

To: Clients and Friends
From: Smith & Downey
Date: February 16, 2009
Re: CHIP 2009 and WRERA

I. Children's Health Insurance Program Reauthorization Act of 2009.

One of the first bills signed by the new President was the Children's Health Insurance Reauthorization Act of 2009, which is generally effective April 1, 2009. CHIP 2009 enables States to provide CHIP coverage by offering eligible individuals the opportunity to receive CHIP financial aid in obtaining coverage under employer health plans. The Act also: (1) requires group health plans to permit employees and dependents who are eligible for plan coverage but not enrolled to enroll mid-year if they request coverage within 60 days after (a) losing coverage due to becoming ineligible for coverage under Medicaid or CHIP; or (b) being determined to be eligible for financial aid under Medicaid or CHIP with respect to plan coverage; (2) requires employers that sponsor health plans to notify employees in writing of any financial aid that is available to them under Medicaid or CHIP in the State in which each employee resides with respect to coverage under the plan (once model notices have been issued by the regulators, as expected sometime within the next year); and (3) requires health plan administrators to disclose, upon request, enough information to the applicable State about benefits under the plan for the State to determine whether it would be cost effective to provide financial aid with respect to coverage under the plan and to enable the State to provide any required supplemental benefits.

Action Item: Employers should revise their Plan documents, SPDs, administrative forms, insurance contracts and stop-loss contracts to reflect the new mid-year special enrollment option, and, once the State-specific model notices have been issued, should amend their SPDs or enrollment materials to include the required notice about available Medicaid or CHIP financial aid.

II. WRERA

In late December, the President signed the Worker, Retiree and Employer Recovery Act of 2008. WRERA makes a number of benefit law changes that present opportunities for employees and employers, and obligations for employers. The following is a summary of those changes.

(Note that there are a number of unanswered questions raised by, and ambiguities contained in, WRERA's provisions that will need to be answered and clarified, respectively, in future IRS guidance or Congressional technical corrections.)

1. Waiver of MRD Rules for 2009. Participants in tax-qualified retirement plans, 403(b) plans, governmental 457(b) plans and IRAs must take distributions from those arrangements on

dates and schedules contained in the Code Section 401(a)(9) Minimum Required Distribution rules.

In an attempt to ease the financial burden on participants who would be forced to liquidate investments in a down market in order to satisfy these MRD rules, WRERA provides that the MRD rules need not be satisfied for a single year, 2009. Note that this relief is not available to defined benefit plans or 457(b) plans sponsored by tax-exempt entities.

Under the relief granted by the new rules, if a participant's required beginning date (the later of age 70 ½ or termination of employment) occurs in 2009, he or she would not be required to take a 2009 distribution by the April 1, 2010 MRD deadline, because this first distribution relates to a 2009 event and the MRD rules are waived for 2009. However, this participant would be required to take his or her second, 2010 MRD, in 2010.

In addition, if a death benefit beneficiary is due in 2009 to receive one of his or her five annual installments under the death benefit MRD rule, the beneficiary need not receive it, effectively extending the beneficiary's required five-year distribution period to six years.

Note that, because of the limited nature of this relief, if the MRD rules require that a participant commence distributions by April 1, 2009 because he or she attained age 70-1/2 in 2008, that participant still must take a first distribution by April 1, 2009 because that distribution relates to a 2008 event and the MRD rules are not waived for 2008. However, this same participant will not be required to take his or her second, 2009 MRD, in 2009.

Plans may permit -- but are not required to permit -- participants to directly rollover 2009 distributions that would have been ineligible for rollover as an MRD without WRERA. These direct rollovers are not subject to the 20% withholding and direct rollover requirements that otherwise apply to direct rollovers (e.g., plans do not have to modify their rollover notices to reflect this special 2009 rule).

Action Item: On or before the last day of the plan year beginning after 2010 (2011 for governmental plans), employers may need to adopt plan amendments reflecting the 2009 MRD waiver (and, if desired, the direct rollover option), although employers must operate their plans in compliance with these rules beginning with 2009.

2. Clarification for Roth Account to Roth IRA Rollovers. As we have discussed in an earlier client e-Alert, under the Pension Protection Act of 2006, participants in tax-qualified plans, 403(b) plans and governmental 457(b) plans were allowed to convert their distributions from those plans to a Roth IRA by rolling the distribution directly to a Roth IRA, beginning in 2008. These rollovers will result in immediate taxation of the distribution, but will eliminate taxation on future earnings within the Roth IRA (if the earnings are withdrawn in a qualifying distribution). For 2008 and 2009, these rollovers will not be available to any individual whose adjusted gross income exceeds \$100,000 or to any married individual who files a separate tax return. For years after 2009, these rollovers will be available regardless of AGI and filing status,

because the PPA AGI restriction is eliminated (for 2010 and later) by the Tax Increase Prevention and Reconciliation Act (which was enacted May 17, 2006).

WRERA adds a clarification that confirms the PPA AGI restriction does not apply to any rollover from a Roth 401(k) account or a Roth 403(b) account to a Roth IRA, regardless of the year of the rollover.

Action Item: This clarification was not intended as a change in the law, but provides certainty to a participant with a Roth 401(k) account or a Roth 403(b) account (there is no AGI restriction for establishing a Roth 401(k) account or a Roth 403(b) account) concerning the participant's ability to roll a distribution from such an account to a Roth IRA, in 2008 or later. Employers with Roth subaccounts in their 401(k) or 403(b) plans may need to revise their current distribution notices and election forms and update their plans' operational procedures to reflect this clarification, and all employers, whether or not their plan has a Roth feature, may need to revise their notices, forms and operational procedures for non-Roth distributions after 2009.

3. Required Non-Spouse Beneficiary Rollovers. Under the PPA, Plans could permit non-spouse beneficiaries to directly rollover death benefits to "inherited IRAs" established by those beneficiaries. (Prior to the PPA, only spouses had this option.)

WRERA requires that tax-qualified plans, 403(b) plans and governmental 457(b) plans provide for non-spouse beneficiary direct rollovers to inherited IRAs, effective for plan years beginning after 2009.

Action Item: When these new rules become effective, the mandatory 20% withholding and direct rollover notice requirements will presumably apply to distributions to all death benefit beneficiaries, rather than just spouses. Employers must revise their distribution notices and election forms and update their plans' operational procedures to reflect these new developments.

4. EACA Changes. The PPA created the new concept of an "Eligible Automatic Contribution Arrangement" under which employers could automatically enroll employees (subject to specified requirements) in their 401(k) and 403(b) plans.

One of the specified requirements was that the accounts of automatically enrolled participants who fail to designate the investments options for their accounts be invested in the plan's Qualified Default Investment Alternative. WRERA repealed this particular EACA requirement, although for risk management reasons all employers should, indeed, direct the investment of such participants' accounts to their plans' QDIAs.

(WRERA also clarifies that amounts withdrawn from an EACA by a participant upon revoking an automatic enrollment under the voluntary withdrawal rules under PPA do not count against the participant's Code Section 402(g) annual voluntary salary reduction limit.)

These EACA changes are effective for plan years beginning after 2007.

Action Item: Employers with EACA features in their plans should revise their plans' operational procedures to ensure that amounts withdrawn, since 2008, from an EACA account under the voluntary withdrawal rules under PPA do not count against the participant's Code Section 402(g) annual voluntary salary reduction limit.

5. Return of Excess Voluntary Deferrals, Matching Contributions, and/or After-tax Contributions. The PPA provided that, if excess voluntary deferrals, matching contributions, and/or after-tax contributions are required to be returned to a participant in a 401(k) plan or a 403(b) plan because of a violation of the law's ADP and/or ACP tests, gains or losses on the excess amounts from the end of the affected plan year to the distribution date do not need to be taken into account in calculating the amount that is required to be withdrawn.

WRERA extended this rule specifying that "gap period" earnings and losses similarly should be ignored when returns are made of voluntary salary reduction contributions that exceed the dollar limit on those contributions under Code Section 402(g) (i.e., \$16,500 in 2009, plus a \$5,500 age 50 catch-up in 2009). This expansion of the rule is effective for excess deferrals made in years beginning after 2007.

Action Item: Employers should revise their plans' operational procedures (and, if necessary, their plan documents) to ensure that gap period earnings are not returned when 2008 excess amounts are returned to participants.

6. Non-Dependents in HRAs. In its Health Reimbursement Account guidance, the IRS has stated that HRAs do not enjoy all of the tax advantages otherwise available to self-funded health plans if they cover designated beneficiaries of deceased participants who were not the participants' spouses or dependents for tax purposes. That guidance required HRAs with such a provision to remove it by the first day of their first plan year beginning after 2008.

WRERA added new Code Section 105(j), which exempts certain governmental employer HRAs that contained such a provision on or before January 1, 2008 to continue coverage of deceased plan participants' beneficiaries who were not spouses or tax dependents of the participants.

Action Item: Affected employers should check their HRA documents to ensure that they do not cover designated beneficiaries of deceased participants who were not the participants' spouses or dependents for tax purposes.

7. QDIA Protection for Employers for Beneficiaries' Plan Accounts. WRERA clarifies the PPA to make clear that an employer may invest the account of a death benefit beneficiary who does not direct an investment in the plan's QDIA and enjoy protection with respect to the performance of that investment.

8. Cash Balance Plan Vesting. WRERA clarifies that the PPA rule that imposes the defined contribution plan three-year cliff/six-year graded vesting rule on "hybrid" defined benefit plans applies only to plan participants who were credited with service after the PPA's relevant effective date (i.e., generally, after 2007).

Action Item: Affected employers should confirm that their plan administration reflects this approach.

9. Defined Benefit Plan Changes. WRERA made a number of changes to the funding and related rules for defined benefit plans. The following are the most important of those changes:

(a) Under the PPA, benefit accruals under a defined benefit plan must be frozen if the plan's funding status falls below a specified level. For plan years beginning from 10/1/08-9/30/09, WRERA permits employers to use their plan's prior year's higher funding status for purposes of applying this benefit accrual freeze rule.

(b) PPA required increased post-PPA "transition period funding" for some underfunded defined benefit plans. WRERA provides relief from these rules for many affected plans for the 2008 through 2010 period. The PPA required increased post-PPA "transition period funding" for some underfunded defined benefit plans. The PPA provides funding target percentages over a three year period (92% in 2008, 94% in 2009, 96% in 2010, and 100% thereafter). Under PPA, if the plan misses one of its funding targets during the transition year, the plan would lose the transition relief and would be required to be funded to 100% of the plan's funding target. WRERA provides relief from these rules for many affected plans that could not otherwise meet their funding target. WRERA requires that the plan meet the PPA transition funding target percentage for each of the three transition years (2008-2010), but does not require immediate funding to 100% of the plan's funding target if a transition funding target percentage is missed.

(c) WRERA provides relief, for the 10/1/08 - 9/30/09 period, from some of the PPA increased funding rules applicable to multiemployer defined benefit plans by treating the plan's status the same as the plan's status the prior year.

(d) PPA specified strict plan asset valuation rules for determining the funding required for defined benefit plans. WRERA softens these rules by providing that projected earnings on plan assets are taken into account when using the "averaged market value" option to valuing plan assets.

(e) In determining a plan's "target normal cost", WRERA requires a plan to consider administrative expenses expected to be paid from a defined benefit plan reduced by any mandatory employee contributions expected to be made during the plan year.

(f) PPA limits the lump sums that may be paid from underfunded defined benefit plans. WRERA exempts from these limits lump sums payable because of a plan's cash-out of

benefits valued at \$5,000 or less. WRERA also clarifies that hybrid plans (*e.g.*, cash-balance plans) may cash out participants' account balances that are \$5,000 or less without applying the present value rules (*i.e.*, the whipsaw rules) under ERISA and the Code.

(g) PPA provided some employers who sponsor both defined benefit and defined contribution plans with relief from the 25% of covered payroll combined deduction limit for contributions to defined benefit and defined contribution plans. WRERA provides that there is no 25% limit if employer contributions to the defined contribution plan do not exceed 6%, and, if employer contributions exceed 6%, only the amounts over 6% are counted toward the combined 25% limit.

Action Item: Defined benefit plan sponsors should discuss these new WRERA rules with their actuaries and should ensure that these requirements are taken into account in the administration of their plans.

10. Special Funding Relief for Small DB Plans. PPA provided that defined benefit plans must determine the Code section 415 limit for non-annuity payments subject to the Code section 417(e) present value requirements using the greatest of (i) 5.5 percent, (ii) a rate that provides a benefit of not more than 105 percent of the benefit provided if the applicable interest rate under Code section 417(e)(3) and (iii) the plan's rate. WRERA simplifies this calculation for small employers to require that the determination be made using the greater of 5.5% or the plan's rate. For this purpose a small employer plan is, generally, a plan sponsored by an employer with 100 or fewer employees who received at least \$5,000 of compensation in the prior year.

Action Item: Affected defined benefit plan sponsors should discuss this new WRERA rule with their actuaries and should ensure that these requirements are taken into account in the administration of their plans.

11. PFEA Amendment Date Extension. The Pension Funding Equity Act of 2004 (PFEA) (among other things) changed the interest rate that plans (generally only defined benefit pension plans) must use to determine the value of non-annuity benefits. The PFEA interest rate applied only to 2004 and 2005 and PFEA required that the plan amendment to add the PFEA interest rate to the plan be adopted by the end of the plan year beginning in 2006. PPA extended the use of the PFEA interest rate for 2006 and 2007 and extended the deadline for adopting the PFEA/PPA interest rate plan amendment to the end of the plan year beginning in 2008. WRERA extends the deadline for adopting the PFEA/PPA interest rate plan amendment to the end of the plan year beginning in 2009.

Action Item: Defined benefit plan sponsors should amend their plans prior to the last day of the 2009 plan year to include the PFEA/PPA interest rate and should confirm that the rate has been used for calculations of the value of non-annuity benefits in plan years beginning after 2003.

12. At Risk Plans. PPA established new rules that, in very general terms, (i) require underfunded pension plans to become fully funded within seven years; (ii) impose new mortality and interest rate assumptions to be used in determining the plan's liabilities and participant benefits (e.g., lump sums); (iii) with exceptions for small plans and collectively bargained plans, impose onerous funding and benefit restrictions, including special actuarial assumptions, on plans that are "at risk" plans (generally, plans with a funding percentage for the preceding year of less than 80 percent (without regard to the special "at risk" actuarial assumptions) and a funding percentage for the preceding year of less than 70 percent (taking into account the special "at risk" actuarial assumptions). The 80 percent prong is generally phased in as follows by substituting the following percentage for "80 percent": below 65 percent funded in 2008, below 70 percent funded in 2009, below 75 percent funded in 2010 and below 80 percent funded in 2011 and future years.

Under PPA, the determination of the 70 percent prong for 2008 may be determined using estimates provided by the Secretary of Treasury. WRERA also applies this rule for purposes of the 80 percent prong (as phased in under PPA).

Action Item: Affected defined benefit plan sponsors should discuss this new WRERA rule with their actuaries and should ensure that these requirements are taken into account in the administration of their plans.

13. Market Rate of Return and Amendments to ADEA. WRERA amends the Age Discrimination in Employment Act to provide that, in the case of a governmental hybrid plan, a method of crediting interest that is established pursuant to federal, state or local law is generally treated as a market rate of return so long as the method of crediting interest does not otherwise violate any other provision of the ADEA.

Action Item: Affected governmental defined benefit plan sponsors should discuss this new WRERA rule with their actuaries and should ensure that these requirements are taken into account in the administration of their plans.

Please contact us if we can be of assistance in your CHIP 2009 or WRERA compliance efforts.