TECHNICAL EXPLANATION OF H.R. 4, THE "PENSION PROTECTION ACT OF 2006," AS PASSED BY THE HOUSE ON JULY 28, 2006, AND AS CONSIDERED BY THE SENATE ON AUGUST 3, 2006

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TITLE I: REFORM OF FUNDING RULES FOR SINGLE-EMPLOYER DEFINED BENEFIT PENSION PLANS[2]

A. Minimum Funding Standards for Single-Employer Defined Benefit Pension Plans (secs. 302-308 of ERISA, and sec. 412 and new sec. 430 of the Code)

Present Law

In general

Single-employer defined benefit pension plans are subject to minimum funding requirements under the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code (the "Code").[3] The amount of contributions required for a plan year under the minimum funding rules 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. The amount of required annual contributions is determined under one of a number of acceptable actuarial cost methods. Additional contributions are required under the deficit reduction contribution rules in the case of certain underfunded plans. No contribution is required under the minimum funding rules in excess of the full funding limit (described below).

General minimum funding rules

Funding standard account

As an administrative aid in the application of the funding requirements, a defined benefit pension plan is required to maintain a special account called a "funding standard account" to which specified charges and credits are made for each plan year, including a charge for normal cost and credits for contributions to the plan. Other charges or credits may apply as a result of decreases or increases in past service liability as a result of plan amendments, experience gains or losses, gains or losses resulting from a change in actuarial assumptions, or a waiver of minimum required contributions.

In determining plan funding under an actuarial cost method, a plan's actuary generally makes certain assumptions regarding the future experience of a plan. These assumptions

[2] Some provisions that are identical or similar to the pension provisions in the bill were contained in other bills reported by the House Committees on Ways and Means and Education and the Workforce and the Senate Committees on Finance and Health, Education, Labor and Pensions, or passed by the House or the Senate during the 109th Congress. These bills include H.R. 2830, S. 1953, and

S. 1783.

[3] Multiemployer defined benefit pension plans are also subject to the minimum funding requirements, but the rules for multiemployer plans differ in various respects from the rules applicable to single-employer plans. Governmental plans and church plans are generally exempt from the minimum funding requirements.

typically involve rates of interest, mortality, disability, salary increases, and other factors affecting the value of assets and liabilities. If the plan's actual unfunded liabilities are less than those anticipated by the actuary on the basis of these assumptions, then the excess is an experience gain. If the actual unfunded liabilities are greater than those anticipated, then the difference is an experience loss. Experience gains and losses for a year are generally amortized as credits or charges to the funding standard account over five years.

If the actuarial assumptions used for funding a plan are revised and, under the new assumptions, the accrued liability of a plan is less than the accrued liability computed under the previous assumptions, the decrease is a gain from changes in actuarial assumptions. If the new assumptions result in an increase in the plan's accrued liability, the plan has a loss from changes in actuarial assumptions. The accrued liability of a plan is the actuarial present value of projected pension benefits under the plan that will not be funded by future contributions to meet normal cost or future employee contributions. The gain or loss for a year from changes in actuarial assumptions is amortized as credits or charges to the funding standard account over ten years.

If minimum required contributions are waived (as discussed below), the waived amount (referred to as a "waived funding deficiency") is credited to the funding standard account. The waived funding deficiency is then amortized over a period of five years, beginning with the year following the year in which the waiver is granted. Each year, the funding standard account is charged with the amortization amount for that year unless the plan becomes fully funded.

B. Special Funding Rules for Plans Maintained by Commercial Airlines

Present Law

Minimum funding rules in general

Single-employer defined benefit pension plans are subject to minimum funding requirements under the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code (the "Code").[93] The amount of contributions required for a plan year under the minimum funding rules 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. The amount of required annual contributions is determined under one of a number of acceptable actuarial cost methods. Additional contributions are required under the deficit reduction contribution rules in the case of certain underfunded plans. No contribution is required under the minimum funding rules in excess of the full funding limit. A detailed description of the present-law funding rules is provided in Title I, above.

Notice of certain plan amendments

A notice requirement must be met if an amendment to a defined benefit pension plan provides for a significant reduction in the rate of future benefit accrual. In that case, the plan administrator must furnish a written notice concerning the amendment. Notice may also be required if a plan amendment eliminates or reduces an early retirement benefit or retirement-type subsidy. The plan administrator is required to provide the notice to any participant or alternate payee whose rate of future benefit accrual may reasonably be expected to be significantly reduced by the plan amendment (and to any employee organization representing affected participants). The notice must be written in a manner calculated to be understood by the average plan participant and must provide sufficient information to allow recipients to understand the effect of the amendment. In the case of a single-employer plan, the plan administrator is generally required to provide the notice at least 45 days before the effective date of the plan amendment. In the case of a multiemployer plan, the notice is generally required to be provided 15 days before the effective date of the plan amendment.

PBGC termination insurance program

The minimum funding requirements permit an employer to fund defined benefit plan benefits over a period of time. Thus, it is possible that a plan may be terminated at a time when plan assets are not sufficient to provide all benefits accrued by employees under the plan. In order to protect plan participants from losing retirement benefits in such circumstances, the PBGC guarantees basic benefits under most defined benefit plans. When an underfunded plan terminates, the amount of benefits that the PBGC will pay depends on legal limits, asset

[93] Code sec. 412. The minimum funding rules also apply to multiemployer plans, but the rules for multiemployer plans differ in various respects from the rules applicable to single-employer plans.

allocation, and recovery on the PBGC's employer liability claim. There is a dollar limit on the amount of otherwise guaranteed benefits based on the year in which the plan terminates. For plans terminating in 2006, the maximum guaranteed benefit for an individual retiring at age 65 and receiving a single life annuity is $3,971.59 per month or $47,659.08 per year.[94] The dollar limit is indexed annually for inflation. The guaranteed amount is reduced for benefits starting before age 65. In the case of a plan or a plan amendment that has been in effect for less than five years before a plan termination, the amount guaranteed is phased in by 20 percent a year.[95]

Termination premiums

Under the Deficit Reduction Act of 2005, a new premium generally applies in the case of certain plan terminations occurring after 2005 and before 2011. A premium of $1,250 per participant is imposed generally for the year of the termination and each of the following two years. The premium applies in the case of a plan termination by the PBGC or a distress termination due to reorganization in bankruptcy, the inability of the employer to pay its debts when due, or a determination that a termination is necessary to avoid unreasonably burdensome pension costs caused solely by a decline in the workforce. In the case of a termination due to reorganization, the liability for the premium does not arise until the employer is discharged from the reorganization proceeding. The premium does not apply with respect to a plan terminated during bankruptcy reorganization proceedings pursuant to a bankruptcy filing before October 18, 2005.

Minimum coverage requirements

The Code imposes minimum coverage requirements on qualified retirement plans in order to ensure that plans cover a broad cross section of employees.[96] In general, the minimum coverage requirements are satisfied if one of the following criteria are met: (1) the plan benefits at least 70 percent of employees who are not highly compensated employees; (2) the plan benefits a percentage of employees who are not highly compensated employees which is at least

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The PBGC generally pays the greater of the guaranteed benefit amount and the amount that was covered by plan assets when it terminated. Thus, depending on the amount of assets in the terminating plan, participants may receive more than the amount guaranteed by PBGC.

Special rules limit the guaranteed benefits of individuals who are substantial owners covered by a plans whose benefits have not been increased by reason of any plan amendment. A substantial owner generally is an individual who: (1) owns the entire interest in an unincorporated trade or business; (2) in the case of a partnership, is a partner who owns, directly or indirectly, more than 10 percent of either the capital interest or the profits interest in the partnership; (3) in the case of a corporation, owns, directly or indirectly, more than 10 percent in value of either the voting stock of the corporation or all the stock of the corporation; or (4) at any time within the preceding 60 months was a substantial owner under the plan. ERISA sec. 4022(b)(5).

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The phase in does not apply if the benefit is less than $20 per month.

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Code sec. 410(b).

70 percent of the percentage of highly compensated employees participating under the plan; or
(3) the plan meets the average benefits test.

Certain employees may be disregarded in applying the minimum coverage requirements. Under one exclusion, in the case of a plan established or maintained pursuant to an agreement which the Secretary of Labor finds to be a collective bargaining agreement between air pilots represented in accordance with title II of the Railway Labor Act and one or more employers, all employees not covered by such agreement may be disregarded. This exclusion does not apply in the case of a plan which provides contributions or benefits for employees whose principal duties are not customarily performed aboard aircraft in flight.

Alternative deficit reduction contribution for certain plans

Under present law, certain employers ("applicable employers") may elect a reduced amount of additional required contribution under the deficit reduction contribution rules (an "alternative deficit reduction contribution") with respect to certain plans for applicable plan years. An applicable plan year is a plan year beginning after December 27, 2003, and before December 28, 2005, for which the employer elects a reduced contribution. If an employer so elects, the amount of the additional deficit reduction contribution for an applicable plan year is the greater of: (1) 20 percent of the amount of the additional contribution that would otherwise be required; or (2) the additional contribution that would be required if the deficit reduction contribution for the plan year were determined as the expected increase in current liability due to benefits accruing during the plan year.

An applicable employer is an employer that is: (1) a commercial passenger airline;
(2) primarily engaged in the production or manufacture of a steel mill product, or the processing of iron ore pellets; or (3) an organization described in section 501(c)(5) that established the plan for which an alternative deficit reduction contribution is elected on June 30, 1955.

Explanation of Provision

In general

The provision provides special funding rules for certain eligible plans. For purposes of the provision, an eligible plan is a single-employer defined benefit pension plan sponsored by an employer that is a commercial passenger airline or the principal business of which is providing catering services to a commercial passenger airline.

The plan sponsor of an eligible plan may make one of two alternative elections. In the case of a plan that meets certain benefit accrual and benefit increase restrictions, an election allowing a 17-year amortization of the plan's unfunded liability is available. A plan that does not meet such requirements may elect to use a 10-year amortization period in amortizing the plan's shortfall amortization base for the first taxable year beginning in 2008.

Election for plans that meet benefit accrual and benefit increase restriction

requirements

In general

Under the provision, if an election of a 17-year amortization period is made with respect to an eligible plan for a plan year (an "applicable" plan year), the minimum required contribution is determined under a special method.[97] If minimum required contributions as determined under the provision are made: (1) for an applicable plan year beginning before January 1, 2008 (for which the present-law funding rules apply), the plan does not have an accumulated funding deficiency; and (2) for an applicable plan year beginning on or after January 1, 2008 (for which the funding rules under the provision apply), the minimum required contribution is the contribution determined under the provision.

The employer may select either a plan year beginning in 2006 or 2007 as the first plan year to which the election applies. The election applies to such plan year and all subsequent plan years, unless the election is revoked with the approval of the Secretary of the Treasury. The election must be made (1) no later than December 31, 2006, in the case of an election for a plan year beginning in 2006, or (2) not later than December 31, 2007, in the case of a plan year beginning in 2007. An election under the provision must be made in such manner as prescribed by the Secretary of the Treasury. The employer may change the plan year with respect to the plan by specifying a new plan year in the election. Such a change in plan year does not require approval of the Secretary of the Treasury.

Determination of required contribution

Under the provision, the minimum required contribution for any applicable plan year during the amortization period is the amount required to amortize the plan's unfunded liability, determined as of the first day of the plan year, in equal annual installments over the remaining amortization period. For this purpose, the amortization period is the 17-plan-year period beginning with the first applicable plan year. Thus, the annual amortization amount is redetermined each year, based on the plan's unfunded liability at that time and the remainder of the amortization period. For any plan years beginning after the end of the amortization period, the plan is subject to the generally applicable minimum funding rules (as provided under the bill, including the benefit limitations applicable to underfunded plans). The plan's prefunding balance and funding standard carryover balance as of the first day of the first year beginning after the end of the amortization period is zero.[98]

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Any charge or credit in the funding standard account determined under the present-law rules or any prefunding balance or funding standard carryover balance (determined under the funding provisions of the bill) as of the end of the last year preceding the first applicable year is reduced to zero.

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If an election to use the special method is revoked before the end of the amortization period, the plan is subject to the generally applicable minimum funding rules beginning with the first plan year for which the election is revoked, and the plan's prefunding balance as of the beginning of that year is zero.

Any waived funding deficiency as of the day before the first day of the first applicable plan year is deemed satisfied and the amount of such waived funding deficiency must be taken into account in determining the plan's unfunded liability under the provision. Any plan amendment adopted to satisfy the benefit accrual restrictions of the provision (discussed below) or any increase in benefits provided to such plan's participants under a defined contribution or multiemployer plan will not be deemed to violate the prohibition against benefit increases during a waiver period.[99]

For purposes of the provision, a plan's unfunded liability is the unfunded accrued liability under the plan, determined under the unit credit funding method. As under present law, minimum required contributions (including the annual amortization amount) under the provision must be determined using actuarial assumptions and methods, each of which is reasonable (taking into account the experience of the plan and reasonable expectations), or which, in the aggregate, result in a total plan contribution equivalent to a contribution that would be obtained if each assumption and method were reasonable. The assumptions are required also to offer the actuary's best estimate of anticipated experience under the plan. Under the election, a rate of interest of 8.85 percent is used in determining the plan's accrued liability. The value of plan assets used must be the fair market value.

If any applicable plan year with respect to an eligible plan using the special method includes the date of enactment of the provision and a plan was spun off from such eligible plan during the plan year, but before the date of enactment, the minimum required contribution under the special method for the applicable plan year is an aggregate amount determined as if the plans were a single plan for that plan year (based on the full 12-month plan year in effect prior to the spin off). The employer is to designate the allocation of the aggregate amount between the plans for the applicable plan year.

Benefit accrual and benefit increase restrictions

Benefit accrual restrictions. - Under the provision, effective as of the first day of the first applicable plan year and at all times thereafter while an election under the provision is in effect, an eligible plan must include two accrual restrictions. First, the plan must provide that, with respect to each participant: (1) the accrued benefit, any death or disability benefit, and any social security supplement are frozen at the amount of the benefit or supplement immediately before such first day; and (2) all other benefits under the plan are eliminated. However, such freezing or elimination of benefits or supplements is required only to the extent that it would be permitted under the anticutback rule if implemented by a plan amendment adopted immediately before such first day.

Second, if an accrued benefit of a participant has been subject to the limitations on benefits under section 415 of the Code and would otherwise be increased if such limitation is increased, the plan must provide that, effective as of the first day of the first applicable plan year

[99] ERISA sec. 304(b); Code sec. 412(f).

(or, if later, the date of enactment) any such increase will not take effect. The plan does not fail to meet the anticutback rule solely because the plan is amended to meet this requirement.

Benefit increase restriction. – No applicable benefit increase under an eligible plan may take effect at any time during the period beginning on July 26, 2005, and ending on the day before the first day of the first applicable plan year. For this purpose, an applicable benefit increase is any increase in liabilities of the plan by plan amendment (or otherwise as specified by the Secretary) which would occur by reason of: (1) any increase in benefits; (2) any change in the accrual of benefits; or (3) any change in the rate at which benefits become nonforfeitable under the plan.

Exception for imputed disability service.– The benefit accrual and benefit increase restrictions do not apply to any accrual or increase with respect to imputed serviced provided to a participant during any period of the participant's disability occurring on or after the effective date of the plan amendment providing for the benefit accrual restrictions (on or after July 26, 2005, in the case of benefit increase restrictions) if the participant was: (1) was receiving disability benefits as of such date or (2) was receiving sick pay and subsequently determined to be eligible for disability benefits as of such date.

Rules relating to PBGC guarantee and plan terminations

Under the provision, if a plan to which an election applies is terminated before the end of the 10-year period beginning on the first day of the first applicable plan year, certain aspects of the PBGC guarantee provisions are applied as if the plan terminated on the first day of the first applicable plan year. Specifically, the amount of guaranteed benefits payable by the PBGC is determined based on plan assets and liabilities as of the assumed termination date. The difference between the amount of guaranteed benefits determined as of the assumed termination date and the amount of guaranteed benefits determined as of the actual termination date is to be paid from plan assets before other benefits.

The provision of the bill under which defined benefit plans that are covered by the PBGC insurance program are not taken into account in applying the overall limit on deductions for contributions to combinations of defined benefit and defined contribution plans, does not apply to an eligible plan to which the special method applies. Thus, the overall deduction limit applies.

In the case of notice required with respect to an amendment that is made to an eligible plan maintained pursuant to one or more collective bargaining agreements in order to comply with the benefit accrual and benefit increase restrictions under the provision, the provision allows the notice to be provided 15 days before the effective date of the plan amendment.

Termination premiums

If a plan terminates during the five-year period beginning on the first day of the first applicable plan year, termination premiums are imposed at a rate of $2,500 per participant (in lieu of the present-law $1,250 amount). The increased termination premium applies notwithstanding that a plan was terminated during bankruptcy reorganization proceedings pursuant to a bankruptcy filing before October 18, 2005 (i.e., the present-law grandfather rule does not apply).

The Secretary of Labor may waive the additional termination premium if the Secretary determines that the termination occurred as the result of extraordinary circumstances such as a terrorist attack or other similar event. It is intended that extraordinary circumstances means a substantial, system-wide adverse effect on the airline industry such as the terrorist attack which occurred on September 11, 2001. It is intended that the waiver of the additional premiums occur only in rare and unpredictable events. Extraordinary circumstances would not include a mere economic event such as the high price of oil or fuel, or a downturn in the market.

Alternative election in the case of plans not meeting benefit accrual and benefit increase restrictions

In lieu of the election above, a plan sponsor may elect, for the first taxable year beginning in 2008, to amortize the shortfall amortization base for such taxable year over a period of 10 plan years (rather than seven plan years) beginning with such plan year. Under such election, the benefit accrual, benefit increase and other restrictions discussed above do not apply. This 10year amortization election must be made by December 31, 2007.

Authority of Treasury to disqualify successor plans

If either election is made under the provision and the eligible plan is maintained by an employer that establishes or maintains one or more other single-employer defined benefit plans, and such other plans in combination provide benefit accruals to any substantial number of successor employees, the Secretary of Treasury may disqualify such successor plans unless all benefit obligations of the eligible plan have been satisfied. Successor employees include any employee who is or was covered by the eligible plan and any employee who performs substantially the same type of work with respect to the same business operations as an employee covered by the eligible plan.

Alternative deficit reduction contribution for certain plans

In the case of an employer which is a commercial passenger airline, the provision extends the alternative deficit reduction contributions rules to plan years beginning before

December 28, 2007.

Application of minimum coverage rules

In applying the minimum coverage rules to a plan, management pilots who are not represented in accordance with title II of the Railway Labor Act are treated as covered by a collective bargaining agreement if the management pilots manage the flight operations of air pilots who are so represented and the management pilots are, pursuant to the terms of the agreement, included in the group of employees benefiting under the plan.

The exclusion under the minimum coverage rules for air pilots represented in accordance with title II of the Railway Labor Act does not apply in the case of a plan which provides contributions or benefits for employees whose principal duties are not customarily performed aboard an aircraft in flight (other than management pilots described above).

Effective Date

The provision is effective for plan years ending after the date of enactment except that the modifications to the minimum coverage rules apply to years beginning before, on, or after the date of enactment.