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The National Employee Savings and Trust Equity Guarantee Act ("NESTEG")

(as favorably reported out of the Senate Finance Committee on 7/26/05)*

I. Single-Employer Plans

A. Minimum Funding Rules

In General: The bill is consistent with the funding reforms that were contained in both the Administration's funding proposal and H.R. 2830, the pension funding reform bill that was reported out of the House Education and the Workforce Committee on June 30th. Like them, this bill replaces the current funding rules with new funding rules. Generally, these new rules require contributions equal to the "target normal cost" of the plan for the plan year and require amortization of any underfunding over a 7-year period. This is substantially shorter than the current law normal funding rules; however, the deficit reduction contribution required for underfunded plans is eliminated. The target amount of funding is dependent on the financial status of the plan sponsor, with plans that are in "at-risk" status having a higher target liability.

Determination of Target Liability and Annual Contributions: Like the Education and the Workforce Committee bill and the Administration's proposal, the bill changes the current law concept of a funding standard account. Under the bill, if the plan's assets equal its "target liability," the required minimum contribution is equal to its "target normal cost." The target liability is equal to the present value of all benefit liabilities accrued to date. The target normal cost is equal to the present value of all benefits accrued or earned during the plan year, including increases in past service benefits attributable to increases in compensation. Other assumptions underlying the target liability and the target normal cost will change if the plan sponsor is financially weak (i.e., the plan's target liability would equal the plan's "at-risk target liability" and the target normal cost would be the "at-risk target normal cost"). (See below for a more detailed discussion of plans in "at-risk" status.) The concept of basing the target liability and the target normal cost on the financial status of the plan sponsor was not contained in the House Education and the Workforce Committee bill, but was part of the Administration's proposal.

In general, if the plan's assets exceed its target liability, the target normal cost is reduced by the excess, which in certain instances may cause the minimum required contribution to be zero. If, however, the plan's assets are less than its target liability, additional contributions are required to amortize that shortfall over 7 years (unlike current law where amortizations periods differ based on the source of the shortfall and could be as long as 30 years). There will be a year-by-year determination of shortfall amounts and the related amortization periods; consequently, there could be up to 7 different shortfalls being amortized at once. The IRS will still have the authority to issue funding waivers, with the waived amounts amortized in the 5 year period starting the year after the waiver is granted. If the value of the plan's assets (reduced by

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* This summary is based on the Joint Committee on Taxation's Description of the Chairman's Mark of the National Employee Savings and Trust Equity Guarantee Act – JCX-56-05 (July 22, 2005).

the prefunding balance, if any) equals or exceeds the plan's target liability, then all of the shortfall amortizations and funding waiver amortizations are cancelled.

The bill attempts to address the business community's concern about the volatility of required contributions by imposing a limitation on increases and decreases in required contributions. This rule would apply for plan years beginning after 2007. The maximum required contribution is the preceding year's minimum required contribution *plus* the greater of 30 percent of the plan's normal cost for the preceding year or 2 percent of the plan's target liability for the preceding year. The minimum required contribution is the preceding year's required contribution *minus* the greater of 30 percent of the plan's normal cost for the preceding year or 2 percent of the plan's target liability for the preceding year. This minimum required contribution for the preceding year is determined after the application of these limits for that year. Rules are also prescribed for contributions made after the valuation date and for the last scheduled payment of a series of amortization payments. In addition, this minimum does not apply to required payments due to costs attributable to benefit improvements for the current year.

Under the bill, the target liability will be equal to 100 percent of the plan's accrued liability. To ease the burden of meeting the 100 percent target liability, the bill phases in the funding requirement for the 2007 and 2008 plan years. In the 2007 plan year, the target liability is 93 percent of the accrued liability; in the 2008 plan year it is 96 percent. Thereafter the target liability is 100 percent. For small plans with 100 or fewer participants, the target liability is phased in ratably over 5 years. Under this phase-in, the target liabilities for these small plans are 92 percent of the plan's accrued liability in 2007, 94 percent in 2008, 96 percent in 2009, 98 percent in 2010 and 100 percent beginning in 2011.

<u>Special Funding Rule For Plans Maintained by Commercial Airlines</u>: A special funding rule applies for certain single employer defined benefit plans maintained by commercial passenger airlines. If the plan sponsor elects to have the rule apply, the minimum required funding contribution will be amortized over a 14-year period, rather than the 7-year period for other employers. In determining the present value of benefits for purposes of calculating the required funding contribution, the plan's interest rate will be used rather than the duration-matched interest rates from the yield curve (discussed below). In order for an airline to elect this special funding rule, the plan must freeze accruals on all benefits. If the plan terminates after the airline elects this funding rule, the PBGC guarantee provisions are applied as if the plan terminated on the first day of the plan year in which the special funding rule applied.

<u>Financially-Weak Plan Sponsors</u>: If a plan sponsor is "financially weak," and the plan's assets are not at least equal to an "applicable percentage" of the plan's target liability, the plan is considered "at risk" and the liability for that plan is determined assuming all employees will retire at the earliest retirement age and that they will elect the retirement benefit available under the plan that would result in the highest present value of liabilities. However, this at-risk liability can never be lower than the target normal cost or target liability determined without regard to these at-risk rules. The applicable percentage of the plan's target liability would be 93 percent for 2007, 96 percent for 2008, and 100 percent for 2009 and thereafter. Thus, even if a plan

sponsor is financially weak, if the plan's assets are at least equal to the applicable percentage, the plan would not be considered at-risk.

A plan sponsor is considered financially weak if, for a period of 3 consecutive years, (i) it has outstanding senior unsecured debt which has been rated as below investment grade by *each* of the nationally recognized credit rating agencies that has issued a credit rating; or (ii) if the plan sponsor does not have any outstanding senior unsecured debt that has been rated, but one or more of the credit rating agencies has issued a credit rating on the plan sponsor, all of the rating agencies that have rated the plan sponsor rated such sponsor as below investment grade. There is a special rule if the plan sponsor's credit rating goes up from one below investment grade rating to a better below investment grade rating from the same rating agency. Under the special rule, the year or years that such an improvement occurs (the "improvement period") is not taken into account in determining whether the sponsor is financially weak -- only the plan years immediately before and after the improvement period are treated as consecutive years. If there is no further improvement in subsequent years, the plan sponsor may return to being a financially-weak plan sponsor. There are phase-in rules for plan sponsors that are financially weak for less than 5 consecutive years, and special controlled group rules will apply for determining whether a sponsor is considered financially weak. In plans with fewer than 500 participants, the employer is not considered financially weak. In addition, these rules will not apply to a multiple employer plan where substantially all of the employers are rural electric or telephone cooperatives or are certain agricultural cooperatives. Finally, the Treasury Department is required to provide rules about how to determine if a plan sponsor is financially weak in those instances where a plan sponsor with 500 or more participants is not rated by any nationally recognized credit rating agency.

<u>Valuation Date</u>: Similar to the Administration's proposal, for purposes of determining annual funding amounts, all plans with more than 100 participants must use the first day of the plan year as the valuation date. Plans with 100 or fewer participants can continue to choose the valuation date.

<u>Interest Rates</u>: The bill requires that the interest rates used in determining the target liability (i.e., the present value of all benefit liabilities) be based on a yield curve of high-quality corporate bonds of varying maturities and the rates used be matched to the duration of the liabilities that are to be valued. The Treasury Department is to publish the yield curve on a monthly basis and the yield curve must be based on a 3-month average of the duration-matched rates. This new manner of calculating the present value of benefit liabilities will be phased in over 3 years. In the 2006 plan year, the current rules (a single, composite long-term corporate bond index rate based on a 4-year weighted average) will apply. For the 2007 plan year, the target liability will be based one-third on using the new yield curve method of determining the present value of benefit liabilities and two-thirds on using the current method of determining benefit liabilities. In the 2008 plan year, two-thirds of the target liability will be based on the present value of benefit liabilities using the yield curve methodology and one-third using current law. In the 2009 plan year, the new yield curve methodology must be used in determining benefit liabilities.

Mortality Tables: While no specific mortality table is prescribed (unlike the House Education and the Workforce Committee bill), Treasury is directed to prescribe a mortality table based on "the actual experience of pension plans and projected trends in such experience." Treasury is to review the mortality table at least once every five years and prescribe a new table if one is needed.

Determination of Asset Values: Plan assets must be valued at their fair market value as of the valuation date. A plan sponsor may also use an average of the values of assets for the 3 months prior to the plan's valuation date (the 80 percent to 120 percent corridor under current law would be repealed).

Prefunding Balances: One of the major concerns raised by employer groups regarding the Administration's proposal was the loss of the use of credit balances in determining annual funding amounts. This bill permits the use of a "prefunding balance" to satisfy minimum required contribution obligations. The prefunding balance is equal to the credit balance that was in the plan's funding standard account as of the end of the 2006 plan year (these new funding rules do not apply until the 2007 plan year). The prefunding balance will be increased by any contribution made to the plan in excess of the minimum required contribution for the year and will be reduced by the amount of the prefunding balance used to offset the minimum required contribution for the year. The prefunding balance must also be adjusted as of the valuation date to reflect the rate of gain or loss on the plan's underlying assets (i.e., marked to market) in accordance with Treasury regulations. In determining the amount of the minimum required contribution for a year, the value of the plan's assets must be reduced by the amount of the prefunding balance.

B. Benefit Restrictions Based on Funding

Like both the Administration's proposal and the House Education and the Workforce Committee bill, the proposal includes restrictions on increasing benefits, paying lump sums, and accruing new benefits if the plan falls below certain funded percentages.

Benefit Increases: In general, a plan sponsor cannot increase benefits if the plan is less than 80 percent funded (i.e., the ratio of the plan's assets compared to its target liability is less than 80 percent). A benefit increase occurs if the plan's liabilities increase, regardless of whether by a plan amendment, due to any (i) increase in benefits, (ii) change in the accrual of benefits, or (iii) change in the rate in which benefits become vested. Plan amendments required by the IRS as a condition of issuing a determination letter would not be prohibited. There are also exceptions for plans maintained pursuant to a collective bargaining agreement. An increase in benefits under a collectively bargained plan which does not base benefits on a participant's compensation may occur if the rate of the increase does not exceed the contemporaneous increase of average wages of plan participants. Also, the restrictions would not apply to benefit increases by reason of a collective bargaining agreement ratified before the limitation would apply and when the plan was at least 80 percent funded. This exception would only apply for the term of the collective bargaining agreement that provides such an increase or the date which is 3 years after the date the limitation would otherwise apply, whichever occurs earlier.

Benefit increases would be permitted if the plan sponsor made contributions (in addition to the minimum required contribution for the year) that would result in the plan being at least 80 percent funded. This limitation on benefit increases does not apply to a plan for the first 5 years the plan (or a predecessor plan) is in effect.

Benefit Payments: If a plan is less than 60 percent funded for the prior plan year, the plan is prohibited from making certain types of payments. In order for these benefit restrictions to cease, the plan actuary must certify that the plan is at least 60 percent funded in the current year or the plan sponsor must make sufficient contributions (or provide security, as described below) in order for the plan to be at least 60 percent funded. If the plan is not at least 60 percent funded by the end of the year, the restrictions continue until the plan has been at least 60 percent funded for 2 consecutive years. In addition, the failure to make contributions (or provide security) required to get the plan to at least 60 percent funded is treated as a failure to make a minimum required contribution for the year for purposes of the quarterly contribution rules, the excise tax, and the lien that is imposed on plans for failure to make the minimum required contribution. A plan sponsor may provide security in lieu of contributions, which the plan may foreclose on if (i) the plan sponsor fails to make any required minimum payment, (ii) after 7 years, or (iii) upon plan termination. Generally, the only benefit payments that can be made are in the form of a life annuity. Plan sponsors in bankruptcy whose plans are less than 100 percent funded will also be subject to these benefit payment restrictions, until the plan becomes 100 percent funded. In the event the plan is no longer subject to the prohibition on certain forms of distributions, the right to benefit payments is automatically restored, unless the plan provides otherwise. (Unlike the Administration's proposal and the House Education and the Workforce Committee bill, a plan amendment is not required to restore the right to payments.)

Benefit Accruals: A plan that is less than 60 percent funded for the prior year must cease all future benefit accruals. Generally, the rules applicable to the restrictions imposed on benefit payments (discussed above) will apply in the case of freezing future benefit accruals (i.e., the consequences flowing from (i) the plan failing to be at least 60 percent funded and (ii) failure to make the required contributions (or provide security) by the end of the current year; and the rules relating to the resumption of benefit accruals would apply). One of the modifications agreed to at the Finance Committee mark-up, however, eliminated the restrictions applicable to a plan sponsor in bankruptcy. For plans that are subject to a collective bargaining agreement that was ratified before the plan became less than 60 percent funded, the freeze on accruals would not apply until the date the collective bargaining agreement terminates, or 3 years after the freeze would otherwise apply, whichever occurs earlier. The restriction on benefit accruals does not apply to a plan for the first 5 years the plan (or a predecessor plan) is in effect.

Determining Funding Levels – Prefunding Balances: In determining the plan's funded percentage for purposes of the above restrictions, certain distributions for the preceding 2 years must be added back. In addition, plan assets do not have to be reduced by the prefunding balances in determining whether any of these restrictions will apply. However, prefunding balances cannot be used to satisfy any payment obligations required to lift any of these restrictions nor can any of these contributions be used to increase the prefunding balance.

Notice to Participants: The plan administrator must provide written notice to participants and beneficiaries of these limitations within a reasonable period of time before they will take effect, and must also provide them written, advance notice of the date the restrictions will cease.

Plant Shutdown and Unpredictable Contingent Event Benefits: Unlike the Administration's proposal and the House Education and the Workforce Committee's bill, the proposal does not prohibit pension plans from offering shutdown benefits and other unpredictable contingent event benefits. However, the PBGC's guaranty will apply as if the plan amendment adding the benefit was adopted at the time the shutdown or other contingent event occurred. Therefore, the current law 5-year phase-in of the PBGC guaranty will apply.

C. Multiemployer Plans

Unlike the bill approved by the House Education and the Workforce Committee, the Finance Committee bill does not contain comprehensive reforms to the funding rules applicable to multiemployer plans. In general, the bill does not change the multiemployer plan funding rules except to repeal the alternative minimum funding account rules and extend controlled-group liability for required contributions to multiemployer plans. In addition, the bill contains a few targeted reforms.

First, the bill increases the limit on deductions for contributions to multiemployer plans to an amount equal to the difference between 130 percent of the plan's current liability and the value of plan assets. In addition, the combined limit on deductions for contributions to combinations of defined benefit and defined contribution plans would be repealed with respect to multiemployer plans.

The bill also includes the multiemployer plan funding notice requirement that was added to ERISA (as part of the Pension Funding Equity Act of 2004) in the Internal Revenue Code, and imposes an excise tax of $100 per day per participant for failure to meet the notice requirement.

D. Increase in Deduction Limitations

For 2006, the bill would allow the deduction limitation to increase to an amount equal to the difference between 180 percent of the plan's current liability and the value of the plan's assets. For years after 2006, the maximum deductible amount is the greater of (i) the excess of the sum of the plan's target liability, the plan's target normal cost, and a "cushion amount," over the plan's assets and (ii) the minimum required contribution for the year. In addition, for plans that are not in the "at-risk" category, this calculation can be performed as if the plan was in "at-risk" status. The cushion amount is equal to the sum of 80 percent of the plan's target liability for the plan year and the amount by which the target liability would increase based on future compensation increases, or, for plans that do not base past service benefits on compensation, on expected increases in benefits (based off of the average of such benefit increases over the past 6 years).

Similar to the Education and the Workforce bill, for the 2006 plan year, the combined plan deduction limitation (i.e., the deductible limit for plan sponsors maintaining one or more defined benefit and defined contribution plan) would not apply to the extent contributions to one or more defined contribution plans does not exceed 6 percent of compensation. For years after 2006, generally, the combined deduction limitation will no longer apply.

E. Lump Sum Distributions

The bill changes the interest rate used to determine the value of lump sum distributions. Under current law, the applicable interest rate is the Treasury Department-determined rate of the interest on 30-year Treasury securities. Under the bill, the yield curve-based interest rates used for funding purposes also will be used to determine the lump sum distribution amount. However, the yield-curve method will be phased-in from 2007 to 2010, with distributions calculated, in part, based upon the Treasury Department-determined 30-year Treasury securities rate. The entire distribution would be calculated using the yield curve beginning in 2011. Special rules regarding plan amendments to effectuate this change, including relief from the anti-cutback rule, are also included.

F. Deferred Compensation Restrictions

The bill would impose certain restrictions with respect to nonqualified deferred compensation provided to the chief executive officer and the top four highest compensated officers of a company. The restrictions would apply (i) during the portion of the year in which a plan sponsor (a) is “financially weak” (as discussed above) and (b) maintains a plan that is 80 percent or less funded, (ii) when a plan sponsor is in bankruptcy, and (iii) during the 12-month period beginning on the date which is 6 months before plan termination if the plan’s assets are not sufficient to meet certain plan liabilities. Under the restrictions, a plan sponsor cannot directly or indirectly transfer assets or otherwise reserve assets in a trust (or other arrangement) for purposes of paying deferred compensation to the prohibited group. The bill description is not clear as to what it means to “reserve assets.” The bill requires that the plan administrator give notice to the nonqualified plan sponsor of the occurrence of the events which trigger these restrictions. The bill also includes various rights and remedies for enforcement of this provision, including a right of action by the Secretary of Labor to recover assets transferred or reserved in violation of these restrictions, together with attorney’s fees. Assets that are set aside or transferred during the restricted period generally will result in taxable income for the individual whose deferred compensation the assets are being used to reserve, along with an additional 20 percent tax applied to the amounts required to be included in income and interest at the underpayment rate plus 1 percent (i.e., the penalties imposed under Code section 409A would apply).

G. PBGC Premium Increases

Flat-rate premiums will increase from $19 per participant to $30 per participant starting in 2006, with indexing based on wage increases starting in 2007. The $9 per $1,000 of underfunding amount for the variable rate premium is not changed, but the manner in which that underfunding amount is to be calculated is changed to reflect the amount by which the plan is underfunded under the new funding rules. In addition, the bill repeals, starting in 2007, the current law rule under which no variable rate premium is required if contributions for the prior year were at least equal to the full funding limit.

H. PBGC Benefit Guaranty

The amount of PBGC guaranteed benefits is frozen once a plan sponsor enters bankruptcy. The plan sponsor is to notify the plan administrator when the plan sponsor enters bankruptcy. The plan administrator must notify plan participants and beneficiaries of the bankruptcy and its effect on benefit guarantees.

I. PBGC Premiums for Small and New Plans

For new plans of employers with 100 or fewer employees, the flat rate PBGC premium will be $5 per plan participant for the first five years of the plan's existence. There are rules to determine whether the plan sponsor is a small employer and whether the plan is a new plan. In addition, the variable rate premium for new plans would be phased in over the first 6 years of the establishment of the plan. Unlike the premium amount applicable to large plans, which is linked to a plan's underfunding, the variable rate premium for small plans (with less than 25 employees) is no more than $5 per plan participant.

J. Other PBGC-Related Provisions

The PBGC will be authorized to pay interest on premium overpayments in the same way that interest is calculated on the underpayment of PBGC premiums. The bill would also change the definition of "substantial owners" for purposes of determining the limitation on PBGC guarantees. Another provision deals with the determination of pension benefits based on recoveries from plan sponsors.

K. Disclosure Requirements

Actuarial and Summary Annual Reports: A plan's actuarial report and the summary annual report ("SAR") must include the plan's (i) fair market value of plan assets, (ii) target liability and target normal cost, and (iii) "at-risk" target liability and "at-risk" target normal cost. The SAR must also include (i) a statement of the plan's funded target liability percentage (i.e., the ratio of the plan's assets compared to its target liability) for the plan year and the 2 preceding plan years, (ii) a statement of whether the plan sponsor was financially weak over the same period, and (iii) the limits on benefits guaranteed by the PBGC if the plan is terminated while underfunded.

A plan making quarterly contributions must file an actuarial report no later than February 15th following the close of the plan year (for calendar year plans), and any subsequent contributions may be reflected in an amended actuarial report filed with the Form 5500. The SAR would be due 15 days after the filing date for the Form 5500 (i.e., August 15th).

Summary Actuarial Report: The bill would require plan sponsors to provide a "summary actuarial report" to participants that generally includes the same information provided in the actuarial report and the SAR. Similar to the SAR accelerated filing date, the report would be due 15 days after the filing date for the Form 5500. Failure to provide the report would generally result in an excise tax of $100 per day per participant, generally capped at $500,000.

II. Cash Balance and Hybrid Pension Plans

A. In General

The bill addresses issues relating to (i) the treatment of cash balance and hybrid pension plans under the age discrimination rules, (ii) the "whipsaw" problem, and (iii) requirements for cash balance plan conversions. The provisions apply on a prospective basis only. Significantly, the bill would (for the first time) define a "cash balance plan" as a defined benefit plan under which the accrued benefit is based on the balance of a hypothetical account determined by reference to annual pay credits and interest credits. Treasury would be directed to define other hybrid pension plans.

B. Age Discrimination

Under the proposal, a cash balance or hybrid pension plan would not violate the age discrimination rules merely because the interest credit applicable to a participant's hypothetical account each year applies over a longer period of time for a younger worker than for an older worker, provided the rate of pay or interest credit does not decrease on account of age.

C. Whipsaw

The bill also cures the whipsaw problem by permitting plan sponsors to use a "market rate" of return instead of the 30-year Treasury rate and still pay a lump sum benefit equal to the participant's account balance. Treasury would be directed to determine what constitutes a "market rate" of return, but the proposal stipulates that a plan's interest credit must generally be a rate not less than the applicable Federal mid-term interest rate. Treasury would provide alternatives to the use of this rate under certain circumstances (e.g., in the case of a pension equity plan where the interest credit may be based on a fixed rate of 3 percent).

D. Vesting

Benefits under a cash balance or hybrid plan must vest after 3 years of service.

E. Conversions

Significantly, in the event of a cash balance conversion (or similar hybrid plan conversion), a plan must meet one of the following requirements:

- The conversion cannot result in the wear-away of accrued benefits or early retirement subsidies and the plan must provide either:

    - all participants covered under the plan before the conversion with the greater of accruals under the old formula or new formula for at least 5 years after the conversion, or

    - participants who at the time of the conversion were at least age 40 and had combined age and service of at least 55 with (i) the greater of the benefits under the old formula or new formula, or (ii) a choice between benefits determined under the old or new formula; or

- After the conversion, the plan must provide all participants who were covered at the time of conversion with (i) the greater of the benefits determined under the old formula or new formula, or (ii) a choice between benefits determined under the old or new formula; or
- The plan sponsor must provide additional credits or additional opening account balances so as to provide benefits that would be substantially equal to either of the prior two alternatives, as determined under Treasury regulations.

F. DB/K Plans

The bill also provides for a new type of hybrid plan, which is the combination of a defined benefit plan and a 401(k) plan (the "DB/K Plan"). The defined benefit portion of the plan must provide a minimum benefit of 1 percent of final average compensation per year of service up to 20 years, without regard to whether the participant makes a contribution under the 401(k) portion of the plan. Benefits under the defined benefit portion of the plan must be fully vested within 3 years. The defined benefit portion of the plan is not subject to the top heavy rules. The 401(k) portion of the plan must provide for automatic enrollment at a rate of at least 4 percent of compensation and a matching fully-vested contribution equal to at least 50 percent of the employee's contribution up to 4 percent of compensation. The nondiscrimination rules for 401(k) plans will be deemed to be satisfied for these amounts. Contributions to the 401(k) plan (either higher matching contributions or after-tax contributions) and defined benefit accruals higher than the minimum benefit are permitted, subject to the applicable nondiscrimination rules.

III. Other Pension Reform Provisions

A. Diversification Requirements

Diversification Rights: In general, the bill imposes diversification requirements on a defined contribution plan holding publicly-traded employer securities (other than a "stand-alone ESOP"). More specifically, amounts attributable to elective deferrals and after-tax employee contributions could be diversified at all times, and amounts attributable to employer matching and employer nonelective contributions could be diversified after a participant completes 3 years of service. A 3-year transition rule would apply to amounts invested in employer securities acquired before the first year in which the new rules apply. In addition, plans would be required to provide at least 3 diversified investment options other than employer securities or employer real property. Other investment options generally offered under the plan must be available, and plans must allow diversification elections at least quarterly, on the same basis as the opportunity to make other investment changes, except as provided in regulations or by reason of securities laws.

Notice of Diversification Rights: The bill requires that the plan provide notice at least 30 days before the participant becomes eligible to diversify his or her investments, setting forth such right and describing the importance of diversifying investments.

B. Disclosure and Notice Requirements

Benefit Statements for Defined Contribution and Defined Benefit Plans: The bill requires defined contribution plans (other than one-participant plans) and tax-deferred annuities to provide quarterly benefit statements to participants with the right to direct investments, annual statements to other participants, and benefit statements upon written request (limited to one request per year). In addition, defined benefit plans would be required to furnish benefit statements every three years or annually furnish a notice of the availability of statements, or provide benefit statements upon written request (limited to one request per year).

Governmental and church plans are exempt from the notice requirements. Statements may be in electronic form if they are reasonably accessible, including through a secure plan website (if permitted in regulations). The DOL is directed to develop one or more model benefit statements. Failure to provide such statements would generally result in an excise tax of $100 per day per participant and a court-ordered civil penalty of $100 per day.

Blackout Notices: The bill amends the Code to include the blackout notice requirements added to ERISA by the Sarbanes-Oxley Act of 2002, and makes technical modifications to the requirements under ERISA. ERISA, as amended by the Sarbanes-Oxley Act of 2002, generally requires that advance notices of a blackout be given to plan participants. The bill adds similar requirements to the Code and revises the definition of "blackout period" to include a suspension, limitation, or restriction of any ability of participants to direct or diversify assets credited to their accounts, or to obtain loans or distributions from the plan, that is otherwise available under the plan, without regard to whether the ability is specifically provided for in the terms of the plan. Failure to provide notice would result in an excise tax of $100 per day per participant. The blackout notice requirements under the Code would not apply to governmental, church, or one-participant retirement plans.

Investment Education Notices: Defined contribution plans (other than governmental, church, and one-participant plans) and tax-deferred annuities would be required to annually provide a model form (as developed by Treasury in consultation with DOL) to participants and beneficiaries containing basic investment guidelines. The model form must also include addresses for Internet sites, and a worksheet that a participant or beneficiary may use to calculate certain amounts related to retirement savings. In addition, the DOL is required to develop an

Internet site to be used by individuals in calculating, among other things, their retirement income. The model form may be in electronic form if reasonably accessible.

Information Relating to Investment in Employer Securities: Plan administrators of defined contribution plans that permit participants to direct investments in employer securities would be required to provide participants with all reports, proxy statements, and other communications regarding investments in employer securities to the extent that such communications are required to be provided to investors under the securities laws. Such reports and statements may be provided in electronic form if reasonably accessible.

C. Investment Education

Investment Advice: The bill generally provides that neither an employer nor other plan fiduciary of a participant-directed individual account plan shall be liable under the general ERISA fiduciary rules with regard to investment advice provided by a "qualified investment adviser," so long as certain safe harbor requirements are satisfied in selecting the investment adviser and the investment adviser meets certain disclosure requirements. However, this does not provide relief from the prohibited transaction rules under the Code and ERISA, unlike the investment advice provisions contained in the House Education and the Workforce Committee bill.

Qualified Retirement Planning Services: Employers would be allowed to offer employees a choice between cash compensation and qualified retirement planning services provided by an "eligible investment adviser" on a pre-tax basis (capped at $1,000 per participant, per year).

D. Portability Provisions

Rollover of After-Tax Amounts: Rollovers of after-tax amounts through a direct rollover into defined contribution plans, defined benefit plans, and tax-deferred annuities would be permitted, but only if the plan or annuity separately accounts for such contributions and earnings thereon.

Rollovers by Nonspouse Beneficiaries: The bill provides for direct transfers by nonspouse beneficiaries from a qualified plan, tax-deferred annuity, or governmental 457 plan to an IRA, which is treated as an inherited IRA (i.e., not an IRA of the nonspouse beneficiary) for purposes of the minimum distribution rules.

Faster Vesting: All employer contributions to defined contribution plans (not just employer matching contributions) must vest under either a three-year cliff or six-year graded minimum vesting schedules.

Rollovers to Roth IRAs: The bill permits distributions from qualified plans, tax-deferred annuities, and governmental 457 plans to be rolled over directly to a Roth IRA, provided that the current law Roth IRA conversion rules are satisfied and any pre-tax contributions become currently taxable (but excluding the additional 10 percent penalty).

SIMPLE IRAs: The special 25 percent tax on early withdrawals from a SIMPLE IRA during the initial 2-year period of participation would be eliminated, and rollovers to and from SIMPLE IRAs and other eligible retirement plans (i.e., an IRA, 401(a), 403(b), or 457(b) plan) would also be permitted.

Automatic Rollovers: The bill establishes an alternative to the requirement that involuntary distributions that exceed $1,000 must be rolled over into an IRA in the absence of a participant election, by providing that a plan may transfer the distribution to the PBGC under an expanded version of the PBGC missing participant program, effective as of the date of the default rollover provisions.

Missing Participants: A PBGC missing participant program would be established for defined benefit multiemployer plans, and defined contribution plans that voluntarily elect to use the program.

No Reduction in Unemployment Compensation Upon Rollover: The bill provides that a rollover distribution does not constitute "the receipt of retirement benefits" which would trigger a reduction in unemployment compensation.

E. Miscellaneous

Additional IRA Contributions for Certain Employees: The bill includes a "rifle-shot" provision that would permit IRA catch-up contributions of up to $1,500 per year in 2005, and $3,000 per year in 2006-2009, to be made by certain 401(k) participants receiving at least a 50% matching contribution in the form of employer stock from an employer that later files for bankruptcy under specified circumstances. Effective for contributions made after December 31, 2004 and before January 1, 2010.

Updating EPCRS: Treasury would be directed to continuously update and improve EPCRS, and the bill clarifies that Treasury has authority to waive income, excise, or other taxes.

Notice and Consent Period Regarding Distributions: The notice and consent rules would be modified to extend the maximum time period for providing certain distribution notices from 90 days to 180 days before the distribution date.

Reporting Simplification: Treasury and the DOL would be directed to simplify the Form 5500 annual reporting rules for plans with fewer than 25 employees, and to exempt one-participant plans with less than $250,000 in assets from filing a Form 5500.

IV. Governmental and Tax-Exempt Employer Plans

A. Purchase of Permissive Service Credit

The bill amends the purchase of service credit and transfer rules enacted in 1997 and 2001 to clarify that state and local governmental employees may purchase enhanced benefits and benefits for which there is no performance of service, including through amounts transferred from 403(b) or governmental 457 plans.

B. Minimum Distribution Rules

Treasury would be directed to issue regulations under which a governmental plan is treated as complying with the minimum distribution rules if it complies with a reasonable, good faith interpretation of those requirements.

C. Waiver of the 10 Percent Early Withdrawal Tax on Certain Distributions

The 10-percent early withdrawal tax would not apply to distributions from a qualified defined benefit pension plan made to a public safety employee after separation from service after the attainment of age 50.

D. Extension of Moratorium on the Application of the Nondiscrimination Rules

All governmental plans (not just state and local plans) would be exempt from the nondiscrimination and minimum participation rules.

E. Incentive and Retention Plans for Educational Institutions

The bill would allow certain voluntary early retirement incentive plans of local educational agencies or tax-exempt education associations to be treated as bona fide severance plans for purposes of Code section 457, welfare benefit plans for purposes of ERISA, and defined benefit plans exempt from ADEA. In addition, it provides that certain payments not in excess of 2 times the section 457(b) deferral limit under an employment retention plan of a local educational agency or tax-exempt education association are not includible in income until paid.

F. Withholding on Distributions from Governmental Retirement Plans

The bill clarifies that the wage withholding rules, applicable to governmental 457 plan distributions pre-EGTRRA, may be applied to a series of distributions beginning before January 1, 2002 if the distributions are payable over a period of less than 10 years.

G. Indian Tribal Government Plans

The term "governmental plan" includes a defined benefit plan established or maintained for its employees by an Indian tribal government.

V. Women's Pension Protections

A. Study of Spousal Consent Rules Related to DC Plan Distributions

The DOL and Treasury would be directed to conduct a joint study examining the feasibility of imposing spousal consent requirements, similar to the QJSA and QPSA rules, on all defined contribution plans.

B. Clarification of the QDRO Rules

The DOL is directed to issue, not later than one year after enactment, regulations clarifying the status of certain domestic relations orders, including that a domestic relations order will not fail to be a QDRO solely because it is issued after or modifies a previous domestic relations order or QDRO, or because of the time at which it is issued.

C. Modification to Distributions Under the Joint and Survivor Rules

Participants would be allowed to elect a new "qualified optional survivor annuity," defined as an annuity for the life of the participant with a survivor annuity for the life of the spouse that is equal to an "applicable percentage" of the amount of the annuity that is payable during the joint lives of the participant and the spouse. Specifically, if the survivor annuity under a plan's qualified joint and survivor annuity is less than 75 percent of the annuity payable during the joint lives of the participant and spouse, the survivor annuity (i.e., the applicable percentage) is 75 percent of the annuity payable during their joint lives. If, however, the annuity during the joint lives of the participant and spouse is 75 percent or greater, the survivor annuity (i.e., the applicable percentage) is 50 percent of the annuity payable during their joint lives.

VI. Corporate-Owned Life Insurance

Benefits paid under a corporate-owned life insurance ("COLI") policy would not be taxable only if certain notice and consent requirements are satisfied and if (i) the insured was an employee within 12 months of death, (ii) the insured is a "highly compensated employee" under Code section 414(q) (without regard to the top-paid group rules) or a "highly compensated individual" under Code section 105(h)(5) with a salary in the top 35 percent of employees, including any director, or (iii) the benefits are payable to the individual's family, designated beneficiary (other than the employer), a trust for the benefit of such persons, or the individual's estate, or are used to purchase an equity interest in the employer from any of such persons.

Under the notice and consent requirements, the employee, prior to the issuance of the contract, must (i) be notified in writing of the coverage and the maximum face amount for which the employee could be insured at issuance, (ii) be informed in writing that the employer will be the beneficiary of any death benefits under the policy, and (iii) provide written consent to being insured and to the coverage continuing after the employee's termination of employment.

In addition, employers maintaining COLI programs would be subject to annual reporting and recordkeeping requirements.

These provisions would apply to contracts issued after the date of enactment, excluding contracts issued pursuant to a Code section 1035 exchange. Material increases in the death benefit or other material changes may be treated as a new contract.