

REINHART

E-NEWSLETTER

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Employee Benefits E-News

November 30, 2006

November 2006 Employee Benefits Update

SELECT COMPLIANCE DEADLINES

401(k) Plan Safe Harbor Notice Deadline

New 401(k) Safe Harbor Content Requirements

Plan sponsors who maintain a safe harbor 401(k) plan must notify eligible employees of the plan's intent to satisfy the safe harbor. IRS guidance deems the notice to be timely if provided by December 1, 2006 for calendar year plans. Safe harbor notices can no longer incorporate by reference provisions of the summary plan description as to contributions, distributions and vesting under a plan.

Since the safe harbor notice must now describe a plan's vesting provisions, plan sponsors should note any accelerated vesting that will be required for nonsafe harbor contributions under the Pension Protection Act of 2006 (the "Act"). Effective for contributions made in or after the 2007 plan year, the Act requires nonsafe harbor contributions to vest under either a three-year cliff or a six-year graded schedule. Current safe harbor contributions must continue to be immediately vested.

Any automatic enrollment features that may be implemented in 2007 in accordance with provisions of the Act also should be outlined in the safe harbor notice.

Notice Requirements for the "Flexible Adoption Method"

Generally, a plan will not meet the 401(k) safe harbor requirements unless plan provisions satisfying the safe harbor rules are adopted before the first day of the plan year and remain in effect for an entire 12-month plan year. As an exception to the plan year requirement, plan sponsors may use the "flexible adoption method" to comply with the safe harbor regulations.

A plan that provides for the use of the current year testing method may be amended after the first day of the plan year and no later than 30 days before the last day of the plan year to adopt the safe harbor method using nonelective contributions. If so adopted, the safe harbor method is effective as of the first day of the plan year. To use the flexible adoption method, a plan must also provide a "contingent notice" and a "follow-up notice."

1000 North Water Street
P.O. Box 2965
Milwaukee, Wisconsin
53201-2965
414-298-1000
800-553-6215

22 East Mifflin Street
P.O. Box 2018
Madison, Wisconsin
53701-2018
608-229-2200
800-728-6239

W233 N2080
Ridgeview Parkway
P.O. Box 2265
Waukesha, Wisconsin
53187-2265
262-951-4500
800-928-5529

2215 Perrygreen Way
Rockford, Illinois
61107
815-633-5300
800-840-5420

8400 East Prentice Avenue
Penthouse
Greenwood Village, Colorado
80111
303-843-6042

The contingent notice must satisfy the traditional safe harbor notice requirements, except that, in lieu of setting forth the safe harbor contributions used under the plan, the notice must specify that the plan may be amended during the plan year to include the safe harbor nonelective contribution, and that, if the plan is amended, a follow-up notice will be provided.

The follow-up notice requirement is satisfied if, no later than 30 days before the last day of the plan year, each eligible employee is given a notice stating that the safe harbor nonelective contributions will be made for the plan year. The notice must be in writing or in such other form as may be prescribed by the IRS, and is permitted to be combined with the contingent notice, described above, for the next plan year.

***Reinhart Comment:** Note that the new automatic enrollment safe harbor under the Act which is described later is not available before the 2008 plan year.*

Amendments Required for Final 401(k) and 401(m) Regulations

IRS Revenue Procedure 2005-66 provided guidance on when plan amendments required under the final 401(k) and 401(m) regulations must be adopted. The final regulations were generally effective for plan years beginning on or after January 1, 2006 and made changes in the operation of defined contribution plans with 401(k) and 401(m) features.

Amendments required to maintain a plan's qualified status must be adopted by the later of the last day of the plan year in which the change is effective, or the due date of the employer's tax return (including extensions) for the tax year in which the change is effective. Discretionary amendments must be adopted by the last day of the plan year in which the change is effective (subject to anti-cutback rules which may require earlier adoption). If your plan contains 401(k) or 401(m) features, you will want to review whether any amendments must be adopted by year end.

Hurricane Katrina Relief

The Department of Labor ("DOL") has announced that plan administrators, employers and other entities that were affected by Hurricane Katrina and are located in the hardest hit areas of Louisiana and Mississippi may request a further extension of the 2005 Form 5500 filing deadline to December 31, 2006. The extension also applies to employers located outside the affected areas which are unable to obtain the necessary information from service providers, banks or insurance companies whose operations were located in the specified areas and were affected by Hurricane Katrina.

RETIREMENT PLAN DEVELOPMENTS

IRS Announces Pension Plan Limitations for 2007

On October 18, 2006, the IRS announced the 2007 tax year cost-of-living and statutory adjustments applicable to dollar limitations for retirement plans. Increases include, but are not limited to, the following:

- The limit for the maximum annual benefit for a defined benefit plan will increase from \$175,000 to \$180,000;
- The limit for the maximum annual addition for a defined contribution plan will increase from \$44,000 to \$45,000;

- The limit for a deferral under a 401(k), 403(b) or 457 plan will increase from \$15,000 to \$15,500;
- The limit for catch-up contributions remains the same at \$5,000;
- The limit for annual compensation will increase from \$220,000 to \$225,000;
- The maximum ESOP account balance subject to a five-year distribution period will increase from \$850,000 to \$915,000;
- Each dollar amount of ESOP account balance in excess of \$915,000 that adds one year to the five-year distribution period will increase from \$175,000 to \$180,000;
- The limit used in the definition of highly compensated employees remains the same at \$100,000; and
- The dollar limit concerning the definition of key employee in a top-heavy plan is increased from \$140,000 to \$145,000.

The Social Security taxable wage base, which governs the amount of pay subject to Social Security tax withholding and affects plans that are "integrated" with Social Security, increases from \$94,200 to \$97,500 for 2007.

Pension Protection Act of 2006: Provisions Effective on January 1, 2007 or Later

Our October EB Update outlined provisions of the Act that were effective on or before the August 17, 2006 enactment date. The following summary highlights key provisions of the Act affecting single employer defined benefit plans, defined contribution plans and other employee benefits which become effective for plan years beginning on January 1, 2007 or later.

Many of these provisions will require additional guidance from the IRS or DOL before they can be fully implemented. Treasury officials indicate that the Act requires governmental agencies to issue guidance or perform some task in approximately 407 instances. Guidance is expected to be issued in phases. The Treasury Department hopes to publish guidance very soon on applicable mortality tables, a unified definition of a government plan, Subchapter S ESOPs and the opening of the determination letter process for cash balance plans that have requested letters over the past six years. Guidance on lump sum distributions calculated using interest rates higher than the retroactive rates set by the Act is also expected soon.

Provisions Effective for 2007 Plan Years

Defined Benefit Plans:

- **Repeal of 4011 Notice.** The Act repeals the requirement for underfunded single-employer defined benefit plans that are subject to the Pension Benefit Guaranty Corporation ("PBGC") variable premium rates to provide notice to participants regarding the plan's funding status and the limit on PBGC guaranteed benefits. Transitional rules regarding the reporting of a plan's funded status may apply in 2007. This notice is replaced in 2008 by a new annual funding notice. See Reinhart's E-Newsletter dated November 15, 2006 for more details.

Reinhart Comment: Although the Act repeals the Employee Retirement Income Security Act ("ERISA") § 4011 notice requirement, the PBGC recently announced that it will continue

to allow the use of these rules to determine the eligibility for reporting a waiver for missed quarterly contributions in 2007. ERISA requires plan administrators and contribution sponsors of defined benefit plans to notify the PBGC within 30 days of the occurrence of a reportable event (e.g., the failure to make a quarterly installment or other payment required under Code § 412 and ERISA § 302 funding rules by the due date for the payment). The PBGC has waived this requirement for, among others, employers with 500 or fewer participants in its defined benefit plans for whom a participant notice under ERISA § 4011 was either not required for the plan year for which the quarterly contribution was owed or was not required for the prior plan year.

- In-service Distribution Rules. Under current law, 401(k) plans and other profit-sharing plans can allow in-service distributions. But in-service distributions generally are not permitted from defined benefit plans or money purchase plans. The Act now allows these plans to start permitting distributions to participants who have attained age 62, and who have not separated from service but are instead in a phased retirement program.

Reinhart Comment: In addition to greater flexibility, adopting this rule change may give new impetus to employers considering some sort of phased retirement program.

Defined Contribution Plans:

- Right to Diversify. Defined contribution plans that require employees to invest employee contributions and elective deferrals in publicly traded employer securities must allow participants to immediately diversify out of the employer securities. Employer contributions invested in employer securities must be eligible for diversification after the participant has completed three years of participation. The rules on diversifying employer contributions invested in employer securities will be phased in over a three-year period beginning in 2007. Not less than three investment options other than employer securities must be offered to participants eligible for diversification. Each investment option must be diversified and have materially different risk and return characteristics.

Reinhart Comment: Employee stock ownership plans generally are not subject to the new rules. However, a plan holding employer securities that are not publicly traded may be treated as holding publicly traded securities if the plan sponsor's parent or any other member of a controlled group, which includes the plan sponsor, has issued publicly traded securities.

- Notice of Right to Divest Employer Securities. Plan administrators of defined contribution plans that invest in publicly traded employer securities must provide a new notice to participants no later than 30 days before a participant is eligible to exercise a right to divest employer securities. The notice must explain the right of diversification and describe the importance of diversifying investments. Because elective deferrals and nonelective and matching contributions may be first eligible for diversification at different times, plan administrators may be required to send more than one notice. The Secretary of Treasury is to prescribe a model notice by February 13, 2007. See Reinhart's E-Newsletter dated November 15, 2006 for more details.

Investment Advice. The Act added a prohibited transaction exemption ("PTE") to ERISA section 408 allowing plan sponsors to arrange for a fiduciary advisor to provide investment advice to participants pursuant to an eligible investment advice arrangement.

» The PTE is effective for all advice rendered after December 31, 2006.

» The PTE requires the fiduciary advisor to be a bank, financial institution or other registered investment advisor.

» An eligible investment advice arrangement can be either a flat fee arrangement with a fiduciary advisor or an arrangement whereby the investment advice is provided by a computer model. Under a flat fee arrangement, fees received by a fiduciary advisor must not be dependent on the participant's investment selections. Any computer model must satisfy specific criteria, such as the criteria described in the DOL Opinion Letter 2001-9A to SunAmerica, and be approved by an independent investment expert. Moreover, the fiduciary advisor is responsible for numerous detailed disclosures to participants.

Reinhart Comment: Under the new PTE, an employer remains liable for the prudent selection and periodic review of the fiduciary advisor, but is not responsible for monitoring specific advice.

- Default Investment Safe Harbor. The Act gives the DOL authority to describe a safe harbor for default investments where a participant has failed to make an investment election in a defined contribution plan that allows participants to direct the investment of their accounts. The DOL issued proposed regulations on September 27, 2006 on "qualified default investment alternatives (QDIAs)." Participants must receive notice at least 30 days before the default investment goes into effect, and annually thereafter. Three different types of QDIAs were proposed by the DOL: (i) a life-cycle fund or targeted-retirement-date fund; (ii) a balanced fund; or (iii) a managed investment fund. See Reinhart's E-Newsletter dated October 19, 2006 for more details.

- Accelerated Vesting for Nonelective Contributions. The Act extends the vesting requirements that apply to matching contributions to all employer contributions to a defined contribution plan. Plan sponsors must now apply either a three-year cliff vesting or six-year graded vesting schedule to all employer contributions. The provision generally applies to contributions made on or after January 1, 2007 and considers service completed prior to 2007. However, different effective dates apply to collectively bargained plans and leveraged ESOPs.

» *Collectively Bargained Plans*. The effective date is the earlier of (1) the date on which the last collective bargaining agreement ratified before August 17, 2006 terminates; or (2) January 1, 2009.

» *Leveraged ESOPs*. A leveraged ESOP that had an outstanding exempt loan on September 26, 2005 must comply with this provision on the earlier of (1) the date the loan is fully repaid; or (2) the date on which the loan was, as of September 26, 2005, scheduled to be fully repaid.

Defined benefit plans are not affected.

- Missing Participant Program. The PBGC is required to allow defined contribution plans to use the PBGC's missing participant program. However, this provision is not effective until the PBGC publishes final regulations describing the procedures for such plans to use the program.

- Hardship Distributions. By February 13, 2007, the IRS must revise the rules for determining whether a participant has suffered a hardship or unforeseeable emergency to include other beneficiaries under the plan. A participant may now receive a hardship distribution if certain events, as defined under the terms of the plan, occur with respect to the participant, spouse, dependent or another beneficiary under the plan.

Miscellaneous Provisions:

- Change of Consent Period for Joint and Survivor Notices. If the present value of a participant's vested accrued benefit exceeds \$5,000, the plan may not distribute the participant's benefit without his written consent. Under pre-Act law, distribution notices had to have been provided to the participant no less than 30 and no more than 90 days before the date distribution began. The Act substitutes "no earlier than 180 days" for "no earlier than 90 days". See Reinhart's E-Newsletter dated November 15, 2006 for more details.
- Rollovers of After Tax Contributions. After-tax contributions may be rolled over from a qualified retirement plan to any another qualified retirement plan (defined contribution or defined benefit) or a 403(b) tax-sheltered annuity, provided the rollover is a direct rollover and the recipient plan separately accounts for the after-tax contributions (and earnings).
- Rollovers by Nonspouse Beneficiaries. Effective for plan years beginning after December 31, 2006, nonspouse beneficiaries may roll over an inherited retirement account or benefit from a qualified plan, governmental 457(b) plan or a tax-deferred annuity directly to an IRA established in the name of the nonspouse beneficiary. These distributions are treated as eligible rollover contributions and the IRA is treated in the same manner as an inherited IRA of a spouse for purposes of the minimum distribution rules.

Reinhart Comment: Plan sponsors should consider making necessary revisions to 402(f) notices, distribution forms and summary plan descriptions as soon as possible in order to notify nonspouse beneficiaries of the possibility of waiting for a distribution until 2007 in order to take advantage of the new rollover rules.

- Periodic Pension Benefit Statements. Administrators of defined benefit plans must furnish benefit statements to participants with vested benefits who are employed by the employer at least once every three years. Alternatively, administrators may provide a notice of availability of pension benefit statements annually.

Administrators of defined contribution plans with participant directed investments must furnish benefit statements to participants and beneficiaries each calendar quarter, while administrators of other individual account plans must furnish statements annually. The Secretary of Labor is required to publish model benefit statements within one year of the August 17, 2006 date of enactment. The effective date of this provision is extended for collectively bargained plans. See Reinhart's E-Newsletter dated November 15, 2006 for more details.

- Saver's Credit Made Permanent. The saver's credit, a nonrefundable tax credit for qualified retirement saving contributions for taxpayers with a maximum AGI of \$50,000 for joint filers, \$37,500 for heads of household and \$25,000 for individuals, was scheduled to sunset at the end of 2006. The Act makes the saver's credit permanent and permits taxpayers to have refunds attributable to the saver's credit directly deposited into an applicable retirement plan beginning with the 2007 taxable year.
- Reserves for Medical Benefits Provided Through a Bona Fide Association. The Act permits employers to deduct contributions to fund a reserve for medical benefits (other than retiree medical benefits) provided through a bona fide association.

Provisions Effective for 2008 Plan Years

Defined Benefit Plans:

- Changes to the Minimum Funding Rules for Single Employer Plans. The Act revamps the minimum funding rules for single employer defined benefit plans and establishes a new minimum required contribution. Some of the more important changes are highlighted in the following list:

» *Minimum Required Contribution.* If the plan's assets are less than the "funding target," the minimum required contribution for the year is equal to the plan's "target normal cost" plus the amortization of the "funding shortfall." If the plan's assets equal or exceed the "funding target," the minimum required contribution is the "target normal cost" (reduced by the excess). The "target normal cost" for the year generally is the present value of benefit liabilities expected to accrue during the plan year, including increases in past service benefits attributable to current year increases in compensation. The "funding shortfall" is the excess of the plan's funding target over the plan's assets (as calculated after subtracting any credit balances from plan assets). A plan's "funding target" is equal to 100% of the present value of all benefit liabilities accrued to date. The new 100% funding target is phased in over four years.

» *Funding Shortfall.* Under the new rules, if a plan has a funding shortfall, the underfunded amount must be amortized over seven years. In determining the "shortfall amortization base," the present value of "shortfall amortization installments" due under existing amortization schedules is subtracted from the funding shortfall. This new shortfall amortization base is amortized in seven shortfall amortization installments. If a plan's assets exceed the plan's funding target (i.e., there is no funding shortfall for the year (as calculated after subtracting any credit balances from plan assets)), all shortfall amortization bases and installments for preceding years are reduced to zero.

» *Quarterly Contributions.* Plans that have a "funding shortfall" in the preceding plan year are required to make the minimum required contribution for the year in quarterly installments equal to 25% of the lesser of (i) 90% of the minimum required contribution for the plan year or (ii) 100% of the minimum required contribution for the preceding plan year. These installment payments are due on April 15, July 15 and October 15 of the plan year, and January 15 of the following year. Interest, equal to the plan's interest rate plus 5%, shall be applied on the amount of any underpayment.

Reinhart Comment: The above-listed changes to the funding rules are not representative of all changes made by the Act but only highlight what we consider to be the more important changes.

- Interest Rate Assumption for Lump Sum Distributions. The Act changes the interest rate and mortality tables used to calculate the minimum value of certain optional forms of benefit, including lump sums. Plans must use the corporate bond yield curve to determine the three segment rates needed to calculate the minimum value. Transitional rules apply from 2008 to 2011. In addition, plans must use the mortality table required for minimum funding purposes when calculating the lump sum distribution.

Reinhart Comment: Generally, the new rules will reduce the lump sum that would otherwise be payable under pre-Act law by increasing the applicable interest rate.

- "At Risk" Rules. If a plan is "at-risk," the plan sponsor must make greater contributions to the plan to reflect the "at-risk" liability. A plan will be considered "at-risk" if, for the preceding plan year, the plan is both (i) less than 80% funded using the

actuarial assumptions set forth under the general funding rules and (ii) less than 70% funded using the "at-risk" actuarial assumptions (discussed below). The 80% funded requirement is phased in over four years: 2008-65%, 2009-70%, 2010-75%, and 2011-80%. For purposes of determining whether a plan is at least 70% funded in 2008, Treasury is directed to prescribe the methods for determining a plan's funding status for the preceding plan year. Plans with 500 or fewer participants are never considered "at-risk."

- Deduction Limits for Single-Employer Defined Benefit Plans. Beginning in 2008, the maximum deductible amount for single-employer plans is increased to the greater of:
 - » The plan's funding target plus the target normal cost (plus a cushion amount (only for "at-risk" plans)) minus the value of plan assets; and
 - » The minimum required contribution for the plan year.
- Section 4010 Filings with the PBGC. The Act changes the circumstances under which sponsors of single-employer defined benefit plans must report certain information to the PBGC. Under prior law, plan sponsors must report to the PBGC if the aggregate unfunded vested benefit for plans within a controlled group exceeded \$50 million. Under the Act, 4010 filings are required if a single plan's funding target attainment percentage is less than 80%. The Act also describes the information required in the 4010 filing and provides that the PBGC may waive the requirement in appropriate circumstances, such as for small plans.
- Annual Funding Notice. Plan administrators of all defined benefit plans must furnish an expanded version of the multiemployer funding notice required under the Pension Funding Equity Act beginning with the 2008 plan year. The notice must be furnished to participants, beneficiaries, labor organizations, contributing employers and the PBGC within 120 days after the end of the plan year. Small plans must furnish the notice by the due date for the annual report, including extensions. See Reinhart's E-Newsletter dated November 15, 2006 for more details.
- Additional Information Required on Form 5500 for Defined Benefit Plans. Plan administrators of defined benefit plans must provide the funded percentage of other plans in the annual report when the liabilities under the plan consist, in whole or in part, of liabilities under two or more plans. In addition, multiemployer plans must provide information on contributing employers, participants who receive no employer contributions, amortization extensions, employer withdrawals, plan or asset mergers, whether the plan is in critical or endangered status and whether the plan used the shortfall funding method. See Reinhart's E Newsletter dated November 15, 2006 for more details.
- SAR Repealed for Defined Benefit Plans. Plan administrators of defined benefit plans will no longer be required to provide a Summary Annual Report ("SAR"). Instead, some of the information on the SAR will be included in the new funding notice.
- Interest Credits for Cash Balance and Hybrid Plans. Cash balance and hybrid plans must provide that interest credits (or equivalent amounts) for the plan year do not exceed the market rate of return as defined by Treasury regulations. In addition, an interest credit of less than zero cannot cause a participant's account balance to decrease below the aggregate amount of contributions credited to the account. These provisions are effective beginning in 2008, but plan sponsors may elect to apply these provisions for any period after June 29, 2005. Extended effective dates apply for collectively bargained plans.

- Vesting for Cash Balance and Hybrid Plans. Cash balance and other hybrid plans must provide that an employee's accrued benefit from employer contributions is 100% vested after three years of service. This provision is effective beginning in 2008, but plan sponsors may elect to apply this provision for any period after June 29, 2005. Extended effective dates apply for collectively bargained plans.
- Transfer of Excess Pension Assets to Retiree Health Accounts. The Act integrates funding rule changes with existing rules on the transfer of excess pension assets to retiree health accounts to allow "excess pension assets" in a defined benefit plan to be transferred to retiree health accounts in a "qualified transfer." The Act also broadens the scope of such transfers to include transfers between single-employer defined benefit plans and multiemployer health plans.

Defined Contribution Plans:

- Automatic Enrollment Contributions and New ADP/ACP Safe Harbors. The Act includes several significant changes which encourage 401(k) plan sponsors to consider an automatic enrollment feature. The Act removes state wage and withholding law impediments to automatic enrollment, simplifies administration and addresses fiduciary concerns. The Act also creates a new optional nondiscrimination safe harbor design for plans with a qualified automatic enrollment arrangement that does not require immediate vesting and may be more affordable to employers than the safe harbor which that made available in 1999. The new safe harbor alternative offers immediate relief from ADP/ACP testing even if automatic enrollment is applied to only newly hired employees. When fully implemented at the beginning of the 2008 plan year, the Act's new rules make automatic enrollment very attractive for increasing 401(k) participation or avoiding nondiscrimination testing. See Reinhart's E-Newsletter dated October 9, 2006 for more details.
- Extension of Distribution Period for Excess Contributions. Eligible automatic contribution arrangements have an extended period to refund excess contributions. Currently, distributions of contributions in excess of a plan's ADP limit must be made within two and one-half months after the end of a plan year or the contributions will be subject to excise taxes. Under the Act, eligible automatic contribution arrangements have six months after the end of a plan year to distribute excess contributions.
- Changes in Treatment of Excess Contributions. Excess contributions from all 401(k) plans are includible in the employee's income for the year of distribution, and only interest on the excess contributions that was earned through the end of the plan year tested must be distributed (i.e., no "gap period" income).
- Blackout Periods. The Act eliminates a fiduciary's protection under ERISA section 404(c) during blackout periods when a participant is unable to direct his or her investments. However, if the fiduciaries satisfy certain specified requirements (to be issued by the DOL) with respect to the blackout, then they will not be liable under ERISA for any loss occurring during the blackout period.

Miscellaneous Provisions:

Overall Deduction Limits Released. Under current law, where an employer has a combination of defined benefit and defined contribution plans, the deduction limit for single employer plans cannot exceed the greater of 25% of the compensation paid or accrued for that year to participants, or the amount necessary to meet the minimum funding standard of the defined benefit plan, but not less than the amount of the plan's unfunded current liability. Any amounts that exceed this limit are subject to a 10%

excise tax. Under the Act, in determining the deduction limit where there is a combination of one or more defined benefit and one or more defined contribution plans, any defined benefit plan guaranteed by the PBGC will not be taken into account. Thus, the deduction for contributions to these plans is not affected by the overall limit on deductions for combinations of plans. Next, the overall deduction limit to combination plans applies to contributions to defined contribution plans only to the extent that the contributions exceed 6% of the compensation otherwise paid or accrued during the tax year to the plans' beneficiaries.

- Additional Survivor Annuity Option. In addition to offering a Qualified Joint and Survivor Annuity ("QJSA"), pension plans must now offer a "qualified optional survivor annuity." Plans with a QJSA that is less than 75% must also offer a 75% joint and survivor annuity. Plans with a QJSA of 75% or more must offer a 50% joint and survivor annuity option. Extended effective dates may apply for collectively bargained plans.
- Increased Fidelity Bond. For plan years beginning in 2008, the maximum fidelity bond amount is \$1 million (increased from \$500,000) for plans invested in employer securities.
- Electronic Display of Annual Report. The DOL will display basic plan information and actuarial information on its Website within 90 days after annual reports are filed. Plan sponsors and plan administrators must also display the information on any Intranet Website maintained for communication with employees. See Reinhart's E-Newsletter dated November 15, 2006 for more details.
- Direct Rollovers to Roth IRAs. The Act would allow a direct rollover from a qualified plan, a tax sheltered annuity (section 403(b)) or a governmental section 457 plan to a Roth IRA. Rollovers are subject to the current law conversion restrictions (\$100,000 adjusted gross income limit) until these are eliminated after 2009.

Reinhart Comment: *Prior law changes allow conversions to Roth IRAs beginning in 2010 with applicable income tax spread out over three years.*

Provisions Effective for 2009 Plan Years

All Plans:

- Amendments. Plan amendments required by the Act must be made by the last day of the first plan year beginning on or after January 1, 2009. Thus, for calendar year plans, plan sponsors must adopt all amendments required by the Act by December 31, 2009.

Provisions Effective for 2010 Plan Years

Miscellaneous Provisions:

- Defined Benefit 401(k) Plan ("DB(k)"). Beginning with plan years in 2010, a plan sponsor with 500 or fewer employees can establish a combination defined benefit 401(k) plan.
 - » A DB(k) plan sponsor can adopt a single plan and trust document for the plan;
 - » The plan can file a single Form 5500;
 - » Each portion of the plan must follow the applicable rules under the Code and ERISA;

» The 401(k) portion must be an automatic enrollment plan with a default contribution of 4% of pay and certain other safe harbor features; and

» The DB(k) will be exempt from ADP/ACP and top heavy testing; however, each portion of the plan must separately satisfy other nondiscrimination requirements.

Fiduciaries May Propose Plan Investment Strategies that Reduce Volatility

Due to new minimum funding requirements for defined benefit pension plans and new financial accounting standards for reporting liabilities associated with such plans, plan sponsors and fiduciaries are reviewing their plans' investment strategies. Specifically, some are considering deemphasizing equities in favor of fixed-income securities. This would lower expected returns, but also make asset values less volatile - the latter being an increasingly important objective for plan sponsors.

On October 3, 2006, the DOL issued ERISA Op Letter No. 2006-08A stating that a defined benefit plan fiduciary may, consistent with the requirements of ERISA's prudence, exclusive purpose, and diversification requirements, consider the liability obligations of the plan and the risks associated with those liability obligations in determining a prudent investment strategy for the plan.

In its analysis, the DOL found that there is nothing in ERISA or the regulations that would limit a plan fiduciary's ability to take into account the risks associated with benefit liabilities or how those risks relate to the portfolio management in designing an investment strategy. Thus, the DOL concluded that a fiduciary would not violate his fiduciary duties solely because he implemented an investment strategy for a plan that took into account the plan's liability obligations and the risks associated with those liabilities, and resulted in reduced volatility in the plan's funding requirements. However, the advisory opinion also points out that whether a particular investment strategy is prudent for a particular plan "depends on all the facts and circumstances involved."

WELFARE AND FRINGE BENEFIT PLAN DEVELOPMENTS

New DOL Website to Help Employers Comply With Welfare Benefit Laws

The DOL has launched a new interactive Website, entitled "Health Benefits Advisor," to serve as a resource for employers in complying with the various federal health benefit laws. According to a DOL news release, the Website is designed to help employers and other plan officials understand their responsibilities in operating group health plans. The Website provides information on the:

- Consolidated Omnibus Budget Reconciliation Act ("COBRA");
- Health Insurance Portability and Accountability Act ("HIPAA");
- Newborns' and Mothers' Health Protection Act;
- Mental Health Parity Act; and
- Women's Health and Cancer Rights Act.

You may access the Website directly by following this link:
<http://www.dol.gov/elaws/ebsa/health/>

IRS Announces Limits for Health Savings Accounts, Adoption Assistance Programs, and Qualified Transportation Fringe Benefits

The IRS announced the 2007 Health Savings Account ("HSA") limitations for contributions and deductibles, as well as out-of-pocket numbers for HSA High Deductible Health Plans ("HDHP"). The limitation increases include, but are not limited to, the increases noted in the following chart:

	2006	2007
HSA Statutory Contribution Maximum		
Individual	\$2,700	\$2,850
Family	\$5,450	\$5,650
HDHP Minimum Deductible Amount		
Individual	\$1,050	\$1,100
Family	\$2,100	\$2,200
HDHP Maximum Out-of-Pocket Amount		
Individual	\$5,250	\$5,500
Family	\$10,500	\$11,000
Catch-Up Contributions (age 55 or older)	\$700	\$800

For 2007, the maximum amounts that can be excluded from an employee's gross income for qualified adoption assistance expenses, and for expenses related to adoption of a child with special needs, will increase from \$10,960 to \$11,390 per child. In 2007, the exclusion will begin to phase out for taxpayers with adjusted gross income above \$170,820, and will be completely phased out at \$210,820.

The limit on the monthly amount that can be excluded from income for qualified parking expenses will increase from \$205 in 2006 to \$215 in 2007. The aggregate monthly limit for transit passes (e.g., bus passes) and/or transportation in a commuter highway vehicle (e.g., van pooling) will increase from \$105 in 2006 to \$110 in 2007. The standard mileage rate for the business use of an automobile will increase from 44-1/2¢ per mile in 2006 to 48-1/2¢ per mile in 2007.

DOL Issues HSA Guidance on the Avoidance of ERISA Requirements

On October 27, the DOL issued Field Assistance Bulletin ("FAB") No. 2006-02. In a series of questions and answers, the DOL elaborates on the employer's role in setting up HSAs for employees, selecting the HSA trustee, and the rules and limitations the trustee can place on the HSA. The following summarizes key issues addressed in the DOL's latest guidance:

- "Nonvoluntary" establishment of an HSA will not violate the earlier DOL advice that the establishment of an HSA must be "completely voluntary" by the employee. Thus, employers may open HSAs for employees without an employee's prior consent.
- Employers offering high-deductible health plans may limit the number of HSA providers without causing the HSA to become an ERISA plan. To do so, the employer

may rely on the group health insurer exemption outlined in DOL regulations, which prohibits the employer from contributing to the HSA or from "endorsing" the HSA operator, but permits the employer to discuss the benefits of HSAs in general. Alternatively, the employer could rely on earlier guidance in FAB 2004-01, which requires completely voluntary employee participation in the HSA, but permits the employer to limit the number of HSA marketers in the workplace.

- Simply paying employees' HSA account fees or limiting the number of HSA vendors that can market their services at the employer's worksite will not turn an HSA program into an ERISA plan.
- Employee contributions to an HSA through an IRC § 125 cafeteria plan that save the employer FICA and FUTA taxes will not be treated as "compensation received in connection with an FSA."
- An HSA vendor can offer its own HSA product to its own employees without coming under the provisions of ERISA, and a vendor can attract HSA business by putting cash incentives into the HSAs.
- The DOL also encourages the practice of using debit, credit and stored-value cards to link HSA funds with a credit line by stating that "a prohibited transaction would not result merely from an HSA accountholder directing the payment of HSA funds to the credit line vendor to reimburse the vendor for HSA expenses paid with a credit card."
- Simply offering employees easy access to one HSA provider that offers one single investment option "would not, in the view the department, afford employees a reasonable choice of investment options."
- Employers must avoid creating a list of favored HSA vendors combined with getting discounts from those vendors on non-HSA services in return for sending them the HSA business.
- Employers also must ensure the prompt transmission of participants' HSA contributions into their accounts in order to avoid violation of the prohibited transaction provisions of the Internal Revenue Code.
- Class prohibited transaction exemptions issued for IRAs do not apply to HSAs.

TRICARE Amendment Affects Employer Group Health Plans

On October 17, 2006, President Bush signed the John Warner National Defense Authorization Act for Fiscal Year 2007 (the "JW Act"). The JW Act contains several changes to TRICARE - the health plan that covers United States military personnel. One of these changes bans the use of financial incentives to encourage TRICARE-eligible employees to opt out of (or decline enrollment in) an employer's group health plan and to enroll in (or remain in) TRICARE. The JW Act applies to state or local governments but not employers with fewer than 20 employees. Effective January 1, 2008, the new ban is modeled on the language that prohibits comparable financial incentives in connection with Medicare.

GENERAL TOPICS

IRS Releases Final Regulations Dealing With the Use of Electronic Technologies for Participant Elections and Consents

On October 10, 2006, the IRS published final regulations that establish uniform rules for the use of electronic media to provide notices to plan participants/beneficiaries and to transmit elections or consents relating to employee benefit arrangements. The regulations are the exclusive rules for electronic communications relating to any notice, election or similar communication provided to or made by a participant or beneficiary from any defined benefit plans, defined contribution plans, 403(b) plans, simplified employee pension plans, SIMPLE retirement plans, 457 plans, accident or health plans, cafeteria plans, educational assistance programs, qualified transportation fringe programs, Medical Savings Accounts or Health Savings Accounts. The regulations also function as a safe harbor for any electronic communications that are not required to be in writing and coordinate with the Electronic Signatures Global and National Commerce (E-SIGN) Act.

The rules do not apply to notices, elections, consents or disclosures over which the DOL or PBGC has interpretive and regulatory authority, such as furnishing summary plan descriptions or summary annual reports, suspension of benefits notices and COBRA notices. The regulations also do not apply to other requirements under the Code, such as tax reporting, tax records or substantiation of expenses.

Under the regulations, a plan can provide electronic communications if the participant has made an informed consent (or confirms the consent) in a manner that reasonably demonstrates that the participant can access the notice in electronic form. Alternatively, the plan can provide electronic communications if the participant is advised, at the time the applicable notice is provided, that he or she may request a notice in writing on paper at no charge. In addition, the recipient of the notice must be effectively able to access the electronic medium.

The regulations also allow electronic acknowledgement or notarization of a signature (for participant elections, including spousal consents) but the signature must be witnessed in the physical presence of the plan representative or notary public regardless of whether the signature is provided on paper or through an electronic medium.

The regulations apply to applicable notices provided, and to participant elections made, on or after January 1, 2007.

Reinhart Comment: *Employers that already provide benefit plan notices electronically and accept electronic elections should review their procedures to determine if they comply with the new rules.*

DOL Finalizes Amendment on Securities Lending Exemption

On October 30, 2006, the DOL issued final Class Prohibited Transaction Exemption 2006-16 ("CPTE 2006-16") expanding the opportunities for securities lending between employee benefit pension plans, banks and broker-dealers. CPTE 2006-16 will allow pension plans to earn additional income by lending securities from their investment portfolios to a greater array of permissible borrowers. The new exemption, which becomes effective on January 2, 2007, revokes and replaces CPTE 81-6 and 82-63.

The sale, exchange or leasing of any property between a plan and a disqualified person is a prohibited transaction. This is true regardless of whether the transaction is direct or indirect. Under CPTE 81-6, however, plans could lend securities that are held as plan assets to banks, broker-dealers registered under the Securities Exchange Act of 1934 ("1934 Act"), or dealers in exempted government securities exempt from registration under section 15(a)(1) of the 1934 Act who are parties in interest. This exemption freed these loans from all of ERISA's party-in-interest prohibited transaction rules except the

prohibitions relating to acquisitions and holdings of employer securities and real property. However, CPTe 81-6 provided no relief from ERISA's prohibition against fiduciary self-dealing.

CPTe 82-63 granted a class exemption allowing certain compensation arrangements to be made for the benefit of a fiduciary that performs securities lending services.

Under the new CPTe 2006-16, the categories of permissible borrowers have been expanded to include broker-dealers and banks of the United Kingdom, Canada and certain other foreign broker-dealers and banks. In addition, the types of collateral that may be offered to plans for securities lending transactions have been broadened to include:

- negotiable certificates of deposits payable in the United States;
- mortgage-backed securities;
- the British pound, the Canadian dollar, the Swiss franc, the Japanese yen and the Euro;
- securities issued by Multilateral Development Banks;
- rated foreign sovereign debt; and
- irrevocable letters of credit issued by certain foreign banks.

Further, if the pension plan's U.S.-domiciled lending agent agrees to indemnify the plan against losses resulting from a borrower's default, CPTe 2006-16 permits a plan to accept any other type of collateral currently permitted by the Securities and Exchange Commission under Rule 15c3-3 of the 1934 Act.

This *Employee Benefits Update* provides general information about employee benefits issues. It should not be construed as legal advice or a legal opinion. Readers should seek legal counsel concerning specific factual situations confronting them.

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