

Summary of Pension Protection Act of 2006

Provisions that Impact Qualified Retirement Plans

On August 17, 2006, President Bush signed the Pension Protection Act of 2006 (PPA) into law. It includes a number of significant provisions that affect defined benefit plans (corporate or public employee pensions) and defined contribution plans (401(k), 403(b) profit sharing, governmental 457(b), etc.). These provisions impact both plan participants and plan sponsors.

PERMANENCY OF ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001 (EGTRRA) PROVISIONS

Major EGTRRA retirement provisions that would have ended in 2010 will be made permanent, including:

- Higher total dollar limits for defined contribution and SEP plans (\$46,000 in 2008 and \$49,000 in 2009);
- Higher deferral limits on elective pre-tax deferrals (\$16,500 in 2009 for 401(k), 403(b) and governmental 457(b) plans and \$16,500 in 2010);
- SIMPLE IRA elective deferral limits increase (\$11,500 in 2009 and \$11,500 in 2010);
- IRA contribution increases (\$5,000 in 2009, \$5,000 in 2010);
- Additional catch-up contributions for workers age 50 and older \$2,500 for SIMPLE IRA plans, \$5,500 (2009) and \$5,500 (2010) for 401(k), 403(b) and governmental 457(b) plans and \$1,000 for IRAs in 2009 and 2010;
- The deduction limit for contributions to Profit Sharing plans continues at 25% of aggregate compensation (up to the compensation limit – \$245,000 for 2009 and \$245,000 for 2010);

- Roth 401(k)s and Roth 403(b)s are made permanent;
- Enhanced rollover rules (including qualified plan rollovers of distributions of after-tax contributions, direct rollovers from IRAs to employer plans, and rollovers of distributions from governmental 457(b) plans.

AUTOMATIC ENROLLMENT STATE LAW PREEMPTION

Effective immediately, any state law that would prohibit or restrict an automatic enrollment provision (such as wage garnishment laws) is preempted by PPA, subject to minimum standards established by the Department of Labor (DOL). This preemption does not apply to plans that are not subject to Employee Retirement Income Security Act of 1974 (ERISA), such as state and local government plans and non-electing church plans.

AUTOMATIC ENROLLMENT DEFAULT INVESTMENTS

For plan years beginning after December 31, 2006, this provision defines the process fiduciaries must follow to make “default” investment decisions, should automatically enrolled plan participants not provide instructions for how they want their contributions allocated. ERISA section 404(c) relief will be provided to these “default” investments if the DOL guidelines are followed.

SAFE HARBOR AUTOMATIC ENROLLMENT

Beginning in 2008, PPA provides for a safe harbor design for automatic enrollment in 401(k), 403(b) and governmental 457(b) plans, assuming all contribution and vesting requirements are met and proper notification is provided to employees prior to enrollment. Also, employees must have a 90-day penalty-free opt out period.



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BENEFIT STATEMENTS

Beginning in 2007, plan sponsors of employer-sponsored retirement plans (excluding one-person plans) will be required to send benefit statements to plan participants:

- Quarterly for participant-directed defined contribution plans;
- Annually for employer-directed defined contribution plans; and
- Every three years for defined benefit plans.

These benefit statements must include a discussion of the importance of portfolio diversification and the risk of holding more than 20% of the portfolio in a single security (e.g. employer stock). They must also explain how to reallocate investments (if applicable) and refer participants to the Department of Labor website for more information about investing and diversification.

LIABILITY RELIEF FOR PLAN SPONSORS OFFERING INVESTMENT ADVICE TO PLAN PARTICIPANTS

Beginning in 2007, limited relief from fiduciary liability will be available to plan sponsors who enter into an “eligible investment advice arrangement” on behalf of their plan with a “fiduciary advisor,” if:

- The terms of the agreement require compliance by a “fiduciary advisor” with the requirements of the new exemption; and
- Under the terms of the agreement, a “fiduciary advisor” acknowledges that he or she is acting as a plan fiduciary. Plan sponsors and other authorizing fiduciaries are still held liable for the prudent selection and periodic review of a “fiduciary advisor.”

However, the plan sponsor and other authorizing fiduciaries are not responsible for monitoring the specific investment advice given to plan participants by a “fiduciary advisor.”

ACCELERATED VESTING FOR MATCHING CONTRIBUTIONS

PPA applies the vesting schedules for matching contributions currently in effect under EGTRRA contributions to non-elective contributions, such as profit sharing. Vesting for all employer contributions to a defined contribution plan must be at least as fast as either a 3-year cliff, in which a participant must be 100% vested after three years, OR a six-year graduated schedule in which a participant must be 20% vested after the second year and another 20% for each additional year thereafter until fully vested after six years. This provision is effective for plan years beginning after December 31, 2006.

EMPLOYER SECURITIES DIVERSIFICATION

Beginning in 2007, plan sponsors will be required to allow employee contributions invested in publicly held employer securities to be diversified out of the employer securities at any time. It also requires that employer contributions invested in publicly held employer securities be able to be diversified after three years of service. In addition, a plan sponsor is required to notify participants of their ability to diversify when they become eligible. This provision does not apply to Employee Stock Ownership Plans that have no employee or matching contributions.



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ROLLOVER OF INHERITED QUALIFIED PLAN ASSETS BY NON-SPOUSE BENEFICIARIES

Beginning in 2007, non-spouse beneficiaries of a decedent's employer-sponsored retirement plan (such as a 401(k) plan, or 403(b)) may roll over their inherited account to a beneficiary or decedent IRA.

The rollover must be done by direct rollover. If the money is distributed to a beneficiary, it CANNOT be rolled over into a decedent IRA — or any other IRA owned by the beneficiary — nor can it be rolled back over to the decedent's original plan.

The decedent IRA must be a traditional IRA, and will be subject to the required distribution rules applicable to a non-spouse beneficiary. These rules, generally, require annual distributions determined using the single life expectancy of the beneficiary.

This provision is available only to a beneficiary who meets the definition of "Designated Beneficiary." It also requires the Internal Revenue Service issue rules allowing trusts inheriting qualified plan assets to roll those assets to a decedent IRA. Presumably, the IRS's look-through trust rules will be used for this purpose.

DIRECT ROLLOVERS INTO ROTH IRAS

Direct rollovers from an employer-sponsored retirement plan to a Roth IRA can be completed without the requirement of making the rollover first to a traditional IRA beginning in 2008. This allows for a tax loophole to by-pass the pro-rata distribution rule that applies to traditional IRAs. Under the new law when a participant terminates employment and has after-tax contributions in their plan, they could request a

direct rollover of their after-tax contributions to a Roth IRA, without creating a taxable event, provided the plan allows for a separate distribution of their after-tax contributions. Of course, the Roth IRA conversion rules still apply (i.e. no more than \$100,000 modified adjusted gross income MAGI to be eligible). However, the \$100,000 MAGI limit for conversion eligibility does not apply after December 31, 2009.

DEFINED BENEFIT PLAN REFORM

PPA provides modifications to pension funding rules intended to shore up struggling defined benefit plans.

Beginning in 2007, employers must distribute individual benefit statements to defined benefit plan participants every three years or upon request. Beginning in 2008, employers are also required to provide an annual statement detailing the funding status of the plan to plan participants within 120 days of the close of the plan year.

Also, beginning in 2008, PPA will require most defined benefit plans to become fully funded over the following seven years. If the plan is less than fully funded, the shortfall will be amortized over the seven year period. PPA includes a process for defining "at-risk" plans and stipulates that such plans fulfill accelerated funding requirements.

COMBINED DEFINED BENEFIT AND 401(K) PLANS (DB/K PLANS)

Companies with 500 employees or fewer will be permitted to set up combined defined benefit and automatic enrollment 401(k) plan beginning in 2010.



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The components will operate as separate plans, for ERISA and Internal Revenue Service purposes, but will have a single plan document and only one Annual 5500 Report.

OTHER RETIREMENT PLAN ENHANCEMENTS

Other employer-sponsored retirement plan rules will change as a result of the PPA. The following provisions have varying effective dates.

- The Form 5500-EZ filing threshold will be increased to \$250,000 and simplified Form 5500 filing requirements will be developed for plans with fewer than 25 participants. This is effective for plan years beginning in 2007.
- Beginning in 2007, after-tax assets may be rolled over between 401(k) and 403(b) plans, if the receiving plan separately accounts for such assets.
- Hardship distributions rules from 401(k) and 403(b) plans will be expanded to include any beneficiary (not just a spouse or other dependant).
- Fidelity Bond maximum will increase from \$500,000 to \$1,000,000 for plans holding employer securities. This is effective for plan years beginning after December 31, 2007.
- The blackout notice for plans benefiting sole owner/partners and their spouses only will be removed retroactive to the original effective date of the Sarbanes-Oxley Act.
- Distributions to qualified Armed Forces Reservists (including National Guardsman) called to active duty between September 11, 2001 and December 31, 2007 and who serve for more than 179 days will

be exempt from the 10% early withdrawal tax on distributions from 401(k) and 403(b) plans. They will also be allowed to rollover amounts equal to those distributions to IRAs within a two-year period. This provision applies to distributions taken after September 11, 2001.

ADVICE WITHIN ERISA-QUALIFIED PLANS

Beginning in 2007, advisors affiliated with the plan fiduciary may provide investment advice to plan participants if:

- The advice related fees received by the fiduciary advisor do not vary based on the investment options selected by the plan participant, or
- The fiduciary advisor uses a computer model certified by an independent third party.

Before any advisory services may be provided, participants must receive a disclosure including how the fiduciary advisor is compensated for the investment advice.

HOW WILL THE PENSION PROTECTION ACT OF 2006 AFFECT YOU?

To take advantage of these new provisions, please call your RBC Wealth Management® Financial Consultant. It's important to note that — in addition to affecting defined benefit plans and defined contribution plans — the PPA also includes provisions affecting IRAs and 529 savings plans.

RBC Wealth Management does not provide tax or legal advice. All decisions regarding the tax or legal implications of your investments should be made in connection with your independent tax or legal advisor.

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