

PPA – A Year In Review

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PPA Guidance During Prior Year

- Qualified Default Investment Alternatives (QDIAs)
- Automatic Contribution Arrangements
- Distribution-Related Provisions
- Funding Rules and Benefit Restrictions
- Hybrid Plans

Qualified Default Investment Alternatives

Default Investments – Final Regulations

- Background
- DOL issued final regulations 10/24/2007
 - Regulations intended to be effective December 24, 2007
- The final regulation applies to situations beyond automatic enrollment
- Plan fiduciary remains responsible for prudent selection and monitoring of default investment

Default Investments – Final Regulations

- Required conditions to receive fiduciary relief under §404(c)
 - Participants (beneficiaries) provided opportunity to direct investments of their accounts
 - Absent participant's election, assets will be invested in a "qualified default investment alternative" ("QDIA")
 - Written notice provided; upon initial eligibility and annually thereafter
 - Plan provides that any materials (e.g., prospectuses, proxy voting materials) provided to Plan regarding the "QDIA" shall be passed through to participants on a quarterly basis
 - Transfers from "QDIA" to other investment alternative permitted (no less frequently than quarterly) without financial penalties
 - Plan must offer broad range of investment alternatives as defined under Section 404(c)

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Default Investments – Final Regulations

- "Qualified Default Investment Alternative" ("QDIA") – Types of investment products
 - a life-cycle or targeted retirement date fund or account
 - a balanced fund
 - an investment management service
- A QDIA may be managed by:
 - Investment Company registered under the Investment Act of 1940 (e.g. mutual funds)
 - ERISA Section 3(38) Investment Manager (Managed Account Provider, Registered Investment Advisor)
 - Bank Trustees of Collectively Managed Funds
 - Plan Sponsor who is a named fiduciary

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Default Investments – Final Regulations

- Special Rules Relating To “Capital Preservation” Products
 - Plans are permitted to use capital preservation products such as Money Market and Stable Value Funds as a QDIA for the first 120 days following a participant’s initial investment if all balances are then transferred to one of the three permitted QDIA vehicles
 - Final regulations “grandfather” balances invested in a Stable Value product prior to 12/24/07 effective date. The exemption does not apply to future contributions.
 - No other grandfather provisions were provided for to exempt existing balances

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Default Investments – Final Regulations

- “Qualified Default Investment Alternative”(“QDIA”) must comply with the following:
 - May not impose financial penalties or otherwise restrict the ability to transfer investments from one investment alternative to any other investment beyond those rules applicable to all participants
 - May not hold or acquire employer securities (with certain limited exceptions)

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Default Investments – Final Regulations

- Notice Requirements
 - No less 30 days before first such investment and before the beginning of each plan year each participant must receive:
 - a description of the circumstances under which individual account assets may be invested in a QDIA
 - an easily understood description of the QDIA objectives, risk and return characteristics and fees/expenses
 - an explanation of where investment information concerning the other investment alternatives in the plan may be obtained

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Default Investments – Final Regulations

- Notice Requirements
 - Notice may be provided at eligibility date if participant is permitted to “unwind” contributions as permitted under automatic enrollment rules (IRC Section 414(w)) *
 - Notice may be provided as a separate form or included with other required notices for auto-enrollment, safe harbor 401(k), etc.
 - Fiduciary protection only extends to amounts invested after notice requirements are satisfied

** The unwind provisions are part of the eligible automatic contribution arrangements in the Pension Protection Act.*

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Default Investments – Sample Timeline

	December 1	January 1	February 1	March 1 thru 31	April thru December
<ul style="list-style-type: none"> > Select QDIA > Determine action with existing default fund if necessary > Determine if the 120 day option is preferred > Determine if all money or employee only will default to a QDIA 	<ul style="list-style-type: none"> > Provide annual notice to notify current and newly eligible employees 	<ul style="list-style-type: none"> > Provide notice to newly eligible employees > All new contributions are defaulted to a QDIA > Transfer from existing default funds, if QDIA relief is desired 	<ul style="list-style-type: none"> > Provide notice to newly eligible employees > All new contributions are defaulted to a QDIA 	<ul style="list-style-type: none"> > Provide notice to newly eligible employees > All new contributions are defaulted to a QDIA > If 120 day option, move assets from capital preservation fund 	<ul style="list-style-type: none"> > Provide notice to newly eligible employees > All new contributions are defaulted to a QDIA > If 120 day option, move assets from capital preservation fund

Automatic Contribution Arrangements

Automatic Contribution Arrangements – Background

- Proposed Regulations on Automatic Contribution Arrangements issued November 8, 2007
- Formalization of practices already in place
- Two new options (can overlap)
 - Eligible Automatic Contribution Arrangement (EACA)
 - Qualified Automatic Contribution Arrangement (QACA)
- Timing of new options

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Automatic Contribution Arrangements – General ACA Requirements (pre PPA)

- Automatic contribution arrangements (“ACA”) currently exist today
- Requirements
 - Initial notice
 - Default investment option in absence of election
- Elective Contribution Options
 - Single rate
 - Escalation
- Benefits
 - Low opt-out rate usually boosts ADP/ACP test results
 - Asset accumulation
 - Tax advantaged

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Automatic Contribution Arrangements – General ACA Requirements (PPA)

- PPA added state preemption for an ACA
- Notice Requirements for Preemption
 - All eligible employees
 - Timing
 - Initial and Annual Notices
 - Content
 - Additional details necessary for EACA v. QACA
- Eligible Employees
 - All participants without an affirmative election in place
 - Includes existing population, not just new hires

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Automatic Contribution Arrangements – General ACA Requirements (PPA)

- Contributions
 - Default contribution rates must be uniform
 - Allowable exceptions
 - Escalation
 - Affirmative election
 - Statutory limits

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Automatic Contribution Arrangements – ACA Administration Requirements (PPA)

- Notice distribution – must affirmatively provide (posting on bulletin board or website is not enough)
- Determining eligible participants
- Maintaining contribution rates

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Automatic Contribution Arrangements – General EACA Requirements

- Two key benefits
 - Unwind provision
 - Extension for corrective distributions
- Must utilize Qualified Default Investment Alternative (QDIA)
 - Not required if plan isn't subject to ERISA (e.g., governmental plan)
- Can incorporate with existing QACA
- Notice
 - Can be incorporated with QDIA notice
 - Must detail unwind, if offered

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Automatic Contribution Arrangements – EACA Unwind

- Not mandatory
- Option to request total withdrawal of deferrals and earnings within 90 days after first elective deferral under EACA
- Amounts refunded treated as income in year of distribution
- Other in-service withdrawal options not required
- Amount distributed can only be attributable to this plan feature
- Forfeiture issue for plans with partial or immediate vesting
- Removal of distributed amounts from ADP/ACP testing

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Automatic Contribution Arrangements – General QACA Requirements

- Safe Harbor
 - ADP
 - ACP (for match) – may still need to test after-tax, if offered
 - Top Heavy
- Can also operate as an EACA
- Default deferral rates
 - Minimum of 3% initial election, subsequent annual increases to 4%, 5% and then 6%
 - May not exceed 10% in any year
 - Can increase as late as end of plan year following year of initial default

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Automatic Contribution Arrangements – General QACA Requirements

- Employer contributions:
 - 3% non-elective contribution for NHCEs **or**;
 - Matching contribution of 100% of first 1% of compensation and 50% of the next 5% of compensation (minimum required total match = 3.5%)
 - Cannot match deferrals in excess of 6%
 - 2-year cliff vesting
 - Subject to current ADP / ACP safe harbor rules, as modified for QACA
- Notice
 - All ACA requirements
 - Existing Safe Harbor notice requirements

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Distribution-Related Provisions of PPA (Notice 2008-30)

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Distribution-Related Provisions

- IRS Notice 2008-30 Issued March 2008
- Roth IRA Rollovers
- Qualified Optional Survivor Annuity (QOSA)
- Minimum Lump Sums (Section 417(e) benefits)

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Distribution-Related Provisions – Roth IRA Rollovers

- Background
 - “Pre PPA: from
 - another Roth IRA
 - a non-Roth IRA
 - a designated Roth account in a defined contribution plan
 - PPA (for distributions > 12/31/07) : from
 - qualified retirement plans
 - eligible governmental Section 457(b) plans
 - Section 403(b) tax-sheltered annuities

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Distribution-Related Provisions – Roth IRA Rollovers

- Notice 2008-30
 - Must offer option to participants
 - Permitted (not required) to offer to non-spouse beneficiaries
 - Plan administrators not responsible for confirming participant eligibility
 - Direct rollovers not subject to mandatory withholding
 - Plan administrator permitted to have voluntary withholding agreement with a participant

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Distribution-Related Provisions – Qualified Optional Survivor Annuity (QOSA)

- Background
 - DB and MP plans must pay QJSA form, and must provide written explanation
 - PPA requires a qualified optional survivor annuity (QOSA)
 - If QJSA < 75%, QOSA = 75%
 - If QJSA >= 75%, QOSA = 50%
 - QOSA must be actuarially equivalent to a single life annuity
 - terms and conditions of QOSA included in QJSA notice

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Distribution-Related Provisions – Qualified Optional Survivor Annuity (QOSA)

- Notice 2008-30
 - QOSA must be AE to SL annuity - not subsidized QJSA
 - Spousal consent required only if QOSA is not AE to QJSA
 - Written explanation - QOSA is optional form, no need to call it a QOSA
 - No requirement to offer QOSA-based preret survivor annuity
 - QOSA requirement effective for ASDs in 2008 plan years (potential later dates for collectively bargained plans)

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Distribution-Related Provisions – Minimum Lump Sums

- Background
 - Pre-PPA: applicable interest & mortality assumptions
 - 1994 mortality (projected to 2002)
 - 30-year Treasury rate
 - PPA: revised applicable interest & mortality assumptions
 - 2008 plan years
 - PPA minimum funding assumptions
 - Three segment rates
 - RP-2000 mortality projected beyond the distribution year
 - Regulations require QJSA be at least as valuable as any other form for married participant
 - Regulations provide 417(e) benefits deemed not to violate if determined using applicable interest & mortality table

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Distribution-Related Provisions – Minimum Lump Sums

- Notice 2008-30
 - Amendments providing “greater-of” LS benefits (greater of pre-PPA assumptions or post-PPA assumptions)
 - Will not be deemed to violate QJSA most valuable requirement
 - Applies only until the last day of first plan year beginning on or after January 1, 2009 (the last day of first plan year beginning on or after January 1, 2011 for governmental plans)
 - If greater-of for only a specified period of time
 - Section 411(d)(6) relief is provided
 - Only to 1st amendment implementing post-PPA applicable interest & mortality (if the adoption date is before the end of the period noted above)
 - For 1st amendment purposes, ignore amendments adopted on or before June 30, 2008

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PPA Funding Rules and Benefit Restrictions

PPA Funding Rules for Single Employer Plans

- IRS issued proposed regulations on August 31 2007, December 28, 2007, and April 11, 2008
- Provides rules for determining assets and liabilities, funding balances, benefit restrictions, quarterly contributions and other items for single employer defined benefit plans
- Timing of actuarial valuation and corresponding plan sponsor, actuary and trustee responsibilities greatly accelerated
- Applies to plan years beginning in 2009
 - Can be relied on for 2008 plan years
- Comment deadline is July 14, 2008 for most recently issued guidance

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PPA Funding Rules – Plan Liabilities

Discount Rate Choices

- The current full yield curve
 - Likely produces the lowest liability and normal cost on 1-1-08
 - More volatile over time, no 24 month averaging as for segment rates
- The regular 3-segment interest rates
- The transition 3-segment interest rates

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PPA Funding Rules – Plan Liabilities

Discount Rate Choices (12/31/07 Rates)

- Yield Curve
 - effective interest rate of 6.1% - 6.3% for most plans?
 - possibly a 3% to 6% lower liability

- Three-segment rates
(24 month average)

Segment 1	5.31%
Segment 2	5.92%
Segment 3	6.43%

- Transition segment rates
(24 month average)

Transition Tier 1	5.72%
Transition Tier 2	5.92%
Transition Tier 3	6.09%

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PPA Funding Rules – Plan Assets

- Fair market value as of valuation date
- Or, average of fair market values from any evenly-spaced periods over the preceding two years
 - Constrain result to 90% - 110% corridor around market value
- Plan sponsor must notify EA in writing of the method

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PPA Funding Rules – Plan Assets

Valuing Plan Assets: Examples

- Market value as of 1/1/08
- Average of 1/1/08 and 1/1/07 market value
 - Adjust 1/1/07 for contributions and distributions made during 2007
- Average of 1/1/08, 1/1/07, and 1/1/06 market value
 - Adjust 1/1/07 for 2007 contributions and distributions
 - Adjust 1/1/06 for 2006 and 2007 contributions and distributions
- Average semi-annual, quarterly or monthly market values over one or two preceding years

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PPA Funding Rules – Plan Assets

Valuing Plan Assets: Observations

- Usually average asset value will be less than market value
 - Resulting, on average, in increased contributions, PBGC premiums and risk of benefit restrictions
- However average assets will be less volatile
 - Resulting in less volatile contribution requirements from year-to-year
 - 90% - 110% corridor reduces the volatility avoided by averaging

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PPA Funding Rules

- Changes in funding method, asset valuation method and assumptions for the first plan year PPA applies do not require IRS approval
- Funding Strategy / Policy
 - Potential for Volatility in year to year contribution requirements
 - Use of contributions in excess of minimum from prior years to control contribution swings
 - Monitoring of assets and interest rates throughout year

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Benefit Restrictions – 2008 Effective Dates (Calendar Plan Year) and Thresholds

Benefit Improvements	January 1	Prior year AFTAP < 80%
Shutdown Benefits	January 1	Prior year AFTAP < 60%
Lump Sum Payments	April 1	<u>Prior Year AFTAP</u> < 60%: only life annuities < 80%: up to ½ of value
Benefit Accrual	April 1	Prior year AFTAP < 60%

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How to Avoid Benefit Restrictions

- Surrender carryover and prefunding balances
 - legally required if doing so avoids lump sum limitations
 - collectively bargained plans must do so to avoid any of the restrictions
- Contribute additional amount to raise funding percentage to threshold
- Contribute funding target increase due to shutdown or plan amendment
 - Amounts are in addition to the regular funding requirement

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How to Avoid Benefit Restrictions

- For 2007, change asset method to market value if larger than actuarial value
 - Automatic approval if method not changed since 2002
- Post security
 - Surety bond, cash or US govt. securities maturing in less than 3 years
 - Released back to employer under escrow agreement only when actuary certifies that AFTAP is at least 90% (using assets without security)

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IRS Proposed Regulations on Hybrid Plans

Transitional and Proposed Guidance

- Notice 2007-6 provided transitional guidance
- Proposed regulations issued 12/27/07 generally affirms and builds on Notice 2007-6
 - Proposed to be effective January 1, 2009 (as late as January 1, 2010 for collectively bargained plans)
 - Can be relied on in the interim

Key PPA Hybrid Plan Provisions

- Statutory Hybrid Plan
- Legality of basic design confirmed
 - Not age discriminatory
 - No more whipsaw
 - Generally prospective
- Modest ongoing plan mandates
- Modest future conversion mandates
- No-inference regarding past years

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Impact of Being Statutory Hybrid Plan

- Burdens
 - 3-year vesting
 - Indexing cannot be negative cumulatively
 - Capital preservation rule
 - No wear-away on conversions to these plans
- Relief
 - Exempt from whipsaw if lump sum based formula
 - If not lump sum based no expectation of relief anyway
 - Safe harbor for age discrimination
 - But may also be available to other designs

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Age Discrimination Safe-Harbor New IRC 411(b)(5)

- Available to all DB plans but with some restrictions
- Accumulated benefit can't be higher for any similarly situated actual or potential younger employee
- Plans that can't pass safe-harbor must rely on "basic rule" of IRC 411(b)(1)(H) and 1988 proposed regs. – rate of benefit accrual cannot reduce because of age
- Generally can use if all participants covered in same type of formula
 - All accumulated benefits expressed as hypothetical accounts, PEP accumulations or normal retirement annuities
 - Greater-of or sum-of (A+B) formulas can use safe harbor
- Problematic conversion designs

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Interest Credits

- Interest credit rates can't exceed market rates
 - Reasonable minimum / stand-alone fixed rates ok
- Proposed regulations say Notice 96-8 rates and tier 3 corporate bond rates are ok
- Preamble says they are considering fixed rates
 - 4% or 5% as stand alone rate
 - 3% or 4% if minimum with variable using 96-8 or tier 3

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Conversion Restrictions Effective 6/30/05

- Minimum on “A+B” basis – no wear-away
 - Part A: accrued benefit at conversion
 - Part B: cash balance with no opening balance
- Opening balance alternative with “extended wear-away”

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Minimum 3-Year Vesting

- No graded vesting alternative
- Applies to past and future years of service
- Applies on a participant-by-participant basis
- Applies to participant’s entire benefit if covered at all under hybrid provisions

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Minimum Lump Sums

- No whipsaw calculations needed for distributions after August 17, 2006
- Can eliminate whipsaw provisions in operation
 - Formally amend by end of 2009 plan year
 - Special 30-day 204(h) notice requirement
- Not clear if annuity conversion restrictions
 - PPA silent but rumor that restrictions will apply
- No guidance on effective date provision for plans that did not comply with Notice 96-8

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Issues for Existing Hybrid Sponsors

- May need to change current interest crediting basis
 - Existing fixed rate or fixed minimum may be too high
 - Preservation of capital restriction needed if negative credits possible
 - Review stability / lookback periods to determine if they comply
 - Restate annual rate to be nominal not effective
- May consider other changes to interest crediting basis
 - Switch to tier-3 corporate rate
 - Introduce fund returns with preservation of capital
 - Plan may automatically switch to new 417(e) basis and may want to retain 30-year T-Bonds or switch to some other safe harbor rate
- Review annuity conversion basis
 - Plan may automatically switch to new 417(e) basis
 - No guidance yet on extent plan may vary from 417(e) basis

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Issues for Existing Hybrid Sponsors (continued)

- Lump sum issues
 - May want to remove lump sum whipsaw going forward
 - Not clear the extent to which IRS will impose retroactive whipsaw for plans that did not comply with Notice 96-8
- Determine how to apply 3-year vesting requirements
- Review VAPs with AIRs below 5% or that credit returns based on outside index or portion of plan assets
- Plans with greater-of formulas may require changes
- Many issues are uncertain due to possible changes in regulations or because no definitive guidance yet
 - Extent of anti-cutback relief may also not be clear
- Whether to proceed now or wait for further guidance should be discussed with legal counsel