LAW and BUSINESS

FRASER TREBILCOCK DAVIS & DUNLAP, P.C.

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The Pension Protection Act of 2006

By Darrell Lindman, J.D. and Brian Gallagher, Intern

Due to a few highly publicized bankruptcies and corporate scandals resulting in lost retirement benefits to rank and file workers, on top of an impending Social Security crisis, retirement security has made its way back to the forefront of debate among many political and legal circles. Public concern has been exacerbated by reports that the governmental entity responsible for insuring failed plans, the Pension Benefit Guaranty Corporation (the "PBGC"), is financially strained after having to assume benefit payments for some large plans after their collapse. Against this backdrop, on July 31, 2006, Congress passed the Pension Protection Act of 2006 (the "PPA" or the "Act"), which was signed into law by President Bush on August 17, 2006. This new Act represents the most sweeping legislation in the area of deferred compensation since the Employee Retirement Income Security Act of 1974 ("ERISA"). The PPA includes many changes for defined benefit ("DB"), defined contribution ("DC"), and hybrid plans alike—changes that could have a substantial effect on cash flow and the bottom line for businesses.

> *"The PPA includes many changes for defined benefit, defined contribution, and hybrid plans alike - changes that could have a substantial effect on cash flow and the bottom line for businesses"*

Defined Benefit Plans

The central focus of the PPA is the new scheme of funding rules for DB plans. The overall effect of these provisions is to make the amount of the employer's required annual contribution contingent upon the funded status of the plan. Essentially, the Act requires an employer's contribution to cover the present value of benefits expected to be accrued by participants in the current year in addition to an amount sufficient to amortize any preexisting funding shortfall within seven years. Plans that are significantly underfunded will be subject to more rigorous funding requirements as well as other restrictions.

A plan's funded status is determined by comparing the value of the plan's assets to the present value of its expected future benefit obligations. Assets are generally measured at fair market value, and while smoothing (measuring the value of plan assets by taking their average value over a number of years) is still permitted, its parameters have been greatly restricted. Under the Act, expected future benefit obligations are discounted to present value using an interest rate based on corporate bonds maturing in three different time segments. Funded status is then measured by taking a ratio of the value of assets over the present value of expected future benefits.

Under the PPA, if a single-employer plan was less than 80% funded in the previous year, it is considered "at-risk" and the employer's required contribution is correspondingly increased. At-risk plans face heightened PBGC reporting requirements, and are ineligible to use funding credit balances carried over from previous years. Sponsors will also be prohibited from amending these plans to increase benefits, and from paying lump sums that exceed the lesser of 50% of the participant's accrued benefit or 100% of the present value of the portion guaranteed by the PBGC; the balance of the participant's accrued benefit must be paid as an annuity. Having any plan in at-risk status can even have repercussions for the sponsor's ability to maintain a non-qualified deferred compensation plan for executives.

Single-employer plans that were less than 60% funded in the previous year are subject to all of the restrictions mentioned in the previous paragraph. In addition, until funding returns to the 60% level, these plans must cease accruals and may not pay benefits based on an "unpredictable contingent event," such as a plant

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THE PENSION PROTECTION ACT OF 2006

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shutdown. Finally any plans with funding shortfalls in the previous year will be required to make contributions on a quarterly basis.

Other significant changes specifically applicable to DB plans include: the opportunity for in-service distributions to participants at age 62, a new 75% qualified joint-and-survivor annuity ("QJSA") requirement, and the permanent replacement of 30-year treasury bond rates with a corporate bond yield curve for the calculation of lump sum distributions.

DEFINED CONTRIBUTION PLANS

Although much of the discussion of the PPA has centered around the DB funding provisions, the Act also changes many of the rules applicable to DC plans.

> *"...the PPA further expands rollover options to permit account balances to be rolled over directly into Roth IRAs, and to allow all beneficiaries to roll over account balances."*

Paramount among these provisions is the approval of 401(k) plans with an automatic enrollment feature. Under such a plan, once the employee becomes eligible to participate, a pre-determined percentage of the employee's pay is automatically contributed to their 401(k) account unless the employee affirmatively opts out of the arrangement. Prior to the Act, some courts had found that this practice violated state laws pertaining to payroll withholding. Not only does the Act specifically permit these arrangements, it encourages employers to adopt them by providing a new optional non-discrimination safe-harbor to automatic enrollment plans meeting certain criteria. All employers maintaining automatic enrollment 401(k) plans must provide a notice to participants when they are enrolled that contains an explanation of the plan and an opportunity to decline participation.

New rules pertaining to participant directed account investments require more participant education and more latitude for diversification of holdings, particularly when employer securities are involved. The Act requires the Department of Labor to issue regulations providing guidance for selecting default investments for plans with participant directed investments, and grants a safe-harbor to employers that comply with those regulations. The PPA also contains new prohibited transaction rules with regard to investments; most notably, plan fiduciaries may now be compensated for furnishing investment advice to participants, provided certain checks and safeguards are in place.

Additionally, the PPA introduces more stringent vesting standards, requiring 3-year cliff or 6-year graded vesting for employer contributions to DC plans.

HYBRID PLANS

Although the Act contains provisions dealing with other types of hybrid plans, the hallmark in this area is the Act's treatment of cash balance plans. The growth of cash balance plans has been stunted in recent years by participants who claimed these plans discriminate against older workers, resulting in a debate that has divided courts and commentators. The PPA has resolved this controversy, declaring that, at least prospectively, cash balance plans will be protected from age discrimination claims, provided they employ 3-year vesting and an interest crediting rate not exceeding certain standards. Furthermore, if a participant in such a plan elects a lump sum distribution, the Act permits the plan to simply distribute the participant's account balance, eliminating the so-called "whipsaw effect," and with it another area of much controversy. For employers interested in converting their traditional plans to a hybrid plan, the Act contains applicable rules and guidelines.

OTHER SIGNIFICANT PROVISIONS

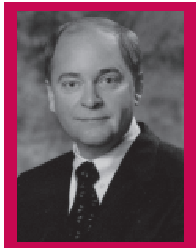
Other notable changes made by the Act include eliminating the 2010 sunset provision on many aspects of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"). This includes making Roth 401(k) plans a permanent part of the deferred compensation landscape, continuing EGTRRA's increases on contributions and other limits, extending catch-up contributions for employees age 50 and older, and maintaining the expanded rollover options available under EGTRRA. In fact, the PPA further expands rollover options to permit account balances to be rolled over directly into Roth IRAs, and to allow all beneficiaries to

roll over account balances.

The PPA contains new disclosure and notice requirements that vary depending on plan type. Finally, the Act will require Form 5500 filings to be made electronically to facilitate posting on a new website to be developed by the Department of Labor. If a plan sponsor maintains an intranet site for employees, the employer is also required to post an electronic Form 5500 on this site.

Necessary Action

These are but a few of the major highlights of what is truly a massive (1000+ pages) piece of legislation. It is imperative that plan sponsors review their qualified retirement plans for compliance with these new standards and evaluate whether they will take advantage of some of the new opportunities available under the Pension Protection Act. All plan amendments required by this legislation must be made before the end of the plan year beginning in 2009. If you would like any assistance in this endeavor, please contact Darrell Lindman at (517) 377-0844.



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Attorney Activities of Note

- Robert B. Nelson spoke to the Customer Choice Coalition Conference at the Downton Lansing Radisson on September 25th. His topic was "Energizing Competition in Michigan".

- Ryan M. Wilson spoke at the October 18th, Ingham County Bar Association Luncheon Lecture. His topic was "Planning for Incapacity: Powers of Attorney and Patient Advocate Designations".

- Twelve attorneys with Fraser Trebilcock Davis & Dunlap, P.C., have been listed in the *2006 Michigan Super Lawyers*. The dozen attorneys from the Firm are: Mark A. Bush (General Litigation), Michael E. Cavanaugh (Business Litigation), Graham K. Crabtree (Appellate), Peter L. Dunlap (Alternative Dispute Resolution), Anita G. Fox (Business Litigation), Mark R. Fox (Business Litigation), former Chief Judge Peter D. Houk (Alternative Dispute Resolution), Darrell A. Lindman (Employee Benefits/ERISA), David E.S. Marvin (Administrative Law), Michael H. Perry (Environmental Litigation), David D. Waddell (Business/Corporate), and Anne Bagno Widlak (Employment & Labor).

  2006 Michigan Super Lawyers is based on the survey of more than 30,000 attorneys across the state who have been in practice for five years or more. Lawyers listed in *Michigan Super Lawyers* are chosen by their peers and through the independent research of *Law & Politics*.

- Eight attorneys with Fraser Trebilcock Davis & Dunlap, P.C., have been listed in *The Best Lawyers in America* for 2007. Recognized attorneys from the Firm are: Douglas J. Austin (Real Estate Law), Stephen L. Burlingame (Corporate, M&A and Securities Law), Michael E. Cavanaugh (Commercial Litigation), Peter L. Dunlap (Personal Injury Litigation), Iris K. Linder (Corporate Law), Darrell A. Lindman (Employee Benefits Law), David E.S. Marvin (Government Regulatory, Administrative) and David D. Waddell (Gaming Law). Lawyers listed in *The Best Lawyers in America* are nominated and selected by their peers from other law firms for excellence in their field of legal services.

Moyne joins Fraser Trebilcock Davis & Dunlap, P.C.

Mary M. Moyne has joined the law firm of Fraser Trebilcock Davis & Dunlap, P.C., where she will continue her intellectual property law practice, assisting clients with patent, trademark, trade dress, service mark, and copyright matters.

Ms. Moyne earned her B.S. degree in Electrical Engineering from the University of Michigan - Dearborn and her J.D. from Wayne State University Law School. She is licensed to practice before the United States Patent and Trademark Office, the United States Court of Appeals for the Federal Circuit, and the Untied States District Court for the Western District of Michigan. Prior to joining Fraser Trebilcock Davis & Dunlap, P.C., Ms. Moyne was a shareholder in the firm of McLeod & Moyne, P.C.

Golden Nugget

Myth: Estate planning is only for the rich.

Fact: Many factors other than wealth affect the need for estate planning, such as: (1) caring for a minor or disabled child; (2) transferring ownership of property in accordance with your wishes; (3) caring for your surviving spouse or parent; (4) naming a guardian or conservator for a minor child; (5) transferring a closely held family business; (6) transferring ownership of property in another state; (7) charitable giving; (8) avoiding probate; (9) avoiding taxes; and (10) care of pets. These are only a few of the many reasons to plan your estate. Each person has his or her own objectives, but owning a lot of assets is usually not the primary reason to plan.

Interested in more information about Estate Planning and Probate issues? Sign up for Ryan Wilson's free monthly *Golden Bullets*. It is available in print and email format. For a subscription call Mr. Wilson at 517/377-0897 or email him at rwilson@fraserlawfirm.com.

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