

SUMMARY OF SELECTED PROVISIONS OF H.R. 4, THE PENSION PROTECTION ACT OF 2006

ISSUE	CURRENT LAW	H.R. 4 ¹	COMMENTS
SINGLE-EMPLOYER PENSION FUNDING			
IN GENERAL	<p>Requires minimum contributions to single-employer defined benefit plans equal to the greater of (a) the contributions required under the deficit reduction contribution (“DRC”) rules, or (b) the contributions required under the plan’s funding standard account (the “ERISA funding rules”).</p> <p>If the DRC rules apply, sponsors generally must contribute a specified percentage of the plan’s unfunded liabilities. DRC contribution percentages currently range from 18% to just over 30% of the difference between the value of plan assets and 100% of liabilities, as defined using special DRC interest rate and mortality assumptions (“current liability”).</p>	<p>Starting with plan years beginning in 2008, the current law two-tiered system would be replaced with a single funding regime.</p> <p>The minimum required funding for any plan year would be the sum of (i) the plan’s normal cost for the plan year and (ii) the “shortfall contribution” necessary to amortize the difference between assets and 100% of liabilities over 7 years. The shortfall contribution would be required for the current year and each of the next 6 years (unless the plan became 100% funded at an earlier date).</p> <p>Normal cost refers to all benefits that a plan expects to pay in the future that accrue during the year (including increases in benefits earned in prior years where the increase is attributable to compensation increases).</p>	<p>By way of example, in very simple terms, ignoring normal cost and assuming a zero interest-rate environment, the bill provides that if a plan has liabilities of \$100 and assets of \$86, the sponsor has a minimum contribution of \$2 in each of the next 7 years.</p>
TRANSITION FOR 2006 AND 2007	For plan years beginning during 2004 and 2005, a temporary corporate bond interest rate was used for certain purposes.	The current funding rules, including an extension of the temporary corporate bond rate, would remain in effect for plan years beginning in 2006 and 2007.	
FUNDING TARGET	DRC contributions are required only if a plan falls below 90% funded on a current liability basis, or 80% for plans that have been 90% funded in two consecutive years out of the last three years.	Contributions would be required for a plan year if the sum of (i) the plan’s normal cost for the year and (ii) 100% of the plan’s liability on the valuation date, are more than the value of the plan’s assets.	
PHASE-IN OF FUNDING TARGET		<p>The 100% funding target would not apply until 2011 for plans that are funded up to 92% in 2008; 94% in 2009; and 96% in 2010. Plans subject to the DRC for plan years beginning in 2007 do not qualify for this transition rule.</p> <p>Eligibility for the phase-in of the 100% target (i.e., funding to 92% in 2008 etc.) is significant because plans that reach these thresholds are not required to</p>	<p>This “ladder” phase-in is not a traditional phase-in. As a result, many plans (including non-DRC plans) will either have to immediately fund up to the applicable threshold (92% in 2008) or immediately move from a 90% funding</p>

¹ H.R. 4, The Pension Protection Act of 2006, was approved by the full House on July 28, 2006. H.R. 4 is the package of retirement reforms agreed upon by House and Senate conferees that worked to reconcile H.R. 2830 and S. 1783. This chart is based on a preliminary review of the bill language. Legislative history is not available.

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		subtract credit balances in determining their shortfall contributions. Such plans are also exempt from the benefit restriction rules (but not the at-risk rules) even if the subtraction of credit balances would otherwise trigger the restrictions, as discussed below.	target to a 100% funding target in 2008.
INTEREST RATE FOR VALUING LIABILITIES	<p>Liabilities of all durations are valued using a single interest rate.</p> <p>Prior to 2004, the interest rate used to determine liability for DRC purposes was based on the 30-year Treasury bond. For plan years beginning in 2004 and 2005, the interest rate is based on a mix of long-term corporate bonds that are AAA, AA and A rated. After 2005, the interest rate is scheduled to revert to the rate on the 30-year Treasury bond.</p>	<p>Liabilities would be valued using a yield curve comprised of AAA, AA and A rated corporate bonds of varying maturities.</p> <p>Separate interest rates would be established for each of three maturity “segments” – liabilities due (1) in 5 or fewer years, (2) between 5 and 20 years and (3) those longer than 20 years. In lieu of using the segment rates, a plan can elect to value liabilities for purposes of determining minimum contributions without regard to the segment rates (<i>i.e.</i>, by applying a true yield curve). Such an election may be changed only with the consent of Treasury.</p> <p><i>Transition.</i> The change in liability attributable to the new interest rate, yield curve, and interest rate smoothing rules (discussed below) would be phased in during 2008 and 2009. During 2008, liability would be one-third new liability and two-thirds liability under the rules in effect during 2007 (including extension of the temporary corporate bond rate). Those ratios would be flipped during 2009.</p>	There are a number of unanswered questions regarding the construction of the yield curve, including how the different classes of bonds will be weighted. Ordinarily, some of these issues might be addressed in legislative history, but H.R. 4 was passed without any accompanying legislative history. Other issues presumably will be addressed by Treasury in constructing the yield curve.
INTEREST RATE SMOOTHING	The interest rate used to value liabilities is the weighted average of the interest rate for the previous 4 years (weighted 40%, 30%, 20% and 10%, starting with the most recent year in the four-year period).	<p>Interest rates would be smoothed over 24 months with no weighting.</p> <p>A plan can elect to determine the interest rate on a non-smoothed basis. Such an election may be changed only with the consent of Treasury.</p>	Reflects a compromise between the Senate’s 12-month smoothing and the House’s 3-year smoothing.
ASSET SMOOTHING	Under current law, a plan can use the actual fair market value on the valuation date or the prescribed average value. Treasury regulations allow for the actuarial smoothing of asset values within a prescribed corridor (generally no less than 80% and no more than 120% of fair market value).	<p>Asset values could be smoothed but restricts period of smoothing to 24 months.</p> <p>Prescribed corridor would be narrowed to 90% to 110%.</p>	Notwithstanding early reports from congressional staff, the ceiling on the prescribed corridor is 110%, not 105%.

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MORTALITY TABLE FOR VALUING LIABILITIES	The Secretary of Treasury prescribes the mortality tables used in determining a plan's current liability. On December 1, 2005, Treasury issued proposed regulations that would replace the current table, GAM 1983, with RP-2000.	Directs Treasury to prescribe a mortality table <i>Substitute Mortality Table.</i> Allows a plan to use a substitute mortality table if the Secretary of Treasury determines that (i) the table reflects the actual experience of the plan and projected trends in experience and (ii) the plan has sufficient experience on which to base the substitute table, provided that each plan maintained by the employer and its affiliates uses its own substitute mortality table. <i>Effective Date.</i> RP-2000 will be effective as provided in to-be-issued final regulations. The substitute mortality table provisions are effective starting for plan years beginning in 2008.	Presumably Treasury will prescribe a mortality table that tracks its recently proposed regulation. The requirement that each plan maintained by an employer and its affiliates use a substitute mortality table if any plan uses one is designed to prevent "cherry picking" of plans with substandard mortality, e.g., to prevent using a substitute mortality table for an hourly plan with substandard mortality while using the standard table for a salaried plan with above average mortality experience.
OPTIONAL FORMS OF DISTRIBUTION	An assumption regarding the probability that lump sums and other optional forms of distribution will be paid is not required (or permitted) under the DRC rules.	Probability that lump sums and other optional forms of distribution will be paid would be taken into account, and any difference in value would need to be reflected in liability.	
TREATMENT OF GAINS AND LOSSES	The ERISA funding rules, but not the DRC rules, provide for amortization of gains or losses.	Losses (actuarial and investment) are recognized immediately and amortized over 7 years. Gains are also amortized over 7 years and netted against loss amortization schedules.	Immediate recognition of gains was not an element of either House or Senate bill, but was added as part of the conference and could materially reduce contributions in certain situations. The statutory change that adds amortization of investment gains is very subtle. We understand that Committee language was expected to highlight the change, but

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<p>TREATMENT OF CREDIT BALANCES</p>	<p>Under current law, if a sponsor makes a contribution in excess of the minimum required contribution in any year, the excess plus interest is maintained as a “credit balance” that can be credited against future required contributions.</p> <p>Generally, under the DRC rules, the credit balances are not subtracted from assets for purposes of determining whether a shortfall contribution is required, but they are subtracted for purposes of determining the amount of the shortfall contribution. Credit balances are not subtracted for any other purpose.</p> <p>Credit balances are increased based on the plan’s expected rate of return on assets.</p>	<p>The following changes in the treatment of credit balances would be made:</p> <ul style="list-style-type: none"> - Credit balances would be subtracted from assets for determining the amount of the shortfall contribution for plans funded below the phased-in funding target (which does not subtract existing credit balances). Note: Credit balances that cannot be used to satisfy a contribution obligation as a result of an agreement with the PBGC would not be subtracted from assets for this purpose. - Credit balances could not be used to offset minimum contributions for plans that were below 80% funded for the preceding year. For this purpose, existing credit balances as of the end of plan years beginning in 2007 are not subtracted from assets and Treasury would prescribe methods of estimating funded percentages for 2007 (to determine whether the restriction applies in 2008). - Credit balances cannot be created by any contribution to the extent that the contribution has the effect of avoiding any of the benefit limitations discussed below. In effect, contributions that bring a plan up to a benefit limitation threshold would be treated as required contributions. - Beginning in 2008, credit balances would be marked to market based on the plan’s actual rate of return. <p>As described further below, credit balances would also be subtracted from assets for purposes of determining whether a plan is “at risk” and, in the case of a plan that is funded below the phased-in funding target, whether the benefit restrictions apply.</p>	<p>H.R. 4 was passed without legislative history.</p> <p>The subtraction of credit balances for purposes of determining the amount of minimum contributions is arguably different than current law in that credit balances are only subtracted from assets in plans that fall into the DRC. As a result, the bill would expand the situations in which credit balances are subtracted from assets. For example, assuming a zero interest rate environment and no normal cost, if a plan has liabilities of \$100, assets of \$86 and a credit balance of \$7, the plan would have a minimum contribution of \$21 (\$100 minus \$86 minus \$7) amortized over 7 years and would therefore have to contribute \$3 per year. However, the \$7 credit balance could be used to satisfy this annual obligation until exhausted.</p>

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SPECIAL RULES FOR AT-RISK PLANS	Not applicable.	<p>Plans that are defined as “at-risk” would be subject to accelerated funding requirements. At-risk plans would be required to (i) assume that during the current year and the next 10 years all participants will retire upon reaching the earliest retirement age; (ii) assume that benefits will be paid in lump sums (or in whatever form results in the largest liability for the plan); and (iii) in the case of a plan that has been at-risk for 2 out of 4 years, apply a “loading factor” equal to \$700 per participant plus 4% of current liability for the plan year.</p> <p><i>Definition of At-Risk.</i> Defines a plan as at-risk for a year based on whether, for the preceding plan year, the plan’s assets were (1) less than 70% of its liabilities calculated assuming that the plan is at-risk but disregarding the loading factor and (2) less than 80% of its liabilities calculated using non-at-risk assumptions. For this purpose, credit balances would be subtracted from assets. Also, the 80% prong would be phased in as follows: 65% in 2008; 70% in 2009, 75% in 2010; 80% in 2011 and thereafter.</p> <p><i>Phase-In.</i> Once a plan becomes at-risk, the difference between standard liability and at-risk liability would be phased in 20% per year.</p> <p><i>Small Plan Exception.</i> Plans with 500 or fewer participants would be exempt from the at-risk rules.</p> <p><i>Automobile Manufacturer Exception.</i> The at-risk rules would not apply to liabilities attributable to employees who work for automobile manufacturers (and certain auto parts suppliers) and who were offered but chose not to accept an early retirement package during 2006.</p> <p><i>Effective Date:</i> Plan years beginning in 2008. Directs Treasury to prescribe estimation methodologies for</p>	<p>The subtraction of credit balances means that plans that are well-funded on an economic basis may be considered at-risk by virtue of credit balances. These plans could waive their credit balances or could simply accept the consequences of at-risk status.</p> <p>Note that shortfall amortization schedules established while the plan was considered at-risk would continue to be applicable after a plan ceases to be at-risk. The result is that once a plan ceases to be at-risk, the 20% phase-in of at-risk liability ceases, but the amortization schedule with respect to the already phased-in at-risk liability continues until the plan is funded to 100% of non-at risk liability. However, because the bill includes a provision allowing amortization of actuarial gains, a plan that ceases to be at-risk will have an actuarial gain that is amortized over 7 years and netted against the outstanding amortization bases. This has the effect</p>

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		determining funded percentages for 2007 (to determine whether a plan is at risk in 2008). Years prior to 2008 would not be taken into account in determining the extent of the 20% phase in.	of mitigating the consequences of the accelerated funding requirements once a plan ceases to be at risk.
RESTRICTIONS ON BENEFITS	There are restrictions on lump sum payments and benefit increases for certain plans that are severely underfunded or have liquidity problems.	<p><i>Less than 80% funded.</i> Benefit increases prohibited unless immediately paid for or funded to the extent necessary to bring the plan to at least 80% funded. Exception permits increases in flat dollar plans that do not exceed rate of pay increases.</p> <p><i>Between 60% and 80% funded.</i> Only partial lump sums (generally no more than 50% of a participant's accrued benefit) would be permitted.</p> <p><i>Less than 60% funded.</i> Plan would have to be frozen, plant shutdown benefits could not be triggered (unless immediately paid for or funded to the extent necessary to bring the plan to at least 60% funded) and lump sums would be prohibited.</p> <p><i>Bankruptcy Reorganization.</i> Unless 100% funded, lump sums would be prohibited.</p> <p><i>Subtraction of Credit Balances.</i> For these purposes, all credit balances would have to be subtracted from assets in determining a plan's funded percentage.</p> <p><i>Mandatory Waiver of Credit Balances.</i> All plans, including non-collectively bargained plans, would generally have to immediately waive credit balances to avoid triggering restrictions on lump sums and other accelerated payout forms. Collectively-bargained plans would generally have to immediately waive credit balances to avoid triggering any other benefit restrictions.</p> <p><i>Exception for Fully-Funded Plans.</i> The benefit restrictions do not apply to a plan that is funded up to</p>	

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		<p>92% in 2008; 94% in 2009; 96% in 2010; and 100% thereafter, determined without subtracting credit balances from assets.</p> <p><i>Effective Date:</i> Plan years beginning in 2008, subject to delay for collectively-bargained plans.</p>	
COMMERCIAL AIRLINES	<p>Very generally, during 2004 and 2005, a commercial passenger airline may elect an alternate DRC contribution. The alternate DRC contribution is equal to the greater of (i) 20% of the amount that would otherwise be required and (ii) the expected increase in liability due to benefits accruing during the plan year. Restrictions on benefit increases apply if the alternate DRC election is made.</p>	<p>Provides special funding rules for commercial passenger airlines. Any commercial passenger airline may elect to apply the new funding rules modified to provide for 10-year (rather than 7-year) amortization of any funding shortfalls.</p> <p>Instead, a plan of a commercial passenger airline that is frozen is eligible for an alternative funding system. Under the alternative funding system, the required contribution for a year would be the amount necessary to amortize the unfunded liability over 17 years, the plan would use a statutorily-prescribed interest rate to value liabilities and assets would be determined on a fair market value basis (i.e., no actuarial smoothing).</p> <p>If a plan terminates while the alternative funding system applies, the PBGC guarantee is frozen as of the first date the alternative system applied.</p>	
SPECIAL RULES	Not applicable.	<p>Would delay the effective date of the funding and benefit restriction rules for certain large defense contractors, certain plans rescued from distress termination through a PBGC settlement and multiple employer plans of rural agricultural, electric, and telephone cooperatives.</p>	
OTHER PENSION FUNDING-RELATED CHANGES			
DEDUCTION LIMITS	<p>Under current law, an employer may generally deduct plan contributions that increase the plan's funding level to 100% of current definition of liability. This limit does not allow plans to create a funding cushion to help satisfy future liabilities. If a sponsor makes contributions in excess of the deduction limits, the contributions are nondeductible and subject to a 10%</p>	<p>For 2006 and 2007, maximum deductible contributions to single-employer plans would increase to the excess of 150% of current liability over plan assets. Thereafter, employers could generally make deductible contributions equal to the excess of target liability, target normal cost, and the "cushion amount" over the value of plan assets. In any event, however,</p>	<p>The increases in the deduction limits are generous. Employers generally can elect to fund their plans to no less than 150% of liability.</p>

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	<p>excise tax.</p> <p><i>Combined Plan Limit.</i> An employer that maintains both a defined contribution plan and a defined benefit plan may only make deductible contributions to the two plans up to the greatest of the following: (i) 25% of participants' compensation; (ii) the minimum funding requirement with respect to the defined benefit plan; or (iii) if the DRC rules apply, the amount needed to bring the plan to 100% of current liability. In general, elective contributions are disregarded for this purpose.</p>	<p>employers could make deductible contributions to bring the plan to full funding using at-risk liability assumptions (even if the plan is not considered at-risk).</p> <p><i>Cushion Amount.</i> The cushion amount is the sum of (1) 50% of target liability and (2) the amount target liability would increase if projected compensation increases were taken into account or, if the plan does not base benefits on compensation, benefit increases expected in succeeding plan years.</p> <p><i>Combined Plan Limit.</i> Effective in 2008, any plan covered by PBGC insurance would not be taken into account in applying the combined plan limit. For 2006 and 2007, the combined plan limit would not apply to the extent that contributions by an employer to one or more defined contribution plans do not exceed 6% of compensation paid or accrued to the beneficiaries under the plan.</p>	<p><i>Combined Plan Limit.</i> For many large employers, the bill would effective repeal the combined plan limit.</p>
<p>VARIABLE RATE PBGC PREMIUMS</p>	<p>Very generally, certain underfunded single-employer pension plans pay an additional variable-rate premium of \$9 per \$1,000 of unfunded vested benefits.</p>	<p>No rate change in variable rate premium, but full funding limit exemption would be repealed.</p> <p>Liability for purposes of the variable rate premium would be the same as liability for purposes of the funding rules except that the interest rate would be a spot rate (<i>i.e.</i>, not smoothed over 24 months), assets would be valued at fair market value, and credit balances would not be subtracted from assets in determining underfunding.</p> <p>The \$1,250 per participant termination premium enacted earlier this year would be made permanent.</p> <p><i>Effective Date:</i> Plan years beginning in 2008.</p>	<p>The elimination of the full funding limit exemption could result in plans that have not previously paid a variable rate premium having to pay such premiums. Also, it appears that changes in liability definitions, including application of at-risk rules, would lead to increased variable premiums.</p> <p>The Senate bill proposal to apply variable rate premiums to unvested benefits was not included in the bill.</p>

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DISCLOSURE TO PARTICIPANTS	Multiemployer defined benefit plans, but not single employer plans, must provide an annual plan funding notice to each plan participant and beneficiary, each labor organization representing participants and beneficiaries, to each contributing employer, and to the PBGC.	New plan funding notice due 120 days after end of the plan year for single employer plans with more than 100 participants. Disclosure of a lengthy list of items would be required, including disclosure of year-end assets and year-end liabilities as determined for variable rate premium purposes (i.e., fair market value of assets and liabilities determined using a spot interest rate). A plan would also be required to disclose whether a PBGC 4010 filing was made. <i>Effective Date:</i> Plan years beginning in 2008.	The new plan funding notice would also require disclosure of the plan's funded percentage. For this purpose (but not for purposes of disclosing asset values), credit balances would be subtracted from assets.
PBGC 4010 INFORMATION	Section 4010 of ERISA generally requires companies sponsoring defined benefit plans with more than \$50 million of underfunding to provide the PBGC with confidential corporate information and a statement of the plan's funded status (i.e., termination liability calculated using PBGC specified assumptions, which generally result in a substantially greater liability than under current liability).	Companies would be required to provide the PBGC with the information currently required under section 4010 if the funding percentage of a plan (including affiliate's plans) was less than 80% for the preceding year. For this purpose, credit balances would be subtracted from assets. <i>Effective Date:</i> Plan years beginning in 2008.	Significantly, H.R. 4 does not require disclosure to participants of information provided to the PBGC under section 4010.
LUMP SUMS	Statutory assumptions must be used in determining the minimum value of certain optional forms of payments, including lump sums. The applicable interest rate is the annual interest rate on 30-year Treasury securities. The applicable mortality table is a fixed blend of 50 percent of the male mortality rates and 50 percent of the female mortality rates from the 1994 Group Annuity Reserving Table.	The minimum value (i.e., the amount) of lump sums and certain other optional forms of payments would have to be calculated using interest rates derived from the modified yield curve (i.e., the segment rates). However, the interest rate used for the minimum value of lump sums would be a spot rate, not the smoothed rate used to measure liability. The mortality table would be developed by Treasury and based on the mortality table applicable for funding purposes (which would presumably be the table described in recently issued IRS proposed regulations). However, for this purpose, any substitute mortality table used by a plan would be inapplicable. <i>Effective Date:</i> The new interest rate would be phased in 20% per year over a 5-year period beginning in 2008. There is no phase in of the mortality table, although one may be provided in final regulations.	

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NQDC RESTRICTIONS	There are no specific restrictions on the establishment or funding of executive compensation under the DRC Rules or ERISA Rules. Income tax provisions under Code section 409A impose immediate taxation and a 20-percent penalty on an employee or independent contractor who benefits under a deferred compensation plan that does not meet specific statutory rules.	<p>Amends Code section 409A to provide for immediate taxation and the 20-percent penalty if any asset is set aside in a trust (or other arrangement as determined by Treasury) for purposes of paying nonqualified deferred compensation (“NQDC”) to any “covered employee” of a publicly-held company while (i) any pension plan of the employer or an affiliate is considered at-risk, (ii) a pension plan of the sponsor is in a bankruptcy reorganization, or (iii) during the period starting 18 months prior to termination of any underfunded pension plan of the employer or an affiliate. The prohibited set aside of assets would include transfers of vested benefits to a rabbi trust.</p> <p><i>Covered employees.</i> The Code section 409A taxation and penalty would apply for any prohibited transfers for a current or former employee who is or has been (i) one of the “top five” officers for purposes of Code section 162(m) whose compensation was reported on the employer’s proxy statement or (ii) one of the Rule 16 officers (i.e., insiders whose equity compensation is subject to short-swing profit rules.)</p> <p><i>Tax gross-ups.</i> The income inclusion and 20-percent penalty also would apply to any gross-up payment attributable to taxes and penalties assessed as a result of the NQDC restriction and deny the employer a deduction for such gross-up payment.</p> <p><i>Effective Date:</i> Would apply to transfers made after the date of enactment. Note, however, that a plan cannot be considered at-risk prior to plan years beginning in 2008.</p>	<p>Unlike the House and Senate bill, H.R. 4 clarifies that the restrictions do not apply to amounts contributed to a rabbi trust prior to the date the plan becomes at-risk.</p> <p>H.R. 4 also defines covered employee more narrowly to include only senior executives and insiders in contrast to the House bill, which applied the restrictions to all employees who had an NQDC benefit.</p>
MULTIEMPLOYER PENSION FUNDING	Very generally, multiemployer plans are subject to funding rules that are analogous to the ERISA funding rules that apply to single-employer plans. In this regard, liabilities are amortized over a variety of periods and the plan’s actuary generally determines the applicable actuarial assumptions. Additional	Preserves the basic funding methodology that applies to multiemployer plans, but shortens the amortization periods for certain liabilities. Requires the adoption of a funding improvement plan in the case of a multiemployer plan in “endangered status” and a rehabilitation plan in the case of a multiemployer plan	

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	contributions may be required if a multiemployer plan is in reorganization status or is insolvent.	<p>in “critical status.” Endangered or critical status depends on various funding thresholds and the solvency of the plan. Very generally, endangered or critical status results in increased contributions, but, in the case of a plan in critical status, may also involve reductions to previously earned non-core benefits. Also makes changes in the deduction limits applicable to multiemployer plans.</p> <p><i>Effective Date:</i> Plan years beginning in 2008. Certain provisions sunset at the end of 2014.</p>	
HYBRID PLANS			
BASIC DESIGN	The Internal Revenue Code, Employee Retirement Income Security Act and the Age Discrimination in Employment Act provide that a defined benefit plan is age discriminatory if the rate of a participant’s benefit accrual declines on account of age. With the exception of limited regulatory guidance, current law does not include specific rules governing hybrid plans, such as cash balance and pension equity plans (PEPs). Instead, hybrid plans are subject to the rules generally applicable to defined benefit plans.	<p>Amends the Code, ERISA and the ADEA to provide that defined benefit plans are not age discriminatory if, as of any date, a participant’s accrued benefit, determined under plan terms, would be equal to the accrued benefit of any similarly situated, younger individual. As a result, cash balance plans are not age discriminatory so long as pay and annual interest credits for older workers are not less than pay and annual interest credits for younger workers and interest credits are not greater than a market rate of return.</p> <p>The bill makes clear that benefits are to be measured on an “accrued to date” basis (rather than an annual basis).</p> <p><i>Treatment of Existing Plans.</i> Effective June 29, 2005 on a prospective basis. Provides that the changes should not be construed to create an inference with respect to the status of plans under the law prior to enactment.</p>	<p>Because H.R. 4 applies to all defined benefit plans, its age discrimination clarification applies to cash balance plans, pension equity plans (“PEPs”), and other hybrid plans.</p> <p>It is likely that the pension negotiators intended the “no inference” statutory language to be accompanied by more detailed legislative history but since the House passed a new pension bill rather than a conference report the new House bill did not have accompanying legislative history.</p>

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BEYOND HYBRIDS	Some have suggested that certain other plan designs that incorporate a time value of money feature may run afoul of the pension age discrimination rules. In this regard, for example, questions have arisen about the legality of certain offset plans, plans that provide for pre-retirement indexing of benefits, and contributory plans.	Provides that any offset permitted under the tax laws and any offset for Social Security are not age discriminatory. Also indicates that indexing accrued benefits cannot be age discriminatory, provided that the indexing cannot result in a loss of accrued benefits (except in the case of a benefit provided in the form of a variable annuity). <i>Effective Date:</i> Effective for periods after June 29, 2005.	
LUMP SUMS & WHIPSAW	The IRS takes the position that in calculating the amount of a single sum distribution under a cash balance plan, the balance of a participant's account balance must be projected to normal retirement age using the plan's interest crediting rate and then discounted back to present value using the statutorily prescribed interest rate. If the rate used to project exceeds the discount rate, the plan generally must pay more than the account balance. This is often referred to as "whipsaw."	Permissible to pay account balances so long as plan does not provide interest credits in excess of a market rate of return. <i>Effective Date:</i> Applies to distributions after the date of enactment. Provides that the changes should not be construed to create an inference with respect to whipsaw under the law prior to enactment.	Significantly, the bill applies to distributions, and not benefits accrued, after the date of enactment.
INTEREST CREDITS	The whipsaw rules for lump sums generally limit interest crediting rates. In addition, there have been questions about interest crediting rates that may fall below zero.	As mentioned above, conditions the age discrimination rules for cash balance plans on crediting interest at a market rate. Provides special rules for minimum guaranteed rates of return, returns equal to the greater of a fixed and variable rate, and interest rates that may fall below zero on an annual basis so that such rates are considered market rates of return. Prohibits interest rates that cause a decline in the accrued benefit, determined on a cumulative basis. <i>Effective Date:</i> For existing plans, effective for years beginning in 2008, subject to a delay for collectively-bargained plans.	Directs Treasury to address issues related to the market interest rate requirement. A key issue will be the extent to which minimums, floors, and "greater of" interest crediting will limit or impact the maximum interest crediting. The prohibition against cumulative negative crediting rates will make it more difficult for cash balance plans to offer equity rates of return.
VESTING	Participants must have a nonforfeitable right to 100% of their accrued benefit according to either a 5 or 7 year vesting schedule (100% after 5 years or 20% for	Would require vesting for cash balance plans and pension equity plans after 3 years. No option of graded vesting.	3-year vesting is a general requirement for cash balance and pension equity

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	each year of service after 3 years of service).	<p><i>Effective Date:</i> For existing plans, effective for years beginning in 2008, subject to a delay for collectively-bargained plans.</p>	<p>plans. It is not solely a condition of whipsaw relief.</p> <p>It is unclear whether the new vesting rule would apply to pay credits that have already accrued or only to credits after the effective date.</p>
CONVERSIONS AND MANDATES	Current law does not expressly address conversions but does require advance notice of any reduction in the rate of benefit accrual and protection of accrued benefits for services already performed.	<p>No wear-away of early or normal retirement benefits in any conversion to a cash balance or pension equity plan.</p> <p>The accrued benefit as of the date of the conversion cannot be less valuable than the sum of the accrued benefit under the pre-conversion plan terms plus the accrued benefit under the new hybrid formula.</p> <p><i>Pop-Up.</i> Any early retirement subsidy under the pre-conversion formula must be credited to the new account balance if a participant terminates and becomes eligible for the subsidy.</p> <p><i>Effective Date:</i> Effective for conversions adopted after, and taking effect after, June 29, 2005. Provides that no inference should be made as to conversions prior to the effective date.</p>	<p>The no wear-away requirements are strictly limited to conversions to cash balance and pension equity plans. This is not a blanket prohibition against wear-away.</p> <p>H.R. 2830 included a parenthetical that appeared to bless the inclusion of transition credits as a permanent part of opening account balances to reflect all or a part of the value of early retirement subsidies. This parenthetical was not included in H.R. 4, raising questions about whether such a practice could be considered age discriminatory.</p> <p>Although not entirely clear, the pop-up provision appears to apply only if the opening account balance in a conversion reflects the value of benefits accrued under the pre-conversion</p>

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			formula. If so, the bill would require that the early retirement subsidy be reflected in the account when earned.
PERMANENCE OF RETIREMENT SAVINGS INCENTIVES			
IRAS AND RETIREMENT PLANS	<p>The Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”) made numerous changes affecting retirement plans and IRAs. These provisions sunset (<i>i.e.</i>, expire) after 2010.</p> <p>The provisions affected by the EGTRRA sunset include changes that expanded the contribution limits for IRAs and retirement plans and created catch-up contributions for those age 50 and older. The EGTRRA sunset also affects a host of other important provisions, including creating Roth 401(k) plans and providing incentives for small businesses to offer pension plans.</p>	<p>Makes permanent the provisions of EGTRRA that relate to retirement plans and IRAs.</p> <p>Effective after 2006, indexes the dollar limits for IRA contributions for inflation.</p>	
SAVER’S CREDIT	<p>The Saver’s Credit is a non-refundable tax credit available to eligible taxpayers that satisfy certain AGI limits and make contributions to a defined contribution plan or IRA. The Saver’s Credit is scheduled to expire at the end of 2006.</p>	<p>Makes the Saver’s Credit permanent.</p> <p>Effective after 2006, indexes the Saver’s Credit income limits for inflation.</p>	
529 COLLEGE TUITION PLANS	<p>EGTRRA made a number of changes affecting college tuition programs described in Code section 529. These provisions sunset (<i>i.e.</i>, expire) after 2010.</p>	<p>Makes permanent the provisions of EGTRRA that relate to section 529 college tuition programs and provides Treasury with new regulatory authority to combat abuse.</p>	
AUTOMATIC ENROLLMENT AND DEFAULT INVESTMENTS			
AUTOMATIC ENROLLMENT SAFE HARBOR	<p>401(k) plans generally must satisfy nondiscrimination tests that compare the actual deferral percentages (the “ADP”) of highly compensated employees (“HCEs”) to the deferral percentages of non-highly compensated employees (“NHCEs”). In addition, 401(k) plans that provide for matching or after-tax employee contributions must satisfy the ACP test, which compares the rate at which HCEs receive</p>	<p>Provides an additional nondiscrimination safe harbor for plans with an automatic enrollment feature (whereby an employee is treated as having elected to make salary reduction contributions at a stated level unless the employee affirmatively elects otherwise). Plans that satisfy the automatic enrollment safe harbor (1) would be deemed to satisfy the ADP and ACP tests (with respect to matching contributions),</p>	<p>The automatic enrollment requirements apply to all employees, including HCEs.</p> <p>Although not referenced explicitly, section 403(b) plans would be eligible for</p>

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	<p>matching contributions (and make after-tax employee contributions) to the rate at which NHCEs receive matching contributions. 401(k) plans are also subject to certain requirements that ensure that owners and key employees do not disproportionately benefit under the plan, called “top-heavy rules.” A 401(k) plan that satisfies certain contribution, notice and vesting requirements (a “safe harbor plan”) is deemed to satisfy these requirements (other than with respect to after-tax employee contributions).</p>	<p>and (2) would not be subject to the top-heavy plan rules.</p> <p>Requires that unless an employee elects otherwise, the employee is treated as making an election to defer equal to a percentage of compensation not in excess of 10%. The default rate must be at least equal to the following percentages of compensation:</p> <p>3% -- first year of participation 4% -- second year 5% -- third year 6% -- fourth year and thereafter.</p> <p><i>Treatment of Existing Employees.</i> Current employees on the date the arrangement is implemented would be exempt from the automatic enrollment requirements if they have made a deferral election (including an election not to participate).</p> <p><i>Matching or Nonelective Contributions.</i> To satisfy the terms of the automatic enrollment safe harbor, an employer generally must make either (i) a nonelective contribution of at least 3% of compensation on behalf of all eligible NHCEs, or (ii) (a) a 100% match on non-HCE elective contributions up to 1% plus (b) a 50% match on non-HCE elective contributions that exceed 1% up to 6% of compensation (or a permitted equivalent).</p> <p><i>Vesting.</i> Unlike the current law safe harbor, employer contributions for purposes of the safe harbor must be vested within 2 years.</p> <p><i>Notice.</i> Same basic annual notice that applies to safe harbor plans also required for automatic enrollment safe harbor plans.</p> <p><i>Effective Date:</i> Plan years beginning after 2007.</p>	<p>the safe harbor with respect to matching contributions, as under the current law safe harbor.</p> <p>Although existing employees would be exempt under the House bill, a plan could elect to apply a new automatic enrollment program to such employees.</p>

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CORRECTIVE DISTRIBUTIONS AND EXCESS CONTRIBUTIONS	With limited exceptions, current law rules prohibit in-service distributions from 401(k) plans and 403(b) arrangements for amounts attributable to elective deferrals. One exception is for excess contributions that are distributed from a qualified cash or deferred arrangement within 2½ months after the end of the plan year. In such a case, the 10% penalty tax on early distributions is inapplicable.	Plans with an automatic enrollment feature that meet certain requirements (including providing an annual notice) may allow employees to elect during the first 3 months after the start of automatic contributions to receive a corrective distribution in an amount equal to the automatic elective contributions (plus earnings). Corrective distributions are taxed in the year paid, disregarded in applying the ADP test, and exempt from the 10% penalty tax. Also provides that corrective distributions (as well as distributions of excess contributions) made from a plan with a qualifying automatic enrollment feature may be distributed within 6 months after the end of the plan year. Applies to 401(k) and 403(b) plans, and governmental 457(b) plans. <i>Effective Date:</i> Plan years beginning after 2007.	The corrective distribution rules allow plans to pay out small amounts (at the election of an employee) that were contributed in connection with an automatic enrollment arrangement before the employee took advantage of the opportunity to opt out.
DEFAULT INVESTMENTS	ERISA section 404(c) provides that where a participant or beneficiary exercises control over the assets in their individual account, no person who is otherwise a fiduciary shall be liable for any loss or breach resulting from the participant or beneficiary's exercise of control. Department of Labor regulations condition "404(c) relief" upon satisfaction of a number of regulatory requirements, including notice and disclosure requirements. Section 404(c) does not provide relief from fiduciary responsibility for the selection (and ongoing monitoring) of investment choices made available under a plan but only from the direct results of investment decisions.	Directs the Secretary of Labor to issue final regulations, no later than 6 months after the date of enactment, which provide safe harbor guidance on the appropriateness of designating default investments that include "a mix of asset classes consistent with capital preservation or long-term capital appreciation, or a blend of both." Provides that a participant shall be treated as having elected to have the plan sponsor exercise control over assets in his or her individual account until the participant specifically elects to exercise control (<i>i.e.</i> , provides 404(c) relief), where contributions are invested in accordance with prescribed regulations and each participant (1) receives, within a reasonable period of time before each plan year, a notice explaining the employee's right under the plan to make investment elections, (2) has a reasonable period after the receipt of notice and before the beginning of the year to make an election, and (3)	The direction to issue guidance is not specific to automatic enrollment arrangements, although it most frequently arises in that context.

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ERISA PREEMPTION	Some have expressed concern that automatic enrollment may violate state garnishment laws because employees' wages are withheld without the affirmative consent of the employee.	<p>receives a notification explaining how contributions made under the arrangement will be invested in the absence of an election.</p> <p>Preempts any state law that would prohibit or restrict the inclusion of an automatic enrollment feature, provided that the plan provides notice to affected employees within a reasonable period before each year, including an explanation of (1) an employee's right to opt out of the automatic enrollment feature and (2) how contributions made under the arrangement will be invested.</p> <p><i>Effective Date:</i> Date of enactment.</p>	<p>Preemption of state garnishment laws is limited to plans that are covered by ERISA.</p> <p>Unlike traditional preemption, this preemption would be conditioned upon an annual notice requirement.</p>
INVESTMENT ADVICE			
IRAS AND EMPLOYMENT-BASED PLANS	<p>IRAs and employment-based plans are generally subject to provisions that preclude a "prohibited transaction" ("PT") between the plan and parties in interest. These provisions make it difficult for an entity to provide investment advice to an IRA owner or a plan participant or beneficiary if such advice could cause the adviser or any affiliate to receive additional compensation.</p> <p>IRAs are subject to the PT rules in the Code and are not subject to ERISA. Employment-based plans, however, are subject to the PT rules as defined in both ERISA and the Code.</p> <p>Under current law, managed account programs allow plan fiduciaries to provide investment advice through the use of computer programs developed by an independent third party. These programs were first explicitly blessed by the DOL in Advisory Opinion 2001-09A (the "SunAmerica Opinion").</p>	<p><i>Two New Exemptions.</i> Two new PT exemptions – a compensation-based exemption and a computer-based model exemption – would be provided under ERISA and the Code for the provision of investment advice and the acquisition or sale of securities in connection with such advice. As discussed below, however, the computer-based model would be available for IRAs only after study and approval by the DOL.</p> <p><i>General requirements.</i> The fiduciary of an employment-based plan would have to select and approve the investment adviser. In all cases, the adviser would be required to undergo independent audits to ensure compliance with the PT exemptions and make certain detailed disclosures to the advisee, including disclosure that the adviser is acting as a fiduciary, disclosure of all parties who have a role in developing the advice, and disclosure of all parties' compensation in connection with the advice or the sale and purchase of securities in connection with the advice. The adviser also would be required to render advice in a format designed to be reasonably understood by the average investor (subject to a DOL-provided model format), update the advice for no</p>	<p>In addition to ERISA protections, plan participants would have recourse under Federal securities laws, banking laws and State insurance laws governing the behavior of regulated entities.</p> <p><i>Compensation-Based Exemption.</i> There are numerous questions about the scope and application of the compensation-based exemption.</p> <p><i>Computer-Based Exemption.</i> The new exemption would permit plan fiduciaries to develop the computer programs, subject to audit by an independent third-party.</p>

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		<p>additional charge upon a material change and update the advice at least annually. All compensation for any purchase or sale in connection with the advice would have to meet a “reasonable compensation” standard and be rendered under terms that are at least as favorable as any other arms length transaction in which the adviser or an affiliate is compensated for similar purchases or sales of securities.</p> <p><i>“Fiduciary adviser.”</i> The advice would have to be provided by a “fiduciary adviser,” which includes, among others, a registered broker-dealer or investment adviser, a bank or similar financial institution, or an insurance company. The adviser is defined to include all affiliates of the fiduciary adviser.</p> <p><i>Compensation-Based Exemption.</i> This PT exemption requires that the direct or indirect receipt of compensation by the adviser not vary based on any investment decision pursuant to the investment advice.</p> <p><i>Computer-Based Exemption.</i> An additional exemption would be available for advice based on a computer model that provides specific investment advice. The exemption would cover the same transactions covered by the compensation-based exemption. In order to fall within the exemption, very generally, (1) the computer model must satisfy certain parameters, including taking into account all investment options under the plan and applying generally accepted investment theories taking into account the participant’s age, life expectancy, risk tolerance, and other assets; (2) the computer model must not be biased in favor of investments offered by the adviser or its affiliates; (3) an independent investment expert certifies that the model is appropriate; and (4) the only investment advice provided under the program is provided by the computer model.</p>	<p>Unlike the SunAmerica Opinion, the new exemption would explicitly depend on the model taking into account all investment options that are available under the plan, including the options of unaffiliated entities and company stock.</p>

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		<p><i>Study of Feasibility of Computer-Based Exemption for IRAs.</i> The Department of Labor would be directed to conduct a study on the feasibility of extending to IRAs the computer model-based class exemption for employment-based plans, discussed above. The study be would be provided to the key House and Senate pension committees by December 31, 2007. If the Department determines that it is feasible to extend the computer model-based exemption to IRAs, the exemption would become effective for IRAs. If it is determined that it is not feasible, the Department of Labor would be required to issue a new class exemption for advice with respect to IRAs (conditions to be determined).</p> <p><i>Effective Date:</i> Applies to investment advice provided after 2006.</p>	
FIDUCIARY RESPONSIBILITY IN SELECTING AN INVESTMENT ADVISER	<p>Current law fiduciary rules require that a plan sponsor act prudently in the selection of a provider of investment advice, and continue to monitor and otherwise engage in periodic review of the provider.</p>	<p>A plan fiduciary (usually the plan sponsor) would not be treated as failing to meet the fiduciary duty requirements of ERISA by arranging for the provision of investment advice if (1) the advice is provided by a permitted fiduciary adviser (as defined for purposes of the investment advice exemption); (2) the terms of the arrangement require the fiduciary adviser to comply with the requirements applicable to the investment advice exemption, discussed above; and (3) the terms of the arrangement require the adviser to specifically acknowledge in writing that it is a fiduciary of the plan with respect to the provision of the advice.</p> <p><i>Effective Date:</i> Applies to investment advice provided after 2006.</p>	<p>The plan sponsor (or other plan fiduciary) would still be subject to general fiduciary requirements on the prudent selection and periodic review of a fiduciary adviser. The plan sponsor would not, however, have a duty to monitor the specific advice given by the fiduciary adviser to any particular recipient of the advice.</p>
DIVERSIFICATION RIGHTS			
INVESTMENT RIGHTS	<p>The Internal Revenue Code and ERISA impose few restrictions on the investment of defined contribution plan assets in employer securities. The Code does not</p>	<p><i>Elective Deferrals.</i> Diversification rights must be immediate with respect to employee contributions and elective deferrals.</p>	<p>Under the bill, the 3-year transition rule applicable to existing amounts invested</p>

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	<p>impose any restrictions on plans other than employee stock ownership plans (“ESOPs”), which must permit participants who have attained age 55 and have 10 years of participation in the plan to diversify the investment of a portion of their accounts in assets other than employer securities. ERISA limits the ability of defined contribution plans to require that more than 10% of elective deferrals be invested in employer stock. However, a number of exceptions apply to the 10% limitation, including an exception for a plan that is an ESOP. In addition, contributions other than elective deferrals are not subject to any restrictions.</p>	<p><i>Matching and Nonelective Contributions.</i> With respect to amounts attributable to matching and nonelective contributions, participants must be allowed to divest themselves of any employer securities upon completion of 3 years of service.</p> <p><i>Alternative Investments.</i> Where diversification rights are required to be available, the plan must offer at least 3 diversified investment options to the participant.</p> <p><i>Exceptions.</i> Exceptions are provided for privately held companies, stand-alone ESOPs and one-participant plans.</p> <p><i>Effective Date:</i> Subject to a special effective date for collectively bargained plans, the proposal generally would be effective for plan years beginning in 2007. For existing amounts attributable to nonelective and matching contributions, other than amounts held in employer stock by individuals aged 55 or over with at least 3 years of service, the diversification requirements would be phased-in ratably over 3 years (i.e., 33% first year, 66% second year, 100% third year).</p> <p><i>Notice of Right to Diversify.</i> Effective in 2007, but no sooner than 90 days after enactment, a notice would be required no later than 30 days before first date an individual is eligible to diversify.</p>	<p>in employer stock does not apply to amounts attributable to employee contributions or elective deferrals.</p> <p>Note also that the option of 3-year rolling vesting that was included in H.R. 2830 was not included in H.R. 4.</p>
<p>PERIODIC BENEFIT STATEMENTS</p>	<p>Plan administrators must furnish a benefit statement to any participant or beneficiary who makes a written request. A plan administrator is only required to provide one statement to a participant or beneficiary within a single 12-month period. A benefit statement must indicate the following:</p> <ul style="list-style-type: none"> ▪ The total accrued benefit; and 	<p>Participants in defined contribution plans subject to ERISA (other than stand-alone ESOPs) who have the right to direct their investments would have to be given quarterly benefits statements. Participants also would have to be advised of the risk of holding more than 20 percent in the security of any single entity.</p> <p>Participants who do not have the right to direct their</p>	<p>The annual investment education requirement that was included in S. 1783 was dropped.</p>

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	<ul style="list-style-type: none"> ▪ The vested accrued benefit or the earliest date on which the accrued benefit will become vested. 	<p>investments would have to be given the benefits statement annually.</p> <p>In the case of defined benefit plans, the statement would be required to be given every 3 years (and upon request), with an alternative option to provide annual notice of the availability of a benefits statement in lieu of providing it every 3 years.</p> <p><i>Effective Date:</i> Plan years beginning in 2007, subject to a delay for collectively-bargained plans.</p>	
PORTABILITY			
FASTER VESTING OF EMPLOYER NONELECTIVE CONTRIBUTIONS	<p><i>Nonelective Contributions:</i> Present law requires that participants have a nonforfeitable right to 100% of their accrued benefit according to either a 5 or 7 year vesting schedule (100% after 5 years or 20% for each year of service after 3 years of service).</p> <p><i>Matching Contributions:</i> Present law rules require that a participant have a nonforfeitable right to 100% of employer matching contributions after 3 years of service or a nonforfeitable right to 20% of employer matching contributions for each year of service beginning with the participant's second year of service and ending with 100% after 6 years of service.</p>	<p>Participants would have a nonforfeitable right to employer nonelective contributions to a defined contribution plan after 3 years of service or a nonforfeitable right to 20% of employer matching contributions for each year of service beginning with the participant's second year of service and ending after 6 years of service.</p> <p><i>Effective Date:</i> Subject to a special effective date for collectively bargained plans, the proposal generally would be effective for contributions made in plan years beginning after 2006 for employees with at least 1 hour of service after such effective date.</p>	<p>Conforms rule for nonelective contributions to the vesting rule in effect for matching contributions.</p> <p>The accelerated vesting schedule for employer contributions would not apply to "old money." The provision would only apply to contributions for plan years beginning after the effective date.</p>
ROLLOVERS BY NONSPOUSE BENEFICIARIES	<p>When a retirement plan participant dies, employer sponsored retirement plans typically provide that remaining plan benefits must be distributed promptly in a lump sum. Surviving spouses are eligible to roll that distribution into an IRA or other eligible retirement plan. Non-spouse beneficiaries, however, are not permitted to roll over such distributions and can be forced to receive plan benefits immediately and incur an immediate tax liability. This problem does not exist if retirement assets are held in an IRA at the time of death because IRA non-spouse beneficiaries may maintain the inherited IRA and</p>	<p>Provides that the benefits received by a non-spouse beneficiary from a retirement plan may be directly transferred to an IRA. The IRA is then treated as an inherited IRA and benefits must be distributed in accordance with the minimum distribution rules that apply to inherited IRAs. The provision applies to amounts payable to a non-spouse beneficiary under a qualified retirement plan, governmental section 457(b) plan, or a 403(b) annuity.</p> <p><i>Effective Date:</i> Distributions after December 31, 2006.</p>	<p>This provision effectively provides for parity between retirement benefits inherited by a non-spouse through a retirement plan and through an IRA.</p>

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	receive distributions in accordance with the minimum distribution rules (generally within 5 years or over the life expectancy of the beneficiary).		
COVERAGE EXPANSION			
TRIBAL PLANS	Under current law, there has been some uncertainty regarding whether plans sponsored by Indian tribal governments are governmental plans. In particular, the treatment of tribal plans under section 457 has been unclear.	Expands the definition of a governmental plan to explicitly include plans maintained by an Indian tribal government or an agency or instrumentality of such government, provided that substantially all of the participants are employees who perform services in essential government functions and not in the performance of commercial activities (whether or not a governmental function). <i>Effective Date:</i> Any year beginning on or after the date of the enactment.	This provision will exempt tribal plans from a number of the requirements that apply to tax-qualified plans. The provision does not address whether nonqualified deferred compensation arrangements maintained by Indian tribal governments are covered by section 457. The provision does, however, make it somewhat more difficult to argue that such plans are in fact covered by section 457. The governmental function requirement is likely to raise a number of difficult questions about what constitutes a governmental function.
DB/K PLANS	No special rules.	A combination defined benefit plan and 401(k) plan that meets certain requirements (a “DB/k”) (1) would be exempt from the top-heavy rules; (2) would be deemed to satisfy the ADP test for elective contributions and ACP test for matching contributions; (3) may be funded through a single trust; and (4) may file a single Form 5500. The DB portion of the DB/k would have to: (i)	

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		<p>provide a minimum benefit of 1% of final average compensation per year of service up to 20 years and (ii) provide for full vesting after 3 years. The 401(k) would have to: (i) provide matching contributions of 50% of at least 4% of pay; (ii) provide immediate vesting of matching contributions and satisfy other present-law rules for safe harbor contributions; and (iii) institute automatic enrollment up to 4% of pay.</p> <p>In lieu of a final average pay formula, a DB/k could provide a cash balance benefit that provides certain minimum benefits that depend on the age of a participant.</p> <p>A DB/k would only be available to employers with fewer than 500 employees when it is established.</p> <p><i>Effective Date:</i> Plan years beginning in 2010.</p>	
ERISA REFORMS			
MAPPING INVESTMENT OPTIONS	ERISA section 404(c) provides that where a participant or beneficiary exercises control over the assets in his or her individual account, no person who is otherwise a fiduciary shall be liable for any loss or breach resulting from the participant or beneficiary's exercise of control.	<p>Makes clear that the 404(c) safe harbor for plan fiduciaries applies to a "qualified change in investment options," whereby a participant's account is reallocated by the plan among one or more remaining or new investment options which are reasonably similar in characteristics, including risk and rate of return of the prior options, so long as the following requirements are met:</p> <ol style="list-style-type: none"> 1. At least 30 days and no more than 60 days prior to the change, notice is provided to participants and beneficiaries, including information about the existing and new investment options and an explanation that absent affirmative instructions to the contrary, the participant's account will be invested in the existing or new options; 2. The participant has not provided to the plan administrator an affirmative instruction to the 	Significantly, the new provision allows for mapping to both new and existing investment options.

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		<p>contrary; and</p> <p>3. The investment options chosen by the participant or beneficiary prior to the planned change are the product of the participant or beneficiary's control over the account assets.</p> <p><i>Effective Date:</i> Applies to plan years beginning in 2008, subject to a delay for collectively-bargained plans.</p>	
SAFEST AVAILABLE ANNUITY REQUIREMENT	<p>DOL Interpretive Bulletin 95-1 could be construed as requiring defined contribution plan sponsors that offer an annuity as an optional form of distribution to select the "safest available annuity." Concerns about how to comply with this standard have led many sponsors not to provide for an annuitized optional form of benefit.</p>	<p>Directs the Secretary of Labor, within 1 year after date of enactment, to issue final regulations clarifying that the selection of an annuity contract as an optional form of distribution from a defined contribution plan is not subject to the safest available annuity standard, but remains subject to otherwise applicable fiduciary requirements.</p>	<p>There was significant discussion regarding possible legislative history to add substance to the direction to Labor. However, as passed, H.R. 4 did not have legislative history.</p>
PLAN ASSET RULES	<p>Department of Labor regulations provide that when a plan has an equity interest in another entity, the plan's assets generally include the underlying assets of the other entity unless an exception applies. There are a number of different exceptions including exceptions for publicly offered securities and for entities where ownership by benefit plan investors is not significant. The exception where benefit plan investors are not "significant" generally applies if such investors own less than 25% of the value of each class of equity interest in the entity. For this purpose, the term "benefit plan investor" is defined to include, among others, governmental plans, church plans, foreign plans and Keogh plans covering only self-employed individuals.</p>	<p>Amends the definition of "benefit plan investor" to include only an employee benefit plan covered by ERISA or the PT provisions of the Code (<i>e.g.</i>, governmental, church and foreign plans are excluded).</p> <p>Disregards any equity interest that is held by a person who has discretionary authority or provides investment advice with respect to the assets of the entity.</p> <p>Also provides that an entity is considered to hold plan assets only to the extent of the percentage of the equity interest owned by benefit plan investors.</p> <p><i>Effective Date:</i> Date of enactment.</p>	<p>Did <u>not</u> expand the exception where benefit plan investors are not significant to exclude any entity if less than 50% of all of the equity interests are held by benefit plan investors. Threshold remains 25%.</p>

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SELF-CORRECTION PERIOD	ERISA and the Code do not provide for a self-correction period during which fiduciaries who become aware of a PT may self-correct and thus avoid a violation of the PT rules. Therefore, if a fiduciary or party in interest engages in a PT, they generally cannot “undo” the PT after the fact and thus remain subject to fiduciary liability and penalty taxes.	<p>Adds a new self-correction provision to ERISA and the Code that would permit certain transactions in connection with the acquisition, holding or disposition of any security or commodity to be corrected within a given period of time, generally 14 days after the fiduciary or party in interest discovered or reasonably should have discovered the error, and avoid a violation of the PT rules.</p> <p>The self-correction period does not apply to transactions involving the acquisition or sale of employer securities or employer real property. Also, self-correction is not available to fiduciaries or parties in interest that know that a transaction is a PT.</p> <p><i>Effective Date:</i> Date of enactment.</p>	
CROSS-TRADING	Purchases or sales between accounts of a single investment manager can raise prohibited transaction concerns.	<p>Exempts the purchase and sale of any security between a plan and any other account managed by the same investment manager if a number of conditions are satisfied that generally ensure that the purchase or sale is for market consideration.</p> <p><i>Effective Date:</i> Date of enactment.</p>	
DEFINITION OF AMOUNT INVOLVED	Section 502(i) of ERISA provides that the Secretary of Labor may assess a civil penalty against a party in interest that engages in a PT. The amount of the civil penalty is based on the “amount involved” in each PT for each year. The term “amount involved” generally means the amount of money and the fair market value of the other property given or received.	<p>Provides the following exceptions to the general definition of “amount involved”:</p> <ul style="list-style-type: none"> - Where the PT involves fees paid to a service provider, “amount involved” means only the amount in excess of reasonable compensation. - In the case of principal transactions involving securities or commodities, the “amount involved” means only the amount received by the disqualified person in excess of the amount such person would have received in an arm’s length transaction. <p><i>Effective Date:</i> Date of enactment.</p>	

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OTHER PT REFORMS	In some circumstances, the PT rules prevent plans from engaging in otherwise favorable financial transactions.	Includes a number of new statutory prohibited transaction exemptions, including exemptions that facilitate block trading, electronic or alternative trading systems, and foreign exchange transactions. The bill also provides bonding relief for brokers and dealers registered under section 15(b) of the 1934 Act. <i>Effective Date:</i> Date of enactment.	
MISCELLANEOUS CHANGES			
TAX-FREE IRA DISTRIBUTIONS FOR CHARITY	Minimum required distributions from IRAs are generally required following attainment of age 70½. Minimum required distributions that are paid directly to charities are nonetheless includible in gross income. While distributions that are paid directly to charities are potentially deductible, they are subject to certain income limits.	Allows IRA owners that have attained age 70½ to exclude IRA distributions up to \$100,000 from income if such distribution is made directly to a charitable organization and would otherwise be tax deductible (without regard to otherwise applicable income limits). <i>Effective Date:</i> Distributions in 2006 and 2007 with a sunset on December 31, 2007.	
PAYMENT OF HEALTH AND LTC PREMIUMS WITH GOVERNMENTAL PLAN ASSETS	There are no special rules that exclude from income distributions from qualified retirement plans to pay for qualifying health care or long-term care (“LTC”) coverage. Thus, distributions from qualified retirement plans are generally includible in the participant’s income for the year distributed. In addition, with limited exception, a distribution from a qualified retirement or annuity plan received before age 59 ½, death, or disability generally is subject to a 10-percent early withdrawal tax on the amount includible in income.	Provides that certain pension distributions from an eligible governmental retirement or annuity plan (i.e., grandfathered 401(k), 403(b) or 457 plan) that are used to pay for qualified health insurance or LTC premiums are excludible from income. Specifically, provides that an eligible retired public safety officer may, after separation from service as a result of disability or attainment of normal retirement age, elect to have amounts not yet distributed from a qualified governmental plan distributed directly to an insurer to pay for qualifying health care or LTC coverage. <i>Exclusion Limits:</i> Up to \$3,000 annually of the amount distributed is excludable from income to the extent it is used to purchase qualifying health care or long-term care coverage. <i>Effective Date:</i> The proposal is effective for distributions after 2006.	

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TRANSFERS OF EXCESS PENSION ASSETS FOR RETIREE HEALTH	<p>Defined benefit plan assets generally may not revert to an employer prior to termination of the plan. However, a plan may make a qualified transfer of excess assets to a separate account that is part of the plan to provide medical benefits to currently retired employees. In order to be a qualified transfer, the transfer must meet certain requirements, including a requirement that the retiree medical plan meet certain minimum cost requirements. Excess assets generally means the excess, if any, of the value of plan assets over 125% of the plan's current liability.</p>	<p>Would continue to permit a qualified transfer of excess amounts to a separate account in a pension plan to provide medical benefits to retired employees. For this purpose, excess assets generally would mean the excess, if any, of the value of plan assets reduced by credit balances over 125% of the plan's liability plus normal cost for the year. In valuing plan assets for this purpose, the lesser of fair market value or the smoothed value used for funding must be used.</p> <p>In addition, new retiree health transfer options would be created for "qualified future transfers" and "collectively bargained transfers" to provide medical benefits to future retired employees. Each new type of transfer would be subject to a series of requirements and would allow transfers at a reduced 120% threshold. However, if the plan's funded status subsequently fell below 120%, either the employer must bring the plan back to 120% funded or the assets in the account would be transferred back to the general assets of the plan to do the same. Special minimum cost requirements would apply.</p> <p><i>Effective Date:</i> Transfers after the date of enactment.</p> <p><i>Multiemployer Plans.</i> Retiree health transfers would also be allowed for multiemployer plans after 2006.</p>	
ANNUITY/LTC COMBINATION PRODUCTS, SECTION 1035 EXCHANGES, AND DAC CHANGES	<p>It is unclear whether long-term care (LTC) insurance riders to annuity contracts can be tax-qualified under section 7702B, although tax-qualified riders to life insurance contracts are permitted. Charges assessed against a life or annuity contract's cash value to fund a LTC rider are treated as distributions from the base contract.</p> <p>Section 1035 does not provide a tax-free exchange rule for LTC insurance, nor does it expressly address the effect of LTC riders on the tax-free exchange of a base contract.</p>	<p>Provides that LTC riders or other LTC coverage under an annuity contract is treated as a separate contract from the annuity, thus clarifying that such riders can be tax-qualified under section 7702B. Insurance benefits from such qualified LTC riders generally are excludible from income as accident & health benefits, including benefits that reduce the base contract's cash value. Charges assessed against a life or annuity contract's cash value to fund a qualified LTC rider are not includible in income, although they reduce the base contract's "investment in the contract."</p>	

ISSUE	CURRENT LAW	H.R. 4 ¹	COMMENTS
	<p>Under the deferred acquisition cost rules of section 848, annuity contracts are subject to a 1.75% rate, group life insurance contracts are subject to a 2.05% rate, and non-group life insurance contracts are subject to a 7.7% rate.</p>	<p>Section 1035 is amended to allow tax-free exchanges of qualified LTC insurance contracts, and extends exclusion provisions to other circumstances involving qualified LTC insurance contracts and riders.</p> <p>The deferred acquisition cost rules are amended to treat annuity and life insurance contracts with qualified LTC riders as specified insurance contracts subject to the 7.7% rate.</p> <p><i>Effective Date:</i> The above amendments apply to contracts issued after December 31, 1996, but only with respect to periods beginning after December 31, 2009. The amendments to section 1035 apply to exchanges after December 31, 2009.</p>	
<p>TREATMENT OF DEATH BENEFITS PAID FROM COLI</p>	<p>Section 101(a) generally provides an exclusion from income for amounts received by reason of the death of an insured under a life insurance contract.</p>	<p><i>General rule.</i> In the case of certain “employer-owned life insurance contracts,” the section 101(a) exclusion is limited to the amount of premiums and other consideration paid by the employer policyholder for the contract. There are two types of exceptions to this rule, provided certain notice and consent requirements are met.</p> <p><i>Exceptions based on the insured’s status.</i> The general rule does not apply where (a) the insured was an employee during the prior 12 months, or (b) at the time the contract was issued, the insured was a director or “highly compensated” employee or individual (generally including, for example, the 35% highest paid employees).</p> <p><i>Exceptions for amounts paid to insured’s heirs, etc.</i> The general rule does not apply to the extent that amounts are (a) paid to the insured’s family or designated beneficiary, certain trusts, or the estate of the insured, or (b) used to buy back stock or other equity type interests in the policyholder from the persons referred to in (a).</p>	

ISSUE	CURRENT LAW	H.R. 4 ¹	COMMENTS
		<p><i>Notice and consent requirements.</i> Before the contract is issued, the employee must (1) be notified in writing (a) that he/she will be insured, (b) of the maximum face amount at issuance, and (c) that the employer policyholder will be the beneficiary of the death benefit, and (2) provide written consent to being insured and that the such coverage may continue after the insured terminates employment.</p> <p><i>Definition of “employer-owned life insurance contract:</i> A life insurance contract is an employer-owned life insurance contract if it (a) is owned by a person engaged in a trade or business and under which that person (or a related person) is directly or indirectly a beneficiary, and (b) covers the life of an insured who is an employee with respect to the trade or business when the contract is issued. An employer-owned life insurance contract does not include a contract covering the life of a non-U.S. citizen or resident.</p> <p><i>Effective date.</i> The new rule applies to contracts issued after the date of enactment, except for a contract issued after such date in a “section 1035 exchange” for a contract issued prior to that date. A special rule exists for material changes to contracts.</p>	
CHARITABLE REFORMS	The Internal Revenue Code contains voluminous provisions regulating charitable giving and tax-exempt charitable organizations	Contains a series of reforms affecting charitable giving and charitable organizations.	
SELECT PROVISIONS OF H.R. 2830 AND S. 1783 THAT WERE <u>NOT</u> INCLUDED IN H.R. 4			
GOVERNMENTAL 401(K) PLANS	Except for certain plans grandfathered in 1986, state and local governments are not allowed to maintain 401(k) plans.	No provision	S. 1783 would have permitted state and local governments to maintain a 401(k) plan and provided for coordination of contribution limits with governmental 457 plans.

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TAX ON CERTAIN SIMPLE IRA DISTRIBUTIONS	A 25% penalty for early withdrawals from a SIMPLE IRA applies during a participant's first 2 years of participation.	No provision	S. 1783 would have provided that all early withdrawals from a SIMPLE IRA will be subject to the standard 10% penalty.
TRANSFERS OF INVOLUNTARY DISTRIBUTIONS TO THE PBGC	A plan is generally required to make an automatic rollover of an involuntary distribution that exceeds \$1,000 into an IRA, unless the participant affirmatively elects to receive the distribution directly or have the distribution transferred to an IRA or qualified plan.	No provision	S.1783 would have provided that a plan may provide for the transfer of an involuntary distribution that exceeds \$1,000 to the PBGC, instead of to an IRA.
QUALIFIED RETIREMENT PLANNING SERVICES	Certain employer-provided fringe benefits, including qualified retirement planning services provided to an employee and his or her spouse by an employer maintaining a qualified employer plan, are excludible from gross income and wages for employment tax purposes. However, where an employer provides a choice between cash and retirement planning services, employees who elect qualified retirement planning services are nonetheless taxable.	No provision	Both House and Senate bills included provisions to facilitate tax-preferred retirement planning advice, including advice purchased on a pre-tax basis through a payroll deduction arrangement.
SUBROGATION	It is not uncommon for the terms of a health plan to provide that plan beneficiaries must reimburse the plan for amounts paid for medical care to the extent the beneficiary recovers that amount from a third-party (e.g., the party who caused an injury). The Supreme Court has indicated that in some situations ERISA does not provide an action to enforce these plan terms.	No provision	H.R. 2830 would have clarified that ERISA provides an action by a plan fiduciary to enforce plan terms that create a right of recovery by reimbursement or subrogation with respect to benefits provided to participants and beneficiaries.
CARRY FORWARD OF UNUSED AMOUNTS IN A HEALTH FSA	Elective deferrals in a health flexible spending account ("HFSA") are subject to a use-it-or-lose-it rule. As a result of Code section 125's general prohibition against the deferral of benefits beyond the close of the plan year (including the claims run-out period), HFSA benefits which remain unclaimed as of the close of the plan year are forfeited by the	No provision	H.R. 2830 would have provided that up to \$500 of unused HFSA benefits (i.e., unreimbursed elective deferrals) are exempted from the use-it-or-lose-it rule and may be (1) carried

ISSUE	CURRENT LAW	H.R. 4 ¹	COMMENTS
	participant into the general assets of the employer and may not be returned to the participant.		forward into the HFSA for the succeeding plan year, or (2) contributed by the employer to a health savings account ("HSA") for the benefit of the employee.

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