

Client Alert

A report
for clients
and friends
of the Firm March 2007

The U.S. Department of Labor and the Treasury Department Issue PPA Guidance

The U. S. Department of Labor ("DOL") and the Treasury Department have issued guidance with respect to the following Pension Protection Act ("PPA") provisions which are effective this year:

- Periodic Benefit Statements
- Benefit Distribution Notices and Consent Period
- Hardship Withdrawals to Assist Beneficiaries
- Rollovers to Non-Spouse Beneficiaries

In order to comply with certain requirements included in this guidance, action may be required by May 15, 2007.

Field Assistance Bulletin 2006-03 ("FAB 2006-03"), issued by the DOL, provides guidance to retirement plan sponsors and administrators for good faith compliance with the pension benefit statement distribution requirements of the Employee Retirement Income Security Act of 1974 ("ERISA"), as amended by the PPA. Since the PPA requires the DOL to provide model benefit statements by August 18, 2007, the guidance set forth in FAB 2006-03 has been issued pending the issuance of such models and related regulations.

Through Notice 2007-7, the Treasury Department provides guidance with regard to some of the distribution requirements of the pension benefit sections of the Internal Revenue Code of 1986 (the "Code"), as amended by the PPA.

Periodic Benefit Statements

In most situations, the PPA removed the requirement that benefit plan recipients make an affirmative request for an estimate of their retirement benefit. Plan sponsors and administrators now have a responsibility to advise participants, through periodic statements, of the amount of their accrued or accumulated pension to date, the vesting schedule for such benefits, the permitted disparity floor-offset arrangement, if any, applied in determining the accrued benefit, and, if applicable, the importance of diversifying the investment of these assets to minimize the risk of loss.

Section 105(a) of ERISA allows these benefit statements to be delivered in written, electronic, or other appropriate forms to the extent that such form is reasonably accessible to the participant or beneficiary. FAB 2006-03 states that compliance with the electronic delivery safe harbor provided in DOL Regulation Section 2520.104b-1(c) or the electronic media rules in Treasury Regulation Section 1.401(a)-21 will be deemed to satisfy the requirements of Section 105(a). (See our Client Alert: [Treasury Dept. Issues Final Rules on Electronic Media Use for Notices and Participant Elections](#)) for further guidance on employing this method of delivery. However, the DOL indicates that these are not the exclusive acceptable means of delivery.

If a plan administrator decides to satisfy the distribution requirement by providing continuous access to benefit statement information through a secured website, the plan must still issue an annual notice to participants and beneficiaries, starting prior to when the first statement should be distributed (as discussed below), explaining the availability of the benefit statement information and the procedure to access such information. Such notice can be distributed by any method permitted by Section 105(a) and must advise participants and beneficiaries of their right to obtain a paper version of the benefit statement without charge.

Keep in mind that a plan administrator who fails to provide a timely benefit statement to a participant may be liable for \$100 for each day of delay if such participant brings a civil action, or for such other relief as a court may deem proper.

The type of benefit plan¹ determines both the frequency with which these benefit statements must be distributed, as well as the possibility of additional content requirements:

I. Defined Contribution Plans

The requirements for benefit statements distributed by defined contribution plans differ depending on whether the participants have the ability to direct the investment of the funds in their accounts. If a defined contribution plan permits participants to take loans from the plan, but does not otherwise provide for participant direction of account assets, the plan will not be considered a participant directed account for purposes of these benefit statement requirements.

A. Investments Directed by Participants

Those plans that allow for participant investment direction must distribute quarterly benefit statements within forty-five (45) days of the end of the applicable quarter. Accordingly, calendar year plans must issue their first statements for the quarter ending March 31, 2007 and distribute the statements no later than May 15, 2007. Fiscal year plans must issue their first statements for the first quarter that begins after December 31, 2006 (e.g., for a plan year that begins April 1, 2007, the first statement must be issued for the quarter that ends on June 30, 2007 and distributed no later than August 14, 2007).

Among other requirements, these benefit statements must list the limitations and restrictions by the plan on the ability of participants and beneficiaries to direct investments, an explanation of the importance of diversification, and a direction to the DOL website (www.dol.gov/ebsa/investing.html) for further information on investing and diversification. In FAB 2006-03, the DOL provides relief for plan sponsors and administrators who failed to provide diversification notices to plan participants with respect to the ability to diversify account assets prior to January 1, 2007, by providing that diversification information may be included in the periodic benefit statement. FAB 2006-03 provides model language to explain the importance of diversifying the investment of individual account assets to participants, which is included at the end of this Client Alert.

The DOL also acknowledged that the information required to be provided by defined contribution plans that allow participant direction may be provided to participants by the use of multiple documents and by sources other than the plan sponsor or administrator.

B. Investments Directed by Plan Sponsors and Administrators

Defined contribution plans that do not permit participants to direct the investment of their benefit account assets must issue annual benefit statements. The first statement for both calendar and fiscal year plans is for the calendar year ending December 31, 2007, and must be distributed no later than February 14, 2008.

2. Defined Benefit Plans

Defined benefit plan administrators have the option of distributing individualized benefit statements once every three years, or providing an annual notice to participants and beneficiaries that they may obtain such benefit statements upon request. The first triennial statement should be issued for the plan year that begins in 2009. If a plan sponsor or administrator elects the annual notice option, the first notice must be distributed no later than December 31, 2007, and provide an explanation of the procedure for requesting a benefit statement.

3. Special Schedule for Collectively Bargained Plans

Although FAB 2006-03 does not provide further guidance, Section 508(c)(2) of the PPA states that a plan maintained pursuant to one or more collective bargaining agreements ratified on or before August 17, 2006, must apply these benefit statement requirements to plan years that begin following the earlier of (1) December 31, 2008 or (2) the later of (a) December 31, 2007, or (b) the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension to the collective bargaining agreement following August 17, 2006).

¹ One-participant retirement plans are not subject to the requirements to issue a benefit statement.

Benefit Distributions

Treasury Department Notice 2007-7 addresses notices to be provided to participants immediately prior to retirement, hardship distributions, and rollovers for nonspouse beneficiaries.

1. Content of Benefit Distribution Notice and Period for Distribution

Plan sponsors and administrators should take immediate action to update the notices distributed in anticipation of a participant's retirement. In particular, the notice regarding the consent to distribute benefits must include a description of the impact of failing to defer distributions. Plan sponsors and administrators must make a reasonable attempt to provide sufficient language to satisfy this requirement, using the guidance provided below, in order to avoid being viewed as failing to satisfy this notice requirement prior to the issuance of final regulations. Such language should be drafted so as to be understood by the average participant and include (1) a description of how much larger benefits will be as a result of deferring their distribution of a defined benefit plan benefit, perhaps including a description of the financial effect of deferral on the amount of the normal form of benefit, (2) a description of the investment options available under the plan (including fees) for deferred distributions from a defined contribution plan, and (3) the relevant sections of the summary plan description which contain information that may materially affect the participant's decision to defer.

As permitted by the PPA, any notice distributed after December 31, 2006 with regard to a rollover, a consent to the distribution of benefits, or an explanation and spousal waiver of a qualified joint and survivor annuity may be provided to a participant or beneficiary up to 180 days prior to the annuity starting date.

2. Hardship Withdrawals

The PPA provided that Code Section 401(k) and 403(b) may allow for a hardship withdrawal for a hardship event incurred by a beneficiary who is not a spouse or dependent of a plan participant, if the plan provides for such withdrawals. Notice 2007-7 lists the following additional qualification requirements for such withdrawals: the beneficiary must be a "primary beneficiary" as evidenced by being (a) named as a beneficiary under the plan, and (b) having an unconditional right under the plan to at least a portion of the participant's account balance upon the death of the participant.

3. Rollovers for Nonspouse Beneficiaries

Rollovers of benefits from Code Section 401(a) plans, 403(b) plans, and governmental 457(b) plans may now be made with respect to nonspouse beneficiaries. In this case, the rollover must be a direct trustee to trustee transfer into an "inherited" individual retirement account or annuity which names both the deceased plan participant and the beneficiary (*e.g.*, Tom Smith as beneficiary of John Smith). Such rollover is also possible when the participant's named beneficiary is a trust.

Notice 2007-7 clarified that this type of rollover is optional for plan sponsors or administrators, but if permitted, it must be permitted on a nondiscriminatory basis. As an exception, for purposes of safe harbor distributions from a terminated defined contribution plan, as provided by the DOL Regulations, the terminating plan will be deemed to permit nonspouse beneficiary rollovers regardless of whether the terms of such plan actually allow such rollovers.

Even if a plan provides for rollovers to nonspouse beneficiaries, Notice 2007-7 states that a plan is not required to modify its rollover notice to incorporate such changes, or provide such notices to nonspouse beneficiaries. Typically, distributions that are eligible for rollovers are subject to a 20% mandatory withholding unless the distribution is rolled into an eligible retirement plan. Notice 2007-7 clarifies that eligible rollover distributions to nonspouse beneficiaries are not subject to the 20% withholding requirement.

Notice 2007-07 indicates that any amount that is not a required minimum distribution for the year in which the rollover occurs is eligible for rollover. Different rules apply depending on when the participant died in relation to when his or her required minimum distributions would have been required to begin.

On February 13, 2007, the Internal Revenue Service issued additional guidance with respect to the application of the minimum distribution rules to rollovers made on behalf of nonspouse beneficiaries. This guidance clarifies that despite a plan provision for application of the 5-year rule, a nonspouse beneficiary may treat the plan as using the life expectancy rule for determining the rollover amount and the required minimum distribution under the individual retirement account *if* the rollover is made before the end of the year following the year of the participant's death.

Plan sponsors and administrators should consult with counsel regarding this recent guidance, as well as other PPA requirements that must be satisfied in 2007.

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Model Diversification Language Provided Under FAB 2006-03

“To help achieve long-term retirement security, you should give careful consideration to the benefits of a well-balanced and diversified investment portfolio. Spreading your assets among different types of investments can help you achieve a favorable rate of return, while minimizing your overall risk of losing money. This is because market or other economic conditions that cause one category of assets, or one particular security, to perform very well often cause another asset category, or another particular security, to perform poorly. If you invest more than 20% of your retirement savings in any one company or industry, your savings may not be properly diversified. Although diversification is not a guarantee against loss, it is an effective strategy to help you manage investment risk. In deciding how to invest your retirement savings, you should take into account all of your assets, including any retirement savings outside of the Plan. No single approach is right for everyone because, among other factors, individuals have different financial goals, different time horizons for meeting their goals, and different tolerances for risk. It is also important to periodically review your investment portfolio, your investment objectives, and the investment options under the Plan to help ensure that your retirement savings will meet your retirement goals.”

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