TECHNICAL EXPLANATION OF H.R. 1000, THE "PENSION SECURITY ACT OF 2003," AS PASSED BY THE HOUSE OF REPRESENTATIVES ON MAY 14, 2003

Prepared by
the Staff of the
JOINT COMMITTEE ON TAXATION

May 19, 2003
JCX-51-03

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INTRODUCTION

H.R. 1000, the "Pension Security Act of 2002," was introduced on February 27, 2003, and referred to the House Committees on Education and the Workforce and Ways and Means. The Committee on Education and the Workforce marked up the bill on March 6, 2003, and reported the bill, as amended, on March 18, 2003 (H.R. Rep. No. 108-43, Part 1). On May 9, 2003, the Committee on Ways and Means discharged the bill. The bill was passed by the House of Representatives on May 14, 2003.

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a technical explanation of H.R. 1000, as passed by the House of Representatives.

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[1] This document may be cited as follows: Joint Committee on Taxation, *Technical Explanation of H.R. 1000, the "Pension Security Act of 2003," as Passed by the House of Representatives on May 14, 2003* (JCX-51-03), May 19, 2003.

I. IMPROVEMENTS IN PENSION SECURITY

A. Periodic Pension Benefits Statements (secs. 101 and 108 of the bill, new secs. 414(w) and 6652(m) of the Code, and secs. 105 and 502 of ERISA)

Present Law

Pension benefit statements

ERISA[2] provides that a plan administrator must furnish a benefit statement to any participant or beneficiary who makes a written request for such a statement. This requirement applies in the case of any plan that is subject to ERISA.[3] This requirement applies to both individual account plans[4] (including an employee stock ownership plan[5]) and defined benefit plans. The benefit statement must indicate, on the basis of the latest available information: (1) the total benefits accrued for a participant or beneficiary; and (2) the participant's or beneficiary's vested accrued benefit, if any, or the earliest date on which the accrued benefit will become vested. A plan administrator is not required to provide more than one benefit statement to a participant or beneficiary during any 12-month period. If the plan administrator fails or refuses to furnish the benefit statement within 30 days of the participant's or beneficiary's written request, the participant or beneficiary may bring a civil action to recover from the plan administrator $110 a day, within the court's discretion, or other relief that the court deems proper.

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[2] References to "ERISA" are to the Employee Retirement Income Security Act of 1974.

[3] Certain plans are exempt from ERISA, such as governmental plans and church plans.

[4] An "individual account plan" is the term generally used under ERISA for a defined contribution plan, i.e., a plan that provides for an individual account for each participant and for benefits based solely on contributions to the account, and any income, expenses, gains, losses, or forfeitures allocated to the account.

[5] An employee stock ownership plan (an "ESOP") is a defined contribution plan that is designated as an ESOP, is designed to invest primarily in stock of the employer, and meets certain other requirements. An ESOP is required to offer certain plan participants the right to diversify investments in employer securities. Depending on the design of the plan, an ESOP may allow participants to direct the investment of the assets in their accounts. Like other defined contribution plans, an ESOP may provide for different types of contributions, including employer nonelective contributions, elective deferrals under a qualified cash or deferred arrangement, after-tax employee contributions, or employer matching contributions. Elective deferrals, after-tax employee contributions, and employer matching contributions are subject to special nondiscrimination tests.

Statements to participants on separation from service

Under ERISA, a plan administrator must furnish a statement to each participant who (1) separates from service during the year, (2) is entitled to a deferred vested benefit under the plan as of the end of the plan year, and (3) whose benefits were not paid during the year. The statement must set forth the nature, amount, and form of the deferred vested benefit to which the participant is entitled. The plan administrator generally must provide the statement no later than 180 days after the end of the plan year in which the separation from service occurs. If the plan administrator fails to provide the statement, the Secretary of Labor or the participant may bring a civil action for appropriate relief.

Investment guidelines

Present law does not require that participants be given guidelines relating to the investment of retirement savings.

Explanation of Provision

Investment education notices under the Code[6]

The provision requires the plan administrator of an applicable pension plan to provide investment education notices to applicable individuals. An applicable pension plan is a qualified retirement plan (sec. 401(a)), a qualified annuity plan (sec. 403(a)), a tax-sheltered annuity plan (sec. 403(b)), or a governmental eligible deferred compensation plan (sec. 457) that permits a participant to direct the investment of his or her account,[7] or under which a participant's accrued benefit depends on hypothetical investments directed by the participant (including a defined benefit plan). An applicable pension plan does not include a one-participant retirement plan[8] or a

[6] All references to the "Code" are to the Internal Revenue Code. All section references and descriptions of law refer to the Code unless otherwise indicated.

[7] The right to direct investments includes the right of an applicable individual in an employee stock ownership plan to direct the investment of a portion of his or her account under present law and the right of an applicable individual to direct the plan to divest the individual's account of employer securities and reinvest an equivalent amount as provided under the provision relating to diversification requirements for defined contribution plans that hold employer securities.

[8] A one-participant retirement plan is a plan that (1) on the first day of the plan year, covered only one individual (and the individual's spouse) and the individual owned the 100 percent of the plan sponsor (whether or not incorporated), or covered only one or more partners (and their spouses) in the plan sponsor, (2) meets the minimum coverage requirements without being combined with any other plan that covers employees of the business, (3) does not provide benefits to anyone except the individual (and the individual's spouse) or the partners (and their spouses), (4) does not cover a business that is a member of an affiliated service group, a controlled group of corporations, or a group of corporations under common control, and (5) does not cover a business that leases employees.

plan that is subject to the benefit statement requirements under ERISA (as revised by the provision). Accordingly, the investment education notice requirement applies to plans that are exempt from ERISA, such as governmental plans and church plans.

The investment education notice must be provided on enrollment in the plan and at least annually thereafter. An applicable individual is a plan participant, an alternate payee under a qualified domestic relations order, or a beneficiary of a deceased participant or an alternate payee.

The investment education notice is required to contain an explanation, for the long-term retirement security of participants and beneficiaries, of generally accepted investment principles, including risk management and diversification, and a discussion of the risk of holding substantial portions of a portfolio in securities of any one entity, such as employer securities.

The notice must be written in a manner calculated to be understood by the average plan participant and provide sufficient information (as determined under Treasury guidance) to allow recipients to understand the notice. The notice is required to be in writing and may be provided in electronic or other form (or electronically posted on the plan's website) to the extent that such form is reasonably accessible to the applicable individual.

A penalty is imposed on a plan administrator that fails to provide the required investment education notice. The penalty is $100 per failure per applicable individual; the maximum amount of penalty that can be imposed on the plan administrator for all failures during a calendar year is $50,000. No penalty is imposed if the failure is due to reasonable cause and not to willful neglect.

Benefit statements under ERISA

In general

The provision provides new benefit statement requirements under ERISA, which depend in part on the type of plan and the individual to whom the statement is required to be provided.

Requirements for individual account plans

The plan administrator of an individual account plan is generally required to provide a benefit statement: (1) to a plan participant at least annually; and (2) to a plan beneficiary, upon written request, but limited to one request during any 12-month period.

In the case of an applicable individual account plan, the plan administrator is required to provide a benefit statement at least quarterly to any participant or beneficiary who has the right to direct the investment of the assets in his or her account. An applicable individual account plan is defined as any individual account plan, except that it does not include an ESOP unless the ESOP holds contributions (or earnings thereon) that are subject to special nondiscrimination tests that apply under the Code to elective deferrals, employee after-tax contributions, and matching

contributions.[9] An applicable individual account plan does not include a one-participant retirement plan (as defined above).

Any benefit statement is required to indicate, on the basis of the latest available information, the total benefits accrued for the participant or beneficiary, and the participant's or beneficiary's vested accrued benefit, if any, or the earliest date on which the accrued benefit will become vested. In the case of a quarterly statement provided to a participant or beneficiary of an applicable individual account plan, the benefit statement must also include: (1) the value of each investment to which assets in the individual's account are allocated (determined as of the plan's most recent valuation date), including the value of any assets held in the form or employer securities (without regard to whether the securities were contributed by the employer or acquired at the direction of the plan or the individual); (2) an explanation of any limitations or restrictions on the right of the individual to direct an investment; and (3) an explanation of the importance, for the long-term retirement security of participants and beneficiaries, of a well-balanced and diversified investment portfolio, including a discussion of the risk of holding more than 25 percent of a portfolio in the security of any one entity, such as employer securities.

Requirements for defined benefit plans

The administrator of a defined benefit plan is generally required either (1) to furnish a benefit statement at least once every three years to each participant who has a vested accrued benefit and who is employed by the employer at the time the benefit statements are furnished to participants, or (2) to provide such a participant at least annually with notice (at the participant's last known address) of the availability of a benefit statement and the manner in which the participant can obtain it. The Secretary of Labor is authorized to provide that years in which no employee or former employee benefits under the plan need not be taken into account in determining the three-year period. The annual notice of the availability of a benefit statement may be included with other communications to the participant if done in a manner reasonably designed to attract the attention of the participant.

The administrator of a defined benefit plan is also required to furnish a benefit statement to a participant or beneficiary upon written request, limited to one request during any 12-month period.

A benefit statement is required to indicate, on the basis of the latest available information, the total benefits accrued for the participant or beneficiary, and the participant's or beneficiary's vested accrued benefit, if any, or the earliest date on which the accrued benefit will become vested. In the case of benefit statements provided automatically to participants at least every three years, information may be based on reasonable estimates determined under regulations prescribed by the Secretary of Labor in consultation with the Pension Benefit Guaranty Corporation.

[9] An ESOP that satisfies these special nondiscrimination tests by meeting certain safe harbor contribution requirements is not considered an applicable individual account plan.

Form of benefit statements

Benefit statements must be written in a manner calculated to be understood by the average plan participant. This requirement applies also to the additional information required to be provided to a participant or beneficiary of an applicable individual account plan. A benefit statement may be provided in written, electronic, or other appropriate form to the extent that such form is reasonably accessible to the recipient.

The Secretary of Labor is directed to promulgate, not later than 75 days after the date of enactment of the provision, interim final rules necessary to carry out the provision. In addition, the Secretary of Labor is directed to issue, not later than 180 days after the date of enactment of the provision, initial guidance and a model benefit statement, written in a manner calculated to be understood by the average plan participant, that may be used by plan administrators in complying with the benefit statement requirements.

Civil penalty

As under present law, if a plan administrator fails to furnish a required benefit statement, the participant or beneficiary may bring a civil action for recovery from the plan administrator of up to $110 a day or other relief that the court deems proper. In addition, the provision includes a new penalty in the case of a plan administrator that fails to provide a quarterly benefit statement to a participant or beneficiary of an applicable individual account plan. Under the provision, the Secretary of Labor may assess a civil penalty against a plan administrator of up to $1,000 a day for each day that a plan administrator has failed to provide the required quarterly benefit statement and has not corrected the failure by providing the required benefit statements to affected participants and beneficiaries.

Effective Date

The provision is generally effective for plan years beginning on or after the date that is one year after the date of enactment of the provision. In the case of a plan maintained pursuant to one or more collective bargaining agreements, the provision is effective for plan years beginning on or after the date of the commencement of the first plan year beginning on or after the earlier of: (1) the later of (a) the date that is two years after the date of enactment, or (b) the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after the date of enactment); and (2) the date that is three years after the date of enactment.

B. Inapplicability of Relief from Fiduciary Liability During Blackout Periods (secs. 102 and 108 of the bill and sec. 404(c) of ERISA)

Present Law

Fiduciary rules under ERISA

In general

ERISA contains general fiduciary duty standards that apply to all fiduciary actions, including investment decisions. ERISA requires that a plan fiduciary generally must discharge its duties solely in the interests of participants and beneficiaries and with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. ERISA generally requires a fiduciary to diversify the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. In the case of an individual account plan[10] (other than a money purchase pension plan), the requirement of diversification in investments and the general prudence requirement (to the extent that it requires diversification) generally are not violated by the holding of employer securities.

A plan fiduciary that breaches any of the fiduciary responsibilities, obligations, or duties imposed by ERISA is personally liable to make good to the plan any losses to the plan resulting from such breach and to restore to the plan any profits the fiduciary has made through the use of plan assets. A plan fiduciary may be liable also for a breach of responsibility by another fiduciary (a "co-fiduciary") in certain circumstances.

Special rule for participant control of assets

ERISA provides a special rule for an individual account plan that permits participants to exercise control over the assets in their individual accounts. Under the special rule, if a participant exercises control over the assets in his or her account (as determined under regulations), the participant is not deemed to be a fiduciary by reason of such exercise and no person who is otherwise a fiduciary is liable for any loss, or by reason of any breach, that results from the participant's exercise of control.

Regulations issued by the Department of Labor describe the requirements that must be met in order for a participant to be treated as exercising control over the assets in his or her account. With respect to investment options, the regulations provide in part:

- the plan must provide at least three different investment options, each of which is diversified and has materially different risk and return characteristics;
- the plan must allow participants to give investment instructions with respect to each investment option under the plan with a frequency that is appropriate in light of the

[10] An "individual account plan" is the term generally used under ERISA for a defined contribution plan.

reasonably expected market volatility of the investment option (the general volatility rule);

- at a minimum, participants must be allowed to give investment instructions at least every three months with respect to least three of the investment options, and those investment options must constitute a broad range of options (the three-month minimum rule);
- participants must be provided with detailed information about the investment options, information regarding fees, investment instructions and limitations, and copies of financial data and prospectuses; and
- specific requirements must be satisfied with respect to investments in employer stock to ensure that employees' buying, selling, and voting decisions are confidential and free from employer influence.

If these and the other requirements under the regulations are met, a plan fiduciary may be liable for the investment options made available under the plan, but not for the specific investment decisions made by participants.

Notice to participants and beneficiaries of blackout periods

In general

The Sarbanes-Oxley Act of 2002[11] amended ERISA to require that the plan administrator of an individual account plan provide advance notice of a blackout period (a "blackout notice") to plan participants and beneficiaries to whom the blackout period applies.[12] Generally, notice must be provided at least 30 days before the beginning of the blackout period.[13] In the case of a blackout period that applies with respect to employer securities, the plan administrator must also provide timely notice of the blackout period to the employer (or the affiliate of the employer that issued the securities, if applicable).

Definition of blackout period

A blackout period is any period during which any ability of participants or beneficiaries under the plan, which is otherwise available under the terms of the plan, to direct or diversify assets credited to their accounts, or to obtain loans or distributions from the plan, is temporarily suspended, limited, or restricted if the suspension, limitation, or restriction is for any period of more than three consecutive business days. However, a blackout period does not include a suspension, limitation, or restriction that (1) occurs by reason of the application of securities

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[11] Pub. L. No. 107-204.

[12] ERISA sec. 101(i), as enacted by section 306(b) of the Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act of 2002 also provides that a director or executive officer of a publicly-traded corporation is prohibited from trading in employer stock during blackout periods in certain circumstances (sec. 306(a)). These provisions are effective January 26, 2003.

[13] The blackout notice requirement does not apply to a one-participant retirement plan.

laws, (2) is a change to the plan providing for a regularly scheduled suspension, limitation, or restriction that is disclosed through a summary of material modifications to the plan or materials describing specific investment options under the plan, or changes thereto, or (3) applies only to one or more individuals, each of whom is a participant, alternate payee, or other beneficiary under a qualified domestic relations order.

Timing of notice

Notice of a blackout period is generally required at least 30 days before the beginning of the period. The 30-day notice requirement does not apply if (1) deferral of the blackout period would violate the fiduciary duty requirements of ERISA and a plan fiduciary so determines in writing, or (2) the inability to provide the 30-day advance notice is due to events that were unforeseeable or circumstances beyond the reasonable control of the plan administrator and a plan fiduciary so determines in writing. In those cases, notice must be provided as soon as reasonably practicable under the circumstances unless notice in advance of the termination of the blackout period is impracticable.

Another exception to the 30-day period applies in the case of a blackout period that applies only to one or more participants or beneficiaries in connection with a merger, acquisition, divestiture, or similar transaction involving the plan or the employer and that occurs solely in connection with becoming or ceasing to be a participant or beneficiary under the plan by reason of the merger, acquisition, divestiture, or similar transaction. Under the exception, the blackout notice requirement is treated as met if notice is provided to the participants or beneficiaries to whom the blackout period applies as soon as reasonably practicable.

The Secretary of Labor may provide additional exceptions to the notice requirement that the Secretary determines are in the interests of participants and beneficiaries.

Form and content of notice

A blackout notice must be written in a manner calculated to be understood by the average plan participant and must include (1) the reasons for the blackout period, (2) an identification of the investments and other rights affected, (3) the expected beginning date and length of the blackout period, and (4) in the case of a blackout period affecting investments, a statement that the participant or beneficiary should evaluate the appropriateness of current investment decisions in light of the inability to direct or diversify assets during the blackout period, and (5) other matters as required by regulations. If the expected beginning date or length of the blackout period changes after notice has been provided, the plan administrator must provide notice of the change (and specify any material change in other matters related to the blackout) to affected participants and beneficiaries as soon as reasonably practicable.

Notices provided in connection with a blackout period (or changes thereto) must be provided in writing and may be delivered in electronic or other form to the extent that the form is reasonably accessible to the recipient. The Secretary of Labor is required to issue guidance regarding the notice requirement and a model blackout notice.

Penalty for failure to provide notice

In the case of a failure to provide notice of a blackout period, the Secretary of Labor may assess a civil penalty against a plan administrator of up to $100 per day for each failure to provide a blackout notice. For this purpose, each violation with respect to a single participant or beneficiary is treated as a separate violation.

Explanation of Provision

Under the provision, relief from fiduciary liability for any loss or breach resulting from a participant's or beneficiary's exercise of control over assets in his or her account does not apply in connection with the direction or diversification of assets credited to an account during a blackout period if, by reason of the imposition of the blackout period, the ability of the participant or beneficiary to direct or diversify the assets in the account is suspended, limited, or restricted.

In addition, under the provision, if the fiduciary authorizing the blackout period meets the requirements of ERISA in connection with authorizing the blackout period, no fiduciary will be liable under ERISA for any loss occurring during the blackout period as a result of a participant's or beneficiary's exercise of control over assets in his or her account before the blackout period. Matters to be considered in determining whether a fiduciary has met the requirements of ERISA include whether the fiduciary: (1) has considered the reasonableness of the expected length of the blackout period; (2) has provided the required notice of the blackout period; and (3) has acted in accordance with the general fiduciary duty standards of ERISA in determining whether to enter into the blackout period.

Under the provision, if a blackout period arises in connection with a change in the investment options offered under the plan, a participant or beneficiary is deemed to have exercised control over the assets in his or her account before the blackout period if, after reasonable notice of the change in investment options is given to the participant or beneficiary, assets in the account are transferred either to plan investment options in accordance with the participant's or beneficiary's affirmative election, or in any case where these is no such election, in the manner set forth in the notice.

In addition, under the provision, a limitation or restriction that may govern the frequency of transfers between investment vehicles under a plan is not treated as the imposition of a blackout period to the extent the limitation or restriction is disclosed to participants or beneficiaries through a summary plan description or materials describing specific investment alternatives under the plan.

The Secretary of Labor is required to issue, on or before December 31, 2004, interim final regulations providing guidance on how employers or other affected plan fiduciaries can satisfy their fiduciary responsibilities during a blackout period during which the ability of a participant or beneficiary to direct the investment of the assets in his or her account is suspended.

Effective Date

The provision is generally effective for plan years beginning on or after the date that is one year after the date of enactment of the provision. In the case of a plan maintained pursuant to one or more collective bargaining agreements, the provision is effective for plan years beginning on or after the date of the commencement of the first plan year beginning on or after the earlier of: (1) the later of (a) the date that is two years after the date of enactment, or (b) the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after the date of enactment); and (2) the date that is three years after the date of enactment.

C. Informational and Educational Support for Pension Plan Fiduciaries (secs. 103 and 108 of the bill and new sec. 404(e) of ERISA)

Present Law

ERISA contains general fiduciary duty standards that apply to all fiduciary actions, including investment decisions. ERISA requires that a plan fiduciary generally must discharge its duties solely in the interests of participants and beneficiaries and with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. ERISA generally requires a fiduciary to diversify the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. In the case of an individual account plan[14] (other than a money purchase pension plan), the requirement of diversification in investments and the general prudence requirement (to the extent that it requires diversification) generally are not violated by the holding of employer securities.

A plan fiduciary that breaches any of the fiduciary responsibilities, obligations, or duties imposed by ERISA is personally liable to make good to the plan any losses to the plan resulting from such breach and to restore to the plan any profits the fiduciary has made through the use of plan assets. A plan fiduciary may be liable also for a breach of responsibility by another fiduciary (a "co-fiduciary") in certain circumstances.

Explanation of Provision

The Secretary of Labor is directed to establish a program under which information and educational resources are to be made available on an ongoing basis to persons serving as pension plan fiduciaries, so as to assist them in diligently and efficiently carrying out their fiduciary duties under ERISA. The program is to provide information about the practices that define prudent investment procedures for plan fiduciaries. Information provided must address the relevant investment considerations for defined benefit and defined contribution plans, including investment in employer securities by such plans. In developing the program, the Secretary of Labor is to solicit information from the public, including investment education professionals.

Effective Date

The provision is generally effective for plan years beginning on or after the date that is one year after the date of enactment of the provision. In the case of a plan maintained pursuant to one or more collective bargaining agreements, the provision is effective for plan years beginning on or after the date of the commencement of the first plan year beginning on or after the earlier of: (1) the later of (a) the date that is two years after the date of enactment, or (b) the date on which the last of such collective bargaining agreements terminates (determined without

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[14] An "individual account plan" is the term generally used under ERISA for a defined contribution plan.

regard to any extension thereof after the date of enactment); and (2) the date that is three years after the date of enactment.

D. Diversification Requirements for Defined Contribution Plans that Hold Employer Securities (secs. 104 and 108 of the bill, new sec. 401(a)(35) of the Code, and new sec. 204(j) of ERISA)

Present Law

In general

Defined contribution plans may permit both employees and employers to make contributions to the plan. Under a qualified cash or deferred arrangement (i.e., a section 401(k) plan), employees may elect to make pretax contributions to a plan, referred to as elective deferrals. Employees may also be permitted to make after-tax contributions to a plan. In addition, a plan may provide for employer nonelective contributions or matching contributions. Nonelective contributions are employer contributions that are made without regard to whether the employee makes elective deferrals or after-tax contributions. Matching contributions are employer contributions that are made only if the employee makes elective deferrals or after-tax contributions.

Under the Code, elective deferrals, after-tax employee contributions, and employer matching contributions are subject to special nondiscrimination tests.[15] Certain employer nonelective contributions may be used to satisfy these special nondiscrimination tests. In addition, plans may satisfy the special nondiscrimination tests by meeting certain safe harbor contribution requirements.

The Code requires employee stock ownership plans ("ESOPs") to offer certain plan participants the right to diversify investments in employer securities. ERISA limits the amount of employer securities that can be acquired or held by employer-sponsored retirement plans. The extent to which the ERISA limits apply depends on the type of plan and the type of contribution involved.

Diversification requirements applicable to ESOPs under the Code

An ESOP is a defined contribution plan that is designated as an ESOP and is designed to invest primarily in stock of the employer and that meets certain other requirements under the Code. An ESOP can be an entire plan or it can be a component of a larger defined contribution plan. An ESOP may provide for different types of contributions, including employer nonelective contributions and others. For example, an ESOP may include a qualified cash or deferred arrangement that permits employees to make elective deferrals.[16]

Under the Code, ESOPs are subject to a requirement that a participant who has attained age 55 and who has at least 10 years of participation in the plan must be permitted to diversify

[15] Sec. 401(k) and (m).

[16] Such an ESOP design is sometimes referred to as a "KSOP."

the investment of the participant's account in assets other than employer securities.[17] The diversification requirement applies to a participant for six years, starting with the year in which the individual first meets the eligibility requirements (i.e., age 55 and 10 years of participation). The participant must be allowed to elect to diversify up to 25 percent of the participant's account (50 percent in the sixth year), reduced by the portion of the account diversified in prior years.

The participant must be given 90 days after the end of each plan year in the election period to make the election to diversify. In the case of participants who elect to diversify, the plan satisfies the diversification requirement if (1) the plan distributes the applicable amount to the participant within 90 days after the election period, (2) the plan offers at least three investment options (not inconsistent with Treasury regulations) and, within 90 days of the election period, invests the applicable amount in accordance with the participant's election, or (3) the applicable amount is transferred within 90 days of the election period to another qualified defined contribution plan of the employer providing investment options in accordance with (2).[18]

10-percent limit on the acquisition of employer securities under ERISA

ERISA prohibits defined benefit plans and money purchase pension plans (other than certain plans in existence before the enactment of ERISA) from acquiring employer securities if, after the acquisition, more than 10 percent of the assets of the plan would be invested in employer stock.[19] Except as discussed below with respect to elective deferrals, this 10-percent limitation generally does not apply to defined contribution plans other than money purchase pension plans.[20] In addition, the ERISA requirement that plan assets be diversified is generally not violated by the acquisition or holding of employer securities in a defined contribution plan.[21]

The 10-percent limitation on the acquisition of employer securities, described above, applies separately to the portion of a plan consisting of elective deferrals (and earnings thereon) if any portion of an individual's elective deferrals (or earnings thereon) are required to be invested in employer securities pursuant to plan terms or the direction of a person other than the participant. This restriction does not apply if (1) the amount of elective deferrals required to be invested in employer securities does not exceed more than one percent of any employee's compensation, (2) the fair market value of all defined contribution plans maintained by the

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[17] Sec. 401(a)(28). The present-law diversification requirements do not apply to employer securities held by an ESOP that were acquired before January 1, 1987.

[18] IRS Notice 88-56, 1988-1 C.B. 540, Q&A-16.

[19] ERISA sec. 407.

[20] The 10-percent limitation also applies to a defined contribution plan that is part of an arrangement under which benefits payable to a participant under a defined benefit plan are reduced by benefits under the defined contribution plan (i.e., a "floor-offset" arrangement).

[21] Under ERISA, a defined contribution plan is generally referred to as an individual account plan. Plans that are not subject to the 10-percent limitation on the acquisition of employer securities are referred to as "eligible individual account plans."

employer is no more than 10-percent of the fair market value of all retirement plans of the employer, or (3) the plan is an ESOP.

Explanation of Provision

In general

Under the Code and ERISA, certain defined contribution plans of employers with publicly-traded stock are required to provide diversification rights with respect to amounts invested in employer securities. Such a plan is required to permit applicable individuals at least quarterly to direct that the portion of the individual's account held in employer securities be invested in alternative investments. Under the provision, an applicable individual includes (1) any plan participant and (2) any beneficiary who has an account under the plan with respect to which the beneficiary is entitled to exercise the rights of a participant. The time when the diversification requirements apply depends on the type of contributions invested in employer securities.

Plans subject to requirements

The diversification requirements apply to defined contribution plans, other than certain ESOPs. The diversification requirements apply to an ESOP only if the ESOP holds contributions (or earnings thereon) that are subject to the special nondiscrimination tests that apply to elective deferrals, employee after-tax contributions, and matching contributions. Accordingly, an ESOP that holds elective deferrals, employee contributions, employer matching contributions, or nonelective employer contributions used to satisfy the special nondiscrimination tests generally is subject to the diversification requirements under the provision (unless another exception applies). The diversification requirements do not apply to an ESOP that satisfies these special nondiscrimination tests by meeting certain safe harbor contribution requirements. The diversification rights applicable under the provision are broader than those applicable under the Code's present-law ESOP diversification rules. Thus, an ESOP that is subject to the new requirements is excepted from the present-law diversification requirements.[22]

The diversification requirement does not apply to a defined contribution plan holding employer securities if there is no class of stock issued by the employer (or a member of the employer's controlled group) that is readily tradable on an established securities market. The proposal also provides for other exceptions to the diversification requirements in such circumstances as may be determined jointly by the Secretary of Treasury and the Secretary of Labor in regulations. It is intended that the Secretary of Treasury and the Secretary of Labor will identify exceptions to the diversification requirements in appropriate cases. For example, an exception may be appropriate if no stock of the business maintaining the plan (including stock

[22] An ESOP will not be treated as failing to be designed to invest primarily in qualifying employer securities merely because the plan provides diversification rights as required under the provision or greater diversification rights than required under the provision.

held in the plan) is publicly traded, but a member of the employer's controlled group has issued a limited amount of publicly traded stock.

Elective deferrals and employee contributions

In the case of amounts attributable to elective deferrals under a qualified cash or deferred arrangement and employee after-tax contributions, any applicable individual must be permitted to direct that such amounts be invested in alternative investments.

Other contributions

In the case of amounts attributable to all other contributions (i.e., nonelective employer contributions and employer matching contributions) that are invested in employer securities, an applicable individual with a benefit based on three years of service must be permitted to direct that such amounts be invested in alternative investments. For this purposes, an applicable individual has a benefit based on three years of service if the individual would be an applicable individual if only participants with at least three years of service were taken into account.[23] That is, an applicable individual with a benefit based on three years of service is (1) a participant with three years of service, or (2) a beneficiary with respect to a participant with three years of service if the beneficiary has an account under the plan with respect to which the beneficiary is entitled to exercise the rights of a participant.

An alternative is available for satisfying the diversification requirements with respect to the portion of an individual's account attributable to contributions other than elective deferrals and employee after-tax contributions that is held in employer securities. Under the alternative, the time when an applicable individual must be permitted to diversify that portion of the account is based on when the employer securities were allocated to the account. Diversification must be permitted no later than the last day of the third plan year after the plan year in which the allocation occurred. For example, if employer securities are allocated to an applicable individual's account in July 2008, and the plan year is the calendar year, the individual must be permitted no later than December 31, 2011, to make a diversification election with respect to the employer securities. The provision does not preclude the three-year period from being measured more frequently than annually. For example, the plan may provide diversification rights with respect to employer securities as of the end of the calendar quarter that occurs three years after the calendar quarter in which the securities were allocated to the account.

Requirements for investment alternatives

The plan is required to give applicable individuals a choice of at least three investment options, other than employer securities, each of which is diversified and has materially different risk and return characteristics. The plan must also permit the applicable individual to choose from any of the investment options offered under the plan, subject to such restrictions as may be provided by the plan limiting the choice to periodic, reasonable opportunities that occur at least quarterly.

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[23] Years of service are defined as under the rules relating to vesting (sec. 411(a)).

Transition rule

In general

The provision includes a transition rule for the first five years for which the new diversification requirements apply to a plan. Under the transition rule, in the case of employer securities of any class that are held in the plan on the effective date of the provision, diversification rights generally must be provided with respect to the applicable percentage of each class of employer securities as shown in the following table.

Table 1.--Applicable Percentage for Employer Securities Held on Effective Date

Plan year for which diversification applies:	Applicable percentage:
First year	Greater of amount that would be required under present-law ESOP diversification rule or 20 percent
Second year	Greater of amount that would be required under present-law ESOP diversification rule or 40 percent
Third year	60 percent
Fourth year	80 percent
Fifth year or thereafter	100 percent

The applicable percentage is reduced to the extent necessary to reflect any previous diversification of employer securities pursuant to an election under the present-law ESOP diversification requirements.

The transition rule is illustrated by the following example. Suppose that the account of a participant with at least three years of service holds 200 shares of employer stock on the date the diversification requirements become effective. In the first year for which diversification applies, 20 percent (i.e., 40 shares) of that stock is subject to the diversification requirements. In the second year for which diversification applies, an additional 20 percent (for a total of 40 percent), or an additional 40 shares of the stock (for a total of 80 shares), is subject to the diversification requirements. Similarly, in the third and fourth years for which diversification applies, 60 and 80 percent of the stock respectively (a total of 120 and 160 shares respectively) are subject to the diversification requirements. In the fifth year for which diversification applies, 100 percent of the stock (i.e., all 200 shares) is subject to the diversification requirements.

Plans subject to the 10-percent limitation under ERISA

The applicable percentage is 100 percent with respect to employer securities attributable to employee after-tax contributions and elective deferrals (and earnings thereon) held in a plan under which the elective deferrals are treated as a separate plan for purposes of the ERISA 10-percent limitation on the acquisition of employer securities. The determination of whether elective deferrals are treated as a separate plan and thus are subject to the 100 percent diversification rule (rather than the phase-in) is made as of the date of enactment.

Effective Date

The provision is generally effective for plan years beginning on or after December 31, 2003, and with respect to employer securities allocated to accounts before, on, or after the date of enactment of the provision. In the case of a plan maintained pursuant to one or more collective bargaining agreements, the provision is effective for plan years beginning on or after the date of the commencement of the first plan year beginning on or after the earlier of: (1) the later of (a) the date that is two years after the date of enactment, or (b) the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after the date of enactment); and (2) the date that is three years after the date of enactment. The provision does not apply to employer securities held by an ESOP that were acquired before January 1, 1987 (and thus are not subject to the present-law diversification requirement).

E. Prohibited Transaction Exemption for the Provision of Investment Advice (secs. 105 and 108 of the bill, sec. 4975 of the Code, and sec. 408 of ERISA)

Present Law

The Code prohibits certain transactions between an employer-sponsored retirement plan and a disqualified person.[24] Disqualified persons include a fiduciary of the plan, a person providing services to the plan, and an employer with employees covered by the plan. For this purpose, a fiduciary includes any person who (1) exercises any authority or control respecting management or disposition of the plan's assets, (2) renders investment advice for a fee or other compensation with respect to any plan moneys or property, or has the authority or responsibility to do so, or (3) has any discretionary authority or responsibility in the administration of the plan.

Prohibited transactions include (1) the sale, exchange or leasing of property, (2) the lending of money or other extension of credit, (3) the furnishing of goods, services or facilities, (4) the transfer to, or use by or for the benefit of, the income or assets of the plan, (5) in the case of a fiduciary, any act that deals with the plan's income or assets for the fiduciary's own interest or account, and (6) the receipt by a fiduciary of any consideration for the fiduciary's own personal account from any party dealing with the plan in connection with a transaction involving the income or assets of the plan. However, certain transactions are exempt from prohibited transaction treatment, for example, certain loans to plan participants.

Under the Code, if a prohibited transaction occurs, the disqualified person who participates in the transaction is subject to a two-tier excise tax. The first level tax is 15 percent of the amount involved in the transaction. The second level tax is imposed if the prohibited transaction is not corrected within a certain period and is 100 percent of the amount involved.[25]

Explanation of Provision

The provision adds a new category of prohibited transaction exemptions in connection with the provision of investment advice with respect to plan assets for a fee if: (1) the investment of plan assets is subject to the direction of plan participants or beneficiaries; (2) the

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[24] Under the Code, the prohibited transaction rules apply to qualified retirement plans and qualified retirement annuities, as well as individual retirement accounts and annuities, Archer MSAs, and Coverdell education savings accounts. Under ERISA, similar prohibited transaction rules apply to employer-sponsored retirement plans and welfare benefit plans. The prohibited transaction rules under the Code and ERISA do not apply to governmental plans or church plans.

[25] Under ERISA, the Secretary of Labor may assess a civil penalty against a person who engages in a prohibited transaction, other than a transaction with a plan covered by the prohibited transaction rules of the Code. The penalty may not exceed five percent of the amount involved in the transaction for each year or part of a year that the prohibited transaction continues. If the prohibited transaction is not corrected within 90 days after notice from the Secretary of Labor, the penalty may be up to 100 percent of the amount involved in the transaction.

advice is provided to the plan or a participant or beneficiary by a fiduciary adviser in connection with a sale, acquisition or holding of a security or other property (an "investment transaction") for purposes of investment of plan assets; and (3) certain other requirements are met.[26] Under the provision, the following are exempt from prohibited transaction treatment: (1) the provision of investment advice to the plan, participant or beneficiary; (2) an investment transaction (including any lending of money or other extension of credit associated with the investment transaction) pursuant to the advice; and (3) the direct or indirect receipt of fees or other compensation by a fiduciary adviser or an affiliate thereof (or any employee, agent or registered representative of the fiduciary adviser or an affiliate) in connection with the provision of the advice or an investment transaction pursuant to the advice.

Under the provision, certain requirements must be met in order for the exemption to apply. When initially providing advice about a security or other property, the fiduciary adviser must provide to the recipient of the advice, on a reasonably contemporaneous basis, written notification of specified information (discussed below) as well as any disclosure required in connection with the investment transaction under any applicable securities laws. In addition, the investment transaction must occur solely at the direction of the recipient of the advice; the compensation received by the adviser and its affiliates in connection with the investment transaction must be reasonable; and the terms of the investment transaction must be at least as favorable as an arm's length transaction would be.

The written notification required to be provided by the fiduciary adviser must include information about the following: (1) all fees or compensation to be received by the adviser or any affiliate (including from a third party) in connection with the advice or the investment transaction; (2) any material affiliation or contractual relationship of the adviser or its affiliates in the security or other property involved in the investment transaction; (3) any limitation placed on the scope of the investment advice to be provided by the fiduciary adviser with respect to an investment transaction; (4) the types of services provided by the adviser in connection with the provision of investment advice; (5) the adviser's status as a fiduciary of the plan in connection with the provision of the advice; and (6) the ability of the recipient of the advice separately to arrange for the provision of advice by another adviser that could have no material affiliation with and receive no fees or other compensation in connection with the security or other property. In addition, in connection with the initial advice or subsequent advice, the required information must be maintained in currently accurate form and must be provided to a recipient of investment advice (without charge) at least annually and also when requested by the recipient of the advice or when there is a material change in the information. In the event of a material change in the information, currently accurate information must be provided to the recipient at a time reasonably contemporaneous to the change.

The written notification can be provided electronically. Any notification (or currently accurate information) must be written in a clear and conspicuous manner, calculated to be understood by the average plan participant, and be sufficiently accurate and comprehensive so as to reasonably apprise participants and beneficiaries of the required information. The Secretary of

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[26] The provision amends the prohibited transaction rules under both the Code and ERISA.

Labor is directed to issue a model form for the disclosure of fees and other compensation as required by the provision.

The fiduciary adviser must maintain for at least six years any records necessary for determining whether the requirements for the prohibited transaction exemption were met. A prohibited transaction will not be considered to have occurred solely because records were lost or destroyed before the end of six years due to circumstances beyond the adviser's control.

For purposes of the provision, "fiduciary adviser" is defined as a person who is a fiduciary of the plan by reason of the provision of investment advice to the plan, a participant or beneficiary and who is also: (1) registered as an investment adviser under the Investment Advisers Act of 1940 or under State laws; (2) a bank, a similar financial institution supervised by the United States or a State, or a savings association (as defined under the Federal Deposit Insurance Act), but only if the advice is provided through a trust department that is subject to periodic examination and review by Federal or State banking authorities; (3) an insurance company qualified to do business under State law; (4) registered as a broker or dealer under the Securities Exchange Act of 1934; (5) an affiliate of any of the preceding; or (6) an employee, agent or registered representative of any of the preceding who satisfies the requirements of applicable insurance, banking and securities laws relating to the provision of advice. "Affiliate" means an affiliated person as defined under section 2(a)(3) of the Investment Company Act of 1940. "Registered representative" means a person described in section 3(a)(18) of the Securities Exchange Act of 1934 or a person described in section 202(a)(17) of the Investment Advisers Act of 1940.

Subject to certain requirements, the employer or other person who is a plan fiduciary, other than a fiduciary adviser, is not treated as failing to meet the prohibited transaction requirements (or the fiduciary requirements of ERISA), solely by reason of the provision of investment advice as permitted under the provision, or of contracting for or otherwise arranging for the provision of the advice. This rule applies if: (1) the advice is provided under an arrangement between the employer or plan fiduciary and the fiduciary adviser, for the provision of investment advice by the fiduciary adviser as permitted under the provision; (2) the terms of the arrangement require compliance by the fiduciary adviser with the requirements of the provision; and (3) the terms of the arrangement include a written acknowledgement by the fiduciary adviser that the fiduciary adviser is a plan fiduciary with respect to the provision of the advice. The fiduciary responsibility requirements of ERISA must also be met in connection with the provision of investment advice.

The provision does not exempt the employer or a plan fiduciary from fiduciary responsibility under ERISA for the prudent selection and periodic review of a fiduciary adviser with whom the employer or plan fiduciary has arranged for the provision of investment advice. The employer or plan fiduciary does not have the duty to monitor the specific investment advice given by a fiduciary adviser.

The provision also provides that nothing in the fiduciary responsibility provisions of ERISA is to be construed to preclude the use of plan assets to pay for reasonable expenses in providing investment advice.

Effective Date

The provision is effective with respect to investment advice provided on or after January 1, 2005.

F. Study Regarding Impact on Retirement Savings of Participants and Beneficiaries by Requiring Consultants to Advise Plan Fiduciaries of Individual Account Plans (sec. 106 of the bill)

Present Law

ERISA generally provides that a person is a plan fiduciary to the extent the fiduciary exercises any discretionary authority or control over management of the plan or exercises authority or control over management or disposition of its assets, renders investment advice for a fee or other compensation, or has any discretionary authority or responsibility in the administration of the plan. As a result, a person who makes investment decisions with respect to a qualified retirement plan is generally a plan fiduciary.

Generally, the plan trustee has exclusive authority and responsibility for managing and controlling plan assets and is thus responsible for investing plan assets. However, the plan may make the trustee subject to the direction of a named fiduciary, or the authority for managing plan assets may be delegated to an investment manager. An investment manager is a registered investment adviser, bank, trust company, or insurance company that is appointed by a named fiduciary of the plan with the power to manage, acquire, or dispose of plan assets. The investment manager must acknowledge in writing its status as a fiduciary.

Under some individual account plans,[27] participants and beneficiaries have the right to direct the investment of the assets in their accounts under the plan.

Present law does not provide for a study regarding the effect of independent consultants to advise plan fiduciaries in connection with individual account plans.

Explanation of Provision

The Secretary of Labor is directed to undertake a study of the costs and benefits to participants and beneficiaries of requiring independent consultants to advise plan fiduciaries in connection with individual account plans. In conducting the study, the Secretary of Labor is to consider the following: (1) the benefits to plan participants and beneficiaries of engaging independent advisers to provide investment and other advice regarding the assets of the plan to persons who have fiduciary duties with respect to the management or disposition of plan assets; (2) the extent to which independent advisers are currently retained by plan fiduciaries; (3) the availability of assistance to fiduciaries from appropriate Federal agencies; (4) the availability of qualified independent consultants to serve the needs of individual account plan fiduciaries in the United States; (5) the impact of the additional fiduciary duty of an independent adviser on the strict fiduciary obligations of plan fiduciaries; (6) the impact of new requirements (consulting fees, reporting requirements, and new plan duties to prudently identify and contract with qualified independent consultants) on the availability of individual account plans; and (7) the

[27] An "individual account plan" is the term generally used under ERISA for a defined contribution plan.

impact of a new requirement on the plan administration costs per participant for small and mid-size employers and the pension plans they sponsor.

The Secretary of Labor is directed to undertake this study as soon as practicable after the date of enactment of the provision. The Secretary of Labor is required to issue a report on the results of the study not later than one year after the date of enactment, including any recommendations for legislative changes, to the House Committee on Education and the Workforce and the Senate Committee on Health, Education, Labor, and Pensions.

Effective Date

The provision is effective on the date of enactment.

G. Employer-Provided Qualified Retirement Planning Services (sec. 107 of the bill and sec. 132(m) of the Code)

Present Law

Under present law, certain employer-provided fringe benefits are excludable from gross income and wages for employment tax purposes.[28] These excludable fringe benefits include qualified retirement planning services provided to an employee and his or her spouse by an employer maintaining a qualified employer plan. A qualified employer plan includes a qualified retirement plan or annuity, a tax-sheltered annuity, a simplified employee pension, a SIMPLE retirement account, or a governmental plan, including an eligible deferred compensation plan maintained by a governmental employer.

Qualified retirement planning services are retirement planning advice and information. The exclusion is not limited to information regarding the qualified employer plan, and, thus, for example, applies to advice and information regarding retirement income planning for an individual and his or her spouse and how the employer's plan fits into the individual's overall retirement income plan. On the other hand, the exclusion does not apply to services that may be related to retirement planning, such as tax preparation, accounting, legal or brokerage services.

The exclusion does not apply with respect to highly compensated employees unless the services are available on substantially the same terms to each member of the group of employees normally provided education and information regarding the employer's qualified plan.

Explanation of Provision

The provision permits employers to offer employees a choice between cash compensation and eligible qualified retirement planning services. The provision only applies to qualified retirement planning services provided by a qualified investment advisor. It is intended that qualified investment advisors will be certified and regulated under applicable laws and regulations. In addition, it is intended that qualified investment advisors also include investment advisors within a financial institution's trust or custody department chartered under the National Bank Act.[29] As under present law, the provision applies only to amounts for retirement planning advice and information and does not apply to services that may be related to retirement planning, such as tax preparation, accounting, legal or brokerage services.

Under the provision, no amount is includible in gross income or wages merely because the employee is offered the choice of cash in lieu of eligible qualified retirement planning services. Also, no amount is includible in income or wages merely because the employee is offered a choice among eligible qualified retirement planning services. The amount of cash offered is includible in income and wages only to the extent the employee elects cash. The exclusion does not apply to highly compensated employees unless the salary reduction option is

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[28] Secs. 132 and 3121(a)(20).

[29] 12 U.S.C. 92(a).

available on substantially the same terms to all employees normally provided education and information about the plan.

Under the provision, salary reduction amounts used to provide eligible qualified retirement planning services are generally treated for pension plan purposes the same as other salary reduction contributions. Thus, such amounts are included in compensation for purposes of applying the limits on contributions and benefits, and an employer is able to elect whether or not to include such amounts in compensation for nondiscrimination testing.

Effective Date

The provision is effective for taxable years beginning after December 31, 2003.

II. OTHER PROVISIONS RELATING TO PENSIONS

A. Amendments to the Retirement Protection Act of 1994 (sec. 201 of the bill and sec. 769(c) of the Retirement Protection Act of 1994)

Present Law

Under the Code and ERISA, defined benefit pension plans are required to meet certain minimum funding rules. In some cases, additional contributions are required if a defined benefit pension plan is underfunded. Additional contributions generally are not required in the case of a plan with a funded current liability percentage of at least 90 percent. A plan's funded current liability percentage is the value of plan assets as a percentage of current liability. In general, a plan's current liability means all liabilities to employees and their beneficiaries under the plan. Quarterly minimum funding contributions are required in the case of certain underfunded plans.

The Pension Benefit Guaranty Corporation ("PBGC") insures benefits under most defined benefit pension plans in the event the plan is terminated with insufficient assets to pay for plan benefits. The PBGC is funded in part by a flat-rate premium per plan participant, and a variable rate premium based on the amount of unfunded vested benefits under the plan.

Under present law, a special rule modifies the minimum funding requirements in the case of certain plans.[30] The special rule applies in the case of plans that (1) were not required to pay a variable rate PBGC premium for the plan year beginning in 1996, (2) do not, in plan years beginning after 1995 and before 2009, merge with another plan (other than a plan sponsored by an employer that was a member of the controlled group of the employer in 1996), and (3) are sponsored by a company that is engaged primarily in interurban or interstate passenger bus service.

The special rule treats a plan to which it applies as having a funded current liability percentage of at least 90 percent for plan years beginning after 1996 and before 2005 if for such plan year the funded current liability percentage is at least 85 percent. If the funded current liability of the plan is less than 85 percent for any plan year beginning after 1996 and before 2005, the relief from the minimum funding requirements applies only if certain specified contributions are made.

For plan years beginning after 2004 and before 2010, the funded current liability percentage will be deemed to be at least 90 percent if the actual funded current liability percentage is at least at certain specified levels.

The relief from the minimum funding requirements applies for the plan year beginning in 2005, 2006, 2007, and 2008 only if contributions to the plan equal at least the expected increase in current liability due to benefits accruing during the plan year.

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[30] Sec. 769(c) of the Retirement Protection Act of 1994, Pub. L. No. 103-465, as amended by sec. 1508 of the Taxpayer Relief Act of 1997, Pub. L. No. 105-34.

Explanation of Provision

The provision modifies the special funding rule for plans sponsored by a company engaged primarily in interurban or interstate passenger bus service by making the rule permanent.

In addition, the provision modifies the rule by providing that (1) the funded current liability percentage of a plan to which the rule applies is treated as not less than 90 percent for purposes of the minimum funding rules applicable to underfunded plans, and (2) the funded current liability percentage of a plan to which the rule applies is treated as not less than 100 percent for purposes of the quarterly contribution requirement. Under the provision, the mortality table to be used in determining the amount of unfunded vested benefits for purposes of PBGC variable rate premiums is the mortality table used under the plan.

Effective Date

The provision is effective with respect to plan years beginning after December 31, 2002.

B. Pension Plan Reporting Simplification (sec. 202 of the bill)

Present Law

A plan administrator of a pension, annuity, stock bonus, profit-sharing or other funded plan of deferred compensation generally must file with the Secretary of the Treasury an annual return for each plan year containing certain information with respect to the qualification, financial condition, and operation of the plan. Title I of ERISA also may require the plan administrator to file annual reports concerning the plan with the Department of Labor and the Pension Benefit Guaranty Corporation ("PBGC"). The plan administrator must use the Form 5500 series as the format for the required annual return.[31] The Form 5500 series annual return/report, which consists of a primary form and various schedules, includes the information required to be filed with all three agencies. The plan administrator satisfies the reporting requirement with respect to each agency by filing the Form 5500 series annual return/report with the Department of Labor, which forwards the form to the Internal Revenue Service and the PBGC.

The Form 5500 series consists of 2 different forms: Form 5500 and Form 5500-EZ. Form 5500 is the more comprehensive of the forms and requires the most detailed financial information. A plan administrator generally may file Form 5500-EZ, which consists of only one page, if (1) the only participants in the plan are the sole owner of a business that maintains the plan (and such owner's spouse), or partners in a partnership that maintains the plan (and such partners' spouses), (2) the plan is not aggregated with another plan in order to satisfy the minimum coverage requirements of section 410(b), (3) the employer is not a member of a related group of employers, and (4) the employer does not receive the services of leased employees. If the plan satisfies the eligibility requirements for Form 5500-EZ and the total value of the plan assets as of the end of the plan year and all prior plan years beginning on or after January 1, 1994, does not exceed $100,000, the plan administrator is not required to file a return.

With respect to a plan that does not satisfy the eligibility requirements for Form 5500-EZ, the characteristics and the size of the plan determine the amount of detailed financial information that the plan administrator must provide on Form 5500. If the plan has more than 100 participants at the beginning of the plan year, the plan administrator generally must provide more information.

Explanation of Provision

The Secretary of the Treasury and the Secretary of Labor are directed to modify the annual return filing requirements with respect to plans that satisfy the eligibility requirements for Form 5500-EZ (referred to as a "one-participant retirement plan") to provide that if the total value of the plan assets of such a plan as of the end of the plan year does not exceed $250,000, the plan administrator is not required to file a return. In addition, the provision directs the Secretary of the Treasury and the Secretary of Labor to provide simplified reporting

[31] Treas. Reg. sec. 301.6058-1(a).

requirements for plan years beginning after December 31, 2004, for certain plans with fewer than 25 employees.

Effective Date

The provision relating to one-participant retirement plans is effective for plans beginning on or after January 1, 2003. The provision relating to simplified reporting for plans with fewer than 25 employees is effective on the date of enactment.

C. Improvement of Employee Plans Compliance Resolution System (sec. 203 of the bill)

Present Law

A retirement plan that is intended to be a tax-qualified plan provides retirement benefits on a tax-favored basis if the plan satisfies all of the requirements of section 401(a). Similarly, an annuity that is intended to be a tax-sheltered annuity provides retirement benefits on a tax-favored basis if the program satisfies all of the requirements of section 403(b). Failure to satisfy all of the applicable requirements of section 401(a) or section 403(b) may disqualify a plan or annuity for the intended tax-favored treatment.

The Internal Revenue Service ("IRS") has established the Employee Plans Compliance Resolution System ("EPCRS"), which is a comprehensive system of correction programs for sponsors of retirement plans and annuities that are intended, but have failed, to satisfy the requirements of section 401(a), section 403(a), or section 403(b), as applicable.[32] EPCRS permits employers to correct compliance failures and continue to provide their employees with retirement benefits on a tax-favored basis.

The IRS has designed EPCRS to (1) encourage operational and formal compliance, (2) promote voluntary and timely correction of compliance failures, (3) provide sanctions for compliance failures identified on audit that are reasonable in light of the nature, extent, and severity of the violation, (4) provide consistent and uniform administration of the correction programs, and (5) permit employers to rely on the availability of EPCRS in taking corrective actions to maintain the tax-favored status of their retirement plans and annuities.

The basic elements of the programs that comprise EPCRS are self-correction, voluntary correction with IRS approval, and correction on audit. The Self-Correction Program ("SCP") generally permits a plan sponsor that has established compliance practices to correct certain insignificant failures at any time (including during an audit), and certain significant failures within a 2-year period, without payment of any fee or sanction. The Voluntary Correction Program ("VCP") program permits an employer, at any time before an audit, to pay a limited fee and receive IRS approval of a correction. For a failure that is discovered on audit and corrected, the Audit Closing Agreement Program ("Audit CAP") provides for a sanction that bears a reasonable relationship to the nature, extent, and severity of the failure and that takes into account the extent to which correction occurred before audit.

The IRS has expressed its intent that EPCRS will be updated and improved periodically in light of experience and comments from those who use it.

Explanation of Provision

The Secretary of the Treasury is directed to continue to update and improve EPCRS (or any successor program), giving special attention to (1) increasing the awareness and knowledge of small employers concerning the availability and use of EPCRS, (2) taking into account special

[32] Rev. Proc. 2002-47, 2002-29 I.R.B. 133.

concerns and circumstances that small employers face with respect to compliance and correction of compliance failures, (3) extending the duration of the self-correction period under SCP for significant compliance failures, (4) expanding the availability to correct insignificant compliance failures under SCP during audit, and (5) assuring that any tax, penalty, or sanction that is imposed by reason of a compliance failure is not excessive and bears a reasonable relationship to the nature, extent, and severity of the failure.

The provision clarifies that the Secretary has the full authority to effectuate the foregoing with respect to EPCRS (or any successor program) and any other employee plans correction policies, including the authority to waive income, excise or other taxes to ensure that any tax, penalty or sanction is not excessive and bears a reasonable relationship to the nature, extent and severity of the failure.

Effective Date

The provision is effective on the date of enactment.

D. Flexibility in Nondiscrimination, Coverage, and Line of Business Rules (sec. 204 of the bill and secs. 401(a)(4), 410(b), and 414(r) of the Code)

Present Law

A plan is not a qualified retirement plan if the contributions or benefits provided under the plan discriminate in favor of highly compensated employees (sec. 401(a)(4)). The applicable Treasury regulations set forth the exclusive rules for determining whether a plan satisfies the nondiscrimination requirement. These regulations state that the form of the plan and the effect of the plan in operation determine whether the plan is nondiscriminatory and that intent is irrelevant.

Similarly, a plan is not a qualified retirement plan if the plan does not benefit a minimum number of employees (sec. 410(b)). A plan satisfies this minimum coverage requirement if and only if it satisfies one of the tests specified in the applicable Treasury regulations. If an employer is treated as operating separate lines of business, the employer may apply the minimum coverage requirements to a plan separately with respect to the employees in each separate line of business (sec. 414(r)). Under a so-called "gateway" requirement, however, the plan must benefit a classification of employees that does not discriminate in favor of highly compensated employees in order for the employer to apply the minimum coverage requirements separately for the employees in each separate line of business. A plan satisfies this gateway requirement only if it satisfies one of the tests specified in the applicable Treasury regulations.

Explanation of Provision

The Secretary of the Treasury is directed to modify, on or before December 31, 2004, the existing regulations issued under section 414(r) in order to expand (to the extent that the Secretary may determine to be appropriate) the ability of a plan to demonstrate compliance with the line of business requirements based upon the facts and circumstances surrounding the design and operation of the plan, even though the plan is unable to satisfy the mechanical tests currently used to determine compliance.

The Secretary of the Treasury is directed to provide by regulation applicable to years beginning after December 31, 2004, that a plan is deemed to satisfy the nondiscrimination requirements of section 401(a)(4) if the plan satisfied the pre-1994 facts and circumstances test, satisfies the conditions prescribed by the Secretary to appropriately limit the availability of such test, and is submitted to the Secretary for a determination of whether it satisfies such test (to the extent provided by the Secretary).

Similarly, a plan will comply with the minimum coverage requirement of section 410(b) if the plan satisfies the pre-1989 coverage rules, is submitted to the Secretary for a determination of whether it satisfied the pre-1989 coverage rules (to the extent provided by the Secretary), and satisfies conditions prescribed by the Secretary by regulation that appropriately limit the availability of the pre-1989 coverage rules.

Effective Date

The provision relating to the line of business requirements under section 414(r) is effective on the date of enactment. The provision relating to the nondiscrimination requirements under section 401(a)(4) is effective on the date of enactment, except that any condition of availability prescribed by the Secretary will not be effective before the first year beginning not less than 120 days after the date on which such condition is prescribed. The provision relating to the minimum coverage requirements under section 410(b) is effective for years beginning after December 31, 2004, except that any condition of availability prescribed by the Secretary by regulation will not apply before the first year beginning not less than 120 days after the date on which such condition is prescribed.

E. Extension to all Governmental Plans of Moratorium on Application of Certain Nondiscrimination Rules Applicable to State and Local Government Plans (sec. 205 of the bill, sec. 1505 of the Taxpayer Relief Act of 1997, and secs. 401(a) and 401(k) of the Code)

Present Law

A qualified retirement plan maintained by a State or local government is exempt from the rules concerning nondiscrimination (sec. 401(a)(4)) and minimum participation (sec. 401(a)(26)). All other governmental plans are not exempt from the nondiscrimination and minimum participation rules.

Explanation of Provision

The provision exempts all governmental plans (as defined in sec. 414(d)) from the nondiscrimination and minimum participation rules.

Effective Date

The provision is effective for years beginning after December 31, 2003.

F. Notice and Consent Period Regarding Distributions (sec. 206 of the bill and sec. 417 of the Code)

Present Law

Notice and consent requirements apply to certain distributions from qualified retirement plans. These requirements relate to the content and timing of information that a plan must provide to a participant prior to a distribution, and to whether the plan must obtain the participant's consent to the distribution. The nature and extent of the notice and consent requirements applicable to a distribution depend upon the value of the participant's vested accrued benefit and whether the joint and survivor annuity requirements (sec. 417) apply to the participant.

If the present value of the participant's vested accrued benefit exceeds $5,000,[33] the plan may not distribute the participant's benefit without the written consent of the participant. The participant's consent to a distribution is not valid unless the participant has received from the plan a notice that contains a written explanation of (1) the material features and the relative values of the optional forms of benefit available under the plan, (2) the participant's right, if any, to have the distribution directly transferred to another retirement plan or IRA, and (3) the rules concerning the taxation of a distribution. If the joint and survivor annuity requirements apply to the participant, this notice also must contain a written explanation of (1) the terms and conditions of the qualified joint and survivor annuity ("QJSA"), (2) the participant's right to make, and the effect of, an election to waive the QJSA, (3) the rights of the participant's spouse with respect to a participant's waiver of the QJSA, and (4) the right to make, and the effect of, a revocation of a waiver of the QJSA. The plan generally must provide this notice to the participant no less than 30 and no more than 90 days before the date distribution commences.

If the participant's vested accrued benefit does not exceed $5,000, the terms of the plan may provide for distribution without the participant's consent. In that case, the plan must provide that, if the amount of the distribution exceeds $1,000, the plan administrator will transfer the distribution to a designated IRA unless the participant elects to receive the distribution directly or have it directly transferred to another retirement plan or IRA. Before making a distribution, the plan administrator generally is required to provide to the participant a notice that contains a written explanation of (1) the participant's right, if any, to have the distribution directly transferred to another retirement plan or IRA, (2) the fact that a distribution that exceeds $1,000 will be transferred to a designated IRA unless the participant elects otherwise, and (3) the rules concerning the taxation of a distribution. The plan generally must provide this notice to the participant no less than 30 and no more than 90 days before the date distribution commences.

[33] The portion of a participant's benefit that is attributable to amounts rolled over from another plan may be disregarded in determining the present value of the participant's vested accrued benefit.

Explanation of Provision

Under the provision, a qualified retirement plan is required to provide the applicable distribution notice no less than 30 days and no more than 180 days before the date distribution commences. The Secretary of the Treasury is directed to modify the applicable regulations to reflect the extension of the notice period to 180 days and to provide that the description of a participant's right, if any, to defer receipt of a distribution shall also describe the consequences of failing to defer such receipt.

Effective Date

The provision and the modifications required to be made under the provision apply to years beginning after December 31, 2003. In the case of a description of the consequences of a participant's failure to defer receipt of a distribution that is made before the date 90 days after the date on which the Secretary of the Treasury makes modifications to the applicable regulations, the plan administrator is required to make a reasonable attempt to comply with the requirements of the provision.

G. Annual Report Dissemination
(sec. 207 of the bill and sec. 104(b)(3) of ERISA)

Present Law

ERISA generally requires the plan administrator of each employee pension benefit plan and each employee welfare benefit plan to file an annual report concerning the plan with the Secretary of Labor within seven months after the end of the plan year. Within nine months after the end of the plan year, the plan administrator generally must furnish to each participant and to each beneficiary receiving benefits under the plan a summary of the annual report filed with the Secretary of Labor for the plan year.

Explanation of Provision

The requirement that a plan administrator furnish a summary annual report is satisfied if the report is made reasonably available through electronic means or other new technology.

Effective Date

The provision is effective for reports for years beginning after December 31, 2003.

H. Technical Corrections to the SAVER Act
(sec. 208 of the bill and sec. 517 of ERISA)

Present Law

The Savings Are Vital to Everyone's Retirement ("SAVER") Act initiated a public-private partnership to educate American workers about retirement savings and directed the Department of Labor to maintain an ongoing program of public information and outreach. The Act also convened a National Summit on Retirement Savings held June 4-5, 1998. A second National Summit on Retirement Savings was held February 27 through March 1, 2002, co-hosted by the President and the bipartisan Congressional leadership. The National Summit brings together experts in the fields of employee benefits and retirement savings, key leaders of government, and interested parties from the private sector and general public. The delegates are selected by the Congressional leadership and the President. The National Summit is a public-private partnership, receiving substantial funding from private sector contributions. The goals of the National Summits are to: (1) advance the public's knowledge and understanding of retirement savings and facilitate the development of a broad-based, public education program; (2) identify the barriers which hinder workers from setting aside adequate savings for retirement and impede employers, especially small employers, from assisting their workers in accumulating retirement savings; and (3) develop specific recommendations for legislative, executive, and private sector actions to promote retirement income savings among American workers.

Explanation of Provision

Under the provision, future National Summits on Retirement Savings are to be held in 2006 and 2010.

Six new statutory delegates are added to future National Summits: the Chairman and Ranking Member of each of the following: the Senate Committee on Finance, the House Committee on Ways and Means, and the Subcommittee on Employer-Employee Relations of the House Committee on Education and the Workforce. The provision also clarifies that new delegates are to be appointed for each future National Summit (as was the intent of the original legislation) and sets deadlines for their appointment.

The provision also sets deadlines for the Department of Labor to publish the Summit agenda and gives the Department of Labor limited reception and representation authority.

Effective Date

The provision is effective on the date of enactment.

I. Missing Participants
(sec. 209 of the bill and secs. 206(f) and 4050 of ERISA)

Present Law

The plan administrator of a defined benefit pension plan that is subject to Title IV of ERISA, is maintained by a single employer, and terminates under a standard termination is required to distribute the assets of the plan. With respect to a participant whom the plan administrator of a single employer plan cannot locate after a diligent search, the plan administrator satisfies the distribution requirement only by purchasing irrevocable commitments from an insurer to provide all benefit liabilities under the plan or transferring the participant's designated benefit to the Pension Benefit Guaranty Corporation ("PBGC"), which holds the benefit of the missing participant as trustee until the PBGC locates the missing participant and distributes the benefit.

The PBGC missing participant program is not available to multiemployer plans or defined contribution plans and other plans not covered by Title IV of ERISA.

Explanation of Provision

The PBGC is directed to prescribe rules for terminating multiemployer plans similar to the present-law missing participant rules applicable to terminating single-employer plans that are subject to Title IV of ERISA.

In addition, plan administrators of certain types of plans not subject to the PBGC termination insurance program under present law are permitted, but not required, to elect to transfer missing participants' benefits to the PBGC upon plan termination. Specifically, the provision extends the missing participants program (in accordance with regulations) to defined contribution plans, defined benefit plans that have no more than 25 active participants and are maintained by professional service employers, and the portion of defined benefit plans that provide benefits based upon the separate accounts of participants and therefore are treated as defined contribution plans under ERISA.

Effective Date

The provision is effective for distributions made after final regulations implementing the provision are prescribed.

J. Reduced PBGC Premiums for Small and New Plans (secs. 210 and 211 of the bill and sec. 4006 of ERISA)

Present Law

Under present law, the Pension Benefit Guaranty Corporation ("PBGC") provides insurance protection for participants and beneficiaries under certain defined benefit pension plans by guaranteeing certain basic benefits under the plan in the event the plan is terminated with insufficient assets to pay benefits promised under the plan. The guaranteed benefits are funded in part by premium payments from employers who sponsor defined benefit plans. The amount of the required annual PBGC premium for a single-employer plan is generally a flat rate premium of $19 per participant and an additional variable-rate premium based on a charge of $9 per $1,000 of unfunded vested benefits. Unfunded vested benefits under a plan generally means (1) the unfunded current liability for vested benefits under the plan, over (2) the value of the plan's assets, reduced by any credit balance in the funding standard account. No variable-rate premium is imposed for a year if contributions to the plan were at least equal to the full funding limit.

The PBGC guarantee is phased in ratably in the case of plans that have been in effect for less than five years, and with respect to benefit increases from a plan amendment that was in effect for less than five years before termination of the plan.

Explanation of Provision

Reduced flat-rate premiums for new plans of small employers

Under the provision, for the first five plan years of a new single-employer plan of a small employer, the flat-rate PBGC premium is $5 per plan participant.

A small employer would be a contributing sponsor that, on the first day of the plan year, has 100 or fewer employees. For this purpose, all employees of the members of the controlled group of the contributing sponsor are to be taken into account. In the case of a plan to which more than one unrelated contributing sponsor contributes, employees of all contributing sponsors (and their controlled group members) are to be taken into account in determining whether the plan was a plan of a small employer.

A new plan means a defined benefit plan maintained by a contributing sponsor if, during the 36-month period ending on the date of adoption of the plan, such contributing sponsor (or controlled group member or a predecessor of either) has not established or maintained a plan subject to PBGC coverage with respect to which benefits were accrued for substantially the same employees as in the new plan.

Reduced variable-rate PBGC premium for new plans

The provision provides that the variable-rate premium is phased in for new defined benefit plans over a six-year period starting with the plan's first plan year. The amount of the variable-rate premium is a percentage of the variable premium otherwise due, as follows: zero percent of the otherwise applicable variable-rate premium in the first plan year; 20 percent in the

second plan year; 40 percent in the third plan year; 60 percent in the fourth plan year; 80 percent in the fifth plan year; and 100 percent in the sixth plan year (and thereafter).

A new defined benefit plan is defined as described above under the flat-rate premium provision of the provision relating to new small employer plans.

Reduced variable-rate PBGC premium for small plans

In the case of a plan of a small employer, the variable-rate premium is no more than $5 multiplied by the number of plan participants in the plan at the end of the preceding plan year. For purposes of the provision, a small employer is a contributing sponsor that, on the first day of the plan year, has 25 or fewer employees. For this purpose, all employees of the members of the controlled group of the contributing sponsor are to be taken into account. In the case of a plan to which more than one unrelated contributing sponsor contributed, employees of all contributing sponsors (and their controlled group members) are to be taken into account in determining whether the plan was a plan of a small employer.

Effective Date

The reduction of the flat-rate premium for new plans of small employers and the reduction of the variable-rate premium for new plans apply to plans first effective after December 31, 2003. The reduction of the variable-rate premium for small plans applies to plan years beginning after December 31, 2003.

K. Authorization for PBGC to Pay Interest on Premium Overpayment Refunds (sec. 212 of the bill and sec. 4007(b) of ERISA)

Present Law

The PBGC charges interest on underpayments of premiums, but is not authorized to pay interest on overpayments.

Explanation of Provision

The provision allows the PBGC to pay interest on overpayments made by premium payors. Interest paid on overpayments is to be calculated at the same rate and in the same manner as interest charged on premium underpayments.

Effective Date

The provision is effective with respect to interest accruing for periods beginning not earlier than the date of enactment.

L. Rules for Substantial Owner Benefits in Terminated Plans (sec. 213 of the bill and secs. 4021, 4022, 4043, and 4044 of ERISA)

Present Law

Under present law, the Pension Benefit Guaranty Corporation ("PBGC") provides participants and beneficiaries in a defined benefit pension plan with certain minimal guarantees as to the receipt of benefits under the plan in case of plan termination. The employer sponsoring the defined benefit pension plan is required to pay premiums to the PBGC to provide insurance for the guaranteed benefits. In general, the PBGC will guarantee all basic benefits which are payable in periodic installments for the life (or lives) of the participant and his or her beneficiaries and are non-forfeitable at the time of plan termination. The amount of the guaranteed benefit is subject to certain limitations. One limitation is that the plan (or an amendment to the plan which increases benefits) must be in effect for 60 months before termination for the PBGC to guarantee the full amount of basic benefits for a plan participant, other than a substantial owner. In the case of a substantial owner, the guaranteed basic benefit is phased in over 30 years beginning with participation in the plan. A substantial owner is one who owns, directly or indirectly, more than 10 percent of the voting stock of a corporation or all the stock of a corporation. Special rules restricting the amount of benefit guaranteed and the allocation of assets also apply to substantial owners.

Explanation of Provision

The provision provides that the 60-month phase-in of guaranteed benefits applies to a substantial owner with less than 50 percent ownership interest. For a substantial owner with a 50 percent or more ownership interest ("majority owner"), the phase-in occurs over a 10-year period and depends on the number of years the plan has been in effect. The majority owner's guaranteed benefit is limited so that it cannot be more than the amount phased in over 60 months for other participants. The rules regarding allocation of assets apply to substantial owners, other than majority owners, in the same manner as other participants.

Effective Date

The provision is effective for plan terminations with respect to which notices of intent to terminate are provided, or for which proceedings for termination are instituted by the PBGC, after December 31, 2003.

M. Benefit Suspension Notice
(sec. 214 of the bill)

Present Law

Under present law,[34] a plan will not fail to satisfy the vesting requirements with respect to a participant by reason of suspending payment of the participant's benefits while such participant is employed. Under the applicable Department of Labor ("DOL") regulations, such a suspension is only permissible if the plan notifies the participant during the first calendar month or payroll period in which the plan withholds benefit payments. Such notice must provide certain information and must also include a copy of the plan's provisions relating to the suspension of payments.

In the case of a plan that does not pay benefits to active participants upon attainment of normal retirement age, the employer must monitor plan participants to determine when any participant who is still employed attains normal retirement age. In order to suspend payment of such a participant's benefits, generally a plan must, as noted above, promptly provide the participant with a suspension notice.

Explanation of Provision

Under the provision, the Secretary of Labor is required to modify the regulations relating to the benefit suspension notice (1) to permit the information currently required to be set forth in a suspension notice generally to be included in the summary plan description, rather than in a separate notice, and (2) not to require that the notice include a copy of relevant plan provisions. However, individuals reentering the workforce to resume work with a former employer after having begun to receive benefits would still receive the notification of the suspension of benefits (and a copy of the plan's provisions relating to suspension of payments). Such notice is required to be provided during the first calendar month, or during the first four- or five-week payroll period ending in a calendar month, in which the plan withholds payments.

Effective Date

The provision applies for plan years beginning after December 31, 2003.

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[34] ERISA sec. 203(a)(3)(B).

N. Studies
(sec. 215 of the bill)

Present Law

Retirement plans for small employers

Present law offers certain retirement plan designs for small businesses.

A business that employs fewer than 100 employees can establish a simplified retirement plan called the savings incentive match plan for employees ("SIMPLE") retirement plan. A SIMPLE plan can be either an individual retirement arrangement (an "IRA") for each employee (a "SIMPLE IRA") or part of a defined contribution plan that includes a qualified cash or deferred arrangement under section 401(k) (a "SIMPLE section 401(k) plan").

A simplified employee pension ("SEP") is an IRA to which employers may make contributions up to the limits applicable to defined contribution plans. Effective for taxable years beginning before January 1, 1997, certain employers with no more than 25 employees could maintain a salary reduction SEP (a "SARSEP") under which employees could make elective deferrals. The SARSEP rules were generally repealed with the adoption of rules for SIMPLE plans. However, contributions may continue to be made to SARSEPs that were established before 1997.

Present law does not require a study as to other plan designs for small employers.

Recent pension legislation

Title VI of the Economic Growth and Tax Relief Reconciliation Act of 2001[35] ("EGTRRA") made various changes in the rules for IRAs and employer-sponsored retirement plans, including provisions to expand retirement plan coverage and strengthen pension security. Present law does not provide for a study of the effect of this legislation.

Explanation of Provision

Study on small employer group plans

The provision directs the Secretary of Labor, in consultation with the Secretary of the Treasury, to conduct a study to determine (1) the most appropriate form or forms of pension plans that would be simple in form and easy to maintain by multiple small employers, while providing ready portability of benefits for all participants and beneficiaries, (2) alternative arrangements providing comparable benefits that may be established by employee or employer associations, (3) alternative arrangements providing comparable benefits to which employees

[35] Pub. L. No. 107-16. The provisions of EGTRRA generally do not apply for years beginning after December 31, 2010.

may contribute independent of employer sponsorship, and (4) appropriate methods and strategies for making such pension plan coverage more widely available to American workers.

The Secretary of Labor is required to consider the adequacy and availability of existing pension plans and the extent to which existing models may be modified to be more accessible to both employees and employers. The Secretary of Labor is required to issue a report on the results of the study within 18 months of the date of enactment, including recommendations, to the House Committees on Education and the Workforce and Ways and Means, and the Senate Committees on Health, Education, Labor, and Pensions and Finance. Recommendations in the report must include one or more model plans or arrangements as described above which may serve as the basis for appropriate administrative or legislative action.

Study on effect of legislation

The provision also directs the Secretary of Labor to report to the House Committee on Education and the Workforce and the Senate Committee on Health, Education, Labor and Pensions regarding the effect of the bill and title VI of EGTRRA on pension coverage, including any change in the extent of pension plan coverage for low and middle-income workers, the levels of pension plan benefits generally, the quality of pension plan coverage generally, workers' access to and participation in pension plans, and retirement security. This report is required to be submitted no later than five years after the date of enactment.

Effective Date

The provision is effective on the date of enactment.

O. Interest Rate Range for Additional Funding Requirements (sec. 216 of the bill, sec. 412 of the Code, and sec. 302 of ERISA)

Present Law

In general

Under the Code and ERISA, defined benefit pension plans are subject to both minimum and maximum[36] funding requirements. Under the minimum funding rules, the amount of contributions required for a plan year is generally the plan's normal cost for the year (i.e., the cost of benefits allocated to the year under the plan's funding method) plus that year's portion of other liabilities that are amortized over a period of years, such as benefits resulting from a grant of past service credit.

Additional contributions for underfunded plans

Under a special funding rule,[37] additional contributions to a plan are generally required if the plan's funded current liability percentage is less than 90 percent.[38] A plan's "funded current liability percentage" is the value of plan assets as a percentage of the plan's current liability. In general, a plan's current liability means all liabilities to employees and their beneficiaries under the plan.

If a plan is subject to the special rule, an additional contribution, called a "deficit reduction contribution," is required. The amount of the deficit reduction contribution for a plan year is based on a variety of elements. In general, however, the deficit reduction contribution includes the amount equal to 30 percent of unfunded liabilities.[39] This amount is reduced if the plan's funded current liability percentage is greater than 60 percent. Other factors that affect the amount of the deficit reduction contribution include whether the plan has an unfunded liability

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[36] The maximum funding requirement for a defined benefit plan is referred to as the full funding limitation. Additional contributions are not required if a plan has reached the full funding limitation.

[37] The rule applies to single-employer plans, other than single-employer plans with no more than 100 participants on any day in the preceding plan year. Single-employer plans with more than 100 but not more than 150 participants are generally subject to lower contribution requirements under the special funding rule.

[38] Under an alternative test, a plan is not subject to the special rule for a plan year if (1) the plan's funded current liability percentage for the plan year is at least 80 percent, and (2) the plan's funded current liability percentage was at least 90 percent for each of the two immediately preceding plan years or each of the second and third immediately preceding plan years.

[39] Only "new" unfunded liabilities are subject to this rule. "New" unfunded liabilities do not include certain liabilities as of 1988 or 1995.

related to benefits accrued before 1988 or 1995 or to changes in the mortality table used to determine contributions, and whether the plan provides for unpredictable contingent event benefits (that is, benefits that depend on contingencies that are not reliably and reasonably predictable, such as facility shutdowns or reductions in workforce). In any case, the amount of additional contributions cannot exceed the amount needed to increase the plan's funded current liability percentage to 100 percent.

Required interest rate

Specific interest rate and mortality assumptions must be used in determining a plan's current liability for purposes of the special funding rule. The interest rate used to determine a plan's current liability must be within a permissible range of the weighted average[40] of the interest rates on 30-year Treasury securities for the four-year period ending on the last day before the plan year begins.[41] The permissible range is generally from 90 percent to 105 percent.[42] The IRS publishes the applicable rate on a monthly basis. The Department of the Treasury does not currently issue 30-year Treasury securities. As of March 2002, the IRS publishes the average yield on the 30-year Treasury bond maturing in February 2031 as a substitute.

Timing of plan contributions

In general, plan contributions required to satisfy the funding rules must be made within 8½ months after the end of the plan year. If the contribution is made by such due date, the contribution is treated as if it were made on the last day of the plan year.

In the case of a plan with a funded current liability percentage of less than 100 percent for the preceding plan year, estimated contributions for the current plan year must be made in quarterly installments during the current plan year. The amount of each required installment is 25 percent of the lesser of (1) 90 percent of the amount required to be contributed for the current plan year or (2) 100 percent of the amount required to be contributed for the preceding plan year.

PBGC premiums

Because benefits under a defined benefit pension plan may be funded over a period of years, plan assets may not be sufficient to provide the benefits owed under the plan to employees and their beneficiaries if the plan terminates before all benefits are paid. The Pension Benefit Guaranty Corporation ("PBGC") generally insures the benefits owed under defined benefit

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[40] The weighting used for this purpose is 40 percent, 30 percent, 20 percent and 10 percent, starting with the most recent year in the four-year period.

[41] The interest rate used under the plan must be consistent with the assumptions which reflect the purchase rates which would be used by insurance companies to satisfy the liabilities under the plan. Sec. 412(b)(5)(B)(iii)(II).

[42] If the Secretary of the Treasury determines that the lowest permissible interest rate in this range is unreasonably high, the Secretary may prescribe a lower rate, but not less than 80 percent of the weighted average of the 30-year Treasury rate.

pension plans in the event the plan is terminated with insufficient assets. Employers pay premiums to the PBGC for this insurance coverage.

PBGC premiums include a flat-rate premium and, in the case of an underfunded plan, a variable rate premium based on the amount of unfunded vested benefits. In determining the amount of unfunded vested benefits, the interest rate used is 85 percent of the interest rate on 30-year Treasury securities for the month preceding the month in which the plan year begins.

Required reporting

A plan administrator of a pension, annuity, stock bonus, profit-sharing or other funded plan of deferred compensation generally must file with the Secretary of the Treasury an annual return for each plan year containing certain information with respect to the qualification, financial condition, and operation of the plan. Under ERISA, the plan administrator is also required to file annual reports of certain information about the plan with the Department of Labor and the PBGC. The plan administrator satisfies the reporting requirement with respect to each agency by filing the Form 5500 series annual return/report with the Department of Labor, which forwards the form to the Internal Revenue Service and the PBGC.

Certain actuarial information about the plan is required to be reported on the Form 5500. This actuarial information generally must be based on the use of reasonable actuarial assumptions; however, for certain purposes (e.g., the plan's current liability), the highest allowable statutory interest rate must be used. Once the Form 5500 has been filed, these actuarial assumptions may not be changed.[43]

Special interest rate for 2002 and 2003

The Job Creation and Worker Assistance Act of 2002[44] amends the permissible range of the statutory interest rate used in calculating a plan's current liability for purposes of applying the additional contribution requirements. Under this provision, the permissible range is from 90 percent to 120 percent for plan years beginning after December 31, 2001, and before January 1, 2004.[45]

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[43] *See, e.g.,* Prop. Treas. Reg. 1.412(b)-1(g).

[44] Pub. L. No. 107-147.

[45] In connection with the expanded interest rate range available for 2002 and 2003, special rules apply in determining current liability for the preceding plan year for plans years beginning in 2002 (when the expanded range first applies) and 2004 (when the expanded range no longer applies). In each of those years ("present year"), current liability for the preceding year is redetermined, using the permissible range applicable to the present year. This redetermined current liability will be used for purposes of the plan's funded current liability percentage for the preceding year, which may affect the need to make quarterly contributions, and for purposes of determining the amount of any quarterly contributions in the present year, which is based in part on the preceding year.

In addition, for plan years beginning after December 31, 2001, and before January 1, 2004, the interest rate used in determining the amount of unfunded vested benefits for PBGC variable rate premium purposes is increased to 100 percent of the interest rate on 30-year Treasury securities for the month preceding the month in which the plan year begins.

Explanation of Provision

Interest rate for 2001

Under the provision, the permissible interest rate range that applies for 2002 and 2003 applies also in determining the amount of additional contributions for a plan year beginning in 2001 (the "2001 plan year"). The permissible range is therefore from 90 percent to 120 percent for this purpose.

PBGC conforming changes

With respect to the provision of the Job Creation and Worker Assistance Act of 2002 providing a special rule for the interest rate used in determining the amount of unfunded vested benefits for PBGC variable rate premium purposes, the provision makes conforming changes so that the special rule applies for purposes of notices and reporting required with respect to underfunded plans.[46]

Effective Date

The provision is effective as if included in section 405 of the Job Creation and Worker Assistance Act of 2002.

The employer or plan administrator may elect whether to use an interest rate in the expanded range (i.e., an interest rate between 105 percent and 120 percent) for the 2001 plan year. Such election is to be made in a manner and at a time prescribed by the Secretary of the Treasury and, once made, may not be revoked. For example, in the case of a plan for which the Form 5500 for the 2001 plan year has already been filed, the Secretary could provide that an election whether to use an interest rate in the expanded range for the 2001 plan year is made on the Form 5500 for the 2002 plan year, so that an amended Form 5500 for 2001 need not be filed. In addition, an election to use an interest rate in the expanded range for 2001 is not treated as a change in actuarial assumptions for purposes of Form 5500 reporting. Therefore, the fact that the Form 5500 has been filed for the 2001 plan year does not preclude the use of an interest rate in the expanded range for the 2001 plan year.

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[46] In addition, under the provision, in any year for which a new mortality table prescribed by the Secretary of Treasury applies in determining a plan's current liability, the interest rate used in determining the amount of unfunded vested benefits for PBGC variable rate premium purposes is 115 percent of the interest rate on 30-year Treasury securities for the month preceding the month in which the plan year begins.

III. GENERAL PROVISIONS

A. Provisions Relating to Plan Amendments (sec. 301 of the bill)

Present Law

Present law provides a remedial amendment period during which, under certain circumstances, a plan may be amended retroactively in order to comply with the qualification requirements.[47] In general, plan amendments to reflect changes in the law generally must be made by the time prescribed by law for filing the income tax return of the employer for the employer's taxable year in which the change in law occurs. The Secretary of the Treasury may extend the time by which plan amendments need to be made.

Explanation of Provision

The provision permits certain plan amendments made pursuant to the changes made by the bill or by title VI of the Economic Growth and Tax Relief Reconciliation Act of 2001[48] ("EGTRRA") (or regulations issued thereunder) to be retroactively effective. If the plan amendment meets the requirements of the provision, then the plan will be treated as being operated in accordance with its terms and the amendment will not violate the prohibition of reductions of accrued benefits. In order for this treatment to apply, the plan amendment is required to be made on or before the last day of the first plan year beginning on or after January 1, 2006 (January 1, 2008, in the case of a governmental plan). If the amendment is required to be made to retain qualified status as a result of the changes in the law (or regulations), the amendment is required to be made retroactively effective as of the date on which the change became effective with respect to the plan and the plan is required to be operated in compliance until the amendment is made. Amendments that are not required to retain qualified status but that are made pursuant to the changes made by the bill or EGTRRA (or applicable regulations) may be made retroactively effective as of the first day the plan is operated in accordance with the amendment.

A plan amendment will not be considered to be pursuant to the bill or EGTRRA (or applicable regulations) if it has an effective date before the effective date of the provision of the bill or EGTRRA (or regulations) to which it relates. Similarly, the provision does not provide relief from section 411(d)(6) for periods prior to the effective date of the relevant provision (or regulations) or the plan amendment.

The Secretary is authorized to provide exceptions to the relief from the prohibition on reductions in accrued benefits. It is intended that the Secretary will not permit inappropriate reductions in contributions or benefits that are not directly related to the provisions of the bill or

[47] Sec. 401(b).

[48] Pub. L. No. 107-16. The provisions of EGTRRA generally do not apply for years beginning after December 31, 2010.

EGTRRA. For example, it is intended that a plan that incorporates the section 415 limits by reference can be retroactively amended to impose the section 415 limits in effect before EGTTRA.[49] On the other hand, suppose a plan incorporates the section 401(a)(17) limit on compensation by reference and provides for an employer contribution of three percent of compensation. It is expected that the Secretary will provide that, in that case, the plan cannot be amended retroactively to reduce the contribution percentage for those participants not affected by the section 401(a)(17) limit, even though the reduction will result in the same dollar level of contributions for some participants because of the increase in compensation taken into account under the plan as a result of the increase in the section 401(a)(17) limit under EGTRRA. As another example, suppose that under present law a plan is top-heavy and therefore a minimum benefit is required under the plan, and that under the provisions of EGTRRA, the plan is not considered to be top-heavy. It is expected that the Secretary will generally permit plans to be retroactively amended to reflect the new top-heavy provisions of EGTRRA.

Effective Date

The provision is effective on the date of enactment.

[49] See also, section 411(j)(3) of the Job Creation and Worker Assistance Act of 2002, which provides a special rule for plan amendments adopted on or before June 30, 2002, in connection with EGTRRA, in the case of a plan that incorporated the section 415 limits by reference on June 7, 2001, the date of enactment of EGTRRA.