107th Congress) (Report
2nd Session) SENATE (107-???

NATIONAL EMPLOYEE SAVINGS AND TRUST EQUITY GUARANTEE ACT

August __, 2002.—Ordered to be printed

Mr. Baucus, from the Committee on Finance, submitted the following

REPORT

[To accompany S. 1971]

The Committee on Finance, to which was referred the bill (S. 1971) to amend the Internal Revenue Code of 1986 and the Employee Retirement Income Security Act of 1974 to protect the retirement security of American workers by ensuring that pension assets are adequately diversified and by providing workers with adequate access to, and information about, their pension plans, and for other purposes, having considered the same, report favorably thereon with an amendment in the nature of a substitute and recommend that the bill as amended do pass.

CONTENTS

Page

I. LEGISLATIVE BACKGROUND

The Senate Committee on Finance marked up S. 1971 (the "National Employee Savings and Trust Equity Guarantee Act") on July 11, 2002, and ordered the bill, as amended, favorably reported by voice vote.

The Committee held a hearing on February 27, 2002, regarding retirement security. The Committee also held a hearing on April 18, 2002, regarding corporate governance and executive compensation.

II. EXPLANATION OF THE BILL

TITLE I. DIVERSIFICATION OF PENSION PLAN ASSETS

A. Defined Contribution Plans Required to Provide Employees with Freedom to Invest Their Plan Assets (sec. 101 of the bill, new sec. 401(a)(35) of the Code, and new sec. 204(j) of ERISA)

Present Law

In general

Qualified retirement plans are subject to regulation under the Internal Revenue Code (the "Code") and under the Employee Retirement Income Security Act of 1974 ("ERISA"). Some of the requirements under the Code and ERISA for qualified retirement plans are identical or very similar. For example, both the Code and ERISA impose minimum participation and vesting requirements. Other requirements are contained only in the Code or only in ERISA. In the case of a Code requirement, failure to satisfy the requirement could result in the loss of qualified status for the plan or in the imposition of an excise tax. In the case of an ERISA requirement, failure to satisfy the requirement could result in the imposition of a penalty or a civil action by a participant or the Department of Labor.

The Code and ERISA contain different rules that limit the investment of defined contribution plan assets in employer securities. The extent to which the limits apply depends on the type of plan and the type of contribution involved.

Diversification requirements applicable to employee stock ownership plans ("ESOPs")

An ESOP is a defined contribution plan that is designated as an ESOP and is designed to invest primarily in stock of the employer. 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 401(k) feature that permits employees to make elective deferrals.[1]

Under the Code,[2] 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 the investment of the participant's account in assets other than employer securities. The diversification requirement applies to a participant for six years, starting with the year in which the individual firsts 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.

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

[2] All references are to provisions of the Code unless otherwise indicated.

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).[3]

10-percent limit on the acquisition of employer securities

The Employee Retirement Income Security Act of 1974 ("ERISA") prohibits 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. This 10-percent limitation generally does not apply to other types of defined contribution plans.[4] Thus, most defined contribution plans, such as profit-sharing plans, stock bonus plans, and ESOPs, are not subject to any limit under ERISA on the amount of employer contributions that can be invested in employer securities. In addition, a fiduciary generally is deemed not to violate the requirement that plan assets be diversified with respect to the acquisition or holding of employer securities in such plans.[5]

Under ERISA, 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 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.

Reasons for Change

The Committee understands that employer securities are one possible investment for defined contribution plans. In some cases, the plan may offer employer securities as one of several investment options made available to plan participants. In other cases, the plan may provide that certain contributions are invested in employer securities. For example, many plans

[3] Sec. 401(a)(28); IRS Notice 88-56, 1988-1 C.B. 540, Q&A 16.

[4] The 10-percent limitation also applies to defined benefit plans and 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).

[5] Under ERISA, plans that are not subject to the 10-percent limitation on the acquisition of employer securities are referred to as "eligible individual account plans."

provide that employer matching contributions with respect to employee elective deferrals under a qualified cash or deferred arrangement are to be invested in employer securities.

Present law has facilitated and encouraged the acquisition of employer securities by qualified plans, particularly in the case of ESOPs. Thus, for example, present law provides that the dividends paid on employer securities held by an ESOP are deductible under certain circumstances and also allows an ESOP to borrow to acquire the employer securities. Present law recognizes that employer securities can be a profitable investment for employees as well as a corporate financing tool for employers. Employees who hold employer securities through a defined contribution plan often feel that they have a stake in the business, leading to increased profitability.

On the other hand, the Committee recognizes that diversification of assets is a basic principle of sound investment policy and that requiring that certain contributions be invested in employer securities may create tension with the objectives of diversification. Failure to adequately diversify defined contribution plan investments may jeopardize retirement security.

The Committee believes that allowing participants greater opportunity to diversify plan investments in employer stock will help participants achieve their retirement security goals, while continuing to allow employers and employees the freedom to choose their own investments. Thus, the Committee bill requires defined contribution plans that hold employer securities that are publicly traded to permit qualified plan participants to direct the plan to reinvest employer securities in other assets. The Committee bill generally requires diversification in accordance with the present-law rules regarding vesting.

The Committee believes that the current role of ESOPs should be preserved; thus, the bill does not apply additional diversification requirements to "stand alone" ESOPs, meaning ESOPs that do not hold elective deferrals and related contributions. Again, the Committee believes this strikes an appropriate balance between the principle of diversification and the goals served by ESOPs. For example, some ESOPs hold a controlling interest in the employer, and the Committee believes it is appropriate to encourage this form of ownership.

Explanation of Provision

In general

Under the provision, in order to satisfy the requirements under the Code and under ERISA, certain defined contribution plans are required to provide diversification rights with respect to amounts invested in employer securities. Such a plan is required to permit applicable individuals to direct that the portion of the individual's account held in employer securities be invested in alternative investments. 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 generally apply to any defined contribution plan holding publicly-traded employer securities (i.e., securities issued by the employer or a member of the employer's controlled group of corporations[6] that are readily tradable on an established securities market). For this purpose, a plan holding employer securities that are not publicly traded is generally treated as holding publicly-traded employer securities if the employer (or any member of the employer's controlled group of corporations) has issued any class of publicly-traded stock. This treatment does not apply if the employer (and any parent corporation[7] of the employer) has not issued any publicly-traded security or any special class of stock that grants particular rights to, or bears particular risks for, the holder or the issuer with respect to any member of the employer's controlled group that has issued any class of publicly-traded stock. The Secretary of the Treasury has the authority to provide other exceptions in regulations. For example, an exception may be appropriate if no stock of the employer maintaining the plan (including stock held in the plan) is publicly traded, but a member of the employer's controlled group has issued a small amount of publicly-traded stock.

The diversification requirements do not apply to an ESOP that (1) does not hold contributions (or earnings thereon) that are subject to the special nondiscrimination tests that apply to elective deferrals, employee after-tax contributions, and matching contributions, and (2) is a separate plan from any other qualified retirement plan of the employer. Accordingly, an ESOP that holds elective deferrals, employee contributions, employer matching contributions, or nonelective employer contributions used to satisfy the special nondiscrimination tests (including the safe harbor methods of satisfying the tests) is subject to the diversification requirements under the provision. An ESOP that is subject to the diversification requirements under the provision is no longer subject to the present-law ESOP diversification rules.[8]

The diversification requirements under the provision do not apply to a one-participant retirement plan. A one-participant retirement plan is a plan that (1) on the first day of the plan year, covers only an individual (or the individual and his or her spouse) and the individual owns the entire business maintaining the plan (whether or not incorporated) or covers only one or more partners (or partners and their spouses) in a business partnership, (2) meets the minimum

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[6] For this purpose, "controlled group of corporations" has the same meaning as under section 1563(a), except that, in applying that section, 50 percent is substituted for 80 percent.

[7] For this purpose, "parent corporation" has the same meaning as under section 424(e), i.e., any corporation (other than the employer) in an unbroken chain of corporations ending with the employer if each corporation other than the employer owns stock possessing at least 50 percent of the total combined voting power of all classes of stock with voting rights or at least 50 percent of the total value of shares of all classes of stock in one of the other corporations in the chain.

[8] Providing the diversification rights required under the provision, or greater diversification rights, will not cause an ESOP to fail to be designed to invest primarily in qualifying employer securities under section 4975(e)(7)(A).

coverage requirements without being combined with any other plan that covers employees of the business, (3) does not provide benefits to anyone except the individuals (and spouses) described in (1), (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 uses leased employees.[9]

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 that are invested in employer securities, 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), an applicable individual who is a participant with three years of service,[10] a beneficiary of such a participant, or a beneficiary of a deceased participant must be permitted to direct that such amounts be invested in alternative investments.

The provision provides a transition rule for amounts attributable to these other contributions that are invested in employer securities acquired before the first plan year for which diversification requirements apply. Under the transition rule, for the first three years for which the new diversification requirements apply to the plan, the applicable percentage of such amounts is subject to diversification as shown in Table 1, below. In determining the portion of the account subject to diversification under the transition rule, any previous diversification of employer securities pursuant to an election under the present-law ESOP diversification requirements is taken into account. The transition rule does not apply to plan participants who have three years of service and who have attained age 55 by the beginning of the first plan year beginning after December 31, 2002.

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[9] The term "one-participant retirement plan" is defined in the provision relating to notice of a transaction suspension period.

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

Table 1 – Applicable Percentage for Employer Securities Held on Effective Date

Plan year for which <u>diversification applies</u>:	<u>Applicable percentage</u>:
First year...............................	33 percent (or, if greater, the amount that would be required under present-law ESOP diversification rule)
Second year..........................	66 percent
Third year.............................	100 percent

The application of the transition rule is illustrated by the following example. Suppose that the account of a participant with at least three years of service held 120 shares of employer stock contributed as matching contributions before the diversification requirements became effective. In the first year for which diversification applies, 33 percent (i.e., 40 shares) of that stock is subject to the diversification requirements. In the second year for which diversification applies, a total of 66 percent of 120 shares of stock (i.e., 79 shares, or an additional 39 shares) is subject to the diversification requirements. In the third year for which diversification applies, 100 percent of the stock, or all 120 shares, is subject to the diversification requirements. In addition, in each year, employer stock in the account attributable to elective deferrals and employee after-tax contributions is fully subject to the diversification requirements, as is any new stock contributed to the account.

<u>Requirements for investment alternatives</u>

In order to satisfy the diversification requirements, 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. Other investment options offered by the plan generally also have to be available. A plan may not impose restrictions or conditions with respect to the investment of employer securities that are not imposed on the investment of other plan assets (other than restrictions or conditions imposed by reason of the application of securities laws). Such a restriction or condition includes a provision under which a participant who divests his or her account of employer securities receives less favorable treatment (such as a lower rate of employer contributions) than a participant whose account remains invested in employer securities. A plan does not fail to meet the diversification requirements merely because the plan limits the times when investment changes can be made to periodic, reasonable opportunities that occur at least quarterly.

<u>Effective Date</u>

The provision is generally effective for plan years beginning after December 31, 2002. In the case of a plan maintained pursuant to one or more collective bargaining agreements, the provision is effective for plan years beginning after the earlier of (1) the later of December 31, 2003, or the date on which the last of such collective bargaining agreements terminates

(determined without regard to any extension thereof after the date of enactment), or
(2) December 31, 2004.

TITLE II. PROTECTION OF EMPLOYEES DURING PENSION PLAN TRANSACTION SUSPENSION PERIOD

A. Notice to Participants or Beneficiaries of Transaction Suspension Periods (sec. 201 of the bill, new sec. 4980G of the Code, and new sec. 101(i) of ERISA)

Present Law

The Code and ERISA require various notices to be provided to participants and beneficiaries under an employer-sponsored retirement plan regarding their rights under the plan. Present law does not specifically require that participants be given advance notice of temporary periods during which the ability to direct investments or to obtain loans or distributions from the plan is restricted.

Failure to provide a notice required under the Code may result in the imposition of an excise tax (e.g., sec. 4980F, relating to notice requirements for plans significantly reducing benefit accruals) or a reporting penalty (e.g., sec. 6652(i), relating to a failure to give written explanation of qualifying rollover distributions). Failure to provide a notice required under ERISA may result in the imposition of a civil penalty.[11]

Reasons for Change

In the course of normal plan operation, periods may occur during which a plan participant's ability to direct the investment of his or her account or obtain loans or distributions from the plan is restricted (a so-called "blackout" period). These periods usually occur in connection with administrative changes, such as a change in recordkeepers or in the investment options offered under a plan. Such a period may result also from changes in the plan in connection with a corporate transaction, such as a sale or merger. The Committee believes that plan participants should be given advance notice of such a period, before the period begins, in order to give participants the opportunity to prepare for any restrictions that will occur. For example, if the ability to direct investments will be restricted, a participant may wish to make investment changes before the restriction period begins.

Explanation of Provision

In general

Under the provision, the Code and ERISA require that advance notice of a transaction suspension period must be provided by the administrator of an applicable pension plan to the applicable individuals to whom the transaction suspension period applies (and to any employee

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[11] ERISA also permits the Secretary of Labor, a participant, a beneficiary, or a plan fiduciary to bring civil action to enforce any ERISA requirements.

organization representing such individuals). An applicable individual (as defined under the provision relating to diversification) is (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. Generally, notice must be provided at least 30 days before the beginning of the transaction suspension period.

An applicable pension plan is a qualified retirement plan or annuity, a tax-sheltered annuity plan, or an eligible deferred compensation plan of a governmental employer that maintains accounts for participants and beneficiaries. An applicable pension plan includes a plan that is a governmental plan or a church plan, and such a plan is subject to the notice requirement under the Code. However, governmental plans (including an eligible deferred compensation plan of a governmental employer) and church plans are generally exempt from ERISA. As a result, the ERISA notice requirement does not apply to such a plan.

An applicable pension plan does not include a one-participant retirement plan, defined as a plan that (1) on the first day of the plan year, covers only an individual (or the individual and his or her spouse) and the individual owns the entire business maintaining the plan (whether or not incorporated) or covers only one or more partners (or partners and their spouses) in a business partnership, (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 individuals (and spouses) described in (1), (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 uses leased employees.

Definition of transaction suspension period

A transaction suspension period means a period of more than three consecutive business days during which certain rights are significantly restricted. The rights that are relevant for purposes of a transaction suspension period are rights otherwise provided under the plan to one or more applicable individuals to direct investments (including investments in employer securities) or to obtain loans or distributions from the plan. However, rights that are significantly restricted because of the application of securities laws or other circumstances specified in regulations and restrictions required in connection with a qualified domestic relations order are not taken into account in determining whether a transaction suspension period occurs.

Whether an individual's right to direct investments or obtain loans or distributions from the plan is significantly restricted is generally determined by reference to the normal rights and procedures provided under the plan. A variety of factors may be relevant in making this determination. For example, if, in connection with a change in plan recordkeepers, no investment directions, loans, or distributions can be executed over a three-day weekend (i.e., a Saturday, a Sunday, and a Monday that is a Federal holiday), then no transaction suspension period results if the participants would not, under the terms of the plan, have been able to engage in such transactions during that period in any event. As another example, suppose a plan provides that a participant's loan request will be processed within 30 days from the time the loan request is submitted. The mere fact that, in connection with a change in plan administrators, the processing of loan requests is suspended for a ten-day period does not result in a transaction suspension period if participants' ability to submit loan requests continues during the ten-day period and the ten-day suspension does not cause the processing of loan requests to take longer than the 30-day period provided in the plan. In addition, if a plan provides that a participant's ability to make investment changes, or obtain a loan or a distribution, is limited for a certain period in connection with a qualified domestic relations order with respect to the participant's account, that limitation generally does not result in a transaction suspension period.

In the case of a right that may be exercised at only certain times, for example, on only certain days during a month, in determining whether there is a transaction period, it may be relevant to consider the time until the right is again available. For example, if, under the plan, rights may be exercised only on the first three business days of the month, a significant restriction placed on those rights for those three days has the effect of restricting those rights until the following month, even though the restriction is for only three days.

Factors in addition to the time period involved may also be relevant in determining whether a transaction suspension period occurs, and the relevant factors may vary depending on the rights affected. For example, suppose a plan offers a variety of investment options, including three options that have similar characteristics (e.g., similar risk and return characteristics). If the ability to transfer funds into only one of these options is restricted, this might not result in a transaction suspension period for purposes of the provision, because participants have the right to transfer funds into similar investment options. In addition, a transaction suspension period does not occur as a result of plan provisions that restrict a participant's right to direct the investment of the assets in his or her account to certain periods, such as the first fifteen days of each month.

Timing of notice

Notice of a transaction suspension period is generally required at least 30 days before the beginning of the period. An exception applies in the case of a transaction suspension period imposed because of an event outside the control of the employer, plan, or plan administrator. In that case, notice must be provided as soon as reasonably practicable under the circumstances. The Secretary of the Treasury is given the authority to provide additional exceptions (and to specify the time when notice is required) in the case of a transaction suspension period due to other circumstances specified by the Secretary, including the application of securities laws.

In the case of a transaction suspension period beginning within 30 days after a major corporate disposition by a corporation maintaining the plan, the notice requirements are treated as met if, not later than 30 days before the disposition, the plan administrator (or the employer maintaining the plan) provides notice of the transaction suspension period. A "major corporate disposition" means the disposition of substantially all of the stock of the corporation, or a subsidiary thereof, or the disposition of substantially all of the assets used in a trade or business of the corporation or subsidiary. In accordance with Treasury regulations, similar rules will apply in the case of an entity that is not a corporation.

It is intended under the provision that participants will be given the opportunity to execute investment changes with respect to their accounts, or obtain loans or distributions otherwise permitted under the plan, before the transaction suspension period begins.

Form and content of notice

Notice of a transaction suspension period 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 the recipients to understand the timing and effect of the transaction suspension period. Specifically, the notice is required to include (1) the reasons for the suspension, (2) an identification of the investments and other rights under the plan that are affected, (3) the expected beginning date and length of the suspension period,[12] and (4) in the case of a transaction suspension period affecting rights related to plan investments, a statement that the applicable individual should evaluate the appropriateness of current investment decisions in light of the inability to direct or diversify assets during the expected period of suspension. The notice must be provided in writing and may be delivered in electronic or other form that is reasonably expected to result in receipt of the notice by the applicable individual. The Secretary of the Treasury is required, in consultation with the Secretary of Labor, to issue a model transaction suspension period notice.

Sanctions for failure to provide notice

Excise tax

An excise tax generally applies in the case of a failure to provide notice of a transaction suspension period as required under the Code. A reporting penalty applies in the case of a failure related to a governmental plan or a church plan.

Under the provision, an excise tax is generally imposed on the employer if notice of a transaction suspension is not provided.[13] The excise tax is $100 per day for each applicable individual with respect to whom the failure occurred, until notice is provided or the failure is otherwise corrected. If the employer exercises reasonable diligence to meet the notice requirements, the total excise tax imposed during a taxable year will not exceed $500,000.

No tax will be imposed with respect to a failure if the employer does not know that the failure existed and exercises reasonable diligence to comply with the notice requirement. In addition, no tax will be imposed if the employer exercises reasonable diligence to comply and provides the required notice as soon as reasonably practicable after learning of the failure. In the case of a failure due to reasonable cause and not to willful neglect, the Secretary of the Treasury is authorized to waive the excise tax to the extent that the payment of the tax would be excessive or otherwise inequitable relative to the failure involved.

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[12] If the expected beginning date or length of the transaction suspension period changes after notice has been provided, notice of the change must be provided as soon as reasonably practicable.

[13] In the case of a multiemployer plan, the excise tax is imposed on the plan. In the case of a tax-sheltered annuity program under section 403(b) that is not treated as established or maintained by the employer for purposes of ERISA, the excise tax is imposed on the plan administrator.

The excise tax does not apply in the case of a failure to provide notice of a transaction suspension period with respect to a governmental plan or a church plan. In that case, on notice and demand by the Secretary, a penalty applies of $100 per day for each applicable individual with respect to whom the failure occurs, until notice is provided or the failure is otherwise corrected.[14] The limitations and exceptions to the excise tax apply also to the penalty.

ERISA civil penalty

In the case of a failure to provide notice of a transaction suspension period as required under ERISA, the Secretary of Labor is authorized to assess a civil penalty of up to $100 per day for each violation.[15] For this purpose, each violation with respect to a single participant or beneficiary is treated as a separate violation.

Effective Date

The provision is generally effective for plan years beginning after December 31, 2002. In the case of a plan maintained pursuant to one or more collective bargaining agreements, the provision is effective for plan years beginning after the earlier of (1) the later of December 31, 2003, or the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after the date of enactment), or (2) December 31, 2004. No later than 120 days after enactment of the provision, the Secretary of the Treasury is required to specify (1) the circumstances under which 30 days notice of a transaction suspension period is not required and (2) the time by which notice is required to be provided in those circumstances.

[14] In the case of a governmental plan or church plan, a penalty does not apply to a failure to provide notice to an employee organization.

[15] The civil penalty under ERISA does not apply to a governmental plan or a church plan that is exempt from ERISA.

B. Inapplicability of Relief from Fiduciary Liability During Suspension of Ability of Participant or Beneficiary to Direct Investments (sec. 202 of the bill and sec. 404(c) of ERISA)

Present Law

Fiduciary rules under ERISA

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 care, prudence, and diligence. With respect to plan assets, ERISA 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.[16]

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 a defined contribution 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 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 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

[16] Certain defined contribution plans are not subject to the diversification requirement for investments or the general prudence requirement (to the extent that it requires diversification) with respect to investments in employer stock.

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.

Reasons for Change

The Committee believes that participants generally should not be considered to exercise control over the assets in their accounts when they are prevented from making investment changes because of a transaction suspension period. On the other hand, transaction suspension periods are sometimes necessary to ensure the proper administration of a plan. Accordingly, the Committee believes that a fiduciary that fulfills its fiduciary responsibilities under ERISA in connection with authorizing the transaction suspension period should not be responsible for losses that occur during the transaction suspension period with respect to investments chosen by the participant.

Explanation of Provision

Under the provision, relief from fiduciary liability for any loss or breach resulting from a participant's exercise of control over assets generally does not apply in the case of a transaction suspension period during which the ability of the participant to direct the investment of the assets in his or her account is suspended by a plan sponsor or fiduciary. For this purpose, transaction suspension period is defined as under the provision requiring advance notice of a transaction suspension period. Under a special rule, if a transaction suspension period occurs in connection with a change in the investment options offered under the plan, a participant is deemed to have exercised control over the assets in his or her account before the transaction suspension period if, after notice of the change in investment options is given to the participant, assets in the account of the participant are transferred either (1) to investment options in accordance with the participant's affirmative election (provided that the election otherwise meets the conditions for the participant to exercise control over the assets in the account), or (2) in the absence of an affirmative election by the participant and where fiduciary relief applied with respect to the prior investment options, to investment options with reasonably comparable risk and return characteristics in the manner set forth in the notice.

In addition, if the fiduciary meets the requirements of ERISA in connection with authorizing the transaction suspension period, the fiduciary will not be liable for any loss occurring during the period as a result of a participant's or beneficiary's exercise of control over assets in his or her account before the period. Matters to be considered in determining whether the requirements of ERISA were satisfied include (but are not limited to) whether the fiduciary

(1) determined that the expected transaction suspension period was reasonable, (2) provided notice of the transaction suspension period (as required under another provision of the bill), and (3) acted in accordance with the general fiduciary duty standards of ERISA in determining whether to enter into the transaction suspension period. The Secretary of Labor is required, in consultation with the Secretary of Treasury, to issue, before December 31, 2002, final regulations providing guidance, including safe harbors, on how plan fiduciaries will be able to satisfy their fiduciary responsibilities during a transaction suspension 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 after December 31, 2002. In the case of a plan maintained pursuant to one or more collective bargaining agreements, the provision is effective for plan years beginning after the earlier of (1) the later of December 31, 2003, or the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after the date of enactment), or (2) December 31, 2004.

C. Clarification of Participant Access to Remedies under ERISA (sec. 203 of the bill and sec. 409 of ERISA)

Present Law

ERISA contains several provisions under which a participant may bring a civil action against a plan fiduciary.[17]

A participant may bring a civil action for appropriate relief under the general fiduciary liability provision of ERISA.[18] Under this provision, 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. In addition, the fiduciary is subject to other equitable or remedial relief as a court deems appropriate, including the removal of the fiduciary. This general fiduciary liability provision has been interpreted to provide broad relief (including money damages) and to authorize the award of damages to make the plan whole for investment losses due to a breach of fiduciary duty. However, amounts recovered under the general fiduciary liability provision are not payable to a participant personally, even in the case of a civil action brought by a participant, because such recovery must be on behalf of the plan.[19]

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[17] ERISA sec. 502(a). Some of these provisions also allow the Secretary of Labor or another plan fiduciary to bring a civil action.

[18] ERISA sec. 409, relating to liability for breach of fiduciary duty. Participant civil actions for breach of such duties are authorized in ERISA sec. 502(a)(2).

[19] *Massachusetts Mutual Life Insurance Co. v. Russell*, 473 U.S. 134 (1985).

In the case of a recovery with respect to an individual account plan,[20] amounts recovered generally are payable to the plan and allocated to participants' accounts.[21] Issues have arisen under present law regarding the extent to which damages recovered under the general fiduciary liability provision with respect to a breach of fiduciary liability affecting a participant's individual account under an individual account plan are to be allocated to the participant's account.

ERISA also gives a participant the right to bring a civil action--

- to recover benefits due to him or her under the terms of the plan, to enforce his or her rights under the terms of the plan, or to clarify his or her rights to future benefits under the terms of the plan,[22] or
- to enjoin any act or practice which violates any provision of this title or the terms of the plan, or to obtain other appropriate equitable relief to redress such violations or to enforce any provisions of this title or the terms of the plan.[23]

These provisions enable a participant to seek recovery on his or her own behalf, not just on behalf of the plan, including recovery for a breach of fiduciary duty.[24] However, "appropriate equitable relief" that a participant may obtain on his or her own behalf does not include money damages (i.e., compensatory damages).[25] Participants in defined contribution plans who have brought action against a plan fiduciary under one of these ERISA provisions have been denied the recovery of damages for the difference between the earnings on their accounts and the amount of earnings they would have received if the plan administrator had complied with the participants' instructions as to the transfer or distribution of the accounts because lost earnings are considered compensatory damages.[26]

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[20] Under ERISA, a defined contribution plan is generally referred to as an individual account plan.

[21] Funds held under a defined contribution plan must be allocated to participants' accounts in accordance with a definite formula. The plan must provide for the valuation of amounts held by the plan, and allocations and adjustments of participants' accounts in accordance with the valuation, at least once a year. *See* Rev. Rul. 80-155, 1980-1 C.B. 84.

[22] ERISA sec. 502(a)(1)(B).

[23] ERISA sec. 502(a)(3).

[24] *Varity Corporation v. Charles Howe*, 516 U.S. 489 (1996).

[25] *Mertens v. Hewitt Associates*, 508 U.S. 248 (1993).

[26] *Helfrich v. PNC Bank, Kentucky, Inc.*, 267 F.3d 477 (6th Cir. 2001), *cert.den.*, reported at 2002 U.S. LEXIS 1558 (March 18, 2002); *Kerr v. Charles F. Vatterott & Co.*, 184 F.3d 938 (8th Cir. 1999). In *Ream v. Frey*, 107 F.3d 147 (3rd Cir. 1997), a participant brought an action under ERISA section 502(a)(3) for breach of fiduciary duty against a former trustee of a plan that was no longer functioning. The Circuit Court noted that, while the district court

Reasons for Change

The Committee believes that, in the case of a breach of fiduciary duty that causes financial harm to the accounts of individual participants under an individual account plan, ERISA was intended to make available the full range of ERISA relief so as to put a participant's account in the financial position it would have been in if the fiduciary breach had not occurred. The Committee wishes to remove any doubt that may exist under present law as to whether such relief is available. Accordingly, the Committee bill provides that amounts recovered for harm to particular accounts is to be allocated to those accounts to the extent the court deems appropriate.

Explanation of Provision

The provision clarifies that, in the case of a fiduciary breach with respect to an individual account plan, the relief available under the general fiduciary liability provision of ERISA will, to the extent the court deems appropriate, be apportioned to each individual account affected by the breach. No inference is intended as to the scope of recovery available to participants under present law.

Effective Date

The provision is effective on the date of enactment.

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seemed to treat the complaint as an action for money damages, the participant sought only to recover his vested interest in the plan, which largely reflected his own contributions, so that the relief granted to the participant could be characterized as restitution (i.e., a form of equitable relief).

D. Increased Maximum Bond Amount for Plans Holding Employer Securities (sec. 204 of the bill and sec. 412(a) of ERISA)

Present Law

ERISA generally requires every fiduciary and every person who handles funds or other property of an employee benefit plan (a "plan official") to be bonded under a qualifying bond. A plan official without a qualifying bond is prohibited from receiving, handling, or otherwise exercising control of any funds or property of an employee benefit plan. The amount of the bond is fixed annually at no less than 10 percent of the funds handled but must be at least $1,000 and not more than $500,000 (unless the Secretary of Labor prescribes a larger amount after notice and an opportunity to be heard). Qualifying bonds must have a corporate surety which is an acceptable surety on Federal bonds and meet certain other requirements.

Reasons for Change

The present-law bonding requirement is intended to protect employee benefit plan participants against losses that result from fraud or dishonesty on the part of plan officials who handle plan assets. The maximum amount of the bond has been $500,000 since the bonding requirement was enacted in 1962 under a predecessor to ERISA. The Committee is aware that many employee benefit plans have significant investments in employer securities. Such investments can be beneficial for plan participants; however, recent highly publicized cases regarding the financial distress of companies with plans that invest in employer securities highlight the additional risks that such investments can pose. Thus, the Committee believes it is appropriate to provide additional protection for such plans by raising the maximum bond amount.

Explanation of Provision

The bill raises the maximum bond amount to $1 million for fiduciaries of plans that hold employer securities.

Effective Date

The provision is effective for plan years beginning after December 31, 2002.

TITLE III. PROVIDING INFORMATION TO ASSIST PARTICIPANTS

A. Benefit Statements and Investment Guidelines (secs. 301-302 of the bill, new sec. 4980H of the Code, and secs. 104 and 105 of ERISA)

Present Law

Pension benefit statements

ERISA 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, including defined contribution and defined benefit plans. The benefit statement must indicate, on the basis of the latest available information, (1) the participant's or beneficiary's total accrued benefit, and (2) the participant's or beneficiary's vested accrued benefit or the earliest date on which the accrued benefit will become vested. A participant or beneficiary is not entitled to receive more than one benefit statement 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 $100 a day, within the court's discretion, or other relief that the court deems proper.[27]

Individual statements to participants on separation from service

A plan administrator must furnish an individual 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.[28] The individual 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 individual 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 individual 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 investment guidelines relating to retirement savings.

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[27] ERISA also permits the Secretary of Labor, a participant, a beneficiary, or a fiduciary to bring civil action to enforce any ERISA requirements.

[28] This information is based on an annual registration statement that the plan administrator is required to file under the Code with the Secretary of Treasury with respect to all participants who meet these requirements for the plan year. The annual registration statement is filed by means of Schedule SSA of the Form 5500. The Code and ERISA require that the plan administrator furnish an individual statement to the participant.

Reasons for Change

The Committee believes that regular information concerning the value of retirement benefits, especially the value of benefits accumulating in a defined contribution plan account, is necessary to increase employee awareness and appreciation of the importance of retirement savings. In addition, under some employer-sponsored retirement plans, participants are responsible for directing the investment of the assets in their accounts under the plan. Awareness of investment principles, including the need for diversification, is fundamental to making investment decisions consistent with long-term retirement income security. The Committee believes participants should be provided with investment guidelines and information for calculating retirement income to enable them to make sound investment and retirement savings decisions.

Explanation of Provision

Pension benefit statements

In general

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

Requirements for defined contribution plans

In the case of an applicable pension plan, the plan administrator is required under the Code and ERISA to provide a benefit statement (1) to an applicable individual who has the right to direct the investment of the assets in his or her account, at least quarterly, (2) to other applicable individuals, at least annually, and (3) to a beneficiary who is not an applicable individual, upon written request, but limited to one request during any 12-month period. An applicable pension plan is defined (as under the provision relating to notice of a transaction suspension period) as a qualified retirement plan or annuity, a tax-sheltered annuity plan, or an eligible deferred compensation plan of a governmental employer that maintains accounts for participants and beneficiaries (other than a one-participant retirement plan).[29] An applicable individual is defined (as under the provision relating to notice of a transaction suspension period) as (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 benefit statement is required to indicate, on the basis of the latest available information, (1) the total benefits accrued, and (2) the vested accrued benefit or the earliest date

[29] An applicable pension plan includes a plan that is a governmental plan or a church plan, and such a plan is subject to the benefit statement requirement under the Code. However, governmental plans (including an eligible deferred compensation plan of a governmental employer) and church plans are generally exempt from ERISA. As a result, the ERISA benefit statement requirement does not apply to such a plan.

on which the accrued benefit will become vested. In addition, the statement must include the value of investments allocated to the individual's account (determined as of the plan's most recent valuation date), including the value of any employer securities (without regard to whether the securities were contributed by the employer or acquired at the direction of the individual), and an explanation of any limitations or restrictions on the right of the individual to direct investments.

Requirements for defined benefit plans

Under the provision, the administrator of a defined benefit plan is generally required under ERISA either (1) to furnish a benefit statement at least once every three years[30] 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 furnish at least annually to each such participant notice of the availability of a benefit statement and the manner in which the participant can obtain it. The notice 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, (1) the total benefits accrued, and (2) the vested accrued benefit or the earliest date on which the accrued benefit will become vested. In the case of a statement provided to a participant (other than at the participant's request), information may be based on reasonable estimates determined under regulations prescribed by the Secretary of Labor.

Form of benefit statement

The benefit statement is required to be written in a manner calculated to be understood by the average plan participant. It is required to be provided in writing and may be delivered in electronic or other form that is reasonably expected to result in receipt of the statement by the applicable individual. For example, regulations could permit current benefit statements to be provided on a continuous basis through a secure plan website for a participant or beneficiary who has access to the website.

The Secretary of Labor is directed to develop one or more model benefit statements, written in a manner calculated to be understood by the average plan participant, that may be used by plan administrators in complying with the requirements of ERISA and the Code. The use of the model statement is optional. It is intended that the model statement include items such as the amount of nonforfeitable accrued benefits as of the statement date that are payable at normal retirement age under the plan, the amount of accrued benefits that are forfeitable but that may become nonforfeitable under the terms of the plan, information on how to contact the Social

[30] 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.

Security Administration to obtain a participant's personal earnings and benefit estimate statement, and other information that may be important to understanding benefits earned under the plan.

Investment guidelines

In general

Under the provision, the plan administrator of an applicable pension plan is required under the Code and ERISA to provide at least annually a model form relating to basic investment guidelines to applicable individuals.[31] "Applicable pension plan" and "applicable individual" are defined as under the provision relating to required benefit statements.

Model form

Under the provision, the Secretary of the Treasury is directed, in consultation with the Secretary of Labor, to develop and make available a model form containing basic guidelines for investing for retirement. Such guidelines generally include (1) information on the benefits of diversification of investments, (2) information on the essential differences, in terms of risk and return, of pension plan investments, including stocks, bonds, mutual funds and money market investments, (3) information on how an individual's investment allocations under the plan may differ depending on the individual's age and years to retirement, as well as other factors determined by the Secretary, (4) sources of information where individuals may learn more about pension rights, individual investing, and investment advice, and (5) such other information related to individual investing as the Secretary determines appropriate. In addition, the Secretary has the authority to vary the required information depending on the type of plan. For example, some information may be omitted in the case of a plan that does not provide for investment direction by participants.

The model form must also include addresses for Internet sites, and a worksheet, that an individual can use to calculate (1) the retirement age annuity value of the individual's vested benefits under the plan (determined by reference to varied historical annual rates of return and annuity interest rates), and (2) other important amounts relating to retirement savings, including the amount that an individual must save in order to provide a retirement income equal to various percentages of his or her current salary (adjusted for expected growth prior to retirement). The Secretary of Labor is also required to develop an Internet site to be used by an individual in making these calculations, the address of which will be included in the model form.

The Secretary of the Treasury is directed to provide at least 90 days for public comment before publishing final notice of the model form and to update the model form at least annually.

The model form must be written in a manner calculated to be understood by the average plan participant and must be in writing and may be delivered in electronic or other form that is reasonably expected to result in receipt by the applicable individual.

[31] The ERISA requirement does not apply to a plan that is exempt from ERISA, such as a governmental plan or a church plan.

Sanctions for failure to provide information

Excise tax

Under the provision, an excise tax generally applies in the case of a failure to provide a benefit statement or an investment guideline model form as required under the Code. However, a reporting penalty applies in the case of a failure related to a governmental plan or a church plan.

The excise tax is generally imposed on the employer if a required benefit statement or model form is not provided.[32] The excise tax is $100 per day for each participant or beneficiary with respect to whom the failure occurs, until the benefit statement or model form is provided or the failure is otherwise corrected. If the employer exercises reasonable diligence to meet the benefit statement or model form requirement, the total excise tax imposed during a taxable year will not exceed $500,000. The $500,000 annual limit will apply separately to failures to provide required benefit statements and failures to provide the model form.

No tax will be imposed with respect to a failure if the employer does not know that the failure existed and exercises reasonable diligence to comply with the benefit statement or model form requirement. In addition, no tax will be imposed if the employer exercises reasonable diligence to comply and provides the required benefit statement or model form within 30 days of learning of the failure. In the case of a failure due to reasonable cause and not to willful neglect, the Secretary of the Treasury is authorized to waive the excise tax to the extent that the payment of the tax would be excessive or otherwise inequitable relative to the failure involved.

The excise tax does not apply in the case of a failure to provide a benefit statement or model form with respect to a governmental plan or a church plan. In that case, on notice and demand by the Secretary, a penalty applies of $100 per day for each applicable individual with respect to whom the failure occurs, until the benefit statement or model form is provided or the failure is otherwise corrected. The limitations and exceptions to the excise tax apply also to the penalty.

ERISA civil penalty

The ERISA remedies that apply in the case of a failure or refusal to provide a benefit statement under present law apply if the plan administrator fails or refuses to furnish a benefit statement or model form required under the provisions.[33] That is, the participant or beneficiary is entitled to bring a civil action to recover from the plan administrator $100 a day, within the court's discretion, or such other relief that the court deems proper.

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[32] In the case of a multiemployer plan, the excise tax is imposed on the plan. In the case of a tax-sheltered annuity program under section 403(b) that is not treated as established or maintained by the employer for purposes of ERISA, the excise tax is imposed on the plan administrator.

[33] The civil penalty under ERISA does not apply to a governmental plan or a church plan that is exempt from ERISA.

Effective Date

The provision is generally effective for plan years beginning after December 31, 2003. In the case of a plan maintained pursuant to one or more collective bargaining agreements, the provision is effective for plan years beginning after the earlier of (1) the later of December 31, 2004, or the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after the date of enactment), or (2) December 31, 2005.

B. Information on Optional Forms of Benefit (sec. 303 of the bill)

Present Law

Under a defined benefit plan, benefits generally must be paid in the form of an annuity for the life of the participant unless the participant consents to a distribution in another form. In the case of a married participant, benefits must be paid in the form of a qualified joint and survivor annuity ("QJSA") unless the participant and his or her spouse consent to another form of benefit. A QJSA is an annuity for the life of the participant, with a survivor annuity for the life of the spouse which is not less than 50 percent (and not more than 100 percent) of the amount of the annuity payable during the joint lives of the participant and his or her spouse. The participant and his or her spouse may waive the right to a QJSA provided certain requirements are satisfied, including a requirement that a written explanation be provided of the effect of a waiver of the annuity.

Defined benefit plans generally provide that a participant may choose among other forms of benefit offered under the plan, such as a lump sum distribution. These optional forms of benefit generally must be actuarially equivalent to the life annuity benefit payable to the participant.

A defined benefit plan must specify the actuarial assumptions that will be used in determining optional forms of benefit under the plan in a manner that precludes employer discretion in the assumptions to be used. For example, a plan may specify that a variable interest rate will be used in determining actuarial equivalent forms of benefit, but may not give the employer discretion to choose the interest rate.

In addition, statutory actuarial assumptions must be used in determining the minimum value of certain optional forms of benefit, such as a lump sum. That is, the lump sum payable under the plan may not be less than the amount of the lump sum that is actuarially equivalent to the life annuity payable to the participant, determined using the statutory assumptions. The statutory assumptions consist of an applicable mortality table (as published by the Internal Revenue Service) and an applicable interest rate.

Reasons for Change

The Committee believes that a participant should have sufficient information to evaluate the relative values of various optional forms of benefit available to the participant under a plan before making a decision as to which form of benefit to elect.

Explanation of Provision

Under the provision, the Secretary of the Treasury is directed to issue (within 30 days of enactment of the provision) regulations requiring the plan administrator of a defined benefit plan that provides optional forms of benefit to provide a statement comparing the relative values of optional forms of benefits payable under the plan. The statement must be provided at a time specified by the Secretary of the Treasury and must be written in a manner calculated to be understood by the average plan participant. The statement must include such information as the Secretary determines appropriate to enable a plan participant, spouse, or surviving spouse to make an informed decision as to what form of benefit to elect. For example, in the case of a plan that provides a subsidized early retirement annuity benefit, it is intended that the information will include, at a minimum, a quantification of whether and how the subsidy is included in determining other forms of benefit (e.g., a lump sum) payable at early retirement age.

Effective Date

The provision is effective on the date of enactment.

C. Fiduciary Duty to Provide Material Information Relating to Investment in Employer Stock (sec. 304 of the bill and sec. 404(c) of ERISA)

Present Law

ERISA contains general fiduciary duty standards that apply to all fiduciary actions. Among them are requirements that plan fiduciaries generally discharge their duties solely in the interest of participants and beneficiaries and with care, prudence, and diligence. 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 in certain circumstances.

ERISA provides a special rule for a defined contribution plan that permits participants to exercise control over the assets in their individual accounts.[34] Under the special rule, if a participant or beneficiary exercises control over the assets in his or her account, the participant or beneficiary 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 or beneficiary's exercise of control.

Reasons for Change

[34] ERISA sec. 404(c).

The Committee believes that, in the case of a defined contribution plan that allows participants and beneficiaries to exercise control over the assets in their individual accounts, the same material investment information that the plan sponsor is required to disclose to investors under securities laws should be provided to participants and beneficiaries whose accounts are invested in employer stock. The Committee believes that plan sponsors and plan administrators should have a fiduciary duty to provide this information.

Explanation of Provision

The bill amends ERISA to provide that sponsors and administrators of defined contribution plans that permit participants and beneficiaries to exercise control over the assets in their individual accounts have a fiduciary duty to ensure that, in connection with investments of such assets in employer stock, the participant or beneficiary is provided with the same material investment information that would generally be required to be disclosed by the employer to investors under applicable securities laws. The provision of misleading information by the plan sponsor or administrator is a violation of this requirement.

In the case of a failure to provide material investment information, the Secretary of Labor is authorized to assess a civil penalty of up to $1,000 per day. In addition, such a failure would violate the fiduciary rules of ERISA. As a result, the fiduciary could be liable under present-law rules 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.

Effective Date

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

D. Electronic Disclosure of Insider Trading
(sec. 305 of the bill and sec. 101 of ERISA)

Present Law

Disclosure rules under ERISA

ERISA contains rules requiring the provision of certain information to employee benefit plan participants and beneficiaries by plans sponsors and administrators. For example, ERISA generally requires distribution to plan participants and beneficiaries of written summaries of employee benefit plans as well as summaries of any modifications to certain plan provisions. The required disclosures advise participants and beneficiaries of their rights and benefits under plans and applicable law, provide them access to plan financial information, and provide them opportunities to prevent or redress any violations of their rights.

Elective deferrals

A defined contribution plan can accept varied types of contributions, depending on the design of the particular plan. In general, defined contribution plans can accept elective deferrals, which are contributions made under a qualified cash or deferred arrangement (i.e., a "section

401(k) plan") that are made by reason of the employee's election to have the employer make the contributions to the plan rather than paying them directly to the employee in cash.

Reasons for Change

Many defined contribution plans that accept elective deferrals permit those deferrals to be invested in employer stock or real property. Participants and beneficiaries in such plans have the same interest as other investors in receiving information about any sale or purchase of employer stock by an officer, director, or affiliate of the employer ("insider trades"). Thus, the Committee believes that any insider trade that is required to be disclosed to the SEC should also be specifically disclosed to participants and beneficiaries in the plans. The Committee believes that the posting of such information on a plan website (or providing it upon request in another form) will not unreasonably burden employers and will facilitate participants' and beneficiaries' access to the information.

Explanation of Provision

The provision amends ERISA to require that an employer that sponsors a defined contribution plan that permits elective deferrals to be invested in employer stock or real property must disclose to participants and beneficiaries any insider trade that is required to be disclosed to the SEC. Within a reasonable period after disclosure to the SEC, the insider trade information must be posted on the plan's website or provided upon request, in the case of a participant or beneficiary who does not have access to a plan website. It is intended that the Department of Labor will provide guidance with respect to requests for disclosure in the case of such a participant or beneficiary. For example, participants could be permitted to make standing requests to receive any insider trade disclosures in some other form.

Under the provision, the SEC is permitted to accept electronic disclosure in place of any form of disclosure otherwise required with respect to participants and beneficiaries.

Effective Date

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

E. Fiduciary Rules for Plan Sponsors Designating Independent Investment Advisors (sec. 306 of the bill and new sec. 404(e) of ERISA)

Present Law

ERISA requires an employee benefit plan to provide for one or more named fiduciaries who jointly or severally have the authority to control and manage the operation and administration of the plan. In addition to fiduciaries named in the plan, or identified pursuant to a procedure specified in the plan, a person is a plan fiduciary under ERISA 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. In certain circumstances, a fiduciary under ERISA may be liable for a breach of responsibility by a co-fiduciary.

Reasons for Change

The Committee believes that providing specific rules under which a fiduciary may arrange for independent investment advice to be provided to participants who are responsible for directing the investment of their retirement assets will facilitate the provision of such investment advice without undercutting the fiduciary requirements of ERISA. The provision of independent investment advice will better enable participants to make sound investment decisions.

Explanation of Provision

In general

The provision amends ERISA by adding specific rules dealing with the provision of investment advice to plan participants by a qualified investment adviser. The provision applies to a defined contribution plan that permits a participant or beneficiary to exercise investment control over the assets in his or her account. Under the provision, if certain requirements are met, an employer or other plan fiduciary will not be liable for investment advice provided by a qualified investment adviser.

Qualified investment adviser

Under the provision, a "qualified investment adviser" is defined as a person who is a plan fiduciary by reason of providing investment advice and who is also (1) a registered investment adviser under the Investment Advisers Act of 1940 or registered as an investment adviser under the laws of the State (consistent with section 203A of the Investment Advisers Act[35]) in which the adviser maintains its principal office, (2) a bank or similar financial institution, (3) an insurance company qualified to do business under State law, or (4) a comparably qualified entity under criteria to be established by the Secretary of Labor. In addition, any individual who provides investment advice to participants on behalf of the investment adviser (such as an employee thereof) is required to be (1) a registered investment adviser under Federal or State law as described above,[36] (2) a registered broker or dealer under the Securities Exchange Act, (3) a registered representative under the Securities Exchange Act or the Investment Advisers Act, or (4) any comparably qualified individual under criteria to be established by the Secretary of Labor.

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[35] *See*, 15 U.S.C. 80b-3a. Nothing in the proposal is intended to restrict the authority under present law of any State to assert jurisdiction over investment advisers and investment adviser representatives based on their presence in the State or the fact that they have clients in the State.

[36] An individual who is registered as an investment adviser under the laws of a State is a qualified investment adviser only if the State has an examination requirement to qualify for such registration.

A qualified investment adviser is required to provide the following documents to the employer or plan fiduciary: (1) the contract for investment advice services, (2) a disclosure of the fees to be received by the investment adviser, and (3) documentation that the investment advisor is a qualified investment adviser. A qualified investment adviser that acknowledges its fiduciary status will be a fiduciary under ERISA with respect to investment advice provided to a participant or beneficiary.

Requirements for employer or other fiduciary

Before designating the investment adviser and at least annually thereafter, the employer or other fiduciary is required to obtain written verification that the investment adviser (1) is a qualified investment adviser, (2) acknowledges its status as a plan fiduciary that is solely responsible for the investment advice it provides, (3) has reviewed the plan document (including investment options) and determined that its relationship with the plan and the investment advice provided to any participant or beneficiary, including the receipt of fees or compensation, will not violate the prohibited transaction rules, (4) will consider any employer securities or employer real property allocated to the participant's or beneficiary's account in providing investment advice, and (5) has the necessary insurance coverage (as determined by the Secretary of Labor) for any claim by a participant or beneficiary.

In designating an investment adviser, the employer or other fiduciary is required to review the documents provided by the qualified investment adviser. The employer or other fiduciary is also required to make a determination that there is no material reason not to engage the investment adviser.

In the case of (1) information that the investment adviser is no longer qualified or (2) concerns about the investment adviser's services raised by a substantial number of participants or beneficiaries, the employer or other fiduciary is required within 30 days to investigate and to determine whether to continue the investment adviser's services.

An employer or other fiduciary that complies with the requirements for designating and monitoring an investment adviser will be deemed to have satisfied its fiduciary duty in the prudent selection and periodic review of an investment adviser and does not bear liability as a fiduciary or co-fiduciary for any loss or breach resulting from the investment advice.

Effective Date

The provision applies to investment advisers designated after the date of enactment.

TITLE IV. OTHER PROVISIONS RELATING TO PENSIONS

A. Employee Plans Compliance Resolution System (sec. 401 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.[37] 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.

[37] Rev. Proc. 2002-47, 2002-29 I.R.B. 1.

Reasons for Change

The Committee commends the IRS for the establishment of EPCRS and agrees with the IRS that EPCRS should be updated and improved periodically. The Committee believes that future improvements should facilitate use of the compliance and correction programs by small employers and expand the flexibility of the programs.

Explanation of Provision

The provision clarifies that the Secretary of the Treasury has the full authority to establish and implement 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.

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 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.

Effective Date

The provision is effective on the date of enactment.

B. Extension to all Governmental Plans of Moratorium on Application of Certain Nondiscrimination Rules Applicable to State and Local Government Plans (sec. 402 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.

Reasons for Change

The Committee believes that application of the nondiscrimination and minimum participation rules to governmental plans is unnecessary and inappropriate in light of the unique circumstances under which such plans and organizations operate. Further, the Committee believes that it is appropriate to provide for consistent application of the minimum coverage, nondiscrimination, and minimum participation rules for governmental plans.

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 plan years beginning after December 31, 2002.

C. Notice and Consent Period Regarding Distributions (sec. 403 of the bill, sec. 417 of the Code, and sec. 205 of ERISA)

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,[38] 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

[38] 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.

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.

Reasons for Change

The Committee understands that an employee is not always able to evaluate distribution alternatives, select the most appropriate alternative, and notify the plan of the selection within a 90-day period. The Committee believes that requiring a plan to furnish multiple distribution notices to an employee who does not make a distribution election within 90 days is administratively burdensome. In addition, the Committee believes that participants who are entitled to defer distributions should be informed of the impact of a decision not to defer distribution on the taxation and accumulation of their retirement benefits.

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 modifications made or required by the provision are effective for years beginning after December 31, 2002. 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.

D. Technical Corrections to Saver Act (sec. 404 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.

Reasons for Change

The Committee believes it is appropriate to make modifications and clarifications regarding the administration of future National Summits on Retirement Savings.

Explanation of Provision

Under the provision, future National Summits on Retirement Savings are to be held in 2006 and 2010. To facilitate the administration of future National Summits, the Department of Labor is given authority to enter into cooperative agreements (pursuant to the Federal Grant and Cooperative Agreement Act of 1977) with any appropriate, qualified entity.

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. Further, the President, in consultation with the Congressional leadership, is permitted to appoint additional Summit participants, not to exceed the lesser of three percent of all additional participants or 10 participants, from a list of nominees provided by the private sector partner in Summit administration. 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, gives the Department of Labor limited reception and representation authority, and specifies that the Department of Labor consult with the Congressional leadership in drafting the post-Summit report.

Effective Date

The provision is effective on the date of enactment.

E. Missing Participants
(sec. 405 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.

Reasons for Change

The Committee recognizes that no statutory provision or formal regulatory guidance exists concerning an appropriate method of handling the benefits of missing participants in terminated multiemployer plans or defined contribution plans and other plans not subject to the PBGC termination insurance program. Therefore, sponsors of these plans face uncertainty with respect to the benefits of missing participants. The Committee believes that it is appropriate to extend the established PBGC missing participant program to these plans in order to reduce uncertainty for plan sponsors and increase the likelihood that missing participants will receive their retirement benefits.

Explanation of Provision

The PBGC is directed to prescribe for terminating multiemployer plans rules 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.

F. Reduced PBGC Premiums for Small and New Plans (secs. 406-407 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.

Reasons for Change

The Committee believes that reducing the PBGC premiums for new plans and small plans will reduce the administrative costs of establishing and maintaining defined benefit pension plans, particularly by small employers.

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 is 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 provision relating to flat-rate premiums for 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 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 taken into account in determining whether the plan is 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 is effective with respect to plans first effective after December 31, 2002. The reduction of the variable-rate premium for small plans is effective with respect to plan years beginning after December 31, 2002.

G. Authorization for PBGC to Pay Interest on Premium Overpayment Refunds (sec. 408 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.

Reasons for Change

The Committee believes that an employer or other person who overpays PBGC premiums should receive interest on a refund of the overpayment.

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.

H. Rules for Substantial Owner Benefits in Terminated Plans (sec. 409 of the bill and secs. 4022 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.

Reasons for Change

The Committee believes that the present-law rules concerning limitations on guaranteed benefits for substantial owners are overly complicated and restrictive and thus may discourage some small business owners from establishing defined benefit pension plans.

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 applies 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, 2002.

I. Benefit Suspension Notice
(sec. 410 of the bill)

Present Law

Under present law,[39] 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.

Reasons for Change

The Committee believes the regulations relating to the benefit suspension notice should be amended to reduce the regulatory burden on plan administrators while at the same time assuring that adequate information is provided to employees.

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, 2002.

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

J. Interest Rate Range for Additional Funding Requirements (sec. 411 of the bill, sec. 412 of the Code, and secs. 302 and 4006 of ERISA)

Present Law

In general

ERISA and the Code impose both minimum and maximum[40] funding requirements with respect to defined benefit pension plans. The minimum funding requirements are designed to provide at least a certain level of benefit security by requiring the employer to make certain minimum contributions to the plan. The amount of contributions required for a plan year is generally the amount needed to fund benefits earned during that year 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

Additional contributions are required under a special funding rule if a single-employer defined benefit pension plan is underfunded.[41] Under the special rule, a plan is considered underfunded for a plan year if the value of the plan assets is less than 90 percent of the plan's current liability.[42] The value of plan assets as a percentage of current liability is the plan's "funded current liability percentage."

If a plan is underfunded, the amount of additional required contributions is based on certain elements, including whether the plan has an unfunded liability 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). However, the amount of additional contributions cannot exceed the amount needed to increase the plan's funded current liability percentage to 100 percent.

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[40] 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.

[41] Plans with no more than 100 participants on any day in the preceding plan year are not subject to the special funding rule. Plans with more than 100 but not more than 150 participants are generally subject to lower contribution requirements under the special funding rule.

[42] Under an alternative test, a plan is not considered underfunded if (1) the value of the plan assets is at least 80 percent of current liability and (2) the value of the plan assets was at least 90 percent of current liability for each of the two immediately preceding years or each of the second and third immediately preceding years.

Required interest rate

In general, a plan's current liability means all liabilities to employees and their beneficiaries under the plan. The interest rate used to determine a plan's current liability must be within a permissible range of the weighted average of the interest rates on 30-year Treasury securities for the four-year period ending on the last day before the plan year begins.[43] The permissible range is from 90 percent to 105 percent. As a result of debt reduction, the Department of the Treasury does not currently issue 30-year Treasury securities.

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.[44]

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. In order to protect employees and their beneficiaries, the Pension Benefit Guaranty Corporation ("PBGC") generally insures the benefits owed under defined benefit pension plans. Employers pay premiums to the PBGC for this insurance coverage.

In the case of an underfunded plan, additional PBGC premiums are required based on the amount of unfunded vested benefits. These premiums are referred to as "variable rate premiums." 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.

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[43] 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 (section 412(b)(5)(B)(iii)(II)).

[44] No additional quarterly contributions are due once the plan's funded current liability percentage for the plan year reaches 100 percent.

Special interest rate for 2002 and 2003

Section 405 of the Job Creation and Worker Assistance Act of 2002,[45] enacted March 9, 2002, provides a special interest rate rule applicable in determining the amount of additional contributions for plan years beginning after December 31, 2001, and before January 1, 2004 (the "applicable plan years"). The special rule expands the permissible range of the statutory interest rate used in calculating a plan's current liability for purposes of applying the additional contribution requirements for the applicable plan years. The permissible range is from 90 percent to 120 percent for these years.

Under a related special rule, 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 applicable plan year begins.

Reasons for Change

Additional contributions are due within 8½ months after the end of the plan year if the plan was sufficiently funded for the preceding plan year. The Committee believes that the special interest rate rule provided under the Job Creation and Worker Assistance Act of 2002 should be phased in for contributions for the 2001 plan year that are due within 8½ months after the end of the plan year.

Explanation of Provision

The provision expands the permissible range of the statutory interest rate used in calculating a plan's current liability for purposes of determining the amount of additional contributions for a plan year beginning in 2001 (the "2001 plan year") that must be contributed to the plan within 8½ months after the end of the plan year (e.g., by September 15, 2002, in the case of a plan that uses the calendar year as the plan year). The permissible range is from 90 percent to 108 percent for this purpose.

In addition, 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.

Effective Date

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

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

K. Voluntary Early Retirement Incentive Plans Maintained by Local Educational Agencies and Other Entities (sec. 412 of the bill, sec. 457 of the Code, sec. 3(2)(B) of ERISA, and sec. 4(l)(1) of the Age Discrimination in Employment Act)

Present Law

Eligible deferred compensation plans of State and local governments and tax-exempt employers

A "section 457 plan" is an eligible deferred compensation plan of a State or local government or tax-exempt employer that meets certain requirements. For example, amounts that can be deferred under section 457 cannot exceed certain dollar limits ($11,000 for 2002). Amounts deferred under a section 457 plan are generally includible in gross income when paid or made available (or, in the case of governmental section 457 plans, when paid). Subject to certain exceptions (e.g., a qualified retirement plan), amounts deferred under a plan that does not comply with section 457 (an "ineligible plan") are includible in income when the amounts are not subject to a substantial risk of forfeiture. Section 457 does not apply to any bona fide vacation leave, sick leave, compensatory time, severance pay, disability pay, or death benefit plan. Additionally, section 457 does not apply to qualified governmental excess benefit plans that provide benefits in excess of those that are provided under a qualified retirement plan maintained by the governmental employer.

ERISA

ERISA provides rules governing the operation of most employee benefit plans. The rules to which a plan is subject depends on whether the plan is an employee welfare benefit plan or an employee pension benefit plan. For example, employee pension benefit plans are subject to reporting and disclosure requirements, participation and vesting requirements, funding requirements, and fiduciary provisions. Employee welfare benefit plans are not subject to all of these requirements. In addition, governmental plans are exempt from ERISA.

Age Discrimination in Employment Act

The Age Discrimination in Employment Act ("ADEA") generally prohibits discrimination in employment because of age. An exemption is provided from certain restrictions in ADEA for certain defined benefit plans that offer early retirement benefits or social security supplements and for a voluntary early retirement incentive plan that is consistent with the purposes of ADEA.

Reasons for Change

The Committee is aware that some public school districts and related tax-exempt education associations provide certain employees with voluntary early retirement incentive benefits similar to benefits that can be provided under a defined benefit plan. If provided under a defined benefit plan, these benefits would not be includible in income until paid and would also generally be permitted under ADEA. However, for reasons related to the structure of State-maintained defined benefit plans covering these employees and fiscal operations of the local school districts, these benefits are provided to the employees directly, rather than under the defined benefit plan. The Committee believes it is appropriate to treat these benefits in a manner similar to the treatment that would apply if the benefits were provided under the defined benefit plan. The Committee also believes that it is appropriate to address the treatment of certain employment retention plans maintained by local school districts and related tax-exempt education associations

Explanation of Provision

Early retirement incentive plans of local educational agencies and education associations

The provision deals with the treatment of certain voluntary early retirement incentive plans under section 457, ERISA, and ADEA. The provision applies to voluntary early retirement incentive plans that are maintained by local educational agencies and tax-exempt education associations which principally represent employees of one or more such agencies, and that make payments or supplements as an early retirement benefit, a retirement-type subsidy, or a social security supplement in coordination with a defined benefit plan maintained by a State or local government or by such an association.

Under the provision, a voluntary early retirement incentive plan is treated as a bona fide severance plan for purposes of section 457, and is therefore not subject to the limits under section 457, to the extent the payments or supplements could otherwise be provided under the defined benefit plan. For purposes of the provision, the payments or supplements that could otherwise be provided under the defined benefit plan are to be determined by applying the accrual and vesting rules for defined benefit plans.[46]

Under the provision, a voluntary early retirement incentive plan is also treated as a welfare plan for purposes of ERISA (other than a governmental plan that is exempt from ERISA). Additionally, for purposes of ADEA, the bill provides that a voluntary early retirement incentive plan is treated as part of the defined benefit plan and that payments or supplements under voluntary early retirement incentive plans are not severance pay that may be subject to certain deductions under ADEA.

Employment retention plans of local educational agencies and education associations

The provision deals with the treatment of certain employment retention plans under section 457 and ERISA. The provision applies to employment retention plans that are maintained by local educational agencies and tax-exempt education associations which principally represent employees of one or more such agencies and that provide compensation to an employee (payable on termination of employment) for purposes of retaining the services of the employee or rewarding the employee for service with educational agencies or associations.

[46] The accrual and vesting rules have the effect of limiting the social security supplements and early retirement benefits that may be provided under a defined benefit plan; however, government plans are exempt from these rules.

Under the provision, special tax treatment applies to the portion of an employment retention plan that provides benefits that do not exceed twice the applicable dollar limit on deferrals under section 457 ($11,000 for 2002). The provision provides an exception from the rules under section 457 for ineligible plans with respect to such portion of an employment retention plan. This exception applies for years preceding the year in which benefits under the employment retention plan are paid or otherwise made available to the employee. In addition, such portion of an employment retention plan is not treated as providing for the deferral of compensation for tax purposes.

Under the provision, an employment retention plan is also treated as a welfare plan for purposes of ERISA (other than a governmental plan that is exempt from ERISA).

Effective Date

The provision is generally effective on the date of enactment. The amendments to section 457 apply to taxable years ending after the date of enactment. The amendments to ERISA apply to plan years ending after the date of enactment. No inference is intended to be drawn from the provision as to the application of any law to any arrangement to which the provision does not apply or for any period or year for which the provision does not apply.

L. Automatic Rollovers of Certain Involuntary Distributions (sec. 413 of the bill and sec. 404(c) of ERISA)

Present Law

In general

If a qualified retirement plan participant ceases to be employed by the employer that maintains the plan, the plan may distribute the participant's nonforfeitable accrued benefit without the consent of the participant (an "involuntary distribution") and, if applicable, the participant's spouse, if the present value of the benefit does not exceed $5,000. Generally, a participant may roll over an involuntary distribution from a qualified plan to an individual retirement account or annuity (an "IRA") or to another qualified plan. Before making a distribution that is eligible for rollover, a plan administrator must provide the participant with a written explanation of the ability to have the distribution rolled over directly to an IRA or another qualified plan and the related tax consequences.

IRS guidance on default rollovers

Under a 2000 ruling issued by the IRS,[47] a qualified retirement plan may provide that the default form of payment of an involuntary distribution is a direct rollover to an IRA, unless the participant elects (1) a direct rollover to another qualified retirement plan or IRA or (2) to receive the payment in cash. Under the plan described in the ruling, the plan administrator selected an

[47] Rev. Rul. 2000-36, 2000-2 C.B. 140.

IRA trustee, custodian or issuer, established the IRA on behalf of the participant, and made initial investment choices for the account.

The ruling noted that the Department of Labor had advised the Treasury Department and the IRS that, in the context of a default direct rollover as described in the ruling, the participant ceases to be a participant covered under the plan within the meaning of ERISA and the distributed assets cease to be plan assets for purposes of ERISA if the distribution constituted the entire benefit rights of the participant. The ruling also noted that the Department of Labor had advised that the selection of an IRA trustee, custodian, or issuer and IRA investment for purposes of a default direct rollover would constitute a fiduciary act subject to the general fiduciary standards and prohibited transaction provisions of ERISA. In addition, the Department of Labor noted that plan provisions governing the default direct rollover of distributions, including the participant's ability to affirmatively opt out of the arrangement, must be described in the plan's summary plan description furnished to participants and beneficiaries.

Automatic rollover of involuntary distributions

Under the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"),[48] a direct rollover to an IRA must be automatic for an involuntary distribution that exceeds $1,000 and that is an eligible rollover distribution from a qualified retirement plan.[49] That is, the distribution must be rolled over automatically to a designated IRA, unless the participant affirmatively elects to have the distribution transferred to a different IRA or a qualified plan or to receive it directly.

ERISA fiduciary rules

ERISA contains general fiduciary duty standards that apply to all fiduciary actions related to employer-sponsored pension plans, including actions related to the investment of plan assets. However, these fiduciary rules generally do not apply to IRAs.

ERISA provides a special rule for a defined contribution plan that permits participants to exercise control over the assets in their individual accounts.[50] 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.

In connection with the EGTRRA provisions relating to automatic direct rollovers, the ERISA provision dealing with fiduciary liability when a participants exercises control over the assets in his or her account was amended to provide that, in the case of an automatic direct rollover, the participant is treated as exercising control over the assets in the IRA upon (1) the

[48] Pub. L. No. 107-16.

[49] Section 401(a)(31)(B) of the Code, as added by section 657 of EGTRRA.

[50] ERISA sec. 404(c).

earlier of a rollover of all or a portion of the amount to another IRA, or one year after the automatic rollover is made, or (2) the making of an automatic rollover in a manner consistent with guidance provided by the Secretary of Labor.[51] EGTRRA directed the Secretary of Labor to prescribe regulations, not later than three years after the date of enactment of EGTRRA, providing safe harbors under which the designation of an institution and investment of funds in accordance with the automatic direct rollover provision are deemed to satisfy the general fiduciary duty requirements of ERISA.[52] The automatic rollover provisions apply to distributions made after the Department of Labor has adopted final regulations providing the required safe harbor. No such regulations have been adopted.

Reasons for Change

The Committee recognizes that the provision added to ERISA in connection with the automatic rollover requirement, under which the individual is treated as exercising control over the assets in the IRA, has caused concern as to whether the assets in the IRA would be treated as plan assets that are subject to the fiduciary rules of ERISA. Such treatment would be inconsistent with the Department of Labor's position that, in the case of a default direct rollover to an IRA, the distributed assets cease to be plan assets. Confusion over whether the fiduciary rules of ERISA would apply with respect to assets held in an IRA has made it difficult for the Department of Labor to issue guidance related to automatic rollovers, including safe harbors for the designation of an institution to hold the distributed assets and the investment of the assets after distribution. The Committee believes it is appropriate to clarify the operation of the automatic rollover provision. This will facilitate the issuance of guidance by the Department of Labor and the implementation of the automatic rollover provision.

Explanation of Provision

The provision repeals the ERISA provision relating to when a participant is considered to exercise control over the assets in an IRA following an automatic rollover. The provision thus clarifies that amounts transferred from a qualified retirement plan to an IRA in an automatic rollover are no longer plan assets for ERISA purposes, as indicated under the Department of Labor's position with respect to default direct rollovers before the enactment of EGTRRA. In addition, the provision directs the Department of Labor, not later than December 31, 2002, to issue interim final regulations, or other administrative guidance, under which the designation of an institution and investment of funds in accordance with the automatic rollover provision are deemed to satisfy the general fiduciary duty requirements of ERISA.[53] The provision provides that the automatic rollover provision applies to distributions made after December 31, 2003.

Effective Date

[51] ERISA sec. 404(c)(3), as added by section 657 of EGTRRA. Section 411(t) of the Job Creation and Worker Assistance Act of 2002 made clerical corrections to the wording of this provision.

[52] ERISA sec. 404(a).

[53] Sec. 404(a) of ERISA.

The provision is effective as if included in the provisions of EGTRRA.

M. Extension of Transition Rule to Pension Funding Requirements (sec. 414 of the bill and sec. 769(c) of the Retirement Protection Act of 1994)

Present Law

Under present law, 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 plan underfunding.

Under present law, a special rule modifies the minimum funding requirements in the case of certain plans. 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 a plan year beginning in 2005, 2006, 2007, or 2008 only if contributions to the plan for the plan year equal at least the expected increase in current liability due to benefits accruing during the plan year.

Reasons for Change

The present-law funding rules for plans maintained by certain interstate bus companies were enacted because the generally applicable funding rules required greater contributions for such plans than were warranted give the special characteristics of such plans. In particular, these plans are closed to new participants and have demonstrated mortality significantly greater than that predicted under mortality tables that the plans would otherwise be required to use for minimum funding purposes. The Committee believes that it is appropriate to provide an extension of the special minimum funding rules for these plans for two years.

Explanation of Provision

The provision modifies the special funding rules for plans sponsored by a company engaged primarily in interurban or interstate passenger bus service by providing that, for plan years beginning in 2004 and 2005, the funded current liability percentage of the plan will be treated as at least 90 percent for purposes of determining the amount of required contributions (100 percent for purposes of determining the timing of plan contributions). In addition, for these years, the mortality table used under the plan will be used in determining the amount of unfunded vested benefits under the plan.

Effective Date

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

N. Studies (secs. 421-425 of the bill)

Present Law

Present law does not require studies specifically relating to the revitalization of defined benefit plans, floor-offset ESOPs, an insurance system for defined contribution plans, or fees related to the investment of defined contribution plan assets.

Reasons for Change

The Committee has a continuing interest in retirement income security and in the roles that defined contribution plans and defined benefit plans play in providing that security. The Committee believes it is appropriate to conduct studies of certain issues relating to defined contribution plans, specifically, the establishment of an insurance arrangement for defined contribution plans, administrative and transactions fees charged in connection with the investment of defined contribution plan assets, and existing floor-offset ESOP arrangements, as well as a study of possible ways to revitalize interest in defined benefit plans.

Explanation of Provision

Study regarding insurance system for individual account plans

The Pension Benefit Guaranty Corporation (the "PBGC") is required, as soon as practicable after the date of enactment, to undertake a study relating to the establishment of an insurance system for defined contribution plans and to report the results thereof, with recommendations for legislative changes, within two years after the date of enactment, to the House Committees on Ways and Means and on Education and the Workforce and the Senate

Committees on Finance and on Health, Education, Labor and Pensions. In conducting the study, the PBGC is required to consider the feasibility of such a system, the problem with insuring investments in employer securities, and options for developing such a system.

Study regarding fees charged by individual account plans[54]

The Department of Labor is required to undertake a study of the administrative and transaction fees incurred by participants and beneficiaries in connection with the investment of assets in their accounts under defined contribution plans and to report the results thereof, with recommendations for legislative changes, within one year after the date of enactment, to the House Committees Ways and Means and on Education and the Workforce and the Senate Committees on Finance and on Health, Education, Labor and Pensions. In conducting the study, the Department of Labor is required to consider how the fees compare to fees charged for similar services provided to investors not in defined contribution plans and whether participants and beneficiaries are adequately notified of the fees.

Study on revitalizing defined benefit plans

The Secretary of the Treasury is required to undertake a study on ways to revitalize employer interest in defined benefit plans and to report the results thereof, with recommendations for legislative changes, within 18 months after the date of enactment, to the House Committees on Ways and Means and on Education and the Workforce and the Senate Committees on Finance and on Health, Education, Labor and Pensions. In conducting the study, the Secretary is required to consider (1) ways to encourage the establishment of defined benefit plans by small and mid-sized employers, (2) ways to encourage the continued maintenance of defined benefit plans by larger employers, and (3) legislative proposals to accomplish these objectives.

Study on floor-offset ESOPs[55]

The PBGC is required to undertake a study to determine the number of floor-offset ESOPs still in existence and the extent to which such plans pose a risk to plan participants or beneficiaries or to the PBGC and to report the results thereof, with legislative proposals, within 12 months after the date of enactment, to the House Committees on Ways and Means and on Education and the Workforce and the Senate Committees on Finance and on Health, Education, Labor and Pensions.

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[54] Under ERISA, a defined contribution plan is generally referred to as an individual account plan.

[55] A floor-offset arrangement is an arrangement under which benefits payable to a participant under a defined benefit plan are reduced by benefits under a defined contribution plan. Generally, in the case of a floor-offset arrangement, ERISA prohibits the defined contribution plan from acquiring employer securities if, after the acquisition, more than 10 percent of the assets of the plan would be invested in employer stock. However, under a special transition rule, this prohibition does not apply to a defined contribution plan, including an ESOP, that is part of a floor-offset arrangement established on or before December 17, 1987.

Effective Date

The provision is effective on the date of enactment.

O. Plan Amendments (sec. 431 of the bill)

Present Law

Plan amendments to reflect amendments to 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.

Reasons for Change

The Committee believes that employers should have adequate time to amend their plans to reflect amendments to the law while operating their plans in compliance with such amendments.

Explanation of Provision

The provision permits certain plan amendments made pursuant to the changes made by the bill or by the Economic Growth and Tax Relief Reconciliation Act of 2001 (the "2001 Act"), 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 for purposes of the Internal Revenue Code. 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, 2005 (January 1, 2007, 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 the 2001 Act (or applicable regulations) could be made retroactive 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 the 2001 Act (or applicable regulations) if it has an effective date before the effective date of the provision of the bill or Act (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 the 2001 Act. 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 the 2001

Act.[56] 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 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 the 2001 Act. 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 the 2001 Act, the plan is not be 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 the 2001 Act.

Effective Date

The provision is effective on the date of enactment.

[56] 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 the 2001 Act, in the case of a plan that incorporated the section 415 limits by reference on June 7, 2001, the date of enactment of the 2001 Act.

TITLE V. PROVISIONS RELATING TO EXECUTIVES AND STOCK OPTIONS

A. Repeal of Limitation on Issuance of Treasury Guidance Regarding Nonqualified Deferred Compensation (sec. 501 of the bill)

Present Law

General tax treatment of nonqualified deferred compensation

The determination of when amounts deferred under a nonqualified deferred compensation arrangement are includible in the gross income of the individual earning the compensation depends on the facts and circumstances of the arrangement. A variety of tax principles and Code provisions may be relevant in making this determination, including the doctrine of constructive receipt, the economic benefit doctrine, the provisions of section 83 relating generally to transfers of property in connection with the performance of services, and provisions relating specifically to nonexempt employee trusts (sec. 402(b)) and nonqualified annuities (sec. 403(c)).

In general, the time for inclusion of nonqualified deferred compensation depends on whether the arrangement is unfunded or funded. If the arrangement is unfunded, then the compensation is generally includible in income when it is actually or constructively received. If the arrangement is funded, then income is includible for the year in which the individual's rights are transferable or not subject to a substantial risk of forfeiture.

In general, an arrangement is considered funded if there has been a transfer of property under section 83. Under that section, a transfer of property occurs when a person acquires a beneficial ownership interest in such property. The term "property" is defined very broadly for purposes of section 83.[57] Property includes real and personal property other than money or an unfunded and unsecured promise to pay money in the future. Property also includes a beneficial interest in assets (including money) that are transferred or set aside from claims of the creditors of the transferor, for example, in a trust or escrow account. Accordingly, if, in connection with the performance of services, vested contributions are made to a trust on an individual's behalf and the trust assets may be used solely to provide future payments to the individual, the payment of the contributions to the trust constitutes a transfer of property to the individual that is taxable under section 83. On the other hand, deferred amounts are generally not includible in income in situations where nonqualified deferred compensation is payable from general corporate funds that are subject to the claims of general creditors, as such amounts are treated as unfunded and unsecured promises to pay money or property in the future.

As discussed above, if the arrangement is unfunded, then the compensation is generally includible in income when it is actually or constructively received under section 451. Income is constructively received when it is credited to an individuals' account, set apart, or otherwise made available so that it can be drawn on at any time. Income is not constructively received if

[57] Treas. Reg. sec. 1.83-3(e). This definition in part reflects previous IRS rulings on nonqualified deferred compensation.

the taxpayer's control of its receipt is subject to substantial limitations or restrictions. A requirement to relinquish a valuable right in order to make withdrawals is generally treated as a substantial limitation or restriction.

Special statutory provisions govern the timing of the deduction for nonqualified deferred compensation, regardless of whether the arrangement covers employees or nonemployees and regardless of whether the arrangement is funded or unfunded.[58] Under these provisions, the amount of nonqualified deferred compensation that is includible in the income of the individual performing services is deductible by the service recipient for the taxable year in which the amount is includible in the individual's income.

Rulings on nonqualified deferred compensation

In the 1960's and early 1970's, various IRS revenue rulings considered the tax treatment of nonqualified deferred compensation arrangements.[59] Under these rulings, a mere promise to pay, not represented by notes or secured in any way, was not regarded as the receipt of income for tax purposes. However, if an amount was contributed to an escrow account or trust on the individual's behalf, to be paid to the individual in future years with interest, the amount was held to be includible in income under the economic benefit doctrine. Deferred amounts were not currently includible in income in situations in which nonqualified deferred compensation was payable from general corporate funds that were subject to the claims of general creditors and the plan was not funded by a trust, or any other form of asset segregation to which individuals had any prior or privileged claim.[60] Similarly, current income inclusion did not result when the employer purchased an annuity contract to provide a source of funds for its deferred compensation liability if the employer was the applicant, owner and beneficiary of the annuity contract, and the annuity contract was subject to the general creditors of the employer.[61] In these situations, deferred compensation amounts were held to be includible in income when actually received or otherwise made available.

Proposed Treasury regulation 1.61-16, published in the Federal Register for February 3, 1978, provided that if a payment of an amount of a taxpayer's compensation is, at the taxpayer's option, deferred to a taxable year later than that in which such amount would have been payable

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[58] Secs. 404(a)(5), (b) and (d) and sec. 83(h).

[59] The seminal ruling dealing with nonqualified deferred compensation is Rev. Rul. 60-31, 1960-1 C.B. 174.

[60] Rev. Rul. 69-650, 1969-2 C.B. 106; Rev. Rul. 69-49, 1969-1 C.B. 138.

[61] Rev. Rul. 72-25, 1972-1 C.B. 127. *See also*, Rev. Rul. 68-99, 1968-1 C.B. 193, in which the employer's purchase of an insurance contract on the life of the employee did not result in an economic benefit to the employee if all rights to any benefits under the contract were solely the property of the employer and the proceeds of the contract were payable only to the employer.

but for his exercise of such option, the amount shall be treated as received by the taxpayer in such earlier taxable year.[62]

Section 132 of the Revenue Act of 1978

Section 132 of the Revenue Act of 1978[63] was enacted in response to proposed Treasury regulation 1.61-16. Section 132 of the Revenue Act of 1978 provides that the taxable year of inclusion in gross income of any amount covered by a private deferred compensation plan is determined in accordance with the principles set forth in regulations, rulings, and judicial decisions relating to deferred compensation which were in effect on February 1, 1978. The term, "private deferred compensation plan" means a plan, agreement, or arrangement under which the person for whom service is performed is not a State or a tax-exempt organization and under which the payment or otherwise making available of compensation is deferred. However, the provision does not apply to certain employer-provided retirement arrangements (e.g., a qualified retirement plan), a transfer of property under section 83, or an arrangement that includes a nonexempt employees trust under section 402(b). Section 132 was not intended to restrict judicial interpretation of the law relating to the proper tax treatment of deferred compensation or interfere with judicial determinations of what principles of law apply in determining the timing of income inclusion.[64]

Reasons for Change

The Committee is aware of recent press reports of the popular use of deferred compensation arrangements by executives to defer current taxation of substantial amounts of income. It has been reported that executives often use arrangements which allow deferral of income, but also provide security of future payment to the executive, even if the arrangement, on its face, says otherwise. The Committee is concerned that many nonqualified deferred compensation arrangements have developed which allow improper deferral of income. The Committee believes that the Secretary of the Treasury should issue guidance on nonqualified deferred compensation targeted to arrangements which result in improper deferral of income and should not be bound by the restrictions imposed by Section 132 of the Revenue Act of 1978, which may impede the Treasury Department from issuing appropriate guidance to address such arrangements.

Explanation of Provision

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[62] Prop. Treas. Reg. 1.61-16, 43 Fed. Reg. 4638 (1978).

[63] Pub. L. No. 95-600.

[64] The legislative history to the provision states that the Congress believed that the doctrine of constructive receipt should not be applied to employees of taxable employers as it would have been under the proposed regulation. The Congress also believed that the uncertainty surrounding the status of deferred compensation plans of taxable organizations under the proposed regulation was not desired and should not be permitted to continue.

The provision repeals section 132 of the Revenue Act of 1978. It is intended that the Secretary of the Treasury issue guidance with respect to the tax treatment of nonqualified deferred compensation arrangements focusing on arrangements that improperly defer income. For example, it is intended that the Secretary address what is considered a substantial limitation under the constructive receipt doctrine and situations in which an individual's right to receive compensation is, at least in form, subject to substantial limitations, but in fact is not so limited. It is also intended that the Secretary address arrangements which purport to not be funded, but should be treated as so. In addition, it is intended that the Secretary address arrangements in which assets, by the technical terms of the arrangements, appear to be subject to the claims of an employer's general creditors, but practically are unavailable to creditors. Arrangements that the Secretary is expected to address include the following: the ability to receive funds on account of financial hardship, the use of trusts or other arrangements under which the rights of general creditors to gain access to funds is limited, the use of triggers and third-party guarantees to fund arrangements, and the ability to receive funds subject to a forfeiture of some portion of the participant's deferred compensation (often referred to as a "haircut").

It is not intended that the Secretary take the position (as taken in proposed Treasury regulation 1.61-16) that all elective nonqualified deferred compensation is currently includible in income.

No inference is intended that the Secretary is prohibited under present law from issuing guidance with respect to nonqualified deferred compensation arrangements or that any existing nonqualified deferred compensation guidance issued by the Secretary is invalid. In addition, no inference is intended that any arrangements covered by future guidance provide permissible deferrals of income under present law.

Effective Date

The provision is effective for taxable years beginning after the date of enactment.

B. Taxation of Deferred Compensation Provided through Offshore Trusts (sec. 502 of the bill and sec. 83 of the Code)

Present Law

The determination of when amounts deferred under a nonqualified deferred compensation arrangement are includible in the gross income of the individual earning the compensation depends on the facts and circumstances of the arrangement. A variety of tax principles and Code provisions may be relevant in making this determination, including the doctrine of constructive receipt, the economic benefit doctrine, the provisions of section 83 relating generally to transfers of property in connection with the performance of services, and provisions relating specifically to nonexempt employee trusts (sec. 402(b)) and nonqualified annuities (sec. 403(c)).

In general, the time for inclusion of nonqualified deferred compensation depends on whether the arrangement is unfunded or funded. If the arrangement is unfunded, then the compensation is generally includible in income when it is actually or constructively received (i.e., when it is paid or otherwise made available). If the arrangement is funded, then income is includible for the year in which the individual's rights are transferable or not subject to a substantial risk of forfeiture.

In general, an arrangement is considered funded if there has been a transfer of property under section 83. Under that section, a transfer of property occurs when a person acquires a beneficial ownership interest in such property. The term "property" is defined very broadly for purposes of section 83.[65] Property includes real and personal property other than money or an unfunded and unsecured promise to pay money in the future. Property also includes a beneficial interest in assets (including money) that are transferred or set aside from claims of the creditors of the transferor, for example, in a trust or escrow account. Accordingly, if, in connection with the performance of services, vested contributions are made to a trust on an individual's behalf and the trust assets may be used solely to provide future payments to the individual, the payment of the contributions to the trust constitutes a transfer of property to the individual that is taxable under section 83. On the other hand, deferred amounts are generally not includible in income in situations where nonqualified deferred compensation is payable from general corporate funds that are subject to the claims of general creditors, as such amounts are treated as unfunded and unsecured promises to pay money or property in the future.

Rabbi trusts

A "rabbi trust" is a trust or other fund established by the employer to hold assets from which nonqualified deferred compensation payments will be made. The trust or fund is generally irrevocable and does not permit the employer to use the assets for purposes other than to provide nonqualified deferred compensation. However, the terms of the trust or fund provide that the assets are subject to the claims of the employer's creditors in the case of bankruptcy.

As discussed above, for purposes of section 83, property includes a beneficial interest in assets set aside from the claims of creditors, such as in a trust or fund, but does not include an unfunded and unsecured promise to pay money in the future. In the case of a rabbi trust, terms providing that the assets are subject to the claims of creditors of the employer in the case of bankruptcy have been the basis for the conclusion that the creation of a rabbi trust does not cause the related nonqualified deferred compensation arrangement to be funded for income tax purposes.[66] As a result, no amount is included in income by reason of the rabbi trust; generally income inclusion occurs as payments are made from the trust.

The Internal Revenue Service has issued guidance setting forth model rabbi trust provisions.[67] Revenue Procedure 92-64 provides a safe harbor for taxpayers who adopt and

[65] Treas. Reg. sec. 1.83-3(e). This definition in part reflects previous IRS rulings on nonqualified deferred compensation.

[66] This conclusion was first provided in a 1980 private ruling issued by the IRS with respect to an arrangement covering a rabbi; hence the popular name "rabbi trust." Priv. Ltr. Rul. 8113107 (Dec. 31, 1980).

[67] Rev. Proc. 92-64, 1992-2 C.B. 422, modified in part by Notice 2000-56, 2000-2 C.B. 393.

maintain grantor trusts in connection with unfunded deferred compensation arrangements. The model trust language requires that the trust provide that all assets of the trust are subject to the claims of the general creditors of the company.

Reasons for Change

The Committee is aware of recent press reports of the popular use of deferred compensation arrangements by executives to defer current taxation of substantial amounts of income. It has been reported that executives often use arrangements which allow deferral of income, but also provide security of future payment to the executive, even if the arrangement, on its face, says otherwise. Since the concept of a rabbi trust was developed, techniques have developed that attempt to protect the assets from creditors despite the terms of the trust. For example, the trust or fund may be located in a foreign jurisdiction, making it difficult or impossible for creditors to reach the assets. Amounts used to provide deferred compensation that are held in a trust located in a foreign jurisdiction are difficult to reach by creditors, in many cases so difficult that the assets are effectively out of the reach of general creditors. The Committee believes that except in limited situations, the primary purpose of such arrangements is to protect the assets from the claims of general creditors. Thus, such assets should not be considered to be subject to the claims of creditors under U.S. tax laws.

Explanation of Provision

The provision provides that assets that are designated or otherwise available for the use of providing nonqualified deferred compensation and are located outside the United States (e.g., in a foreign trust, arrangement or account) are not treated as subject to the claims of general creditors. Therefore, to the extent of such assets, nonqualified deferred compensation amounts are not treated as unfunded and unsecured promises to pay, but are treated as property under section 83 and includible in income when the right to the compensation is no longer subject to a substantial risk of forfeiture, regardless of when the compensation is paid. No inference is intended that nonqualified deferred compensation assets located outside of the U.S. would be treated as subject to the claims of creditors under present law.

The provision does not apply to assets located in a foreign jurisdiction if substantially all of the services to which the nonqualified deferred compensation relates are performed in such foreign jurisdiction.

The provision is specifically intended to apply to foreign trusts and arrangements that effectively shield from the claims of general creditors any assets intended to satisfy nonqualified deferred compensation obligations. The provision provides the Secretary of the Treasury authority to prescribe regulations as are necessary to carry out the provision and to provide additional exceptions for specific arrangements which do not result in improper deferral of U.S. tax if the assets involved in the arrangement are readily accessible in any insolvency or bankruptcy proceeding.

Effective Date

The provision is effective for amounts deferred after the date of enactment in taxable years ending after such date.

C. Treatment of Loans to Executives (sec. 503 of the bill and new sec. 7872A and sec. 7872 of the Code)

Present Law

In general, gross income includes all income from any source, including compensation for past, present or future services, unless an exclusion applies. The proceeds of a bona fide loan are not income for Federal tax purposes, because the recipient is obligated to repay the loan. The issue of whether a payment is a bona fide loan or represents income to the payee may arise in various contexts (including in an employment context) and depends on the facts and circumstances. In analyzing whether there is an obligation to repay an amount, relevant factors include the existence of (1) a promissory note or other evidence of indebtedness, (2) a schedule for repayment of a sum certain in the reasonably foreseeable future, (3) collateral or security, and (4) the payee's ability to repay, as well as the actual practice of the parties with respect to enforcing repayment obligations.

Under present law, a loan that provides for the payment of interest at a rate below the applicable Federal rate (a "below-market-rate loan") between certain parties is recharacterized as a transaction in which the lender made a loan to the borrower in exchange for a note requiring the payment of interest at the applicable Federal rate. In the case of compensation-related loans, this rule results in the parties being treated as if: (1) the borrower paid interest to the lender at the applicable Federal rate which is includible in income by the lender, and (2) the lender paid compensation to the employee or other person performing services. A compensation-related loan is a below-market loan directly or indirectly between an employer and an employee or between an independent contractor and a person for whom such independent contractor provides services.

In general, a below-market-rate loan is either a demand loan, the interest on which is payable at less than the applicable Federal rate, or a term loan, under which the amount of the loan exceeds the present value of all payments due under the loan, using a discount rate equal to the applicable Federal rate. A demand loan is any loan which is payable on demand of the lender; a term loan is any loan other than a demand loan.

Reasons for Change

The Committee is aware of recent press reports regarding loans made to executives by corporations. In some cases, the total amount loaned to a single individual has been extraordinary. For example, loans totaling over $90 million and even several billions of dollars have been reported publicly. In some cases such loans could not have been obtained from a commercial lender on similar terms. The Committee is concerned that there is no business purpose for such loans, other than to provide a benefit to the executive, and that such loans are in essence compensatory in nature. Thus, the Committee believes that loans to executives and certain other individuals in connection with the performance of services should be treated as compensation unless certain requirements are satisfied.

In addition, the Committee believes that the present-law rules regarding below-market-rate loans do not require the imputation of an adequate rate of interest in the case of very large loans. Thus, the Committee believes the imputed interest rate on such loans should be increased.

Explanation of Provision

Certain loans treated as compensation

Under the provision, an arrangement that would otherwise be a direct or indirect loan[68] made to an applicable employee of a C corporation is treated as compensation (and therefore includible in gross income and wages for payroll tax purposes) unless certain requirements are satisfied. An applicable employee is an officer, director,[69] five-percent owner of the employer, or any employee of the employer if outstanding loans from the employer exceed $1 million. In the case of a person who is an applicable employee solely by reason of having outstanding loans in excess of $1 million, only the amount of outstanding loans in excess of such amount is treated as compensation. Amounts treated as compensation under the provision are treated as a supplemental wage payment on the date the loan was made.

A direct or indirect loan is treated as compensation under the provision unless (1) there is a promissory note or other written evidence of indebtedness, (2) there is adequate collateral or security for the debt, and (3) there is a fixed schedule for repayment providing for substantially equal payments (or such other form as permitted by the Secretary) over a period not to exceed 10 years.[70] The following may not be taken into account in determining whether there is adequate collateral or security for the loan: (1) any stock or capital or profits interest in the employer, (2) any option or other contract to purchase such stock or interests, (3) any restricted stock or ownership interest, (4) any nonqualified deferred compensation, or (5) other similar assets to the extent provided by the Secretary.

Loans from qualified plans and relocation loans are not subject to the provision. A relocation loan is a loan the proceeds of which are used by the employee to purchase a principal residence if the purchase is in connection with the commencement of work by an employee or a change in the principal place of work of an employee to which section 217 applies (relating to the deduction for moving expenses).

The provision also does not apply to a loan which, without regard to the provision, is recharacterized as compensation or dividends with respect to which amounts are otherwise

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[68] For example, a loan from the employer to a child or other family member of the employee would be considered a loan to the employee.

[69] All directors are treated as employees for purposes of the provision.

[70] An arrangement that would otherwise be treated as a loan will not be treated as compensation under the provision merely because the loan is a below-market-rate loan. In such cases, the arrangement is treated as a loan and the below-market-rate loan rules (as modified under the provision) will apply to impute interest.

includible in gross income. The provision is not intended to impose tax on amounts otherwise includible in gross income.

Except in the case of repayments, as described below, the below-market-rate loan rules do not apply to an arrangement to the extent that it is treated as compensation under the provision. In addition, to the extent that a loan is treated as compensation under the provision, the rules relating to interest on certain deferred payments (sec. 483), loans from foreign trusts (sec. 643(i)), and the determination of issue price in the case of certain debt instruments issued for property (sec. 1274) do not apply.

The Secretary is directed to prescribe rules for the for the application of the Federal tax laws in the event an applicable employee repays any amount of a loan which was includible in income under the provision. To the extent the Secretary determines appropriate, such rules are to provide that (1) the employee is allowed a deduction (and the employer is to include in gross income) for the taxable year of the repayment any portion of the amount repaid that was included in income of the employee (or allowed as a deduction to the employer) and (2) the amount treated as compensation for employment tax purposes (other than income tax withholding) for the calendar year of the repayment are reduced by the portion of any amount repaid that was previously treated as compensation. It is intended that any deduction provided to an applicable employee with respect to a repayment is to be subject to the two-percent floor on itemized deductions. It is also intended that the Secretary prescribe rules, to the extent appropriate, providing for application of and adjustments to the below-market-rate loan rules in the case of repayments.

The Secretary is authorized to issue such regulations as are necessary or appropriate to carry out the provision. It is expected that such rules will address situations such as the payment of a bonus that coincides with a payment under the loan agreement, and rules specifying the proper treatment of an arrangement treated as a loan when made if the employee subsequently fails to make scheduled payments when due.

Imputed interest rate for below-market-rate loans

If the amount of all outstanding loans of an applicable individual (not taking into account loans treated as compensation) with respect to the same service recipient exceeds $1 million,[71] then the interest rate imputed under the below-market-rate loan rules is the applicable Federal rate plus three percentage points. This increased interest rate applies on the outstanding balance in excess of $1 million. Such amount is treated as a separate loan for this purpose.

Effective Date

The provision is effective for loans made or refinanced after the date of enactment. Except as provided by the Secretary, modifications to a loan after the effective date are

[71] All loans from the employer (whether or not below-market-rate loans) are taken into account in determining whether the $1 million threshold is exceeded.

considered a new loan. It is intended that a demand loan outstanding on the effective date is not treated as a new loan after the effective date merely because it is a demand loan.

D. Required Wage Withholding at Top Marginal Rate for Supplemental Wage Payments in Excess of $1 Million (sec. 504 of the bill and sec. 13273 of the Revenue Reconciliation Act of 1993)

Present Law

An employer must withhold income taxes from wages paid to employees; there are several possible methods for determining the amount of income tax to be withheld. The IRS publishes tables (Publication 15, "Circular E") to be used in determining the amount of income tax to be withheld. The tables generally reflect the income tax rates under the Code so that withholding approximates the ultimate tax liability with respect to the wage payments. In some cases, "supplemental" wage payments (e.g., bonuses or commissions) may be subject to withholding at a flat rate,[72] based on the third lowest income tax rate under the Code (27 percent for 2002).[73]

Reasons for Change

The Committee believes that because most employees who receive annual supplemental wage payments in excess of $1 million will ultimately be taxed at the highest marginal rate, it is appropriate to raise the withholding rate on such payments so that withholding more closely approximates the ultimate tax liability with respect to these payments.

Explanation of Provision

Under the provision, once annual supplemental wage payments to an employee exceed $1 million, any additional supplemental wage payments to the employee in that year are subject to withholding at the highest income tax rate (38.6 percent for 2002), regardless of any other withholding rules and regardless of the employee's Form W-4.

This rule applies only for purposes of wage withholding; other types of withholding (such as pension withholding and backup withholding) are not affected.

Effective Date

The provision is effective with respect to wage payments made after December 31, 2002.

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[72] Sec. 13273 of the Revenue Reconciliation Act of 1993.

[73] Sec. 101(c)(11) of the Economic Growth and Tax Relief Reconciliation Act of 2001.

E. Chief Executive Officer Required To Sign Corporate Income Tax Returns (sec. 511 of the bill and sec. 6062 of the Code)

Present Law

The Code requires[74] that the income tax return of a corporation must be signed by either the president, the vice-president, the treasurer, the assistant treasurer, the chief accounting officer, or any other officer of the corporation authorized by the corporation to sign the return.

The Code also imposes[75] a criminal penalty on any person who willfully signs any tax return under penalties of perjury that that person does not believe to be true and correct with respect to every material matter at the time of filing. If convicted, the person is guilty of a felony; the Code imposes a fine of not more than $100,000[76] ($500,000 in the case of a corporation) or imprisonment of not more than three years, or both, together with the costs of prosecution.

Reasons for Change

The Committee believes that the filing of accurate tax returns is essential to the proper functioning of the tax system. The Committee believes that requiring that the chief executive officer of a corporation sign its corporate income tax returns will elevate the level of care given to the preparation of those returns.

Explanation of Provision

The bill requires that the chief executive officer of a corporation sign that corporation's income tax returns. If the corporation does not have a chief executive officer, the IRS may designate another officer of the corporation; otherwise, no other person is permitted to sign the income tax return of a corporation. The Committee intends that the IRS issue general guidance, such as a revenue procedure, to (1) address situations when a corporation does not have a chief executive officer, and (2) define who the chief executive officer is, in situations (for example) when the primary official bears a different title or when a corporation has multiple chief executive officers. The Committee intends that, in every instance, the highest ranking corporate officer (regardless of title) sign the tax return.

Effective Date

The provision is effective for returns filed after the date of enactment.

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[74] Sec. 6062.

[75] Sec. 7206.

[76] Pursuant to 18 U.S.C. 3571, the maximum fine for an individual convicted of a felony is $250,000.

F. Exclusion of Incentive Stock Options and Employee Stock Purchase Plan Stock Options from Wages (sec. 521 of the bill and secs. 421(b), 423(c), 3121(a), 3231, and 3306(b) of the Code)

Present Law

Generally, when an employee exercises a compensatory option on employer stock, the difference between the option price and the fair market value of the stock (i.e., the "spread") is includible in income as compensation. In the case of an incentive stock option or an option to purchase stock under an employee stock purchase plan (collectively referred to as "statutory stock options"), the spread is not included in income at the time of exercise.[77]

If the statutory holding period requirements are satisfied with respect to stock acquired through the exercise of a statutory stock option, the spread, and any additional appreciation, will be taxed as capital gain upon disposition of such stock. Compensation income is recognized, however, if there is a disqualifying disposition (i.e., if the statutory holding period is not satisfied) of stock acquired pursuant to the exercise of a statutory stock option.

Federal Insurance Contribution Act ("FICA") and Federal Unemployment Tax Act ("FUTA") taxes (collectively referred to as "employment taxes") are generally imposed in an amount equal to a percentage of wages paid by the employer with respect to employment.[78] The applicable Code provisions[79] do not provide an exception from FICA and FUTA taxes for wages paid to an employee arising from the exercise of a statutory stock option.

There has been uncertainty in the past as to employer withholding obligations upon the exercise of statutory stock options. On June 25, 2002, the IRS announced in Notice 2002-47[80] that until further guidance is issued, it would not assess FICA or FUTA taxes, or impose Federal income tax withholding obligations, upon either the exercise of a statutory stock option or the disposition of the stock acquired pursuant to the exercise of a statutory stock option.

Reasons for Change

The Committee agrees with the position taken by the IRS in Notice 2002-47 and believes that it is appropriate to clarify statutorily the treatment of statutory stock options for employment tax and income tax withholding purposes. The Committee believes that it is appropriate to provide specific exclusions from withholding requirements for wages attributable to statutory stock options.

Explanation of Provision

[77] Sec. 421.

[78] Secs. 3101, 3111 and 3301.

[79] Secs. 3121 and 3306.

[80] Notice 2002-47, 2002-28 I.R.B. 1.

The provision provides specific exclusions from FICA and FUTA wages for remuneration on account of the transfer of stock pursuant to the exercise of an incentive stock option or under an employee stock purchase plan, or any disposition of such stock. Thus, under the provision, FICA and FUTA taxes do not apply upon the exercise of a statutory stock option.[81] The provision also provides that such remuneration is not taken into account for purposes of determining Social Security benefits.

Additionally, the provision provides that Federal income tax withholding is not required on a disqualifying disposition, nor when compensation is recognized in connection with an employee stock purchase plan discount. Present law reporting requirements continue to apply.

Effective Date

The provision is effective on the date of enactment.

[81] The provision also provides a similar exclusion for wages under the Railroad Retirement Tax Act.

G. Capital Gain Treatment on Sale of Stock Acquired from Exercise of Statutory Stock Options to Comply with Conflict of Interest Requirements (sec. 522 of the bill and sec. 421 of the Code)

Present Law

Statutory stock options

Generally, when an employee exercises a compensatory option on employer stock, the difference between the option price and the fair market value of the stock (i.e., the "spread") is includible in income as compensation. Upon such exercise, an employer is allowed a corresponding compensation deduction. In the case of an incentive stock option or an option to purchase stock under an employee stock purchase plan (collectively referred to as "statutory stock options"), the spread is not included in income at the time of exercise.[82]

If an employee disposes of stock acquired upon the exercise of a statutory option, the employee generally is taxed at capital gains rates with respect to the excess of the fair market value of the stock on the date of disposition over the option price, and no compensation expense deduction is allowable to the employer, unless the employee fails to meet a holding period requirement. The employee fails to meet this holding period requirement if the disposition occurs within two years after the date the option is granted or one year after the date the option is exercised. A disposition that occurs prior to the expiration of the applicable holding period(s) (a "disqualifying disposition") does not qualify for capital gains treatment. In the event of a disqualifying disposition, the income attributable to the disposition is treated by the employee as income received in the taxable year in which the disposition occurs, and a corresponding deduction is allowable to the employer for the taxable year in which the disposition occurs.

Sale of property to comply with conflict of interest requirements

The Code provides special rules for recognizing gain on sales of property which are required in order to comply with certain conflict of interest requirements imposed by the Federal government.[83] Certain executive branch Federal employees (and their spouses and minor or dependent children) who are required to divest property in order to comply with conflict of interest requirements may elect to postpone the recognition of resulting gains by investing in certain replacement property within a 60-day period. The basis of the replacement property is reduced by the amount of the gain not recognized. Permitted replacement property is limited to any obligation of the United States or any diversified investment fund approved by regulations issued by the Office of Government Ethics. The rule applies only to sales under certificates of divestiture issued by the President or the Director of the Office of Government Ethics.

Reasons for Change

[82] Sec. 421.

[83] Sec. 1043.

To comply with Federal conflict of interest requirements, executive branch personnel may be required, before the statutory holding period requirements have been satisfied, to divest holdings of stock acquired pursuant to the exercise of statutory stock options. Because Federal conflict of interest requirements mandate the sale of such shares, the Committee believes that such individuals should be afforded the tax treatment that would be imposed had the individual held the stock for the required holding period.

Explanation of Provision

Under the provision, an eligible person who, in order to comply with Federal conflict of interest requirements, is required to sell shares of stock acquired pursuant to the exercise of a statutory stock option is treated as satisfying the statutory holding period requirements, regardless of how long the stock was actually held. An eligible person generally includes an officer or employee of the executive branch of the Federal Government (and any spouse or minor or dependent children whose ownership in property is attributable to the officer or employee). Because the sale is not treated as a disqualifying disposition, the individual is afforded capital gain treatment on any resulting gains. Such gains are eligible for deferral treatment under section 1043.

The employer granting the option is not allowed a deduction upon the sale of the stock by the individual.

Effective Date

The provision is effective for sales after July 1, 2002.

III. BUDGET EFFECTS OF THE BILL

A. Committee Estimates

In compliance with paragraph 11(a) of rule XXVI of the Standing Rules of the Senate, the following statement is made concerning the estimated budget effects of the provisions of the committee amendment to the bill as reported.

ESTIMATED REVENUE EFFECTS OF S. 1971,
THE "NATIONAL EMPLOYEE SAVINGS AND TRUST EQUITY GUARANTEE ACT,"
AS REPORTED BY THE COMMITTEE ON FINANCE

Fiscal Years 2002 - 2012

[Millions of Dollars]

Provision	Effective	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2002-07	2002-12
Diversification of Pension Plan Assets - defined contribution plans required to provide employees with freedom to invest their plan assets	**generally pyba 12/31/02**							***Negligible Revenue Effect***						
Protection of Employees During Pension Plan Transaction Suspension Period														
1. Notice to participants or beneficiaries of transaction suspension periods	generally pyba 12/31/02							*Negligible Revenue Effect*						
2. Inapplicability of relief from fiduciary liability during suspension of ability of participant or beneficiary to direct investments	generally pyba 12/31/02							*No Revenue Effect*						
3. Clarification of participant access to remedies under ERISA	DOE							*No Revenue Effect*						
4. Increased maximum bond amount of plans holding employer securities	pyba 12/31/02							*No Revenue Effect*						
Total of Protection of Employees During Pension Plan Transaction Suspension Period								***Negligible Revenue Effect***						
Providing of Information to Assist Participants														
1. Periodic pension benefit statements	generally pyba 12/31/03							*Negligible Revenue Effect*						
2. Defined contribution plans required to provide adequate investment education to participants	generally pyba 12/31/03							*Negligible Revenue Effect*						
3. Information on optional forms of benefit	DOE							*Negligible Revenue Effect*						
4. Fiduciary duty to provide material information relating to investment in employer securities	pyba 12/31/02							*No Revenue Effect*						
5. Electronic disclosure of insider trading	pyba 12/31/02							*No Revenue Effect*						
6. Fiduciary rules for plan sponsors designating independent investment advisors	iada DOE							*No Revenue Effect*						
Total of Providing of Information to Assist Participants								***Negligible Revenue Effect***						
Other Proposals Relating to Pension														
A. General Provisions														
1. Employee Plans Compliance Resolution System [1]	DOE							*Negligible Revenue Effect*						
2. Extension to all governmental plans of moratorium on application of certain nondiscrimination rules applicable to State and local plans	pyba 12/31/02							*Negligible Revenue Effect*						

Provision	Effective	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2002-07	2002-12
3. Notice and consent period regarding distributions	yba 12/31/02	*Negligible Revenue Effect*												
4. Technical corrections to Saver Act [2]	DOE	*No Revenue Effect*												
5. Missing participants [2]	[3]	---	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]
6. Reduced PBGC premiums for small and new plans [2]	pfea 12/31/02 & yba 12/31/02	---	---	-3	-5	-6	-7	-7	-7	-8	-8	-8	-21	-59
7. Authorization for PBGC to pay interest on premium overpayment refunds [2]	iafpbnet DOE	---	-3	-3	-3	-3	-3	-3	-3	-3	-3	-3	-15	-30
8. Rules for substantial owner benefits in terminated plans [2]	noitta 12/31/02	---	---	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]
9. Benefit suspension notice	pyba 12/31/02	*No Revenue Effect*												
10. Interest rate range for additional funding requirements for the 2001 plan year [5]	[6]	109	258	-43	-110	-91	-62	-92	-98	-55	-16	-1	62	-199
11. Voluntary early retirement incentive plans maintained by local educational agencies and other entities	tyea DOE	---	-1	-4	-7	-10	-10	-10	-10	-10	-10	-10	-32	-82
12. Automatic rollovers of certain mandatory distributions	[7]	*Negligible Revenue Effect*												
13. 2-year extension of transition rule to pension funding requirement relating to plans of interstate bus lines...........	pyba 12/31/02	*Negligible Revenue Effect*												
B. Studies	DOE	*No Revenue Effect*												
C. Plan Amendments	DOE	*No Revenue Effect*												
Total of Other Proposals Relating to Pension		**109**	**254**	**-53**	**-125**	**-110**	**-82**	**-112**	**-118**	**-76**	**-37**	**-22**	**-6**	**-370**
Provisions Relating to Executive Compensation and Stock Options														
A. Provisions Relating to Executives														
1. Repeal of limitation on issuance of Treasury guidance regarding nonqualified deferred compensation	tyba DOE	*Negligible Revenue Effect*												
2. Taxation of deferred compensation provided through offshore trusts	ada DOE	---	67	76	56	28	9	5	4	4	20	23	235	290
3. Treatment of employment loans made to executives [8] ...	lmora DOE	*Negligible Revenue Effect*												
4. Required wage withholding at top marginal rate for supplemental wage payments in excess of $1 million	wpma 12/31/02	---	115	19	11	11	9	[9]	8	9	10	9	165	201
5. Chief Executive Officer required to sign corporate income tax returns..	rfa DOE	*Negligible Revenue Effect*												
B. Stock Options														
1. Exclusion of incentive stock options and employee stock purchase plan stock options from wages	DOE	*No Revenue Effect*												
2. Capital gain treatment on sale of stock acquired from exercise of statutory stock options to comply with conflict of interest requirements	sa 7/1/02	---	[9]	[9]	1	1	1	[9]	1	1	[9]	[9]	2	5
Total of Provisions Relating to Executive Compensation		**---**	**182**	**95**	**68**	**40**	**19**	**5**	**13**	**14**	**30**	**32**	**402**	**496**
NET TOTAL		**109**	**436**	**42**	**-57**	**-70**	**-63**	**-107**	**-105**	**-62**	**-7**	**10**	**396**	**126**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.

[Legend and Footnotes for the Table appear on the following page]

Legend and Footnotes for the Table:

Legend for "Effective" column:

ada = amounts deferred after
DOE = date of enactment
iafpbnet = interest accruing for periods beginning not earlier than
iada = investment advisors designated after
lmora = loans made or refinanced after
noitta = notice of intent to terminate after
pfea = plans first effective after
pyba = plan years beginning after
rfa = returns filed after
sa = sales after
tyba = taxable years beginning after
tyea = taxable years ending after
wpma = wage payments made after
yba = years beginning after

[1] Directs the Secretary of the Treasury to update and improve program.
[2] Estimate provided by the Congressional Budget Office.
[3] Effective for distributions made from terminating plans that occur after the PBGC has adopted final regulations implementing provisions.
[4] Loss of less than $500,000.
[5] Includes estimated effects on PBGC variable-rate premiums provided by Congressional Budget Office.
[6] Effective as if included in section 405 of the "Job Creation and Work Assistance Act of 2002."
[7] Effective as if included in "Economic Growth and Tax Relief Reconciliation Act of 2001."
[8] Estimate reflects enactment of the "Corporate and Auditing Accountability, Responsibility and Transparency Act," on July 30, 2002.
[9] Gain of less than $500,000.

B. Budget Authority and Tax Expenditures

Budget authority

In compliance with section 308(a)(1) of the Budget Act, the Committee states that the revenue provisions of the committee amendment to the bill do not involve new or increased budget authority.

Tax expenditures

In compliance with section 308(a)(2) of the Budget Act, the Committee states that the revenue-reducing provisions of the committee amendment to the bill involve increased tax expenditures (see revenue table in Part III.A., above). The revenue increasing provisions of the Committee amendment to the bill generally involve reduced tax expenditures (see revenue table in Part III.A., above).

C. Consultation with Congressional Budget Office

In accordance with section 403 of the Budget Act, the Committee advises that the Congressional Budget Office has not submitted a statement on the committee amendment to the bill. The letter from the Congressional Budget Office has not been received, and therefore will be provided separately.

IV. VOTES OF THE COMMITTEE

In compliance with paragraph 7(b) of rule XXVI of the Standing Rules of the Senate, the following statements are made concerning the votes taken on the Committee's consideration of the amendment to the bill.

Roll call votes

No roll call votes were taken on the amendment to the bill.

Motion to report the committee amendment

The amendment to the bill was ordered favorably reported by voice vote, a quorum being present, on July 11, 2002.

V. REGULATORY IMPACT AND OTHER MATTERS

A. Regulatory Impact

Pursuant to paragraph 11(b) of Rule XXVI of the Standing Rules of the Senate, the Committee makes the following statement concerning the regulatory impact that might be incurred in carrying out the provisions of the bill as amended.

Impact on individuals and businesses

The Committee amendment to the bill includes provisions relating to qualified retirement plans, including provisions designed to increase retirement income security by (1) providing employees with greater opportunity to diversify plan investments in employer securities, (2) requiring plans to provide additional information with respect to plan benefits and investments, and (3) clarifying fiduciary requirements under ERISA. The Committee amendment to the bill also includes a variety of provisions intended to reduce administrative burdens on employers with regard to pension plans, including provisions relating to required funding contributions, reductions of Pension Benefit Guaranty Corporation premiums for certain plans, and other plan administration issues. The Committee amendment also includes directives for a number of studies relating to specific issues that affect retirement income security. Some of these provisions may impose additional administrative requirements on employers that sponsor retirement plans; however, in some cases the employer may avoid application of the provisions through plan design. In addition, some of the provisions will reduce regulatory burdens on employers that sponsor retirement plans.

The Committee amendment also includes provisions relating to certain executive compensation arrangements and the proper tax treatment of such arrangements. The Committee amendment requires that tax returns be signed by a company's chief executive officer. This provision is not expected to affect paperwork burdens.

The Committee amendment provides that certain stock options are not subject to withholding and provides for the treatment of stock acquired pursuant to the exercise of stock options to comply with Federal conflict-of-interest requirements.

Impact on personal privacy and paperwork

The provisions of the Committee amendment to the bill do not impact personal privacy.

Some provisions of the bill relating to pension plans will reduce paperwork burdens on employers that sponsor qualified retirement plans. Other provisions may impose additional burdens on employers; however, in many cases an employer may reduce such burdens through plan design. The provision regarding withholding requirements with respect to certain stock options will reduce regulatory burdens on individuals and businesses that currently apply withholding to these options. The provision relating to the sale of stock to comply with conflict of interest rules may require individuals who seek to take advantage of the tax benefits provided by the provision to maintain records to demonstrate eligibility for the tax benefits.

B. Unfunded Mandates Statement

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995 (P.L. 104-4).

The Committee has determined that the revenue provisions of the bill do not contain Federal mandates on the private sector. The Committee has determined that the revenue provisions of the bill do not impose a Federal intergovernmental mandate on State, local, or tribal governments.

C. Tax Complexity Analysis

Section 4022(b) of the Internal Revenue Service Reform and Restructuring Act of 1998 (the "IRS Reform Act") requires the Joint Committee on Taxation (in consultation with the Internal Revenue Service and the Department of the Treasury) to provide a tax complexity analysis. The complexity analysis is required for all legislation reported by the Senate Committee on Finance, the House Committee on Ways and Means, or any committee of conference if the legislation includes a provision that directly or indirectly amends the Internal Revenue Code (the "Code") and has widespread applicability to individuals or small businesses.

The staff of the Joint Committee on Taxation has determined that a complexity analysis is not required under section 4022(b) of the IRS Reform Act because the bill contains no provisions that amend the Code and that have "widespread applicability" to individuals or small businesses.

VI. CHANGES IN EXISTING LAW MADE BY THE BILL AS REPORTED

In the opinion of the Committee, it is necessary in order to expedite the business of the Senate, to dispense with the requirements of paragraph 12 of rule XXVI of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the bill as reported by the Committee).