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MEMORANDUM TO CLIENTS

Re: <u>Pension Legislation Update</u>

It is been a busy last couple of weeks in Congress and the Administration for pension legislation. Here is a brief update on recent developments.

A. Ways and Means Consideration of Portman-Cardin Bill

On July 18, the House Ways and Means Committee approved by voice vote a revised and slimmed-down version of the Portman-Cardin pension reform legislation (H.R. 1776). The revised Portman-Cardin bill is much shorter (91 pages vs. over 200), contains far fewer provisions (44 vs. 85), and is much less costly ($48 billion/10 years vs. over $200 billion/10 years) than the introduced version.

Most significantly, the bill would:

- temporarily replace the interest rate on 30-Year Treasury securities with a blended corporate rate for plans years beginning in 2004 through 2006;
- accelerate, to 2004, the employer plan and IRA contribution limit increases being phased in under EGTRRA;
- gradually increase the minimum distribution "required beginning date" from age 70-1/2 to age 75;
- further expand pension "portability;" and
- provide a partial exclusion for the first 5 years of "lifetime annuity payments" from qualified defined contribution plans, 403(b)s, governmental 457(b)s, and IRAs.

Our summary of the key provisions in the revised bill is attached.

As reported in the newspapers and on national news, the Ways and Means mark-up of the revised bill was extremely contentious and filled with partisan rancor. At one point in the proceedings, Capitol police were summoned to the Committee, although accounts differed on why they were called. The dispute began when Democrats insisted upon the full reading of the bill to protest the fact that the revised bill was not made available to Members until late the night before the mark-up. Most Democratic members then left the hearing room and went to an adjacent meeting room, leaving only Rep. Pete Stark (D-CA) on the panel to object to any motions to stop the reading. Tempers flared between Rep. Stark and the Republican members, especially after Ways and Means Chairman Bill Thomas (R-CA) ruled that a Stark objection to a motion to stop the reading had been offered too late. Rep. Stark left the hearing room, and the bill was approved by voice vote without any Democrats present.

The dispute then spilled onto the House floor when Minority Leader Nancy Pelosi (D-CA) offered a Democratic resolution condemning Republican actions at the mark-up and calling for a new mark-up. Controversy over the matter continued into last week. On July 23 Chairman Thomas apologized on the House floor for certain actions taken during the mark-up.

House floor action on the bill has not yet been scheduled and will not occur until September at the earliest. It is possible that the Committee will hold a new mark-up of the bill before it goes to the floor. Needless to say, this "history" does not bode well for expeditious action.

B. 30-Year Treasury Replacement and Funding Proposals

On July 8, the Bush Administration released its proposal for a replacement for the 30-Year Treasury rate, as well as far-reaching and onerous funding and disclosure proposals affecting defined benefit plans.

30-Year Treasury Replacement Proposals – The Administration recommended the following for both funding and lump sum payout calculations.

- For two years (2004-05), the 30-Year Treasury rate would be replaced with a blend of corporate bond rates similar to the introduced version of the Portman-Cardin bill.

- Over the next three years (2006-08), a corporate bond “yield curve” would be phased-in and would become the exclusive rate

for calculating liabilities and contributions beginning in year five.

- Lump-sum payouts would be computed using the 30-Year Treasury rate as under current law in the first two years (2004-05). A phase-in to a corporate bond yield curve would occur over the next three years.

Disclosure Proposals

- All companies would be required to disclose to participants and beneficiaries the value of pension plan assets on a termination basis as part of their ERISA summary annual report.

- Companies maintaining plans with more than $50 million in underfunding would be required to disclose certain financial data (e.g., assets, liabilities, and funding ratios) to the general public.

- Companies would be required to disclose plan liabilities as measured by the proposed yield curve before it is fully phased-in for funding purposes.

Benefit Restrictions

- A plan, sponsored by a company with a below-investment grade credit rating, that falls below 50 percent funded on a termination basis would be frozen and prohibited from making any benefit improvements or paying lump sums, unless the company makes contributions or provides security to fully fund these items.

- Similar restrictions would apply to a plan sponsored by a company that files for bankruptcy at a time when the plan is less than 50 percent funded; the PBGC's guaranty limit would be fixed as of the day the sponsor files for bankruptcy.

On July 15, the Education and the Workforce Subcommittee on Employer-Employee Relations and the Ways and Means Subcommittee on Select Revenue Measures held a hearing on the Administration's proposals. As part of their testimony at the hearing, Peter Fisher, the Treasury Undersecretary for Domestic Finance, and Ann Combs, the Assistant Secretary for the DOL Employee Benefits Security Administration, fleshed out the Administration's proposals. Mr. Fisher indicated that the Administration's proposals were only the first step, and that the

Administration would be undertaking a comprehensive review of all of the funding rules. He outlined a number of major areas for attention, including –

- volatility caused by the deficit reduction contribution requirements;
- funding targets based upon current liability;
- deduction rules that limit what sponsors may contribute in good times; and
- the accuracy of mortality tables.

The Administration's proposals have not been well received by business groups or Congress. Business groups have expressed concern that the proposals have not been adequately considered and could have a very harmful impact upon plans. Several Members of the Ways and Means and Education and the Workforce Committees expressed similar concerns at the July 15 hearing. Most significantly, the revised version of the Portman-Cardin bill as approved by the Ways and Means Committee did not include the Administration's proposals. Nevertheless, some key Members of these Committees have expressed interest in further examining the Administration's yield curve proposal and beginning a comprehensive review of the pension funding rules. It is possible that Congressional action will continue in the fall.