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Re: Issues That Will Require Immediate Attention Under The New Pension Law

Dear Clients and Other Friends:

The Pension Protection Act of 2006 ("PPA") expected to be signed by President Bush today makes significant changes to the laws regulating defined benefit pension plans and other qualified retirement plans. We will discuss the more significant changes in a series of letters over the next few weeks. Most of the pension changes are not effective until 2008. We thought it might be useful to begin by highlighting some other issues that will require more immediate attention. Unless otherwise noted, these changes are effective in 2007:

1. **New diversification requirements for public company defined contribution plans that hold employer stock.** PPA requires plans that hold employer stock to permit participants to diversify their accounts into other investments. Under the new rules, participants may direct that their 401(k) accounts be moved from employer stock to other investments regardless of the participant's length of service. Employer stock held in a participant's account that was acquired with matching contributions or other employer contributions does not have to be subject to diversification until the participant has completed three years of service. (For participants under age 55, the diversification requirement on stock acquired with employer contributions prior to the 2007 plan year phases in over a three-year period beginning in 2007.)

Many employers have already moved toward permitting participants to diversify out of employer stock. Employers that still require participant accounts to remain invested in employer stock will need to give this issue attention before the start of the 2007 plan year.

This change does not apply to non-public companies. It also does not apply to public company free-standing ESOPs that do not hold any 401(k), employee after-tax, or employer matching contributions and are separate from any other qualified retirement plan of the employer.

Employers subject to the new diversification requirement must give notices to participants at the time they become eligible to diversify.

2. **Benefit statements.** Beginning with the 2007 plan year, defined contribution plans that allow participants to direct investment of their own accounts must automatically provide quarterly benefit statements. The new law includes some

new requirements regarding the content of such statements, so even plans that currently provide quarterly statements may need to make some changes. If a defined contribution plan does not allow participants to direct investment, the statement only has to be provided once a year.

Defined benefit plans must either (i) automatically provide a benefit statement every three years or (ii) provide an annual notice that a benefit statement is available upon request. The statement or notice only has to be provided automatically to active employees with vested benefits. Other participants (e.g. nonvested participants and vested former employees) are entitled to request a benefit statement but don't have to receive one otherwise.

3. **Investment advice.** Beginning in 2007, plans are permitted (not required) to provide new types of investment advice to participants. This one is totally voluntary – you don't have to do anything about it, but this provision has received a lot of press attention and so you should be aware of it. Moreover, we think many participants would appreciate this type of advice as they consider how to invest their accounts. We will be sending a separate letter about this soon.
4. **Rollovers by Non-Spouse Beneficiaries.** In the past, a beneficiary who was a deceased participant's spouse was permitted to roll the death benefit over to an IRA or another qualified plan, but the rollover opportunity was not available to other beneficiaries. PPA changes that effective January 1, 2007 so that any beneficiary can elect a rollover to an IRA.
5. **Faster Vesting for Defined Contribution Plans.** The 2001 EGTRRA legislation required faster vesting (3-year cliff or 2 to 6-year graded vesting) for employer matching contributions, but left the old vesting rules (5-year cliff or 3 to 7-year graded) in place for other employer contributions. Beginning with the 2007 plan year, PPA applies the EGTRRA vesting rules to all employer contributions, not just match. This change does not apply to defined benefit plans. There is a delayed effective date for certain leveraged ESOPs.
6. **Phased retirement.** Prior law prohibited a defined benefit plan from paying benefits to a participant who had not yet terminated employment and had not attained normal retirement age. This restriction prevented arrangements where an employee would shift to part-time status and begin drawing part of their pension. Beginning in 2007, a DB plan can permit employees age 62 or older to go on full or partial pension even if they have not totally separated from employment.
7. **Cash Balance plans.** Some employers have been reluctant to consider cash balance or pension equity plans due to uncertainty about age discrimination issues. PPA resolves this issue. Also, the recent Court of Appeals decision in the IBM case confirms that even without PPA, age discrimination is not a problem. If you have been considering cash balance but reluctant to proceed, this would be a good time to revisit the subject.

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8. **402(f) Statements.** Plans formerly had to provide benefit election forms no more than 90 days before the benefit commencement date. PPA extends this to 180 days.

Please let us know if you have any questions about the above issues. As I mentioned earlier, we will be sending additional letters over the next few weeks about other provisions of the new law.

Sincerely,

A. David Kelly

ADK/jks/rah