AMERICAN BENEFITS COUNCIL

March 9, 2010

SUMMARY OF REVISED SENATE FUNDING LEGISLATION

RELIEF PROVISIONS.

On March 9, the Senate adopted an amendment offered by Senators Johnny Isakson (R-GA) and Ben Cardin (D-MD) to modify the funding relief provisions in the Senate extenders bill (H.R. 4213, now called the American Workers, State and Business Relief Act (AWSBRA)). Senate passage of the bill is expected this week. This document summarizes the funding relief provided under the amendment.

Period of funding relief. Employers would be entitled to elect to apply either the 2 and 7 rule or the 15-year rule, both of which are described below, for any two plan years during the period starting with the first plan year beginning in 2008 and ending with the first plan year beginning in 2011. The two plan years need not be consecutive.

There is one caveat. An employer may not elect the relief for a year if the due date for contributions for that year is earlier than the date of enactment. So, for example, small calendar year plans that use an end of the year valuation date would not be permitted to use the relief for 2008 since the due date for contributions for 2008 (9/15/09) has already passed.

2 and 7. Under the 2 and 7 rule, employers would be able to amortize their "shortfall amortization base" for the year in question over seven years, but the seven-year amortization would start two years late. So, for example, the shortfall amortization base for 2010 would be amortized over seven years starting in 2012. During the two-year delay period, the employer would only owe interest on the shortfall amortization base.

15-year rule. Under the 15-year rule, employers would be able to amortize their shortfall amortization base for the year in question over 15 years.

Active plan requirement. There is not any requirement that, in order to use the 15-year amortization rule with respect to a defined benefit plan, the defined benefit plan must be an active plan that provides ongoing accruals. The addition of such an active plan requirement remains a distinct possibility on the House side.

CASH FLOW RULE.

In general. In general, under the cash flow rule, a plan sponsor that elects to use the 2 and 7 rule or the 15-year rule must make a contribution to the plan, in addition to any contribution otherwise required, equal to the sum of (a) the aggregate excess employee compensation over $1 million (indexed) and (b) the aggregate amount of extraordinary dividends and redemptions for the plan year.

Excess employee compensation. Under the excess employee compensation component of the cash flow rule, if any employee's compensation exceeds $1 million (indexed), the employer must make a "matching contribution" to the plan for that year of an amount equivalent to the excess. This rule is not limited to the top five employees or any other subset of employees; it applies to all employees of the employer. So the amount that must be contributed is the aggregate excesses with respect to all employees of the employer.

Subject to certain exceptions described below, all taxable compensation for a year is taken into account for purposes of the $1 million rule, so that, for example, all regular pay, equity compensation, bonuses, incentive compensation, other special pay, etc., are taken into account for the year in which they are includible in income. Also, if an employer funds its nonqualified deferred compensation (through a rabbi trust or otherwise), that amount must be treated as current compensation for purposes of the $1 million rule, even though the amount may not be taxable. (In the case of rabbi trust that relates to a defined benefit nonqualified plan, there is no guidance on how to allocate contributions to particular employees.) However, compensation attributable to services rendered before March 1, 2010 is disregarded.

In addition, unlike the prior bill, the amendment disregards nonqualified deferred compensation, restricted stock, stock options, or stock appreciation rights that are paid or granted under a binding written contract that was in effect on March 1, 2010. However, the exception does not apply to other amounts paid under a binding contract, such as salary, bonuses, and incentive compensation (unless the bonuses or incentive compensation is deferred). The amendment also adds an exception for commission income. The other new element of the amendment in this area is an exception for restricted stock with at least a five-year vesting period that is granted after February 28, 2010.

Dividends and redemptions. Under the second part of the cash flow rule, an employer must also make a "matching contribution" to the plan for a year equal to the "extraordinary dividends and redemptions" for the year. "Extraordinary dividends and redemptions" are defined as the excess of (a) the sum of dividends declared by the plan sponsor during the plan year, plus the aggregate amount paid for stock redemptions during the plan year, over (b) the greater of (i) the adjusted net income for accounting purposes of the plan sponsor for the preceding year or (ii) the historical dividend amount.

The referenced definition of net income disregards any after-tax gain or loss on assets. In addition, the amendment provides specifically that net income is determined before any reduction by reason of interest, taxes, depreciation, or amortization (i.e.,"EBITDA"). Also, if

the plan sponsor has determined and declared dividends in the same manner for at least the five preceding years, and determines and declares a dividend for the plan year using such manner, the dividend declared in the plan year is the "historical dividend amount" for purposes of the rule described above. In other words, assume that a plan sponsor has paid $.10 per share for the last five years, and does so again in the current year. In that case, in determing the threshold for extraordinary dividends and redemptions, the $.10 dividend declared for the current year would be substituted for adjusted net income, but only if such amount were greater than adjusted net income. This rule allows an employer to keep paying its historical dividend even if the employer has a bad year and has little or no net income.

A number of special rules apply. Dividends declared, and redemptions occurring, before March 1, 2010 are not taken into account. Dividends paid within a controlled group are similarly disregarded. In addition, redemptions that are made pursuant to an employee benefit plan or are made on account of the death, disability, or termination of employment of a shareholder or employee are not taken into account. Finally, dividends and redemptions with respect to preferred stock are disregarded if (a) dividends accrue with respect to such stock in all events, (b) interest accrues on any unpaid dividends, and (c) either (i) the stock was issued before March 1, 2010 or (ii) the stock is held by an employee benefit plan. A technical clarification is needed to this provision to ensure that it applies to preferred stock that is issued on or after March 1, 2010, but which simply replaces previously issued preferred stock.

Another technical issue that will need to be resolved is the use of plan years for determining financial concepts, such as EBITDA, since such concepts are not determined on a plan year basis.

Length of time. A critical aspect of the cash flow rule is the length of time that it applies. If the employer elects the 2 and 7 rule with respect to a year, the cash flow rule applies for three years, starting with the later of (a) the year for which the relief is elected, or (b) the first plan year beginning after December 31, 2009. This is reduced from nine years under the original draft of the HIRE Act, and from four years under the filed bill.

If the employer elects the 15-year amortization rule, the cash flow rule applies for five years, starting with the later of (a) the year for which the relief is elected, or (b) the first plan year beginning after December 31, 2009. This is reduced from 15 years under the original draft of the HIRE Act, and from seven years under the filed bill.

Contributions made under the cash flow rule. The contributions to the plan made pursuant to the cash flow rule would be in addition to any minimum contributions otherwise required. The additional contributions would not give rise to a credit balance; instead, the additional contributions would be applied to reduce the last amortization payments with respect to the year for which the employer elected relief. Under the amendment, it is not clear how this rule works if the employer has elected relief for two years. Also, it appears that credit balances can be used to satisfy this obligation to make additional contributions.

The required additional contributions would be capped at an amount sufficient to fully pay off the present value of the unamortized portion of the shortfall amortization base for which the employer elected relief.

The required additional contributions for a year are also subject to an additional limit. Under this limit, the additional contributions cannot exceed the excess of (a) the amount that would have been required to be contributed during the relief period without the funding relief, over (b) the amount that was required to be contributed taking the relief into account. In other words, the additional contributions cannot cause the employer to be in a worse situation on a cumulative basis than if the employer had not elected the relief.

Assume, however, that this "no worse than present law" limit applies to limit the additional contributions. For example, assume that, without this limit, the additional contributions would have been $1 million. But the limit reduces the additional contribution to $800,000. The extra $200,000 amount that is not contributed "carries over" to the next year and is treated as a required additional contribution in the next year (subject again to the limit in the next year). These carryovers last for a total of four years (in the case of the 2 and 7 rule) or seven years (in the case of the 15-year rule). So, for example, if relief is elected with respect to 2010, the last year in which the carryover can apply is 2013 (in the case of the 2 and 7 rule) or 2016 (in the case of the 15-year rule).

The additional contributions are disregarded in applying the quarterly contribution rules. Thus, for example, in determining whether sufficient quarterly contributions have been made for a year, all additional contributions required for the current or prior year are disregarded.

If an employer elects relief with respect to more than one plan, the additional contributions would be allocated, under Treasury rules, on a pro rata basis among the plans, including collectively bargained plans, based on the relative reduction in the first year funding relief provided. This rule will produce some odd results where an employer elects relief with respect to plans that are very different in size. The small plan or plans will almost always receive a share of the additional contributions that is disproportionately large compared to its size.

Controlled group basis. For purposes of the cash flow rule, all members of a plan sponsor's controlled group are aggregated. Thus, for example, excess compensation paid by one member of a controlled group can trigger requirements to make additional contributions to a plan maintained by another member of the controlled group.

Mergers and acquisitions. The amendment provides that Treasury is to prescribe rules for the application of the cash flow rule where there is a merger or acquisition. This is a significant concern. There is a clear need for a transition rule so that the actions of a company that did not elect relief do not instantly affect a second company that merges with the first company and that did elect the relief. There is a clear precedent in the law for such a transition rule; see, e.g., Code section 410(b)(6)(C). In light of the fact that the amendment does not adopt such a transition rule, Treasury may not provide transition relief, which

would make the cash flow rule a significant problem with respect to some mergers and acquisitions.

Benefit restrictions. In general, the amendment provides that for purposes of the rule requiring a plan to be frozen if it is under 60% funded, the plan's 2008 funded status would apply to 2009 and 2010, thus extending the WRERA rule by one year. Similarly, the amendment, unlike the bill, generally provides that for purposes of applying the restriction on prohibited payments to social security leveling options, a plan's 2008 funded status applies for purposes of 2009 and 2010. A transition rule is needed with respect to the social security leveling option rule, since many plans have already applied the restrictions to social security leveling options for 2009 (and in some cases 2010); without a transition rule, such plans would have violated the law by applying such restrictions.

Credit balance lookback rule. Under current law, an employer is not permitted to use its credit balance with respect to a plan if the plan was less than 80% funded in the prior year. The amendment provides relief with respect to such rule in the case of a plan maintained exclusively by one or more organizations described in Code section 501(c)(3) (generally, charities). Under the relief, a plan's funded status for the last year starting before September 1, 2008 shall, for purposes of this credit balance rule, be deemed to apply for the next two years (if greater than the actual funded status for that year). For example, in the case of a calendar year plan, the 2008 funded status would apply in 2009 and 2010.

Plans subject to the pre-PPA funding rules. These plans would generally be treated as in the Pomeroy/Tiberi bill, so that modified versions of the 2 and 7 rule and the 15-year rule would apply. Also, multiple employer plans (determined without regard to certain employer aggregation rules) consisting exclusively of section 501(c)(3) organizations would be treated like "eligible cooperative plans", except that, unlike the Pomeroy/Tiberi bill, this change would be effective for plan years beginning after December 31, 2007 unless the employer elects to delay the application of this rule by one year.

Other non-funding provisions. The amendment does not include any provisions regarding fee disclosure or the nondiscrimination rules. The House is expected to include the former in its funding bill and is considering including the latter.