

Committee on Ways and Means

H.R. 2830, the *Pension Protection Act of 2005* Summary of Managers' Amendment

Enhancing Retirement Savings in IRAs and Pension Plans

- Makes permanent the IRA and pension provisions enacted under the *Economic Growth and Tax Relief Reconciliation Act of 2001*. The 2001 law increased annual contribution limits for IRAs and qualified pension plans, created additional “catch-up” contributions for individuals age 50 and older, and created incentives for small employers to offer pension plans.
- Permanently extends the saver’s credit, which is scheduled to expire after December 31, 2006. In addition, taxpayers could choose to have the IRS directly deposit the credit to a savings account, IRA or pension plan.
- Encourages employers to automatically enroll workers in defined contribution (DC) pension plans. Employees would be given the option to opt-out. Many pension experts believe that automatic enrollment will increase pension participation and retirement savings.
- Waives the 10-percent early distribution penalty for public safety employees who participate in governmental pension plans with a delayed retirement option plan (DROP) benefit feature.
- Waives the 10-percent early distribution penalty for military reservists and national guardsmen who are called to active duty for at least 180 days. Withdrawn amounts may be repaid to the IRA or pension plan within two years of the distribution without regard to the annual contribution limits.
- Expands IRA eligibility for members of the military by treating combat pay as earned income for purposes of IRA contributions. Combat pay would continue to be tax-free.
- Directs the Treasury to provide for “split tax refunds” in which taxpayers may direct all or a portion of their tax refund to be automatically deposited to an IRA of their choice.
- Allows tax-free rollovers from the IRA or pension of a deceased individual to an IRA or pension of a designated beneficiary. Under current law, such transfers are tax-free only if made to the account of a spouse.
- Allows disabled individuals to contribute to an IRA even if they do not have earned income, thus increasing retirement savings opportunities for individuals with disabilities.

Affordability of Health Care and Long-Term Care

- Allows public safety officers who retire or become disabled to make tax-free distributions of up to \$5,000 annually from governmental pension plans if the distribution is used to purchase health or long-term care insurance.
- Encourages the development of combination insurance products, which provide consumers with various insurance protections in a single product while also providing a saving feature. Combination products may be more attractive to consumers and less expensive.
- Allows taxpayers to carry forward up to \$500 of unused Flexible Spending Account (FSA) balances each year. The provision applies to health care FSAs and dependent care FSAs. In the case of health care FSAs, the unused amount may be transferred to a Health Savings Account.

Funding Reforms for Single Employer Pension Plans

Strengthens the outdated funding rules to ensure that workers' traditional defined benefit (DB) pensions are adequately funded.

- Employers must fund up to 100 percent of their pension liabilities. Funding shortfalls must be filled within seven years. Current law requires employers to fund only 90 percent of their liabilities (80 percent in some cases) and provides for amortization periods as long as 30 years.
- Liabilities must be measured using three interest rates calculated from a corporate bond yield curve. A yield curve approach improves accuracy by using short-term rates to measure short-term liabilities and using longer-term rates to measure longer-term liabilities. Current law requires use of a single interest rate regardless of when benefit obligations are due. This results in inadequate funding by some plans and over-funding by others. The current-law corporate bond rate is extended by one year until the modified yield curve begins to phase in.
- Requires use of updated mortality tables and allows plans to apply for use of a substitute table if the mortality experience of their workforce is unique.
- Severely underfunded plans are subject to accelerated funding rules to reduce the risk of plan termination with inadequate funding.
- Underfunded pension plans cannot increase benefits or pay plant shutdown benefits unless those liabilities are paid for up front. This prevents the employer from digging a deeper hole by promising new benefits when it can't afford to pay benefits that have already been earned.
- Plans that are less than 80-percent funded cannot use credit balances to avoid minimum required contributions. In addition, the use of credit balances is reformed so that plans cannot use credit balances to offset both current and future liabilities at the same time.

- Employers are prohibited from funding executive compensation plans when pension plans of rank-and-file workers are severely underfunded. As under current law, executive compensation is not protected if the employer files for bankruptcy.
- Creates incentives to increase pension contributions during profitable years.
- Gradually increases the flat-rate premium paid to the Pension Benefit Guaranty Corporation (PBGC) from \$19 to \$30 per participant and indexes the premium annually to reflect wage growth. In addition, employers that terminate their plans in bankruptcy must pay a \$1,250 premium per participant for three consecutive years once they emerge from bankruptcy.

Funding Reforms for Multiemployer Pension Plans

- Most amortization periods for multiemployer plans are reduced from 30 years to 15 years.
- The maximum tax-deductible funding limit is increased from 100 percent of the full funding limit to 140 percent of current liability, thus encouraging increased pension contributions during profitable years.
- Triggers are used to identify financially troubled plans and to measure financial improvement.
 - Plans with a funding status between 65 and 80 percent are deemed to be endangered (“yellow zone”). The trustees must adopt a financial plan to improve funding by one-third within 10 years (or by one-fifth within 15 years, in some cases).
 - Plans that are less than 65 percent funded are deemed to be critical (“red zone”). Trustees must adopt a reorganization plan to exit the red zone within 10 years. The plan must include a combination of measures to reduce costs and increase contributions.

Providing Legal Certainty to Hybrid Pension Plans

Clarifies current law by creating a uniform age discrimination standard for all DB plans.

- A plan is not age discriminatory if an employee’s entire accrued benefit is equal to or greater than that of a similarly situated younger worker in the plan.
- The bill also clarifies that an accrued benefit under a hybrid pension plan may be calculated as the worker’s current account balance or the current value of the accumulated percentage of the employee’s final average compensation.
- Clarifies that hybrid pension plans are not bound by the so-called “whipsaw” method for calculating minimum lump sum payments. This flawed methodology can harm plan participants, and penalize workers who wait until normal retirement age to collect their pension benefits.

Other Provisions

- Creates new notice and disclosure requirements for single and multiemployer pension plans to provide better and timelier information to workers, retirees and the PBGC about the financial condition of the plan.
- Offers employers the option to give employees access to professional investment advice. Fiduciary safeguards are created to protect workers from potential conflicts of interest. In addition, fiduciary responsibilities are clarified by providing that the fiduciary advisor, not the employer, is liable for the advice given.
- Encourages employers to offer lifetime annuities as a distribution option from defined contribution pension plans by clarifying the standards that apply to annuity selection. Specifically, the bill directs the Secretary of Labor to issue regulations to clarify that the selection of an annuity as a form of distribution from the plan is subject to the current applicable fiduciary standards under the Employee Retirement Income Security Act (ERISA).
- Clarifies that health plans may recover benefits paid to a participant once the participant is reimbursed by a third-party for the same expenses. For example, if a health plan pays medical expenses on behalf of a participant who was injured in an automobile accident, the provision ensures that the health plan can be reimbursed for the benefits paid once the participant recovers medical expenses from the third person (e.g., an automobile insurer).
- Allows sponsors of participant-directed 401(k) plans to modify investment options when a pension plan changes administrators or replaces existing investment options. To keep participants invested in funds that meet their investment needs, the bill requires plans to inform participants that if no contrary instruction is given, the portion of their accounts invested in the fund being eliminated will be “mapped” to a designated fund with similar investment or risk/reward characteristics. If, in fact, no instruction is given, fiduciary protection is provided for when investment options are changed.