February 2009

Worker Retiree and Employer Recovery Act of 2008 Provides Pension Funding and Tax Relief

Congress passed by unanimous consent the Worker Retiree and Employer Recovery Act of 2008 ("WRERA") which was signed into law on December 23, 2008. Among the features of WRERA are:

I. Minimum Required Distributions

The Code provides that benefit payments under an individual retirement annuity ("IRA") must begin by the April 1 following the year in which the individual attains age 70½, and with respect to tax-qualified plans, except for 5% owners, must begin by April 1st of the year following the later of the year in which the individual retires or attains age 70½. This portion of the account that is distributed each year is referred to as a required minimum distribution or RMD. WRERA suspends the required minimum distribution for 2009. For tax-qualified plans, these amounts will be eligible to be rolled over, to the extent that they would otherwise qualify as eligible rollover distributions (although tax-qualified plans will not be required to offer direct rollovers for these amounts). Congress anticipated that the IRS would provide similar relief for 2008 but it declined to do so, citing administrative difficulties such as individuals having already received a RMD in 2008. The new law also allows beneficiaries not to receive distributions in 2009 for the purpose of implementing the five-year RMD schedule imposed on distributions received by beneficiaries after the death of a participant.

II. Non-Spouse Rollover

Prior to the Pension Protection Act of 2006 ("PPA"), only a surviving spouse could rollover a participant's interest in a qualified plan. PPA extended this treatment to non-spouse beneficiaries with respect to distributions after December 31, 2006. In Notice 2007-7, the IRS took the position, criticized by several members of Congress, that non-spouse rollovers were permitted but not required. Under WRERA, effective for plan years beginning after December 31, 2009, a tax-qualified plan must permit non-spouse rollovers. Until that date, non-spouse rollovers are permitted.

III. Roth 401(k) Rollovers

WRERA allows participants to rollover a distribution from a Roth 401(k) to a Roth IRA, without having the distribution includible in gross income and without regard to the $100,000 limitation that normally applies to Roth IRAs.

IV. Eased Funding Rules

WRERA permits single-employer plans that fall below the phase-in funding targets to utilize PPA's transitional relief rules. For example, a plan that was less than

92% funded in 2008 would be permitted to work towards becoming 94% funded in 2009, 96% funded in 2010 and 100% in 2011. Without this change, companies with plans that were less than 92% funded in 2008 would have been subject to a rule requiring them to become 100% funded in 2009. As under PPA, plans established after 2007 or plans subject to a deficit reduction contribution in 2007 are not eligible for this transitional relief.

V. Asset Smoothing

Prior to the PPA, there was a 4-year smoothing period to recognize unanticipated market gains and losses. PPA reduced that 4-year period to 2 years. It also left unclear as to how the asset smoothing was to be effected. Proposed regulations issued by the IRS interpreted PPA narrowly, using a strict mathematical approach using fair market value. As a result, the average market values may be below fair market value over the long term. Consequently, many plan sponsors elected not to use the averaged rate.

WRERA clarifies that the averaging method is to be adjusted for expected earnings. The expected earnings are to be determined by the plan's actuary based upon an assumed rate of return, not to exceed the applicable PPA third segment interest rates.

However, there is an important restriction on asset smoothing. The end result cannot be more than 10% off the fair market value, a number that is substantially less than that experienced by some plans. It is anticipated that plan sponsors will be seeking expanded relief on this issue in 2009, for example, a 30% corridor in 2009, a 20% corridor in 2010, and 10% thereafter. Also, companies will be seeking the right to elect asset smoothing for 2009 without regard to whether the company used fair market value in 2008.

VI. Target Normal Cost

WRERA requires a plan's target normal cost to include the amount of "plan-related expenses" (undefined, but hopefully limited to administrative expenses and not including investment-related expenses) to be paid from plan assets during the plan year. It also requires a plan's target normal cost to exclude the amount of mandatory employee contributions expected to be made during the plan year.

VII. Benefit Accruals

PPA imposes certain benefit limitations on underfunded defined benefit plans. For example, benefit accruals must be frozen when a plan's adjusted funding target attainment percentage ("AFTAP") is less than 60%, unless the amount necessary to attain the 60% level is contributed to the plan in addition to the regular minimum required amount. WRERA provides that for planning years beginning on or after October 1, 2008 and before October 1, 2009, a prior year's AFTAP may be substituted for the current year's AFTAP. For plan years beginning January 1, 2009, that means looking to the plan's January 1, 2008 AFTAP rather than January 1, 2009. WRERA

also provides that small benefits that may be involuntarily cashed out because their present value is less than $5,000 are not subject to these underfunded plan restrictions.

VIII. 415 Limits on Lump Sum Benefits

For employers with no more than 100 employees who received at least $5,000 of compensation from the employer in the preceding plan year, the maximum benefit that can be provided in a lump sum is determined using a fixed 5.5% interest rate, rather than the greater of 5.5% or 105% of the corporate bond yield curve rate.

IX. Maximum Deductible Contributions for Defined Benefit Plans With Overlapping Defined Contribution Plan

WRERA clarifies the manner in which this limit, provided for in PPA 2006, is to be calculated. If contributions to defined contribution plans are less than 6% of compensation, the defined benefit plan is not subject to the overall deduction limit. If contributions to the defined contribution plan exceeds 6% of compensation, only defined contributions in excess of 6% are taken into account with respect to the overall deduction limit.

X. Cash Balance Plans

1. The special 3-year vesting rule applies only to those participants who are credited with at least one hour of service after the applicable effective date for the plan (generally the plan year beginning after December 31, 2007).

2. The new interest crediting rules for cash balance plans in existence on June 29, 2005, apply to plan years beginning after December 31, 2007, unless the plan sponsor elects to apply the rules early.

XI. At-Risk Defined Benefit Plans

A plan that is at-risk, i.e., has a funding target attainment percentage of less than 80% and a funding target attainment percentage of less than 70% if certain specified at-risk actuarial assumptions are applied, is subject to higher funding levels. WRERA expanded the transitional rules for determining if a plan is at-risk.

XII. Small Plans

For plans with fewer than 100 participants who elect a valuation date other than the first day of the plan year, the IRS is authorized to establish special rules for purposes of quarterly contributions and benefit restrictions.

XIII. Permissible Withdrawals Under Automatic Contribution Arrangements

1. The requirement that an eligible automatic contribution arrangement satisfy, in the absence of a participant investment election, the requirements of DOL regulations with respect to qualifying default investment alternatives, is repealed.

2. Permissive withdrawals are disregarded for purposes of applying the annual limit on elective deferrals ($16,500 in 2009).

XIV. Gap Period Income

Conforming to the Pension Protection Act change for correction of actual deferral percentage and actual contribution percentage violations, in the event that the Code Section 402(g) limit is exceeded for a year ($16,500 in 2009), only the income earned on the excess deferral during the year is returned: the "gap income" from year-end until the date of return is disregarded.

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This memorandum only touches upon some of the highlights of WRERA. If you wish to discuss any of these changes in detail, please call the undersigned.

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