

To: Our Clients and Friends

November 23, 2009

## Qualified Retirement Plans: End of Year Compliance Items

The Pension Protection Act of 2006 ("PPA") made several changes to the laws governing qualified retirement plans and requires documentary and operational changes to such plans by the end of the 2009 plan year. Below is a brief summary of each of those changes. Also included are brief summaries of the provisions of the Heroes Earnings Assistance and Relief Tax Act of 2008 ("HEART Act") and the Worker, Retiree and Employer Recovery Act of 2008 ("WRERA") that require amendments or other changes that may be included in 2009 year-end amendments, but are not required until later dates.

### Pension Protection Act of 2006

- Expedited Vesting for Employer Contributions. For plan years beginning on or after January 1, 2007, most employer contributions to defined contribution plans must vest according to an expedited schedule. An employer now must use a cliff-vesting schedule, which requires the contributions be fully vested after three years, or a graduated vesting schedule requiring full vesting after six years by allowing for stepped-up vesting in 20% increments starting at two years.
- Diversification of Investments. For plan years beginning on or after January 1, 2007, defined contribution plans must provide participants the right to diversify the investment of elective deferrals or after-tax contributions in the employer's publicly-traded stock into other investments. Participants must be given the same right with respect to all such investments attributable to employer contributions after completing three years of service with the employer.
- Rollover of After-Tax Contributions. For plan years beginning on or after January 1, 2007, distributions from defined benefit or defined contribution plans attributable to after-tax contributions may now be rolled over to defined benefit plans or Internal Revenue Code ("Code") Section 403(b) annuity plans. The plans receiving the rollover amounts must separately account for those amounts and the earnings on those amounts.
- Qualified Optional Survivor Annuities. For plan years beginning on or after January 1, 2007, defined benefit plans and defined contribution plans offering a survivor annuity must provide an additional annuity option known as a "qualified optional survivor annuity." If the qualified joint and survivor annuity offered under a plan is less than 75% of the annuity payable during the joint

lives of the participant and spouse, a 75% qualified optional survivor annuity is required. If the qualified joint and survivor annuity offered is greater than or equal to 75%, the qualified optional survivor annuity must be 50%.

- Required Benefit Statements. For plan years beginning on or after January 1, 2007, participants and beneficiaries of defined contribution plans who are permitted to direct the investment of the assets of their plan accounts must be provided quarterly benefit statements. Participants or beneficiaries who are not permitted to direct their investments need only be provided annual benefit statements. These statements, among other things, must reflect the value of the account, including the value of each investment assets are allocated to, be written in a manner calculated to be understood by the participants and include an explanation of any limits or restrictions on the right to direct investment and the importance and prudence of diversification of investments.
- Rollovers to Roth IRAs. For plan years beginning on or after January 1, 2008, distributions from qualified defined benefit or defined contribution plans, 403(a) or 403(b) annuity plans and governmental 457(b) plans may be directly rolled over to Roth IRAs. For plan years beginning on or after January 1, 2010, WRERA makes this rollover available to individuals who earn over \$100,000. Previously, such individuals were only permitted to rollover to a Roth IRA from a designated Roth account under a plan.
- Present Value Determinations. For plan years beginning on or after January 1, 2008, the interest rate assumption and mortality table used by defined benefit plans for determining the present value of optional forms of benefits, including lump sum distributions, must be consistent with the rules set forth at Code Section 417(e)(3).
- Underfunded Plan Limitations. For plan years beginning on or after January 1, 2008, defined benefit plans that fail to maintain certain funding levels may face increased restrictions on benefit accruals and distributions as well as providing new benefits. These limitations, as provided under Code Section 436, must be reflected in the terms of the plan.
- Cash Balance Plan Vesting. For plan years beginning on or after January 1, 2008, amounts contributed by an employer under a cash balance plan on behalf of an employee must be fully vested after an employee completes three years of service with the employer.
- Cash Balance Plan Interest Crediting. In order to not be deemed age discriminatory, the interest crediting rate used to calculate benefits under a cash balance or other hybrid plan must be amended to ensure that it is not greater than a market rate of return. Pursuant to the PPA, amendments adjusting the interest crediting rates for plan years beginning on or after January 1, 2008, were due by the end of the 2009 plan year. However, because final regulations clarifying permissible market rates of return have yet to be published, and are not expected to go into effect before the first plan year beginning on or after January 1, 2011, the IRS recently provided guidance stating that interest crediting plan amendments are not required until the end of the 2010 plan year. The IRS has recently provided that interest crediting rates that are adopted prior to the issuance of the final regulations and which are in excess of a market rate of return per such regulations, will not violate anti-cutback rules under Code Section 411(d)(6) because it reduces the interest crediting rate on participants' accounts in order to satisfy those regulations.

- Elimination of Whipsaw Calculations from Cash Balance Plans. For plan years beginning on or after January 1, 2007, whipsaw calculations may be prospectively eliminated from cash balance plans. A “whipsaw calculation” is one where, when determining a lump sum distribution under a cash balance plan, the participant’s hypothetical account balance is projected forward to his or her normal retirement age at one interest rate, then discounted back to the distribution date using a smaller rate. This would result in the distribution of a balance greater than the present value of that which would be in the hypothetical account.

## **Heroes Earnings Assistance and Relief Tax Act of 2008**

While plan amendments are generally not required until the end of 2010 under the HEART Act, the following amendments may be made along with those discussed above which are required by PPA.

- Death Benefits. With respect to any deaths occurring on or after January 1, 2007, defined benefit and defined contribution plans must provide that beneficiaries of participants who die during qualified military service will be entitled to the same vesting and benefits features (other than benefits accruals for the period of qualified military service) as beneficiaries of actively employed participants.
- Distributions During Military Service. For plan years beginning on or after January 1, 2009, an individual may take a distribution as though he or she was severed from employment while on qualified military service for more than 30 days. If such a distribution is elected, the individual may not make elective deferrals or employee contributions to the plan during the 6 month period beginning on the date of such distribution.
- Differential Military Pay. For plan years beginning on or after January 1, 2009, if an employer provides differential military pay to individuals away from work due to qualified military service, any defined benefit or defined contribution plan sponsored by that employer must provide that such pay must be considered compensation for determining contributions or benefits under the plan. “Differential military pay” or “differential pay” is comprised of those amounts an employer provides to employees away from work due to military service. It generally represents the difference or a portion of the difference between what the employees are being paid for their military service and the amount they would be earning if actively employed by the employer.

## **Worker Retiree and Employer Recovery Act of 2008**

- Rollovers to Non-Spouse Beneficiaries. For plan years beginning on or after January 1, 2010, non-spouse beneficiaries must be eligible to roll over distributions to which they are entitled to individual retirement accounts or individual retirement annuities described under Code Sections 408(a) and 408(b) (IRAs), respectively.
- 2009 Required Minimum Distributions. Pursuant to WRERA, defined contribution plans are not required to distribute required minimum distributions for the 2009 plan year. Plan sponsors may choose to waive 2009 RMDs or give participants or beneficiaries the choice as to whether or not they would like to receive 2009 RMDs. Also, plan sponsors may allow participants to treat 2009 RMDs as eligible rollover distributions, which would not be allowed in a typical plan year. Although plan amendments reflecting the way in which an employer deals with 2009 Required Minimum

Distributions are not required until the last day of the 2011 plan year for most plans, employers are expected to have procedures in place by December 1, 2009, when the IRS's transition relief for failure to operate in accordance with the terms of the plan expires.

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