AMERICAN BENEFITS COUNCIL

May 27, 2010

SUMMARY OF HOUSE AND SENATE SINGLE-EMPLOYER PLAN FUNDING RELIEF LEGISLATION

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BACKGROUND.

On March 10, the Senate passed an "extenders bill" (H.R. 4213, as amended by the Senate, the "American Workers, State and Business Relief Act"). On May 26, House Ways and Means Committee Chairman Sandy Levin offered a different version of the extenders bill (H.R. 4213, as further amended, the "American Jobs and Closing Tax Loopholes Act of 2010"). Both bills contain provisions providing defined benefit plan funding relief. This document summarizes the single-employer plan funding relief provided under the two bills.

It is our understanding that there has been extensive coordination between the House and the Senate in developing the funding provisions in the House bill. Accordingly, it is anticipated that the House bill funding provisions will, in whole or at least in substantial part, be included in the final version of the extenders bill.

SUMMARY.

In general, the bills contain the following provisions, all of which are explained further below:

- A choice between electing funding relief under the 2 and 7 rule or the 15-year rule for any two years during the 2008-2011 period.

- There is no requirement that a plan provide ongoing accruals in order to be eligible for the funding relief.

- Under the cash flow rule, a plan sponsor that elects funding relief must make an additional contribution to the plan equal to the sum of (1) the aggregate excess employee compensation, and (2) the aggregate amount of dividends and stock redemptions over a specified threshold.
    - Excess employee compensation is generally taxable compensation over $1 million (indexed), subject to certain exceptions including an exception for certain amounts paid pursuant to a written binding contract.
    - The threshold against which dividends and redemptions are measured is generally prior year "EBITDA" under the Senate bill, and the five-year average of "EDBA" under the House bill.
    - There are a number of exceptions to the dividend and redemption rule, including different protections under the two bills for historical dividends. Neither bill protects historical redemptions.
    - Under both bills, the cash flow rule lasts for three years in the case of the 2 and 7 rule, and lasts for five years in the case of the 15-year rule.
    - Under both bills, contributions under the cash flow rule are capped at the cumulative amount of relief used, so that a plan sponsor could lose all funding relief.

- Both bills require reporting and disclosure by plan sponsors electing funding relief. The House bill requirements in this regard are much more detailed.

- If a plan is at least 60% funded to the 2008 year, benefit accruals do not need to be frozen for the 2009, 2010, and, in the case of the House bill, 2011 plan years.

- Both bills provide short-term relief from the prohibited payment benefit restriction for social security leveling options. In addition, under certain circumstances, the House bill provides short-term relief from the requirement that a plan sponsor waive its credit balance to the extent necessary to avoid the restriction on shutdown benefits.

- Both bills provide a lookback rule permitting plan sponsors to use their credit balance in certain later years if their plan was at least 80% funded for the 2008 year. The Senate bill limits this rule to charities, but the House bill applies the rule to all plan sponsors.

- Under the House bill, plan sponsors are required to report actuarial and financial information to the PBGC under ERISA section 4010 not only if they have a plan that is less than 80% funded (which is present law), but also if the aggregate unfunded vested benefits of their plans exceed $75 million.

RELIEF PROVISIONS.

Period of funding relief.

Senate bill. 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 last plan year beginning in 2011. The two plan years need not be consecutive.

There are two caveats. First, 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.

Second, if a plan sponsor elects to apply the relief for two years, the plan sponsor must elect the same relief provisions—either the 2 and 7 rule or the 15-year rule—for both years.

House bill. The House bill is the same as the Senate bill with the following exceptions. First, there is no requirement that a plan sponsor use the same form relief in different years, so that a plan sponsor could use the 2 and 7 rule with respect to one year and the 15-year rule with respect to a second year.

Second, the House bill permits a plan sponsor to elect relief for any plan year for which the due date for contributions occurs on or after March 10, 2010. Thus, very generally, plan sponsors may elect relief for plan years beginning July 1, 2008 or later.

Third, the House bill prohibits a plan sponsor from electing relief with respect to a plan if, as of the date of the election, (1) the plan sponsor is in reorganization bankruptcy, (2) any required minimum contributions have not been made by the applicable due date, (3) there is a lien in favor of the plan (due to the failure to make timely required minimum contributions, or (4) a distress termination has been initiated for the plan).

2 and 7.

House and Senate bills. 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.

House and Senate bills. 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.

House and Senate bills. There is not any requirement that, in order to use either the 2 and 7 rule or 15-year amortization rule with respect to a defined benefit plan, the defined benefit plan must be an active plan that provides ongoing accruals.

CASH FLOW RULE.

In general.

House and Senate bills. 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 dividends and redemptions for the plan year in excess of a specified threshold.

Excess employee compensation.

Senate bill. Under the excess employee compensation component of the Senate's 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.

The bill 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 bill also provides an exception for commission income. In addition, there is an exception for restricted stock with at least a five-year vesting period that is granted after February 28, 2010.

House bill. The House bill is the same as the Senate bill with the following exceptions. First, the House bill clarifies that the binding written contract exception described above also applies to restricted stock units. Second, the House bill disregards compensation attributable to services rendered before January 1, 2010 (as opposed to March 1, 2010 under the Senate bill).

Third, under the House bill, the exception for commission income does not apply to any key employees (generally as defined in Code section 416(i)). For large companies, in general, the top 50 officers by compensation are key employees. Finally, the House bill does not contain the Senate's exception for restricted stock with at least a five-year vesting period.

Dividends and redemptions.

Senate bill. 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 bill 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 determining 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.

House bill. The House bill is the same as the Senate bill with the following exceptions. First, the House bill takes dividends into account when they are paid, as opposed to when they are declared.

Second, the House bill uses a different definition of company income as a threshold above which the sum of dividends and redemptions can trigger the cash flow rule. Unlike the Senate bill, which generally uses EBITDA for the preceding plan year, the House bill generally uses the company's average annual net income for the plan sponsor's last five fiscal years ending before the plan year. For this purpose, annual net income is determined in accordance with generally accepted accounting principles (before after-tax gain or loss on any sale of assets), but without regard to any reduction by reason of depreciation or amortization (i.e., "EBDA"). However, any loss year will be treated as a year with zero income.

Third, the historical dividend rule is modified as follows. Under the House bill, the company determines if there is any excess under the EBDA rule described above ("EBDA excess"). If there is an excess, the company then determines the sum of (1) the total redemptions paid during the year, plus (2) the excess of the dividends paid over the median amount of dividends paid during the plan sponsor's last five fiscal years. If this sum is smaller than the EBDA excess, only such smaller sum triggers the cash flow rule.

Conceptually, this rule permits companies to pay dividends up to the median amount paid during the last five years without triggering the cash flow rule solely based on such dividends.

Fourth, under the Senate bill, redemptions are disregarded to the extent that they 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. The House bill limits this rule to stock that is not listed on an established securities market. In addition, the House bill replaces the "employee benefit plan" reference with a reference to either a qualified retirement plan or a shareholder-approved program.

Fifth, stock distributions to shareholders are disregarded. This appears to be intended to protect stock dividends.

Finally, the preferred stock rule is modified in several respects in the House bill. First, the House deleted any generic exemption from the redemption rule for preferred stock. Instead, the House bill added an exemption from the redemption rule for securities that were, when issued, not listed on an established securities market if such securities are or had previously been held (1) directly or indirectly by or for the Federal government or a Federal reserve bank or (2) by a national government-related entity or an employee benefit plan, but only if such securities are substantially identical to securities held by or for the Federal government or a Federal reserve bank.

Second, the House bill applies the preferred stock dividend rule to all preferred stock issued on or before May 21, 2010 (or replacement stock for such preferred stock), not just preferred stock with mandatory dividends. Also, the preferred stock dividend rule does not apply to subsequently issued stock that is contributed to a plan. Finally, dividends on the preferred stock do not trigger the cash flow rule but, unlike the Senate bill, are taken into account in determining whether other dividends and redemptions trigger the cash flow rule.

Length of time.

House and Senate bills. 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.

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.

Contributions made under the cash flow rule.

Senate bill. 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 bill, 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.

House bill. The House bill is the same as the Senate bill except that in the case of a plan sponsor that elects the 2 and 7 rule, the “carryover” period described in the third preceding paragraph is three years instead of four years.

__Controlled group basis__.

House and Senate bills. 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__.

House and Senate bills. The bills provide 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.

REPORTING AND DISCLOSURE.

Senate bill. Under the Senate bill, if a plan sponsor elects the 2 and 7 rule or the 15-year rule, the plan sponsor must provide notice of this election to participants, beneficiaries, and the PBGC.

House bill. The House bill establishes a much more detailed regime regarding reporting and disclosure. Under the House bill, the notice is due within 30 days of the election of relief and must be provided, in addition to the recipients described in the Senate bill, to each labor organization representing the participants and beneficiaries.

The notice shall contain:

- A statement that "recently enacted legislation permits employers to delay pension funding";
- The contributions that would have been required but for the election;
- The reduction in the contributions for the year on account of the election;
- The number of plan years to which the reduction will apply;
- The plan's termination liabilities and the fair market value of the plan's assets as of the end of the year preceding the year for which relief is elected;
- An explanation of the cash flow rule;
- A statement that the cash flow rule may cause an increase in contributions and that the annual funding notice will provide a notice of any such increase.

Treasury is required to develop a model notice for this purpose. Failures to comply with the notice regime will be treated in a manner similar to failures to provide ERISA section 204(h) notices regarding the reduction of future benefit accruals. Thus, failures will be subject to an excess tax regime, and egregious failures will render the election of funding relief void.

Treasury "may", in consultation with the Department of Labor, may permit the notices to be provided electronically. Hopefully, Treasury promptly exercises this authority to avoid significant additional costs for plans.

As referenced above, the annual funding notice must describe any excess employee compensation, dividends, and redemptions triggering the cash flow rule.

It is somewhat surprising that the new notice is within Treasury's jurisdiction since the very closely related annual funding notice is within DOL's jurisdiction. Moreover, the information provided in the annual funding notice is exceedingly complex, in part because participants are provided with a plan's funded status under different and very technical scenarios. This new notice adds a notice of the plan's funded status under another scenario which is not consistent with any of the funded status statements in the annual funding notice. It would be very helpful for participants and less costly for plans if the two notices could be combined, one agency could be put in charge of the combined notice, and the required information could be simplified and shortened, with additional information available on request.

BENEFIT RESTRICTIONS.

Senate bill. In general, the bill 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 (if the funded status for such years is lower), thus extending the WRERA rule by one year. Similarly, 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.

House bill. The House bill is the same as the Senate bill except for the following changes. First, the WRERA rule would generally be extended for two years (instead of one year), so that, in general, a plan's 2008 funded status would apply to 2009, 2010, and 2011 for purposes of the rule requiring a plan to be frozen if it is under 60% funded. Second, instead of providing a lookback rule, the House bill exempts social security leveling options from the prohibited payment rule with respect to payment streams that commence no later than December 31, 2011. Also, under the House bill, the social security leveling option relief generally applies to payments that commence after December 31, 2010, except that a plan sponsor may elect to apply the relief to payments that commence after the date of enactment.

Also, the House bill provides that in the case of plan years beginning before January 1, 2012, a plan sponsor subject to the benefit restriction applicable to unpredictable contingent event benefits may avoid such restriction by contributing the value of the benefit (or the amount necessary to increase the plan's funded status to 60%) instead of being forced to waive its credit balance to avoid the restriction. This rule applies to unpredictable contingent events occurring on or after January 1, 2010.

CREDIT BALANCE LOOKBACK RULE.

Senate bill. 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 bill 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. Thus, if the plan was at least 80% funded for 2008, the plan sponsor could use its credit balance for 2009, 2010, and 2011.

House bill. The House bill is similar to the Senate bill, with small adjustments to the date references. But the major difference is that the provision applies to all plans, not just plans maintained by charities.

PLANS SUBJECT TO THE PRE-PPA FUNDING RULES.

Senate bill. Plans subject to the funding rules in effect prior to the Pension Protection Act of 2006 ("PPA") would generally be permitted to elect modified versions of the 2 and 7 rule or the 15-year rule. Also, eligible charity plans—i.e., 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"; 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.

House bill. The House bill is very similar to the Senate bill, but with a few differences. First, the conditions applicable to the funding relief generally—regarding the plan sponsor not being in bankruptcy, etc.—also apply to employers sponsoring plans subject to the pre-PPA funding rules. Second, the cash flow rule applies in a slightly modified way to pre-PPA plans electing relief. Third, under the House's version of 2 and 7 relief, the deficit reduction contribution is in all cases deemed to be zero for up to two years. Fourth, pre-PPA plans are subject to rules similar to the notice rules applicable to PPA plans.

In addition, the definition of "eligible charity plan" would be modified in several respects. First, the plan could be maintained by a single charity, but there must be employees accruing benefits under the plan. Second, it appears that the employees accruing benefits must be employed in at least 20 states. Third, each employee accruing benefits (other than a de minimis number) must be employed by an employer described in Code section 501(c)(3) and the primary exempt purpose of each such employer must be to provide services with respect to children. Finally, a plan is only an eligible charity plan if the plan sponsor elects to be so treated.

Finally, the effective date of this provision is plan years beginning after December 31, 2008, or in the case of eligible charity plans, plan years beginning after December 31, 2009.

REPORTING TO PBGC.

Senate bill. No provision.

House bill. Under current law, in general, plan sponsors must report certain actuarial and financial information to the PBGC under ERISA section 4010 if any plan in the sponsor's controlled group is less than 80% funded. The House bill provides that such reporting is also required if the aggregate unfunded vested benefits of plans within the controlled group exceed $75 million (disregarding plans with no unfunded vested benefits). This provision applies to years beginning after 2009. The bill does not address the confidentiality issues that have been of concern, especially to private companies.