

LEADING DEFINED BENEFIT AND DEFINED CONTRIBUTION PLAN REFORM ISSUES

ISSUE	CURRENT LAW	ADMINISTRATION PROPOSAL	HOUSE (H.R. 2830) ¹	SENATE (S. 1783)
FUNDING REFORM				
INTEREST RATE FOR FUNDING RULES	Based on a mix of AAA, AA and A rated long-term corporate bonds. Scheduled to revert to the 30-year Treasury rate after 2005.	AA rated corporate bonds of varying maturities.	“Investment grade corporate bonds” of varying maturities.	Same as House.
YIELD CURVE	Single interest rate	Yield curve	Separate rates for each of three “segments” of yield curve.	Same as House.
SMOOTHING	The interest rate used to value liabilities is smoothed over 4 weighted years. Asset values may be smoothed within prescribed corridors (80% to 120% of fair market value).	Near-spot rate for valuing liabilities. Asset values would have to be fair market value.	Interest rates smoothed over 3 years. Asset values could be smoothed but restricts period of smoothing to 3 years. Prescribed corridor would be narrowed to 90% to 110%.	Interest rates smoothed over 1 year. Asset values could be smoothed but restricts period of smoothing to 1 year. No corridor limitation.
AMORTIZATION PERIOD	DRC-required contribution percentages for plans below 90% of current liability range from 30% to just over 18% of the shortfall per year.	Shortfall below 100% of redefined liability amortized over 7 years.	Same as Administration proposal.	Same as Administration proposal.
AT RISK PLANS (CREDIT RATINGS)	Not applicable	Plans sponsored by employers that have debt rated below investment grade (called “at risk plans”) by all of the major credit rating agencies would have to be funded assuming that they will be terminated.	Same consequences to at risk classification as Administration proposal. Defines at risk plans based on whether plans are funded at less than 60% (and not based on their credit ratings).	Slightly less stringent consequences to at risk classification. Defines at risk plans based on whether plans are funded below 93% <u>and</u> sponsored by employers that have debt rated below investment grade for 3 consecutive years.
CREDIT BALANCES	Credit balances are not subtracted from assets for determining whether DRC contributions are required, but are subtracted from assets for determining the amount of required contributions. Credit balances grow at the plan’s assumed rate of return. Credit balances do not affect the limited current law benefit restrictions.	There would be no credit balances and existing credit balances would be eliminated.	Same as current law except for 3 changes. 1. Subtracts credit balances from assets for purposes of the benefit restrictions and at risk determination. 2. Prohibits use for plans that are less than 80% funded. 3. Marks to market credit balances	Same as current law except for 3 changes. 1. Subtracts credit balances from assets for purposes of determining whether a shortfall contribution is required. 2. Restricts use for plans that are below 80% funded by requiring actual contributions equal to the greater of 25% of the minimum required

¹ As reported by House Education & Workforce Committee and amended by House Ways & Means Committee.

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			based on the plan's actual rate of return.	contribution or normal cost. 3. Same mark-to-market as House.
TRANSITION	Not applicable	Funding changes fully phased in by 2008.	Current "temporary" funding rules effective in 2006 (e.g., long-term corporate bond rate). Interest rate changes fully phased-in by 2009. 100% funding target phased in over 5 years beginning in 2007 for plans that were not subject to DRC in 2006.	Same as House for 2006. Same interest rate phase in for House. 100% funding target phased in over 3 years beginning in 2007 (5-year phase-in for small plans).
DEDUCTION LIMITS	Up to 100% of current liability. However, employers that maintain a defined benefit and a defined contribution plan may only make deductible contributions up to 25% of participants' compensation.	Up to 130% of the plan's funding target. Combined plan limit preserved.	Up to 150% of the plan's normal liability plus normal cost. Combined plan limit preserved but inapplicable to the extent defined contribution plan contributions do not exceed 6% of participants' pay.	Up to 180% of target liability plus normal cost plus projected compensation increases. Combined plan limit repealed for PBGC-covered plans.
LUMP SUMS	30-year Treasury interest rate used to determine minimum value of lump sums.	Yield curve rates used to determine minimum values. Change phased in over 2 years.	Same as Administration but change phased in over 5 years. Uses modified yield curve.	Same as House but uses true yield curve (i.e., no segments).
RESTRICTIONS ON BENEFITS	Restricts lump sums and benefit increases in certain narrow circumstances. No restrictions on benefit accruals.	<i>80% or less funded.</i> Benefit increases would be prohibited and, if the sponsor is considered financially weak, lump sums would be prohibited. <i>60% or less funded.</i> Lump sums would be prohibited and, if the sponsor is financially weak, the plan would have to be frozen.	<i>80% or less funded.</i> Benefit increases and lump sums prohibited. <i>60% or less funded.</i> Plan would have to be frozen. <i>Collectively-bargained plans.</i> No special rules.	<i>80% or less funded.</i> Benefit increases prohibited. <i>60% or less funded.</i> Plan would have to be frozen <u>and</u> lump sums restricted. <i>Collectively-bargained plans.</i> Company generally required to immediately fund up to avoid triggering restrictions.
FLAT-RATE PBGC PREMIUMS	Flat-rate premium of \$19 per participant.	Flat rate premiums would be increased from \$19 to \$30 and would be indexed for wage growth.	Flat-rate premium changes similar to Administration proposal.	Flat-rate premium changes similar to Administration proposal.
VARIABLE RATE PBGC PREMIUMS	Variable rate premium is \$9 per \$1,000 of underfunding. Plans at the full funding limit (generally, at 90% of current liability) are exempt.	PBGC would have authority to increase the variable rate premium. Full funding limit exemption repealed.	No rate change in variable rate premium, but full funding limit exemption would be repealed.	Variable rate premium changes similar to House.

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DISCLOSURE TO PBGC	Companies sponsoring plans with more than \$50 million of underfunding must provide the PBGC with confidential corporate information and the plan's funded status on a termination basis.	Same as current law.	The \$50 million trigger would be eliminated. Instead, disclosure would be required for plans that (i) are less than 60% funded for the preceding year or (ii) are less than 75% funded and sponsored by an employer in a troubled industry.	Similar to House but would also require disclosure for plans that are (i) underfunded by more than \$50 million and (ii) either less than 90% funded or sponsored by an employer with a below investment grade debt rating.
DISCLOSURE TO PARTICIPANTS	No special funding notice to participants unless plan is less than 90% funded and paying a variable rate premium.	No special funding notice.	New plan funding notice due 90 days after end of the plan year.	Same as House.
COMMERCIAL PASSENGER AIRLINES	During 2004 and 2005, a commercial passenger airline may elect an alternate DRC contribution equal to the greater of (i) 20% of the amount that would otherwise be required and (ii) the expected increase in liability due to benefits accruing during the plan year. Restrictions on benefit increases apply.	No special provisions.	No special provisions.	Allows commercial passenger airlines to (i) amortize unfunded liability over 20 years and (ii) use the interest rate selected by the plan's actuary to measure liability. To elect the special rule, a plan must be frozen and may not be subsequently amended to increase benefits.
HYBRID PLANS				
BASIC DESIGN	Hybrid plans have been repeatedly blessed by the IRS and Treasury. However, one district court has held that the cash balance and pension equity plan ("PEP") designs are inherently age discriminatory.	Cash balance plans are not age discriminatory so long as pay credits for older workers are not less than pay credits for younger workers.	Hybrid plans are not age discriminatory if a participant's entire accrued benefit, determined under the plan terms, would be equal to the accrued benefit of any similarly situated, younger individual.	Essentially same as Administration proposal. Would create maximum and minimum interest crediting rates and require vesting after 3 years. Similar rules to be developed by Treasury for PEPs.
TREATMENT OF EXISTING PLANS	Not applicable	Effective after enactment on a prospective basis only. Provides that "no inference" is intended as to the status of cash balance and other hybrid plans under current law.	Effective June 29, 2005 on a prospective basis.	Generally effective on a prospective basis July 31, 2005. Essentially the same no inference provisions as the Administration proposal.
LUMP SUMS	To determine the minimum lump sum payable, the IRS requires a cash balance plan to project a participant's account balance to normal retirement age using the plan's interest crediting rate and then discount back to present value using a statutorily prescribed discount rate. If the present value is more than the account balance, the IRS takes the position the present value must be paid.	Permissible to pay account balances so long as plan does not provide interest credits in excess of a market rate of return.	Essentially the same as Administration proposal.	Essentially the same as Administration proposal.

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CONVERSIONS	Current law does not regulate conversions other than to provide two participant protections. First, advance notice is generally required. Second, a participant's accrued benefit cannot be reduced.	For the first 5 years following a conversion, benefits earned by all participants must be at least as valuable as the benefits participants would have earned under the traditional defined benefit plan. Prohibits benefit plateaus of normal and early retirement benefits in connection with a conversion.	No special provisions other than current law participant protections.	Similar to the Administration proposal, but provides for more detailed and demanding mandates.
DEFINED CONTRIBUTION PLANS				
PERMANENCE	The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") made several changes affecting retirement plans and IRAs, including increasing contribution limits. These provisions are scheduled to expire after 2010.	The FY 2006 Budget Proposal would make permanent the tax-relief provisions of EGTRRA, including those that apply to retirement plans and IRAs.	Same as Administration proposal as it applies to retirement plans and IRAs.	No provision.
AUTO ENROLLMENT	Plans that provide for automatic enrollment (<i>i.e.</i> , a specified rate of employee contributions unless the employee opts out) are permitted but there have been concerns about the effect of state law garnishment statutes and concerns about fiduciary liability for default investments. There are no special rules for plans that provide for automatic enrollment.	No proposal.	Provides a nondiscrimination safe harbor for plans with an automatic enrollment feature that meets certain requirements. Automatic enrollment under safe harbor would only be required for new hires.	Provides a nondiscrimination safe harbor that is more stringent than the House version. Automatic enrollment under safe harbor would be required for current employees and new hires. Would preempt state law garnishment rules and provide a fiduciary safe harbor for default investments.
INVESTMENT ADVICE	ERISA establishes standards of fiduciary responsibility. ERISA and the Code also contain provisions that identify certain "prohibited transactions" between retirement plans and parties in interest, and then provide a series of exemptions from those sweeping prohibitions if specified conditions are met. The prohibited transaction rules limit the extent to which certain parties in interest, e.g., financial institutions already providing services to a plan, can provide investment advice.	No proposal.	The fiduciary responsibilities of the plan sponsor in connection with arranging for the provision of investment advice would be clarified. A new prohibited transaction exemption would be added to facilitate investment advice from parties in interest. This exemption would be available only for "investment advice" provided by a "fiduciary adviser" in connection with "specified transactions" with respect to "eligible plans" that meet certain requirements.	A limited safe harbor from ERISA fiduciary responsibility would be provided to plan sponsors in connection with the provision of investment advice to plan participants. In general, the safe harbor would be available only with respect to unaffiliated advice, and would not result in any significant change from the rules governing investment advice under current law. No specific relief from the prohibited transaction rules would be provided.