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AUTHOR: Bortz, Jason K.

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SUMMARY OF PROVISIONS OF THE PENSION PROTECTION ACT OF 2006 AFFECTING DEFINED BENEFIT PLAN FUNDING AND HYBRID PLANS

ISSUE	PRIOR LAW	PENSION PROTECTION ACT[1]	COMMENTS
SINGLE-EMPLOYER PENSION FUNDING			
IN GENERAL	Requires minimum contributions to single-employer defined benefit plans equal to the greater of (a) the contributions required under the deficit reduction contribution ("DRC") rules, or (b) the contributions required under the plan's funding standard account (the "ERISA funding rules"). If the DRC rules apply, sponsors generally must contribute a specified percentage of the plan's unfunded liabilities. DRC contribution percentages currently range from 18% to just over 30% of the difference between the value of plan assets and 100% of liabilities, as defined using special DRC interest rate and mortality assumptions ("current liability").	Starting with plan years beginning in 2008, the current two-tiered system is replaced with a single funding regime. The minimum required funding for any plan year under this regime is the sum of (i) the plan's normal cost for the plan year and (ii) the "shortfall contribution" necessary to amortize the difference between assets and 100% of liabilities over 7 years. A shortfall contribution is required for the current year and each of the next 6 years (unless the plan became 100% funded at an earlier date). Normal cost refers to all benefits that a plan expects to pay in the future that accrue during the year (including increases in benefits earned in prior years where the increase is attributable to compensation increases).	By way of example, in very simple terms, ignoring normal cost and assuming a zero interest-rate environment, the Act provides that if a plan has liabilities of \$100 and assets of \$86, the sponsor has a minimum contribution of \$2 in each of the next 7 years.
TRANSITION FOR 2006 AND 2007	For plan years beginning during 2004 and 2005, a temporary corporate bond interest rate was used for certain purposes.	The current funding rules, including an extension of the temporary corporate bond rate, remain in effect for plan years beginning in 2006 and 2007.	
FUNDING TARGET	DRC contributions are required only if a plan falls below 90% funded on a current liability basis, or 80% for plans that have been 90% funded in two consecutive years out of the last three years.	Contributions are required for a plan year if the sum of (i) the plan's normal cost for the year and (ii) 100% of the plan's liability on the valuation date, are more than the value of the plan's assets.	
PHASE-IN OF FUNDING TARGET		The 100% funding target does not apply until 2011 for plans that are funded up to 92% in 2008; 94% in 2009; and 96% in 2010. Plans subject to the DRC for plan years beginning in 2007 do not qualify for this transition rule. Eligibility for the phase-in of the 100% target (*i.e.*, funding to 92% in 2008 etc.) is significant because plans that reach these thresholds are not required to subtract	This "ladder" phase-in is not a traditional phase-in. As a result, many plans (including non-DRC plans) will either have to immediately fund up to the applicable threshold (92% in 2008) or immediately move from a 90% funding target to a 100% funding target in 2008.

[1] The Pension Protection Act of 2006 ("PPA" or "Act"), Public Law No. 109-280, was approved by the full House on July 28, 2006 and the Senate on August 3, 2006. President Bush signed the measure into law on August 17, 2006. The PPA is the package of retirement reforms agreed upon by House and Senate conferees that worked to reconcile different versions of the legislation (originally H.R. 2830 and S. 1783). This chart is based on a review of the Act's language and certain descriptive materials, including the Technical Explanation prepared by the Joint Committee on Taxation (August 3, 2006, JCX-38-06).

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		credit balances in determining their shortfall contributions. Such plans are also exempt from the benefit restriction rules (but not the at-risk rules) even if the subtraction of credit balances would otherwise trigger the restrictions, as discussed below.	
INTEREST RATE FOR VALUING LIABILITIES	Liabilities of all durations are valued using a single interest rate. Prior to 2004, the interest rate used to determine liability for DRC purposes was based on the 30-year Treasury bond. For plan years beginning in 2004 and 2005, the interest rate is based on a mix of long-term corporate bonds that are AAA, AA and A rated. After 2005, the interest rate is scheduled to revert to the rate on the 30-year Treasury bond.	Liabilities will be valued using a yield curve comprised of AAA, AA and A rated corporate bonds of varying maturities. Separate interest rates will be established for each of three maturity "segments" – liabilities due (1) in 5 or fewer years, (2) between 5 and 20 years and (3) those longer than 20 years. In lieu of using the segment rates, a plan can elect to value liabilities for purposes of determining minimum contributions without regard to the segment rates (*i.e.*, by applying a true yield curve). Such an election may be changed only with the consent of Treasury. *Transition*. The change in liability attributable to the new interest rate, yield curve, and interest rate smoothing rules (discussed below) will be phased in during 2008 and 2009. During 2008, liability is one-third new liability and two-thirds liability under the rules in effect during 2007 (including extension of the temporary corporate bond rate). Those ratios will be flipped during 2009.	There are a number of unanswered questions regarding the construction of the yield curve, including how the different classes of bonds will be weighted. These issues presumably will be addressed by Treasury in constructing the yield curve.
INTEREST RATE SMOOTHING	The interest rate used to value liabilities is the weighted average of the interest rate for the previous 4 years (weighted 40%, 30%, 20% and 10%, starting with the most recent year in the four-year period).	Interest rates are smoothed over 24 months with no weighting. A plan can elect to determine the interest rate on a non-smoothed basis. Such an election may be changed only with the consent of Treasury.	Reflects a compromise between the Senate's 12-month smoothing and the House's 3-year smoothing.
ASSET SMOOTHING	A plan can use the actual fair market value on the valuation date or the prescribed average value. Treasury regulations allow for the actuarial smoothing of asset values within a prescribed corridor (generally no less than 80% and no more than 120% of fair market value).	Asset values can be smoothed but PPA restricts period of smoothing to 24 months. Prescribed corridor is narrowed to 90% to 110%.	The Act provides Treasury with authority to prescribe permitted and non-permitted averaging methods.

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MORTALITY TABLE FOR VALUING LIABILITIES	The Secretary of Treasury prescribes the mortality tables used in determining a plan's current liability. On December 1, 2005, Treasury issued proposed regulations that would replace the current table, GAM 1983, with RP-2000.	Directs Treasury to prescribe a mortality table. *Substitute Mortality Table.* Allows a plan to use a substitute mortality table if the Secretary of Treasury determines that (i) the table reflects the actual experience of the plan and projected trends in experience and (ii) the plan has sufficient experience on which to base the substitute table, provided that each plan maintained by the employer and its affiliates uses its own substitute mortality table. *Effective Date*: RP-2000 will be effective as provided in to-be-issued final regulations. The substitute mortality table provisions are effective starting for plan years beginning in 2008.	Presumably Treasury will prescribe a mortality table that tracks its recently proposed regulation. The requirement that each plan maintained by an employer and its affiliates use a substitute mortality table if any plan uses one is designed to prevent "cherry picking" of plans with substandard mortality, *e.g.*, to prevent using a substitute mortality table for an hourly plan with substandard mortality while using the standard table for a salaried plan with above average mortality experience.
OPTIONAL FORMS OF DISTRIBUTION	An assumption regarding the probability that lump sums and other optional forms of distribution will be paid is not required (or permitted) under the DRC rules.	Probability that lump sums and other optional forms of distribution will be paid are taken into account, and any difference in value must be reflected in liability.	
TREATMENT OF GAINS AND LOSSES	The ERISA funding rules, but not the DRC rules, provide for amortization of gains or losses.	Losses (actuarial and investment) are recognized immediately and amortized over 7 years. Gains are also amortized over 7 years and netted against loss amortization schedules.	Immediate recognition of gains was not an element of either House or Senate bill, but was added as part of the conference and could materially reduce contributions in certain situations.
TREATMENT OF CREDIT BALANCES	If a sponsor makes a contribution in excess of the minimum required contribution in any year, the excess plus interest is maintained as a "credit balance" that can be credited against future required contributions. Generally, under the DRC rules, the credit balances are not subtracted from assets for purposes of determining whether a shortfall contribution is required, but they are subtracted for purposes of determining the amount of the shortfall contribution. Credit balances are not subtracted for any other purpose. Credit balances are increased based on the plan's expected rate of return on assets.	The following changes in the treatment of credit balances are made: - Credit balances must be subtracted from assets for determining the amount of the shortfall contribution for plans funded below the phased-in funding target (which does not subtract existing credit balances). Note: Credit balances that cannot be used to satisfy a contribution obligation as a result of an agreement with the PBGC need not be subtracted from assets for this purpose. - Credit balances cannot be used to offset minimum contributions for plans that were below 80% funded for the preceding year. For this purpose, existing credit balances as of the end of plan years beginning in 2007 are not subtracted from assets and Treasury will prescribe methods of estimating funded percentages for 2007 (to determine whether the restriction applies in 2008).	The subtraction of credit balances for purposes of determining the amount of minimum contributions is arguably different than pre-PPA law in that credit balances are only subtracted from assets in plans that fall into the DRC. As a result, the Act expands the situations in which credit balances are subtracted from assets. For example, assuming a zero interest-rate environment and no normal cost, if a plan has liabilities of $100, assets of $86 and a credit balance of $7, the plan would have a minimum contribution of $21 ($100 minus $86 minus $7) amortized over 7 years and would therefore have to contribute $3 per year. However, the $7 credit balance could be used to satisfy this annual obligation until exhausted.

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		- Credit balances cannot be created by any contribution to the extent that the contribution has the effect of avoiding any of the benefit limitations discussed below. In effect, contributions that bring a plan up to a benefit limitation threshold will be treated as required contributions. - Beginning in 2008, credit balances will be marked to market based on the plan's actual rate of return. As described further below, credit balances will also be subtracted from assets for purposes of determining whether a plan is "at risk" and, in the case of a plan that is funded below the phased-in funding target, whether the benefit restrictions apply.	
SPECIAL RULES FOR AT-RISK PLANS	Not applicable.	Plans that are defined as "at-risk" will be subject to accelerated funding requirements. At-risk plans will be required to (i) assume that during the current year and the next 10 years all participants will retire upon reaching the earliest retirement age; (ii) assume that benefits will be paid in lump sums (or in whatever form results in the largest liability for the plan); and (iii) in the case of a plan that has been at-risk for 2 out of 4 years, apply a "loading factor" equal to $700 per participant plus 4% of current liability for the plan year. *Definition of At-Risk*. Defines a plan as at-risk for a year based on whether, for the preceding plan year, the plan's assets were (1) less than 70% of its liabilities calculated assuming that the plan is at-risk but disregarding the loading factor and (2) less than 80% of its liabilities calculated using non-at-risk assumptions. For this purpose, credit balances will be subtracted from assets. Also, the 80% prong will be phased in as follows: 65% in 2008; 70% in 2009, 75% in 2010; 80% in 2011 and thereafter. *Phase-In*. Once a plan becomes at-risk, the difference between standard liability and at-risk liability will be phased in 20% per year. *Small Plan Exception*. Plans with 500 or fewer participants will be exempt from the at-risk rules.	The subtraction of credit balances means that plans that are well-funded on an economic basis may be considered at-risk by virtue of credit balances. These plans could waive their credit balances or could simply accept the consequences of at-risk status. Note that, under PPA, shortfall amortization schedules established while the plan was considered at-risk continue to be applicable after a plan ceases to be at-risk. The result is that once a plan ceases to be at-risk, the 20% phase-in of at-risk liability ceases, but the amortization schedule with respect to the already phased-in at–risk liability continues until the plan is funded to 100% of non-at risk liability. However, because the Act includes a provision allowing amortization of actuarial gains, a plan that ceases to be at-risk will have an actuarial gain that is amortized over 7 years and netted against the outstanding amortization bases. This has the effect of mitigating the consequences of the accelerated funding requirements once a plan ceases to be at risk.

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		Automobile Manufacturers Exception. The at-risk rules will not apply to liabilities attributable to employees who work for automobile manufacturers (and certain auto parts suppliers) and who were offered but chose not to accept an early retirement package during 2006. *Effective Date*: Plan years beginning in 2008. Directs Treasury to prescribe estimation methodologies for determining funded percentages for 2007 (to determine whether a plan is at risk in 2008). Years prior to 2008 are not taken into account in determining the extent of the 20% phase in.	
RESTRICTIONS ON BENEFITS	There are restrictions on lump sum payments and benefit increases for certain plans that are severely underfunded or have liquidity problems.	*Less than 80% funded*. Benefit increases are prohibited unless immediately paid for or funded to the extent necessary to bring the plan to at least 80% funded. Exception permits increases in flat dollar plans that do not exceed rate of pay increases. *Between 60% and 80% funded*. Only partial lump sums (generally no more than 50% of a participant's accrued benefit) are permitted. *Less than 60% funded*. The plan will have to be frozen, plant shutdown benefits cannot be triggered (unless immediately paid for or funded to the extent necessary to bring the plan to at least 60% funded) and lump sums are prohibited. *Bankruptcy Reorganization*. Unless 100% funded, lump sums are prohibited. *Subtraction of Credit Balances*. For these purposes, all credit balances have to be subtracted from assets in determining a plan's funded percentage. *Mandatory Waiver of Credit Balances*. All plans, including non-collectively bargained plans, generally have to immediately waive credit balances to avoid triggering restrictions on lump sums and other accelerated payout forms. Collectively-bargained plans generally have to immediately waive credit balances to avoid triggering any other benefit restrictions. *Exception for Fully-Funded Plans*. The benefit restrictions	

Issue	Prior Law	Pension Protection Act[1]	Comments
		do not apply to a plan that is funded up to 92% in 2008; 94% in 2009; 96% in 2010; and 100% thereafter, determined without subtracting credit balances from assets. *Effective Date*: Plan years beginning in 2008, subject to delay for collectively-bargained plans.	
Commercial Airlines	Very generally, during 2004 and 2005, a commercial passenger airline may elect an alternate DRC contribution. The alternate DRC contribution is equal to the greater of (i) 20% of the amount that would otherwise be required and (ii) the expected increase in liability due to benefits accruing during the plan year. Restrictions on benefit increases apply if the alternate DRC election is made.	Provides special funding rules for commercial passenger airlines. Any commercial passenger airline may elect to apply the new funding rules modified to provide for 10-year (rather than 7-year) amortization of any funding shortfalls. Instead, a plan of a commercial passenger airline that is frozen is eligible for an alternative funding system. Under the alternative funding system, the required contribution for a year is the amount necessary to amortize the unfunded liability over 17 years, the plan must use a statutorily-prescribed interest rate to value liabilities and assets must be determined on a fair market value basis (*i.e.*, no actuarial smoothing). If a plan terminates while the alternative funding system applies, the PBGC guarantee is frozen as of the first date the alternative system applied.	
Special Rules	Not applicable.	Delays the effective date of the funding and benefit restriction rules for certain large defense contractors, certain plans rescued from distress termination through a PBGC settlement and multiple employer plans of rural agricultural, electric, and telephone cooperatives.	
Other Pension Funding-Related Changes			
Deduction Limits	An employer may generally deduct plan contributions that increase the plan's funding level to 100% of current definition of liability. This limit does not allow plans to create a funding cushion to help satisfy future liabilities. If a sponsor makes contributions in excess of the deduction limits, the contributions are nondeductible and subject to a 10% excise tax. *Combined Plan Limit*. An employer that maintains both a defined contribution plan and a defined benefit plan may only make deductible	For 2006 and 2007, maximum deductible contributions to single-employer plans is increased to the excess of 150% of current liability over plan assets. Thereafter, employers can generally make deductible contributions equal to the excess of target liability, target normal cost, and the "cushion amount" over the value of plan assets. In any event, however, employers may make deductible contributions to bring the plan to full funding using at-risk liability assumptions (even if the plan is not considered at-risk). *Cushion Amount*. The cushion amount is the sum of (1)	The increases in the deduction limits are generous. Employers generally can elect to fund their plans to no less than 150% of liability. After 2007, the Act repeals the combined plan limit for PBGC-covered plans. During 2006 and 2007, for many large employers, the Act effectively repeals the combined plan limit. In this regard, it appears that the combined plan limit is entirely inapplicable if the employer contributions to the defined contribution plan do not exceed 6%. The Act, however, appears to have a cliff effect in that

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	contributions to the two plans up to the greatest of the following: (i) 25% of participants' compensation; (ii) the minimum funding requirement with respect to the defined benefit plan; or (iii) if the DRC rules apply, the amount needed to bring the plan to 100% of current liability. In general, elective contributions are disregarded for this purpose.	50% of target liability and (2) the amount target liability would increase if projected compensation increases were taken into account or, if the plan does not base benefits on compensation, benefit increases expected in succeeding plan years. *Combined Plan Limit*. Effective in 2008, any plan covered by PBGC insurance is not be taken into account in applying the combined plan limit. For 2006 and 2007, the combined plan limit does not apply to the extent that contributions by an employer to one or more defined contribution plans do not exceed 6% of compensation paid or accrued to the beneficiaries under the plan.	the combined plan limit is triggered when and if employer contributions to the defined contribution plan exceed 6% of compensation.
VARIABLE RATE PBGC PREMIUMS	Very generally, certain underfunded single-employer pension plans pay an additional variable-rate premium of $9 per $1,000 of unfunded vested benefits.	No rate change in variable rate premium, but full funding limit exemption are repealed. Liability for purposes of the variable rate premium is the same as liability for purposes of the funding rules except that the interest rate is a spot rate (*i.e.*, not smoothed over 24 months), assets are valued at fair market value, and credit balances are not be subtracted from assets in determining underfunding. The $1,250 per participant termination premium enacted earlier this year is made permanent. *Effective Date*: Plan years beginning in 2008.	The elimination of the full funding limit exemption could result in plans that have not previously paid a variable rate premium having to pay such premiums. Also, it appears that changes in liability definitions, including application of at-risk rules, will lead to increased variable premiums. The Senate bill proposal to apply variable rate premiums to unvested benefits was not included in the Act.
DISCLOSURE TO PARTICIPANTS	Multiemployer defined benefit plans, but not single employer plans, must provide an annual plan funding notice to each plan participant and beneficiary, each labor organization representing participants and beneficiaries, to each contributing employer, and to the PBGC.	New plan funding notice due 120 days after end of the plan year for single employer plans with more than 100 participants. Disclosure of a lengthy list of items is required, including disclosure of year-end assets and year-end liabilities as determined for variable rate premium purposes (*i.e.*, fair market value of assets and liabilities determined using a spot interest rate). A plan is also required to disclose whether a PBGC 4010 filing was made. *Effective Date*: Plan years beginning in 2008.	The new plan funding notice will require disclosure of the plan's funded percentage. For this purpose (but not for purposes of disclosing asset values), credit balances will be subtracted from assets.

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PBGC 4010 INFORMATION	Section 4010 of ERISA generally requires companies sponsoring defined benefit plans with more than $50 million of underfunding to provide the PBGC with confidential corporate information and a statement of the plan's funded status (*i.e.*, termination liability calculated using PBGC specified assumptions, which generally result in a substantially greater liability than under current liability).	Companies are required to provide the PBGC with the information currently required under section 4010 if the funding percentage of a plan (including affiliate's plans) was less than 80% for the preceding year. For this purpose, credit balances are subtracted from assets. *Effective Date*: Plan years beginning in 2008.	Significantly, PPA does not require disclosure to participants of information provided to the PBGC under section 4010.
LUMP SUMS	Statutory assumptions must be used in determining the minimum value of certain optional forms of payments, including lump sums. The applicable interest rate is the annual interest rate on 30-year Treasury securities. The applicable mortality table is a fixed blend of 50 percent of the male mortality rates and 50 percent of the female mortality rates from the 1994 Group Annuity Reserving Table.	The minimum value (*i.e.*, the amount) of lump sums and certain other optional forms of payments have to be calculated using interest rates derived from the modified yield curve (*i.e.*, the segment rates). However, the interest rate used for the minimum value of lump sums is a spot rate, not the smoothed rate used to measure liability. The mortality table will be developed by Treasury and based on the mortality table applicable for funding purposes (which would presumably be the table described in recently issued IRS proposed regulations). However, for this purpose, any substitute mortality table used by a plan will be inapplicable. *Effective Date*: The new interest rate will be phased in 20% per year over a 5-year period beginning in 2008. There is no phase in of the mortality table, although one may be provided in final regulations.	
NQDC RESTRICTIONS	There are no specific restrictions on the establishment or funding of executive compensation under the DRC Rules or ERISA Rules. Income tax provisions under Code section 409A impose immediate taxation and a 20-percent penalty on an employee or independent contractor who benefits under a deferred compensation plan that does not meet specific statutory rules.	Amends Code section 409A to provide for immediate taxation and the 20-percent penalty if any asset is set aside in a trust (or other arrangement as determined by Treasury) for purposes of paying nonqualified deferred compensation ("NQDC") to any "covered employee" of a publicly-held company while (i) any pension plan of the employer or an affiliate is considered at-risk, (ii) a pension plan of the sponsor is in a bankruptcy reorganization, or (iii) during the period starting 18 months prior to termination of any underfunded pension plan of the employer or an affiliate. The prohibited set aside of assets includes transfers of vested benefits to a rabbi trust. *Covered Employees*. The Code section 409A taxation and penalty applies for any prohibited transfers for a current	Unlike the House and Senate bill, PPA clarifies that the restrictions do not apply to amounts contributed to a rabbi trust prior to the date the plan becomes at-risk. PPA also defines covered employee more narrowly to include only senior executives and insiders in contrast to the House bill, which applied the restrictions to all employees who had an NQDC benefit. PPA also clarifies that the NQDC restrictions only apply to publicly-held companies.

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		or former employee who is or has been (i) one of the "top five" officers for purposes of Code section 162(m) whose compensation was reported on the employer's proxy statement or (ii) one of the Rule 16 officers (*i.e.*, insiders whose equity compensation is subject to short-swing profit rules.) *Tax Gross-Ups*. The income inclusion and 20-percent penalty also applies to any gross-up payment attributable to taxes and penalties assessed as a result of the NQDC restriction and deny the employer a deduction for such gross-up payment. *Effective Date*: Applies to transfers made after the date of enactment. Note, however, that a plan cannot be considered at-risk prior to plan years beginning in 2008.	
MULTIEMPLOYER PENSION FUNDING	Very generally, multiemployer plans are subject to funding rules that are analogous to the ERISA funding rules that apply to single-employer plans. In this regard, liabilities are amortized over a variety of periods and the plan's actuary generally determines the applicable actuarial assumptions. Additional contributions may be required if a multiemployer plan is in reorganization status or is insolvent.	Preserves the basic funding methodology that applies to multiemployer plans, but shortens the amortization periods for certain liabilities. Requires the adoption of a funding improvement plan in the case of a multiemployer plan in "endangered status" and a rehabilitation plan in the case of a multiemployer plan in "critical status." Endangered or critical status depends on various funding thresholds and the solvency of the plan. Very generally, endangered or critical status results in increased contributions, but, in the case of a plan in critical status, may also involve reductions to previously earned non-core benefits. Also makes changes in the deduction limits applicable to multiemployer plans. *Effective Date*: Plan years beginning in 2008. Certain provisions sunset at the end of 2014.	
TRANSFERS OF EXCESS PENSION ASSETS FOR RETIREE HEALTH	Defined benefit plan assets generally may not revert to an employer prior to termination of the plan. However, a plan may make a qualified transfer of excess assets to a separate account that is part of the plan to provide medical benefits to currently retired employees. In order to be a qualified transfer, the transfer must meet certain requirements, including a requirement that the retiree medical plan meet certain minimum cost requirements. Excess assets generally means the excess, if any, of the value of plan assets over	Continues to permit a qualified transfer of excess amounts to a separate account in a pension plan to provide medical benefits to retired employees. For this purpose, excess assets generally means the excess, if any, of the value of plan assets reduced by credit balances over 125% of the plan's liability plus normal cost for the year. In valuing plan assets for this purpose, the lesser of fair market value or the smoothed value used for funding must be used. In addition, creates new retiree health transfer options	

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	125% of the plan's current liability.	for "qualified future transfers" and "collectively bargained transfers" to provide medical benefits to future retired employees. Each new type of transfer is subject to a series of requirements and allows transfers at a reduced 120% threshold. However, if the plan's funded status subsequently falls below 120%, either the employer must bring the plan back to 120% funded or the assets in the account must be transferred back to the general assets of the plan to do the same. Special minimum cost requirements apply. *Effective Date:* Transfers after the date of enactment. *Multiemployer Plans*. Retiree health transfers are also allowed for multiemployer plans after 2006.	
HYBRID PLANS			
BASIC DESIGN	The Internal Revenue Code (the "Code"), Employee Retirement Income Security Act ("ERISA") and the Age Discrimination in Employment Act ("ADEA") provide that a defined benefit plan is age discriminatory if the rate of a participant's benefit accrual declines on account of age.	Amends the Code, ERISA and the ADEA to provide that defined benefit plans are not age discriminatory if, as of any date, a participant's accrued benefit, determined under plan terms, is equal to the accrued benefit of any similarly situated, younger individual. As a result, cash balance plans are not age discriminatory so long as pay and annual interest credits for older workers are not less than pay and annual interest credits for younger workers and interest credits are not greater than a market rate of return. PPA makes clear that benefits are to be measured on an "accrued to date" basis (rather than an annual basis). *Effective Date*: Effective for periods after June 29, 2005.	Because PPA applies to all defined benefit plans, its age discrimination clarification applies to cash balance plans, pension equity plans ("PEPs"), and other hybrid plans. The application to hybrid plans is made explicit in PPA's definition of "accrued benefit," which makes specific reference to "the balance of a hypothetical account" (cash balance) and "the current value of the accumulated percentage of the employee's final average compensation" (pension equity). While crediting interest at no more than a market rate is a requirement to enjoy the age discrimination protection, it will likely be some time before Treasury issues guidance on what constitutes a market rate.
BEYOND HYBRIDS	Some have suggested that, for the same reasons hybrid plans have been found by a limited number of federal courts to violate the pension age discrimination rules, certain other plan designs that incorporate a time value of money feature could also be judged to run afoul of the age discrimination rules. In this regard, for example, questions have arisen about the legality of certain floor offset plans, plans with pre-retirement indexing of benefits, and contributory plans.	Provides that any offset permitted under the tax laws and any offset for Social Security are not age discriminatory. Also indicates that indexing accrued benefits cannot be age discriminatory, provided that the indexing cannot result in a loss of accrued benefits (except in the case of a benefit provided in the form of a variable annuity). *Effective Date*: Effective for periods after June 29, 2005.	

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TREATMENT OF EXISTING PLANS	Over the past 20 years, numerous companies have converted their traditional defined benefit plans to hybrid plans. According to the PBGC, there are more than 1,500 of these plans as of 2003 providing benefits to more than 8 million participants. Although hybrid plans have been repeatedly blessed by the Treasury Department and the IRS and were affirmed as lawful by courts on numerous occasions, a limited number of federal courts have found such plans to run afoul of the age discrimination rules. For example, in *Cooper v. IBM*, a federal district court in 2003 held that the cash balance plan design was age discriminatory because pay credits to younger participants' accounts had more years to earn interest. In August 2006, in a very significant development, the Seventh Circuit reversed the lower court's determination, finding that the cash balance design was not age discriminatory and that time value of money features do not cause defined benefit plans to violate the age discrimination rules.	Provides that the changes discussed above (see "Basic Design" above) should not be construed to create an inference with respect to the treatment of hybrid plans under the law prior to June 29,. 2005.	It is likely that the pension negotiators intended the "no inference" statutory language to be accompanied by more detailed legislative history than that contained in the Joint Tax Committee Technical Explanation, but because H.R. 4 was not a conference agreement there was not additional legislative history. For existing hybrid plans, PPA's prospective provision does act as a cap on any potential age discrimination liability since future accruals will be judged (and validated) under the PPA provision.
LUMP SUMS & WHIPSAW	The amount of a lump sum benefit paid from a defined benefit plan must be no less than the actuarial equivalent of the normal retirement benefit determined using the statutorily prescribed interest rate and mortality assumptions. In Notice 96-8, the IRS stated that in calculating the amount of a single sum distribution under a cash balance plan, the balance of the participant's hypothetical account must be projected to normal retirement age using the plan's interest crediting rate (if interest credits do not depend on continued employment) and then discounted back to present value using the statutorily prescribed rate. If the rate used by a plan to project forward exceeds the statutory discount rate, the present value of the accrued benefit will exceed the participant's account balance. If the plan pays only the account balance, some courts have concluded that this is an impermissible forfeiture. This is often referred to as "whipsaw."	Permissible to pay account balances as participants' accrued benefits. *Effective Date*: Applies to distributions after the date of enactment. Provides that the changes should not be construed to create an inference with respect to whipsaw under the law prior to enactment.	Significantly, the Act applies to distributions, and not merely benefits accrued, after the date of enactment. While the whipsaw provision was effective upon enactment, it will likely be some period of time before Treasury issues guidance on market rates of return. The whipsaw provision itself does not contain any regulation of interest crediting rates but the basic age discrimination provision requires that interest crediting be at no more than a market rate of return.

ISSUE	PRIOR LAW	PENSION PROTECTION ACT[1]	COMMENTS
INTEREST CREDITS	The whipsaw rules for lump sums generally limit interest crediting rates. In addition, there have been questions about interest crediting rates that may fall below zero.	As mentioned above, the Act conditions the age discrimination rules for cash balance plans on crediting interest at a market rate. The Act makes clear that minimum guaranteed rates of return, returns equal to the greater of a fixed and variable rate, and interest rates that may fall below zero are considered market rates of return. Interest rates that cause a decline in the accrued benefit are prohibited. Directs Treasury to address issues related to the market interest rate requirement. *Effective Date*: For existing plans, effective for years beginning in 2008, subject to a delay for collectively-bargained plans.	A key issue for Treasury guidance will be the extent to which minimums, floors, and "greater of" interest crediting will limit or impact the maximum interest crediting. The statute is not explicit about the period of time over which interest rates cannot cause a decline in the accrued benefit. The intent appears to have been for this to be a cumulative requirement measured at benefit commencement rather than an annual requirement. This intent is indicated in a colloquy during Senate debate between Senators Enzi (R-WY) and Burr (R-NC). The prohibition against declines in accrued benefits due to indexing make it somewhat more difficult for cash balance plans to offer equity rates of return.
VESTING	An employee must have a nonforfeitable right to his accrued benefit under a defined benefit plan equal to either (i) 100% of his accrued benefit after five years of service or (ii) 20% of his accrued benefit after three years of service, with such percentage increasing by 20% for each additional year of service up to 100% after 7 years of service.	Requires vesting for cash balance plans and pension equity plans after 3 years. No option of graded vesting. *Effective Date*: For existing plans, effective for years beginning in 2008, subject to a delay for collectively-bargained plans.	It is unclear whether the new vesting rule will apply to pay credits that have already accrued or only to credits that accrue after the effective date. There are a number of questions about the impact of the new vesting rule where a plan has both hybrid and non-hybrid elements including, for example, where a plan provides participants with a choice between a traditional defined benefit and a hybrid plan benefit. The vesting language suggests the new 3-year rule will apply to the entire plan rather than to particular participants covered by the hybrid formula.
CONVERSIONS AND MANDATES	Although conversions are done in a variety of ways, a typical conversion involves assigning a participant an account balance under the new cash balance plan based on the value of the participant's benefit under the traditional pension plan. On a going forward basis, participants in the cash balance plan receive pay credits and earn interest on their entire account. Some participants in certain conversions, typically older or longer-service participants, have expressed concern that they will receive a pension benefit that is less than they expected under the traditional defined benefit plan formula.	To protect against wear-away, the accrued benefit as of the date of the conversion cannot be less valuable than the sum of the accrued benefit under the pre-conversion plan terms plus the accrued benefit under the new hybrid formula. *Pop-Up*. Any early retirement subsidy under the pre-conversion formula must be credited to the new account balance if a participant terminates and becomes eligible for the subsidy. *Effective Date*: Effective for conversions adopted after, and taking effect after, June 29, 2005. Provides that no	The anti-wear-away requirements are strictly limited to conversions to cash balance and pension equity plans. This is not a blanket prohibition against wear-away. The earlier House bill (H.R. 2830) included a parenthetical that appeared to bless the inclusion of transition credits as a permanent part of opening account balances to reflect all or a part of the value of early retirement subsidies. This parenthetical was not included in PPA, raising questions about whether such a practice could be considered age discriminatory.

ISSUE	PRIOR LAW	PENSION PROTECTION ACT[1]	COMMENTS
	Pre-PPA law does not protect employee expectations but does provide participants with two protections. First, ERISA section 204(h), which was strengthened in the 2001 tax act, requires comprehensive advance notice of a reduction in the rate of benefit accrual. Second, both ERISA and the Code provide that a participant's accrued benefit for services already performed may not be reduced.	inference should be made as to conversions prior to the effective date.	PPA does not specify actuarial assumptions to be used if the accrued benefit as of the date of the conversion is established as an opening account balance. The scope of the pop-up provision is unclear. Under one interpretation, it is merely a restatement of the anti-cutback rule. This interpretation would seem to allow any subsidy earned to be paid out as part of the accrued benefit earned under the prior plan formula. Under another interpretation, the pop-up provision only applies if the opening account balance in a conversion reflects the value of benefits accrued under the pre-conversion formula.
RULES FOR TERMINATING HYBRID PLANS	There are no unique rules regarding the termination of a hybrid plan.	Provides rules for making determinations of benefits upon termination. Specifically provides that, upon plan termination, a plan must provide the following: (1) if the interest credit rate (or equivalent amount) under the plan is a variable rate, the rate of interest used to determine accrued benefits under the plan is equal to the average of the rates of interest used under the plan during the five-year period ending on the termination date, and (2) the interest rate and mortality table used to determine the amount of any benefit under the plan payable in the form of an annuity payable at normal retirement age is the rate and table specified under the plan for such purposes as of the termination date. Note: For purposes of (2), if the rate of interest is a variable rate, then the rate is the average of such rates during the five-year period ending on the termination date.	