

## Summary of S. \_\_\_\_\_

### National Employee Savings and Trust Equity Guarantee Act (NESTEG)

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#### I -- DIVERSIFICATION OF PENSION PLAN ASSETS

*A. Defined contribution plans required to provide employees with freedom to invest their plan assets.*

The bill generally provides that publicly held companies must allow workers to divest themselves of company stock attributable to employer contributions once they have completed 3 years of service. Accounts attributable to employee contributions could be diversified immediately. There is a 3-year phase-in for stock contributed to employer accounts in previous years, except participants who are 55 years old with 3 years of service can diversify immediately. Only free-standing Employee Stock Ownership Plans and single-participant plans are exempt from the requirement.

*B. Notice of freedom to divest employer securities or real property.*

Participants must be notified of the right to divest at least 30 days before the date the participant is first eligible to do so. The notice will describe the importance of diversification. A model notice will be prescribed by the Secretary. Penalties apply to failure to give notice.

#### II -- INFORMATION TO ASSIST PENSION PLAN PARTICIPANTS

*A. Periodic pension benefit statements.*

The bill requires quarterly benefit statements for defined contribution plans that allow workers to direct their own investments, annual statements for plans that do not allow worker investment direction, and once every 3 years to workers in defined benefit plans. In addition to the market value of investments, individually directed plan participant statements would include a description of any restrictions on the right to direct investments, and a notice that investments may not be adequately diversified if over 20% of the account is in one investment.

*Defined contribution plans required to provide adequate investment education to participants.*

All workers must receive annual investment guidelines and retirement planning information. The Secretary of Labor will develop a model form, worksheet and internet calculators.

*B. Duty to provide material information relating to investment in employer securities.*

The bill requires sponsors of defined contribution plans to make sure that all material information the employer is required to disclose to investors under the securities laws also be provided to

workers concerning investments in company stock in the worker's account.

### **III -- PROTECTION OF PENSION PLAN PARTICIPANTS**

#### *A. Notice to participants or beneficiaries of blackout periods.*

An excise tax is added to the Code for failure to provide a blackout notice. Minor corrections to the ERISA provision added in Sarbanes Oxley are also included.

#### *B. Inapplicability of relief from fiduciary liability during suspension of ability of participant or beneficiary to direct investments.*

The bill would provide that the person authorizing or implementing a blackout period arising from a change in investments would not be liable for investment losses if the participant has the opportunity to make an affirmative election before the blackout period, or assets are transferred to default options specified in the notice in the absence of an election, provided the blackout was reasonable under the circumstances and no other fiduciary duties were violated.

#### *C. Liability for breach of fiduciary duty.*

Insiders of publicly traded companies that hold employer securities in individual account plans will be held personally liable like a fiduciary if they knowingly participate in a breach of fiduciary responsibility, or participate in concealing a breach. Recent court decisions have raised uncertainty about the extent to which plan participants may sue a fiduciary on their own behalf to recover losses to their pension plan accounts. The bill clarifies the individual's right to sue.

#### *D. Increase in maximum bond amount.*

Under current law, fiduciaries are required to post a bond equal to 10% of the funds they handle, but not to exceed \$500,000. Fiduciary bonds are designed to cover losses stemming from fraud or dishonesty by plan officials, and the maximum bonding cap has not been raised since the mid-1970s. The bill increases the bond cap to \$1 million for plans containing employer stock.

#### *E. Provisions relating to whistleblower actions involving pension plans.*

Outsiders reporting of pension plan violations would be added to whistleblower protections.

#### *F. Increase in penalties for coercive interference with exercise of ERISA rights.*

Sarbanes Oxley provided stricter penalties for reporting failures than existed for active interference. This provision aligns the two.

### **IV -- OTHER PROVISIONS RELATING TO PENSIONS**

#### *General Provisions*

##### *A. Employee plans compliance resolution system.*

The Employee Plans Compliance Resolution System (EPCRS) allows plan sponsors to correct operational violations with regard to qualified retirement plans without risking plan disqualification. Treasury is directed to update and improve the program with regard to small business plan sponsors.

*B. Extension to all governmental plans of moratorium on application of certain nondiscrimination rules applicable to State and local plans.*

All government plans would be treated like state and local government plans for purposes of not having to comply with certain non-discrimination rules.

*C. Notice and consent period regarding distributions.*

The bill extends the benefit election period from 90 days to 180 days. In addition, participants must be notified of the right to defer payment, if deferral is available and of the impact of failing to defer payment.

*D. Technical corrections to SAVER Act.*

Date and committee name changes regarding the National Summit.

*E. Missing participants.*

PBGC has maintained a “Missing Participant Program” that holds and pays benefits to missing participants of terminated single-employer defined benefit plans covered by PBGC, but other plans have had no help available. The bill would extend this program to terminated plans of private employers not covered by PBGC, including defined contribution plans. PBGC would also be directed to set up a similar program for multiemployer plans.

*F. Reduced PBGC premium for new plans of small employers.*

Reduces the basic PBGC premium for new small employer (100 or fewer employees) plans from \$19 per person to \$5 per person for the first 5 years of the plan’s life.

*G. Authorization for PBGC to pay interest on premium overpayment refunds.*

Allows PBGC to pay interest on premium refunds at the rate charged for underpayments.

*H. Substantial owner benefits in terminated plans.*

Guaranteed benefits for majority owners (50% or more ownership) would phase in over 10 years. Existing law provides a phase in over 30 years for “substantial owners” (more than 10% owners.)

*I. Benefit suspension notice.*

Current rules would be modified to require individual notice to a retiree who returns to work and will have payments suspended, but allows including the notice in the Summary Plan Description,

rather than an individual notice, for other employees.

*J. Voluntary early retirement incentive and employment retention plans maintained by local educational agencies and other entities.*

This provision addresses two issues that affect teachers: retirement plans for that provide retention bonuses, and plans that provide early retirement incentives. Retention bonuses would be treated as severance pay instead of deferred compensation, and early retirement incentives could be age-related.

*K. Automatic rollovers of certain mandatory distributions.*

This provision modifies a provision included in the pension section of the 2001 tax bill to direct the Department of Labor to provide regulatory safe harbors under which amounts transferred from a qualified retirement plan to an IRA in an automatic rollover are no longer plan assets for ERISA purposes.

*L. Extension of Transition Rule to Pension Funding Requirements*

This provision extended funding relief to Greyhound/Amalgamated Transit Union pension plan for 2 more years. This provision was enacted into law in H.R. 3108.

*M. Acceleration of computation of benefits attributable to recoveries of employer liability under section 4062.*

In order to expedite payments, PBGC would be permitted to estimate the amount of benefits payable to participants in PBGC-trusteed plans. Adjustments would be made when final calculations are available.

*N. Multiemployer plan explanation notice.*

Multiemployer plans would be required to provide a notice to participants annually, among other items, the current funded status of the plan and a description of PBGC benefit guarantees.

*O. No reduction in unemployment compensation as a result of pension rollovers.*

States would be prohibited from treating rollovers as income in determining unemployment compensation.

*P. Withholding on distributions from governmental section 457 plans.*

Grandfather's certain distributions, exempting them from withholding requirements imposed by EGTRRA.

*Q. Minimum cost requirements.*

Well-funded defined benefit plans can transfer assets to accounts used to provide post-retirement

medical benefits (“420 transfer”). In order to use this provision, the health benefits cannot generally be reduced. Regulations allow two 10% reductions in the covered group within a 5-year period. This provision would allow a scaleback in benefits of the same magnitude, instead of a reduction in the number of covered beneficiaries.

*R. Coordination of State retirement systems with Social Security.*

Adds Kentucky to the list of states permitted to have covered and non-covered employees in same plan. This provision was enacted into law in H.R. 743.

*S. Temporary Replacement of Interest Rates on 30-Year Treasury Securities Used for Certain Pension Plan purposes*

The interest rate used for funding requirements and PBGC premiums is changed for plan years beginning after December 31, 2003 . For years beginning before December 31, 2006, the proposal replaces the 30-year Treasury rate with the rate of interest on amounts conservatively invested in long-term corporate bonds. For funding purposes, the maximum permissible rate will be 100% of the 4 year weighted average of this rate. A similar provision, effective for only two years, was enacted into law in H.R. 3108.

For plan years beginning after December 31, 2006, the interest rate used for purposes of funding requirements, PBGC premiums and determining lump sum distributions is based on a yield curve reflecting interest rates on corporate bonds of various durations. Under the proposal the yield curve is phased in at a rate of 20 percent each year over five years. During the phase in period, the rate used is based on a combination of the yield curve and the previously applicable rate. For determining funding requirement and PBGC premiums, the previously applicable rate is the rate of interest on amounts conservatively invested in long-term corporate bonds. For purposes of determining lump sum distributions, the previously applicable rate is the 30-year Treasury rate. The yield curve is completely phased in for years beginning after December 31, 2010.

The interest rate used to determine maximum benefit payment will be fixed at 5.5%. For 2004 through 2005, the maximum benefit will be the greater of the benefit at 5.5% or at the 30 year Treasury rate on the last day of the plan year beginning before January 1, 2004. A similar provision was enacted into law in H.R. 3108.

If a deficit reduction contribution was not required to be made to a plan for the plan year beginning after December 31, 1999, and before January 1, 2001, deficit reduction contributions are not required to be made to the plan for plan years beginning after December 31, 2003 and before December 31, 2006.

To allow employers to contribute more in good times, the maximum deductible contribution to a defined benefit plan would be increased to allow employer to fund up to 130% of current liability instead of the current 100%.

Plans of employers with junk bond ratings will have to freeze accruals if vested benefits are less than 50% funded. These plans will also be prohibited from making lump sum payments in excess

of \$5,000. The freeze applies to negotiated plans on the first day of the next collective bargaining agreement. For other plans, it applies on the first day of the next plan year.

The Secretary of the Treasury is directed to prescribe by regulations a method for determining the rates of interest. The Treasury Department is also directed to issue recommendations for changes in funding rules to strengthen funding, and disclosure of funded status.

#### *T. Studies*

*Study regarding fees charged by individual account plans.*

*Joint study on revitalizing defined benefit plans.*

*Study on floor-offset ESOPS.*

#### *U. Purchase of Permissive Service Credit.*

This provision clarifies rules regarding purchase of service credit from a sec. 403(b) annuity or a sec. 457 plan to a governmental defined benefit plan. Purchase of service is permitted by participants in these plans. In the case where service is performed as an employee of an educational organization providing elementary or secondary education, service can be determined under the law of any State or nation.

#### *V. After Tax Rollovers.*

The provision provides that after-tax contributions may be rolled over from a qualified retirement plan to another qualified retirement plan (either defined benefit or defined contribution).

#### *W. Additional Catch-Up Contributions for Certain Individuals*

An eligible individual would be permitted to make additional contributions to an IRA up to \$1,500 per year in tax years 2003 through 2005 and \$3,000 in tax years 2006 and 2007. Eligible individuals were participants in a 401(k) or similar plan, with a matching contribution from a currently bankrupt employer, and the employer is currently under indictment or subject to conviction.

#### *X. Distributions by an S Corporation to an Employee Stock Ownership Plans*

An ESOP maintained by an S Corporation will not be prohibited from repaying a loan that was used to acquire stock with distributions from the S Corp to the ESOP.

#### *Y. Applicable Minimum Distribution Rules to Governmental Plans.*

The proposal directs the Secretary of the Treasury to issue regulations under which a governmental plan is treated as complying with minimum distribution rules, for all years to which such requirements apply, if the plan complies with good faith interpretation of the statutory requirements.

#### *Z. Plan Amendments*

Provisions relating to plan amendments.

## **V -- PROVISIONS RELATING TO EXECUTIVES AND STOCK OPTIONS**

### *Provisions Relating to Executives*

*A. Repeal of 1978 Revenue Act limitation on Secretary of the Treasury's authority to determine year of inclusion of amounts under private deferred compensation plans.*

Repeals the 1978 Revenue Act limitation on Treasury's ability to issue regulations regarding executive compensation.

*B. Treatment of nonqualified deferred compensation plans.*

This provision prohibits deferred compensation plans from permitting distributions to the executive except for 1) death; 2) disability; 3) separation from service; 4) a specified time; 5) an unforeseeable emergency; and 6) change of control, in certain circumstances. When a distribution is made due to change of control, if the individual to whom the distribution is made would be subject to sec. 16(a), of the Securities and Exchange Act of 1934 the distribution is subject to a one year holding period and the golden parachute excise tax.

If a distribution is made pursuant to an impermissible arrangement, the individual to whom the distribution is made would be subject to income tax, interest at the underpayment rate and a 10% penalty. Investment direction for deferred compensation arrangements must be comparable to those of rank and file workers in their defined contribution plan.

The legislation generally provides that funds in an offshore trust will be deemed not to be subject to the claims of creditors, and generally the funds will be taxed. An exception would be provided for situations where the employee for whom the trust is established provides personal services in the foreign jurisdiction.

*C. Denial of Deferral of Certain Stock Option and Restricted Stock Gains.*

Deferral of income tax beyond the date of exercise of stock options would not be permitted.

*D. Increase in Withholding From Supplemental Wage Payments In Excess Of \$1,000,000.*

This provision increases the withholding rate to the highest marginal tax rate on supplemental pay over \$1 million.

## *Stock Options*

### *E. Exclusion Of Incentive Stock Options And Employee Stock Purchase Plan Stock Options From Wages.*

This provision provides for no taxation of the exercise of an incentive stock option (ISO) or under an employee stock purchase plan (ESPP), consistent with a recent Treasury announcement of an indefinite moratorium on requiring withholding of FICA and FUTA on ISOs and ESPPs.

### *F. Treatment Of Sale Of Stock Acquired Pursuant To Exercise Of Stock Options To Comply With Conflict-Of-Interest Requirements.*

The modification eliminates the holding period requirement for capital gains treatment with respect to ISOs and ESPPs for executive branch appointees and nominees who are required to divest these holdings. Current law requires them to hold the options for two years after the granting of the option, or one year from the exercise of the option, to receive this treatment.

## **VI -- WOMEN 'S PENSION PROTECTION**

### *A. Study of Spousal Consent for Distributions From Defined Contribution Plans*

Joint study of application of spousal consent rules to defined contribution plans.

Authorizes a study of the feasibility of authenticated electronic spousal consent, and whether pension plan rules need modification for application to profit sharing plans.

### *B. Division of Pension Benefits Upon Divorce Treatment of subsequent qualified domestic relations orders.*

This section is intended to clarify that a domestic relations order issued subsequent to a divorce can be a Qualified Domestic Relations Order (QDRO).

### *C. Railroad Retirement*

*Entitlement of divorced spouses to railroad retirement annuities independent of actual entitlement of employee.*

Extension of tier II railroad retirement benefits to surviving former spouses pursuant to divorce agreements.

### *D. Modifications of Joint and Survivor Annuity Requirements*

*Modifications of joint and survivor annuity requirements.*

Mandates an alternative joint and survivor annuity option under pension plans that do not fully subsidize the qualified joint and survivor annuity.

## VII -- TAX COURT

Conforms retirement and benefit programs of the Tax Court to those of Article III Courts.

## VIII -- OTHER PROVISIONS

### *A. Exclusion of education benefits provided by employers to children of employees.*

This section permits employers to provide educational benefits to the children of their employees. Employers could provide up to \$2,000 in scholarships to children of their employees pursuant to section 127 of the Code (“educational assistance programs”). The benefits would be excludable to the employee, subject to the annual aggregate limit of \$5,250.

### *B. Exclusion from Gross Income for Amounts Paid under National Health Service Corps Loan Repayment Program*

Excludes from gross income and employment taxes education loan repayments provided under the NHSC Loan Repayment Program and similar state programs.

### *C. Temporary Exclusion for Group Legal Services Benefits*

Reinstates for one year the exclusion from income of employer-provided group legal services.

### *D. Transfer of Funds from Black Lung Trust Fund to Combined Benefits Fund*

Eliminates the aggregate limit on the amount of excess black lung benefit trust assets available to pay premiums, and transfers the additional amounts available to the UMWA Combined Benefit Fund.

### *E. Extension of Provision Permitting Qualified Transfers of Excess Pension Assets to Retiree Health Accounts*

Extended the ability of well-funded defined benefit plans to transfer assets to pay for retiree health costs (Sec. 420) through 2013. This provision was enacted into law in H.R. 3108.

### *F. Determination of Basis Amounts Paid from Foreign Pension Plans*

Ensures that an amount distributed from a foreign pension plan is included in the calculation of the recipient’s basis only to the extent that the recipient previously has been subject to taxation on such amount, either in the United States or the foreign jurisdiction.

### *G. Modify Qualification Rules for Tax-Exempt Property and Casualty Insurance Companies*

Under this provision tax-exempt status is only available if (a) gross receipts for the taxable year do not exceed \$600,000, and (b) the premiums received for the taxable year are greater than 50 percent of gross receipts. In addition, the definition of insurance company for property and casualty companies was conformed to the definition used for life insurance companies. This

provision was enacted into law in H.R. 3108.

*H. Tax Treatment of Company-Owned Life Insurance (“COLI”)*

Limits the availability of tax-free proceeds on company-owned life insurance, and provides disclosure and reporting requirements.

*I. Reporting of Certain Taxable Mergers and Acquisitions*

Requires additional reporting to Treasury if gain or loss is recognized by shareholders of one corporation due to acquisition of the stock or assets of another corporation.