hewitt Comments
Liability Underlying Funding Calculations		
<p>General Rules</p> <ul style="list-style-type: none"> For the ongoing valuation, plans fund to 100% of projected liabilities. For Current Liability purposes, for plans that fall below 90% funding of Current Liability, the funding target is 100% of Current Liability, subject to various volatility exemption rules and exemptions for small plans. 	<p>2008+</p> <ul style="list-style-type: none"> The Funding Target is generally 100% of the present value of all benefits accrued under the plan as of the beginning of the plan year. 	<ul style="list-style-type: none"> Plans in At-Risk Status will have a larger Funding Target due to the required use of more conservative At-Risk assumptions. This, in turn, will create a larger Minimum Required Contribution.
Funding Shortfall		
<p>General Rules</p> <ul style="list-style-type: none"> For both the ongoing valuation and the Current Liability valuation, the funding shortfall is the difference between the corresponding liability and the Actuarial Value of Assets. 	<p>2008+</p> <ul style="list-style-type: none"> The Funding Shortfall for a year is the excess, if any, of the Funding Target over the Value of Plan Assets (reduced by all credit balances). 	
Amortization of Funding Shortfalls		
<p>General Rules</p> <ul style="list-style-type: none"> For the ongoing valuation, the amortization of funding shortfalls varies depending on the source of the shortfall. Gains/losses are amortized over five years, assumption changes over ten years, and plan amendments over 30 years. Unfunded Current Liability is amortized over varying periods depending on the amount of the shortfall. The larger the amount of underfunding, the faster the required amortization. Plans that have an unfunded Current Liability may be required to make an additional DRC. 	<p>2008+</p> <ul style="list-style-type: none"> The Shortfall Amortization Base established for any plan year is the difference between the Funding Shortfall and the present value of the prior remaining bases (up to six). The Shortfall Amortization Base can be positive (loss) or negative (gain) and is amortized over seven years. The amount of the amortization of the Shortfall Amortization Base for any year is called the Shortfall Amortization Installment. All present-value calculations are based on the use of the yield curve Segment Rates (see below) in effect at the Valuation Date. The Shortfall Amortization Charge is the aggregate total of all Shortfall Amortization Installments (but not less than zero). A Shortfall Amortization Base is not created for the year if the Value of Plan Assets is equal to or greater than the Funding Target. For purposes of this calculation, the Value of Plan Assets is reduced by the Prefunding Balance (PB) if the PB is going to be used to reduce the Minimum Required Contribution. 	<ul style="list-style-type: none"> A plan would not be subject to the DRC in 2007 if (i) the Current Liability Gateway Percentage (calculation made using highest allowable interest rate) was at least 90% in 2007, or (ii) the Gateway Percentage was at least 80% in 2007 and the Gateway Percentage for 2005 and 2006 was at least 90% (or the Gateway Percentage for 2004 and 2005 was at least 90%). Note that if the Gateway Percentage for 2005 was below 90%, then the Gateway Percentage for 2007 must be at least 90% to be eligible for transition rule. It is anticipated that plan sponsors will be interested in

Current Law	PPA	Hewitt Comments
	<ul style="list-style-type: none"> If the Funding Shortfall is \$0, all existing Shortfall Amortization Bases are eliminated. Special rules apply to various plan sponsors in the airline industry that extend the period of amortization. <p>Special Rules for 2008, 2009, and 2010</p> <ul style="list-style-type: none"> For plans that were not subject to the DRC in 2007, PPA phases in the requirement to create Shortfall Amortization Bases for years 2008 through 2010. For these plans, if the Value of Plan Assets (reduced by the PB if the PB is elected to be used to reduce the Minimum Required Contribution) is equal to or greater than the applicable percentage of the Funding Target, then no Shortfall Amortization Base is created. The applicable percentage is 92% in 2008, 94% in 2009, and 96% in 2010. A plan must meet this transition “exemption” test for all prior years to be eligible for the applicable percentage in a given year. 	<p>performing multi-year projections to evaluate various funding strategies (especially in connection with the various PPA phase-ins and other transition rules).</p>
Interest Rate to Value Liabilities		
<p>General Rules</p> <ul style="list-style-type: none"> For the ongoing valuation, liabilities are present-valued using an interest rate equal to the expected rate of return on assets. For the DRC, the yield on 30-year Treasury bonds is the basis used to calculate Current Liability. For this purpose, the Treasury is using the yield on the 30-year Treasury bond maturing in February 2031. Current Liability is calculated based on an interest rate between a 90% to 105% corridor of the four-year weighted average of 30-year Treasury rates. <p>Special Rules for 2004 and 2005</p> <ul style="list-style-type: none"> For the DRC, a Corporate Bond Rate based on conservative, long-term corporate bonds (with continued use of the 30-year Treasury rate for certain purposes) is used. The Corporate Bond Rate is a composite rate based on three publicly available, long-term corporate bond indices in the top three quality levels (e.g., AAA, AA, A). 	<p>Special Rules for 2006 and 2007</p> <ul style="list-style-type: none"> The special Corporate Bond Rate rules that applied to 2004 and 2005 plan years are extended to 2006 and 2007 plan years. <p>2008+</p> <ul style="list-style-type: none"> The Funding Target is determined using three Segment Rates (i.e., interest rates) that apply to benefits paid during three distinct time periods: less than five years, between five and 20 years, and 20+ years. The three Segment Rates are based on an underlying Corporate Bond Yield Curve, which is developed from a 24-month average of yields on investment grade corporate bonds in the top three quality levels. Alternatively, a plan can elect to use the full yield curve without the 24-month averaging. The new rates are phased in over three years, although a plan can elect to ignore the phase-in. New plans established after 2007 cannot use the 	<ul style="list-style-type: none"> The Treasury will be the sole source for the Segment Rates and underlying yield curves. It is anticipated that the Treasury will publish this information once a month following the end of a month. The option to use the full yield curve without averaging could help minimize contribution volatility for those plan sponsors who have made an effort to more closely “match” the duration of plan assets to the underlying plan liabilities. The Treasury is to prescribe regulations specifying how to make any required

Current Law	PPA	Hewitt Comments
<p>Current Liability is based on an interest rate between a 90% to 100% corridor of the four-year weighted average of the Corporate Bond Rates (i.e., the upper end of the corridor is reduced to 100%).</p>	<p>Segment Rate phase-in.</p> <ul style="list-style-type: none"> • A plan can elect to use the yield curve for the month that includes the Valuation Date, or for any of the four months which precede the Valuation Date. • Any elections made with regard to the yield curve to use cannot be changed without approval from the Treasury. 	<p>elections.</p>
Mortality Table and Other Assumptions		
<p>General Rules</p> <ul style="list-style-type: none"> • For Current Liability determination, the 1983 GAM mortality table is used for healthy lives. • The Treasury is to periodically update the mortality table. • For all other purposes, the plan’s enrolled actuary must use a reasonable assumption. • Assumption changes that result in a large decrease (as defined in current law) in unfunded Current Liability must be approved by the Treasury. 	<p>2008+</p> <ul style="list-style-type: none"> • Unless permission is granted by the Treasury to use a table that is specific to the employer, the designated mortality assumption is to be prescribed by the Treasury, is to reflect mortality improvements, and is to be revised at least once every ten years. The Treasury will also be specifying separate mortality tables for disabled participants. • The Funding Target must reflect any subsidies provided through lump sums and any other optional forms of benefit. • For all other purposes, the plan’s enrolled actuary must use a reasonable assumption. • Assumption changes that result in a large decrease (as defined in PPA) in the Funding Shortfall must be approved by the Treasury. 	<ul style="list-style-type: none"> • It is anticipated the Treasury will adopt the mortality tables proposed in December of 2005, which are based on the RP-2000 table, with separate tables for annuitants and non-annuitants, projected seven and 15 years, respectively, beyond the Valuation Date. • The Treasury is also likely to require the use of the new mortality table for Current Liability purposes in 2007.
At-Risk Plans and At-Risk Liability		
<p>General Rules</p> <ul style="list-style-type: none"> • There is no definition of “At-Risk” plans. 	<p>2008+</p> <ul style="list-style-type: none"> • A pension plan is deemed to be in At-Risk Status for a given year if the Funding Target Attainment Percentage (FTAP) for the prior year is less than 80% (ignoring At-Risk Status) and the FTAP for the prior plan year (based on At-Risk Status) is less than 70%. The FTAP is determined by dividing the Value of Plan Assets (reduced by all credit balances) by the Funding Target. The 80% test is phased in as 65% in 2008, 70% in 2009, and 75% in 2010. The 70% test is modified for certain automobile companies and suppliers. • For a plan in At-Risk Status, the 	<ul style="list-style-type: none"> • The At-Risk Funding Target cannot be less than the Funding Target determined without regard to At-Risk Status. Similarly, the At-Risk Target Normal Cost cannot be less than the Target Normal Cost determined without regard to At-Risk Status. • For purposes of the 80%/70% test for 2008 plan years, the

Current Law	PPA	Hewitt Comments
	<p>Funding Target and Target Normal Cost must be determined assuming each participant who is eligible to elect benefits in the plan year and the following ten plan years will (i) retire at their earliest retirement date (but not before the end of the year) and (ii) elect the form of payment with the highest value.</p> <ul style="list-style-type: none"> • If a plan has been in At-Risk Status for two of the four preceding plan years, the Funding Target must be increased by an additional load of \$700 per participant and 4% of the Funding Target. Target Normal Cost is increased by 4%. • The Funding Target for the plan reflects the full At-Risk Funding Target only if the plan has been in At-Risk Status for five or more consecutive years. If it has been in this status less than five consecutive years, the At-Risk Funding Target is phased in at 20% per consecutive year. Years before 2008 are not considered. • The At-Risk rules are not applicable to plans with fewer than 501 participants (on a controlled group basis). 	<p>Treasury is to provide guidance on how to determine the plan's funded ratio for the 2007 plan year.</p> <ul style="list-style-type: none"> • The liability impact of being in At-Risk Status will vary greatly from plan to plan depending on demographics, the early retirement assumptions used in the valuation, and the extent to which the plan subsidizes early retirement benefits.
Actuarial Value of Assets		
<p>General Rules</p> <ul style="list-style-type: none"> • Asset smoothing is allowed, but not to exceed a five-year period. • The asset value used must be between 80% and 120% of market value. 	<p>2008+</p> <ul style="list-style-type: none"> • The Value of Plan Assets can be either market value or an average value. • If an average value is used, the average value is to be determined over a period that does not exceed 24 months. In addition, the final Value of Plan Assets must be between 90% and 110% of market value. • Contributions made after the Valuation Date on behalf of the prior plan year must be discounted back to the Valuation Date using the Effective Interest Rate. 	<ul style="list-style-type: none"> • The Treasury is to issue guidance on how to calculate an average value. • The Effective Interest Rate is the single rate of interest which, if used instead of the Segment Rates, would result in the same Funding Target.

Current Law	PPA	Hewitt Comments
Valuation Date		
<p>General Rules</p> <ul style="list-style-type: none"> The Valuation Date can be any date within the plan year. 	<p>2008+</p> <ul style="list-style-type: none"> For plans with more than 100 participants (on a controlled group basis), the Valuation Date must be the first day of the plan year. For plan with fewer than 101 participants (on a controlled group basis), the Valuation Date can be any date within the plan year. 	<ul style="list-style-type: none"> Most large plans already use a valuation date as of the first day of the plan year.
Credit Balances		
<p>General Rules</p> <ul style="list-style-type: none"> Credit balances are created by contributions in excess of the Minimum Required Contribution. Credit balances are credited with interest using the assumed interest rate (i.e., assumed rate of return on plan assets). Credit balances can be used without restriction to satisfy minimum funding requirements for any plan year. The actuarial value of assets is not reduced by the plan's credit balance to determine whether a DRC is required. However, if a DRC is required, assets are reduced by the credit balance for determination of the DRC. Assets are not reduced by the plan's credit balance for purposes of determining funded status. 	<p>2008+</p> <ul style="list-style-type: none"> Credit balances are preserved, but using a significantly more complicated set of rules. These new rules include the creation of two separate components of credit balance: (1) a Funding Standard Carryover Balance (FSCB), initially equal to the funding standard account balance at the end of the 2007 plan year and (2) a PB based on contributions in excess of the Minimum Required Contribution for plan years after 2007. The FSCB must be entirely used before the PB can be used. Both balances are adjusted annually to reflect actual trust returns. The plan sponsor may voluntarily elect to reduce both the FSCB and the PB (not below zero) to increase the plan's funded status. The FSCB must be \$0 before any portion of the PB can be voluntarily reduced. A plan sponsor elects annually the amount of any excess contributions to be used to increase the PB. Both the FSCB and the PB are generally subtracted from assets for purposes of determining the Minimum Required Contribution. If the Value of Plan Assets for the prior plan year (reduced by the PB) divided by the Funding Target for the prior plan year (determined without regard to At-Risk Status) is less than 80%, then neither the FSCB nor the PB can be utilized to satisfy the current year's Minimum Required Contribution. 	<ul style="list-style-type: none"> For purposes of the 80% rule for the 2008 plan year, the Treasury is to provide guidance on how to determine the plan's funded ratio for the 2007 plan year. The Treasury is to prescribe regulations specifying how to make any required elections. Certain plan sponsors might elect to voluntarily reduce the FSCB and PB in order to avoid one or more of the funding-based benefit limitations in PPA.

Current Law	PPA	Hewitt Comments
Quarterly Contributions		
<p>General Rules</p> <ul style="list-style-type: none"> • A plan is exempt from quarterlies in the current year if it is at least 100% funded on a Current Liability basis in the prior year (at the plan's selected Current Liability interest rate). • If a plan is not exempt, the quarterly amount is 25% of the lesser of 100% of the prior year's Minimum Required Contribution or 90% of the current year's Minimum Required Contribution. • If a quarterly contribution is late, interest is charged at the greater of (1) 175% of the Federal mid-term rate, and (2) the plan's ongoing funding interest rate. 	<p>2008+</p> <ul style="list-style-type: none"> • A plan is required to make quarterly contributions if for the preceding plan year the plan had a Funding Shortfall. • If a plan is required to make quarterly contributions, the quarterly amount is 25% of the lesser of 100% of the prior year's Minimum Required Contribution or 90% of the current year's Minimum Required Contribution. • If a quarterly contribution is late, interest is charged at the plan's Effective Interest Rate plus 5%. 	<ul style="list-style-type: none"> • The "liquidity shortfall" requirements continue unchanged. • PPA does not specify how to determine if a plan must make quarterly contributions for the 2008 plan year. The Treasury will need to issue guidance on how to determine if a plan had a Funding Shortfall for 2007 for this purpose.
Maximum Deductible Limit		
<p>General Rules</p> <ul style="list-style-type: none"> • The greater of the normal cost plus ten-year amortization of unfunded liability or the Minimum Required Contribution, up to the full funding limit, is deductible. • This deductible limit is increased to the plan's unfunded Current Liability, if greater (i.e., the "Supermax"). • Unfunded Current Liability is measured using the plan's selected Current Liability interest rate. <p>Special Rules for 2004 and 2005 Tax Years</p> <ul style="list-style-type: none"> • Same as the general rules, but the underlying 412 minimum and the Supermax are determined using a Current Liability rate within the applicable 90% to 100% corridor of Corporate Bond Rates for 2004 and 2005. • An employer can elect to ignore the Corporate Bond Rate benchmark and the 100% corridor limit in 2004 or 2005 for maximum deductible purposes. In other words, the maximum deductible limit can be based on a 412 minimum and a Supermax, which are calculated using a Current Liability rate between 90% and 105% of 30-year Treasury rates. 	<p>Special Rules for 2006 and 2007 Tax Years</p> <p>The deduction limit is increased to be no less than 150% of Current Liability less the Actuarial Value of Assets. Current Liability is based on the same Corporate Bond Rate used to measure Current Liability for purposes of determining the Minimum Required Contribution.</p> <p>2006+ Tax Years</p> <ul style="list-style-type: none"> • The multiple-plan deduction limit is changed to (i) include contributions to defined contribution plans only to the extent that such contributions exceed 6% of compensation and (ii) exclude contributions to multiemployer plans. <p>2008+ Tax Years</p> <ul style="list-style-type: none"> • The deduction limit is the Target Normal Cost plus 150% of the Funding Target plus the amount the Funding Target would increase if it reflected projected increases in compensation or the expected increase in benefits, less the Value of Plan Assets (unreduced for credit balances). If the plan is insured by the PBGC, the Section 401(a) (17) pay limit may be projected to reflect anticipated increases in the limit. If plan benefits are not based on compensation, then the expected increase in benefits in the future is 	<ul style="list-style-type: none"> • The deduction limit for 2006 and later tax years will be significantly increased for many plans. • The changes to the multiple-plan deduction limit will be particularly helpful to plan sponsors who make large contributions to their defined benefit plans. • For terminating plans, the sponsor can deduct the amount needed to make the plan sufficient (no change from current law).

Current Law	PPA	Hewitt Comments
<ul style="list-style-type: none"> A multiple-plan deduction limit can result in non-deductible contributions to defined contribution plans if large contributions are made to a defined benefit plan. 	<p>based on the average of the increases over the preceding six plan years. In determining the deduction limits, some benefit limits can be projected. If the plan has 100 or fewer participants (on a controlled group basis), then additional rules apply.</p> <ul style="list-style-type: none"> The multiple-plan deduction limit is changed to exclude contributions to defined benefit plans that are insured by the PBGC. 	
Delayed Effective Dates		
<ul style="list-style-type: none"> Limited special rules. 	<ul style="list-style-type: none"> PPA delays the effective date of the funding and benefit limitation rules for rural electric, agricultural, and telephone multiple employer plans until 2017; for defense contractors, until the earlier of when the Cost Accounting Standards (CAS) Board allows recovery of the new contribution rates or 2011; and until 2014 for plans of employers who took over sponsorship of the plan so that the PBGC did not have to terminate the plan. 	<ul style="list-style-type: none"> Companies that are potentially eligible for a delayed effective date should carefully analyze whether they are eligible for the delay and what specific requirements apply to them in the interim.

Single Employer Defined Benefit Plans: Funding-Based Benefit Restrictions

Current Law	PPA	Hewitt Comments
Funding-Based Benefit Limitations—General Rules		
<p>General Rules</p> <ul style="list-style-type: none"> • There are few restrictions. See below for details. 	<p>2008+</p> <ul style="list-style-type: none"> • Poorly funded plans are subject to limitations on benefit increases, lump sum payments, and shutdown benefits, and may be required to freeze ongoing benefit accruals. • Except for the restrictions on accelerated benefit distributions, plan sponsors can make additional contributions to avoid the limitations. These additional contributions are generally required to be the lesser of (i) the amount required to raise the plan’s funded ratio above the specified percentage, or (ii) the increase in the plan’s liabilities due to the amendment or event. These additional contributions do not increase the plan’s credit balance. A plan sponsor can also provide security outside of the plan instead of making cash contributions. • These rules are based on the FTAP. In calculating the FTAP, the Value of Plan Assets is generally reduced by credit balances (as explained below). In addition, assets and liabilities are increased by an amount equal to annuities purchased for nonhighly compensated employees in the prior two plan years, resulting in an Adjusted Funding Target Attainment Percentage (AFTAP). • Plan participants must be notified within 30 days after the plan has become subject to a restriction. • A delayed effective date applies to collectively bargained plans. The limitations are generally effective at the earlier of (i) the end of an agreement ratified before January 1, 2008 and (ii) 	<ul style="list-style-type: none"> • The funding-based benefit restrictions are essentially a new concern for plan sponsors and will complicate both the funding and administration of a plan. • The AFTAP of a plan could be fairly volatile from year to year, though the 24-month averaging of the interest rate used to calculate liabilities and assets will help in this regard. • The FTAP is calculated ignoring At-Risk assumptions, even if the plan is “At-Risk.” A plan that becomes “At-Risk” will not see its funded ratio decreased for purposes of the benefit restrictions. • The Value of Plan Assets used for this purpose is the actuarial value of assets.

Current Law	PPA	Hewitt Comments
	<p>January 1, 2010.</p> <ul style="list-style-type: none"> The restrictions, with the exception of the restriction on accelerated benefit distributions, do not apply to new plans for the first five years of the plan (taking into account predecessor plans). 	
Use of Credit Balances		
No provisions.	<p>2008+</p> <ul style="list-style-type: none"> As noted, the PB and the FSCB are subtracted from the Value of Plan Assets. However, this adjustment is not made if the FTAP exceeds 100% (determined without a subtraction of the PB and FSCB). For this purpose, under a transition rule, plans substitute the following percentages for 100% for 2008 through 2010: 92% in 2008, 94% in 2009, 96% in 2010—but only if the FTAP (determined without a subtraction of the FSCB and PB) is over the specified target for the current plan year and each prior plan year. Credit balances can be voluntarily waived in order to increase the Value of Plan Assets, which will increase the AFTAP. For collectively bargained plans, credit balances must be waived if, by doing so, the limitation would be avoided. For plans other than collectively bargained plans, credit balances must be waived if, by doing so, the limitation on lump sum payments (and other accelerated benefit distributions) would be avoided. 	<ul style="list-style-type: none"> The provision that allows well funded plans to not subtract credit balances is poorly drafted, and PPA contains inconsistent provisions. Additional clarification will be required from the Treasury or via a technical corrections bill to clarify the provisions. It is possible that PPA intended that only either the PB or the FSCB be excluded from assets for purposes of determining the funded ratio.
Limitations on Plan Amendments Increasing Benefits		
<p>General Rules</p> <ul style="list-style-type: none"> A plan amendment increasing a plan's Current Liability may not be adopted if the plan's funded Current Liability percentage would be less than 60%, taking into account the amendment, unless security is provided. Plan amendments increasing benefits are also generally prohibited while a funding waiver is in effect, while an amortization extension is in effect, or if the plan sponsor is in bankruptcy. 	<p>2008+</p> <ul style="list-style-type: none"> Plan amendments which would increase liabilities are prohibited if AFTAP, including the effect of the amendment, is less than 80%. If benefits are not based on compensation, the prohibition does not apply to plan amendments that increase benefits if the rate of the benefit increase does not exceed the contemporaneous rate of increase in the average wages of participants covered by the amendment. 	<ul style="list-style-type: none"> PPA does not change the prohibition on plan amendments increasing benefits while a funding waiver is in effect, or if the plan sponsor is in bankruptcy. Under the exception for benefit increases that are not pay-related, an increase in the flat benefit multiplier from \$20 to \$21 would

Current Law	PPA	Hewitt Comments
		appear not to be subject to restriction if average wages are increasing by 5%.
Limitations on Lump Sum Payments (and Other Accelerated Benefit Distributions)		
<p>General Rules</p> <ul style="list-style-type: none"> • If a plan has liquidity shortfall, lump sums (and other accelerated payment forms) are prohibited. • Lump sum distributions to the top-25 highest-paid employees are restricted if plan assets are less than 110% of Current Liability. 	<p>2008+</p> <ul style="list-style-type: none"> • Lump sum payments (and other accelerated benefit distributions) are prohibited if the AFTAP is less than 60% as of the valuation date. • If the AFTAP is at least 60% but less than 80%, a plan can make prohibited payments, but only equal to the lesser of (i) 50% of the original amount or (ii) the present value equivalent of the PBGC maximum guarantee amount with respect to that participant. • If a plan sponsor is in bankruptcy, lump sum payments (and other accelerated benefit distributions) are prohibited if the AFTAP is less than 100%. • This restriction does not apply to a plan that was frozen for benefit accrual purposes as of September 1, 2005. • Unless the plan provides otherwise, restricted payments resume after the AFTAP is higher than 60%/80%. 	<ul style="list-style-type: none"> • The current law liquidity shortfall provisions and top-25 restrictions were not changed by PPA, and these provisions continue. The use of Current Liability for the top-25 restriction will need to be clarified by the Treasury. • Accelerated benefit distributions include any payment in excess of the single life annuity (plus any social security supplements), in addition to the purchase of annuities.
Benefit Freezes		
<p>General Rules</p> <ul style="list-style-type: none"> • There are no restrictions that would require that benefit accruals must be frozen. 	<p>2008+</p> <ul style="list-style-type: none"> • Benefit accruals must be frozen if the AFTAP is less than 60% as of the valuation date. • Unless the plan provides otherwise, benefit accruals resume after the AFTAP is 60% or higher. 	<ul style="list-style-type: none"> • Note that under the “presumption” provisions (described below), if the actuarial valuation is not completed by the beginning of the 10th month of the plan year, then benefit accruals will have to be frozen as of that date.

Current Law	PPA	Hewitt Comments
Shutdown and Other Unpredictable Contingent Event Benefits		
<p>General Rules</p> <ul style="list-style-type: none"> A defined benefit plan may provide for unpredictable contingent event benefits—benefits that depend on contingencies other than age, service, compensation, death, or disability, including plant shutdown benefits. Unpredictable contingent event benefits are not taken into account for DRC purposes until the event has occurred. 	<p>2008+</p> <ul style="list-style-type: none"> Shutdown and similar types of benefits cannot be paid from plan assets if the AFTAP, including the effect of the event, is less than 60%. 	<ul style="list-style-type: none"> The PBGC guarantees for shut down benefits are also changed by PPA, as explained below.
Presumption as to Funded Status		
<p>No similar provisions apply.</p>	<p>2008+</p> <ul style="list-style-type: none"> If the plan was not subject to limitations in the prior year, then the funded ratio is presumed to be 10% lower in the current year until a new actuarial valuation is done. If the valuation is not done by the beginning of the 4th month of the plan year, then the limitations apply as of the beginning of that 4th month. If the valuation is not done by the beginning of the 10th month of the plan year, then the AFTAP is presumed to be less than 60% as of the beginning of that 10th month. 	<ul style="list-style-type: none"> For purposes of the presumption rule for 2008 plan years, the Treasury is to provide guidance on how to determine the plan's funded ratio for the 2007 plan year. It is unclear how the presumptive rules will actually be applied.

Funding Rules for Multiemployer Defined Benefit Plans and Related Provisions

Current Law	PPA	Hewitt Comments
General Funding Rules for Multiemployer Plans		
<ul style="list-style-type: none"> • Multiemployer plans generally follow the same funding rules as single employer plans, with the exception that the DRC does not apply. Amortization periods are generally longer (15 or 30 years) for most changes in unfunded accrued liability. • Multiemployer plans experiencing financial difficulties can apply for amortization period extensions of up to ten years. • Additional funding rules apply to plans that are in “reorganization” status or that become insolvent. 	<ul style="list-style-type: none"> • PPA retains the current funding rules for multiemployer plans, but shortens the amortization periods to 15 years (for new amortization bases starting in 2008 plan years). • Multiemployer plans meeting certain requirements can get an automatic five-year amortization extension. An additional five-year extension can be granted with approval from the IRS. The automatic extension provision expires on December 31, 2014. • Additional funding rules apply to plans that are “endangered” or in “critical” status (see below). • The maximum deductible limit is increased to 140% of current liability. 	<p>The changes to the funding rules for multiemployer plans are primarily aimed at those plans that are significantly underfunded or have projected funding deficiencies (through the new “endangered” and “critical” status plan rules below). Shortening the amortization period for plan changes from 30 years to 15 years should prevent a recurrence of some funding issues that have resulted when large amortization gain bases have become fully amortized, but plan changes continued for an additional 15 years. Plan sponsors who “target” a contribution using an amortization period of greater than 15 years will need to re-evaluate their strategy.</p>
Additional Funding Rules for Plans in Endangered or Critical Status		
<p>No specific provision as to “endangered” or “critical” plan status.</p>	<p>PPA adds new funding rules for multiemployer plans that are in endangered, seriously endangered, or critical status. The new rules include some relief from excise taxes that would otherwise apply to funding deficiencies for plans that have adopted a rehabilitation plan and are meeting applicable benchmarks.</p> <ul style="list-style-type: none"> • Plans that are less than 80% funded or expected to have a funding deficiency within seven years (after including automatic amortization extensions) are in “endangered” status. Plans meeting 	<p>The new rules attempt to shore up funding for the most troubled multiemployer plans, by requiring funding improvement plans or rehabilitation plans to be adopted by the plan sponsor. Plans in critical status may reduce “adjustable” benefits already earned in order to improve the funded status without violating anti-cutback rules. The rules</p>

Current Law	PPA	Hewitt Comments
	<p>both criteria are in “seriously endangered” status. Plans in endangered status (or seriously endangered status) must adopt a funding improvement plan, which includes benefit reductions and/or contribution increases that will improve the plan’s funded status by one-third within ten years (or by one-fifth within 15 years for some seriously endangered plans).</p> <ul style="list-style-type: none"> • Plans are in “critical” status if they meet any one of four criteria in PPA, including plans that are less than 65% funded and expected to have a solvency problem within seven years, or plans expected to have a funding deficiency within four years (five years if the funded percentage is less than 65%), not taking into account any amortization extensions. Plans in critical status must adopt a rehabilitation plan of benefit reductions and/or contribution increases designed to exit critical status within ten years. An automatic surcharge of 5% (increasing to 10% in the second year) is imposed on employers obligated to contribute to the plan (until a new agreement is reached). Lump sum and other similar payments may not be made (except for amounts less than \$5,000). • Plan amendments increasing benefits may not be adopted after a funding improvement or rehabilitation plan is in place, unless specifically paid for out of additional contributions. • Funded status under these new rules is based on actuarial value of assets, and the accrued liability determined using the unit credit funding method (regardless of what method is used for the regular funding valuation). <p>The rules for endangered and critical status plans expire on December 31, 2014, except that any funding improvement or rehabilitation plans adopted prior to this date continue to apply.</p>	<p>require that employers and bargaining units work together to solve the funding problems. In the event that the parties cannot agree on changes to be implemented, the new rules allow for an automatic implementation of “default” plan changes (usually benefit reductions and minimal contribution increases).</p> <p>PPA will place significant emphasis on the ability of the plan’s actuary to accurately project (for up to ten years) the funded status of the plan and to certify the projections early in the plan year.</p>

Current Law	PPA	Hewitt Comments
Changes to Withdrawal Liability Rules		
<p>On withdrawal from a multiemployer plan, an employer is generally required to pay its share of any unfunded vested benefits, as determined by the plan. The amount of the withdrawal liability may be determined under various methods, usually depending upon the proportion of the employer's contributions over time to the total of all contributions made to the plan. There are many exceptions and special rules that apply to certain cases.</p>	<p>PPA repeals the limitation on withdrawal liability of insolvent employers and updates the rules relating to limitations on withdrawal liability based on companies' net worth (effective for sales beginning in 2007). The rules are also changed to apply withdrawal liability in cases where work is contracted out. Additional changes allow the "free look" provisions to apply to building and construction industry plans, and make changes to the procedures on disputing withdrawal liability determinations.</p>	<p>These are relatively minor changes to the withdrawal rules, addressing some of the perceived loopholes in the current provisions. Interestingly, PPA did not include the elimination of the 20-year cap on withdrawal liability payments that currently applies (such repeal had been included in the prior House-passed version of the pension legislation).</p>
New Notice and Disclosure Requirements		
<p>Annual funding notices for multiemployer plans are required to be sent to all participants, labor organizations, contributing employers, and the PBGC. The notice includes various benefit and financial information, including the plans' funded current liability percentage.</p>	<p>PPA changes and expands some of the annual funding notice requirements and accelerates the timing for distribution of the notices. These changes are similar to the changes for single employer plans. An additional summary report is to be provided to each labor organization and employer obligated to contribute to the plan that includes additional information as to the number of plan participants and employers contributing to the plan, withdrawal liability assessments, and whether the plan is in endangered or critical status. Additionally, the plan administrator must provide, upon written request, additional plan financial information, including periodic actuarial reports, investment manager reports, and any application filed for amortization extension and its outcome.</p>	<p>The new reporting and disclosure rules will provide contributing employers much additional information about the status of the plans that previously may not have been available on a broad basis.</p>

Other Defined Benefit Pension Plan Provisions

Minimum Lump Sum Benefits

Current Law	PPA	Hewitt Comments
<p>General Rules</p> <ul style="list-style-type: none"> The minimum value of a lump sum distribution must be calculated using the 30-year Treasury rate, as prescribed under Internal Revenue Code Section 417(e), and using the unloaded 1994 GAR mortality table, weighted 50% male, projected to 2002. 	<p>2008+</p> <ul style="list-style-type: none"> Lump sums are determined using a yield curve consisting of three interest rates that apply to benefit payments during three distinct time periods: less than five years, between five and 20 years, and in 20+ years. The underlying curve reflects a one-month average of yields for the month preceding the distribution (or such other time as the Treasury may prescribe). The required mortality table is to be the same mortality table prescribed by the Treasury for healthy lives for minimum funding purposes. The change in interest rate is phased in over five years beginning in 2008 at 20% per year. Under the phase-in, the rates used to determine present values will be a blend of the 30-year Treasury rate and the rates from the yield curve described above. 	<ul style="list-style-type: none"> These rules also apply to other decreasing annuity payment forms. The change in the lump sum interest benchmark will likely decrease lump sum benefits payable to many plan participants, and the five year phase-in is intended to ease the change. The change in the mortality table is not phased in since this change will be beneficial to plan participants.

Section 415 Limits

Current Law	PPA	Hewitt Comments
Application of 415 Limit to Lump Sum Distributions		
<ul style="list-style-type: none"> • The interest rate (and mortality table) used to normalize a lump sum (or any decreasing annuity subject to 417(e)(3)) back to straight life for purposes of testing 415 shall be the greater of: <ul style="list-style-type: none"> (i) The applicable interest rate and applicable mortality table under Section 417(e), or (ii) The rate used by the plan (and the plan's mortality table). • The provision above would be effective with plan years beginning on or after January 1, 2006 without any intervening extension of the Pension Funding Equity Act of 2004 (PFEA) provisions. During 2004 and 2005 plan years, the PFEA replaced item (i) above with 5.5% and the applicable mortality table under Section 417(e). 	<ul style="list-style-type: none"> • The interest rate (and mortality table) used to normalize a lump sum (or any decreasing annuity subject to 417(e)(3)) back to straight life for purposes of testing 415 shall be the greatest of: <ul style="list-style-type: none"> (i) 5.5% (and the applicable mortality table under Section 417(e)), (ii) The rate used by the plan (and the plan's mortality table), or (iii) The interest rate that would yield 105% of the lump sum calculated using the applicable interest rate and applicable mortality table under Section 417(e). • This change would be effective with distributions made on or after January 1, 2006 (regardless of plan year). 	<p>PPA extends the 5.5% interest rate floor from PFEA. However, it also introduces another floor—the rate that would otherwise generate a lump sum equal to 105% of the minimum lump sum (calculated at the prevailing Section 417(e) interest rate and mortality table). For plans that define their lump sum interest rate as the 417(e) rate, the 105% floor would never apply. Instead, this new floor is intended to apply in plans that provide a subsidized lump sum basis (using something more generous than the required minimum). In such plans, lump sum recipients bumping into the 415 limits will essentially be limited to a 5% subsidy in their lump sum over the applicable 417(e) interest rate and applicable mortality table (or less, if the 5.5% floor kicks in).</p> <p>Note: these changes would be effective retroactively to all distributions of decreasing annuities made on and after January 1, 2006, which could impact (i.e., reduce) lump sums (and other decreasing annuities) already paid.</p>

Current Law	PPA	Hewitt Comments
Calculation of Three-Year Highest Average Compensation for 415 Limit Purposes		
<ul style="list-style-type: none"> • The annual, straight-life-annuity equivalent of all pension plan distributions cannot exceed the lesser of the Section 415 dollar limit or 100% of the participant's three-year highest average compensation. • For purposes of calculating the three-year highest average compensation, only pay earned with the employer while the employee was an active participant in the plan can be considered. 	<ul style="list-style-type: none"> • For purposes of determining the three-year highest average compensation, PPA eliminates the restriction on considering pre-participation pay. 	<p>In most broad-based pension plans, three-year highest average compensation rarely is the controlling 415 limit; therefore, this change impacts very few participants in few plans. For such participants, the ability to consider pre-participation pay should generally increase the value of the three-year highest average compensation limit. However, for participants with fewer than three years of plan participation, inclusion of any pre-participation pay would likely decrease the applicable three-year highest average compensation limit—though, again, these cases should be extremely rare.</p>

PBGC Guarantee and Related Provisions

Current Law	PPA	Hewitt Comments
PBGC Premiums		
<p>Variable Premium Variable Rate premiums are determined as \$9 per \$1,000 of unfunded vested benefits. Unfunded vested benefits are calculated as the vested current liability in excess of the value of assets as of the close of the plan year. The interest rate used to determine current liability is 85% of the 30-year Treasury rate for the month preceding the first month of the plan year. For 2006 and 2007, assets are determined as the actuarial value of assets. For 2008 and later, assets will be determined as market assets if the IRS finalizes proposed regulations updating the current liability mortality table.</p> <p>A plan is exempt from the Variable Rate premium if contributions for the previous year were not less than the full funding limitation.</p> <p>Special Rules for 2005 and 2006 For 2005 and 2006, vested current liability is determined using 85% of the Corporate Bond Rate.</p> <p>Flat Rate Premium The flat rate premium is \$30 per participant for single employer plans and \$8 per participant for multiemployer plans. The flat rate premium is indexed with national average wages rounded to the nearest \$1.</p>	<p>For 2006 and 2007 For plan years beginning in 2006 and 2007, unfunded vested benefits are determined as the vested current liability calculated using 85% of the Corporate Bond Rate in excess of the actuarial value of assets as of the close of the plan year.</p> <p>2008+ For plan years beginning after 2007, unfunded vested benefits for the Variable Rate premium are determined as the Funding Target (using only vested benefits) in excess of market assets for the plan year. The interest rate used to determine the Funding Target is the first, second or third segment rate for the month preceding the first month of the plan year.</p> <p>The full funding limitation exemption is eliminated for plan years beginning after 2007.</p>	<p>The “vested” Funding Target reflects “At-Risk” liability calculations for plans which are At-Risk. Assets are not reduced for the Funding Standard Carryover Balance or Prefunding Balance, if any.</p> <p>The elimination of the full funding limitation exemption will likely increase the premium paid by plan sponsors who were previously exempt from the Variable Rate premium payment.</p> <p>The Deficit Reduction Act of 2005 had previously increased the flat rate premium as shown under “Current Law.”</p>

Current Law	PPA	Hewitt Comments
Bankruptcy Premiums		
For plans terminated in a distress termination due to reorganization in bankruptcy or insolvency proceedings, a \$1,250 per participant premium is required for three years after a company emerges from bankruptcy reorganization. This requirement does not apply to any plan terminations after December 31, 2010.	The bankruptcy premium applies for all future years.	The Deficit Reduction Act of 2005 introduced this bankruptcy premium.
Guarantee of Shutdown Benefits		
Shutdown benefits triggered prior to a plan termination date are guaranteed by the PBGC subject to normal maximum benefit requirements.	Shutdown benefits are treated as a plan amendment on the date the event occurred. This provision is effective with respect to shutdown benefits that become payable after July 26, 2005.	Due to the five-year phase-in of plan amendments for the PBGC guaranteed benefit, shutdown benefits may be covered at reduced amounts or not at all depending on the date of plan termination.
Bankruptcy as Termination Date		
Under a distress termination, the date of plan termination is determined independently from the date of bankruptcy filing.	Effective 30 days from the date of enactment, if a plan sponsor has filed for bankruptcy, the date of plan termination is the date the bankruptcy petition was filed.	This change could decrease the guaranteed benefits payable to participants in plans which are terminated in a distress termination.
Interest on Overpayments		
The PBGC does not pay any interest on the refund of premium overpayments.	The PBGC is authorized to grant interest on any overpayment of a premium using the same rate charged for underpayments. Interest applies beginning no earlier than the date of enactment.	

Hybrid Pension Plans

Current Law	PPA	Hewitt Comments
Rules Relating to Reduction in Rate of Benefit Accrual: Anti-Age Discrimination		
<ul style="list-style-type: none"> ERISA, the Internal Revenue Code (Code), and the Age Discrimination in Employment Act (ADEA) provide an anti-age discrimination rule which prohibits a plan from reducing or ceasing a participant's rate of benefit accrual on account of the attainment of any age. Application of these rules to hybrid plans—such as cash balance and pension equity plans—has been the subject of significant litigation. 	<ul style="list-style-type: none"> Effective for periods beginning on or after June 29, 2005, ERISA, the Code, and the ADEA are amended to provide a new, single, anti-age discrimination rule for all defined benefit plans, including hybrid plans. Under the new rule, plans will not be treated as failing the anti-age discrimination rule if a participant's accrued benefit as of any date would be equal to or greater than that of any similarly situated, younger individual who is or could be a participant. Similarly situated means the same in every respect—including service, compensation, position, date of hire, and work history—except for age. For purposes of the new rule, subsidized early retirement benefits may be disregarded. For purposes of the new rule, the accrued benefit may be expressed as the balance of a hypothetical account. 	<ul style="list-style-type: none"> By permitting plans to treat the hypothetical account balance as the accrued benefit for purposes of this test, plans should easily be able to pass the similarly situated test. The law change, in essence, concludes that impermissible age discrimination does not exist merely because an older employee has less time to earn interest credits by retirement age than a similarly situated younger employee. This change should eliminate on a prospective basis the litigation risk for hybrid plans relating to age discrimination. The new law provides that no inference is to be drawn from it before the law's effective date.

Current Law	PPA	Hewitt Comments
Rules Relating to Reduction in Rate of Benefit Accrual: Interest Credits		
<ul style="list-style-type: none"> There are no restrictions imposed on rates of interest crediting under hybrid plans. Depending on the rates used, however, plans may experience a “whipsaw” effect, where the lump sum payable from a plan is different from the account balance under the plan due to the difference in interest crediting rate and the Code Section 417(e) bases required for calculating present value of an accrued benefit. This, too, has been the subject of much litigation for hybrid plans. 	<ul style="list-style-type: none"> For years beginning in 2008 (or earlier, at the plan sponsor’s election) or as late as 2010 for collectively bargained plans, hybrid plans will fail the existing anti-age discrimination rules unless interest crediting rates do not exceed a market rate of return to be defined in Treasury regulations. Interest credits may not result in a decrease to the account balance below the aggregate amount of contributions credited to the account. 	<p>Plan sponsors will have to check their plan design to ensure that their interest crediting rate is within a permissible range. Note that the effective date under the law is “years beginning in 2008 . . .”, and it is not clear whether this means calendar years or plan years.</p> <p>This change should eliminate on a prospective basis the litigation risk for hybrid plans relating to “whipsaw” issues. The new law provides that no inference is to be drawn from it regarding whipsaw issues for periods before the law’s effective dates.</p>
Rules Relating to Reduction in Rate of Benefit Accrual: Conversions to Hybrid Plans		
<ul style="list-style-type: none"> Other than anti-cutback rules, there are no rules specifically addressing plan conversions, and how a prior benefit formula and new benefit formula are applied to a participant’s service. 	<ul style="list-style-type: none"> Plan conversions to a hybrid plan occurring after June 29, 2005 must provide existing participants with an accrued benefit that is no less than the sum of their accrued benefit under the old formula, plus an accrued benefit for new years of service based on the new plan formula. The value of any early retirement subsidies applicable to a participant’s accrued benefit under the old formula must be added to their post-conversion accrued benefit if, at the time of their retirement, they are eligible for such early retirement subsidies. Special rules clarify that these conversion rules apply to situations where the conversion is less direct (such as where two or more defined benefit plans are coordinated in such a manner as to have the effect of a conversion, or where there are multiple plan amendments). Other special rules apply to situations such as plan terminations, the use of offsets in a benefit formula, 	<p>The new law bans the use of a “wear-away” transition approach and requires the participant’s accrued benefit to be no less than the sum of the old frozen benefit plus accruals under the new formula. This “no wear away” approach must apply as a minimum even if the participant is allowed to choose between continuing under the old formula and accruing future benefits under the new formula.</p>

Current Law	PPA	Hewitt Comments
	integration with Social Security, and indexing.	
Rules for Computing Accrued Benefits by Reference to Hypothetical Account Balance		
<ul style="list-style-type: none"> There are no rules that permit a plan to treat a hypothetical account balance as the present value of a participant's accrued benefit. IRS Notice 96-1 indicates that, if a plan's accrued benefit is based on a hypothetical account balance, it must be projected up to normal retirement age (using the plan's interest crediting rate), converted to an annuity, and then discounted to a present value using statutorily prescribed rates. 	<ul style="list-style-type: none"> Effective for distributions occurring after the date of enactment, ERISA and the Code are amended to permit hybrid plans to treat a hypothetical account balance, or an accumulated percentage of the participant's final average compensation (in the case of a pension equity plan), as the present value of a participant's accrued benefit. 	<p>This new rule eliminates the whipsaw issue prospectively. Note that hybrid plans must satisfy the new rules regarding market rates of return for interest crediting.</p>
Vesting for Hybrid Plans		
<ul style="list-style-type: none"> Hybrid plans are treated the same as all other qualified plans. They must vest participants at least as quickly as under a five-year cliff vesting schedule or a seven-year graded vesting schedule. 	<ul style="list-style-type: none"> For years beginning in 2008 (or earlier, at the plan sponsor's election), or as late as 2010 for collectively bargained plans, participants in hybrid plans (including existing hybrid plans) must vest at least as quickly as under a three-year cliff vesting schedule. 	<p>The legislation requires the use of an accelerated vesting schedule only in 2008 and beyond. Note that the effective date under the law is "years beginning in 2008. . .", and it is not clear whether this means calendar years or plan years.</p>
Definition of Hybrid Plan		
<ul style="list-style-type: none"> There is no definition of a hybrid plan in the law. 	<ul style="list-style-type: none"> The changes discussed in this section apply to "applicable defined benefit plans," which is defined by the law. The term "hybrid plan" is used herein for simplicity. "Applicable defined benefit plan" is a defined benefit plan under which the accrued benefit, or any portion, is calculated as the balance of a hypothetical account, or as an accumulated percentage of the participant's final average compensation. The law directs the Treasury to issue regulations to include within this definition such plans that have a similar effect as those defined within the statute. 	<p>The definition of applicable pension plan in the law covers cash balance plans and pension equity plans. It will be up to the Treasury to determine how much the definition should be expanded, if at all.</p>

Current Law	PPA	Hewitt Comments
Effect of New Legislation on Hybrid Plans Existing Before Effective Date		
<ul style="list-style-type: none"> • None 	<ul style="list-style-type: none"> • The new law indicates that the changes it creates shall not be construed as creating an inference with respect to whether existing hybrid plans were or were not in compliance with existing rules before the effective dates of this law. 	<p>Certain members of Congress had hoped that a law with retroactive application could be passed, providing protection back to an earlier conversion date. Congress could not agree to provide such protection, and the compromise was to include language indicating that no inference should be drawn from the new rules. Challenges to hybrid plan designs prior to the effective dates of the new law are left up to the courts to decide, based solely on the law at the time. However, plans considering conversion to a hybrid design will be protected from age discrimination and whipsaw claims by following the new rules.</p>
Regulations Relating to Mergers and Acquisitions		
<ul style="list-style-type: none"> • None 	<ul style="list-style-type: none"> • The Treasury is directed to complete regulations within 12 months to address situations where a conversion occurs with respect to a group of employees that are part of a merger, acquisition, or similar transaction. 	

Reporting and Disclosure

Note: Not all notices required under PPA are discussed in this section. See other sections in this Special Report, such as “Automatic Enrollment,” for notice requirements that are specific to those areas.

Current Law	PPA	Hewitt Comments
Defined Benefit Plan Funding Notice		
<p>Summary Annual Report The plan administrator for a defined benefit pension plan must provide a summary annual report (SAR) to each plan participant and each beneficiary receiving benefits under the plan. The SAR contains basic information summarized from the plan’s annual report concerning the plan’s financial condition and activities, and must be provided within two months after the due date of the annual report.</p> <p>Notice to Participants of Funding Status of Plan (Section 4011 Notice) Plan administrators of certain underfunded plans must notify participants and beneficiaries annually of the plan’s funding status and the limits of the PBGC’s guarantee. The notice is due within two months after the due date for the annual report.</p>	<p>Annual Plan Funding Notice PPA repeals the Summary Annual Report requirement for defined benefit plans and the required Notice to Participants of Funding Status (Section 4011 Notice). These are replaced with a new requirement of an annual plan funding notice.</p> <p>The notice will provide information regarding:</p> <ul style="list-style-type: none"> • The plan’s funding target attainment percentage (including the specific percentage attained if under 100%); • Plan assets and liabilities and any funding standard carryover balance or prefunding balance; • Plan assets and liabilities used for variable rate premium calculations; • The number of plan participants retired or separated from service and receiving benefits, retirees or separated participants entitled to future benefits, and active participants; • The plan’s funding policy and asset allocation; • An explanation of any amendments or scheduled benefit changes and the effect on plan liabilities; • A summary of the rules governing plan termination; • A description of the plan benefits eligible to be guaranteed by the PBGC and an explanation of the limits on the PBGC guarantee; and 	<p>The annual plan funding notice will require the plan administrator to compile additional information that is not currently sent to participants and beneficiaries. This notice will likely be more enlightening than the current SAR and Section 4011 notice.</p> <p>There is a one-year gap between the repeal of the Notice to Participants of Funding Status (Section 4011 Notice) and the effective date of the new notice requirements.</p>

Current Law	PPA	Hewitt Comments
	<ul style="list-style-type: none"> • If applicable, a statement that the controlled group was required to provide information to the PBGC. <p>The plan funding information must be provided regarding the current plan year and the two prior years.</p> <p>The notice must be provided by the plan administrator to the PBGC, each participant and beneficiary, each union representing participants, and for a multiemployer plan, each participating employer.</p> <p>The notice generally must be provided within 120 days after the end of the plan year. For a small plan (fewer than 100 employees covered in the preceding year), the notice is due when the plan's annual report is filed.</p> <p>The Department of Labor (DOL) is directed to issue a model notice within one year of enactment.</p> <p>The repeal of the Notice to Participants of Funding Status is effective for plan years beginning after December 31, 2006. The SAR repeal and the new annual plan funding notice apply to plan years beginning after December 31, 2007.</p>	
Additional Annual Reporting Requirements		
<p>Annual Report The plan administrator of a defined benefit plan is required to file an annual report (Form 5500 series) for the plan. The information provided is available to the IRS, DOL, and PBGC. The filing is generally due 210 days after the end of the plan year, but an extension of up to 2-1/2 months is available.</p>	<p>PPA expands the annual reporting requirements to include additional information where liabilities to participants and beneficiaries under a plan consist, in whole or part, of liabilities held under two or more plans as of immediately before the reporting year.</p> <p>The Act also adds several new annual reporting requirements for multiemployer plans and expands disclosure for these plans to include employee organizations and each employer with an obligation to contribute to the plan.</p>	<p>The reporting changes for single employer defined benefit plans are limited. Multiemployer plans will have significantly expanded reporting and disclosure requirements.</p>

Current Law	PPA	Hewitt Comments
	The changes are effective for plan years beginning after December 31, 2007.	
Electronic Display of Annual Report Information		
Form 5500 and most schedules and attachment are open for public inspection. Forms may be filed on paper or electronically.	<p>Certain annual report information must be filed in an electronic format for internet display by the Department of Labor. The DOL must post the information to the internet website within 90 days of the filing.</p> <p>The information must also be displayed on any Intranet website for employees maintained by the plan sponsor (or administrator) in accordance with regulations prescribed by the Secretary of Labor.</p> <p>The provisions are effective for plan years beginning after December 31, 2007.</p>	
Disclosure of Termination Information to Plan Participants		
In a distress termination, the plan administrator must provide a notice of intent to terminate to affected parties at least 60 days and not more than 90 days before the proposed termination date.	<p>In the event of a distress termination of a plan or an involuntary termination initiated by the PBGC, an affected party (participants, beneficiaries, alternate payees, or unions) may request that the plan administrator provide any information provided to the PBGC. Information associated with or otherwise identifying an individual participant or beneficiary is protected, as is certain other confidential information. Information must be provided within 15 days of the original request and within 15 days of the date additional information is provided to the PBGC.</p> <p>In an involuntary termination by the PBGC, a copy of the administrative record relating to the termination shall be provided by the PBGC to an affected party upon request.</p> <p>The plan administrator may charge a reasonable fee for providing information to an affected party (other than for information provided in electronic form).</p>	

Current Law	PPA	Hewitt Comments
	The provisions are generally effective for terminations initiated after the date of enactment.	
4010 Filings with the PBGC		
<p>Filing Criteria Plan sponsors must report plan and financial information to the PBGC if the aggregate unfunded vested benefits for plans within the controlled group exceed \$50 million. Vested benefits are determined using 85% of the 30-year Treasury rate. Assets are determined as the actuarial value of assets.</p> <p>Special Rules for 2005–2007 For information years ending on or after January 1, 2004 and on or before December 31, 2005, the interest rate to calculate unfunded vested benefits is 85% of the Corporate Bond Rate. For information years ending on or after December 31, 2005 and on or before December 30, 2006, the PBGC has waived reporting if it would not be required if 85% of the Corporate Bond Rate were used to determine unfunded vested benefits.</p>	<p>For 2006 and 2007 Current rules, including the \$50 million threshold and use of 85% of the Corporate Bond Rate, apply to information years ending on or before December 31, 2007.</p> <p>2008+ Effective with respect to years beginning after 2007, a 4010 filing is required if the Funding Target Attainment Percentage at the end of the preceding plan year, determined without regard to “At-Risk” status, is less than 80%. Plan assets must be reduced by any Funding Standard Carryover Balance or Prefunding Balance.</p>	<p>Under the new rules, plans are not aggregated for the 80% test, and the funding target liability includes nonvested benefits. While the 80% test may help eliminate 4010 reporting for some plan sponsors, it appears that having just one plan with a percentage less than 80% could trigger reporting for the entire controlled group.</p> <p>Reporting based on the \$50 million threshold will apply for information years ending in 2006 and 2007. Thus, the current rules apply for two more years.</p>
<p>Required Information Plan sponsors must provide financial information for the entire controlled group and actuarial information for non-exempt plans including benefit liabilities based on plan termination assumptions.</p>	<p>In addition to information currently required, plan sponsors must provide the benefit liabilities using PBGC assumptions, the Funding Target of the plan assuming the plan was in “At-Risk” status for at least five plan years, and the Funding Target Attainment Percentage.</p>	<p>While benefit liabilities are currently required by regulations under this section, the additional liability using At-Risk assumptions and the Funding Target Attainment Percentage are new.</p>
<p>Disclosure of Information Information provided to the PBGC cannot be made available to the public, though the PBGC can disclose the information to the House or Senate or any congressional committee or subcommittee.</p>	<p>The current rules still apply; however, the PBGC is required to annually provide certain House and Senate committees with a summary in the aggregate of information the PBGC received.</p>	<p>The PBGC cannot make the information publicly available; whether that information could be released to the public will be governed by the committees’ rules and procedures.</p>

Current Law	PPA	Hewitt Comments
Periodic Pension Benefit Statements		
<p>Under current law, benefit statements need only be provided on request—but not more often than once per year.</p>	<p>PPA modifies the requirements regarding benefit statements. Under PPA:</p> <ul style="list-style-type: none"> • A participant in a defined contribution plan who has the right to direct investments must receive a benefit statement once per quarter; • A participant in a defined contribution plan who does not have the right to direct investments must receive a benefit statement once per year; • An active, vested participant in a defined benefit plan must receive either (1) a benefit statement once every three years, or (2) an annual notice describing the availability of a benefit statement and the manner in which the participant can obtain a benefit statement. <p>Benefit statements must also be provided on request; however, an employer is not required to provide more than one statement every 12 months under this requirement.</p> <p>PPA also adds a number of substantive requirements regarding the content of benefit statements. Most significantly, in the case of a participant who can direct investments, the benefit statement must:</p> <ul style="list-style-type: none"> • Provide information on any restrictions on the right to direct investments; • An explanation on the importance of diversification; and • A statement of the risk of holding more than 20% of a portfolio in the security of any single entity, such as employer securities. <p>For defined benefit plans, the statement must include an explanation of any permitted disparity under 401(l) or a floor-offset arrangement.</p> <p>The Secretary of Labor is to issue a model version of the notice required by PPA no later than one year after enactment.</p>	<p>The provisions of PPA recognize the inherent differences in the need to communicate defined benefit and defined contribution benefit values. While many employers currently provide periodic benefit reporting of their retirement programs, the more exact timing requirements and the substance of what is included under the new PPA requirements may be different from what many organizations provide today. For example, the language of PPA appears to provide that any restriction on the ability to direct investments (fund and plan) must be explained in the notice.</p> <p>PPA provides that the notice may be provided electronically to the extent it is reasonably accessible to the participant or beneficiary but does not make reference to the DOL’s electronic disclosure regulations. Presumably they apply in this case.</p>

Current Law	PPA	Hewitt Comments
	<p>These provisions are effective for plan years beginning after December 31, 2006, with a special effective date for plans maintained pursuant to collective bargaining.</p>	
Notice and Consent Regarding Distributions		
<p>In general, notices and explanations provided by a plan administrator, as well as participant elections and required consent with respect to benefit options, distribution commencement date options, and rollover options must be provided and/or made no earlier than 90 days prior to an annuity starting date.</p> <p>The Code and regulations thereunder identify the required content of notice and consent materials.</p>	<p>The Act extends the current 90-day period to 180 days.</p> <p>The Secretary of the Treasury is directed to modify regulations to reflect the new 180-day rule. Additionally, the Treasury is directed to modify regulations regarding the content of benefit explanations to include a requirement that any explanation of a participant's right to defer receipt of a distribution include a description of the consequences of failing to defer such receipt.</p> <p>This provision is effective for years beginning after December 31, 2006.</p>	<p>The extended period may be helpful to plan administrators. For example, plans that automatically distribute tax notices to all participants will be able to reduce the frequency of distribution. However, for many plans that cannot calculate benefits until shortly before a participant's annuity starting date, this provision will provide little, if any, administrative benefit.</p>

Rules Related to Prohibited Transactions and Fiduciary Liability

Current Law	PPA	Hewitt Comments
Investment Advice		
<p>Existing rules related to prohibited transactions make it difficult for existing fiduciaries to expand their services to include investment advice for individual participants in defined contribution plans.</p>	<p>PPA establishes a set of rules enabling plan fiduciaries to provide investment advice to plan participants. Under these rules:</p> <ul style="list-style-type: none"> • Fees received by the advisor cannot vary based on the investment option selected OR the advice must be provided under a computer model that is certified by an independent party pursuant to standards to be established by the DOL; • Before the initial provision of investment advice, and annually thereafter, the fiduciary advisor provides the participant with information on the investment advice program, including fees, historical rates of return, and the role of other parties with a material role in developing the program; • Transactions occur only at the direction of the participant; • The compensation received by the investment advisor is “reasonable” and the terms of transactions are at least as favorable to the plan as “arm’s length” transactions; • The investment advice program is authorized by a fiduciary other than the fiduciary providing the advice; • The investment advice program is subject to an independent annual audit regarding compliance with these new rules; and • The investment advisor retains evidence of compliance with these requirements for six years. <p>The plan sponsor must use prudence in selecting and monitoring fiduciary advisors, but does not have a duty to monitor the specific investment advice given to any specific participant.</p> <p>This provision is effective for advice provided after December 31, 2006.</p>	<p>While this provision provides additional options when determining if investment advice should be provided, there is still a requirement that the fiduciaries of the plan continue to be subject to ERISA’s fiduciary and prudence requirements with respect to the selection and periodic review of the investment advisor.</p>

Current Law	PPA	Hewitt Comments
Prohibited Transaction Rules Relating to Financial Investments		
<p>Under current law, transactions between a plan and a plan fiduciary or other “party in interest” are prohibited. The prohibition under current law is broadly stated and covers a wide range of transactions. However, there are also a number of specific transactions that Congress has exempted from the prohibited transaction rules.</p>	<p>PPA provides for a range of exemptions from the prohibited transaction rules, for a number of specific categories of transactions. Generally, these new exemptions involve more complex types of transactions. For example, PPA contains relief from prohibited transaction rules for certain block trades, foreign exchange transactions, and transactions executed over an electronic communication network.</p> <p>This provision is effective for transactions occurring after the date of enactment.</p>	
Correction Period for Prohibited Transactions Involving Securities and Commodities		
<p>Under current law, prohibited transactions are subject to an immediate excise tax equal to 15% of the amount involved in the transaction.</p>	<p>PPA creates a new correction period, allowing certain prohibited transactions to be corrected—without triggering any excise taxes—within a 14-day grace period. The 14-day period begins with the date the plan fiduciary or party-in-interest discovers (or reasonably should have discovered) that a transaction was prohibited. The new grace period covers transactions involving the purchase, holding, or disposition of any commodity or security (but does not extend to any employer securities).</p> <p>This provision is effective for transactions where the prohibited nature of the transaction is discovered (or reasonably should have been discovered) after the date of enactment.</p>	

Current Law	PPA	Hewitt Comments
Treatment of Investment of Assets by Plan Where Participant Fails to Exercise Investment Election (Default Investments)		
<p>Section 404(c) of ERISA protects plan fiduciaries from liability in certain circumstances, in the case of a plan that allows participants in a defined contribution plan to direct the investment of their account balances under the plan. Under current law, the exemption under 404(c) of ERISA was available only if a participant affirmatively selected investments.</p>	<p>Section 404(c) protection is extended to plans that use default provisions to invest participant accounts. The protection is available if:</p> <ul style="list-style-type: none"> • The plan invests defaulted amounts in accordance with guidelines to be issued by DOL; and • Affected participants receive an annual notice explaining their right to direct investments and have a reasonable opportunity to exercise investment control. <p>The regulations on default elections to be provided by DOL are to include guidance on the use of asset classes that are consistent with capital preservation and/or long-term capital appreciation.</p> <p>This provision is effective for plan years beginning after December 31, 2006.</p>	<p>This provision will be particularly welcomed by employers utilizing automatic enrollment features (although the PPA provisions are not specifically limited to plans using automatic enrollment).</p> <p>Under the conditions set forth in PPA, the guidelines to be issued by the DOL likely will require that default investments contain a mix of investments—which is especially important to employers looking at premixed portfolios for a default option. It is not yet clear what other common defaults—such as stable value funds—will be acceptable under the DOL guidelines.</p>
404(c) Protection for Blackouts		
<p>Under current DOL regulations, a fiduciary’s ERISA Section 404(c) protection from liability for losses resulting from a participant’s investment decisions may not apply during a blackout.</p> <ul style="list-style-type: none"> • 404(c) protection may not apply to losses incurred during a blackout because the participant does not have a reasonable opportunity to change investments during the blackout period. • 404(c) protection will not apply after the blackout if the participant does not make an affirmative election among the new investments offered after a fund change. Default elections do not receive 404(c) protection. 	<p>PPA clarifies and expands the 404(c) protection available in connection with a blackout:</p> <ul style="list-style-type: none"> • A fiduciary is not liable for losses incurred during the blackout period if the fiduciary satisfied his or her ERISA fiduciary and other related duties relating to the authorization and implementation of the blackout. • If the participant does not make an affirmative election among the new investment funds offered after the blackout, 404(c) protection carries over to the plan’s default investment if: <ul style="list-style-type: none"> — The participant had the opportunity to redirect investments, but failed to do so, — The characteristics (e.g., the risk and return profile) of the default investment funds are similar to those of the funds they replace, and — The participant receives a written notice 30–60 days in advance describing the fund changes and the default investment. <p>This provision is effective for plan years beginning after December 31, 2007, with a special delayed effective date for plans maintained pursuant to collective bargaining.</p>	<p>The relief from liability for losses during the blackout period is helpful. However, it will not always be clear whether a fiduciary has complied with all of his or her fiduciary duties.</p> <p>The relief from liability for default investment fund reallocations is also a welcome development. However, it is not clear that this relief applies if the blackout notice is provided less than 30 days in advance, as is permitted in some cases under the current blackout notice rules.</p> <p>These new rules appear to apply only if the blackout lasts more than three consecutive business days.</p>

Current Law	PPA	Hewitt Comments
Increase in Penalties for Coercive Interference With Exercise of ERISA Rights		
Under current law, coercive interference with the exercise of participants' rights under ERISA carries a maximum fine of \$10,000 and a maximum prison term of one year.	<p>The penalty for coercively interfering with participants' exercise of their rights under ERISA is increased. Under PPA, the maximum fine is increased to \$100,000, and the maximum prison term is extended from one year to ten years.</p> <p>This provision is effective with the date of enactment.</p>	Coercive interference includes activities such as the use of force, fraud, or violence.

EGTRRA and Saver's Credit Permanence

Current Law	PPA	Hewitt Comments
EGTRRA Permanency		
<p>General Rules The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) included significant increases to retirement plan contribution opportunities (e.g., increased contribution limits, the ability to make catch-up contributions, and the ability to make designated Roth contributions to 401(k) and 403(b) plans). These provisions are set to expire in 2010 under a sunset provision in EGTRRA.</p>	<p>PPA makes the retirement plan and IRA provisions of EGTRRA permanent.</p>	<p>For many employers, the lack of a sunset makes certain EGTRRA provisions, like the Roth 401(k), more appealing. In a 2006 Hewitt survey, <i>Hot Topics in Retirement</i>, of the 66% of employers who said they were very or somewhat unlikely to offer the Roth 401(k) in 2006, 39% stated the sunset provision as a reason.</p>
Saver's Credit (for Elective Deferrals and IRA Contributions)		
<ul style="list-style-type: none"> Code Section 25B provides a non-refundable income tax credit for eligible individuals for qualified retirement savings contributions, including elective deferrals to 401(k) plans and IRA contributions. The credit rate depends on the taxpayer's adjusted gross income (AGI) level. Joint returns with AGI of \$50,000 or less, head of household returns of \$37,500 or less, and single returns of \$25,000 or less are eligible for the credit. The maximum annual contribution eligible for the credit is \$2,000. The saver's credit is scheduled to expire at the end of 2006. 	<ul style="list-style-type: none"> The saver's credit is made permanent. Starting in 2007, the AGI levels to determine eligibility and credit rate are indexed for inflation. Indexed amounts are rounded to the nearest multiple of \$500. 	<p>Indexing may support the credit by counteracting a decrease over time in the number of eligible individuals with incomes in the range to which the credit applies.</p> <p>As a general matter, studies have shown that the savings patterns of lower-income households respond to tax incentives and, therefore, this provision may result in increased retirement savings among lower-wage employees.</p>

Diversification and Vesting

Current Law	PPA	Hewitt Comments
Diversification Requirements for Defined Contribution Plans		
<p>Under current law, diversification requirements for company stock are far more limited:</p> <ul style="list-style-type: none"> • They apply only to plans qualified as ESOPs; • They apply only to participants who attain age 55 and complete ten years of plan participation; and • The maximum required diversification is 50% of a participant's benefit. 	<p>PPA amends both the plan qualification provisions of the Code and ERISA to require that defined contribution plans that invest in publicly traded employer securities must provide participants with new diversification rights with respect to such employer securities.</p> <p>Under the new requirements, participants must have the right to diversify employee contributions and elective deferrals immediately. Amounts attributable to employer contributions must be subject to diversification after the participant has completed three years of service.</p> <p>The diversification requirements are met only if a participant can choose between three different investment options, each with different risk and return characteristics.</p> <p>These diversification provisions do not apply:</p> <ul style="list-style-type: none"> • To a plan that is qualified as an ESOP if the plan does not accept any elective employee deferrals under Code Section 401(k) or any employee after-tax or employer matching contributions under Code Section 401(m). • To a plan that invests in employer securities that are not publicly traded. <p>Also, employees eligible to diversify must be given notice describing the right to diversify and the importance of diversification.</p> <p>This provision is effective for plan years beginning after December 31, 2006. However:</p> <ul style="list-style-type: none"> • There is a three-year phase-in applicable to employer contributions used to acquire employer securities in a plan year beginning prior to January 1, 2007. • There are special transition rules for plans governed by collective bargaining. 	<p>Congress weighed the merits of this legislation at various times over the course of the last five years (since companies such as Enron and WorldCom collapsed). While Congress was considering this direction, many employers already liberalized their diversification rules. Hence, the changes adopted by PPA will affect fewer employers now than it would have in the past.</p>

Current Law	PPA	Hewitt Comments
Notice of Freedom to Divest Employer Securities		
<p>General Rules While current law does not require a specific notice regarding the right of a participant to divest himself or herself of employer stock or the importance of diversification, a participant must generally be informed of the material provisions of a plan.</p>	<p>Notice of Right to Divest In connection with the new diversification requirements, PPA amends ERISA to require a plan sponsor to provide participants and beneficiaries with a notice of their right to divest their plan accounts of employer stock. The notice must be provided no later than 30 days before the date the person may exercise the diversification right. The Secretary of the Treasury must provide a model notice within 180 days after the date of enactment.</p>	<p>PPA provides that the notice may be delivered in written, electronic or other appropriate form to the extent the notice is reasonably accessible to the recipient. PPA does not make reference to the existing DOL electronic disclosure rules, but presumably they would apply in this case.</p> <p>It appears that the notice may have to be provided at different times due to the different divestiture rights associated with elective deferrals and employer contributions. Depending on the plan terms, complying with the 30-day time period may be difficult in some situations (for example, plans with immediate diversification).</p>

Current Law	PPA	Hewitt Comments
Faster Vesting		
<p>General Rules Plans must vest nonelective employer contributions at a rate of 100% after five years (five-year cliff) or 20% a year after two years of service (seven-year graded).</p> <p>Matching contributions must vest at a rate of 100% after three years (three-year cliff) or 20% a year after a year of service (six-year graded). Employee contributions are always 100% vested.</p>	<p>PPA applies the current vesting schedule for matching contributions to all employer contributions to a defined contribution plan.</p> <p>The new schedule generally applies to contributions made for plan years beginning after December 31, 2006 (collectively bargained plans have a delayed effective date, as do certain ESOPs).</p>	

Automatic Enrollment

Current Law	PPA	Hewitt Comments
ADP/ACP Safe Harbor for Automatic Enrollment		
<p>Under current law, a safe harbor from the ADP test of Code Section 401(k) and the ACP test of 401(m) is available only if a plan provides employees with a minimum contribution of either:</p> <ul style="list-style-type: none"> • \$1/\$1 on the first 3% of compensation deferred, plus \$0.50/\$1.00 on the next 2% of compensation deferred; or • Nonelective, nonmatching contributions equal to 3% of compensation of all eligible, nonhighly compensated employees. <p>Employer contributions under a safe harbor plan must be 100% vested at all times. Additionally, safe harbor plans are subject to further rules regarding special notices to eligible employees and restrictions on the distribution of employer contributions.</p>	<p>PPA adds a new safe harbor provision to provide employers with yet another alternative to complying with the ADP test of Code Section 401(k) and the ACP test of Code Section 401(m).</p> <p>The new safe harbor alternative is available to a plan that:</p> <ul style="list-style-type: none"> • Uses an automatic enrollment feature for all employees who do not affirmatively waive plan participation (the plan must provide notice of the ability to opt out). • Has a minimum initial automatic employee contribution of 3% of pay and a minimum additional escalation rate of 1% per year for three years (to a minimum automatic deferral rate of 6%). • Does not require a deferral election in excess of 10% of pay. • Has a minimum employer contribution for nonhighly compensated employees—provided as either a minimum matching contribution or a minimum nonelective, nonmatching employer contribution. The minimum matching contribution rate is \$1/\$1 match on the first 1% of compensation deferred and \$0.50/\$1 match on the next 5% of compensation deferred. The minimum nonelective contribution is 3% of compensation. • Vests employer contributions under this new safe harbor (including matching contributions), after two years of service. • Meets other requirements for safe harbor plans under current code provisions—such as notification requirements to participants regarding the plan’s safe harbor provisions and restrictions on plan withdrawals. <p>This provision is effective for plan years beginning after December 31, 2007. A plan adopting these provisions is not required to extend automatic enrollment to current employees eligible to participate before the arrangement was made and who had an election on that date to either participate or not participate.</p>	<p>The additional safe harbor provisions combine two of the hottest trends in defined contribution plan design—safe harbor and automatic enrollment. The alternative created by PPA should give employers another way to extend employee savings and may be especially appealing to employers in industries that may have been discouraged by the higher matching and faster vesting requirements under the current law safe harbor.</p> <p>Many employers are already using automatic enrollment as a tool for increasing plan participation and, thus, enhancing their ability to pass the ADP/ACP tests. The new combination of safe harbor and automatic enrollment offers employers yet another alternative for passing ADP/ACP tests—one that provides relief from the testing immediately (and, thus, is faster than traditional automatic enrollment strategies) and that may (in many situations) be less costly than the “traditional” safe harbor provisions added to the Code in 1999.</p>

Current Law	PPA	Hewitt Comments
Returns of Automatic Enrollment Contributions		
<p>Current law contains no special provisions allowing distribution of amounts contributed to a plan through automatic enrollment—even if the participant has requested that they not participate in the plan.</p>	<p>PPA creates a new withdrawal option that would allow a plan to offer participants a 90-day window to elect to withdraw amounts deferred through an auto enrollment program.</p> <p>These withdrawals are not subject to penalty taxes.</p> <p>This provision is effective for plan years beginning after December 31, 2007.</p>	
Excess Contributions		
<p>Current law provides that “excess” contributions to a plan are subject to excise taxes unless they are distributed within 2-1/2 months after the end of the plan year in which they were contributed. This rule applies to employee 401(k) deferrals subject to the ADP test and employer matching and employee contributions subject to the ACP test.</p> <p>Generally, the distribution of excess contributions must include associated earnings for the plan year and associated earnings for the period from the end of the plan year to the date of the excess contribution distribution (this latter portion referred to as gap earnings).</p>	<p>PPA provides that automatic enrollment plans have an extended period (six months after the end of the plan year) for the distribution of excess contributions.</p> <p>In addition, PPA provides that timely refunds of excess contributions (both from 401(k) plans without automatic enrollment and from automatic enrollment plans) are taxable in the year of distribution instead of the year of contribution.</p> <p>PPA also eliminates the gap earnings requirement on ADP/ACP excesses.</p> <p>This provision is effective for plan years beginning after December 31, 2007.</p>	
State Law Preemption		
<p>ERISA currently preempts state laws insofar as they relate to employee benefit plans.</p>	<p>PPA amends ERISA to explicitly override any state law that prohibits or restricts automatic enrollment features in defined contribution plans, provided a specified notice is given.</p> <p>This provision is effective on the date of enactment.</p>	<p>Questions about state law have often been cited as a concern of employers considering automatic enrollment for their 401(k) plans. This provision of PPA is intended to eliminate any such questions.</p>

Distribution, Portability, and Contribution Rules

Current Law	PPA	Hewitt Comments
Pension Plan Distributions While Working		
<p>Qualified pension plans are defined by Treasury regulations as providing for the payment of benefits after retirement. Plans may pay distributions while participants are still actively employed, although this may not occur until a participant has reached normal retirement age under the plan.</p>	<p>Beginning after 2006, pension plans may be amended to provide for distributions to participants who have attained age 62, even if they are still actively employed.</p>	<p>This new provision is optional, giving sponsors of pension plans additional flexibility regarding when distributions may be made and may give new impetus to employers considering some sort of “phased retirement” program.</p>
Rollovers of After-Tax Contributions to 403(b) Plans and Pension Plans		
<p>A distribution of after-tax contributions may be directly rolled over from a qualified plan to another qualified plan or to an IRA, but not to a Section 403(b) plan or to a qualified defined benefit plan.</p> <p>Similar rules apply to rollovers from Section 403(b) and governmental Section 457 plans.</p>	<p>Starting in 2007, distributions of after-tax contributions (and attributable earnings) from a qualified plan may also be rolled over to a 403(b) plan or a qualified defined benefit plan, provided that the plan receiving the direct rollover separately accounts for the rolled over after-tax contributions and attributable earnings.</p>	<p>Administrators of 403(b) plans that currently do not accept after-tax contributions, and administrators of defined benefit plans, may be reluctant to make the systems changes required to accept rollovers of after-tax contributions.</p> <p>These same changes appear to apply to rollovers of after-tax contributions (and attributable earnings) from Section 403(b) plans and Section 457 plans.</p>
Rollovers to Roth IRAs		
<p>A taxpayer whose adjusted gross income does not exceed \$100,000 may convert funds held in a traditional IRA to a Roth IRA by rolling over a distribution from the traditional IRA to a Roth IRA. (However, a married taxpayer who files an individual return is not eligible to convert traditional IRA funds into Roth IRA funds.)</p> <p>At the time of conversion, the taxpayer pays ordinary federal income taxes on the taxable portion of the amount rolled</p>	<p>PPA permits eligible individuals (i.e., those having adjusted gross income under \$100,000 and meeting tax filing status rules) to roll over distributions from qualified plans, Section 403(b) plans, and governmental Section 457 plans directly to Roth IRAs without the intermediate step of a rollover to a traditional IRA.</p> <p>As with rollovers from traditional IRAs, the employee pays ordinary federal income taxes on the taxable</p>	<p>Future IRS guidance will clarify whether employer plans must offer to make direct rollovers to Roth IRAs. If employers are permitted, but not required, to offer such rollovers, then it is not clear whether plan sponsors will wish to offer participants the opportunity to make direct rollovers to Roth IRAs in light of the added administrative</p>

Current Law	PPA	Hewitt Comments
<p>over from the traditional IRA, but does not pay the 10% early distribution penalty tax that otherwise would apply to a cash distribution from the traditional IRA. Earnings on funds transferred to the Roth IRA will be received tax-free if distributed as part of a qualified distribution.</p> <p>Employees may not roll over to a Roth IRA a distribution from a qualified plan, Section 403(b) plan, or Section 457 plan. However, an employee may indirectly accomplish this result by rolling over a distribution from a qualified plan to a traditional IRA, and then rolling over the funds from the traditional IRA to a Roth IRA.</p>	<p>portion of the eligible rollover distribution from the employer plan, but not the 10% early distribution penalty tax that otherwise would apply to a cash distribution from the employer plan. The Form 1099-R will reflect this special tax treatment.</p> <p>The new rule is effective for amounts rolled over from employer plans on or after January 1, 2008.</p>	<p>complexity (i.e., potentially needing to know income levels and tax filing status, and more complex government reporting).</p>
Hardship Withdrawals to Meet the Needs of Family Members		
<p>Employees may receive hardship withdrawals from 401(k) plans and 403(b) plans. IRS regulations define “safe harbor” withdrawal events for 401(k) plans that automatically qualify as a hardship, including paying unreimbursed medical expenses, educational expenses, or funeral expenses of the participant’s opposite-sex spouse or Section 152 tax dependent. Paying such expenses for a person other than the participant’s opposite-sex spouse or tax dependent does not qualify as a safe harbor hardship. Proposed regulations would apply the same rules to hardship withdrawals from Section 403(b) plans.</p> <p>For withdrawals from Section 457 plans and Section 409A nonqualified plans on account of an unforeseen emergency, the Section 457 regulations and proposed Section 409A regulations apply similar restrictions.</p>	<p>The IRS is required to modify its regulations for Section 401(k), 403(b), 457, and 409A plans to permit hardship or unforeseen emergency withdrawals for expenses of the participant’s beneficiary under the plan, in the same circumstances as would be permitted under the plan to pay an expense of the participant’s opposite-sex spouse or tax dependent. For example, if a 401(k) plan allowed a hardship withdrawal to pay for the unreimbursed medical expenses of a same-sex spouse or tax dependent and a participant designated his or her parent or domestic partner as the beneficiary of his or her 401(k) account, then the plan could permit the participant to receive a hardship withdrawal to pay for the parent’s or domestic partner’s unreimbursed medical expenses.</p> <p>The IRS is required to modify these rules within 180 days of enactment.</p>	<p>Under the revised rules, a hardship withdrawal will be permitted only if the participant designates the other person as a beneficiary. In contrast, eligible expenses of a spouse or Section 152 tax dependent qualify even if that person is not designated as the participant’s beneficiary.</p> <p>Plans are permitted, but not required, to liberalize their hardship withdrawal provisions to take advantage of the more generous rules to be issued by the IRS.</p>

Current Law	PPA	Hewitt Comments
Death Benefit Rollovers by Nonspouse Beneficiaries		
<p>A surviving spouse who receives a death benefit from a qualified plan, Section 403(b) plan, or governmental Section 457 plan that qualifies as an eligible rollover distribution (e.g., a lump sum) may roll over that distribution to any such plan or to an IRA.</p> <p>Nonspouse beneficiaries may not roll over payments of their death benefits.</p>	<p>A designated nonspouse beneficiary may transfer directly to an IRA any death benefit payment made on behalf of a deceased employee from a qualified plan, a Section 403(b) plan, or a governmental Section 457 plan. This transfer election is subject to the following:</p> <ul style="list-style-type: none"> • The payment must be transferred directly to the IRA (i.e., no 60-day rollover). • The payment must be directed to an IRA that is established solely to receive the death benefit. • The IRA will be subject to the minimum distribution rules that apply to beneficiaries. • No rollovers are permitted from the IRA that is established to receive the death benefit. <p>These rules apply to distributions made on or after January 1, 2007.</p>	<p>Nonspouse beneficiaries can now defer the taxation of their death benefits.</p>
Penalty-Free Withdrawals From Retirement Plans for Individuals Called to Active Duty		
<p>General Rules Early distributions from qualified plans (e.g., distributions that are not on account of death, disability, hardship, or attaining age 59-1/2) are subject to a 10% early distribution tax.</p>	<p>PPA creates another distribution that is exempt from the 10% early distribution tax. Reservists ordered or called up for active duty between September 11, 2001 and December 31, 2007 for a period greater than 179 days may take a distribution from an IRA or of elective deferrals from an employer plan without incurring the 10% early distribution tax. The distribution must be made after September 11, 2001. Amounts may then be recontributed to an IRA within two years of the later of the end of the active duty service or the date the PPA is enacted.</p>	<p>The recontributed amounts can be made in the amount of the withdrawal and are not subject to IRA contribution limits and are not deductible.</p>

Spousal Pension Protection

Current Law	PPA	Hewitt Comments
Regulations on Time and Order of Issuance of Domestic Relations Orders		
<p>Current provisions of ERISA (Section 206(d)(3)) and the Internal Revenue Code (Section 414(p)) regarding the assignment of pension benefits pursuant to a qualified domestic relations order (“QDRO”) do not address the time and order of domestic relations orders.</p>	<p>PPA directs the Secretary of Labor to issue regulations to clarify that a domestic relations order otherwise meeting the requirements for a QDRO shall not fail to be treated as a QDRO solely because of the time it is issued or that it is issued after, or revises, another domestic relations order or QDRO.</p> <p>Regulations are to be issued within one year of enactment.</p>	<p>The provision will assist plans in the administration of QDROs.</p>
Requirement for Additional Survivor Annuity Option		
<p>Unless otherwise elected by the participant with consent of the spouse, pension plans must provide retirement benefits to married participants in the form of a qualified joint and survivor annuity (“QJSA”). A QJSA is an annuity for the life of the participant with a survivor annuity for the life of the spouse which is not less than 50% and not more than 100% of the amount payable during the joint lives of the participant and spouse.</p>	<p>PPA requires pension plans to offer a “qualified optional survivor annuity” of 75% payable to the spouse for plans with a QJSA that is less than 75%, and of 50% payable to the spouse for plans with a QJSA of 75% or more. The option must be determined as actuarially equivalent to the single annuity for the life of the participant.</p> <p>Participants must be notified of the availability of the qualified optional survivor annuity.</p> <p>The change is generally effective for plan years beginning after December 31, 2007, with a delayed effective date for collectively bargained plans.</p>	<p>Plans may need to add a 75% joint and survivor spouse option, and in few cases, a 50% joint and survivor spouse option, if not currently offered.</p>

Other Provisions

Current Law	PPA	Hewitt Comments
Nonqualified Deferred Compensation		
<p>General Rules</p> <ul style="list-style-type: none"> • Assets set aside for the payment of nonqualified deferred compensation are subject to tax if the amounts are not subject to claims of general creditors and if the participant has a vested right to the amounts set aside. • Assets set aside in a so-called “rabbi trust” and amounts merely earmarked for payment of nonqualified deferred compensation are taxed when actually paid to the participant. • Under Section 409A, assets set aside to pay nonqualified plan benefits are treated as Section 83 property if the assets are placed in a trust or other arrangement that is located outside the United States, or placed in a trust or other arrangement in which assets become restricted for plan benefits in connection with a change in the employer’s financial condition. Current law, however, does not restrict an employer from setting aside assets for the payment of nonqualified plan benefits if that employer’s qualified plan is underfunded. 	<p>The New Rules</p> <ul style="list-style-type: none"> • If a sponsor of a qualified defined benefit plan sets aside assets in a trust or other arrangement to pay nonqualified plan benefits to a “covered employee” during a “restricted period”: <ul style="list-style-type: none"> — The transferred assets will be taxed at the time of vesting under Code Section 83; and — The 20% tax and interest penalties in effect under Code Section 409A will apply to the amounts taxed under Code Section 83. • A “covered employee” is a current employee (i) who is listed in the proxy statement’s compensation disclosure schedules; or (ii) who qualifies as an insider under Section 16(a) of the Securities Exchange Act of 1934. A “covered employee” also includes each former employee who qualified as a covered employee at the time of termination. • The “restricted period” includes (i) any period during which the qualified plan is in At-Risk status under the new pension funding rules, (ii) any period during which the plan sponsor is in bankruptcy, and (iii) any 12-month period beginning six months before the termination of an underfunded qualified plan. <p>This provision applies to transfers and other reservations of assets after the date of enactment.</p>	<p>In general, these new rules effectively prevent companies with underfunded (“restricted”) pension plans from setting aside or reserving assets to pay nonqualified plan benefits of individuals who are subject to insider trading rules under Section 16(a) of the Securities Exchange Act of 1934.</p> <p>In addition, these new rules appear to apply to CEOs of companies that are not publicly traded.</p>

Current Law	PPA	Hewitt Comments
Tax Treatment of Death Proceeds Under COLI Contracts		
<p>General Rules</p> <ul style="list-style-type: none"> • Death benefits received under a life insurance contract are excludable from taxable income. • No Federal income tax generally is imposed upon the policyholder of a life insurance contract with respect to any earnings under a life insurance contract (inside buildup). 	<p>New Rules</p> <p>An employer generally will be taxed on the portion of the death benefits received under a company-owned life insurance contract (“COLI contract”) that is in excess of the premiums paid. However, this excess benefit will not be taxed:</p> <ul style="list-style-type: none"> • If the insured employee: <ul style="list-style-type: none"> — Is either (i) an employee at any time during the 12-month period before death; or (ii) a director or other “highly compensated” employee at the time the policy is issued; and — Receives notice before the COLI contract is issued; and — Provides written consent to being insured under that contract; or • To the extent that the death benefit is paid to the insured’s heirs or to a beneficiary designated by the insured and the above notice and consent requirements are met. <p>The new rules also impose reporting and recordkeeping requirements on the employer.</p> <p>The new rules generally apply to COLI contracts issued after the date of enactment.</p>	<p>These new provisions are designed to curb perceived abuses related to so-called “janitor insurance”—where an employer insures a large number of employees without any notice and often without any direct or indirect benefit from the arrangement.</p> <p>In general, employers can still use COLI to fund various benefits, provided they obtain the necessary consents. In addition, COLI contracts that are intended to extend beyond termination of employment can generally insure only directors and highly compensated employees.</p> <p>Note: The new rules do not appear to apply to contracts that are both acquired and owned by a Voluntary Employees’ Beneficiary Association (VEBA).</p>
Plan Amendments		
<p>Code Section 401(b) and regulations thereunder provide a remedial amendment period during which a plan may be amended to comply with the Code’s qualification requirements. However, a plan generally cannot be amended in a manner that reduces protected benefits without a statutory provision.</p>	<p>Plan amendments must be made on or before the last day of the first plan year beginning on or after January 1, 2009 (for governmental plans, January 1, 2011).</p> <p>Plans that are retroactively amended pursuant to PPA (or regulations thereunder) will not violate the anti-cutback rules or fail to operate in accordance with plan terms if the provisions of the retroactive amendment are followed from the date the legislative or regulatory amendment takes effect.</p>	<p>Further guidance from the IRS will be necessary to coordinate the deadlines in PPA with the current IRS five-year cycle for remedial plan amendments and determination letter filings.</p>

Health Care

Current Law	PPA	Hewitt Comments
Retiree Health: Use of Excess Pension Assets		
<p>Code Section 420 allows for the transfer of excess assets to a health benefits account under the plan. Only one transfer is allowed each year. “Excess assets” generally means the excess of the value of the plan’s assets over the greater of (i) the accrued liability under the plan or (ii) 125% of the plan’s current liability. Assets transferred may be used only to pay qualified current retiree health liabilities for the taxable year of transfer. Cost maintenance provisions apply during a five-year period beginning with the year the transfer occurs.</p>	<p>PPA adds two new categories for the transfer of excess pension asset—a “qualified future transfer” and a “collectively bargained transfer.” Excess assets for up to ten consecutive years of expected future retiree health costs may be transferred. Excess pension assets are defined using the new PPA standards for pension funding and a 120% funded status threshold. There is also a requirement to maintain the 120% funded status over the transfer period by additional contributions or a transfer back from the health benefits account.</p> <p>A cost maintenance requirement applies during the transfer period and for four years following the transfer period.</p> <p>Collectively bargained plans will be allowed to make a “collectively bargained transfer” only with respect to a plan maintained by an employer which, in its taxable year ending in 2005, provided retiree health benefits under all of the benefit plans maintained by the employer and where the aggregate cost of benefits (and administrative costs) is at least 5% of the employer’s gross receipts for such year.</p> <p>The provisions are effective for transfers of assets after the enactment date.</p>	<p>Maintenance of funded status at 120% and maintenance of costs for a very long period may limit the appeal of these transfer provisions for many plan sponsors.</p>

Current Law	PPA	Hewitt Comments
Annuity and Life Insurance Contracts With Long-Term Care Insurance Feature		
<p>In general, earnings and gains on amounts invested in an individual's deferred annuity contract are not subject to tax during the deferral period. When payout commences, the tax treatment depends on whether the amount distributed is received "as an annuity." For amounts received as an annuity by an individual, an "exclusion ratio" is provided for determining the taxable portion of each payment.</p> <p>Present law provides favorable tax treatment for a qualified long-term care insurance contract, which is treated as an accident and health insurance contract. Amounts received under the contract generally are excludable from income as amounts received for personal injuries or sickness. The excludable amount is subject to a dollar cap of \$250 per day or \$91,250 annually (for 2006), as indexed. If payments under such contracts exceed the dollar cap, then the excess is excludable only to the extent the excess costs are incurred for long-term care services. Amounts in excess of the dollar cap that are not actual costs for long-term care services are fully includable in income without regard to the rules relating to return of basis under Code Section 72.</p> <p>In the case of long-term care insurance coverage provided by a rider on a life insurance contract, the requirements applicable to long-term care insurance contracts apply as if the portion of the contract providing such coverage were a separate contract.</p>	<p>PPA provides tax rules for long-term care insurance that is provided by a rider on, or as part of, an annuity contract, and modifies the tax rules for long-term care insurance coverage provided by a rider on or as part of a life insurance contract.</p> <p>Any charge against the cash value of an annuity contract or the cash surrender value of a life insurance contract made as payment for coverage under a qualified long-term care insurance contract that is part of or a rider on the annuity or life insurance contract is not includable in income. The investment in the contract is reduced (but not below zero) by the charge.</p> <p>PPA expands the rules for tax-free exchanges of certain insurance contracts. The provision provides that no gain or loss is recognized on the exchange of a life insurance contract, an endowment contract, an annuity contract, or a qualified long-term care insurance contract for a qualified long-term care insurance contract.</p> <p>The provision requires information reporting by any person who makes a charge against the cash value of an annuity contract, or the cash surrender value of a life insurance contract, that is excludable from gross income under the provision.</p> <p>The provisions are effective generally for contracts issued after December 31, 1996, but only with respect to taxable years beginning after December 31, 2009.</p>	