

Key Provisions of The Worker, Retiree, and Employer Recovery Act of 2008

The Worker, Retiree, and Employer Recovery Act of 2008 (the "Act"), was enacted on December 23, 2008. The Act primarily makes technical corrections to the Pension Protection Act of 2006 ("PPA"), but also provides some relief from required minimum distribution rules and funding difficulties created by the current economic downturn and includes other provisions. This article focuses on the provisions likely to be of interest to plan sponsors and their advisors.

Required Minimum Distribution Relief. Qualified retirement plans, including 401(k), 403(b) and 457 plans, and individual retirement accounts and annuities ("IRAs"), are subject to annual required minimum distributions ("RMDs"). For employer-sponsored plans, employees must generally begin taking RMDs by the later of April 1 following the year in which the employee attains age 70 ½ or April 1 following the year of retirement. Plan participants who own 5% or more of the employer cannot wait until retirement to start drawing their RMD. If a RMD is not distributed by the required date, a 50% excise tax is imposed on the shortfall not distributed.

The current economic downturn has made RMDs particularly burdensome to older retirees in defined contribution plans and IRAs because RMDs for 2008 are based on December 31, 2007 account balances. Since most account balances have significantly declined since that date, distributions for 2008 are likely to be unusually large relative to the current smaller account balances of many retirees.

The Act provides relief for the **2009** calendar year for defined contribution employer-sponsored qualified retirement plans (including 403(b) plans and 457(b) plans maintained by a government employer) and IRAs by waiving the RMD requirement for 2009 for participants and beneficiaries. Persons who reach age 70 ½ in 2009 will need to take their first RMD by December 31, 2010. (Those who reached 70 ½ in 2008 still must take their RMD under the normal rules.) The relief also applies to required distributions to beneficiaries, and beneficiaries taking RMDs under the 5-year rule get an extra year to complete the payments.

The Act does not waive RMDs for 2008, which are generally required by December 31, 2008. It now appears that IRS will not offer any RMD relief for 2008, although they were urged to do so by Congress.

Due to the waiver in 2009, distributions that would otherwise be RMDs may become "eligible rollover distributions." The Act provides that the direct rollover notice, written explanation, and 20% income tax withholding requirements are not required to apply to distributions that would otherwise be RMDs in 2009. Rather, plans may or may not offer to handle these as direct rollovers.

Plans and IRAs will be required again in 2010 to comply with the RMD rules and the legislative history to the Act indicates how future RMDs will reflect this one-year waiver. The plan or IRA is not required to be amended to get the RMD relief until the 2011 plan year.

Non-Spouse Rollovers. Under the PPA, individual non-spouse beneficiaries are now allowed to rollover amounts from a tax-qualified plan, 403(b) annuity or governmental 457 plan directly to an IRA beginning in 2007. The IRA is then treated as an inherited IRA for purposes of the minimum distribution rules. The IRS has interpreted the PPA provision as permitting – but not requiring – plans to provide such a rollover opportunity. The Act clarifies that tax-qualified plans are required to allow non-spouse rollovers and provide direct rollover notices as a condition of plan qualification. The correction would be effective for plan years beginning after December 31, 2009.

Automatic Enrollment Programs. The PPA included several provisions intended to promote the use of automatic enrollment programs, including a provision allowing a participant in certain arrangements to make a "permissible withdrawal" of automatic contributions within 90 days of the date the first automatic contribution was made on behalf of the participant. One requirement to be an automatic enrollment arrangement eligible for this relief is that the plan has to invest contributions under the arrangement pursuant to the DOL qualified default investment alternative regulations in the absence of a specific investment election by the participant. This requirement is eliminated. In addition, a permissible withdrawal will not be taken into account in applying the annual limit on elective deferrals (\$16,500 in 2009).

Combined Deduction Limit for Defined Benefit and Defined Contribution Plans. The PPA included certain changes designed to loosen the impact of the combined plan deduction limit for plan sponsors that maintain both defined benefit plans and defined contribution plans. Under one change, for plan years beginning in 2006 and 2007, the combined plan limit applies only to the extent contributions to one or more defined contribution plans do not exceed 6 percent of compensation of beneficiaries under the plans. The Act clarifies that the combined plan deduction limit will not apply to either a sponsor's defined contribution or defined benefit plans if contributions to the defined contribution plans do not exceed 6 percent of compensation. If defined contributions exceed six percent of compensation, only the excess counts toward the combined limit.

Roth Rollovers. The PPA permits rollovers from a tax-qualified plan, 403(b) annuity or governmental 457 plan directly to a Roth IRA, subject to the following conditions: (1) the rolled-over amount generally must be included in income (except to the extent it represents cost basis), and (2) adjusted gross income limits are imposed on the ability to perform such rollovers in 2008 and 2009 (the limits do not apply in 2010). Under the PPA, these conditions technically apply even in the case of rollovers to Roth IRAs from designated Roth accounts in a 401(k) or 403(b) plan. The Act clarifies that these conditions do not apply to direct rollovers to a Roth IRA from a Roth 401(k) or Roth 403(b).

Effective Date of Cash Balance Vesting Requirement. In general, the PPA requires cash balance plans to provide for 100 percent vesting after 3 years of service. The Act

provides that this requirement only applies with respect to participants with an hour of service after the applicable effective date for a plan.

Defined Benefit Pension Plan Funding Changes. The economic downturn has made PPA's tighter funding rules even harder to satisfy. The Act provides modest relief, but Congress may consider more as part of an economic stimulus package. Key relief provisions are as follows:

The PPA restructured the minimum funding rules for single-employer defined benefit pension plans to require employers to fully fund pension benefits over an accelerated seven-year schedule. If an employer failed to satisfy the new the PPA funding target in a given year, the employer would be required to make additional contributions to immediately fund 100 percent of the plan's benefits. In light of the current economic crisis, satisfying the new PPA funding targets has proven to be very difficult. The Act provides funding relief by keeping the PPA funding targets at 92 percent for 2008, 94 percent for 2009, and 96 percent for 2010, but allowing employers who have a funding shortfall to fund only up to the applicable funding target as opposed to funding 100 percent of the benefits. Also, the Act clarifies the asset smoothing rules set forth in the PPA.

The PPA imposed benefit restrictions for poorly funded single-employer defined benefit pension plans. Under PPA, all future benefit accruals must cease if the plan's adjusted funding target attainment percentage (AFTAP) is less than 60 percent for a plan year. In light of the economic crisis, the Recovery Act allows plans to substitute the AFTAP of the preceding plan year for the current year. Thus, the future benefit accrual limitation can be avoided if a plan's AFTAP for the preceding plan year is at least 60 percent.

BCG's actuaries have studied the funding law changes and will implement them as the law permits to minimize funding obligations where desired.