



Defined Benefit Plan – Year-End Roundup

Dial-in: 888.278.5522
Passcode: 59642050

Craig A. Bitman
Mark H. Boxer
John G. Ferreira

November 15, 2005

Morgan, Lewis & Bockius LLP

HOW TO PRINT THIS PRESENTATION

- Go to the File Toolbar on the upper left-hand side of your screen
- Select Print
- Select Document
- NOTE: When the Print Window comes up, you must select **PRINT ALL**. If you do not, your printer will only print the current slide.

Introduction

- “Potpourri” of things for Defined Benefit (“DB”) plan sponsors to think about as year-end approaches (including some deadline issues)
- Intended as a checklist; can’t cover all issues in great depth
- Prior MLB publications (LawFlashes) have covered most of these in detail; see “Publications” on our website
- We will respond to posted questions by e-mail (general information, not legal advice)

DB Plan Funding Legislation

- Several proposals for pension funding reform are pending in Congress
- Recent rash of bankruptcies bring this issue into the public eye
- The Bush administration has announced that it will oppose a simple extension of current relief

DB Plan Funding Legislation (cont'd)

- The Rumor: Congress will not pass anything before the end of this calendar year
- The Fact: No minimum funding payments are due until April 15, 2006, so a delay will not prejudice plan sponsors

PBGC Notice Requirements for Under-funded Plans

- The Pension Benefit Guaranty Corporation (PBGC) has issued new rules governing the provision of notice to participants and beneficiaries in under-funded plans
- PBGC Technical Update 05-1 updates the old model notice, and provides detailed guidance and worksheets to assist in determining whether such a notice is required

PBGC Notice Requirements for Under-funded Plans (cont'd)

- Deadlines for providing notice in 2005:
 - If on an extension until October 15, notice must be provided by December 15
 - If on an extension until September 15, notice must be provided by November 15

409A and DB Plans

- General 409A requirements
 - Distribution rules
 - Initial election requirements
 - Second election requirements
 - Anti-acceleration rules
- Integration with qualified plans
 - Timing of elections
 - Changing form of payment

409A and DB Plans (cont'd)

- Transition Relief
 - Change in Election Transition Relief
 - New elections relating to previously deferred compensation can be made until December 31, 2006
 - May not change election to defer amounts payable in 2006 or accelerate to 2006
 - Linked Election Transition Relief: The proposed regulations extend the Notice 2005-1 relief that allows nonqualified plan distribution elections to be linked to elections under the related qualified plan through December 31, 2006

Changes to Electronic Notice Rules

- IRS has recently issued proposed regulations to §401(a) regarding consent procedures for receiving notices electronically
- Generally, the regulations coordinate with the E-SIGN Act with regard to participant consent

Changes to Electronic Notice Rules (cont'd)

- Participants must give affirmative consent in one of two ways:
 - By consenting in a way that demonstrates they can access the electronic form; or
 - By consenting on paper in a way that confirms they can access the electronic form.

Changes to Electronic Notice Rules (cont'd)

- Participants must receive certain disclosure information prior to consenting.
 - Scope of consent
 - Right to receive paper documents
 - Right to withdraw consent
 - Description of update procedures
 - Hardware and software specifications

Changes to Electronic Notice Rules (cont'd)

- Specific rules govern the functioning of the electronic medium used: “FARMS”
 - Friendly (clear, user-friendly format)
 - Accessible (to the user)
 - Review (user may review elections)
 - Modify and confirm (user can modify and confirm elections)
 - Secure (safeguards to prevent unauthorized individuals from making participant elections)

Changes to Electronic Notice Rules (cont'd)

- Participant elections requiring a plan representative or notary witness are now allowed electronically, if the witness observes the electronic signature
 - NOTE: The regulations do not permit electronic notification for all required written notices and elections

Changes to Electronic Notice Rules (cont'd)

- These proposed regs do not apply to notices required by provisions of ERISA under the authority of the DOL or PBGC (e.g., summary plan descriptions, summary annual reports)
- These regulations will apply only to IRS-required notices, elections, consents and similar communications relating to a participant's rights under an employee benefit arrangement

Automatic Cash-Outs from DB Plans

- EGTRRA requires plans to establish IRAs on behalf of participants with involuntarily cashed out benefits of \$1000 or more, absent an affirmative election to the contrary
- Plans with automatic cash-out provisions for benefits of \$5000 or less must amend their plans to reflect this requirement by the end of the first plan year ending on or after March 28, 2005 (for calendar year plans, **December 31, 2005**)

Automatic Cash-Outs from DB Plans (cont'd)

- Two possible options:
 - Amend the plan to comply with the rollover requirement;
or
 - Amend the plan to eliminate automatic cash-outs of amounts greater than \$1000
- One of these options had to be selected for operational purposes by March 28, 2005
- Amendment must be consistent with that choice, and cash-outs for this year must be completed by December 31, 2005 (if not previously done)

Automatic Cash-Outs from DB Plans (cont'd)

- Defined benefit plan sponsors had a difficult choice to make; cash-outs for DB plans are desirable (e.g., to reduce PBGC premiums), but vendors were more difficult to find than for Defined Contributions (“DC”)
 - DC plan vendors often said no (or no unless they could get the DC business)
 - DB plan trustees often said no
- Some sponsors decided to retain cash-outs as of March 28, 2005, hoping they’d find a vendor
- Time is running out! Must comply by December 31, 2005

Optional Forms of Distributions

- The proposed 411(d)(6) regulations are now final
- DB plans may now eliminate certain redundant and “non-core” optional forms of distributions if certain others are retained
- Example: Intermediate joint and survivor payment annuity forms may be eliminated if the largest and smallest optional survivor payment percentages are maintained

Optional Forms of Distributions (cont'd)

- In certain cases, redundant or non-core forms may only be eliminated if they create “significant” burdens and are of no more than “de minimis” value
- The new regulations also clarify prior law with helpful examples; in particular, they explicitly approve “wearaway”

Optional Forms of Distributions (cont'd)

- The new regulations also adopt, or disagree with, the rules from several cases:
 - Bellas adopted (contingent event benefits are now protected)
 - Sheet Metal Workers disagreed with (post-retirement Cost of Living Adjustments (“COLAs”) are protected)
 - Riverside Cement disagreed with (OK to reduce Early Retirement (“ER”) benefit if net benefit increased)

Relative Value Disclosures

- New 417(a)(3) regulations expand the disclosure requirements related to distribution options
- The new rules apply to Qualified Pre-retirement Survivor Annuity ("QPSA") notices provided after June 2004, and to Qualified Joint and Survivor Annuity ("QJSA") notices that relate to distributions with annuity starting dates after September 2004
- For annuities starting February 1, 2006, the election notices must be sent by January 1, 2006

Relative Value Disclosures (cont'd)

- QPSA disclosures
 - Must disclose the financial effect of taking a QPSA on a participant's normal benefit
 - May be general description comparing the value, or one specific to the individual

Relative Value Disclosures (cont'd)

- QJSA disclosures
 - Description of plan's optional forms
 - Eligibility requirements of various forms
 - Financial effect of electing the optional forms
 - Relative value of optional forms as compared to QJSA
- Information may be generally applicable, or participant-specific

Relative Value Disclosures (cont'd)

- Regulations detail permissible estimation techniques and actuarial assumptions
- If estimates are provided, they must be clearly identified as estimates
- If estimates are provided, the notice must offer to provide a more precise calculation upon request

Relative Value Disclosures (cont'd)

- The regulations allow administrators several options for choosing the QJSA form to which optional forms will be compared
- Administrators are also allowed to group optional forms with values that differ less than five percentage points of the lump sum present value of the QJSA

Cash Balance Plans

- *Cooper v. IBM* has changed the entire legal landscape for cash balance plans
- Lower court decision that a cash balance design discriminates based on age, and IBM settlement, has had a “chilling effect” on conversions
- Plan sponsors considering other alternatives (e.g., enhanced DC plans) – IBM, H-P

Cash Balance Plans (cont'd)

- New legislation addressing the issue is unlikely before the end of the calendar year
- IRS ruling and regulatory moratorium continues
- IBM case is currently being briefed for appeal (settlement allows appeal), so may be reversed by the 7th Circuit Court of Appeals – ultimately resolved by Supreme Court

Heinz Case

- Supreme Court decision (June 7, 2004): Violation of anti-cutback rule to add new or more restrictive “suspension of benefits” rules to DB plan, as applicable to prior accrued benefits
- Rev. Proc. 2005-23 limits retroactive effect; if plan has a noncompliant amendment, must be amended out, and back payments made to June 7, 2004

Heinz Case (cont'd)

- Amendment must be in place, and back payments made, before January 1, 2006 for relief to apply
- Must also, by January 1, 2006, notify participants who did not apply for benefits because of a bad suspension rule that they can apply retroactively
- Proposed 411(d)(6) regs make new rule effective June 7, 2004

Disaster Relief for DB Plans

- For plans affected by the hurricanes the IRS has announced an extension of certain deadlines relevant to DB Plans:
 - Minimum funding payments (or waiver applications)
 - Claims procedures
 - Filing of Form 5500
 - Filing of certain employment/excise tax returns

Disaster Relief for DB Plans (cont'd)

- Generally, the IRS Notices extend tax-related deadlines that fall between:
 - August 29, 2005 (August 24, 2005 in Florida), and February 27, 2006 for plans affected by Hurricane Katrina
 - September 23, 2005 and February 27, 2006 for plans affected by Hurricane Rita
- The new deadline is **February 28, 2006**

Disaster Relief for DB Plans (cont'd)

- Eligible “Affected Plans” are those with any of the following located in a disaster area:
 - Single employer’s principal place of business
 - Employer with more than 50% of active plan participants
 - Office of the plan or plan administrator
 - Office of primary record-keeper or actuary

Disaster Relief for DB Plans (cont'd)

- This extension to file and pay does not apply to information returns in the W-2, 1098, 1099 or 5498 series, to Forms 1042-S or 8027, or to employment and excise tax deposits due on or before Feb. 28, 2006
- *IR-2005-110; IR-2005-112*

Disaster Relief for DB Plans (cont'd)

- PBGC has also offered relief, waiving certain penalties and deadlines
 - Premium payments
 - Termination reports
 - Participant notices
 - Reportable event notices

New Determination Letter Process

- IRS has finalized a new system for determination letter applications, detailed in Rev. Proc. 2005-66
- Plans fall into one of five staggered application cycles, and apply for determination letters only once every five to six years (depending on the cycle)

New Determination Letter Process (cont'd)

- Individually designed plans have a regular five year remedial amendment cycle
- Pre-approved plans (master and prototype and volume submitters) have a six year cycle
- Pre-approved DB plans have a different cycle than pre-approved DC plans

New Determination Letter Process (cont'd)

- Generally, individually designed plans are assigned a cycle based on the last digit of their employer identification number (EIN)
- Special assignment rules for some individually designed plans:
 - Multiple employer plans: Cycle B
 - Governmental plans: Cycle C
 - Multiemployer plans: Cycle D
 - Controlled/affiliate service groups:
 - single plan uses EIN on Form 5500
 - multiple plans may jointly elect Cycle A (if unanimous)
 - parent-sub may elect to cycle under parent EIN

New Determination Letter Process (cont'd)

Cycle	EIN end	Last day of first (EGTRRA) cycle	Last day to submit determination letter	Next cycle ends
A	1 or 6	2/1/2006	1/31/2007	1/31/2012
B	2 or 7	2/1/2007	1/31/2008	1/31/2013
C	3 or 8	2/1/2008	1/31/2009	1/31/2014
D	4 or 9	2/1/2009	1/31/2010	1/31/2015
E	5 or 0	2/1/2010	1/31/2011	1/31/2016

New Determination Letter Process (cont'd)

- Pre-approved plans must generally file their applications by January 31 of the year following the year in which the assigned cycle opens
- Mass submitters and national sponsors have until October 31 of the calendar year in which the cycle opens

New Determination Letter Process (cont'd)

- Plan sponsors should apply during the last twelve months of their assigned cycle
- Determination letters may only be relied upon until the end of the plan's first cycle that ends more than twelve months after the application for the letter was received
- Timely amendments for interim qualification is still required
- IRS will issue an annual cumulative list of qualification requirements in November

New Determination Letter Process (cont'd)

- IRS has also extended the remedial amendment period for EGTRRA until the last day of a plan's first application cycle
- For DB plans
 - Last day of initial EGTRRA cycle is January 31, 2013
 - Last day of next cycle is January 31, 2019

Contact Information

- Craig Bitman (New York)
 - 212.309.7190; cbitman@morganlewis.com
- Mark H. Boxer (San Francisco)
 - 415.442.1695; mboxer@morganlewis.com
- John G. Ferreira (Pittsburgh)
 - 412.560.3350; jferreira@morganlewis.com