EXECUTIVE SUMMARY

THE PENSION PROTECTION ACT OF 2006

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I. Introduction

The Pension Protection Act of 2006 ("PPA"), was signed into law by President George W. Bush on August 17, 2006. Some of the key provisions of this comprehensive pension reform legislation: 1) require traditional pension plans be 100% funded within 7 years; 2) make permanent retirement savings incentives created by the Economic Growth and Tax Relief Reconciliation Act, including indexed higher contribution limits for IRAs and 401(k) Plans; 3) permit direct rollovers from retirement plans to Roth IRAs; 4) require plan administrators to comply with new disclosure rules; 5) mandate employers with "at risk" plans to accelerate contributions; and 6) make permanent the 2001 federal tax exclusion for withdrawals to fund higher education expenses from a Section 529 plan. There are different or delayed effective dates for various provisions of the new law, so careful attention should be given to that issue.

While the scope and content of the PPA is fairly broad, most of the PPA's provisions do not affect the services insurance agents and brokers perform for consumers, so they are beyond the scope of and not addressed in this document. IIABA's federal government affairs team was involved in discussions on this legislation and stayed in contact with Majority Leader John Boehner (OH), a key proponent of the bill in the House of Representatives, particularly on the provisions of the bill regarding investment advice.

This Executive Summary focuses exclusively on the sections of the PPA that may affect certain insurance agents and brokers. Those sections include:

- Section 601, which amends the Employee Retirement Income Security Act of 1974 ("ERISA") and Section 4975 of the Internal Revenue Code ("IRC"), by providing exemptions to certain prohibited transactions in the rendering of investment advice;

- Section 844, which amends Section 72 of the IRC with regard to the treatment of annuity and life insurance contracts with a long-term care insurance feature; and
- Section 863, which amends Section 101 of the IRC relative to the treatment of death benefits from corporate-owned life insurance.

II. Section 601 of the PPA (Prohibited Transaction Exemption for the Provision of Investment Advice)

The goal of Section 601 is to make it easier for employees to obtain advice about investment choices for their individual retirement accounts (e.g., 401(k), 403(b) and IRAs) (collectively "Plans" or "Plan"). It eliminates the conflict of interest provisions in prior law that prohibited firms whose funds are among Plan investment choices from also advising Plan participants about which funds to choose. It also provides an exemption for advice by a "fiduciary advisor" under an "eligible investment advice arrangement," as defined below.

Fiduciary Adviser

An insurance agent or broker may qualify as a "fiduciary adviser" of a Plan since the term is defined to include a person who provides investment advice to a Plan participant and who is:

> (i) registered as an investment advisor under the Investment Advisers Act of 1940 … or under the laws of the State in which the fiduciary maintains its principal office and place of business,
> (ii) a bank or similar financial institution … but only if the advice is provided through a trust department of the bank or similar financial institution or savings association which is subject to periodic examination and review by Federal or State banking authorities,
> (iii) an insurance company qualified to do business under the laws of a State,
> (iv) a person registered as a broker or dealer under the Securities Exchange Act of 1934 … ,
> (v) an affiliate of a person described in any of the clauses (i) through (iv), or
> (vi) an employee, agent, or registered representative of a person described in clauses (i) through (v) who satisfies the requirements of applicable insurance, banking, and securities laws relating to the provision of the advice.

Eligible Investment Advice Arrangement

An eligible investment advice arrangement ("Arrangement") is defined to mean an arrangement that either:

> (i) provides that any fees (including commission or other compensation) received by the fiduciary adviser for investment advice … do not vary depending on the basis of any investment option selected, or
> (ii) uses a computer model under an investment advice program meeting [certain] requirements.

Computer Model Requirements

The computer model requirements for investment advice provided pursuant to it are that the model:

> (i) applies generally accepted investment theories that take into account the historic returns of different asset classes over defined periods of time,
> (ii) utilizes relevant information about the participant, which may include age, life expectancy, retirement age, risk tolerance, other assets or sources of income, and preferences as to certain types of investments,
> (iii) utilizes prescribed objective criteria to provide asset allocation portfolios comprised of investment options available under the [P]lan,
> (iv) operates in a way that is not biased in favor of investments offered by the fiduciary adviser or a person with a material affiliation or contractual relationship with the fiduciary adviser, and
> (v) takes into account all investment options under the [Plan] in specifying how a participant's account balance should be invested and is not inappropriately weighted with respect to any investment option.

The Department of Labor, in consultation with the Secretary of the Treasury, is required by the new law to conduct a study to determine the feasibility of computer model investment advice for covered Plans (IRAs, and certain heath savings accounts and trusts) and report the results of the study back to Congress by December 31, 2007. If the Secretary of Labor determines that an effective computer model does not exist for this purpose, an exemption must be granted for these covered Plans from treatment as a prohibited transaction, subject to various conditions.

The computer model and any changes to it must be certified by an "eligible investment expert' who is independent of any investment advisor or registered representative of the investment advisor.

Annual Audit

There must be an annual audit of the Arrangement conducted by an independent auditor. The independent auditor also must issue a written report covering compliance with the Arrangement to the fiduciary who authorized use of the Arrangement.

Disclosure

Prior to providing any investment advice, the fiduciary adviser must disclose to Plan participants, before initially providing any investment advice, written notice of:

> (i) the role of any party that has a material affiliation or contractual relationship with the financial advisor in the development of the investment advice program and in the selection of investment options available under the [P]lan,

(ii) the past performance and historical rates of return of the investment options available under the [P]lan,
(iii) all fees or other compensation relating to the advice that the fiduciary adviser or any affiliate …is to receive (including compensation provided by any third party) in connection with the provision of the advice or in connection with the sale, acquisition, or holding of the security to other property,
(iv) any material affiliation or contractual relationship of the fiduciary adviser or affiliates … in the security or other property,
(v) the manner, and under what circumstances, any participant of beneficiary information provided under the [A]rrangement will be used or disclosed,
(vi) the types of services provided by the fiduciary adviser in connection with the provision of investment advice by the fiduciary adviser,
(vii) [the fact] that the adviser is acting as a fiduciary if the [P]lan in connection with the provision of advice, and
(viii)[the fact] that a recipient of the advice may separately arrange for the provision of advice by another adviser, that could have no material affiliation with and receive no fees or other compensation in connection with the security or other property.

The Secretary of Labor must issue a model form for the disclosure of fees and other compensation to meet the requirements set out above.

Plan Information Retention and Availability

The fiduciary adviser must provide accurate information to the recipient of the advice, without charge: (i) at least annually, (ii) upon request of the recipient, and (iii) concerning any material change to the information required to be provided to the recipient of the advice at a time reasonably contemporaneous to the change in the information.

The information must be kept by the fiduciary advisor for at least 6 years after the provision of the advice.

Other Conditions

Additional requirements are:

(i) the fiduciary adviser provides appropriate disclosure, in connection with the sale, acquisition, or holding of the security or other property, in accordance with all applicable securities laws,
(ii) the sale, acquisition, or holding occurs solely at the direction of the recipient of the advice,
(iii) the compensation received by the fiduciary adviser and affiliates … in connection with the sale, acquisition, or holding of the security or other property is reasonable, and
(iv) the terms of the sale, acquisition, or holding of the security or other property are at least as favorable to the [P]lan as an arm’s length transaction would be.

Effective Date

This exemption applies to investment advice rendered after December 31, 2006.

III. Section 844 of the PPA (Treatment of Annuity and Life Insurance Contracts with a Long-Term Care Insurance Feature)

Section 844 of the PPA allows annuities and life insurance contracts to include a long-term care ("LTC") rider to provide coverage for long-term care needs.

Section 844 also provides that any charge against the cash value of an annuity contract, or the cash surrender value of a life insurance contract, made as payment for coverage under a qualified long-term care insurance contract which is part of or a rider on the annuity or life insurance contract, shall not be included in gross income.

The new law also requires that any person who makes any charge against the cash value of an annuity contract, or the cash surrender value of a life insurance contract, which is excludible from gross income shall make a return, according to the forms or regulations prescribed by the Secretary of the Treasury, setting forth:

(i) the amount of the aggregate of such charges against each such contract for the calendar year,
(ii) the amount of the reduction in the investment in each such contract by reason of such charges, and
(iii) the name, address, and [tax identification number] of the individual who is the holder of each such contract.

Every person required to make the return described above shall furnish to each individual whose name is required to appear in the return a written statement showing:

(i) the name, address, and phone number of the information contact of the person making the payments, and
(ii) the information required to be shown on the return with respect to such individual.

This written statement shall be furnished to the individual on or before January 31 of the year following the calendar year for which the return was required to be made.

Effective Date

Section 844 applies to contracts issued after 1996, but only with respect to taxable years beginning after 2009. It also will be effective for exchanges after 2009.

IV. Section 863 of PPA (Treatment of Death Benefits from Corporate-Owned Life Insurance)

Section 863 of the PPA addresses best practices for corporate-owned life insurance ("COLI"). COLI is life insurance on employee's lives owned by the employer. Formerly known as "key man" insurance since it was originally used for highly-skilled workers or executives, it was purchased to protect against the cost of recruiting and training replacements for key employees. Due to the tax advantages of purchasing this coverage, some corporations began writing such policies on lower-level employees, often without their knowledge or consent. The proceeds of those policies on lower-level employees sometimes were used to fund additional benefits or perks for key executives. That coverage soon became known as "Dead Peasants" insurance. COLI policies could remain in place even after the employee resigned or retired. Upon the death of the covered person, the company benefited and families received either a portion of the proceeds or nothing.

Section 863 is a response to concerns about the manner in which this coverage came to be used. Section 863 provides that payments of life insurance after the covered party's death generally are not taxable to the recipient. For example, proceeds are <u>not</u> taxable when paid to a member of the insured's family; any individual who is the designated beneficiary under the policy (other than the policyholder); a trust established for the benefit of any such member of the family or designated beneficiary; or the estate of the insured. In addition, proceeds used to purchase an equity interest in the applicable policyholder from an employee of the policyholder are <u>not</u> taxable to the recipient.

However, proceeds on such policies paid to the employer <u>are</u> taxable unless:

> (i) the insured was an employee at any time within 12 months before death, or
> (ii) at the time the contract is issued, the insured was a director, a highly compensated employee (i.e., employee who owns at least 5 percent of the employer company or earns an amount set annually by the IRS Commissioner, which for reference purposes was set at $100,000 in 2006) or a highly compensated individual, that is, one of the 5 highest paid officers, a shareholder who owns more than 10 percent in value of the stock of the employer, or is among the highest paid 35% of all employees (other than employees excluded from the calculation, such as employees under age 25 and part-time/seasonal employees).

Section 863 also includes requirements for notice and consent before a policy can be issued. These requirements provide that the employee:

> (A) [is] notified in writing that the applicable policyholder intends to insure the employee's life and the maximum face amount for which the employee could be insured at the time the contract was issued,
> (B) provides written consent to being insured under the contract and that such coverage may continue after the insured terminates employment, and

(C) is informed in writing that an applicable policyholder will be a beneficiary of any proceeds payable upon the death of the employee.

There also are reporting requirements, which provide that:

> [e]very applicable policyholder owning 1 or more employer-owned life insurance contracts issued after the date of the enactment of this section shall file a return (at such time and in such manner as the Secretary [of the Treasury] shall by regulations prescribe) showing for each year such contracts are
> owned - -
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> (1) the number of employees of the applicable policyholder at the end of the year,
> (2) the number of such employees insured under such contracts at the end of the year,
> (3) the total amount of insurance in force at the end of the year under such contract,
> (4) the name, address, and taxpayer identification number of the applicable policyholder and the type of business in which the policyholder is engaged, and
> (5) that the applicable policyholder has a valid consent for each insured employee (or, if all such consents are not obtained, the number of insured employees for whom such consent was not obtained).

Effective Date

The requirements of this section apply to life insurance contracts issued after the date of the enactment of the PPA, August 17, 2006 (except for contracts issued after such date pursuant to an exchange under section 1035 of the IRC for a policy issued on or prior to that date). Any material increase in the death benefit or other material change requires that the policy be treated as a new policy (except that, in the case of a master policy, the addition of covered lives are treated as a new policy only with respect to such additional covered lives).

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