

Pension ANALYST

Important Information

Legislation

November 2006



Pension Protection Act of 2006 Makes Major Changes to Multiemployer Defined Benefit Plans

This is one of a series of *Pension Analyst* publications providing information on specific aspects of the 2006 pension reform legislation affecting multiemployer defined benefit plans. This publication focuses on those changes that are effective in 2006 and 2007. Many of the significant changes affecting funding will be effective in 2008. A later publication will discuss the provisions effective in 2008 and beyond.

WHO'S AFFECTED These developments affect sponsors of and participants in qualified multiemployer defined benefit plans.

BACKGROUND AND SUMMARY On August 17, 2006, President Bush signed into law the Pension Protection Act of 2006 (PPA). The 1000 pages of this new law contain major provisions for comprehensive pension reform and introduce significant changes to enhance retirement security of American workers and their families.

For multiemployer defined benefit plans, PPA improves funding standards which may increase minimum contributions and impact the measurement of plan assets and liabilities. PPA requires enhanced disclosure to participants regarding plan assets and liabilities and imposes stricter reporting requirements to the government concerning the status of underfunded plans. PPA also permits the transfer of certain excess assets from a defined benefit plan to a retiree health plan.

The new law also contains provisions that significantly impact hybrid plans, such as cash balance plans, that are in existence as of June 29, 2005. Prospective conversions of defined benefits plans to hybrid plans are deemed to be non-discriminatory, provided certain requirements are satisfied.

This *Pension Analyst* discusses the PPA provisions that apply immediately (e.g., in 2006, 2007 and retroactively) to multiemployer defined benefit plans, in an effort to help plan sponsors determine the immediate actions needed to keep their plans in compliance with ERISA and the Internal Revenue Code.

ACTION AND NEXT STEPS The provisions of PPA impact plan funding, design and administration. It affects the duties of plan trustees, plan administrators and contributing employers. Many of the provisions of the new law have staggered effective dates. Sponsors should carefully read the information contained in this *Pension Analyst* and should discuss the new law's impact on their plans with their enrolled actuary and their fund counsel. Prudential Retirement's enrolled actuaries are well prepared to respond to your inquiries regarding the effect of the new law on your plan.

IN THIS ISSUE[Provisions Effective Immediately](#)

- [EGTRRA Provisions Made Permanent](#)
- [Determination of Average Compensation for Benefit Limits](#)
- [Hybrid Plan Rules](#)
- [Interest on Refund of PBGC Premiums](#)
- [Withdrawal Liability Rules](#)
- [Revocation of Election Relating to Treatment as a Multiemployer Plan](#)
- [New Deduction Rules](#)
- [Interest Rate Assumptions for Lump Sums](#)
- [QDRO Rules Clarified](#)
- [Increased Penalties for Coercive Interference with ERISA Rights](#)
- [Prohibition on Retaliation against Employers Exercising Their Rights](#)

[Provisions Effective in 2007](#)

- [Extension of Participant Notification Period to 180 Days](#)
- [Non-Spouse Beneficiary Rollovers](#)
- [Rollover of After-Tax Amounts](#)
- [Pension Plans May Make Limited In-Service Distributions](#)
- [Benefit Statements](#)
- [Retiree Health Benefits](#)

[Next Steps](#)**Provisions Effective Immediately****EGTRRA Provisions Made Permanent**

Many [important changes](#) made by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) were scheduled to expire, or sunset after December 31, 2010, unless Congress took action to extend the provisions. Some of the more notable defined benefit plan provisions that PPA has now made permanent include:

- The increased annual compensation limits applied when determining qualified plan contributions.
- The increased limits on the maximum annual benefit limit.
- The revised rules for notification of benefit accrual reductions.
- The simplification of the top-heavy rules, including the definition of key employee.
- The requirement to automatically rollover to an IRA small distributions exceeding \$1,000.
- Multiple rollover rules, including the ability: to make rollovers to and from various types of plans; for a surviving spouse to rollover a death benefit distribution.

EGTRRA permanence is especially welcome news for many plan trustees, who are looking at a January 31, 2010, deadline for amending plan documents to fully reflect EGTRRA provisions.

Determination of Average Compensation for Benefit Limits

In general, a participant's annual benefit under a defined benefit plan is limited to the lesser of (1) the participant's highest three years of average compensation, or (2) \$175,000 (for 2006). PPA clarifies that compensation received during years that the individual was not a plan participant may be taken into account in determining the three-year average. This provision applies to limitation years beginning after December 31, 2005.

Hybrid Plan Rules

PPA now provides guidance that will enable certain hybrid plans, such as cash balance plans, to satisfy the ERISA, Internal Revenue Code (Code) and Age Discrimination in Employment Act (ADEA) rules prohibiting age discrimination. To satisfy these rules, a participant's accrued benefit must be equal to or greater than that of any similarly situated younger individual – i.e., an individual who is identical in every respect, including period of service, compensation, position, date of hire, work history, but not age – who is or could be a participant in the plan.

PPA also requires a defined benefit plan that is converted into a hybrid plan after June 29, 2005, to protect the accrued benefit of any participant who was a participant immediately before the date the conversion amendment was adopted. The participant's total accrued benefit *cannot be less than* the participant's accrued benefit for years of service before the effective date of the amendment *plus* the participant's accrued benefit for years of service after the effective date of the amendment.

Finally, PPA requires hybrid plans to satisfy specific requirements with respect to vesting, interest crediting and the payment of lump sums.

For hybrid plans in existence on June 29, 2005, the interest rate and vesting requirements apply to plan years beginning after December 31, 2007. However, a plan sponsor may elect to have these requirements apply for any period beginning after June 29, 2005, and before the first day of the plan year beginning after December 31, 2007. A delayed effective date applies to plans maintained pursuant to collective bargaining agreements.

The plan conversion rules apply to plan amendments that are adopted and effective after June 29, 2005. However, a plan sponsor may elect to have these rules apply to plan amendments adopted before June 29, 2005, but effective after that date.

A detailed explanation of the impact of PPA on hybrid plans is discussed in our September 2006 *Pension Analyst* titled "[Pension Protection Act of 2006 and Other Recent Developments Provide Guidance on Hybrid Plans.](#)"

Interest on Refund of PBGC Premiums

Before the enactment of the new law, the Pension Benefit Guaranty Corporation (PBGC) charged interest on underpayments of premiums but did not pay interest on overpayments. PPA now authorizes the PBGC to pay interest on premium overpayments. Interest accruing for periods beginning on August 17, 2006, will be calculated at the same rate and in the same manner as interest charged on premium underpayments.

Withdrawal Liability Rules

The new law makes several changes to the employer withdrawal liability rules. Under prior law, a partial withdrawal occurred in a multiemployer plan if a contributing employer:

- Ceased to have an obligation under one or more (but fewer than all) collective bargaining agreements but the employer continues to perform work in the jurisdiction described in the collective bargaining agreement; or
- Transferred work to another location.

As of August 17, 2006, a partial withdrawal also occurs if the contributing employer transfers the work to an entity owned or controlled by the employer.

In addition, when an employer withdraws from a multiemployer plan, it generally needs to pay a portion of the unfunded vested benefits. However, for sales occurring on or after January 1, 2007, PPA revises the limitation of unfunded vested benefits allocable to an employer when substantially all of an employer's assets are sold. PPA also modifies the calculation of the limitation.

Finally, an employer who became a contributing employer in a multiemployer plan was allowed to withdraw from the plan without incurring a withdrawal liability if it satisfied specific requirements. However, this exemption did not apply to plans that primarily cover employees in the building and construction industry. PPA now allows plans that primarily cover employees in the building and construction industry to adopt a rule exempting employers from withdrawal liability if certain requirements are satisfied. This change is effective for plan withdrawals after December 31, 2006.

Revocation of Election Relating to Treatment as a Multiemployer Plan

Within one year of the enactment of the Multiemployer Pension Plan Amendments PPA of 1980 (i.e., by September 26, 1981), a multiemployer plan could irrevocably elect not to be treated as a multiemployer plan if certain requirements were satisfied. This election exempted the plan from the employer withdrawal liability provisions that were included in that legislation.

PPA now allows any multiemployer plan that made this type of election to revoke it if the plan satisfied the multiemployer plan requirements for each of the three plan years before August 17, 2006. The revocation election must be made before August 17, 2007. It will be effective beginning with the first plan year ending after August 17, 2006, and will be irrevocable.

In addition, no later than 30 days before an election is made, the plan must provide notice of the pending election to each:

- Plan participant and beneficiary;
- Labor organization representing such participants or beneficiaries; and
- Employer that has an obligation to contribute to the plan.

The notice must describe the differences between the PBGC guarantees and benefit restrictions for a single employer and multiemployer plan. The DOL is expected to issue a model notice by February 17, 2007. A failure to provide the notice is treated as a failure to file an annual report and a penalty of \$1,100 per day applies.

New Deduction Rules

For tax years beginning in 2006 and 2007, PPA provides that the maximum deductible contribution amount for a multiemployer defined benefit plan is 140% of the plan's current liability, minus the value of plan assets.

In addition, *for tax years beginning in 2006*, contributions to multiemployer plans are not taken into account when applying the special combined plan contribution deduction limit.

Interest Rate Assumptions for Lump Sums

A plan must adjust the annual benefit limit (\$175,000 for 2006) if a participant takes a form of payment other than a single life annuity or a qualified joint and survivor annuity (QJSA). If a single sum payment (or certain other forms of payment) is made, the plan must use an interest rate equal to or the greater of the rate specified in Code Section 417(e)(3) or the rate specified in the plan when making this adjustment.

For plan years beginning in 2004 and 2005, the Pension Funding Equity Act of 2004 (PFEA) replaced the Code Section 417(e)(3) rate with a rate of 5.5%.

However, PPA now requires that effective for distributions made in years beginning after December 31, 2005, the interest rate assumption used for purposes of adjusting the lump sum payment to comply with the benefit limitation rules may not be less than the greater of:

- 5.5%;
- The rate that produces a benefit of not more than 105% of the benefit calculated using the minimum value lump sum interest rate; or
- The interest rate specified in the plan.

Sponsors may need to review lump sum payments previously paid in 2006 to determine if overpayments or underpayments have been made and may need to take corrective action. Hopefully, the IRS will provide guidance in this regard, since PPA was enacted in the second half of the calendar year.

Under PFEA, sponsors were required to amend their plans by the end of the 2006 plan year to reflect these requirements. However, PPA has extended this amendment deadline to the last day of the 2008 plan year.

QDRO Rules Clarified

Effective August 17, 2006, and subject to regulations that the DOL must issue by August 17, 2007, PPA clarifies that the mere fact that a domestic relations order is issued after another domestic relations order or revises another domestic relations order does not cause the order to fail to meet the requirements of a qualified domestic relations order (QDRO). Plan sponsors should be aware of the pending DOL regulations, in case they receive domestic relations orders that may be subject to those rules.

Increased Penalties for Coercive Interference with ERISA Rights

Coercive interference with ERISA rights occurs when a person uses fraud, force or violence (or the threat of force or violence) to restrain, coerce or intimidate any plan participant or beneficiary to interfere with or prevent the exercise of his ERISA rights. A willful act of coercive interference is a criminal offense, subject to fine and/or imprisonment. Effective for violations occurring on or after August 17, 2006, the maximum fine amount is increased from \$10,000 to \$100,000, and the maximum prison term is increased from one year to ten years.

Prohibition on Retaliation against Employers Exercising Their Rights

Effective August 17, 2006, it is unlawful for a plan sponsor or any other person to discriminate against any contributing employer for exercising their ERISA rights or for giving information or testifying before Congress in proceedings relating to ERISA.

Provisions Effective in 2007

Several important PPA provisions are effective in 2007. Some of these provisions are purely operational in nature, while others will require plan amendments. While formal plan amendments may not be needed until 2009, plan sponsors will need to keep track of when and how each new provision was put into place, to be able to adopt the appropriate amendments.

Extension of Participant Notification Period to 180 Days

Qualified plans must provide certain notices to participants and their spouses before distributions may be made. These notices include: the QJSA notice, which must be provided to a participant and his spouse if the plan is subject to the QJSA rules and an optional form of payment may be elected; the notice to a participant describing available optional forms of payment, including the right to defer distribution if QJSA notices are not required; and the notice explaining tax and rollover rules. Effective for distributions made on or after January 1, 2007, the time period for providing any or all of these notices is expanded. The notices will have to be provided no more than 180 days and no less than 30 days before the distribution or annuity starting date.

In addition, PPA directs the IRS to issue rules requiring the notice that describes an employee's right to defer distribution to also describe the tax and retirement savings consequences of not deferring a distribution. Until those regulations are issued, plan sponsors must make a "reasonable attempt" to comply with the new rules.

Non-Spouse Beneficiary Rollovers

Effective for distributions made on or after January 1, 2007, non-spouse beneficiaries will be able to directly rollover death benefit distributions to IRAs. These IRAs will be treated as inherited IRAs and later distributions will be subject to the minimum required distribution rules that apply to IRA beneficiaries (rather than those that apply to owners). Indirect 60-day rollovers are not permitted.

Rollover of After-Tax Amounts

PPA expands the rollover options available for the distribution of employee after-tax contributions. Effective for distributions made on or after January 1, 2007, after-tax amounts may be directly rolled over from a qualified plan to any other qualified plan, including a defined benefit plan, or to a section 403(b) arrangement or IRA. The receiving plan must separately account for the nontaxable after-tax amounts and the taxable related earnings, if both amounts are rolled over. Indirect 60-day rollovers are not permitted and after-tax amounts may not be rolled-over from section 403(b) arrangements to qualified plans. While plans must permit these rollover distributions, and may have to be amended to reflect these new rules, plans will not have to accept rollover contributions of these amounts. Plans that choose to accept such contributions will need to be amended to reflect the new provisions.

Pension Plans May Make Limited In-Service Distributions

Generally, defined benefit plans do not allow in-service payments to a participant who has not terminated employment, although plans are permitted to allow payments once a participant reaches his normal retirement date, even if still employed. The IRS had previously proposed phased retirement rules in 2004

that permitted a pension plan to pay participants a portion of their accrued benefit before normal retirement age, provided the participant's work schedule was reduced.

However, effective for plan years beginning on or after January 1, 2007, defined benefit plans will be able to make distributions to active employees, who have reached age 62, even if the employee has not reduced his work schedule. Plans are not required to permit in-service distributions. If a plan sponsor chooses to offer in-service distributions, the plan would have to be amended. This amendment would be considered a "discretionary amendment" that would have to be adopted by the last day of the plan year that it is effective.

Benefit Statements

Effective for plan years beginning after the earlier of:

- The later of December 31, 2007, or the date on which the last of such collective bargaining agreements terminates; or
- December 31, 2008,

multiemployer defined benefit plans must either:

- Provide benefit statements at least once every three years to participants who have a vested accrued benefit and are still employed at the time the statements are provided; or
- Give each participant, at least annually, a notice of the availability of a benefit statement and the manner in which it can be obtained.

The plan must also furnish a statement to a participant or beneficiary upon written request. However, no more than one statement must be provided upon request during any 12-month period.

The benefit statement must indicate:

- The total benefits accrued;
- The vested accrued benefit or the earliest date on which the accrued benefit will become vested; and
- An explanation of any permitted disparity or floor-offset arrangement that may be applied in determining the accrued benefits.

PPA directs the DOL to provide model statements, satisfying these requirements, by August 17, 2007.

Retiree Health Benefits

For tax years beginning after December 31, 2006, PPA permits a multiemployer pension plan with assets in excess of 120% of the plan's current liability (or funding target) to transfer two but not more than ten years of estimated retiree medical costs to a health account under the plan. The maximum amount that can be transferred is the lesser of the assets in excess of 120% of current liability or the sum of retiree health liabilities. Assets must be reduced by the credit balances when determining the amount of excess assets.

For all years for which a transfer has been made, the contributing employer must make contributions sufficient to maintain the plan's 120% funding level (or transfer assets back from the health account to the pension plan).

Next Steps

Prudential Retirement will continue to monitor the IRS, PBGC and DOL's published guidance regarding these new rules. As guidance is provided, we will make changes to the services that we provide to assist plan sponsors with their plan administration responsibilities.

At this time, service providers that offer plan documents (e.g., IRS pre-approved plans) are looking for additional clarification about plan amendment requirements. In general, PPA provides that required plan amendments may be retroactively effective and will not violate the anti-cutback rule, as long as the plan is operated in compliance with the new provisions as of the appropriate effective dates and the amendments are adopted on or before the last day of the first plan year beginning on or after January 1, 2009. While recent [IRS guidance](#) sets forth adoption deadlines for "interim amendments" (reflecting statutory or regulatory changes) and "discretionary amendments" (reflecting voluntary plan design changes), this guidance also provides an exception to these deadlines when a new law provides a different amendment deadline. IRS representatives recently indicated that the PPA amendment deadline supersedes the standard interim and discretionary amendments deadlines.

In the interim, plan sponsors must operationally comply with the provisions of PPA, based on the various effective dates. Sponsors should review the contents of this publication to assess the impact of PPA on their plan's administration, forms and funding. They should also consult with the plan's enrolled actuary with respect to the impact of PPA on plan design changes. Sponsors of hybrid plans should examine their plan provisions to determine if design changes may be needed.

If you have questions about the information discussed in this *Pension Analyst* and how the PPA changes affect your plan design or operations, please contact your plan's enrolled actuary.

**Summary of Pension Protection Act Provisions
Effective Before January 1, 2008
For Multiemployer Defined Benefit Plans**

Changes Effective Retroactively

- EGTRRA permanence
- Revised calculation of average compensation for benefit limit purposes (limitation years beginning on or after January 1, 2006)
- Hybrid plan conversion rules (conversions made after June 29, 2005)
- New deduction rules (for tax years beginning in 2006 and 2007)
- Interest rate assumptions for lump sums (distributions made in years beginning after December 31, 2005)

Changes Effective upon Enactment (August 17, 2006)

- Interest on refund of PBGC premiums
- Withdrawal liability rules
- Revocation of election relating to treatment as a multiemployer plan
- QDRO rules clarified
- Increased penalties for coercive interference with ERISA rights
- Prohibition on retaliation against employers exercising their ERISA rights

Changes Effective in 2007

- Extension of maximum pre-distribution notice period to 180 days
- Ability for non-spouse beneficiaries to make direct rollovers to IRAs
- Expanded ability to make direct rollovers of after-tax amounts
- Ability to make in-service distributions at age 62
- Expanded benefit statement requirements (effective for plan years beginning after the earlier of (1) the later of December 31, 2007, or the date on which the last of such collective bargaining agreements terminates or (2) December 31, 2008)
- Retiree health benefits

Pension Analyst by Prudential Retirement

The Pension Analyst is published by Prudential Retirement, a Prudential Financial business, to provide clients with information on current legislation and regulatory developments affecting qualified retirement plans. This publication is distributed with the understanding that Prudential Retirement is not rendering legal advice. Plan sponsors should consult their attorneys about the application of any law to their retirement plans. Prudential Financial is a service mark of The Prudential Insurance Company of America, Newark, NJ and its affiliates.

Editor: Mitzi Romano (860) 534-2768