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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)

Required interest rate and mortality table

Specific interest rate and mortality assumptions must be used in determining a plan's current liability for purposes of the special funding rule. For plans years beginning before January 1, 2004, and after December 31, 2005, 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 30year Treasury securities for the four-year period ending on the last day before the plan year begins.[10] The permissible range is generally from 90 percent to 105 percent (120 percent for plan years beginning in 2002 or 2003).[11] The interest rate used under the plan generally must be consistent with the assumptions which reflect the purchase rates that would be used by insurance companies to satisfy the liabilities under the

10 The weighting used for this purpose is 40 percent, 30 percent, 20 percent and 10 percent, starting with the most recent year in the four-year period. Notice 88-73, 1988-2 C.B. 383.

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

12 Code sec. 412(b)(5)(B)(iii)(II); ERISA sec. 302(b)(5)(B)(iii)(II). Under Notice 90-11, 1990-1 C.B. 319, the interest rates in the permissible range are deemed to be consistent with the assumptions

Under the Pension Funding Equity Act of 2004 ("PFEA 2004"),[13] a special interest rate applies in determining current liability for plan years beginning in 2004 or 2005.[14] For these years, the interest rate used must be within a permissible range of the weighted average of the rates of interest on amounts invested conservatively in long-term investment-grade corporate bonds during the four-year period ending on the last day before the plan year begins. The permissible range for these years is from 90 percent to 100 percent. The interest rate is to be determined by the Secretary of the Treasury on the basis of two or more indices that are selected periodically by the Secretary and are in the top three quality levels available.

In determining current liability, the 1983 Group Annuity Mortality Table has been used since 1995.[15] Under present law, the Secretary of the Treasury may prescribe other tables to be used based on the actual experience of pension plans and projected trends in such experience. In addition, the Secretary of the Treasury is required to periodically review (at least every five years) any tables in effect and, to the extent the Secretary determines necessary, update such tables to reflect the actuarial experience of pension plans and projected trends in such experience.[16] Under Prop. Treas. Reg. 1.412(l)(7)-1, beginning in 2007, RP-2000 Mortality Tables are used with improvements in mortality (including future improvements) projected to the current year and with separate tables for annuitants and nonannuitants.[17]

Other rules

Full funding limitation

No contributions are required under the minimum funding rules in excess of the full funding limitation. The full funding limitation is the excess, if any, of (1) the accrued liability under the plan (including normal cost), over (2) the lesser of (a) the market value of plan assets or (b) the actuarial value of plan assets.[18] However, the full funding limitation may not be less than the excess, if any, of 90 percent of the plan's

reflecting the purchase rates that would be used by insurance companies to satisfy the liabilities under the plan.

13 Pub. L. No. 108-218 (2004).

14 In addition, under PFEA 2004, if certain requirements are met, reduced contributions under the deficit reduction contribution rules apply for plan years beginning after December 27, 2003, and before December 28, 2005, in the case of plans maintained by commercial passenger airlines, employers primarily engaged in the production or manufacture of a steel mill product or in the processing of iron ore pellets, or a certain labor organization.

15 Rev. Rul. 95-28, 1995-1 C.B. 74. Separate mortality tables are required to be used with respect to disabled participants.

16 Code sec. 412(l)(7)(C)(ii)(III); ERISA sec. 302(d)(7)(C)(ii)(III).

17 Separate tables continue to apply with respect to disabled participants.

18 For plan years beginning before 2004, the full funding limitation was generally defined as the excess, if any, of (1) the lesser of (a) the accrued liability under the plan (including normal cost) or (b) a current liability (including the expected increase in current liability due to benefits accruing during the plan year) over the actuarial value of plan assets. In general, current liability is all liabilities to plan participants and beneficiaries accrued to date, whereas the accrued liability under the full funding limitation may be based on projected future benefits, including future salary increases.

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.[19] The amount of each required installment is generally 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.[20] If a required installment is not made, interest applies for the period of underpayment at a rate of the greater of (1) 175 percent of the Federal mid-term rate, or (2) the plan rate.

Funding waivers

Within limits, the Secretary of the Treasury is permitted to waive all or a portion of the contributions required under the minimum funding standard for a plan year (a "waived funding deficiency").[21] A waiver may be granted if the employer (or employers) responsible for the contribution could not make the required contribution without temporary substantial business hardship and if requiring the contribution would be adverse to the interests of plan participants in the aggregate. Generally, no more than three waivers may be granted within any period of 15 consecutive plan years.

percentage (170 percent for 2003) of the plan's current liability (including the current liability normal cost), over (2) the lesser of (a) the market value of plan assets or (b) the actuarial value of plan assets, but in no case less than the excess, if any, of 90 percent of the plan's current liability over the actuarial value of plan assets. Under the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), the full funding limitation based on 170 percent of current liability is repealed for plan years beginning in 2004 and thereafter. The provisions of EGTRRA generally do not apply for years beginning after December 31, 2010.

[19] Code sec. 412(m); ERISA sec. 302(e).

[20] If quarterly contributions are required with respect to a plan, the amount of a quarterly installment must also be sufficient to cover any shortfall in the plan's liquid assets (a "liquidity shortfall").

[21] Code sec. 412(d); ERISA sec. 303. Under similar rules, the amortization period applicable to an unfunded past service liability or loss may also be extended.

The IRS is authorized to require security to be provided as a condition of granting a waiver of the minimum funding standard if the sum of the plan's accumulated funding deficiency and the balance of any outstanding waived funding deficiencies exceeds $1 million.

Failure to make required contributions

An employer is generally subject to an excise tax if it fails to make minimum required contributions and fails to obtain a waiver from the IRS.[22] The excise tax is 10 percent of the amount of the accumulated funding deficiency. In addition, a tax of 100 percent may be imposed if the accumulated funding deficiency is not corrected within a certain period.

If the total of the contributions the employer fails to make (plus interest) exceeds $1 million and the plan's funded current liability percentage is less than 100 percent, a lien arises in favor of the plan with respect to all property of the employer and the members of the employer's controlled group. The amount of the lien is the total amount of the missed contributions (plus interest).

Explanation of Provision

Interest rate required for plan years beginning in 2006 and 2007

For plan years beginning after December 31, 2005, and before January 1, 2008, the provision applies the present-law funding rules, with an extension of the interest rate applicable in determining current liability for plan years beginning in 2004 and 2005. Thus, in determining current liability for funding purposes for plan years beginning in 2006 and 2007, the interest rate used must be within the permissible range (90 to 100 percent) of the weighted average of the rates of interest on amounts invested conservatively in long-term investment-grade corporate bonds during the four-year period ending on the last day before the plan year begins.

Funding rules for plan years beginning after 2007 - in general

For plan years beginning after December 31, 2007, in the case of single-employer defined benefit plans, the provision repeals the present-law funding rules (including the requirement that a funding standard account be maintained) and provides a new set of rules for determining minimum required contributions.[23] Under the provision, the minimum required contribution to a single-employer defined benefit pension plan for a plan year generally depends on a comparison of the value of the plan's assets with the plan's funding target and target normal cost. As described in more detail below, under the provision, credit balances generated under present law are carried over (into a

[22] Code sec. 4971. An excise tax applies also if a quarterly installment is less than the amount required to cover the plan's liquidity shortfall.

[23] A delayed effective date applies to certain plans as discussed in Items C, D and E below. Changes to the funding rules for multiemployer plans are discussed in Title II below. Governmental plans and church plans continue to be exempt from the funding rules to the extent provided under present law.

"funding standard carryover balance") and generally may be used in certain circumstances to reduce otherwise required minimum contributions. In addition, as described more fully below, contributions in excess of the minimum contributions required under the provision for plan years beginning after 2007 generally are credited to a prefunding balance that may be used in certain circumstances to reduce otherwise required minimum contributions. To facilitate the use of such balances to reduce minimum required contributions, while avoiding use of such balances for more than one purpose, in some circumstances the value of plan assets is reduced by the prefunding balance and/or the funding standard carryover balance.

The minimum required contribution for a plan year, based on the value of plan assets (reduced by any prefunding balance and funding standard carryover balance) compared to the funding target, is shown in the following table:

If:	***The minimum required contribution is:***
the value of plan assets (reduced by any prefunding balance and funding standard carryover balance) is less than the funding target,	the sum of: (1) target normal cost; (2) any shortfall amortization charge; and (3) any waiver amortization charge.
the value of plan assets (reduced by any prefunding balance and funding standard carryover balance) equals or exceeds the funding target,	the target normal cost, reduced (but not below zero) by the excess of (1) the value of plan assets (reduced by any prefunding balance and funding standard carryover balance), over (2) the funding target.

Under the provision, a plan's funding target is the present value of all benefits accrued or earned as of the beginning of the plan year. A plan's target normal cost for a plan year is the present value of benefits expected to accrue or be earned during the plan year. A shortfall amortization charge is generally the sum of the amounts required to amortize any shortfall amortization bases for the plan year and the six preceding plan years. A shortfall amortization base is generally required to be established for a plan year if the plan has a funding shortfall for a plan year.[24] A shortfall amortization base may be positive or negative, i.e., an offsetting amortization base is established for gains. In general, a plan has a funding shortfall if the plan's funding target for the year exceeds the value of the plan's assets (reduced by any prefunding balance and funding standard carryover balance). A waiver amortization charge is the amount required to amortize a waived funding deficiency.

The provision specifies the interest rates and mortality table that must be used in determining a plan's target normal cost and funding target, as well as certain other actuarial assumptions, including special assumptions ("at-risk" assumptions)

[24] Under a special rule, discussed below, a shortfall amortization base does not have to be established if the value of a plan's assets (reduced by any prefunding balance,

but only if the employer elects to use any portion of the prefunding balance to reduce required contributions for the year) is at least equal to the plan's funding target for the plan year.

for a plan in at-risk status. A plan is in at-risk status for a year if the value of the plan's assets (reduced by any prefunding and funding standard carryover balances) for the preceding year was less than (1) 80 percent of the plan's funding target determined without regard to the at-risk assumptions, and (2) 70 percent of the plan's funding target determined using the at-risk assumptions. Under a transition rule, instead of 80 percent, the following percentages apply: 65 percent for 2008, 70 percent for 2009, and 75 percent for 2010.

Mortality table

Under the provision, the Secretary of the Treasury is directed to prescribe by regulation the mortality tables to be used in determining present value or making any computation under the funding rules.[29] Such tables are to be based on the actual experience of pension plans and projected trends in such experience. In prescribing tables, the Secretary is to take into account results of available independent studies of mortality of individuals covered by pension plans. In addition, the Secretary is required (at least every 10 years) to revise any table in effect to reflect the actual experience of pension plans and projected trends in such experience.

The provision also provides for the use of a separate mortality table upon request of the plan sponsor and approval by the Secretary of the Treasury in accordance with procedures described below. In order for the table to be used: (1) the table must reflect the actual experience of the pension plans maintained by the plan sponsor and projected trends in general mortality experience, and (2) there must be a sufficient number of plan participants, and the pension plans must have been maintained for a sufficient period of time, to have credible information necessary for that purpose. A separate mortality table can be a mortality table constructed by the plan's enrolled actuary from the plan's own experience or a table that is an adjustment to the table prescribed by the Secretary which sufficiently reflects the plan's experience. Except as provided by the Secretary, a separate table may not be used for any plan unless (1) a separate table is established and used for each other plan maintained by the plan sponsor and, if the plan sponsor is a member of a controlled group, each member of the

[28] The applicable long-term corporate bond rate is a rate that is from 90 to 100 percent of the weighted average of the rates of interest on amounts invested conservatively in long-term investment-grade corporate bonds during the four-year period ending on the last day before the plan year begins as determined by the Secretary under the method in effect for 2007.

[29] As under present law, separate mortality tables are required to be used with respect to disabled participants.

controlled group,[30] and (2) the requirements for using a separate table are met with respect to the table established for each plan, taking into account only the participants of that plan, the time that plan has been in existence, and the actual experience of that plan. In general, a separate plan may be used during the period of consecutive year plan years (not to exceed 10) specified in the request. However, a separate mortality table ceases to be in effect as of the earlier of (1) the date on which there is a significant change in the participants in the plan by reason of a plan spinoff or merger or otherwise, or (2) the date on which the plan actuary determines that the table does not meet the requirements for being used.

A plan sponsor must submit a separate mortality table to the Secretary for approval at least seven months before the first day of the period for which the table is to be used. A mortality table submitted to the Secretary for approval is treated as in effect as of the first day of the period unless the Secretary, during the 180-day period beginning on the date of the submission, disapproves of the table and provides the reasons that the table fails to meet the applicable criteria. The 180-day period is to be extended upon mutual agreement of the Secretary and the plan sponsor.

Other assumptions

Under the provision, in determining any present value or making any computation, the probability that future benefits will be paid in optional forms of benefit provided under the plan must be taken into account (including the probability of lump-sum distributions determined on the basis of the plan's experience and other related assumptions). The assumptions used to determine optional forms of benefit under a plan may differ from the assumptions used to determine present value for purposes of the funding rules under the provision. Differences in the present value of future benefit payments that result from the different assumptions used to determine optional forms of benefit under a plan must be taken into account in determining any present value or making any computation for purposes of the funding rules.

The provision generally does not require other specified assumptions to be used in determining the plan's target normal cost and funding target except in the case of at-risk plans (discussed below). However, similar to present law, the determination of present value or other computation must be made on the basis of actuarial assumptions and methods, each of which is reasonable (taking into account the experience of the plan and reasonable expectations), and which, in combination, offer the actuary's best estimate of anticipated experience under the plan.[31]

30 For example, the Secretary may deem it appropriate to provide an exception in the case of a small plan.

[31] The provision retains the present-law rule under which certain changes in actuarial assumptions that decrease the liabilities of an underfunded single-employer plan must be approved by the Secretary of the Treasury.

Effective Date

The extension of the interest rate applicable in determining current liability for plan years beginning in 2004 and 2005 is effective for plan years beginning after December 31, 2005, and before January 1, 2008. The modifications to the single-employer plan funding rules are effective for plan years beginning after December 31, 2007.