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**TECHNICAL CORRECTIONS AND REGULATORY ISSUES WITH RESPECT TO
THE SINGLE-EMPLOYER PLAN FUNDING AND HYBRID PLAN PROVISIONS
OF THE PENSION PROTECTION ACT OF 2006**

This document sets forth possible technical corrections and administrative issues with respect to the single-employer plan funding and hybrid plan provisions of the Pension Protection Act of 2006. The page and line references below are to the version of H.R. 4 that passed the House.¹

OVERALL: Pending the issuance of administrative guidance on the funding and hybrid plan provisions of the Act, employers should be permitted to rely on a reasonable, good faith interpretation of the statutory provisions. [Administrative guidance.]

MINIMUM FUNDING ISSUES

Page 23, line 22 through page 23, line 7, and page 126, lines 15-25; ERISA section 303(b) and Code section 430(b). Under the statute, plan expenses are not part of “target normal cost”. Accordingly, under the new rules, plan expenses are funded, beginning in the year after they are incurred, under the shortfall amortization rules. Confirmation of this would be helpful. [Administrative guidance.]

Page 25, lines 6-12, and page 127, line 24 through page 128, line 5; ERISA section 303(c)(2)(C) and Code section 430(c)(2)(C) Guidance is needed regarding the method of using the segment rates for purposes of determining the amount of any shortfall amortization installment. [Administrative guidance.]

Page 26, lines 16-21, and page 129, lines 9-14; ERISA section 303(c)(5)(A) and Code section 430(c)(5)(A). The legislation provides that if a plan’s assets equal or exceed the phased-in funding target (after subtraction of new credit balances), the shortfall amortization base is zero. This rule can be read to preclude the amortization of a gain in such a situation, which may not have been intended. The provision should be

¹ Substantively, the enacted version is the same, but it does not have line numbers, so the House-passed version is used for convenience of reference.

revised to provide that if a plan's assets equal or exceed the phased-in funding target (after subtraction of new credit balances), credit balances are not subtracted for purposes of determining the shortfall amortization base for the year. This would conform the provision to the apparent intent. [Technical correction or administrative guidance.]

Page 28, lines 17-21, and page 131, lines 10-14; ERISA section 303(d)(1) and Code section 430(d)(1).

(a) The definition of "funding target" should be clarified so as to exclude unpredictable contingent event benefits until they occur. See current Code section 412(l)(7)(B) and ERISA section 302(d)(7)(B). [Technical correction or administrative guidance.]

(b) Treasury Regulation § 1.401(a)(4)-5(b)(3) (containing the "top-25 rule") needs to be modified to reflect the new funding rules and terms. [Administrative guidance.]

(c) In the case of a hybrid plan, a special rule is needed to avoid anomalous results. Assume, for example, that a hybrid plan's interest crediting rate exceeds the effective yield curve rate with respect to the some or all participants. In that case, if the plan uses the crediting rate to project the account balance to normal retirement age and uses the 3-segment yield curve to discount back to the valuation date, the result will be greater than the current account balance, thus treating the plan as having a funding shortfall that does not exist. This is like a funding whipsaw. This can be solved by permitting plans to project hybrid plan benefits at the applicable discount rate. [Administrative guidance.]

Page 33, lines 3-9, and page 135, line 23 through page 136, line 4; ERISA section 303(f)(3)(B) and Code section 430(f)(3)(B). A prefunding balance may not be used to offset minimum funding obligations if the plan has a funding standard carryover balance. There needs to be an exception for situations where the funding standard carryover balance cannot be used by reason of an agreement with the PBGC. [Technical correction or administrative guidance.]

Page 33, lines 20-24 and page 136, lines 15-19; ERISA section 303(f)(3)(C) and Code section 430(F)(3)(C). For purposes of determining whether a plan is at least 80% funded in 2007 (and thus can use credit balances in 2008), the funded ratio should be the funded current liability percentage as defined in current-law Code section 412(l)(9)(C). This is consistent with the fact that existing credit balances are not subtracted for purposes of the 80% test. [Administrative guidance.]

Page 35, line 23 through page 36, line 20, and page 138, line 18 through page 139, line 14; ERISA section 303(f)(5) and Code section 430(f)(5).

(a) A procedure for waiving credit balances is needed. Because of the lookback rules (applicable, for example, for determination of at-risk status), such a procedure may be needed for the 2007 plan year. [Administrative guidance.]

(b) Some agreements between companies and the PBGC require the company to maintain its credit balance, thus arguably precluding the company from waiving its credit balance. This could force companies into at-risk status or the application of benefit restrictions. The law needs to clarify that all companies - - including those with PBGC agreements - - may waive credit balances. [Technical correction or administrative guidance.]

Page 37, lines 15-25, and page 43, line 15 through page 44, line 23, and page 66, lines 10-16; page 140, lines 9-19, and page 146, line 7 through page 147, line 15, and page 169, lines 1-7; ERISA sections 303(f)(6)(B)(ii), 303(g)(4), and 303(j)(2) and Code sections 430(f)(6)(B)(ii), 430(g)(4), and 430(j)(2). The interest rate used to discount a contribution back to the applicable valuation date should be the first segment rate, not the effective interest rate. A blended long-term rate should not be used for short-term discounting. [Technical correction.]

Page 40, lines 4-16, and page 142, line 23 through page 143, line 10; ERISA section 303(f)(8) and Code section 430(f)(8). Assume the following facts. As of January 1, 2008, a company owes \$10 as a minimum contribution to a plan. On September 15, 2009, the company contributes \$30 for 2008. If the additional \$20 contribution is discounted back to January 1, 2008, the value is \$18; discounted back to January 1, 2009, the value would be \$19. Thus, it should be clarified that the credit balance as of January 1, 2009 is \$19. Assume that there is no minimum required contribution for 2009. The \$19 credit balance should be adjusted as of January 1, 2010. The first step would be to “undo” the discounting back to January 1, 2009; thus, as of September 15, 2009, the credit balance is worth the original \$20 amount. Then that \$20 needs to be adjusted for the September 15, 2009 – December 31, 2009 stub period. Since plans do not maintain data for such stub periods - - and it would be difficult to do so - - the plan should be permitted to credit the \$20 credit balance with interest at the first segment rate for this stub period. [Technical correction or administrative guidance.]

Page 42, line 17 through page 43, line 14, and page 145, line 10 through page 146, line 6; ERISA section 303(g)(3)(B) and Code section 430(g)(3)(B). Regulations are needed to permit asset averaging. The regulations should clarify that smoothing is permitted (in addition to averaging) and that smoothing works in the same manner as under current law except that the smoothing period is 24 months instead of 48 months. Thus, for example, the regulations should clarify that smoothing can be based on a comparison to a reasonably expected rate of return (as opposed to a comparison to the “effective interest rate”). [Administrative guidance.]

Page 46, line 19 through page 49, line 3, and page 149, line 12 through page 151, line 19; ERISA section 303(h)(2) and Code section 430(h)(2).

(a) For purposes of administrative guidance regarding the yield curve, each segment rate “should reflect the average of all AAA, AA, and A bonds for each year in each respective segment”. Education and the Workforce Committee report at page 78. This legislative history relates to two issues. First, it provides a mechanism for setting each segment rate, i.e., based on the average of the interest rates for all years in the segment. For this purpose, an assumption needs to be made regarding the length of the third segment; an assumed length of 20 years or more would be appropriate. Second, the report provides guidance on how to weight the different bonds in the top 3 quality levels available. The reference is to equal weighting of all bonds, not equal weighting of each quality level. So the weighting should reflect the prevalence of bonds at each quality level. This interpretation is supported by similar language in the Joint Committee on Taxation explanation of the pension bill at page 14. [Administrative guidance.]

(b) In the description of the segment rates, the reference to “bonds maturing during the [applicable period]” arguably does not accurately describe the construction of the yield curve; for example, a bond maturing in six years would be included in the second segment even though 10 of 12 coupon payments had been made during the first segment. The segment rates should be based on a full yield curve constructed from relevant bonds. [Technical correction or administrative guidance.]

(c) If bonds with puts and calls are considered in constructing the yield curve, imprecise judgments will be needed to calculate option-adjusted spreads. In order to ensure transparency in the construction of the yield curve, bonds with puts and calls should be excluded from consideration, except for bonds with make-whole provisions. [Administrative guidance.]

(d) The election to use the full yield curve without smoothing applies “[s]olely for purposes of determining the minimum required contribution under this section”. For a plan sponsor that makes this election, the statutory language raises questions as to what interest rate should be used for other purposes, such as disclosure, deduction limits, benefit restrictions, and reporting. For all such purposes, it would seem appropriate to use the same interest rate as is used for funding purposes, but the statutory language can be read to require the use of the smoothed segmented yield curve for such other purposes. [Technical correction or administrative guidance.]

Page 49, lines 16 through page 50, line 5, and page 152, lines 6-19; ERISA section 303(h)(2)(F) and Code 430(h)(2)(F). Determination of the methodology used to create the yield curve and the segment rates should be done pursuant to the regulatory process with opportunity for public comment. [Administrative guidance.]

Page 52, line 17 through page 53, line 4, and page 155, lines 4-15; ERISA section 303(h)(3)(C)(ii) and Code section 430(h)(3)(C)(ii). A “significant change in the participants” - - which causes a substitute mortality table to cease to be in effect - - should be interpreted to mean a significant change that results in plan participants as a whole having a materially shorter life expectancy. A substitute mortality table should not cease to be in effect if, for example, there is a big change in the number of participants but the life expectancy of the new group is the same, longer, or only marginally shorter. In addition, even when this rule applies, it should not have any effect on prior valuation dates, even within the same year. Finally, where a substitute mortality table ceases to be in effect for any reason, there should be an expedited process to have a new substitute mortality table approved. For example, if a calendar year plan has a spin-off on July 1 and the spin-off causes the plan’s substitute mortality table to cease to be in effect, an expedited submission process should be available so that the plan is able to apply to use a different substitute mortality table in the following year. [Administrative guidance.]

Page 53, lines 5-18, and page 155, line 16 through page 156, line 5; ERISA section 303(h)(3)(C)(iii) and Code section 430(h)(3)(C)(iii).

- (a) How many participants and how long a history is needed to constitute “credible information”? Administrative guidance
- (b) Plans should be permitted to construct a substitute mortality table based on adjustments to the standard table issued by Treasury, rather than having to construct the substitute table from scratch. [Administrative guidance.]
- (c) With respect to either a substitute mortality table or the standard table, there should be an option to use generational mortality. [Administrative guidance.]

Page 54, lines 1-15 and page 156, line 12 through page 157, line 2; ERISA section 303(h)(3)(C)(iv) and Code section 430(h)(3)(C)(iv).

(a) There should be a de minimis exception from the rule requiring all plans in the controlled group to qualify for and use a substitute mortality table. For example, if a controlled group has a plan with 100,000 participants and a plan with 50 participants, the inability of the 50-person plan to use a substitute mortality table should not preclude the large plan from doing so. [Technical correction or administrative guidance.]

(b) There should be a grace period following an acquisition. The acquisition of a company with a defined benefit plan that does not use a substitute mortality table should not cause other plans in the acquirer’s controlled group to immediately cease to qualify for use of a substitute mortality table. A grace period should apply, beginning

on the date of the acquisition and ending on the last day of the first plan year beginning after the acquisition. See Code section 410(b)(6)(C) for a similar transition rule regarding the section 410(b) coverage rules. [Technical correction or administrative guidance.]

(c) For purposes of the rule requiring all plans in the controlled group to qualify for and use a substitute mortality table, multiemployer plans and multiple employer plans should be disregarded. [Technical correction or administrative guidance.]

(d) If the minimum funding requirements for a multiple employer plan are being determined as if all participants in the plan were employed by a single employer under Code section 413(c)(4)(B), the plan should be able to look to its plan-wide experience as the basis for a substitute mortality table. [Technical correction or administrative guidance.]

Page 54, line 16 through page 55, line 13, and page 157, lines 3-24; ERISA section 303(h)(3)(C)(v) and Code section 4309(h)(3)(C)(v). Treasury needs to establish a procedure for submitting proposed substitute mortality tables. [Administrative guidance.]

Page 56, line 19 through page 57, line 10, and page 159, lines 7-23; ERISA section 303(h)(4) and Code section 430(h)(4).

(a) Assume that a lump sum is projected to be paid seven years after the valuation date. Assume that the plan values both its funding target and lump sums based on the three-segment yield curve (fully phased in). For purposes of taking the lump sum into account for funding purposes, the Treasury rules should not require “double use” of the first segment. In other words, one could project the value of the lump sum payable in seven years by applying the three-segment yield curve. Then one could discount that value back to the valuation date by using the three-segment yield curve. Such a system is not appropriate, since it would apply the first segment twice: once to determine the lump sum (in calculating the present value of annuity payments for years 7-11) and a second time to discount that lump sum back to the valuation date (for years 1-5). [Administrative guidance.]

(b) What mortality assumption should be used to determine the amount of a lump sum payable in a future year? [Administrative guidance]

Page 59, lines 6-9, and page 60, line 22 through page 61, line 2, and page 161, lines 22-25, and page 163, lines 14-19; ERISA sections 303(i)(1)(A)(ii) and 303(i)(2)(B), and Code sections 430(i)(1)(A)(ii) and 430(i)(2)(B). If a plan is at-risk for five consecutive years, the loading factor is phased in as follows: 60% in year 3, 80% in year 4, and 100% in year 5. If a plan is at-risk in years 1, 2, and 5 (but not in years 3 and 4), the loading factor is phased in over five years starting in year 5. This inconsistency does not make

sense. The loading factor should be phased in over five years in all cases. [Technical correction.]

Page 59, line 18, and page 162, line 9; ERISA section 303(i)(1)(B)(i) and Code section 430(i)(1)(B)(i). How should “earliest retirement date” be defined? [Administrative guidance.]

Page 59, line 23 through page 60, line 3, and page 162, lines 14-19; ERISA section 303(i)(1)(B)(ii) and Code section 430(i)(1)(B)(ii). For purposes of determining if a plan is at-risk and for purposes of determining the liability of an at-risk plan, if a plan is currently prohibited in whole or in part from paying lump sums (or other prohibited payments), is that taken into account in determining the “retirement benefits” available under the plan? For this purpose, should a plan make reasonable assumptions regarding its future ability to pay lump sums? Would a “reasonable assumption” rule apply for non-at-risk plans that could become subject to a full or partial ban on lump sums in the future?? [Administrative guidance.]

Page 62, lines 9-14 and page 165, lines 2-6; ERISA section 303(i)(4) and Code section 430(i)(4). For purposes of determining at-risk status in 2008, the “funding target attainment percentage” for 2007 should be (a) in the case of a plan not subject to the DRC in 2007, the funded current liability percentage as defined in current-law Code section 412(l)(9)(C), and (b) in the case of a plan subject to the DRC in 2007, the funded current liability percentage as defined in current-law Code section 412(l)(8). This bifurcated system reflects current law. [Administrative guidance.]

Page 66, line 21, and page 169, line 12; ERISA section 303(j)(3)(A) and Code section 430(j)(3)(A). For 2008, the trigger for whether a plan sponsor must make quarterly contributions should be whether the plan had a funded current liability percentage of at least 100% in 2007. For this purposes, “funded current liability percentage” should be defined in the same manner described above for purposes of determining at-risk status in 2008. (As drafted, the statute could be read to require plans to recalculate their 2007 funded status based on 2008 rules that were not in effect in 2007. For example, the use of substitute mortality tables is not available for 2007, rendering such a recalculation unworkable.) [Technical correction or administrative guidance.]

BENEFIT RESTRICTIONS

Page 81, line 20 through page 82, line 3, and page 184, lines 12-19; ERISA section 206(g)(2)(C) and Code section 436(c)(3). Guidance is needed as to how to measure a “contemporaneous rate of increase in average wages of participants covered by the amendment.” For example, presumably, the increase would be based on participants’ wages as determined under the collective bargaining agreement (i.e., without regard to amounts that can vary based on subsequent events such as overtime payments). [Administrative guidance.]

Page 83, line 1 through page 84, line 25, and page 185, line 14 through page 187, line 9; ERISA section 203(g)(3)(C) and Code section 436(d)(3). The law should permit a plan to make payments that are otherwise prohibited if the plan sponsor makes an additional contribution to the plan equal to the amount otherwise prohibited. Such a payment would keep the plan whole and avoid taking away a valuable right from participants. [Technical correction or administrative guidance.]

Page 85, lines 8-25, and page 187, line 16 through page 188, line 7; ERISA section 206(g)(3)(E) and Code section 436(d)(5).

(a) Lump sum distributions that are \$5,000 or less made pursuant to the involuntary cash-out rules should not be treated as prohibited payments. Otherwise, the rules would just be creating a significant burden on already troubled plans without a material policy justification.

For example, assume that a 75% funded plan has a terminated employee entitled to a \$2,000 lump sum. Unless such lump sums are exempted from the prohibited payment rule, the plan could pay half the lump sum - - \$1,000 - - and would be required to make monthly annuity payments to the retiree of, for example, approximately \$8. [Technical correction or administrative guidance.]

(b) The prohibition or restriction on prohibited payments should not apply to social security level-income options. The law excludes social security supplements from the definition of a prohibited payment; the law should not be read to treat the same stream of payments as a prohibited payment solely because it is made pursuant to a social security level-income option. There is no policy reason for this distinction. Both types of payments should be excluded from the definition of a prohibited payment. At a minimum, the partial prohibition on prohibited payments (for plans that are at least 60% funded but less than 80% funded) should not apply to social security level-income options. Social security level-income options do not give rise to the same plan funding issues as lump sum distribution do, and thus should not be subject to the same set of restrictions. [Technical correction or administrative guidance.]

Page 89, lines 5-18, and page 191, lines 6-18; ERISA section 206(g)(5)(C)(i) and Code section 436(f)(3)(A).

(a) It should be clarified that mandatory waivers of credit balances are only required when a benefit restriction prevents a plan term or collectively bargained provision from taking effect. For example, assume that a plan is 90% funded, and has a credit balance equal to 20% of the funding target, so that its funding target attainment percentage is 70%. The plan does not provide for any prohibited payments and the employer has not agreed to any benefit increase. In that case, no waiver of credit balance is required. If, however, for example, the employer signs a collective

bargaining agreement providing for a benefit increase and the employer does not make the contribution needed to permit such benefit increase to take effect, the mandatory waiver of credit balances would apply. [Administrative guidance.]

(b) Similarly, if no plan participant requests a prohibited payment during a year (and none of the other benefit restriction triggers applies), the mandatory waiver of credit balances should not apply. [Administrative guidance.]

(c) It should also be clarified that the mandatory waiver of credit balances cannot be triggered by a short-term benefit restriction that arises solely by reason of a presumption described in ERISA section 206(g)(7)(A) or (C) and Code section 436(h)(1) or (3). [Administrative guidance.]

Page 90, line 15 through page 92, line 22, and page 192, line 14 through page 194, line 16; ERISA section 206(g)(7) and Code section 436(h). Actuarial certifications are needed to prevent or nullify certain applicable presumptions. It is important that such certifications be permitted to be based on plan liabilities projected forward from the prior year, taking into account significant events (such as plan amendments and plan mergers). (Of course, actual (as opposed to projected) numbers would be required regarding asset values, yield curve interest rates, and mortality and retirement assumptions; however, in the case of assets that are difficult to value, it may be necessary to use an estimate of the value until a final valuation can be completed.) If such projections of plan liabilities are not permitted, many very well funded plans will be unjustifiably subject to benefit restrictions. For example, assume that a plan was 88% funded in 2008 and is actually 100% funded in 2009. If an actuarial certification is not done by April 1, 2009 - - which is very unlikely if projections are not permitted - - that 100% funded plan would be prohibited from paying full lump sums. [Technical correction or administrative guidance.]

Page 90, lines 3-9, and page 192, lines 1-8; ERISA section 206(g)(5)(C)(iii) and Code section 436(f)(3)(C).

(a) A definition of a collectively bargained plan is needed for purposes of the mandatory waiver of credit balances. Specifically, for purposes of this non-effective date provision, a plan should not be treated as collectively bargained unless substantially all of the participants are covered by a collective bargaining agreement. [Administrative guidance.]

(b) The definition used for this credit balance provision should not be the same one that is used for effective date or other purposes. Historically, “collective bargaining effective dates” have consistently applied to plans where participants covered by a collectively bargained agreement constitute at least 25% of the total number of participants. In addition, plans can be aggregated for purposes of this test if they have “essentially the same” benefits and contributions. See, e.g., House Conference Report

for ERISA at 267 (referring to Ways and Means Report at 51-52); General Explanation of TEFRA at 290-91; IRS Notice 88-98; PLRs 9610025, 8618042. The 25% rule and the aggregation rule should apply specifically for purposes of the effective dates of the provisions of the Act. [Administrative guidance.]

Page 93, line 18 through page 94, line 4, and page 195, lines 10-20; ERISA section 206(g)(9)(B) and Code section 436(j)(2). Under this provision, for purposes of the benefit restriction rules, a plan's funding target attainment percentage is determined by increasing the numerator and denominator of the fraction by the aggregate amounts used to purchase annuities for nonhighly compensated employees during the preceding two years. From a funding perspective, lump sum distributions have the same effect as annuity purchases and thus should be treated in the same manner, *i.e.*, lump sum distributions to nonhighly compensated employees during the preceding two years should also increase the numerator and denominator. See new ERISA section 303(j)(4)(E)(iv)(II) and new Code section 430(j)(4)(E)(iv)(II) for an example of another context where lump sums are treated in the same manner as annuity purchases. [Technical correction or administrative guidance.]

Page 95, lines 10-15, and page 196, line 21 through page 197, line 2; ERISA section 206(g)(10) and Code section 436(k). In 2008 (or a later year in the case of a collectively bargained plan), for purposes of applying the presumption rules applicable to the benefit restriction requirements, the "funding target attainment percentage" for 2007 should be (a) in the case of plan not subject to the DRC in 2007, the funded current liability percentage, as defined in current-law Code section 412(l)(9)(C), and (b) in the case of a plan subject to the DRC in 2007, the funded current liability percentage as defined in current-law Code section 402(l)(8). This bifurcated system is consistent with both current law and the new law. [Administrative guidance.]

PLANS WITH DELAYED EFFECTIVE DATES

Page 98, line 4 through page 103, line 13; bill sections 104-106. For purposes of the three delayed effective date provisions - - for eligible cooperative plans, PBGC settlement plans, and eligible government contractor plans - - the following clarifications are needed:

(a) Prior to the delayed effective date, it should be clarified that, for funding purposes, the third segment rate referenced would be substituted for the 30-year Treasury bond interest rate under current law. Thus, for example, the rate used for funding calculations would be based on the four-year weighted average of the third segment rate. [Technical correction or administrative guidance.]

(b) As of the delayed effective date, the transition rules generally applicable in 2008 would apply. For example, the four-year phase-in of the funding target would apply as of the delayed effective date. [Technical correction.]

(c) Prior to the delayed effective date, the new reporting and disclosure rules would apply but such rules would be based on the funding requirements applicable to these plans. Accordingly, for example, funding status disclosures would be based on a plan's funding status as determined under the current-law rules, except that, as noted above, the four-year weighted average of the third segment would apply. [Administrative guidance.]

SECTION 420 TRANSFERS

Page 201, lines 1-14; Code section 420(e)(2). Since credit balances are subtracted from assets in determining whether there are excess pension assets for purposes of section 420, it should be clarified that section 420 transfers do not reduce credit balances. [Administrative guidance.]

Page 201, line 13; Code section 420(e)(2)(B). "shortfall" should be replaced by "target". [Technical correction.]

Page 205, between lines 5 and 6; bill section 114. It needs to be clarified that, except as otherwise provided, the effective date of the technical and conforming amendments is years beginning after December 31, 2007, subject to a collective bargaining delay for the amendments relating to the benefit restrictions. [Technical correction.]

Page 622, lines 15-19; Code section 420(f)(2)(B)(ii)(II). If a qualified future transfer or collectively bargained transfer is made, the employer must, during the transfer period, keep the plan at least 120% funded, which may require transfers back from the section 401(h) account to the non-401(h) part of the plan. It should be clarified that, notwithstanding Code section 420(c)(1)(B), any such transfer back is not subject to the reversion tax. Similarly, any transferred amounts that (i) have not been used for retiree health expenses by the end of the transfer period or the collectively bargained cost maintenance period and (ii) thus have to be transferred back to the non-401(h) part of the plan should not be subject to the reversion tax. [Technical correction or administrative guidance.]

SECTION 414(l).

Page 200, lines 14-20; Code section 414(l)(2)(B)(i)(I). The purpose of Code section 414(l)(2) is to establish rules for allocating excess assets in the case of a plan spin-off. So the reference in the legislation to "funding shortfall" does not work. The reference should be to the deduction limit (i.e., 150% of current liability in 2006 and 2007; or the sum of the funding target, the target normal cost, and the cushion amount for 2008 and subsequent years). [Technical correction.]

RESTRICTIONS ON FUNDING NONQUALIFIED DEFERRED COMPENSATION

Page 208, line 11 through page 209, line 18; Code section 409A(b)(3)(A).

(a) The application of the restriction on funding nonqualified deferred compensation needs to be modified in certain respects. First, there needs to be a grace period following an acquisition. In other words, if, for example, a company acquires a second company that has an at-risk plan or an entity going through reorganization, the restriction should not apply immediately. That could affect companies' interest in acquiring and "rescuing" troubled businesses and/or plans. A grace period should apply, beginning on the date of the acquisition and ending on the last day of the first plan year beginning after the acquisition. See Code section 410(b)(6)(C) for a similar transition rule regarding the section 410(b) coverage rules. [Technical correction or administrative guidance.]

(b) Also, there should be a de minimis rule. If, for example, a 50-person plan maintained by one member of a 100,000-employee controlled group is at-risk, that should not trigger restrictions applicable to the entire controlled group. [Technical correction or administrative guidance.]

Page 212, lines 1-6; Code section 409A(b)(3)(D)(ii).

(a) In the case of a company not subject to reporting under the Securities Exchange Act of 1934, can the CEO be a "covered employee"? It would seem anomalous if the answer were yes, in light of the reliance on the section 162(m) definition, but due to the narrowness of the statutory cross reference, the issue is unclear. [Technical correction or administrative guidance.]

(b) In the middle of a year, how is it to be determined which officers will have their compensation reported to shareholders? That will not be known with certainty until after the end of the year. Accordingly, the determination could be based on the prior year, but that raises issues in the context of company mergers or divestitures. [Administrative guidance.]

Page 212, lines 12-14; bill section 116(c). With respect to the restrictions on funding nonqualified deferred compensation, it should be clarified that there cannot be a restricted period attributable to a plan being at-risk until the at-risk rules apply to the plan. [Administrative guidance.]

MINIMUM LUMP SUM ISSUES

Page 385, line 3; ERISA section 205(g)(3)(B)(iii)(II). "section 205(g)(3)(B)(iii)(II)" should be "205(g)(3)(A)(ii)(II)".

Page 385, lines 5-7, and page 387, lines 3-5; ERISA section 205(g)(3)(B)(iii)(III) and Code section 417(e)(3)(D)(iii), cross-referencing ERISA section 303(h)(2)(G) and Code section 430(h)(2)(G). Under the statute, the phase-in of the new lump sum distribution valuation rules is accomplished through a weighting of the old-law and new-law interest rates. For example, in 2008, if the adjusted third segment rate (without regard to the phase-in) is 6.0% and the 30-year Treasury rate is 5.0%, then the phase-in would call for the use of a phased-in adjusted third segment rate of 5.2%, and similarly for the adjusted first and second segment rates. These phased-in adjusted first, second, and third segment rates would then be combined with the applicable mortality table to compute the lump sum amount. By contrast, the Joint Committee on Taxation explanation [JCX-38-06] appears to call for a weighting of the old-law and new-law lump sum values. It states, “For distributions in 2008 through 2011, minimum lump-sum values are determined as the weighted average of two values: (1) the value of the lump sum determined under the methodology under present law (the ‘old’ methodology); and (2) the value of the lump sum determined using the methodology applicable for 2008 and thereafter (the ‘new’ methodology). For distributions in 2008, the weighting factor is 80 percent for the lump-sum value determined under the old methodology and 20 percent for the lump-sum determined under the new methodology.” These two approaches are not mathematically equivalent, because different results are achieved if the weighting is done based on the interest rates (as under the statute) compared to weighting done based on the lump sum values (as under the Joint Committee’s explanation). Confirmation that the statutory language will govern would be helpful. [Administrative guidance.]

SECTION 415

Page 387, line 12 through page 388, line 11; Code section 415(b)(2)(E)(ii). This section 415 provision is retroactive to the beginning of the 2006 plan year. Distributions have been previously made during 2006 that do not comply with the provision. For purposes of distributions made during all of 2006, reliance on the rules in effect prior to the Pension Protection Act should be permitted. [Technical correction or administrative guidance.]

PBGC PREMIUMS

Page 388, line 22 through page 389, line 7; ERISA section 4006(a)(3)(E)(iii). Under current law, the regulations provide an alternative method of calculating “unfunded vested benefits”, under which projections from the prior year can be used. There is no indication in the legislation of an intent to modify this regulatory provision. Confirmation of the continued validity of the alternative method would be helpful. [Administrative guidance.]

DISCLOSURE AND REPORTING

Page 430, line 3 through page 431, line 17; ERISA section 101(f)(2)(B)(i) and (ii).

Participants will be confused by the array of different information they receive regarding a plan's funded status. For example, assume that as of January 1, 2009, a calendar year plan has \$100 of liabilities, \$95 of assets, and a \$20 credit balance (consisting of a \$2 prefunding balance and an \$18 funding standard carryover balance). As of December 31, 2009, the numbers are \$100 of liabilities (\$95 without smoothing), \$93 of assets (\$98 without smoothing), and a \$22 credit balance. By April 30, 2010, participants would receive the following information with respect to the 2009 year:

Funding target attainment percentage:	75%
Total assets:	\$75 plus a \$2 prefunding balance and an \$18 funding standard carryover balance.
Total liabilities:	\$100
Year-end value of assets:	\$98
Year-end liabilities:	\$95

This will be very confusing to plan participants. What is a funding target attainment percentage? Why is it 75% if there are \$95 of assets in the plan? What is a prefunding balance and a funding standard carryover balance? Is that \$20 of assets in the plan or not? Why is the plan 75% funded at the beginning of the year and overfunded at the end of the year? What happened to the prefunding balance and funding standard carryover balance as of year-end?

Moreover, the participants will subsequently receive information regarding the plan that is inconsistent with the above information. The following year participants will receive a statement showing, that as of January 1, 2010, the funding target attainment percentage is 71%, total assets are \$93, and liabilities are \$100. Participants who have kept the prior year's disclosure will be confused, since the prior year's disclosure showed that as of December 31, 2009, assets were \$98 and liabilities were \$95.

We urge that participants be given simple funding information - - based on smoothed or unsmoothed valuations but not both - - as long as the information is consistent. And since credit balances represent real assets, it is misleading and confusing to participants to subtract or separately state credit balances. [Technical correction.]

Page 449, line 10; ERISA section 104(b)(3). "103(f)" should be "101(f)".

Page 455, lines 4-8; ERISA section 4010(b)(1).

(a) Using an 80% funding target attainment percentage as the test for whether section 4010 filings are required creates problems for small plans that pose no material risk to the PBGC. PBGC needs to exercise its authority - - see page 115 of the Joint

Committee's explanation of the bill - - to exempt small plans where the aggregate unfunded vested benefits do not exceed \$50 million. [Administrative guidance.]

(b) For purposes of the 80% test, credit balances are subtracted. This will require many overfunded plans to submit section 4010 filings. Credit balances should not be subtracted for this purpose. [Technical correction.]

Page 456, lines 3-7; ERISA section 4010(e). The bill should clarify that the section 4010 summary report provided by the PBGC to the committees with jurisdiction (1) should not contain any information that would permit identification of the companies submitting information under section 4010, and (2) should not contain any confidential information regarding the companies. [Technical correction.]

Page 456, line 9; ERISA section 4010(d)(2)(B). "302(d)(2)" should be "303(d)(2)". [Technical correction.]

HYBRID PLANS

In general. There is a significant need for the existing determination letter requests to be processed. [Administrative guidance.]

Page 552, line 19 through page 554, line 2, and page 563, line 13 through page 564, line 20, and page 574, line 8 through page 575, line 15; ERISA section 204(b)(5)(A), Code section 411(b)(5)(A), and ADEA section 4(i)(10)(A).

(a) Under this provision, there are three types of benefit formulas: (i) formulas expressed as an annuity payable at normal retirement age, (ii) formulas expressed as a balance of a hypothetical account, and (iii) formulas expressed as the current value of the accumulated percentage of the employee's final average compensation. Participants who are covered by different types of benefit formulas should not be treated as similarly situated. Otherwise, there would be no mechanism for applying the new age discrimination rule. The pre-existing age discrimination rule can be used to ensure that a plan's mechanism for assigning benefit formulas to participants is not age discriminatory. For example, age discrimination should not exist based on an older participant's election to remain under a traditional formula, even if such formula may produce smaller total benefits at certain points in time. [Administrative guidance.]

(b) Under what circumstances will a plan be considered to "express" an accrued benefit as "the balance of a hypothetical account" or "the current value of the accumulated percentage of the employee's final average compensation"? For example, a plan might credit benefits on one of those bases, but then translate the benefits into an annuity payable at normal retirement age for various purposes, such as distributions. Such a plan should be treated as "expressing" its benefits in the above manner. See Senator Enzi's statement on this point. In addition, a plan should be permitted to be

amended to conform to this provision, including retroactively to June 29, 2005.
[Administrative guidance.]

(c) In the case of a plan that expresses the accrued benefit as an annuity payable at normal retirement age, the accrued benefit of a participant who is older than the plan's normal retirement age should be determined as of the participant's age.
[Administrative guidance.]

Page 554, line 5 through page 555, line 14, and page 564, line 23 through page 566, line 6, and page 575, line 18 through page 577, line 2; ERISA section 204(b)(5)(i), Code section 411(b)(5)(B)(i), and ADEA section 4(i)(10)(B)(i).

(a) What constitutes a market rate of return? There are many issues to be addressed, including the following. Assume that a plan credits interest at the XYZ variable rate and assume that rate is a market rate. Assume further that the plan provides a floor interest rate of, for example, 2%. The last sentence of subclause (I) of the above-cited provisions indicates that no adjustment is needed to the XYZ variable rate to reflect the existence of the floor rate; otherwise, there is no reason for the sentence to be there. Moreover, this precisely reflects a colloquy between Senator Enzi and Senator Gregg. Guidance should confirm this point. [Administrative guidance.]

(b) It should be clarified that equity-based rates of return can be market rates. It should be further clarified that participant-directed "investments", including equity investments, are permitted. [Administrative guidance.]

(c) The "preservation of capital" rule in subclause (II) should be applied at the time of benefit commencement, not on an annual basis. This same issue applies to the "protection against loss" rule in ERISA section 204(b)(5)(E)(ii), Code section 411(b)(5)(E)(ii), and ADEA section 4(i)(10)(E)(ii). This issue was addressed in a colloquy between Senator Enzi and Senator Burr. [Administrative guidance.]

(d) Under bill section 1107, absent Treasury guidance to the contrary, it appears that a plan with an above market rate of return can be amended to reduce such rate of return with respect to previously accrued benefits. Confirmation of this would be helpful. [Administrative guidance.]

Page 555, line 15 through page 557, line 2, and page 566, line 7, through page 567, line 19, and page 577, line 3 through page 578, line 16; ERISA section 204(b)(5)(ii)-(iv), Code section 411(b)(5)(B)(ii)-(iv), and ADEA section 4(i)(10)(B)(ii)-(iv).

(a) In the context of a conversion, assume that certain participants are grandfathered under the old benefit formula or are given a choice and elect to remain under the old formula. The conversion rule - - requiring participants' post-conversion benefits to equal at least the benefit determined under an "A plus B plus pop-up

subsidy” formula - - should not apply to such participants since there was not an “applicable plan amendment” with respect to such participants. [Administrative guidance.]

(b) If a post-June 29, 2005 conversion has already occurred and did not conform to the new rules, how can the plan be brought into compliance? How long does the plan have to cure any defects and will a specific process be required with respect to submissions to the IRS? [Administrative guidance.]

(c) The “pop-up” early retirement benefit or subsidy should be credited in the year of benefit commencement, not in the year that a participant retires, in order to correspond to the manner in which early retirement benefits or subsidies apply. [Technical correction.]

(d) For purposes of converting the early retirement subsidy to a pop-up value, guidance is needed regarding what assumptions may be used. [Administrative guidance.]

(e) Is there a way to reflect the pre-conversion benefit in an opening account balance (subject, of course, to the pop-up of any early retirement benefit or subsidy)? This could, of course, be done, subject to a requirement that the benefit be increased if necessary to reflect the statutory minimum. (Such an increase could be necessary if interest rates fall after the conversion.) But will there be a safe harbor means of establishing an opening account balance that does not require a comparison to the statutory minimum? [Administrative guidance.]

(f) It should be permitted to do a “pure A plus B” conversion. Under such an approach, the early retirement subsidy is payable as part of the “A” component under the prior plan terms to any participant who qualifies for the subsidy. There would be no requirement to convert that subsidy to an account balance or a current value. [Administrative guidance.]

(g) The statute does not require the “A” component to be increased based on post-conversion compensation increases. Confirmation of this would be helpful. [Administrative guidance.]

Page 560, lines 4-23, and page 570, line 20 through page 571, line 14, and page 581, line 19 through page 582, line 14; ERISA section 204(b)(5)(E), Code section 411(b)(5)(E), and ADEA section 4(i)(10)(E). Interest credits (in whatever form, including credits based on equity rates of return) and similar adjustments under an applicable defined benefit plan should be treated as indexing. [Administrative guidance.]

Page 561, line 17 through page 562, line 5, and page 572, lines 10-25; ERISA section 203(f)(1) and Code section 411(a)(13)(A). Under bill section 1107, absent Treasury

guidance to the contrary, it appears that a plan that has incorporated whipsaw into its plan can remove whipsaw with respect to previously accrued benefits. Confirmation of this would be helpful. [Administrative guidance.]

Page 562, lines 6-12 and page 573, lines 1-8; ERISA section 203(f)(2) and Code section 411(a)(13)(B). It should be clarified that the 3-year vesting rule only applies to benefits calculated as the balance of a hypothetical account or as an accumulated percentage of the participant's final average compensation. Thus, for example, 3-year vesting would not apply to benefits calculated under a traditional formula in the following situations:

- (i) Some plan participants are under a traditional formula and other participants are under a hybrid formula.
- (ii) A participant's benefit is the sum of a traditional benefit and a hybrid benefit.
- (iii) A participant's benefit is the greater of a hybrid benefit or a traditional benefit. In this case, the excess (if any) of the traditional benefit over the hybrid benefit would not be subject to three-year vesting.
- (iv) A participant's benefit is a traditional benefit, offset by a hybrid benefit under another plan.

[Administrative guidance.]

Page 584, lines 7-10; bill section 701(e)(2). It should be clarified that the new whipsaw rule applies to a participant who was paid a "non-whipsaw" benefit prior to the date of enactment, and then after the date of enactment makes a claim for an additional whipsaw benefit. Since the new whipsaw rule applies to all distributions after the date of enactment, the new rule should preclude any such claim. See also the colloquy between Senator Enzi and Senator Gregg on the whipsaw rule. [Administrative guidance.]

Page 584, line 11 through page 585, line 3; bill section 701(e)(3).

(a) The 3-year vesting rule should not apply to participants who do not have an hour of service after the effective date. There was no apparent intent to force employers to go back retroactively to vest former employees. [Technical correction or administrative guidance.]

(b) If on June 29, 2005, a plan is a traditional plan, but is converted to an "applicable defined benefit plan" prior to 2008, does the delayed effective date apply with respect to the vesting and interest crediting rules? [Administrative guidance.]

(c) If a plan sponsor does not elect early application of the vesting and interest crediting rules, it does not affect the earlier effective date of the age discrimination and whipsaw provisions. Confirmation of this would be helpful. [Administrative guidance.]

(d) Line 23 on page 584 should be revised to replace “subsections (a) and (b)” with “subsections (a), (b), and (c)”. Otherwise, existing public plans would not get the benefit of the delayed effective date of the interest crediting rules. The same change is needed in the collective bargaining provision on line 11 of page 585. [Technical correction.]

(e) It should be clarified that a plan sponsor may elect early application of the vesting and interest crediting rules as of any date on or after June 29, 2005 (and before the generally applicable effective date). For example, a plan sponsor should be entitled to elect application of such rules as of January 1, 2007. [Administrative guidance.]

(f) In light of the specific reference to plan years on line 12, page 585, clarification is needed that the reference to “years” on line 24, page 584 (and line 2, page 585) refers to plan years. [Technical correction or administrative guidance.]

Page 585, lines 12-13; bill section 701(e)(4). These two lines should be revised to read as follows:

apply to plan years beginning before the earlier of –
(A) the later of –

This would conform this effective date provision regarding collectively bargained plans to the structure of all of the other similar provisions in the legislation. [Technical correction.]

Related Issue. Many of the pro-participant transition approaches - - such as choice or grandfathering or greater of - - raise significant issues under section 401(a)(4) and/or the backloading rules. Favorable clarification of the law would be very helpful to avoid discouraging such transition approaches. [Technical correction or administrative guidance.]

DEDUCTIBILITY

Page 587, line 12 through page 590, line 10; Code section 404(o)(1)-(3).

(a) For purposes of this provision, the determination of a plan’s funding target, target normal cost, cushion amount, and assets should be based on projections to the end of the plan year. This would be consistent with the manner in which Code section 404(a)(1)(D) has been applied in practice under current law. If this is not done, the limit

should be adjusted upward to take into account the fact that the contribution is made as of the end of the year. [Administrative guidance.]

(b) The cushion amount should include 50% of the target normal cost (in addition to 50% of the funding target). Both the funding target and the target normal cost are plan liabilities (especially if a projection is made to year end) and there is no apparent reason to treat them differently in this regard. [Technical correction.]

Page 588, lines 15-24; Code section 414(o)(2)(B). Contributions up to a plan's at-risk liability will be deductible under this provision. For this purpose, it should be clarified that the plan sponsor may assume that (i) at-risk status has been fully phased in, and (ii) the loading factor applies. This same rule should apply to a plan that is at-risk but with respect to which the loading factor does not apply or the phase-in of at-risk liability is not complete. [Technical correction or administrative guidance.]

Page 592, lines 3-7; Code section 404(a)(7)(C)(iv). As of 2008, defined benefit plans covered by Title IV are disregarded in applying the combined plan deduction limit. This provision should be effective starting in 2006, as discussed in the August 3, 2006 colloquy between Senator Grassley and Senator Allen. See Congressional Record for August 3 at S8755-56. This would require a revised effective date in bill section 801(e). [Technical correction.]

Page 593, line 21 through page 594, line 4; Code section 404(a)(1)(D)(i). As noted above, the current practice under Code section 404(a)(1)(D) is to apply the deduction limit based on projections to the end of the year. It would be helpful for this approach to be confirmed with respect to the 150% limit. [Administrative guidance.]

Page 594, lines 8-15; bill section 801(e). Do the deduction limit changes apply to plan years or taxable years beginning after the referenced dates? [Administrative guidance.]

Page 595, line 18 through page 596, line 7; Code section 404(a)(7)(C)(iii). The following apply for 2006 and 2007 only if the preceding technical correction (regarding the effective date of the provision disregarding Title IV plans for purposes of the combined plan limit) is not made:

(a) It should be clarified that the section 404(a)(7) limit does not apply if employer contributions to the defined contribution plan do not exceed 6% of participants' compensation. The statutory language can certainly be read in that way, but could also be read to apply the section 404(a)(7) limit to defined benefit plan contributions wherever there is at least one defined contribution plan and at least one defined benefit plan, regardless of whether the employer contribution to the defined contribution plan are less than 6% of pay. [Administrative guidance.]

(b) The last sentence of Code section 404(a)(7)(A) should be conformed to the change in the deduction limit under Code section 404(a)(1)(D). Such last sentence should permit, in all cases, deduction of the excess of (i) 150% of current liability over (ii) the value of the plan's assets. Without such a rule, a defined benefit plan could be precluded from using the 150% limit under Code section 404(a)(1)(D) solely by reason of contributions to a defined contribution plan that are nondeductible.

SUBSTANTIVE ISSUES

Page 26, line 14 through page 27, line 15, and page 129, line 7 through page 130, line 8; ERISA section 303(c)(5) and Code section 430(c)(5). Under the bill, if a plan is funded below the phased-in funding target, no transition relief applies and the plan's shortfall amortization base is based on a 100% funding target. We understand that this may reflect Congress' intent. If not, we urge that this provision be modified to provide the phase-in to all non-DRC plans. Otherwise, in 2008, many non-DRC plans could reasonably experience a doubling, tripling, or even quadrupling of their funding obligation. [Technical correction or substantive modification.]

Page 82, line 4 through page 85, line 25, and page 184, line 20 through page 188, line 7; ERISA section 206(g)(3) and Code section 436(d). This issue has certainly been raised before, but our concerns continue. For example, if a plan is 50% funded, and the effective date of the lump sum prohibition is approaching with respect to a plan that offers lump sums, one would definitely expect a very large number of retirements among employees in their 50's and 60's. After the effective date, the same could be expected, for example, in the case of a company rumored to be about to declare bankruptcy. This could be devastating to the company and to the plan. We urge that this rule be reconsidered. [Substantive modification.]