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Subject: **Pension Reform (With COLI Best Practices Provision) Moves Forward**

Major References: [*Comparison of the Provisions of The Pension Protection Act of 2005 and The Pension Security and Transparency Act of 2005 Prepared by the Staff of the Joint Committee on Taxation*](#)

Prior Washington Reports: 05-126; 05-125; 05-117

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In their first meeting, which was held within the past few days, House and Senate conferees set out an ambitious schedule with the goal of reconciling by the end of March the provisions of the Pension Protection Act of 2005 ("House Bill") and the Pension Security and Transparency Act of 2005 ("Senate Bill").

The conference process is finally underway after a two-week delay during which Republicans and Democrats wrangled over the number of members to be appointed to the conference committee. Conference Chairman Enzi (R-WY) and Senate Finance Committee Chairman Charles Grassley (R-IA) are urging conferees to work across party lines to ensure that deliberations are completed by March 31, and that the conference report is ready for final votes by April 7, the day before Congress recesses until April 24.

Meeting the April 7 deadline is viewed as being critical in that it is the last opportunity for Congress to act prior to April 15, the date on which employers are required to make their first quarterly pension plan contributions. Prior to January 1, 2006, employers' pension liabilities were determined using a formula that blended various corporate bond rates. Effective January 1, however, this blended rate was replaced with the 30-year Treasury rate, which increases liabilities. It is thought by pension experts who have considered the matter that, unless Congress takes action before April 15, employers will be forced to use the 30-Year Treasury rate to calculate pension liabilities, thereby driving up their required contributions.

Issues For Conference

As discussed in detail in our *Bulletin No. 05-126*, there are a number of differences between the House and Senate Bills that must be resolved in conference. Summarized below are unresolved issues that may be of particular relevance to AALU members.

1. COLI Best Practices. As we reported in December (our *Bulletin No. 05-125*), the COLI provision was not included in the House legislation, but is part of the Senate Bill. AALU continues to believe that the COLI provision has a good chance of surviving conference because it is "revenue negligible," and enjoyed significant bipartisan support when introduced in the House as stand-alone legislation last year.
2. Nonqualified Deferred Compensation Funding. Both the House and Senate Bills include language imposing restrictions on the funding of nonqualified deferred compensation plans if a company's defined benefit plan is underfunded. AALU has, and will continue to, express our concerns about these funding restrictions and will urge conferees to exclude the provisions from the legislation, or, at a minimum, narrow their scope and application.
3. Benefit Restrictions on Underfunded Plans. The House and Senate Bills each contain provisions that impose benefit restrictions on underfunded plans.
4. Airline Industry Relief. In December, we reported that proponents of funding relief for the airline industry would have to battle on two fronts to save the extended 20-year amortization period provided under the Senate Bill, as such relief was not included in House Bill and is opposed by the Administration. While the Administration continues to oppose all industry-specific relief (see discussion below), the House appears to have reconsidered its position. On March 7, the House approved by a non-binding vote of 265-158 a motion sponsored by George Miller (D-CA), ranking Democrat on the House Education and Workforce Committee, which instructs conferees to accept Senate Bill provisions aimed at protecting airline workers, including extension of the amortization period and a prohibition on early retirement benefit cuts for pilots who are forced under Federal Aviation Administration regulations to retire at age 60.

The motion further instructs House negotiators to ensure that the conference report: (i) imposes the minimum additional funding requirements permitted on companies that sponsor pension plans if there is no reasonable likelihood the termination of the plan would impose additional liabilities to the PBGC or there is no reasonable likelihood the plan sponsor would terminate the plan in bankruptcy; (ii) makes the Savers' credit permanent; and (iii) retains the House position allowing tax refunds to be sent directly to an IRA.
5. EGTRRA Provisions. The House Bill would make permanent provisions under the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), which 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. The Senate Bill would not extend the provisions, which are scheduled to sunset in 2010.
6. Cash Balance/Hybrid Provisions. Cash balance plans continue to be a point of contention among members of Congress, as well as members of the business community. The Senate Bill includes provisions that: (a) address age discrimination under cash balance plans; (b) impose interest credit and vesting requirements on cash balance plans; (c) describe how lump sum benefits should be determined; and (d) outline requirements for conversions to cash balance plans. The House Bill includes similar provisions that would create a uniform age discrimination standard. As all cash balance provisions in the House and Senate Bills provisions would apply only prospectively, any resolution of the age discrimination issue in this round of pension legislation will do little to resolve the ongoing disputes over previous cash balance conversions.
7. Investment Advice. Under current law, employers are discouraged from providing defined contribution plan participants with access to professional investment advice because fiduciary responsibilities are unclear and prohibited transaction laws may prevent plan administrators from offering advice to plan participants. Both the Senate and the House Bills include provisions intended to encourage plan sponsors to provide employees with

such access. The Senate Bill provides for a safe harbor that would shield employers from liability if they comply with certain procedures with respect to the designation and monitoring of investment advisors. The House Bill would establish a new exemption from ERISA's prohibited transaction provisions for the retention of investment advisors who meet certain standards. The National Association of Insurance and Financial Advisors ("NAIFA") strongly supports the House Bill provisions, which it believes help to address the "advice gap" enabling NAIFA members who represent 401-k-type plans to provide investment advice to plan participants. NAIFA, however, does not support competing provisions in the Senate Bill, which fail to establish an exemption from ERISA's prohibited transaction provisions.

8. DB-K Plans. The Senate Bill includes provisions that would allow an employer who employs at least two, but no more than 500, employees during the preceding plan year to establish an eligible combined plan, which has come to be referred to as a "DB-K Plan." A DB-K Plan is a plan consisting of a defined benefit plan and a section 401(k) plan, the assets of which are held in a single trust with the assets of each plan clearly identified and allocated to the respective plan. A minimum benefit would be required to be provided under the defined benefit component of the plan, and a reduced safe harbor matching contribution would apply under the plan's 401(k) component. The requirements otherwise applicable to the defined benefit plan and section 401(k) plan would continue to apply. The DB-K plan would be treated as a single plan for purposes of reporting and disclosure requirements. The House Bill does not contain a similar provision.

9. Miscellaneous. Other significant differences to be resolved in conference include:

- (i) Provisions in the House Bill providing for flat rate PBGC premiums;
- (ii) Conflicting provisions in the House and Senate Bills concerning elective contributions under automatic enrollment arrangements and interest rates used to calculate the minimum value of lump sum payments; and
- (iii) Language in the House Bill affording employers broader discretion to reduce or terminate through collective bargaining "non-basic" retirement benefits (*e.g.*, early retirement benefits and life insurance).

Administration Views

Remarks recently made by Assistant Secretary of the Treasury, Mark J. Warshawsky to members of the DC Bar served as a reminder of the veto threat that continues to hang over the proposed legislation. As we reported in our *Bulletins Nos. 05-117* and *05-126*, the Administration issued warnings following passage of the House and Senate Bills that the President's senior advisors would recommend a veto if the net effect of the conference report is to weaken funding requirements for pension plans relative to current law. Warshawsky reiterated this position, indicating that the Administration is still "concerned that the reforms currently being considered by Congress are inadequate and that stronger action is needed to improve the protection of pension benefits, to ensure the integrity of the pension insurance system, and to avert a taxpayer bailout." In this regard, Warshawsky identified a number of issues with respect to which "there are significant differences between the House and Senate Bills and the Administration's proposal," including:

- Overly long phase-in/transition periods;
- Continued use of inaccurate measurements of pension assets and liabilities and mortality tables that do not recognize expected future increases in longevity;
- Lack of any effective mechanism to increase the funding requirements for pension plans with financially weak sponsoring firms;
- Continued use of credit balances; and
- Inclusion of industry-specific (*i.e.*, airlines) and administrative workout programs.

Warshawsky, however, did recognize that the House and Senate Bills incorporated some of the Administration's key provisions, including: (i) increased funding targets for pension plans; (ii) reduced

amortization period for increases in pension underfunding; and (iii) required use of a (modified) yield curve to compute pension liabilities and lump-sum distributions. He also endorsed the combination insurance products included in the House Bill, as discussed below.

Combination Insurance Products

A “combination insurance product” combines an immediate life annuity with the disability form of long-term care insurance. In return for a single premium, an insurance company makes steady periodic payments to a retired household, increasing such payments when a member of the household becomes disabled, to the extent that such individual requires long-term care services. The House Bill would allow long-term care insurance policies to be considered tax-qualified when purchased as a rider on an annuity. Thus, tax benefits given to long-term care policies will not be denied to policies purchased in conjunction with the annuity. In addition, because annuities and long-term care policies are subject to different tax treatments, the investment in the annuity is reduced by the premium for the long-term care policy, and charges against the annuity for long-term care expenses are excluded from gross income. This allows the two parts of the policy to be treated, for income tax purposes, similar to stand-alone policies.

AALU will continue to work for the enactment of the COLI Best Practices provision and will keep you apprised of relevant developments as the conferees work to reconcile the House and Senate Bills over the next few weeks.

Any AALU member who wishes to obtain a copy of the side-by-side Comparison of the Provisions of the House and Senate Bills may do so through the following means: (1) use hyperlink above next to "Major References," (2) log onto the AALU website at AALU.org, enter the *Member Portal* and select *Current Washington Report* for linkage to source material or (3) email Jeff Lavine at lavine@aalu.org and include a reference to this *Washington Report*.

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