EXECUTIVE COMMITTEE MEETING

(S. 321, S. 724, S. 1971)

THURSDAY, JULY 11, 2002

U.S. Senate,

Committee on Finance,

Washington, DC.

The meeting was convened, pursuant to notice, at 10:10 a.m., in room 215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Also present: Senators Rockefeller, Breaux, Graham, Jeffords, Bingaman, Lincoln, Grassley, Murkowski, Nickles, Gramm, Snowe, and Thomas.

Also present: John Angell, Staff Director; Mike Evans, Chief Counsel and Deputy Staff Director; Kolan Davis, Republican Staff Director and Chief Counsel; Carla Martin, Chief Clerk.

Also present: Lindy Paull, Chief of Staff, Joint Committee on Taxation; Barbara Olson, U.S. Treasury Department; Maria Freese, Tax Counsel; Mark Prater, Chief Tax Counsel; Alan Cohen, Chief Social Security Analyst; Kate Kirchgraber, Professional Staff Member; Hope Cooper, Health Policy Advisor.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA, CHAIRMAN, COMMITTEE ON FINANCE

The Chairman. The committee will come to order. Today we are to mark up two bills. The first would expand health insurance coverage to an honorable and highly deserving group.

The second will reform the pension rules as a response to the problems at Enron and were broadly throughout the country. These are critical issues.

With respect to health insurance coverage we have attempted to schedule this mark-up several times over the last three months, now. It seems like some other issues are always more impressing, but we need to move forward. This is as good a time as any, particularly since we will need more time to move the bills to the floor.

With respect to pensions, our bill would complement the corporate accountability proposals that are currently being considered on the floor. Further, the President has urged us to move forward on pensions. By marking the bill up today, we will be in a position to take the bill to the floor and conference quickly.

With that background, let me discuss the bills. First, is the Family Opportunity Act, sponsored by Senator Grassley and co-sponsored by 74 other Senators, including 14 members of this committee.

Here is the problem. Medicaid is generally the only place disabled kids can get important health services, like speech and physical therapy, that will help improve their lives and keep them from getting sicker.

However, under current law, disabled kids lose their Medicaid coverage when their family's income and resource increase beyond the poverty level, and that is just over $18,000 for a family of four.

As a result, as Senator Grassley has noted, some parents are forced to turn down promotions or pay raises so that their disabled children can remain on Medicaid.

The Family Opportunity Act gives hard-working families a little extra support. Specifically, the bill gives States the option to expand Medicaid eligibility to disabled children, and under this bill a family of four earning up to $45,000 a year would remain eligible. This is an important, overdue bill, and I applaud Senator Grassley for his leadership in bringing it to this stage.

The second bill addresses a very different issue, but one that is equally important, protecting the integrity of the pension plans of American workers.

The issue first came to our attention with Enron, but that was only the beginning. Since then, Enron has been joined by other giants of American industry, Tyco, K-

Mart, Worldcom, and more recently, Xerox and Merck, all with questions about their accounting, all with thousands of workers at risk of losing their jobs and their retirement savings if the companies go bankrupt.

We have to nip this problem in the bud. The accounting bill on the Senate floor takes important steps. It addresses issues of transparency and accountability for companies, and does so in a bipartisan way.

Senator Grassley and I have attempted to do the same thing in the pension bill. It is not easy to do. Good pension policy requires a very delicate balance. Companies offer pensions voluntarily, so we need to be careful not to make the rules and regulations so burdensome that companies stop offering pensions.

I believe this bill strikes the right balance. It prevents companies from keeping workers locked into company stock in their retirement plans. At the same time, it allows workers to keep investing in company stock if they decide that is best for them.

We also give workers more tools, so that they really understand the consequences of their actions, such as benefit statements and better investment information. We require advanced warning about blackout periods so workers will not be forced to sit and watch helplessly as the value of their pension plan collapses. We require more information on insider trades by executives, and we address the issue of investment advice.

Let me say a few further things about this particular issue. I understand the frustration of members of the investment community who are precluded from offering investment advice to the workers of the plans that they administer.

But suspending the prohibited transaction rules to allow conflicted advice is very controversial. It is also contrary to the thrust of the rest of our efforts to restore confidence to workers and investors.

I hope to continue working with interested Senators and with the investment community to try to come up with a compromise that fully protects workers as we move to conference on this bill.

In the meantime, the bill creates a safe harbor for employers who want to offer independent investment advice that does not raise the same issues. This seems to be an appropriate first step toward resolving this issue over the coming weeks.

The Chairman's mark also deals with executive compensation. Earlier this week, President Bush called for an end to irresponsibility in the upper echelons of corporate America.

He said that responsible leaders should not collect huge bonuses while the company value declines. He said that they should not grant themselves generous payments as the company prepares for bankruptcy.

Accordingly, the executive compensation provisions of this bill are designed to provide further safeguards to ensure that companies and their officials act with integrity and with honesty.

We do two things. We require more transparency and we ensure that transactions between corporations and individuals are appropriately taxed.

Those are the two bills: pension reform, which includes safeguards for executive compensation, and health insurance for disabled kids. All told, these bills, I think, enjoy broad support, and I hope that we will vote to report them all favorably.

The committee was going to mark up a third bill, that is, pregnant women. Unfortunately, that bill is not ready for mark-up at this time and it will be, accordingly, marked up at a later date. But that bill will not be marked up today. It is not on the schedule.

Senator Grassley?

OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM IOWA

Senator Grassley. Thank you very much, Mr. Chairman. I am very pleased that the committee is holding a mark-up today on a bill that I introduced nearly three years ago. I want to take just a few minutes to talk a little bit about the history because I think it is important to understanding the need for the legislation.

For several years, Senator Kennedy and I have been working on this bill called the Family Opportunity Act to help children with disabilities and their families. The bill became popular in short order. You see the need for the legislation by the people that are lined up in the hall today, and the bill has so many co-sponsors because of the hard work of families and child advocacy groups.

The chart that you see will tell you the list of organizations that have officially endorsed this legislation.

More impressive than the list of organizations are the hundreds and hundreds of letters and calls sent by individual families to the Congress. And just in these binders are a sample of some of the hundreds, and I suppose now thousands, of letters that we have received in support of this legislation.

The combined efforts of individuals and advocacy organizations representing families with children with special health care needs have helped to persuade 74 Senators and over 235 Congressmen to join as co-sponsors of this legislation.

I think these numbers of co-sponsors are very extraordinary. I cannot remember many pieces of legislation that attracted so much support in such a short period of time.

It feels great to work on legislation that has such strong support for working families, because this bill is pro-family. It is meant to keep families together. This bill is pro-work because it lets parents work without losing their children's health care, and our bill is very pro-taxpayer because it lets parents earn money and helps pay their own way for Medicaid coverage for their child.

The legislation is necessary because a main objective in life is to provide for your child to the best of your ability. Our Federal Government takes this goal and turns it upside down under present policy for parents of children with special health care needs.

The government forces these parents to choose between family income and their children's health care needs, and that is a terrible choice for any family to have to make.

Families have to remain in poverty just to keep Medicaid. Obviously, this affects entire families, not just the child with the health care needs.

I became aware of the obstacles facing families from an Iowa family, the Arnold family. The Arnolds tell how their family was prevented from becoming self-sufficient and forces them to stay impoverished so that Adam Arnold could maintain Medicaid coverage. Without Medicaid, Adam, a young boy with multiple medical needs, would not have been able to access the health care services he needed.

Malissa Arnold, Adam's mother, has been forced to turn down promotions and raises in order to keep her earnings low enough for her son to qualify for Medicaid.

What is more, her oldest son, Daniel, was even prevented from working on his own initiative. Like so many teenagers, Daniel was eager to find part-time jobs, but because any earnings that Daniel might have from that job would have counted against his family income, it obviously would have jeopardized Adam's Medicaid status. Daniel was not able to work.

No hardworking family should have to choose between work and caring for a child. Why does the Family Opportunity Act choose Medicaid as a means of coverage? Because Medicaid services are so critical to the well-being of children with multiple medical needs. It covers a lot of services that these children need on a regular basis, such as physical therapy and medical equipment.

Private health plans often are much more limited in what they cover. Many parents cannot afford needed services and multiple co-payments out of pocket.

Our bill creates a State option--let me emphasize, a State option--which allows working parents who have a child with disability to keep working, keep paying taxes, and still have access to Medicaid for their child.

Parents would pay for Medicaid coverage on a sliding scale. They would buy in. No one would have to become impoverished or stay impoverished to secure this very expensive medical help for a child.

The legislation recognizes a universal truth: everybody wants to use their talents to their fullest potential. Most often, that is on the job and profession. But at the same time, every parent wants to provide as much as possible for his or her children and the government should not get in the way.

I think, Mr. Chairman, in regard to the latter bill, the pensions bill, I think you covered it so well. I think you and I are in agreement on the entire bill, so I will just put my statement in the record on the bill on pensions.

[The prepared statement of Senator Grassley appears in the appendix.]

The Chairman. Thank you.

Senator Gramm? Otherwise I will have the staff outline the bill. Senator Gramm?

Senator Gramm. Well, Mr. Chairman, I was going to ask the staff a question about the bill.

The Chairman. Why do I not have the staff outline the bill first, and you can ask the question at the appropriate time.

Ms. Cooper. There are four titles to the Chairman's mark on the Family Opportunity Act. Title 1 has a State option to allow families with a disability to buy in to Medicaid.

Under this option, States could set up a program where families with incomes up to 250 percent of the federal poverty level could pay a premium to Medicaid for coverage of services for a disabled child. Two hundred and fifty percent of the federal poverty level is $57,500 for a family of three, and $45,000 for a family of four.

There is a limited number of children who would be eligible to qualify for this option. According to CBO, the universe is approximately 200,000 children. In order to be eligible, the child must first be under 18 years of age and meet the disability definition for children in the federal statute under the Supplemental Security Income.

This federal definition for disabilities states that a child must have a medically determinable physical or mental impairment which results in marked and severe functional limitations and which can be expected to result in death, or which have lasted or can be expected to last for a continuous period of not less than 12 months.

Depending on the determination process, a child with cerebral palsy, Down Syndrome, or with a neurologic impairment such as spina bifida, may be able to meet the definition.

Title 1 of the Chairman's mark also addresses the interaction between employer-sponsored health coverage in Medicaid. For participating families, the State would require parents to enroll in employer-sponsored private family coverage when a parent is offered this such coverage under a group plan, and when the employer contribution is at least 50 percent of the annual premium costs.

In this case, the parent's private employer-sponsored health plan would serve as the primary insurer for the child. The parent could access services or buy in to Medicaid for services not covered under the employer plan. In this case, Medicaid service is a wrap-around to the private plan.

If a parent's employer does not offer an employer-sponsored coverage, the child may still be eligible to access this option if the child meets the disability and income guidelines.

Both families would pay a premium to Medicaid that is reflected on the coverage on behalf of the disabled child. This provision becomes effective October 1, 2004.

Title 2 of the Chairman's mark addresses 1915(c) of the Medicaid statute. This section of the statute provides States to seek waivers to provide home- and community-based services as alternatives to institutional care.

Specifically, these waivers allow States to provide alternative services to three types of institutional care, including hospitals, nursing homes, or intermediate care facilities for the mentally retarded.

The Chairman's mark proposes to include an additional institution to the list of three existing for which States can seek waivers to provide alternative services: inpatient psychiatric hospitals for individuals under age 21 would be included in this list.

This is a mental health parity issues in that it allows States to provide home- and community-based mental health services to children with mental illness as an alternative to psychiatric hospital care.

Title 3 of the Chairman's mark amends Maternal and Child Health, which is Title 5 of the Social Security Act. This provision establishes authority and funding for family-to-family health centers.

These centers would be modeled after successful demonstration programs and would assist families, providers, and other health professionals by providing resource and referral information.

The final title of the Chairman's mark addresses an administrative matter relating to the interaction between Medicaid and SSI. Under current law, exceptions to cases of 209(b) States which have more restrictive standards, individuals who receive SSI are automatically eligible for Medicaid. Persons eligible for SSI are low-income, and either aged, blind, or disabled.

For purposes of administration, SSI is first granted or paid out on the first day of the month following the date that the individual is actually determined to be eligible. Medicaid also begins on the date in which SSI is granted or paid out.

This provision would confirm Medicaid coverage with the actual date in which the individual was determined to be disabled rather than conforming with the first date of the month guideline.

Senator Nickles. Ms. Cooper, a question on that.

The Chairman. Senator Nickles?

Senator Nickles. Right now, a person would begin receiving SSI after the date that they were determined to be eligible.

Ms. Cooper. Yes.

Senator Nickles. And the Chairman's mark moves that earlier to what?

Ms. Cooper. The Chairman's mark does not actually do anything to SSI at all. What it does, is it allows Medicaid to begin paying the date that the child is determined to be eligible.

The first date of the month is used for administrative purposes for paying out the SSI checks, which may be, for instance, two or three weeks later than the date in which they actually became disabled. Usually this is best seen in the case of a newborn who might be born with a disability and spends time in a neonatal intensive care unit. SSI would not become available until the first date of the month following.

This would allow Medicaid to begin paying the date on which the newborn, in this case, is determined to be disabled. Therefore, it would be able to cover those hospital costs and that type of thing for these eligible children.

Senator Nickles. Right now, if you had a newborn who was severely disabled, and they were born on the 15th, they would not receive payment until the 1st?

Ms. Cooper. Right.

Senator Nickles. All right. Thank you.

Senator Gramm. Mr. Chairman?

The Chairman. Senator Gramm?

Senator Gramm. I do not guess anybody is here from CBO, so let me pose the question to you. One of the things that I have looked in trying to determine how much the bill costs--because other than cost there is no reason why anybody would be opposed to it--it seems to me there are sort of two ways of figuring costs. I would be interested in knowing how it was done.

One, is to simply take the number of people currently qualifying for Medicaid and projecting their income growth and determining their continued eligibility. Another way would be taking everybody in society that has children that would qualify that has an income level below the qualification level. Many of these families would never have been on Medicaid at all, never have been on SSI. Do you have any idea how they figured the cost?

Ms. Cooper. Well, they figured cost, I think, in several different ways. One, is they were able to capture the existing number of children who are eligible based on SSI.

Then in addition to that, there is a bracket of income above that for which the children are not eligible for SSI due to their income but otherwise would be, so they made estimations on that portion.

Senator Gramm. Do you know how they estimated? They assumed they would all qualify?

Ms. Cooper. No, they did not assume that they would all qualify. I think some of it also was related to the employer-sponsored health coverage provision in this bill. So, I do not know.

Senator Gramm. Do you have any idea what they did in terms of, let us say--what is your qualification family income?

Ms. Cooper. The maximum is 250 percent of poverty, which is $45,000 for a family of four.

Senator Gramm. Did they take into account the fact that if I were making $48,000 and I had a child with very substantial medical costs, that I would accept $45,000 to qualify?

Ms. Cooper. I do not understand the question.

Senator Gramm. The question is, I have a severely handicapped child and I am spending $11,000 a year out of my pocket for that child. If I renegotiate my employment contract and take $45,000, I qualify. I think I would figure that out and do it.

Ms. Cooper. All right.

Senator Gramm. I do not think anybody, if this is law, would criticize me or think that something was wrong with me for doing it. Do you know, did they make any assumptions about that?

Ms. Cooper. I believe it is their practice to take that into account, is what I am being advised.

Senator Gramm. Well, it would help, before we go to the floor, if you could get CBO to give us two or three pages on how they made this estimate.

Thank you, Mr. Chairman.

The Chairman. Are there any questions?

Senator Nickles. Mr. Chairman?

The Chairman. Senator Nickles?

Senator Nickles. Just, again, trying to figure out. Senator Grassley makes a very compelling argument. I do not remember the family's name, but I believe it is an Iowa family.

I guess they were originally eligible for Medicaid, and may be presently eligible for Medicaid. The child would be covered. They have an income situation where they can elevate themselves beyond the present limits.

The present limits are what percent?

Ms. Cooper. Two hundred and fifty percent.

Senator Nickles. No, that is in the bill.

Ms. Cooper. I am sorry.

Senator Nickles. Present law.

Ms. Cooper. For Medicaid, generally, it is between 100 and 133. For SSI, it can range on a State-to-State basis. It may be up to 185 percent of poverty. Like, for instance, in Virginia, that is the case.

Senator Nickles. All right. So, this particular family or other families--and maybe thousands of families across the country--find themselves in the situation Senator Gramm basically alluded to that Senator Grassley is trying to solve for a lot of people.

We want to encourage them to be able to work and not be dependent on SSI, and not lose their Medicaid for their disabled child if they happen to make a few more dollars. I think that is the purpose of your amendment, and I compliment you for it.

My concern is that the bill--and correct me if I am wrong--opens this up and makes individuals eligible that were never on SSI, that were never on Medicaid in the first place. Is that correct?

Ms. Cooper. That is possible. Right.

Senator Nickles. Well, it is more than possible. It is going to do it.

Ms. Cooper. Yes.

Senator Nickles. So we are doing a lot more than making sure that a family that is on welfare that is going to make more money does not lose their Medicaid for their disabled child. We are going to open up Medicaid eligibility for, I guess you mentioned the field or the population of 200,000 eligible children. Is that correct?

Ms. Cooper. Yes.

Senator Nickles. Are those 200,000 receiving assistance today?

Ms. Cooper. Some of those 200,000 are receiving assistance today.

Senator Nickles. Do you know how many?

Ms. Cooper. Probably the bulk of them. There is some churning that goes on there because family incomes go up and down from month to month. So, over time, it is possible that a lot of them would be receiving SSI.

Senator Nickles. So a lot of them might be, like, 100,000 of the 200,000? I am kind of uncertain.

Ms. Cooper. That is part of the assumption of CBO that I will have to get a more precise answer on.

Senator Nickles. All right. My point is, and I am trying to appeal to my friend and colleague from Iowa, I am concerned about a massive expansion in Medicaid, a program right now that my State is struggling to pay, not able to pay, not able to basically take advantage of all Medicaid eligibility that they have today. We are going to open it up to a lot of other people, a lot of other people with much higher incomes.

Senator Grassley. If your State legislature decides to do it.

Senator Nickles. All right. But my appeal would be, if we want to solve the problem that Senator Grassley has so articulately stated, why do we not say that the eligible persons here are individuals that have already received or are currently receiving SSI or Medicaid?

In other words, they would not lose their Medicaid if they make more money, but not make it open to anybody in the population that happens to have incomes of less than $45,000 that maybe was never on SSI, or never on Medicaid, and was not losing anything.

My concern is cost. I think it is awfully expensive. It is a State option. A lot of States are going to say it is too expensive. So we passed a bill, and a lot of people are not going to get it.

In other words, if we targeted it more directly at existing people who are presently receiving SSI and/or Medicaid and said, all right, if you earn a little more money you are not going to lose your Medicaid for your disabled child, I think we would help solve the problem that Senator Grassley has stated.

It might be financially more doable for both the State and Federal Government. Whereas, if you just open it up and say anybody less than this, you might find out there are a lot more than 200,000 eligible. I do not know what that population is, but there might be a lot more.

There are a lot of families of four in my State that have incomes of less than $45,000 that might say, well, now we are eligible, that presently were not in the past. So, this provision, which I think you said would cost, what?

Ms. Cooper. It is $5.7 million over 10 years.

Senator Nickles. Could end up being a lot more expensive. I do not know that to be the case, and I have not studied the CBO report. But that is my concern. Does this make sense? Is that a more targeted approach that the States might be able to assume?

Ms. Cooper. That is really an amendment to the provision, so I would defer to Senator Grassley on that.

Senator Grassley. Could I, Hope? And correct me if I am wrong on any of these assumptions I make. First of all, we do not too often question CBO on their judgment of what a legislation is going to cost.

In regard to this one, they have been working on this piece of legislation for a couple years. We had a hard time getting our first score, but since then they have been able to re-score it.

Senator Kennedy and I have adjusted the original legislation down from 600 percent to 250 percent over the course of its introduction until now. I think that the answer I want to give you, is that obviously it will open up to some other people that have not been on it. That is the purpose of it.

Not in a wide open way. We let the States make the decision. Do they want to do it? You have a State option. We do not do it in a way that just is fiscally irresponsible, because any family that can keep their private health insurance, and whatever that private health insurance that they have from their employer or elsewhere, that is going to pay as much as it will pay.

So, the family is going to be paying that if they can afford it and if they have it. If they have got the ability to buy in to Medicaid, they have to pay the State to buy in to Medicaid so that they are doing their share.

Then, lastly, it is important that we have families that are working and doing well, not getting themselves into the position of qualifying for Medicaid in the first place.

In other words, the purpose of the bill is directly opposite the question that you raise, so that families do not impoverish themselves, do not spend down, do not reduce their income, do not quit their job to qualify for Medicaid in the first place.

So the idea is, then, to keep people working and paying taxes. Do not have families put in a position, if they do not want to quit their job for the rest of the family, to put this child that has got special health care needs in out-of-child placement, which would be very anti-family from the standpoint of at least our President's position, as an example.

What else could I add, Hope?

Ms. Cooper. I would just also add that the universe of families is not every family below 250 percent of poverty. The child has to meet this definition of SSI, which greatly restricts the universe of families.

So, it is a very narrow set of families that would be eligible depending on where the State would set the income eligibility guidelines if they were to take up the option. So, it is restricted in that sense.

Senator Gramm. Mr. Chairman?

The Chairman. Senator Gramm?

Senator Gramm. Mr. Chairman, I think we are ready to vote on this. I would just like to make the following points. Senator Grassley's argument is a very strong argument, but it is based on people who are in a position of not taking jobs and not seeking advancement because they are fearful of losing Medicare.

In that case, you are talking about an offset to the cost because they will make more money, they will pay more taxes. So, whatever benefit we are providing is being partially offset.

I think the problem in estimating the cost, is that you have got people who are currently not on Medicare, have never been on Medicare, who are going to qualify for this benefit and who are clearly going to take the benefit. I think anybody would be unfair to their children and unfair to their family not to do it. You cannot expect people to act irrationally.

I think the question is, is the argument as strong when you have got people who have never been on Medicare and you are just simply saying they have never gotten a health benefit from the government? To them, the whole impact is a benefit to them, and a great benefit, but is a total net cost to the taxpayer.

I think the second issue, is Senator Grassley makes the point that, well, States do not have to provide the benefit. But the problem is, if your State does not have the revenue to provide the benefit, your citizens still have to pay the federal taxes to pay the match for States that do have the revenues to provide the benefit.

This is a problem with all of these enriching programs, enriching in the sense of expanding the benefits we have now. Is it for States that have tough budget situations? The taxpayers of those States pay for it.

I do not know whether Arkansas, Oklahoma, or Texas would be able, under the current budget circumstances we are in, or Louisiana, to provide this benefit. But it is not quite right to say, well, you do not have to do it, and therefore you are not affected. You are affected, because every taxpayer in your State paying federal income tax is paying for these increased costs of matching funds.

So, people in Oklahoma, Arkansas, Louisiana, or Texas pay taxes to provide a benefit to people in Michigan that our people do not get--in fact, the same people that are not getting the benefit in Texas.

Somebody making $40,000 that has a child with a severe disability does not get the benefit, but they pay the tax to provide the benefit to somebody in Michigan.

So, I mean, I do not know that it undoes the logic of this bill, but it is a problem. If some way could be found, if we are going to provide money to help people, if we could allocate it to the States so Arkansas gets the money, Texas gets the money, money we provided as taxpayers, and if we cannot afford this full amount, at least we could spend our share to help people, I just say that is a problem that constantly exists in these expansion programs where the States with lower tax bases simply do not get the benefit. It frustrates me.

Senator Nickles. Mr. Chairman?

Senator Lincoln. Mr. Chairman?

The Chairman. Senator Lincoln was seeking recognition.

Senator Lincoln. Well, Mr. Chairman, I thank you. I see the gentleman's point. I have seen that point in a lot of things. Medicare+Choice is one of those programs where we do not get any benefit in Arkansas and our taxpayers pay into a program that other States do benefit from.

But most of our States are in hard economic times, and this is a program that is voluntary that we can choose to participate in. Our State has chosen to participate in several similar programs, like the TEFRA program, which has been very beneficial to disabled children in our State.

In good economic times, it is nice to have that option. As Senator Grassley mentioned, it is not only a voluntary program, but a voluntary program that the State has to vote on and it cannot accept unless all of the other mandatory Medicaid recipients have been taken care of.

So, I think that there is an awful lot of protections that are in there. It is an option we can give States. It is a pool of money that we can make available to them when they can share in some of those costs. I think that our State, for one, would like that option.

Even though there are times when we do hit difficult economic times, we would like the benefit and the ability to be able to service those individuals.

Senator Nickles. Mr. Chairman?

The Chairman. Senator Breaux sought recognition. Senator Breaux?

Senator Breaux. Thank you, Mr. Chairman. I would just make more of a generic comment. Number one, I support the Family Opportunity Act. I mean, trying to provide health insurance for families who are struggling with a disabled child is something that we as a Nation ought to be committed to finding a way to help them with this problem, and also providing health insurance for pregnant women.

In Louisiana, about 25 percent of all the women of childbearing age in our State have no health insurance.

You either pay for it now, or you pay for it later. Women who do not have good prenatal care are likely to have children of low birth weight.

Senator Lincoln and I were talking about it. It is going to cost society. It is going to cost society a lot more than if we try and address the problem up front if we wait until after the problem occurs and then try and address it then.

But I think the thing that we are struggling with today is indicative of a greater problem. We are trying to use these Band-Aid type of approaches to mesh people into a Medicaid program that was never intended to cover all these things.

The fact is, we have got about 43 million Americans who have no health insurance at all. That is where the huge problem is. It is a bigger problem than for prescription drugs and for Medicare. We have 43 million Americans who have no health insurance that pays for anything, hospitals, doctors, nothing. They do not get drugs, they do not get anything.

So what we are trying to do in this Band-Aid type of approach, and maybe it is the only thing we can do for now, is to try and stick some of these people one at a time, 185 percent of poverty. Can we go to 250? Can we keep it at 133? Stick them into a program that was never designed to cover these problems.

The real problem is, I think we ought to face up to the fact that we ought to have mandatory health insurance for all Americans. Not an employer mandate, but everybody in this country should have health insurance and the government should help pay for those who cannot afford to pay for it, and those who can will pay for it, perhaps with some type of a deduction. But that is the overall, big problem.

That is why we are having such a struggle trying to stick people into programs that were never designed to cover these things. But I do support the effort, because that is the only thing we can do.

Senator Nickles. Mr. Chairman?

The Chairman. Senator Nickles?

Senator Nickles. I am guessing, from Senator Grassley's comments, he is not going to support my amendment. I have not called it up, but let me clarify a couple of things. Senator Breaux alluded to something.

I used to run a manufacturing company. We had employees, employees that have disabled kids, that are now covered by private insurance, many of whom will be eligible. They were never eligible for Medicaid, they were never eligible for SSI. They are now under a group plan, a private plan.

They are now eligible, I believe--I did not quite understand the coordination between private insurance or not, but right now they are covered by private insurance. They now would be eligible for Medicaid. Could you explain a little bit? Are we moving people from private coverage to government?

Ms. Cooper. No, not at all. What this bill requires, is that parents who are offered employer-sponsored coverage must take that coverage, that family coverage. That would pay first for all of the services in that plan for that child.

For services that that child needs that is not a part of that plan, the parents could pay a premium to Medicaid to buy those extra services. So, Medicaid sort of supplements that private plan or services as a wrap-around.

Senator Nickles. Let me back up. They presently have it.

Ms. Cooper. Right.

Senator Nickles. They do cover the family.

Ms. Cooper. Right.

Senator Nickles. And so what happens? Nothing changes? The Federal Government does not pay a dime?

Ms. Cooper. For the families where the parents are employed and receive coverage through their employer, they maintain that coverage. That includes coverage for the child.

However, those plans are not always as comprehensive in benefits as necessary for children with disabilities. So for the services that are not included in that plan, those parents could go to Medicaid to get those additional services only.

For instance, maybe they need a wheelchair and medical equipment as a part of the employer plan benefit, so they could go buy the wheelchair from Medicaid. So Medicaid serves only to supplement the benefits from the private plan, so they work together. Medicaid is always the third payor. That is consistent in this bill as well.

Senator Nickles. So they would maintain their existing coverage and this would supplement what those plans did not pay.

Ms. Cooper. Right. They would be required to maintain that coverage.

Senator Nickles. Would plans be able to exclude coverage for disabled kids, or something?

Ms. Cooper. No. No.

Senator Nickles. I do not want to see a shift, is where I am coming from.

Ms. Cooper. No.

Senator Nickles. I do not want to see a shift from presently covered insured families into greater, frankly, movement towards Medicaid. I think the States are drowning--not drowning.

States are suffering and having significant challenges to pay Medicaid benefits in lots of States. We are adding eligibility to that by this bill, and a lot of States are going to say, thank you very much, but we were not able to pay everybody that is presently eligible today.

I am just concerned about that. I am not going to offer the amendment. I thought I might have greater consideration by the Senator from Iowa than I did.

Senator Gramm. Would the Senator yield?

Senator Nickles. I will.

Senator Gramm. How are you going to enforce that? I have got an insurance policy. Let me say, I am Nickles and I am running this company. I like that better than having an insurance policy.

I am providing these services, and I have got some families working at my company that have got disabled children, and they are making $40,000 a year. Obviously, I am going to have a tremendous incentive to change my insurance policy to stop covering the things that Medicaid is covering.

First of all, there is no provide insurance policy anywhere as good as Medicaid in terms of coverage. So, I am going to have every incentive to change my policy or give people an option, and my employees are going to have an incentive to do it. Well, I guess you are going to wrap around them, so maybe they do not.

How do you prevent that from happening?

Ms. Cooper. Well, that is a regulatory issue. I am not sure I have the answer to that. I would say that in some ways this would relieve some of the challenges on private plans for certain families who are seeking to get more of their private plan than is offered through the plan.

If they have an avenue to go to get services, that will help resolve some of the problems that the families are experiencing who have private coverage but are not feeling like they get enough out of that coverage.

I think that would be a State regulatory issue on how those private plans are governed. I think that would be a discriminatory act, and I do not think that would be legal. But I do not know for this hypothetical.

Senator Gramm. I think, again, we have got to take into account that people are going to operate rationally. Over time, there are certain things you can bet on: water wets and fire burns.

If Nickles' employees are going to get the benefit anyway and a taxpayer is going to pay for it, you can bet your life that they are going to find a way so that Nickles does not have to pay for it and so his employees do not have to pay for it.

So, I think this idea of wrapping around private insurance is a pipe dream. Ultimately, private insurance will get out of these areas and we will end up paying the whole thing. I am just saying, we need to be honest up front. What happens is, these programs, we make these totally unrealistic assumptions.

Then we start the program, then we are shocked that it costs two or three times as much as we claimed. I think that the way we ought to estimate the way these things cost, is to assume people are going to try to do what is best for them, and then estimate the cost on the basis of it so we can do rational planning. That is all I am saying. It is obvious to me that that has not been done.

Senator Grassley. Mr. Chairman?

The Chairman. Senator Grassley?

Senator Grassley. If it is appropriate, I would like to move the bill.

The Chairman. The question is on the bill. All those in favor, say aye.

[A chorus of ayes]

The Chairman. Those opposed, no.

[No response]

The Chairman. The bill passes.

Clear the current staff for the next staff, please.

All right. Ms. Paull, you are going to explain the pension.

Ms. Paull. Good morning, Mr. Chairman, members of the committee. You have before you today the National Employee Savings and Trust Equity Guarantee Act. It is my understanding that the committee has circulated a complete description of the modifications to the Chairman's mark, and there are additional modifications that I will briefly go over this morning.

The first set of modifications are described in this document with the eagle on the top of it. The longer description is there. The first set of additional modifications is to make four modifications to the Chairman's mark that was circulated earlier.

These modifications are basically pretty technical clarifications of what the intention of the original provisions were. I would highlight one of the provisions that has to do with the modification for treatment of loans to executives.

The original Chairman's modification provides that certain loans to officers, shareholders, 5 percent owners, and employees who have outstanding loans from the employer in excess of $1 million would be treated as compensation under certain circumstances. The notion here is that it could be a direct loan or an indirect loan.

Under certain circumstances, the indirect loans, there could be all kinds of arrangements. One happen to have been singled out in the modification and I think that caused some confusion. That has to do with split-dollar life insurance.

There was no intention to indicate that you would have a double taxation on those arrangements. Under recently-issued proposed regulations, under certain circumstances, split-dollar life insurance can be treated as loan arrangements, loans to the employee, when the employee owns the policy.

This proposal was not intended to change that rule in the proposed regulations. It was only intended to say, among other things, there could be some arrangements where there is indirect borrowing out of an arrangement that had been entered into with the employer.

With that indirect borrowing, for example, if the employee actually borrowed against an insurance policy or some other kinds of arrangements, it would be picked up here. So, I just wanted to make that clarification because it was not clear, even in the additional modification.

Senator Nickles. Could I ask you a question?

Ms. Paull. Sure.

Senator Nickles. There is a provision that any loan in excess of $1 million will be treated as compensation. Is that the essence of it?

Ms. Paull. Well, no. It depends on the loan. I mean, if the loan has specified terms not to exceed a repayment period of 10 years and it has got collateral that is not related to employment-related things like stock that you have gotten through your employment relationship.

So, you can have bona fide loans, but if they are secured, for example, by stock options or something like that or they are unsecured, you could be swept into this rule in the modification.

Senator Nickles. I am still not very clear. All right.

Ms. Paull. It is not all loans over $1 million, in other words.

Senator Nickles. Is it retroactive to existing loans?

Ms. Paull. It is.

Senator Nickles. Is it prospective for new loans or is it retroactive to cover existing loans? You are a corporate director, officer.

Ms. Paull. It is new loans and new refinancings after--I forget the date. Is it today or next year?

Senator Nickles. After enactment date. It does not do anything to exist loans, is that correct?

Ms. Paull. No, sir.

Senator Nickles. But any new loans, if it is a loan in excess of $1 million, it could be treated as compensation.

Ms. Paull. It could be treated as compensation.

Senator Nickles. All right.

Ms. Paull. If it does not meet these criteria that I was mentioning, that it has a specified term which is under 10 years. It has security and collateral, but the collateral cannot be employment-related, those kinds of things.

Senator Nickles. The collateral cannot be employment-related?

Ms. Paull. That is right.

Senator Nickles. So an officer or director could no receive a $1 million loan to purchase company stock.

Ms. Paull. That is correct. And the million dollar threshold, if I could just clarify, applies to nonofficers and directors, and 5 percent shareholders. It is first dollar on officers and directors, 5 percent shareholders, other employees other than them, you reach this million dollar threshold.

Ms. Freese. Senator, one clarification. You could use a loan to purchase company stock if you did not use the stock as collateral for the loan. If you had some other security, you could use loan proceeds to purchase anything you wanted to. It is using the proceeds of the loan that are collateralized by the employment-based. That is what gets caught up.

Senator Nickles. Thank you for that clarification.

The Chairman. Ms. Paull?

Ms. Paull. All right. The next set of proposals are additional provisions that have been added based on a variety of amendments that were filed yesterday. I would be happy to go through them if you want. But, since the members all kind of knew about the amendments, I would be happy to answer questions, too. Whatever you want.

The Chairman. I just want you to outline the mark, and we will discuss amendments if and when they arise and are offered by members of the committee.

Ms. Paull. Yes. But the additional amendments were all amendments that were going to be offered and the Chairman is now accepting them. I can go through them if you want.

The Chairman. Why do you not just read them?

Ms. Paull. All right. The first amendment has to do with early retirement plans for teachers, in essence, and education associations. Under the proposals, these early retirement benefits would be treated as a severance pay is treated under present law, and therefore excludable in income until paid. So, that is the first set of proposals.

The second proposal is to exclude stock options from the FICA and FUTA tax, which this has been an issue under proposed regulations, and now this would permanently exclude the stock options from the FICA and FUTA tax.

The next issue has to do with the exercise of stock options to comply with taking a position with the Federal Government. If you would exercise a stock option and be in, it would be a conflict of interest when you take a position. This would give you capital gain treatment on the exercise instead of ordinary income treatment.

The next proposal is to deal with the special funding rule for pension defined benefit plans that was provided in the economic stimulus bill for this year and next year. A phase-in of that special funding rule would apply for contributions made this year relating to last year's planned funding.

The next provision would really make a technical clarification to last year's large tax bill having to do with when monies are, in a lump sum, taken out of a pension plan and rolled over into an individual retirement account.

This has to do with a fiduciary liability of the pension plan trustees. It would make sure that they do not have fiduciary liability once the money has been rolled over into the IRA account. There was a glitch under last year's tax law.

The next provision, we require the chief executive officer of a corporation to sign, under penalties of perjury, that the income tax return of the corporation is accurate.

Then there is a series of provisions that the committee has been working on over the years.

Senator Nickles. But before you leave that one, may I ask a question?

Ms. Paull. Sure.

Senator Nickles. So if you are chairman of General Motors, you have to sign the tax return?

Ms. Paull. Chief executive officer.

Senator Nickles. CEO. Excuse me.

Ms. Paull. Yes, sir.

Senator Nickles. And the tax return, I am guessing, for General Motors is probably more than a couple of pages.

Ms. Paull. I would guess that, too. Probably several boxes, at least.

Senator Nickles. All right. And if some mistake is made, and I am going to guess the CEO probably does not personally do the income tax forms--

Senator Gramm. If the Senator would yield. Under the new bill, he has no authority to deal with it. It is all done by an audit committee, which is totally independent.

Senator Nickles. If there is a mistake on the income tax and he or she signs it, what is the penalty?

Ms. Paull. It has to be something material to the effect of the tax return. Also, for any criminal penalties to apply, you would have to have the appropriate criminal intent, that you knew about it and you intentionally did that.

Senator Nickles. Mr. Chairman, I would just make a comment. I think this is ridiculous. There is not a CEO in the country that is going to prepare these tax returns. If someone makes a mistake, I do not know how--I do not know.

I think on occasion we go a little too far, and I think this is an area where we are going a little too far. I am trying to think. I do not know. I almost want to laugh at it.

I used to be CEO of a company, and I never signed a tax return. They were always prepared by our accountant. Our accountant was also our auditor, also our consultant, also our tax preparer. They happened to be all three in one. I do not doubt that there have been mistakes made.

Senator Gramm. You would have four or five different accounting firms now. [Laughter].

Ms. Freese. Senator, the provision does not apply in the case of mistakes. You have to have willful knowledge under the requirements of the language. A mistake will not work.

The Chairman. When I learned that chief executives do not sign, I was surprised. I just assumed that chief executive signed. All of us as taxpayers, as individual, when we have our accountants determine our tax liability, there is a place down there for the taxpayer to sign even though the accountant figured out the tax liability.

As has been stated, criminal prosecution is extremely difficult. It is extremely difficult. I mean, the burden of proof is so high. Tax attorneys have so many different defenses.

The fact of the matter is, it would have to be a willful and almost intentional knowledge of making a material misrepresentation before any liabilities to attach.

More important than all that, I think it is an excellent idea because it helps the CEO of a company know what the heck his employees are doing, to check on his accountants. No CEO is going to want to sign unless he is pretty well assured that this is an accurate representation.

It is going to force him to maybe talk to his auditing committee of the corporation to figure out, is this accurate, is it not accurate. But I believe firmly, if this provision were in the law today, we would not be seeing some of the rank abuses that we have happened to see in the last several months. I think it is an automatic. It should be.

Senator Nickles. Let me ask a couple other questions of staff. Does this apply to only publicly-traded companies or does it apply to every corporation in America?

Ms. Paull. It applies to every corporation in America.

Senator Nickles. It is absurd. Let me give a couple of examples. Every person in this committee knows how complicated foreign taxation is. You know that there are billions of dollars at stake. As much as we work on tax law, you could come up with a dozen different interpretations on foreign tax sales credits and other issues. And we work on it probably more than a lot of CEOs do.

You may have a situation where you are having a lot of money in a large, multi-national corporation, and there might be different ways of doing this. I can see lots of problems here. Maybe not. Maybe the threshold is going to be high enough. But there is a lot of confusion on foreign taxation.

To say, oh, well, we are going to have the CEO sign this, that is going to solve that problem, I think is kind of silly. Our Tax Code is so complicated, so confusing, so difficult, to imply that, well, this is going to solve the problem, I think is kind of ridiculous. Anyway, I made my point.

The Chairman. If I might, on that, we have lots of evidence--lots of evidence--of CEOs telling their accountants, be more aggressive, make this a profit setting, lower taxes here, and pushing them, and pushing them. There is evidence that CEOs are pushing their accountants to, in effect, break the law. I do not think we want that kind of action here.

The CEO knows that he or she is going to liable for taking action, or taking part in an action which violates the law. I think that is going to curb that tension, additionally.

The point that you are making, Senator, is a good one. The Tax Code is complicated. Maybe this will help indirectly reduce the complication of that scope.

Further, we are talking about liability here. I mean, there are lots of different ways to interpret the Code fairly, and tax laws fairly. He or she is not going to be prosecuted. We are just talking about the cases where there is a signed return, where the return itself is a material misrepresentation.

Senator Nickles. Would the Chairman yield? If we are making this apply to every corporation in America, I used to be a CEO and I worked to minimize taxes. I will also tell you, there is a great deal of confusion in the Tax Code.

You could even turn a complicated return over to different auditors, to different firms, and they will come up with different numbers. Again, I think we are just going a little bit too far. I made my point. You have got the votes.

The Chairman. Senator Breaux?

Senator Breaux. I take it that the proposed legislation does not in any way modify the standards for criminality. It only says that the chief executive officer of the corporation is to sign. The law already provides, according to the memo, that the president, the vice president, the treasurer, or assistant treasurer, or chief accounting officer, or any other officer of the corporation has to sign it now. That applies to all corporations. That is the current law.

The only thing we are saying, is that the CEO has to be the one to sign it. We are not changing the criminality standards for what a person can be pursued against criminally in any way, are we?

Ms. Paull. No, we are not.

Senator Breaux. This is the same standard. We are just saying that, right now, all these other officers have to put their name on the form, but somehow the chief executive officer does not.

We are just saying the chief executive officer then has to do the same thing that he or she has been requiring others to do who are officers of the corporation, many of which who probably do not know the details of the tax return at all because an outside accounting firm has done it.

But right now the current law requires officers of the corporation to sign the tax returns. We are not changing the criminality standards at all. They are still the same. I think it is a good provision.

The Chairman. Any more comments?

Senator Nickles. Maybe a perfected amendment would say that we would have the Majority Leader of the Senate sign off on bills as far as their accuracy. I remember, we passed a pension bill that said $15 billion does not count and shall not be scored. That was pretty flagrant in the language.

I resent the argument that lots and lots of CEOs purposely direct people to push the envelope. There is nothing wrong with minimize taxes. There is something wrong with the implied criminality in too broad of a sweep.

The Chairman. Any more comments?

Senator Gramm. Yes. Could I offer an amendment?

The Chairman. You certainly may.

Senator Gramm. Mr. Chairman, I want to give people an opportunity to do something that is good government, but I warn in advance that is about as politically incorrect as an amendment could be. But I think it would send a very good signal if we adopted it, so I am going to try it.

Under current law now--I am not talking about the bill before us--if you pay a corporate executive more than $1 million, you cannot charge it as an expense.

Now, when that law was passed, the *New York Times* predicted that what would happen, would be that compensation to CEOs would be reduced and that there would be all kinds of schemes to have performance-based pay that would get around this law.

Now, I would say that if you listened to the complaints that are being raised about Worldcom, Enron, you name the long list of alphabet soups of companies that have problems, one of the biggest complaints is that we have created these compensation mechanisms where corporate executives have return that is so geared towards the short term because of things like an explosion of stock options.

Now, I think in a small, but not insignificant way, Congress is responsible because we eliminated the traditional mechanisms whereby chief executives were compensated with salary.

So by law, now, if you are going to hire a top-flight chief executive of General Electric, or General Motors, or Worldcom, or whatever, they are going to be paid more than $1 million. I know that offends some people, but they are going to be.

So what we have done with this law, is we have in essence forced them, since it is part of doing business, paying a CEO, into all these schemes to get around this law through stock options, through corporate loans, through all this business. I think we can help clean up corporate accounting and help clean up corporate America by repealing this law.

So what my amendment does, is repeals this provision of law. Now, we are talking about old-fashioned paychecks, now, something people understand. If the old-fashioned paycheck is over $1 million, the company cannot say it is an expense of doing business, paying the corporate executive more than that. That has produced, as was predicted at the time, a proliferation of ways to get around it with loans, with stock options, and things like that.

My amendment would simply repeal that provision and would allow companies that wanted to get out of all these gimmicks to go back and pay their corporate executive what they perceived to be a competitive salary.

The Chairman. Senator Bingaman?

Senator Bingaman. Mr. Chairman, I do not support the amendment. I think the problem that people are concerned about is not whether these top executives are being compensated through salary or through stock options or some other mechanism. The problem is the enormous increase in the compensation.

Kevin Phillips has this new book out, which cites, I think, the top 50 CEOs. I think it is the top 50 in the country, and what they were receiving in 1980, what they were receiving in 1990, and what they were receiving in 2000.

It is an amazing chart, because it shows, and I cannot remember the details, but it is about $3.5 million that was the average salary in 1980. Then it went up above $50 million in 1990, and then it was around $150 million in the year 2000. This is annual compensation of some of these top CEOs.

Now, that is what has got people concerned. It is not whether or not you count it as salary or count it as something else. So, I do not think there is any way you can say that Congress, limiting the amount that can be deducted as salary, has resulted in this enormous increase in compensation.

Senator Gramm. Well, I am not talking about increasing compensation. I am talking about the way it has been given. I am just saying, if I cannot deduct, if the average salary was $3 million in 1980 and we passed this law that said you could only deduct $1 million, how do you think they paid those people?

Senator Bingaman. This is the top 50 CEOs' compensation in the country. It is not the norm.

Senator Gramm. This law applies to everybody.

Senator Bingaman. Right.

Senator Gramm. All I am saying is, why not let companies pay people a paycheck instead of letting them have interest-free loans and all of these deals, and going so much to stock options where people have an incentive to, I have got get that stock up, I have got to keep that stock up. I cannot let the reality of the company reflect on the books.

I just think your issue is another issue. How much should people be paid? That is none of my business.

Senator Bingaman. But also, how much of the pay that people get should be given favorable tax treatment.

Senator Gramm. I am not talking about that.

The Chairman. I think this is not a good amendment. It is contrary to the intent of the bill, it is contrary to public interest, certainly at this time.

The question is on the amendment, unless the Senator from Louisiana had something.

Senator Breaux. I just had one comment. I agree with Senator Gramm. This is a politically incorrect amendment. [Laughter].

Senator Gramm. This law, passed in 1993, helped create some of the abuses we are seeing right now. Yet, we are not willing to correct it because of political correctness. I think we are partly responsible for it. I just thought, with everybody's playing to the grandstands, that we might do one little thing today that would show some good judgment and good policy. But I was wrong, and I withdraw.

The Chairman. The amendment is withdrawn.

Are there any other amendments?

Senator Bingaman. Mr. Chairman?

The Chairman. Senator Bingaman?

Senator Bingaman. Mr. Chairman, I have a couple of amendments that I would just raise and talk about a minute. I will not offer them, but I think they are important.

I have an amendment, amendment number one, that I filed to expand retirement plan coverage to a lot of employees, try to provide some incentives in the law for small employers to do that, for larger employers to do that as well for their low-paid employees. It is a bill that we have introduced and one that I think we should consider as we consider this pension-related legislation.

I understand the necessary work has not been done to have this amendment favorably considered today, and I will, therefore, not push it to a vote.

I do also have an amendment that would offset the cost of this, the additional cost to the Treasury. That is with regard to the treatment that is given to payments under corporate-owned life insurance policies.

This is an issue which I think all of us have recognized there has been significant abuse in the current law, and we need to fix that. Again, we have introduced a bill to accomplish that, and I hope very much that when we get to the floor we can have good bipartisan support to do that.

These COLI policies, as they are called, the way they are now being used, they are being used in ways that have no relationship to the loss of life of the insured. The employers are taking out the policies in circumstances where the employees, in many cases, do not even know it is happening.

So that will be a source of revenue to help pay for the expansion of pension coverage that is in the other amendment. I will withhold offering either of those amendments today, but I urge people to look at them before we get to a floor debate on this issue, and hopefully there we can have them added.

The Chairman. Thank you very much, Senator.

I might say to you that you have been very helpful in these pension provisions, and I am very sympathetic to a lot of the comments that you are making and want to work with you. But I deeply thank you for your efforts. You are trying to improve the bill, as we all are, and I want to help make that movement to get to the floor. Thank you very much.

Senator Nickles. Mr. Chairman?

The Chairman. Senator Nickles?

Senator Nickles. Mr. Chairman, I have filed an amendment to make the IRA changes that we passed under the tax bill in 2001 permanent. I think when you are talking about IRAs, especially, you are talking about pensions, you are talking about planning.

It is probably the most bipartisan element of the tax bill that we passed. I compliment you and Senator Grassley, and also Congressmen Portman and Cardin for their hard work. There are hundreds of votes in the House for these provisions, and I think overwhelming support in the Senate as well.

Unfortunately, this, like other provisions, would sunset so they would not apply in the year 2011 and 2012. I think they should be permanent. When you are talking about tax laws, particularly dealing with retirement, if anything should be permanent it should be this area. I will just say, Senator Grassley requested that I not offer the amendment today. It is my intention to bring it up in the future.

The Chairman. All right. Thank you, Senator.

Senator Grassley?

Senator Grassley. Yes. I have an amendment that was included in a bill I had originally introduced earlier, and it is also an amendment that Senator Kerry would have offered today, but he cannot be here. It deals with a contribution to defined benefit plans, because these are determined,. in part, by calculations using a one-size-fits-all GAAP-mandated mortality tables.

But the fact is, bus drivers simply do not live long as the GAAP-mandated mortality tables would predict. You have a mortality rate, for instance, for Greyhound that is 19 percent higher than the GAAP-mandated mortality tables. Using these tables, you end up with significantly higher contributions to defined benefit plans than are necessary to pay benefits.

Now, Congress recognized and corrected this problem back in 1997 by creating a special transition rule which allows interstate bus lines with closed defined benefit plans to use different mortality tables.

It was the right thing in 1997, but the situation has not changed. The mortality rates of these workers has not improved and it is time to make this special transition rule permanent. That is what this amendment does.

The Chairman. Is there further discussion?

Senator Nickles. Mr. Chairman?

The Chairman. Senator Nickles?

Senator Nickles. Mr. Chairman, I hope we do not do that. I used to be a manager of a plan that was a defined benefit plan, and everybody uses the same mortality tables. Everybody does. If we are going to start having special tables for one little industry, there is no limit to what we will do.

Senator Grassley. Yes. Well, the difference is, this is what is referred to as a frozen defined benefit plan. There is no revenue loss or no revenue impact because of this amendment. Congress recognized this in 1997, but they did it in a temporary rule, thinking that things were different and would correct themselves.

But they have not corrected themselves, so you are going to have these workers paying in a lot more than they are ever going to get out in benefits. Since it is a frozen benefit plan, we ought to--

Senator Nickles. You are saying it is frozen because it has no new entrants coming in as participants?

Senator Grassley. Yes.

Senator Nickles. I could think of dozens of industries that would like to say, oh, they have a different mortality table and, therefore, they are entitled to a different contribution. That will have an impact on what the contributions can be, what the maximum contribution and minimum contribution can be. Maybe I was not aware of what we did in 1997. I am trying to think if I was on this committee.

The Chairman. I think you were.

Senator Nickles. I do not know what happened in 1997, but I just question the wisdom of doing it. I am absolutely certain you could say that people that work in a--well, I started to say oilfield workers, or I am thinking of some of the smelters, that would have a different mortality table than those that work in a tourism office.

I just question the wisdom of doing that, because almost all defined benefit plans are based on standard actuarial tables. They have different levels for males and females. But if you go too far down that road and say we are going to do it different for industry company by company, I just--

The Chairman. If I might just clarify a little here. Essentially, this is a 1997 provision which recognizes that there are certain groups with different mortalities. As it turns out, it is available to lots of different companies and it has been the law since 1997, but only Greyhound, I think, utilizes it

So the amendment, here, is not new law. The amendment here is to extend that current provision for a company today, if they so choose, to use different mortality tables.

Senator Nickles. Would the Chairman yield? My staff tells me that airlines and others have said that they would like to have this provision. My point is, if Greyhound is the only one that is using it--

The Chairman. Well, it has been in existence since 1997.

Senator Nickles. I am just telling you, there is a lot of money--

Senator Murkowski. Mr. Chairman?

The Chairman. Senator Murkowski?

Senator Murkowski. My understanding is, while he indicated that there was a reference to it since 1997, I understand that there was no debate on it. It was simply stuck in. As we have indicated here in discussion, it would primarily allow one company, the Greyhound Company, to use a special mortality table. Obviously, this is a rifle shot for one company.

But there are others that obviously would like to have special consideration: the steel industry, the automobile industry, the mining industry. I do not understand why we should set, necessarily, what would be beneficial to other industries and allow them to have a standard mortality table, but when we are talking about

Greyhound getting their own, I do not think is fair.

I think we should reject the amendment on that basis. I just do not see the justification for it. There was no extended debate in 1997. It was simply something that was stuck in.

The Chairman. If I might just say, too, if it helps Senators make up their minds on this, it is true that some industries have different mortality rates. I do not think anybody would dispute that.

In this case, the mortality rate for some--in this case, bus drivers--is far higher than that predicted by the mortality tables that the current law requires. So this was enacted, and I do not recall the date in 1997. I may have been in the fall of 1997.

But, as a practical matter, the plan has 14,000 participants, and less than 1,000 which are still driving for Greyhound. I do not know whether other companies want to make use of this or not. I only know that it is very important to approve this amendment.

Senator Grassley. Whether or not other companies would take advantage of it is the fact that we have got a lot of groups of people that can choose their own mortality tables, paperworkers, meat cutters, teamsters, construction companies, and generally multi-employer pension funds.

So, we are not doing something here that is special for Greyhound in the sense that they are going to have mortality tables different than others, when other groups of people can choose their own mortality table.

Senator Nickles. Mr. Chairman?

The Chairman. Senator Nickles?

Senator Nickles. I think Senator Murkowski is right. I think this might have been put in. But I do not think it was discussed. I think it might be well to have a hearing and talk about it. The mortality tables are put together on large groups of people. Frankly, all men and women are in these mortality tables.

If you change that, if you do it for one, basically, so they can have greater benefits earlier, you are making some big changes. If it is financially beneficial for one group, you are going to find a lot of other groups that will try to come up with some statistical sample that says that they are entitled to it.

I mentioned that I was CEO of a plan. One of the flexibilities that a CEO has, is that there is a range in contributions that you make in defined contribution plans.

Senator Rockefeller. Don, did you say that you were a CEO of a plan?

Senator Nickles. Yes, I was. I was CEO of a company and fiduciary of a plan.

Senator Rockefeller. Because I have never heard you say that before. I just wanted to verify that.

Senator Nickles. Now you have got me on record. [Laughter]. And a fiduciary of a plan is given an option, on a defined benefit plan, that you have to contribute a certain amount. You have a minimum amount and a maximum amount that you can contribute. Those are determined, to some extent, on the mortality tables.

I just really question the wisdom of saying, well, we are going to say one industry, and maybe there are others that are eligible that may be jumping into it, and say, well, we are going to have our separate mortality tables.

That will skew the rest of the mortality tables, if you want to take it to the statistical nth degree. It just does not make a whole lot of sense. Defined benefits plans are already in a world of hurt and they are in a much greater world of hurt now because the marketplace is really hurt, collapsed.

They were anticipating a rate of return of probably 7 or 8 percent for the last several years, and now that the market has contracted as much as it has the last two years, defined benefit plans are in real hurt. You allow them to use a mortality table that is beneficial to them, they can increase their benefits earlier.

Senator Grassley mentioned that they are multi-employer plans. You have got a lot of multi-employer plans that are already in financial crisis. We are just going to aggravate this. The more I think about it, the less I like it.

I would urge Senator Grassley not to pursue the amendment. If we want to, let us have a hearing and delve into it with some experts that might shed some light. Maybe they would convince this Senator, and others, it is the right thing to do.

The Chairman. Senator Bingaman seeks recognition.

Senator Bingaman. Mr. Chairman, I was just going to say, based on what the Senator from Iowa said, I will support his amendment. But I think it would be useful to have the Department of Treasury, perhaps, look into this and report back to us if they have recommendations for any more generic solution to this problem so that we do not have the circumstance where each company feels like, in order to deal with a problem of this type, they ought to come to Congress. So, I do not know if that is something Treasury could advise us on, but I would hope they could.

Senator Nickles. Well, we have a Treasury representative. Do you have any knowledge of this amendment, any thoughts on it?

Ms. Olson. Well, I guess I would say at this point that we probably do not support the amendment because we would be concerned that it would leave any plan covered by the rule permanently under-funded. We would be happy to take a look at it. Our benefits tax counsel still has his Senate Finance Committee staffer work ethic, and I am sure he would be happy to take on the additional project.

The Chairman. All right. If there is no further discussion--

Senator Murkowski. I have a question. Ms. Olson, did you say under-funded?

Ms. Olson. Yes.

Senator Murkowski. To me, Mr. Chairman, it would seem prudent that we address this with a little more information by simply putting it off and not being impetuous in the sense of just running off here, recognizing that there has never been a hearing on it.

It has never been discussed. It was simply put in to accommodate one company. I cannot support it under that basis. I think we should simply put it off, have a hearing on it, and consider it.

The Chairman. I am going to call for the vote. But I do think that some important questions have been raised and I am going to work with Treasury and with others to see if there might be some changes or way we could modify this amendment before it gets to the floor, or on the floor, because there are some important questions raised here. But, nevertheless, I believe, given the weight of the argument, that this amendment should pass.

Senator Nickles?

Senator Nickles. If I could ask Ms. Olson again. I do not know anything about the health of the defined benefit plan for Greyhound. Do you have any information on that plan?

Ms. Olson. No, sir, I do not.

Senator Nickles. It is very important to know because you are talking about benefit levels. You are talking about one plan. You are talking about one plan that has had, probably, its assets reduced substantially just in the last few days. I just really question the wisdom.

You mentioned something was under-funded. Were you thinking that, if we did this in a lot of industries, it would cause some of the plans to be under-funded? Was that a more generic statement?

Ms. Olson. Well, it is a reference to this provision in particular. Of course, as I understand this provision, in particular, there is only one company that fits within it. So, it is this particular plan. I do not know anything about what the plan's assets are invested in. But saying that it could stay permanently at 90 percent does leave the risk of it being under-funded permanently.

Senator Nickles. Well, I appreciate your caution. I, Mr. Chairman, would hope that the amendment would not be adopted. Maybe, if the Senator would withhold it to where both Treasury and others have a chance to look at it a little bit further, I think it would be prudent to not pass it.

The Chairman. Questions?

Senator Murkowski. Mr. Chairman?

The Chairman. One last comment, then we are going to vote.

Senator Murkowski. Last comment. I wonder, as an alternative, since we had a five-year term on this, from 1997 to the current date, if we could consider extending it for a year or two, which would give us an opportunity then to address it with a hearing, rather than extend it for another five years, or whatever the current extension is. It would seem to me that that would be prudent. I wonder if the individual offering the amendment would consider a one- or two-year extension of it as a compromise?

Senator Grassley. We will buy into your plan.

The Chairman. Two years.

Senator Grassley. The amendment will be thus modified.

The Chairman. Two years.

Senator Murkowski. What was it originally?

Senator Grassley. Five.

Senator Murkowski. I would suggest one or two.

The Chairman. It is two. All right.

The amendment is modified with two years. That is the modification. Without objection, that amendment is agreed to.

Now we are moving to Senator Graham.

Senator Graham. Mr. Chairman, I will be brief. I have filed two amendments. I will not offer either of these amendments, but I would like to make a brief statement.

The first relates to professional employer organizations. One of the, I think, shortfalls of the otherwise very good legislation that we are considering today is that it is limited in its incentives to expand retirement plan coverage. That is the reason that I filed this amendment, which is based on S. 1305, which I have introduced with Senator Grassley.

This would make it easier for professional employer organizations, which are organizations that provide staffing generally, as the name implies, at a professional level, such as in health care, accounting, law, to be able to provide their employees with health and retirement benefits. This is a particularly important issue for smaller businesses which are a primary user of these PEO employees.

I know this is not an issue without controversy. I would hope that between now and when there is another opportunity to consider this, that we could have a full discussion of its implications.

The second issue which was in amendment number two is what I would describe as the re-contribution amendment. We have allowed a number of options for funds that are originally collected for purposes of retirement, whether they be in IRAs or qualified retirement plans, to be used for other good and noble things, like buying a first house, education, or unusual medical expenses.

The problem is, that frequently ends up with the person reaching retirement age with a hollowed out retirement plan that does not provide the level of income that they had based their retirement upon.

This would allow people who have reduced their retirement benefits for one of the allowable purposes later in their life to begin to re-contribute to fill the gap that was created by withdrawing $20,000 to send a child to college, or to make the down payment on a house.

It would not relieve the individual of the current 10 percent penalty which is frequently applicable upon withdrawal of the funds. The re-contributed amount would not affect the individual's ability to make regular contributions and elect deferrals for the year in which the re-contribution is made.

This proposal has an estimate of a $1.2 million revenue loss over the next 10 years. I do not believe we should offer amendments that reduce revenue without an offset.

I, frankly, do not have an offset at this time, and therefore I am alerting the committee to what I think is a serious issue and a modest proposal to help resolve that issue by allowing people in their later years to re-contribute to their retirement. When I have located an offset of $1.2 billion, I will be re-offering this amendment.

The Chairman. Thank you, Senator. I think it is a very intriguing idea, that is, taking the funds that are withdrawn from an IRA and contributing them back without tax consequences. We want to encourage more personal savings in the country, and I think it is very intriguing. I hope we can work out a solution to that.

I think there are no other amendments to the pension bill. I am now going to bring up the pregnant women bill. I am saying that so Senators can know, in about 5 or 10 minutes, we are going to be voting on both, both pension and pregnant women.

We are going to need a quorum of 11, which we now do not have. So, I am urging Senators to stay just for a few more minutes, then also alerting other offices so that we can have the requisite number of Senators present to report out both of those bills.

I might say at the same time that we are going to have a hearing on FMAP, which is very important to a lot of States, and a mark-up on FMAP sometime next week. I am looking at Tuesday of next week to mark-up on FMAP.

Senator Nickles. We should do prescriptions.

The Chairman. We are doing prescriptions when that is right.

Senator Nickles. And when would that be?

The Chairman. Well, you can tell me. We are not there yet.

Senator Murkowski. Mr. Chairman?

The Chairman. Senator Murkowski?

Senator Murkowski. Let me just briefly put members on notice. It is my understanding that, on loans to executives of more than $1 million, we have a provision that, without adequate security and without repayment of terms or loans made below market interest rates, it would not be considered loans, but would be taxed as current compensation.

I do not see the justification for loans to executives within corporations. I have been a CEO. Those are all insider transactions. They are not necessary. Those loans should be referred to the private sector with adequate collateral.

What we have got here, is we are saying you cannot do it over $1 million, but under $1 million you can. I do not see the justification for under $1 million, and I am going to oppose that on the floor with a correcting amendment.

The Chairman. Ms. Paull?

Ms. Paull. Senator, the way the proposal works, is the $1 million threshold applies to other employees of the corporation. The officers, directors, and 5 percent or more shareholders do not have a $1 million threshold, it is any loan if it does not meet the criteria that is established by the bill, be a secured loan.

Senator Murkowski. What is the necessity of the corporation loaning insiders corporation money? They are not in the business of loaning money, they are in the business of doing whatever they do.

Ms. Paull. Well, the legislation tries to set up a bona fide loan. If you do not want to allow any loans, then you could change it. But I just wanted to make sure you understood that the million dollar threshold applies to other employees.

It does not apply to the officers, directors, or 5 percent or more shareholders. In other words, first dollars of loans, if it does not meet the bona fide loan standards, will be taxed as compensation.

Senator Grassley. Mr. Chairman?

The Chairman. Senator Grassley?

Senator Grassley. Could I comment just a minute on, as you announced, the agenda? First of all, I have no problems with taking up the pregnant women's bill, considering the fact that it is on the agenda and members are on notice.

I am not in a position to agree with you, though, that FMAP ought to come up next week. As it is your chairmanship, you obviously have that prerogative, but I would hope that we could work together on scheduling.

I would hope, also, that we would consider issues like FMAP along the lines of other things that this committee is going to have to consider before the end of the year, like the Medicare equity issues, as an example.

The Chairman. Senator Grassley, you are a good friend and good, in effect, co-chairman to work with. I will certainly do my best to work with you.

Senator Snowe. Mr. Chairman? Mr. Chairman?

The Chairman. Ms. Snowe?

Senator Snowe. Getting back to the agenda for next week and the prescription drug mark-up, the concern, obviously, has been expressed by many of us is that, as the Senate Majority Leader has indicated, he is going to bring up prescription drugs on the floor. It may not be a Medicare bill. That would preclude us from doing our work here. I think it is important.

I think we all agree that the committee should be in a position to mark-up this very critical piece of legislation. I am concerned, if in fact that is what the Leader is indicating, that is basically going to render any actions on the part of this committee moot.

The Chairman. I think the Senator makes an excellent point. I very much hope, and it is my intention, that this committee mark up a prescription drug benefit bill, which is the major bill that is on the floor.

In the meantime, the Majority Leader may schedule other legislation. But, whether or not that occurs, it is certainly my intent that this committee keep working today, as many hours as is humanly possible, to get a consensus--if not total consensus, at least a measure--reported out of this committee that has a significant enough majority so that probably it can withstand the 60-vote threshold on the vote. We both know there are two competing bills on the floor. Neither one, probably, is going to get 60 votes.

I told the Majority Leader, yesterday, in fact, that we are working and we are getting closer to getting a bill passed. Frankly, it is up to this committee. We can, in large extent, create our own destiny. That is, the more we work together as members of this committee and do work together with open minds, and compromise, and come up with a bill, then we will be the committee that writes the bill and that will be the major bill that will be on the floor, maybe as an amendment, maybe as a substitute, maybe as an original bill. But it is up to us, frankly, to come together and come up with a prescription drug benefit bill that is going to, in all likelihood, get 60 votes.

But I very much appreciate the concern of the Senator. It is my concern, too, believe me. I will be working very hard to make sure that this committee is the committee that writes the prescription drug bill, the one that gets the votes and passes.

I might say, Senator Graham has been very, very helpful in working with the committee, as has Senator Breaux. They have been extremely helpful. Senator

Grassley, you certainly, Senator, have been very helpful as well. Senator Jeffords and others have been extremely helpful. We are all on the same page.

We are now going to take up the pregnant women bill. I will ask the staff, just very briefly, to describe what is in the bill.

Ms. Kirchgraber. Very briefly, the Chairman's mark gives States the option to expand or add coverage of certain pregnant women under Medicaid and the Children's Health Insurance Program. It also provides for automatic enrollment of babies born to mothers enrolled in these programs.

The Chairman's mark increases the CHIP allotments by $200 million per year to cover the increased costs of these provisions, and it is a State option to pick up coverage of pregnant women.

The Chairman. That is brief. Does anybody have any questions?

Senator Bingaman. Mr. Chairman?

The Chairman. Senator Bingaman?

Senator Bingaman. Mr. Chairman, I strongly support your proposal here. This current law is perverse, in that we have coverage for pregnant women up until they turn 19 years of age, at which point they are no longer covered. This would correct that. I strongly support it and appreciate you bringing it up for mark-up.

Senator Nickles. Mr. Chairman?

The Chairman. Senator Nickles?

Senator Nickles. Correct me if I am wrong, but when we passed the Family Opportunity Act that was about $5.7 billion that I do not believe was paid for. Is this paid for?

Ms. Kirchgraber. Yes, it is. It is fully offset.

Senator Nickles. And what is the cost of it?

Ms. Kirchgraber. The cost is about $1.1 billion over 10 years, and $611 million over 5.

Senator Nickles. And how is it paid for?

Ms. Kirchgraber. It is paid for using Social Security pre-effectuation. Alan can actually describe it better than I could.

Senator Grassley. The same thing Senator Graham used a couple of times in the last week. [Laughter].

Mr. Cohen. That is correct, Senator. The committee has acted favorably on this before and the proposal would extend to Supplemental Security Income cases the current procedure for Social Security disability cases.

Under current law in Social Security disability cases, at least 50 percent of the favorable allowances made by the States have to be reviewed by the quality assurance component of the Social Security

Administration. This would extend that to disabled adults--not children--who apply for Supplemental Security Income.

Senator Nickles. So they would be reviewed as well.

Mr. Cohen. That is correct, Senator.

Senator Nickles. Senator Grassley mentioned Senator Graham has used this a couple of times.

Senator Grassley. I did not do it to denigrate the whole thing. I did not want a long explanation.

[Laughter].

Senator Graham. As a matter of fact, imitation is one of the highest forms of flattery.

Senator Nickles. I do not remember if Senator Graham's bill happened to become law.

Senator Graham. Sadly, not yet.

The Chairman. We have a sufficient quorum. All those in favor of the pregnant women bill, signify by saying aye.

[A chorus of ayes]

The Chairman. Those opposed, no.

[No response]

The Chairman. The ayes have it.

The next question is on the pension bill. All those in favor, say aye.

[A chorus of ayes]

The Chairman. Those opposed, no.

[No response]

The Chairman. The ayes have it. The bill is passed. Both bills have passed.

The committee is adjourned.

[The prepared statement of Senator Hatch appears in the appendix.]

[Whereupon, at 12:02 p.m. the meeting was concluded.]

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UNITED STATES SENATE
COMMITTEE ON FINANCE

Max Baucus, Chairman

Thursday, July 11, 2002
10:00 a.m.
215 Dirksen Senate Office Building

Agenda for Business Meeting

I. **A substitute for S. 321, the Family Opportunity Act of 2002**

II. **A substitute for S. 724, the Mothers and Newborns Health Insurance Act of 2002**

III. **A substitute for S. 1971, the National Employee Savings and Trust Equity Guarantee Act.**

OPENING STATEMENT OF SENATOR CHARLES E. GRASSLEY
AT THE EXECUTIVE SESSION OF S. 1971,
THE NATIONAL EMPLOYEES SAVING AND TRUST GUARANTEE ACT (NESTEG)

MR. CHAIRMAN, THANK YOU FOR CALLING THIS MARK-UP OF S. 1971, THE NATIONAL EMPLOYEE SAVING AND TRUST GUARANTEE ACT (NESTEG).

THIS BILL PROVIDES IMPORTANT PROTECTIONS FOR WORKERS' RETIREMENT SAVINGS IN LIGHT OF THE FINANCIAL IMPROPRIETIES AT ENRON AND WorldCom.

THERE ARE OVER 5,000 EMPLOYEES OF THOSE TWO COMPANIES IN IOWA. I SPEAK FOR ALL OF THEM WHEN I SAY THAT I AM "FIRE-FIGHTING MAD" ABOUT EXECUTIVES AND DIRECTORS WHO PLAY FAST AND LOOSE WITH THE RETIREMENT MONEY OF HONEST, HARD-WORKING CITIZENS.

I INTRODUCED MY BILL LAST FEBRUARY, MR. CHAIRMAN, IN AN EFFORT TO PRODUCE A BILL REPRESENTING A BROAD PENSION PROTECTION CONSENSUS. I THINK WE ACHIEVED THAT OBJECTIVE.

THIS BILL CONTAINS A THREE-YEAR DIVERSIFICATION RULE FOR MATCHING CONTRIBUTIONS IN COMPANY STOCK. IT HAS 30-DAY ADVANCE NOTICE PRIOR TO A COMPANY PLAN BLACKOUT AND HAS REQUIREMENTS FOR PERIODIC BENEFIT STATEMENTS.

MY ORIGINAL BILL CONTAINED A PROVISION RESTRICTING INSIDER TRADING DURING A PLAN BLACKOUT. THE ACCOUNTING BILL THAT IS ON THE FLOOR THIS WEEK CONTAINS A PROVISION MAKING THOSE RESTRICTIONS, SO IT DROPPED OUT OF OUR BILL.

I OBJECT TO THE BANKING COMMITTEE LEGISLATING PENSION PLAN RESTRICTIONS.

AND I HOPE YOU AND I CAN CLEAR THAT UP WITH SENATORS SARBANES AND ENZI IN THE NEXT DAY OR SO. WE SHOULD ALSO CLEAN UP THE 'INSIDER TRADING' LANGUAGE IN S. 2673. THE BILL DOES NOT DESCRIBE PLAN BLACK-OUTS CORRECTLY AND HAS OTHER DEFECTS.

MONTHS AGO I PREDICTED THAT INVESTMENT ADVICE WOULD BE ONE OF THE MOST CONTENTIOUS ISSUES THAT WOULD BE RAISED THIS YEA.

I WAS RIGHT. THERE ARE TWO VERY DIFFERENT POINTS OF VIEW ON INVESTMENT ADVICE. ONE STRONGLY FAVORS INDEPENDENT ADVICE. THAT IS SENATOR BINGAMAN'S APPROACH. THE OTHER FAVORS ALLOWING AFFILIATED ADVISORS.

YOUR MARK CONTAINS THE SAFE HARBOR FOR INDEPENDENT INVESTMENT ADVICE INTRODUCED BY SENATOR BINGAMAN.

I DO NOT THINK THERE IS ANY HARM IN THE BINGAMAN APPROACH. MANY AGREE THAT IT IS CLOSE TO CURRENT LAW.

IT PROBABLY IS NOT A *TOTAL CURE* FOR OUR RETIREMENT SAVING ILLS.

I WANT TO FIND THE BEST WAYS TO PROTECT PLAN PARTICIPANTS, AND HELP THEM TO SAVE *WISELY* FOR RETIREMENT.

MR. CHAIRMAN WOULD YOU AND SENATOR BINGAMAN WORK WITH ME TO FIND OUT IF THERE ARE ADDITIONAL PROVISIONS WE CAN LOOK AT TO HELP PLAN PARTICIPANTS?

NOW LET ME TURN TO EXECUTIVE COMPENSATION. SOME PEOPLE ARE UPSET ABOUT THESE PROVISIONS BEING INCLUDED IN THIS MARK.

WE HAVE SEEN A LOT OF EXECUTIVE HANKY-PANKY REACHING BACK AS MUCH AS 4 OR 5 YEARS.

THIS SET OF PROVISIONS IS FAIR IN LIGHT OF THE BAD BEHAVIOR WE HAVE LEARNED ABOUT.

I AM NOT SAYING THIS TITLE OF THE BILL IS PERFECT, BUT IT IS PRETTY DECENT.

THE PRESIDENT WANTS TO PROHIBIT LOANS TO EXECUTIVES. THIS BILL MERELY RESTRICTS THEM. THAT'S *MORE THAN* FAIR.

IT ALSO REQUIRES PAYMENT OF TAX ON BONUSES. IF YOU GET A BONUS, YOU SHOULD PAY TAX ON IT. SO THAT IS FAIR, TOO.

IF COMPANIES ARE SENDING LARGE AMOUNTS OF MONEY TO OFF-SHORE "RABBI" TRUSTS TO AVOID PAYMENT OF TAXES, WE CAN RE-CAPTURE THE MONEY.

FINALLY LET ME TURN TO THE TEACHER'S ISSUE. THIS IS VERY IMPORTANT TO ME PERSONALLY.

WHEN THE TEACHERS OF IOWA COME TO ME FOR HELP, I WANT TO BE THE FIRST TO EXTEND A HELPING HAND.

IN IOWA, SCHOOL TEACHER TURNOVER IS LOW, AND THE DEDICATION IS HIGH.

TEACHERS STAY ON THE JOB BECAUSE THEY KNOW THAT THE PENSION BENEFITS ARE GREAT, IF YOU CAN LAST UNTIL AGE 65 (WHEN SOCIAL SECURITY KICKS IN).

BUT LIKE SCHOOL TEACHERS EVERYWHERE, THEY GET BURNED OUT.

IN RECOGNITION OF THIS, THE SCHOOL DISTRICTS ALL OVER IOWA HAVE PUT IN VOLUNTARY SUPPLEMENTAL PAYMENT PROGRAMS FOR THEIR SCHOOL TEACHERS.

THESE ARE REALLY LIKE A SOCIAL SECURITY BRIDGE BENEFIT OR A SEVERANCE BENEFIT BUT THAT IS PAID OUT OVER SEVERAL YEARS.

THE BENEFITS ARE MODEST, BUT THEY ARE *VERY IMPORTANT* TO TEACHERS PREPARING FOR RETIREMENT.

FURTHERMORE IN EVERY CASE, THESE BENEFITS ARE MERELY A SUPPLEMENT TO A *GOOD* DEFINED BENEFIT PENSION PLAN.

THE SUPPLEMENTAL PORTION OF THE BENEFIT, UNFORTUNATELY DOES NOT FIT INTO INTERNAL REVENUE CODE AND ERISA SECTION 457 AS IT SHOULD.

THIS BILL MAKES PUBLIC SCHOOL TEACHER SUPPLEMENTAL RETIREMENT BENEFITS PERMISSIBLE. IT WILL HELP TEACHERS IN IOWA AND MANY, MANY OTHER STATES.

THE AARP, AN ORGANIZATION WITH WHICH I HAVE LONG ENJOYED A POSITIVE RELATIONSHIP, HAS RAISED CONCERNS ABOUT THE SCHOOL TEACHERS PLANS.

I KNOW THAT THE NEA, AFT AND THE AARP SHARE SIMILAR GOALS FOR RETIREES.

THIS IS SIMPLY A DISAGREEMENT AMONG FRIENDS.

OUR BILL ATTEMPTS TO ADDRESS THE RETIREMENT PROBLEMS FACED BY TEACHERS.

IT DOES NOT REACH THE RETIREE MEDICAL PROBLEM. I WOULD LIKE TO SOLVE THAT TOO, IF POSSIBLE AT SOME FUTURE TIME.

FOR THE SAKE OF MAKING PROGRESS FOR THE TEACHERS, I WILL AGREE TO PUT IT ASIDE. HOWEVER, I WANT TO CONTINUE THIS DIALOGUE, SO THAT WE CAN HELP MORE WORKERS RETIRE EARLY, *IF THEY CHOOSE TO.*

MR. CHAIRMAN THIS BILL IS AN OVERALL GOOD RESULT.

WE HAVE APPROPRIATE, BUT NOT EXCESSIVE, RETIREMENT PROTECTIONS. WE HAVE APPROPRIATE, BUT NOT EXCESSIVE, LIMITATIONS ON EXECUTIVE COMPENSATION.

I LOOK FORWARD TO HELPING YOU REPORT OUT THE BILL FAVORABLY.

Daschle Statement

Mr. Chairman. I, like you, hope that we can use the reauthorization of Welfare Reform as an opportunity to make real progress in helping low-income families build better lives for themselves and their children.

Since 1996, we have made a lot of progress. One-third of all people receiving benefits are working – triple what it was in 1996. Caseloads have been cut by more than half, and births to teenagers are on the decline. I made clear when we first considered these changes that I had real concerns about the impact that cuts in food stamp benefits and other support services would have on children. Fortunately, our economy was strong – and there were opportunities for people making the transition from welfare to work.

Now comes the hard part. Our economy is struggling. Those who could move easily into the workforce have already done so, and many who took minimum-wage jobs are realizing that they need more skills to move up the economic ladder.

If there's one lesson we have learned so far, it is this: it takes more than a strong economy to turn lives around. It takes strong support. Someone who has never worked before may need vocational training. Some who have dropped out of the work force may need treatment for addiction or dependency. For parents with older children, we need to ensure that our schools can provide the after-school programs that will keep them safe. Non-native English speakers may need intensive help to learn English as a second language.

But most importantly, if we're going to require mothers to work, we also need to make sure they can find the child care that will allow them to do so.

The welfare legislation being reported today represents a significant improvement over the bill passed by the House, and I commend Senator Baucus for that. I appreciate his efforts to put together a bipartisan package. I also want to acknowledge the efforts of Senators Breaux, Rockefeller, Lincoln, Jeffords, Hatch, and Snowe to improve upon the Administration's proposal.

Additional improvements were made during today's markup. I strongly support Senator Graham's amendment to allow states to provide health care coverage for pregnant women and children who are legal immigrants, Senator Snowe's amendment to allow states to count post-secondary education as work, and Senator Conrad's amendment to make sure that families can care for members with disabilities.

However, the mark simply does not devote the resources necessary to ensure that the children whose parents are trying to work have access to decent child care. We are all aware that the resources available for child care under current law are inadequate, and this bill will impose additional work requirements that will create more demand for child care.

This situation is likely to get worse, as state budget shortfalls are forcing many states to reduce their own investments in child care.

For this reason, I have no choice but to vote no on final passage of the bill.

If we are serious about moving people from assistance to self-sufficiency, we need to give them the tools to do so. To me, child care is the most important of those tools. Therefore, I intend to work with Senators Bingaman, Kerry, and other interested colleagues on both sides of the aisle to see to it that greater priority is given to child care when this legislation is considered in the full Senate.

My vote on this mark does not diminish my commitment to getting this bill -- including strong child care provisions -- enacted this year.

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Senate Finance Markup:

"Work, Opportunity, and Responsibility for Kids (WORK) Act of 2002"
(2002 Welfare Reauthorization)

U.S. Senator Blanche Lincoln

June 26, 2002

Thank you Mr. Chairman. I appreciate your leadership and determination to complete welfare reauthorization this year. I thank you and the rest of my colleagues in the "tripartisan" group of Finance Committee members who have worked hard during the last several months to construct a good, solid bill that will help continue the welfare reform success story we started in 1996.

In 1996, I was a house conferee as we worked together in a bipartisan way to foster self-sufficiency through work among welfare recipients. During the last five years, millions of people have left welfare rolls for work. More than 9,000 Arkansas families have moved from welfare over the last five years.

One reason welfare reform has worked so well is because we've remained true to the original aim of welfare policy – to serve as a safety-net in difficult times and to help families become self-sufficient. These successes are a true testament to how effective this policy can be.

However, we need to keep in mind that many people remaining on welfare face greater barriers to work, requiring more attention and resources, than those who have already left.

In Arkansas, 75% of families reported having at least one barrier to employment, and more than 1 out of 4 reported having three or more barriers, including child care, transportation, education and training, mental health, domestic violence, and substance abuse.

The number of barriers that poor mothers face definitely affects their employability, and I am glad we address many of these barriers in the bill before us today.

In Arkansas, access to transportation and child care are the biggest barriers. More than half of families have difficulties gaining access to transportation, and about 1 out of 3 families report difficulties accessing child care.

I am pleased that this bill addresses the transportation needs of rural America by authorizing an automobile purchase demonstration program that provides competitive grants to help low-income families purchase, maintain, or insure automobiles.

I am also pleased that the bill covers the child care costs generated by the new, increased work requirements as well as an extra amount of money to address the current child care need for low-income families. In Arkansas, only 20% of families eligible for child care assistance are actually being served.

Although millions of people have left welfare for work, there is bad news as well: many of these hard-working parents and their children are still in poverty and at the risk of returning to welfare.

Recognizing that, I believe the next step of welfare reform should focus on helping people get long-term, good paying jobs that will help former welfare recipients move up the economic ladder. We must make work pay.

That was my intention when I designed an employment credit with Representative Sandy Levin. My bill, accepted in the "tripartisan" proposal as well as in the mark, replaces the old caseload reduction credit with an employment credit that rewards states for moving people into jobs and extra credit for moving them into good jobs and permanent independence.

A new study released by the Economic Policy Institute (EPI) proves that initial job quality and ongoing work supports like child care and transportation dramatically affects a parents' ability to maintain employment over an extended period.

Former welfare recipients with young children are 67 percent more likely to still be employed after two years if they receive help paying for child care, and twice as likely to still be employed if the job paid an above-poverty starting wage. These trends hold true even if you account for factors like the worker's education level.

These findings are what made it so logical to extend an employment credit to States in place of a caseload reduction credit.

For me, it's really a question of which you value more – keeping the cash caseload "busy" with make-work activities or moving poor parents off of cash assistance and into private-sector jobs.

I know which I value more: moving parents into private sector employment and into a life of self-sufficiency and independence. That has been the underlying goal of welfare reform since 1996.

I understand that some of my colleagues are skeptical of this new concept, and I have reluctantly agreed to place a cap on the employment credit as long as important economic triggers are in place to help poor States like Arkansas, West Virginia, and Louisiana when times are tough.

I still believe that capping the credit that States can receive for putting parents into jobs might provide a perverse incentive to keep people on welfare in an effort to meet the work participation rates. Furthermore, capping the employment credit will disproportionately force poorer states like Arkansas to take money away from valuable work-support services like child care and transportation, which keep families in private sector employment and off of welfare.

However, after much debate, I feel comfortable with our compromise to cap the employment credit even though I feel that it somewhat mutes my philosophy of getting welfare clients into good-paying jobs.

I am also glad that the Chairman's bill continues and expands upon the TANF Supplemental

Grants. This grant is essential for Arkansas, as we have the lowest TANF grant in spending per poor child in the country. While I am happy that Arkansas will receive an increase in the supplemental grant, I still remain concerned that our state remains at the bottom of the list in terms of funding.

Knowing my State will undoubtedly need additional resources to meet the tougher work requirements and the inflexibility of a capped employment credit, I will be pleased to vote for the amendment Sen. Rockefeller will offer today on the Social Services Block Grant (SSBG) funding. This funding helps Arkansas and many Southern states cope with having low TANF grants, and I am disappointed that we were unable to get full funding in this bill. Arkansas uses SSBG money to fill in the gaps in federal funding for vital social services programs, such as child protective services, Meals on Wheels and adult day care, and residential treatment and transportation services for disabled children and adults.

As we move forward on welfare reauthorization, we must remember that we are mostly talking about *mothers with young children.* As I learned first-hand when I recently spent time with a welfare mother in Arkansas, these mothers face the same challenges as does any mother working outside the home: balancing work and family; finding and keeping safe and affordable child care; and accessing reliable transportation. Obtaining these things is much more difficult, and often impossible, for low-income women. It is hard enough for a U.S. Senator with a loving, supportive husband and the necessary financial resources to do these things.

I saw great potential in the 5-year-old son of one of the mothers I visited with in Arkansas. I know he was proud of his mother's efforts to get training and prepare for a job, and I saw how proud she was of her own efforts. The bill we're considering today helps ensure that this mother – and the many like her – will have all the tools and resources necessary to become self sufficient.

Again, I would like to thank the Chairman for his leadership on this issue, and I look forward to today's markup.

Statement of
Senator Orrin G. Hatch
before the
Senator Committee on Finance Mark-up
July 11, 2002

Mr. Chairman and Senator Grassley, thank you for holding this mark up on a number of important Finance Committee bills. I appreciate that the Committee is moving forward on these issues.

There are some complicated issues associated with some of these bills and I look forward to a vigorous debate.

But before we begin, I want to make a special point to commend Senator Grassely on his fierce advocacy on behalf of families struggling to care for a disabled child. I am proud to be a cosponsor, along with 73 of my colleagues, of his bill which would extend a state option for Medicaid coverage for children who qualify for Supplemental Security Income (SSI), but who do not meet the income threshold.

I am aware that many of these parents of disabled children are concerned that by taking a promotion which may increase their salary or taking a new job they might compromise the health care coverage of their child. I know the majority of my colleagues share the concern that families should not have to choose between quality health care and professional advancement.

I recognize that many of these families are struggling with considerable financial burdens associated with the care of these children and that we should provide states with the option to help.

Again, I wish to commend Senator Grassley for his hard work on this issue and to thank Chairman Baucus for including it in today's mark up.

Again, I look forward to a good discussion on these issues.

Statement of Senator Orrin G. Hatch
Mark up of S. 724
The Mothers and Newborns Health Insurance Act of 2002
before the
Senate Committee on Finance
July 11, 2002

Mr. Chairman, had I been able to offer my amendment during the Finance Committee markup, I would have requested unanimous consent to modify my amendment to replace the phrase "all children eligible under SCHIP" with "the greatest extent possible for all children eligible under SCHIP."

Mr. Chairman, I regret that I did not have an opportunity to offer my amendment, but I want my colleagues to stand on notice, that when this bill gets to the floor, I will be offering this amendment.

This is a simple amendment. It states that before we pass a law which allows states the option to cover adults under the SCHIP program, there should be some assurances that states are, to the greatest extent possible, covering poor kids.

Mr. Chairman, as one of the primary authors of the CHIP bill, this legislation remains one of my proudest legislative accomplishments. But it was a big fight to get this bill enacted. One of the main concerns was that this bill would be the proverbial slippery slope to a mammoth and unwieldily universal health care bill.

I fought long and hard to make sure that the Governors, the state legislatures and my colleagues understood that this was not another entitlement type program. CHIP was intended to be a limited program targeting a specific group of children whose parents made too much to qualify for Medicaid, but for whom private health care coverage was cost prohibitive.

I continue to believe that as one of the principle authors of the CHIP bill that I have an obligation to live up to the assurances I made that it was not the intent of the CHIP program to balloon into a big entitlement type health care program.

During the negotiations on CHIP, the issue of covering pregnant women was raised and it was determined that for what it costs to cover prenatal care and delivery and postpartum care, we could cover a great number of poor kids. These were tough choices, to be sure, but I felt strongly that we needed to maintain the integrity of this program.

The need is still very great. According to the Kaiser Commission on Medicaid and the Uninsured, 21.3% of low-income children, that is children in families with incomes less than 200% of poverty, are uninsured. That is nearly 1 in 5 poor kids who do not have any insurance. I think that, as attractive an option as it is, to expand SCHIP to cover pregnant women, we need to make sure that we are addressing the needs of the current eligible population first.

I recognize that some might make a comparison between what states can do under various waiver proposals and what the Chairman is proposing to accomplish with his mark – provide insurance for adults who are currently uninsured. I make a distinction between the rules associated with an experimental demonstration waiver program and the enactment of a federal law. I think that the threshold needs to be higher for a federal law than for a demonstration program, which I why I did not extend my amendment to apply to waiver programs.

Mr. Chairman, again, I regret that I did not have an opportunity to offer this amendment. I look forward to continuing this debate on the Senate floor.

"Family Opportunity Act of 2002"
Chairman's Mark

TITLE I. OPPORTUNITY TO PURCHASE MEDICAID COVERAGE FOR CERTAIN DISABLED CHILDREN

Section 101. Opportunity for Families of Disabled Children to Purchase Medicaid Coverage for Such Children

State Option to Allow Families of Disabled Children to Purchase Medicaid Coverage

Current Law

Federal law establishes the categories or groups of individuals that can be covered under Medicaid and, in many cases, defines specific eligibility rules for these categories. Some groups must be covered under Medicaid (called mandatory groups), while others may be covered at state option. In general, Medicaid is available to low-income persons who are aged, blind or disabled, members of families with dependent children, and certain other pregnant women and children. Applicants' income and resources must be within certain limits, most of which are determined by states, again within federal statutory parameters. States have considerable flexibility in defining countable income and assets for determining eligibility.

For disabled children, there are several potentially applicable Medicaid eligibility groups, some mandatory but most optional. Some of these children could qualify for Medicaid through more than one pathway in any given state. There are four primary coverage groups for which disability status or medical need is directly related to eligibility.

First, subject to one important exception, states are required to cover all children receiving Supplemental Security Income (SSI). Because SSI is a federal program, income and resource standards do not vary by state. In determining financial eligibility, parents' income is deemed available to noninstitutionalized children (but the need of household members is taken into account). If family income is higher than the SSI threshold, the child will not qualify for SSI or Medicaid.

The major exception to the required coverage under Medicaid of SSI recipients occurs in so called "209(b)" states. Such states can apply more restrictive income and resources standards and/or methodologies in determining Medicaid eligibility than the standards applicable under SSI. States that offer State Supplemental Payments (SSP) may also offer Medicaid coverage to SSP recipients who would be eligible for SSI, except that their income is too high.

Second, states may offer medically needy coverage under Medicaid. The medically needy are persons who fall into one of the other categories of eligibility (e.g., is a dependent child) but whose income exceeds applicable financial standards. Income standards for the medically needy can be no higher than 133⅓ percent of the state's former Aid to Families with Dependent Children (AFDC) payment standard in effect on July 16, 1996. Individuals can meet these financial criteria by having income that falls below the medically needy standard, or by incurring medical expenses that when subtracted from income, result in an amount that is lower than the medically needy income standard. Resource standards correspond to those applicable under SSI. Older children or those with very large medical expenses may qualify for medically needy coverage. (Other eligibility pathways for younger children are described below.)

Third, states may extend Medicaid to certain disabled children under 18 who are living at home and who would be eligible for Medicaid via the SSI pathway if they were in a hospital, nursing facility, or intermediate care facility for the mentally retarded, as long as the cost of care at home is no more than institutional care. (This group is also called the Katie Beckett category.) The law allows states to consider only the child's income and resources when determining eligibility for this group. That is, states may ignore parents' income.

Fourth, states have an option to cover persons needing home and community based services, if these persons would otherwise require institutional care covered by Medicaid. These services are provided under waiver programs authorized by Section 1915(c) of Title XIX of the Social Security Act. Unlike the Katie Beckett option, which requires all disabled children within a state to be covered, such programs may be limited to specific geographic areas, and/or may target specific disabled groups and/or specific individuals within a group. States may apply institutional deeming rules which allow them to ignore parents' income in determining a child's eligibility for waiver services.

Disabled children can also qualify for Medicaid via other eligibility pathways for which disability status and medical need are irrelevant. These additional pathways cover children at higher income levels than those applicable to most of the disability-related eligibility categories described above. For example, states are required to provide Medicaid coverage to children under age 6 (and pregnant women) in families with incomes below 133 percent of the federal poverty level (FPL), and in FY2002, for children between ages 6 and 18 in families with income below 100 percent of FPL. States may cover infants under age one (and pregnant women) in families with income between 133 and 185 percent of FPL. Similarly, under the State Children's Health Insurance Program (SCHIP), states may extend Medicaid (or provide other health insurance) to certain children under age 19 who are not otherwise eligible for Medicaid in families with income that is above the applicable Medicaid standard but less than 200 percent of FPL, or in states that already exceed the 200 percent of FPL level for Medicaid children, within 50 percentage points over that existing level.

Chairman's Mark

Effective October 1, 2004, the Chairman's mark would add a new optional eligibility group for disabled children to Medicaid. The new group includes children under 18 years of age who meet the disability definition for children under the Supplemental Security Income (SSI) program and whose family income is above the financial standards for SSI but not more than 250 percent of FPL. States may exceed 250 percent of FPL, but federal financial participation is not available for coverage of disabled children in families with income above that level.

Interaction with Employer-Sponsored Family Coverage

Current Law

States may require Medicaid eligibles to apply for coverage in certain employer-sponsored group health plans (for which such persons are eligible) when it is cost-effective to do so. This requirement may be imposed as a condition of continuing Medicaid eligibility, except that failure of a parent to enroll a child must not affect the child's continuing eligibility for Medicaid.

If all members of the family are not eligible for Medicaid, and the group health plan requires enrollment of the entire family, Medicaid will pay associated premiums for full family coverage if doing so is cost-effective. However, Medicaid will not pay deductibles, coinsurance or other cost-sharing for family members ineligible for Medicaid. Third party liability rules apply to coverage in a group health plan. That is, such plans, not Medicaid, must pay for all covered services under the plan.

Under current law, cost-effectiveness means that the reduction in Medicaid expenditures for Medicaid beneficiaries enrolled in a group health plan is likely to be greater than the additional costs for premiums and cost-sharing required under the group health plan. Group health plan means a plan of (or contributed to by) an employer or employee organization to provide health care (directly or otherwise) for employees and their families.

In sum, when it is cost-effective, Medicaid pays the premiums and other cost-sharing under certain group health plans for Medicaid eligibles, as well as for Medicaid services not covered under the group health plan. This includes payment of any premium and cost sharing amounts that exceed limits placed on such payments in Medicaid law.

Chairman's Mark

The Chairman's mark would allow states to require parents of disabled children who are eligible for the newly defined coverage group to enroll in employer-sponsored family coverage under certain circumstances. Specifically, when the employer of a parent of a disabled child offers family coverage under a group health plan, the parent is eligible for such coverage, and the employer contributes at least 50 percent of the annual premium costs, states may require participation in such employer-sponsored family coverage plan as a condition of continuing Medicaid eligibility for the targeted child under the proposed optional eligibility category. In addition, if such coverage is obtained, states may elect to have families pay an amount that reasonably reflects the premium contribution made by the parent for this coverage on behalf of the disabled child. States may pay any portion of a required premium for family coverage under an employer-sponsored plan; for families with income that does not exceed 250 percent of FPL, the federal government will share in the cost of these payments.

In addition, states that use employer-sponsored family coverage for the new optional eligibility group must insure that these plans, not Medicaid, pay for all covered services under the plan, as is the case with all other third party liability situations.

State Option to Impose Income-Related Premiums

Current Law

Generally, for certain eligibility categories, states may not impose enrollment fees, premiums or similar charges. Further, states are specifically prohibited from requiring payment of deductions, cost-sharing or similar charges for services furnished to persons under 18 years of age (up to age 21, or any reasonable subcategory of such persons between 18 and 21 years of age, at state option).

In certain circumstances, states may impose monthly premiums for enrollment in Medicaid. For example, states may require certain qualified severely impaired persons ages 16 and above who but for earnings would be eligible for SSI to pay premiums and other cost-sharing charges set on a sliding scale based on income. Further, states may require such persons with income between 250 to 450 percent of FPL to pay the full premium. However, the sum of such payments may not exceed 7.5 percent of income.

For other groups, states may not require prepayment of premiums and may not terminate eligibility due to failure to pay premiums, unless such failure continues for at least 60 days. States can also waive premiums when such payments would cause undue hardship.

Chairman's Mark

The Chairman's mark adds a new section to Medicaid law governing premiums applicable to the new optional eligibility group. It would allow states to require families with disabled children eligible for Medicaid under the new optional eligibility group to pay monthly premiums for enrollment in Medicaid on a sliding scale based on family income. Aggregate payments for premiums paid by families for employer-sponsored family coverage may not exceed 5 percent of income.

States may not require prepayment of premiums, nor are states allowed to terminate eligibility of a targeted child for failure to pay premiums unless lack of payment continues for a minimum of 60 days beyond the payment due date. States may waive payment of premiums when such payment would cause undue hardship.

The mark does not change current law with respect to other cost-sharing by beneficiaries (e.g., deductibles, co-insurance, co-payments), which is not permitted for children under 18 years of age. Thus, Medicaid would pay such cost sharing obligations rather than the families of qualifying children under the new optional group.

Section 102. Treatment of Inpatient Psychiatric Hospital Services for Individuals Under 21 in Home or Community-Based Services Waivers

Current Law

Medicaid home and community-based service (HCBS) waivers authorized by Section 1915(c) of Title XIX of the Social Security Act give states the flexibility to develop and implement alternatives to placing Medicaid beneficiaries in hospitals, nursing facilities, or intermediate care facilities for the mentally retarded (ICF-MRs). These waivers allow such individuals to be cared for in their homes and communities as long as the cost is no higher than that of institutional care.

Federal regulations permit HCBS programs to serve the elderly, persons with physical disabilities, developmental disabilities, mental retardation or mental illness. States may also target waiver programs to persons with specific illnesses or conditions, such as technology-dependent children or individuals with AIDS.

Services that may be provided under HCBS waiver programs include: case management, homemaker/home health aide services, personal care services, adult day health, habilitation, and respite care. Other services needed by waiver participants to avoid institutionalization, such as non-medical transportation, in-home support services, special communication services, minor home modifications, and adult day care may also be provided, subject to approval by Centers for Medicare and Medicaid Services (CMS). The law further permits day treatment or other partial hospitalization services, psychosocial rehabilitation, and clinic services for persons with chronic mental illness. Room and board are excluded from coverage except under limited circumstances.

Under HCBS wavier programs, states may select the mix of services that best meets the needs of the targeted population to be served. Programs may be statewide or limited to a specific geographic area.

Chairman's Mark

The mark adds to the list of persons eligible for HCBS waiver programs individuals under 21 years of age requiring inpatient psychiatric hospital services, effective for medical assistance provided on or after January 1, 2003.

Section 103. Development and Support of Family-to-Family Health Information Centers.

Current Law

Title V of the Social Security Act authorizes the Maternal and Child Services Block Grant program, which provides grants to states for improving the health of mothers and children. The program has three components: (1) formula block grants to 59 states and territories; (2) Special Projects of Regional and National Significance (SPRANS); and (3) Community Integrated Service Systems (CISS) grants.

Activities supported under SPRANS include Maternal and Child Health (MCH) research, training, genetic services, hemophilia diagnostic and treatment centers and maternal and child health improvement projects that support a broad range of innovative strategies.

By law, 15 percent of the amount appropriated for the Maternal and Child Health Block Grant Program up to $600 million, is awarded to public and private not-for-profit organizations for SPRANS. SPRANS also receive 15 percent of funds remaining above $600 million after CISS funds are set aside. The CISS programs are initiated when the MCH appropriation exceeds $600 million. Of any amount appropriated over $600 million, 12.75 percent must be for CISS. The remaining amounts are allocated to the block grant program and to SPRANS.

Chairman's Mark

The Chairman's mark would increase funding for SPRANS for the development and support of new family-to-family health information centers. The mark would appropriate to the Secretary out of any money in the Treasury not otherwise appropriated, for this new purpose an additional $3 million for FY2003; $4 million for FY2004; and $5 million for FY2005. For each of fiscal years 2006 and 2007, the bill authorizes to be appropriated to the Secretary $5 million for this purpose. Funds would remain available until expended.

The family-to-family health information centers would: (1) assist families of children with disabilities or special health care needs to make informed choices about health care so as to promote good treatment decisions, cost-effectiveness, and improved health outcomes for such children; (2) provide information regarding the health care needs of, and resources available for children with disabilities or special health care needs; (3) identify successful health delivery models; (4) develop a model for collaboration between such children and health professionals; (5) provide training and guidance with regard to the care of such children; and (6) conduct outreach activities to the families of such children, health professionals, schools, and other appropriate entities and individuals. The family-to-family health information centers would be staffed by families of children with disabilities or special health care needs who have expertise in federal and state public and private health care systems, and health professionals.

The Chairman's mark would require the Secretary to develop such centers in: (1) not less than 25 states in FY2003; (2) not less than 40 states in FY2004; and (3) not less than 50 states in FY2005. States would be defined as the 50 states and the District of Columbia.

Section 104. Restoration of Medicaid Eligibility for Certain SSI Beneficiaries.

Current Law

Except in the case of "209(b)"states, states are required to provide Medicaid benefits to all individuals who are receiving Supplemental Security Income (SSI). Persons eligible for SSI are low-income aged, blind, and disabled individuals. (Under the 209(b) provision, states may apply more restrictive income and resources standards and/or methodologies for determining Medicaid eligibility than the standards under SSI.) For disability purposes, two groups of disabled children exist: those under the age of 18 and those age 18 through 21 (if a full time student). Eligibility for SSI is effective on the later of: (1) the first day of the month following the date the application was filed, or (2) the first day of the month following the date that the individual was determined eligible.

Chairman's Mark

The Chairman's mark confers Medicaid eligibility to persons who are under age 21 and who are eligible for SSI, effective on the later of: (1) the date the application was filed, or (2) the date SSI eligibility was granted.

The Committee's provision would apply to medical assistance for items and services furnished on or after the first day of the first calendar quarter that begins after the date of enactment of this Act.

"Mothers and Newborns Health Insurance Act of 2002"
Chairman's Mark

SECTION 1 - SHORT TITLE

SECTION 2–STATE OPTION TO EXPAND OR ADD COVERAGE OF CERTAIN PREGNANT WOMEN UNDER MEDICAID AND SCHIP

State Option to Expand Coverage Under Medicaid

Current Law

States are required to provide Medicaid coverage to pregnant women with no other children who have family income up to 133 percent of the federal poverty level (FPL), and have the option to extend such coverage to pregnant women with no other children who have family income between 133 and 185 percent of FPL. Both of these eligibility categories are commonly referred to as "poverty-related pregnant women." These pregnant women are entitled only to pregnancy-related services (e.g., prenatal, delivery and postpartum care up to 60 days after delivery). States may increase the effective income level above these standards by modifying applicable income and resource methodologies. In addition, states may seek waivers of program rules to extend Medicaid to pregnant women at higher income levels.

The State Children's Health Insurance Program (SCHIP) allows states to cover uninsured children under age 19 in families with income above applicable Medicaid financial standards. States may choose from among three benefit options when designing their SCHIP programs. They may expand Medicaid, create a new separate state program that must meet minimum benefit requirements, or devise a combination of both approaches. Among the many services available under SCHIP are prenatal care and hospital services. Pregnant women ages 19 and above are eligible for SCHIP only through special waivers of program rules, or when employer-sponsored family coverage subsidized by SCHIP includes adults in families with eligible children.

The federal share of Medicaid costs is equal to the federal medical assistance percentage (FMAP) of those costs. The FMAP is determined annually according to a formula designed to pay a higher federal matching rate to states with lower per capita incomes relative to the national average. The law establishes a minimum FMAP of 50 percent and a maximum FMAP of 83 percent. Under SCHIP, an enhanced FMAP (E-FMAP) is available. The E-FMAP is defined as the FMAP under Medicaid increased by 30 percent of the number of percentage points by which the FMAP for the state is less than 100 percent. E-FMAP ranges from 65 to 85 percent (the statutory upper limit).

Under Medicaid presumptive eligibility rules, states are allowed to temporarily enroll children whose family income appears to be below applicable Medicaid income standards, until a formal determination of eligibility is made. Payments made on behalf of Medicaid children during periods of presumptive eligibility are matched at the regular Medicaid FMAP, but are paid out of state SCHIP allotments.

Federal funds for SCHIP were appropriated in the original enacting statute for FY1998 through FY2007. From each year's appropriation, a state is allotted an amount as determined by a formula set in law. Expenditures associated with presumptive eligibility for children under Medicaid are counted against a state's SCHIP allotment.

Chairman's Mark

Effective for items and services furnished on or after October 1, 2002, the Chairman's mark would allow states meeting two conditions to cover additional pregnant women under Medicaid. Women eligible for such coverage under this provision include those with no other children in families with income exceeding 185 percent of FPL up to a state's SCHIP income level for children in effect as of January 1, 2002. The two conditions that must be met include: (1) the state must cover under Medicaid and SCHIP such pregnant women in lower income families before or in addition to pregnant women in higher income families, and (2) the state must apply an income level to the new group of pregnant women that is no lower than the effective income level in place for pregnant women already covered under the state Medicaid plan as of January 1, 2002. This provision would apply to items and services furnished on or after October 1, 2002, regardless of whether implementing regulations have been issued.

For states expanding coverage to additional pregnant women with incomes *exceeding* 185 percent of FPL, the SCHIP enhanced FMAP would apply and all payments would be counted against the state's SCHIP allotment.

Finally, the Chairman's mark would eliminate the requirement that expenditures associated with presumptive eligibility for children under Medicaid be counted against a state's SCHIP allotment.

State Option to Expand Coverage Under SCHIP

Current Law

In general, SCHIP allows states to cover uninsured children under age 19 in families with incomes that are either: (1) above the state's Medicaid financial eligibility standard but less than 200 percent of FPL, or (2) in states with Medicaid income levels for children already at or above 200 percent of FPL, within 50 percentage points over the state's Medicaid income eligibility limit for children in effect on March 31, 1997.

Generally, states cover SCHIP-eligible kids by either enrolling them into Medicaid expansion programs, or into separate state health insurance plans that meet specific standards for benefits and cost-sharing, or through a combination of both.

States covering SCHIP-eligible children through Medicaid must provide the full range of mandatory Medicaid benefits, including maternity care, and all optional services specified in their state Medicaid plans. Coverage for pregnant women under Medicaid is limited to services related to the pregnancy (e.g., prenatal, delivery, and postpartum care up to 60 days after delivery); complications of pregnancy; and family planning services.

Alternatively, states operating separate state insurance plans may choose any one of three other benefit options: (1) a benchmark benefit package, (2) benchmark equivalent coverage, or (3) any other health benefits plan that the Secretary determines will provide appropriate coverage for the targeted population of uninsured children. These three additional benefit options may include maternity care. However, apart from requiring coverage of inpatient and outpatient hospital services, and physicians' surgical and medical services, there is no specific language in the federal statute that requires provision of prenatal, delivery and postpartum services with these non-Medicaid benefit plan options.

The SCHIP program does not include pregnancy status among its eligibility criteria, and does not cover individuals over age 18. There are two circumstances under which uninsured pregnant women over 18 years would be eligible for SCHIP. First, SCHIP has a "family coverage option" that allows states to provide coverage under a group health plan that may include maternity care to adult females in eligible families. States may cover entire families including parents if the purchase of family coverage is cost effective when compared with the cost of covering only the targeted low-income children in the families involved, and would not substitute for other health insurance coverage. Alternatively, states may apply for waivers of program rules to extend coverage to adults such as parents and pregnant women.

Cost sharing refers to the out-of-pocket payments made by beneficiaries of a health insurance plan. States that chose to implement SCHIP as a Medicaid expansion must follow the nominal cost sharing rules of the Medicaid program. Under separate state programs, total annual aggregate cost-sharing (including premiums, enrollment fees, deductibles, copayments, coinsurance, and other similar charges) for any family may not exceed 5 percent of total income in a year. Preventive services are exempt from cost-sharing.

For each fiscal year, the states and the District of Columbia are allotted a proportion of the total amount of federal SCHIP dollars available. From that amount, federal matching funds are disbursed quarterly to each state by a formula set in statute. The original authorizing legislation for SCHIP requires that 0.25 percent of the program's total authorization be set-aside for five territories. This total is distributed among these territories based on specific percentages defined in statute.

Chairman's Mark

In addition to allowing states to expand Medicaid to cover pregnant women above 185 percent of poverty up to the income eligibility for SCHIP children, the Chairman's mark also allows states to cover additional pregnant women under SCHIP. The SCHIP expansion group includes pregnant women with family income above the state's Medicaid financial eligibility standard for pregnant women in effect on January 1, 2002, up to the income eligibility for SCHIP children in effect as of January 1, 2002. The mark would also require states to meet the following conditions before they are permitted to expand their eligibility. First, the state must have already expanded Medicaid eligibility for pregnant women up to at least185 percent of FPL. Second, the same two conditions required of states choosing to expand coverage to pregnant women under Medicaid must also be met: (1) the state must cover under Medicaid and SCHIP pregnant women in lower income families before or in addition to pregnant women in higher income families, and (2) the state must apply an income level to the new group of pregnant women that is no lower than the effective income level in place for pregnant women covered under the state Medicaid plan as of January 1, 2002. Coverage for pregnant women would be limited to services related to the pregnancy (e.g., prenatal, delivery, and postpartum care up to 60 days after delivery); complications of pregnancy; and family planning services.

The Chairman's mark would prohibit: (1) excluding pregnancy-related services based on a preexisting condition; (2) imposing a waiting period for the purpose of minimizing substitution, and (3) cost sharing for pregnancy-related services.

Children born to women receiving pregnancy-related services under SCHIP Medicaid expansions or separate state plans would be automatically enrolled in such program at the time of birth and would remain eligible for such assistance until the child attains 1 year of age. Unless the state issues a separate eligibility number for the child, such child would retain the medical assistance eligibility identification number of the mother during this eligibility period.

For each of fiscal years 2003 through 2006, the Chairman's mark would add an additional appropriation, in the amount of $200 million, out of funds not otherwise appropriated from the Treasury. A total of 98.95 percent of such funds would be distributed among the states in the same manner as SCHIP funds are distributed under current law. The remaining funds would be distributed among the territories also in the same manner as defined in current law. Funds added to the SCHIP program could be used for child health assistance for targeted low-income children, as well as for pregnancy-related assistance for pregnant women. Funds would be available to states that expand coverage to pregnant woman under title XXI (SCHIP), or title XIX (Medicaid) beyond those covered as of January 1, 2002. Additional funds would not be available to the states before October 1, 2002.

Eligibility of a Newborn

Current Law

A child born to a woman eligible for and receiving medical assistance under a Medicaid state plan on the date of the child's birth, is deemed to have applied for, and to have been found eligible for such assistance. The child remains eligible for such assistance until that child attains 1 year of age as long as the child is a member of the woman's household, and the woman remains (or would remain if pregnant) eligible for Medicaid.

Chairman's Mark

For a child born to a woman eligible for and receiving medical assistance under a Medicaid state plan on the date of the child's birth, the Chairman's mark would remove current law requirements that the child remain a member of the woman's household; and the woman continue to be eligible (or would remain eligible if pregnant) for Medicaid.

Application of Qualified Entities to Presumptive Eligibility for Pregnant Women Under Medicaid

Current Law

Under Medicaid presumptive eligibility rules, states are allowed to temporarily enroll children whose family income appears to be below Medicaid income standards, until a final formal determination of eligibility is made. Entities qualified to make presumptive eligibility determinations include Medicaid providers, agencies that determine eligibility for Head Start, subsidized child care, or the Special Supplemental Food Program for Women, Infants and Children (WIC).

The "Medicare, Medicaid, and SCHIP Benefits Improvement and Protection Act of 2000" (BIPA) added several entities to the list of those qualified to make Medicaid presumptive eligibility determinations. These include agencies that determine eligibility for Medicaid or the State Children's health Insurance Program (SCHIP); certain elementary and secondary schools; state or tribal child support enforcement agencies; certain organizations providing food and shelter to the homeless; entities involved in enrollment under Medicaid, TANF, SCHIP, or that determine eligibility for federally funded housing assistance; or any other entity deemed by a state, as approved by the Secretary of HHS.

Chairman's Mark

For purposes of presumptive eligibility determinations, the Chairman's mark would clarify that qualified providers be included under qualified entities as defined in current law. The Chairman's mark would further clarify that qualified entities would be permitted to make presumptive eligibility determinations for pregnant women in addition to children.

SECTION 3. REVIEW OF STATE AGENCY BLINDNESS AND DISABILITY DETERMINATIONS

Current Law

State agencies are required to conduct blindness and disability determinations to establish an individual's eligibility for: (1) Title II, (Federal Old-Age, Survivors, and Disability Insurance (OASDI) benefits); and (2) Title XVI (Supplemental Security Income, (SSI)). Disability determinations are made in accordance with disability criteria defined in statute as well as standards promulgated under regulations or other guidance.

The Commissioner of Social Security is required to review state agency Title II initial blindness and disability determinations in advance of awarding payment to individuals determined eligible under such requirements. This requirement for review is met when: (1) at least 50 percent of favorable determinations have been reviewed, and (2) other such determinations have been reviewed as necessary to ensure a high level of accuracy.

Chairman's Mark

The Chairman's mark would align the initial review requirements for Title XVI with those currently required under Title II. As under Title II, the Commissioner of Social Security would be required to review initial Title XVI SSI blindness and disability determinations made by state agencies in advance of awarding payments.

For FY2003, the SSI review would be required for 25 percent of all favorable state-determined allowances. In FY2004 and thereafter, review would be required for at least 50 percent of favorable state-determined allowances. To the extent feasible, the Chairman's mark would require that the Commissioner to select for review the determinations that are most likely to be incorrect.

DESCRIPTION OF CHAIRMAN'S MODIFICATIONS TO THE "NATIONAL EMPLOYEE SAVINGS AND TRUST EQUITY GUARANTEE ACT"

Scheduled for Markup
By the
SENATE COMMITTEE ON FINANCE
on July 11, 2002

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

July 9, 2002
JCX-74-02

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INTRODUCTION

The Senate Committee on Finance has scheduled a markup on July 11, 2002, of S. 1971, the "National Employee Savings and Trust Equity Guarantee Act." This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the Chairman's modifications to the "National Employee Savings and Trust Equity Guarantee Act."

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of Chairman's Modifications to the "National Employee Savings and Trust Equity Guarantee Act"* (JCX-74-02), July 9, 2002.

I. DIVERSIFICATION OF DEFINED CONTRIBUTION PLAN ASSETS

Present Law

In general

Qualified retirement plans are subject to regulation under the Internal Revenue Code (the "Code") and under the Employee Retirement Income Security Act of 1974 ("ERISA"). Some of the requirements under the Code and ERISA for qualified retirement plans are identical or very similar. For example, both the Code and ERISA impose minimum participation and vesting requirements. Other requirements are contained only in the Code or only in ERISA. In the case of a Code requirement, failure to satisfy the requirement could result in the loss of qualified status for the plan or in the imposition of an excise tax. In the case of an ERISA requirement, failure to satisfy the requirement could result in the imposition of a penalty or a civil action by a participant or the Department of Labor.

The Code and ERISA contain different rules that limit the investment of defined contribution plan assets in employer securities. The extent to which the limits apply depends on the type of plan and the type of contribution involved.

Diversification requirements applicable to employee stock ownership plans ("ESOPs")

An ESOP is a defined contribution plan that is designated as an ESOP and is designed to invest primarily in stock of the employer. An ESOP can be an entire plan or it can be a component of a larger defined contribution plan. An ESOP may provide for different types of contributions, including employer nonelective contributions and others. For example, an ESOP may include a 401(k) feature that permits employees to make elective deferrals.[2]

Under the Code,[3] ESOPs are subject to a requirement that a participant who has attained age 55 and who has at least 10 years of participation in the plan must be permitted to diversify the investment of the participant's account in assets other than employer securities. The diversification requirement applies to a participant for six years, starting with the year in which the individual firsts meets the eligibility requirements (i.e., age 55 and 10 years of participation). The participant must be allowed to elect to diversify up to 25 percent of the participant's account (50 percent in the sixth year), reduced by the portion of the account diversified in prior years.

The participant must be given 90 days after the end of each plan year in the election period to make the election to diversify. In the case of participants who elect to diversify, the plan satisfies the diversification requirement if (1) the plan distributes the applicable amount to the participant within 90 days after the election period, (2) the plan offers at least three investment options (not inconsistent with Treasury regulations) and, within 90 days of the election period, invests the applicable amount in accordance with the participant's election, or

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[2] Such an ESOP design is sometimes referred to as a "KSOP."

[3] All references are to provisions of the Code unless otherwise indicated.

(3) the applicable amount is transferred within 90 days of the election period to another qualified defined contribution plan of the employer providing investment options in accordance with (2).[4]

10-percent limit on the acquisition of employer securities

The Employee Retirement Income Security Act of 1974 ("ERISA") prohibits money purchase pension plans (other than certain plans in existence before the enactment of ERISA) from acquiring employer securities if, after the acquisition, more than 10 percent of the assets of the plan would be invested in employer stock. This 10-percent limitation generally does not apply to other types of defined contribution plans.[5] Thus, most defined contribution plans, such as profit-sharing plans, stock bonus plans, and ESOPs, are not subject to any limit under ERISA on the amount of employer contributions that can be invested in employer securities. In addition, a fiduciary generally is deemed not to violate the requirement that plan assets be diversified with respect to the acquisition or holding of employer securities in such plans.[6]

Under ERISA, the 10-percent limitation on the acquisition of employer securities, described above, applies separately to the portion of a plan consisting of elective deferrals (and earnings thereon) if any portion of an individual's elective deferrals (or earnings thereon) are required to be invested in employer securities pursuant to plan terms or the direction of a person other than the participant. This restriction does not apply if (1) the amount of elective deferrals required to be invested in employer securities does not exceed more than one percent of any employee's compensation, (2) the fair market value of all defined contribution plans maintained by the employer is no more than 10-percent of the fair market value of all retirement plans of the employer, or (3) the plan is an ESOP.

Description of Proposal

In general

Under the proposal, in order to satisfy the requirements under the Code and under ERISA, certain defined contribution plans would be required to provide diversification rights with respect to amounts invested in employer securities. Such a plan would be required to permit applicable individuals to direct that the portion of the individual's account held in employer securities be invested in alternative investments. An applicable individual would include (1) any plan participant and (2) any beneficiary who has an account under the plan with respect to which the beneficiary is entitled to exercise the rights of a participant. The time when

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[4] Sec. 401(a)(28); IRS Notice 88-56, 1988-1 C.B. 540, Q&A 16.

[5] The 10-percent limitation also applies to defined benefit plans and to a defined contribution plan that is part of an arrangement under which benefits payable to a participant under a defined benefit plan are reduced by benefits under the defined contribution plan (i.e., a "floor-offset" arrangement).

[6] Under ERISA, plans that are not subject to the 10-percent limitation on the acquisition of employer securities are referred to as "eligible individual account plans."

the diversification requirements apply would depend on the type of contributions invested in employer securities.

__Plans subject to requirements__

The diversification requirements would generally apply to any defined contribution plan holding publicly-traded employer securities (i.e, securities readily tradable on an established securities market). For this purpose, a plan holding employer securities that are not publicly traded would generally be treated as holding publicly-traded employer securities if the employer (or any member of the employer's controlled group) has issued any class of publicly-traded common stock. This treatment would not apply if (1) the employer (and any parent corporation of the employer) has not issued any class of publicly-traded stock or any special class of stock that grants particular rights to, or bears particular risks for, the holder or the issuer with respect to an affiliate[7] of the employer that has issued any class of publicly-traded stock, and (2) the plan holds no stock of an affiliate of the employer that has issued any class of publicly-traded stock. The Secretary of Treasury would have the authority to provide other exceptions in regulations. For example, an exception could be appropriate if no stock of the employer maintaining the plan (including stock held in the plan) is publicly traded, but a member of the employer's controlled group has issued a limited amount of publicly-traded stock.

The diversification requirements would not apply to an ESOP that (1) does not hold contributions (or earnings thereon) that are subject to the special nondiscrimination tests that apply to elective deferrals, employee after-tax contributions, and matching contributions, and (2) is maintained as a separate plan with respect to any other qualified retirement plan of the employer. Accordingly, an ESOP that holds elective deferrals, employee contributions, employer matching contributions, or nonelective employer contributions used to satisfy the special nondiscrimination tests (including the safe harbor methods of satisfying the tests) would be subject to the diversification requirements under the proposal. An ESOP that is subject to the diversification requirements under the proposal would no longer be subject to the present-law ESOP diversification rules.[8]

The diversification requirements under the proposal would not apply to a one-person plan. A one-person plan would be a plan that (1) on the first day of the plan year, covers only the employer (and the employer's spouse) and the employer owns the entire business (whether or

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[7] For this purpose, "affiliate" would mean any corporation that is a member of the employer's controlled group as defined under section 1563(a), except that, in applying that section, 50 percent would be substituted for 80 percent, and "parent corporation" would mean any corporation (other than the employer) in an unbroken chain of corporations ending with the employer if each corporation other than the employer owns stock possessing at least 50 percent of the total combined voting power of all classes of stock with voting rights or at least 50 percent of the total value of shares of all classes of stock in one of the other corporations in the chain.

[8] Providing the diversification rights required under the proposal, or greater diversification rights, would not cause an ESOP to fail to be designed to invest primarily in qualifying employer securities under section 4975(e)(7)(A).

not incorporated) or covers only one or more partners (and their spouses) in a business partnership, (2) meets the minimum coverage requirements without being combined with any other plan that covers employees of the business, (3) does not provide benefits to anyone except the employer (and the employer's spouse) or the partners (and their spouses), (4) does not cover a business that is a member of an affiliated service group, a controlled group of corporations, or a group of corporations under common control, and (5) does not cover a business that leases employees.

Elective deferrals and employee contributions

In the case of amounts attributable to elective deferrals under a qualified cash or deferred arrangement and employee after-tax contributions that are invested in employer securities, any applicable individual would have to be permitted to direct that such amounts be invested in alternative investments.

Other contributions

In the case of amounts attributable to all other contributions (i.e., nonelective employer contributions and employer matching contributions), an applicable individual who is a participant with three years of service,[9] a beneficiary of such a participant, or a beneficiary of a deceased participant would have to be permitted to direct that such amounts be invested in alternative investments.

The proposal would provide a transition rule for amounts attributable to these other contributions that are invested in employer securities acquired before the first plan year for which diversification requirements apply. Under the transition rule, for the first three years for which the new diversification requirements apply to the plan, the applicable percentage of such amounts would be subject to diversification as shown in Table 1, below.

Table 1 – Applicable Percentage for Employer Securities Held on Effective Date

Plan year for which diversification applies:	Applicable percentage:
First year	33 percent (or, if greater, the amount that would be required under present-law ESOP diversification rule)
Second year	66 percent
Third year	100 percent

[9] Years of service would be defined as under the rules relating to vesting (sec. 411(a)).

For example, suppose that the account of a participant with at least three years of service held 120 shares of employer stock contributed as matching contributions before the diversification requirements became effective. In the first year for which diversification applies, 33 percent (i.e., 40 shares) of that stock would be subject to the diversification requirements. In the second year for which diversification applies, an additional 33 percent (for a total of 66 percent), or an additional 40 shares of the stock (for a total of 80 shares), would be subject to the diversification requirements. In the third year for which diversification applies, 100 percent of the stock, or all 120 shares, would be subject to the diversification requirements. In addition, in each year, employer stock in the account attributable to elective deferrals and employee after-tax contributions would be fully subject to the diversification requirements, as would any new stock contributed to the account.

In determining the portion of the account subject to diversification under the transition rule, any previous diversification of employer securities pursuant to an election under the present-law ESOP diversification requirements would be taken into account. Suppose, in the example above, the plan is an ESOP and, besides 120 shares of employer stock, the account holds other assets attributable to the previous diversification of 30 shares of employer stock pursuant to an election under the present-law ESOP diversification requirements. In applying the transition rule, the previously diversified stock would be taken into account. As a result, the account would be treated as holding 150 shares of employer stock for purposes of the transition rule. In the first year for which diversification applies, 33 percent of 150 shares of stock (i.e., 50 shares) would be subject to the diversification requirements, reduced by the 30 shares of stock already diversified. As a result, 20 shares of stock held in the account would be subject to diversification for that first year. In the second year, an additional 33 percent (for a total of 66 percent) of 150 shares, or an additional 50 shares of stock (for a total of 100 shares), would be subject to the diversification requirements. In the third year, 100 percent of the stock, or all 150 shares, would be subject to the diversification requirements. In addition, in each year, employer stock in the account attributable to elective deferrals and employee after-tax contributions would be fully subject to the diversification requirements, as would any new stock contributed to the account.

Requirements for investment alternatives

In order to satisfy the diversification requirements, the plan would be required to give applicable individuals a choice of at least three investment options, other than employer securities, each of which would have to be diversified and have materially different risk and return characteristics. Other investment options offered by the plan generally would also have to be available. A plan could not impose restrictions or conditions with respect to the investment of employer securities that are not imposed on the investment of other plan assets (other than restrictions or conditions imposed by reason of the application of securities laws). A plan would not fail to meet the diversification requirements merely because the plan limited the times when investment changes could be made to periodic, reasonable opportunities that occur at least quarterly.

Effective Date

The proposal would generally be effective for plan years beginning after December 31, 2002. In the case of a plan maintained pursuant to one or more collective bargaining agreements, the proposal would be effective for plan years beginning after the earlier of (1) the later of December 31, 2003, or the date on which the last of such collective bargaining agreements terminated (determined without regard to any extension thereof after the date of enactment), or (2) December 31, 2004.

II. PROTECTION OF EMPLOYEES DURING PENSION PLAN TRANSACTION SUSPENSION PERIOD

A. Notice to Participants or Beneficiaries of Transaction Suspension Periods

Present Law

The Code and ERISA require various notices to be provided to participants and beneficiaries under an employer-sponsored retirement plan regarding their rights under the plan. Present law does not specifically require that participants be given advance notice of temporary periods during which the ability to direct investments or to obtain loans or distributions from the plan is restricted.

Failure to provide a notice required under the Code may result in the imposition of an excise tax (e.g., sec. 4980F, relating to notice requirements for plans significantly reducing benefit accruals) or a reporting penalty (e.g., sec. 6652(i), relating to a failure to give written explanation of qualifying rollover distributions). Failure to provide a notice required under ERISA may result in the imposition of a civil penalty.[10]

Description of Proposal

In general

Under the proposal, the Code and ERISA would require that advance notice of a transaction suspension period would have to be provided by the administrator of an applicable pension plan to the applicable individuals to whom the transaction suspension period applies (and to any employee organization representing such individuals). An applicable individual (as defined under the proposal relating to diversification) would be (1) any plan participant and (2) any beneficiary who has an account under the plan with respect to which the beneficiary is entitled to exercise the rights of a participant. Generally, notice would have to be provided at least 30 days before the beginning of the transaction suspension period.

An applicable pension plan would be a qualified retirement plan or annuity, a tax-sheltered annuity plan, or an eligible deferred compensation plan of a governmental employer that maintains accounts for participants and beneficiaries.[11] An applicable pension plan would not include a one-person plan (as defined under the proposal relating to diversification).

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[10] ERISA also permits the Secretary of Labor, a participant, a beneficiary, or a plan fiduciary to bring civil action to enforce any ERISA requirements.

[11] The ERISA notice requirement would not apply to a plan that is exempt from ERISA, such as a governmental plan or a church plan.

Definition of transaction suspension period

A transaction suspension period would mean a period during which certain rights are significantly restricted if the rights are not restored within three consecutive business days from the day the rights are restricted. The rights that would be relevant for this purpose are rights otherwise provided under the plan to one or more applicable individuals to direct investments (including investments in employer securities) or to obtain loans or distributions from the plan. However, rights that are significantly restricted because of the application of securities laws or other circumstances specified in regulations and restrictions required in connection with a qualified domestic relations order would not be taken into account in determining whether a transaction suspension period occurs.

Whether an individual's right to direct investments or obtain loans or distributions from the plan is significantly restricted would generally be determined by reference to the normal rights and procedures provided under the plan. A variety of factors could be relevant in making this determination. For example, if, in connection with a change in plan recordkeepers, no investment directions, loans, or distributions can be executed over a three-day weekend (i.e., a Saturday, a Sunday, and a Monday that is a Federal holiday), then no transaction suspension period would result if the participants would not, under the terms of the plan, have been able to engage in such transactions during that period in any event. As another example, suppose a plan provided that a participant's loan request will be processed within 30 days from the time the loan request is submitted. The mere fact that, in connection with a change in plan administrators, the processing of loan requests is suspended for a ten-day period would not result in a transaction suspension period if participants' ability to submit loan requests continued during the ten-day period and the ten-day suspension did not cause the processing of loan requests to take longer than the 30-day period provided in the plan. In addition, if a plan provided that a participant's ability to make investment changes, or obtain a loan or a distribution, is limited for a certain period in connection with a qualified domestic relations order with respect to the participant's account, that limitation generally would not result in a transaction suspension period.

Factors in addition to the time period involved could also be relevant in determining whether a transaction suspension period occurs, and the relevant factors could vary depending on the rights affected. For example, suppose a plan offered a variety of investment options, including three options that have similar characteristics (e.g., similar risk and return characteristics). If the ability to transfer funds into only one of these options is restricted, this might not result in a transaction suspension period for purposes of the proposal, because participants would have the right to transfer funds into similar investment options. In addition, a transaction suspension period would not occur as a result of plan provisions that restrict a participant's right to direct the investment of the assets in his or her account to certain periods, such as the first fifteen days of each month.

Timing of notice

Notice of a transaction suspension period would generally be required at least 30 days before the beginning of the period. An exception would apply in the case of a transaction suspension period imposed because of an event outside the control of the plan sponsor or administrator. In that case, notice would be required to be provided as soon as reasonably practicable under the circumstances. The Secretary of the Treasury would be given the authority to provide additional exceptions (and to specify the time when notice would be required) in the case of a transaction suspension period due to other circumstances specified by the Secretary, including the application of securities laws.

In the case of a transaction suspension period in connection with a major corporate disposition by a corporation maintaining the plan, the notice requirements would be treated as met if, not later than 30 days before the disposition, the plan administrator (or the corporation maintaining the plan) provides notice of the transaction suspension period, and no further notice would be required if the transaction suspension period begins within 30 days after the disposition. A "major corporate disposition" would mean the disposition of substantially all of the stock of the corporation, or a subsidiary thereof, or the disposition of substantially all of the assets used in a trade or business of the corporation or subsidiary. Similar rules would apply in the case of an entity that is not a corporation.

It is intended under the proposal that participants would be given the opportunity to execute investment changes with respect to their accounts, or obtain loans or distributions otherwise permitted under the plan, before the transaction suspension period begins.

Form and content of notice

Notice of a transaction suspension period would have to be written in a manner calculated to be understood by the average plan participant and provide sufficient information (as determined under Treasury guidance) to allow the recipients to understand the timing and effect of the transaction suspension period. Specifically, the notice would be required to include (1) the reasons for the suspension, (2) an identification of the investments and other rights under the plan that are affected, (3) the expected period of the suspension,[12] and (4) in the case of a transaction suspension period involving the right to direct investments, a statement that the applicable individual should evaluate the appropriateness of current investment decisions in light of the inability to direct or diversify assets during the expected period of suspension. The notice would be required to be provided in writing and could be provided in electronic or other form that is reasonably expected to result in receipt of the notice by the applicable individual. The Secretary of the Treasury would be required, in consultation with the Secretary of Labor, to issue a model transaction suspension period notice.

Sanctions for failure to provide notice

Excise tax

An excise tax would generally apply in the case of a failure to provide notice of a transaction suspension period as required under the Code. A reporting penalty would apply in the case of a failure related to a governmental plan or a church plan.

[12] If the expected length of the transaction suspension period changed after notice has been provided, notice of the change would have to be provided as soon as reasonably practicable.

Under the proposal, an excise tax would generally be imposed on the employer if notice of a transaction suspension is not provided.[13] The excise tax would be $100 per day for each applicable individual with respect to whom the failure occurred, until notice is provided or the failure is otherwise corrected. If the employer exercises reasonable diligence to meet the notice requirements, the total excise tax imposed during a taxable year would not exceed $500,000.

No tax would be imposed with respect to a failure if the employer does not know that the failure existed and exercises reasonable diligence to comply with the notice requirement. In addition, no tax would be imposed if the employer exercises reasonable diligence to comply and provides the required notice as soon as reasonably practicable after learning of the failure. In the case of a failure due to reasonable cause and not to willful neglect, the Secretary of the Treasury would be authorized to waive the excise tax to the extent that the payment of the tax would be excessive or otherwise inequitable relative to the failure involved.

The excise tax would not apply in the case of a failure to provide notice of a transaction suspension period with respect to a governmental plan or a church plan. In that case, on notice and demand by the Secretary, a penalty would apply of $100 per day for each applicable individual with respect to whom the failure occurs, until notice is provided or the failure is otherwise corrected.[14] The limitations and exceptions to the excise tax would apply also to the penalty.

ERISA civil penalty

In the case of a failure to provide notice of a transaction suspension period as required under ERISA, the Secretary of Labor would be authorized to assess a civil penalty of up to $100 per day for each violation.[15] For this purpose, each violation with respect to a single participant or beneficiary would be treated as a separate violation.

Effective Date

The proposal would generally be effective for plan years beginning after December 31, 2002. In the case of a plan maintained pursuant to one or more collective bargaining agreements, the proposal would be effective for plan years beginning after the earlier of (1) the later of December 31, 2003, or the date on which the last of such collective bargaining agreements terminated (determined without regard to any extension thereof after the date of enactment), or (2) December 31, 2004. No later than 120 days after enactment of the proposal, the Secretary of

[13] In the case of a multiemployer plan, the excise tax would be imposed on the plan. In the case of a tax-sheltered annuity program under section 403(b) that is not treated as established or maintained by the employer for purposes of ERISA, the excise tax would be imposed on the plan administrator.

[14] In the case of a governmental plan, a penalty would not apply to a failure to provide notice to an employee organization.

[15] The civil penalty under ERISA would not apply to a governmental plan or a church plan because such plans are not subject to the requirements under ERISA.

the Treasury would be required to specify (1) the circumstances under which 30 days notice of a transaction suspension period is not required and (2) the time by which notice is required to be provided in those circumstances.

B. Inapplicability of Relief from Fiduciary Liability During Suspension of Ability of Participant or Beneficiary to Direct Investments

Present Law

Fiduciary rules under ERISA

ERISA contains general fiduciary duty standards that apply to all fiduciary actions, including investment decisions. ERISA requires that a plan fiduciary generally must discharge its duties solely in the interests of participants and beneficiaries and with care, prudence, and diligence. With respect to plan assets, ERISA requires a fiduciary to diversify the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so.[16]

A plan fiduciary that breaches any of the fiduciary responsibilities, obligations, or duties imposed by ERISA is personally liable to make good to the plan any losses to the plan resulting from such breach and to restore to the plan any profits the fiduciary has made through the use of plan assets. A plan fiduciary may be liable also for a breach of responsibility by another fiduciary (a "co-fiduciary") in certain circumstances.

Special rule for participant control of assets

ERISA provides a special rule for a defined contribution plan that permits participants to exercise control over the assets in their individual accounts. Under the special rule, if a participant exercises control over the assets in his or her account (as determined under regulations), the participant is not deemed to be a fiduciary by reason of such exercise and no person who is otherwise a fiduciary is liable for any loss, or by reason of any breach, that results from the participant's exercise of control.

In order for a participant to be treated as exercising control over the assets in his or her account:

- the plan must provide at least three different investment options, each of which is diversified and has materially different risk and return characteristics;
- the plan must allow participants to give investment instructions with respect to each investment option under the plan with a frequency that is appropriate in light of the reasonably expected market volatility of the investment option (the general volatility rule);
- at a minimum, participants must be allowed to give investment instructions at least every three months with respect to least three of the investment options, and those investment options must constitute a broad range of options (the three-month minimum rule);

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[16] Certain defined contribution plans are not subject to the diversification requirement for investments or the general prudence requirement (to the extent that it requires diversification) with respect to investments in employer stock.

- participants must be provided with detailed information about the investment options, information regarding fees, investment instructions and limitations, and copies of financial data and prospectuses; and
- specific requirements must be satisfied with respect to investments in employer stock to ensure that employees' buying, selling, and voting decisions are confidential and free from employer influence.

If these requirements are met, a plan fiduciary may be liable for the investment options made available under the plan, but not for the specific investment decisions made by participants.

Description of Proposal

Under the proposal, relief from fiduciary liability for any loss or breach resulting from a participant's exercise of control over assets generally would not apply in the case of a transaction suspension period during which the ability of the participant to direct the investment of the assets in his or her account is suspended by a plan sponsor or fiduciary. For this purpose, transaction suspension period would be defined as under the proposal requiring advance notice of a transaction suspension period. Under a special rule, if a transaction suspension period occurs in connection with a change in the investment options offered under the plan, a participant would be deemed to have exercised control over the assets in his or her account before the transaction suspension period if, after notice of the change in investment options is given to such participant, assets in the account of the participant are transferred either (1) to investment options in accordance with the participant's affirmative election, or (2) in the absence of an affirmative election by the participant, to investment options with reasonably comparable risk and return characteristics in the manner set forth in the notice.

In addition, if the fiduciary meets the requirements of ERISA in connection with authorizing the transaction suspension period, the fiduciary would not be liable for any loss occurring during the period as a result of a participant's or beneficiary's exercise of control over assets in his or her account before the period. Matters that would be considered in determining whether the requirements of ERISA were satisfied would include whether the fiduciary (1) considered the reasonableness of the expected transaction suspension period, (2) provided notice of the transaction suspension period (as required under another provision of the proposal), and (3) acted in accordance with the general fiduciary duty standards of ERISA in determining whether to enter into the transaction suspension period. The Secretary of Labor would be required, in consultation with the Secretary of Treasury, to issue, before December 31, 2002, final regulations providing guidance, including safe harbors, on how plan fiduciaries would be able to satisfy their fiduciary responsibilities during a transaction suspension period during which the ability of a participant or beneficiary to direct the investment of the assets in his or her account is suspended.

Effective Date

The proposal would generally be effective for plan years beginning after December 31, 2002. In the case of a plan maintained pursuant to one or more collective bargaining agreements, the proposal would be effective for plan years beginning after the earlier of (1) the later of December 31, 2003, or the date on which the last of such collective bargaining agreements terminated (determined without regard to any extension thereof after the date of enactment), or (2) December 31, 2004.

C. Clarification of Participant Access to Remedies under ERISA

Present Law

Section 502(a) of ERISA contains several provisions under which a participant may bring civil action against a plan fiduciary.[17]

A participant may bring a civil action for appropriate relief under section 409 of ERISA (ERISA sec. 502(a)(2)). Under section 409 of ERISA, a plan fiduciary that breaches any of the fiduciary responsibilities, obligations, or duties imposed by ERISA is personally liable to make good to the plan any losses to the plan resulting from such breach and to restore to the plan any profits the fiduciary has made through the use of plan assets. In addition, the fiduciary is subject to other equitable or remedial relief as a court deems appropriate, including the removal of the fiduciary. Section 409 provides for broad relief in the case of a breach of fiduciary duty, including compensatory damages. However, a fiduciary may not be held personally liable to a participant for damages under section 409, even in the case of a civil action brought by the participant, because recovery under section 409 must be on behalf of the plan.[18] It is not clear under present law to what extent damages recovered under section 409 with respect to a breach of fiduciary liability affecting a participant's individual account under a defined contribution plan are to be allocated to the participant's account.

ERISA also gives a participant the right to bring a civil action--

- to recover benefits due to him or her under the terms of the plan, to enforce his or her rights under the terms of the plan, or to clarify his or her rights to future benefits under the terms of the plan ERISA (sec. 502(a)(1)(B)), or
- to enjoin any act or practice which violates any provision of this title or the terms of the plan, or to obtain other appropriate equitable relief to redress such violations or to enforce any provisions of this title or the terms of the plan (ERISA sec. 502(a)(3)).

These provisions enable a participant to seek recovery on his or her own behalf, not just on behalf of the plan, including recovery for a breach of fiduciary duty.[19] However, "appropriate equitable relief" that a participant may obtain on his or her own behalf does not include money damages (i.e., compensatory damages).[20] Participants in defined contribution plans who have brought action against a plan fiduciary under one of these ERISA provisions have been denied the recovery of damages for the difference between the earnings on their accounts and the amount of earnings they would have received if the plan administrator had complied with the

[17] Some of these provisions also allow the Secretary of Labor or another plan fiduciary to bring a civil action.

[18] *Massachusetts Mutual Life Insurance Co. v. Russell*, 473 U.S. 134 (1985).

[19] *Varity Corporation v. Charles Howe*, 516 U.S. 489 (1996).

[20] *Mertens v. Hewitt Associates*, 508 U.S. 248 (1993).

participants' instructions as to the transfer or distribution of the accounts because lost earnings are considered compensatory damages.[21]

Description of Proposal

The proposal would amend section 409 of ERISA to clarify that, in the case of a fiduciary breach with respect to a defined contribution plan, the relief available under section 409 would, to the extent the court deemed appropriate, be apportioned to each individual account affected by the breach.

Effective Date

The proposal would be effective on the date of enactment of the proposal.

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[21] *Helfrich v. PNC Bank, Kentucky, Inc.*, 267 F.3d 477 (6th Cir. 2001), *cert.den.*, reported at 2002 U.S. LEXIS 1558 (March 18, 2002); *Kerr v. Charles F. Vatterott & Co.*, 184 F.3d 938 (8th Cir. 1999).

D. Increased Maximum Bond Amount for Plans Holding Employer Securities

Present Law

ERISA generally requires every fiduciary and every person who handles funds or other property of a plan (a "plan official") to be bonded. The amount of the bond is fixed annually at no less than ten percent of the funds handled but must be at least $1,000 and not more than $500,000 (unless the Secretary of Labor prescribes a larger amount after notice and an opportunity to be heard). The bonds are intended to protect plans against loss from acts of fraud or dishonesty by plan officials. Qualifying bonds must have a corporate surety which is an acceptable surety on Federal bonds.

Description of Proposal

The proposal would raise the maximum bond amount to $1 million for fiduciaries of plans that hold employer securities.

Effective Date

The proposal would be effective for plan years beginning after December 31, 2002.

III. PROVIDING INFORMATION TO ASSIST PARTICIPANTS

A. Benefit Statements and Investment Guidelines

Present Law

Pension benefit statements

ERISA provides that a plan administrator must furnish a benefit statement to any participant or beneficiary who makes a written request for such a statement. This requirement applies in the case of any plan that is subject to ERISA, including defined contribution and defined benefit plans. The benefit statement must indicate, on the basis of the latest available information, (1) the participant's or beneficiary's total accrued benefit, and (2) the participant's or beneficiary's vested accrued benefit or the earliest date on which the accrued benefit will become vested. A participant or beneficiary is not entitled to receive more than one benefit statement during any 12-month period. If the plan administrator fails or refuses to furnish the benefit statement within 30 days of the participant's or beneficiary's written request, the participant or beneficiary may bring a civil action to recover from the plan administrator $100 a day, within the court's discretion, or other relief that the court deems proper.[22]

Individual statements to participants on separation from service

A plan administrator must furnish an individual statement to each participant who (1) separates from service during the year, (2) is entitled to a deferred vested benefit under the plan as of the end of the plan year, and (3) whose benefits were not paid during the year.[23] The individual statement must set forth the nature, amount and form of the deferred vested benefit to which the participant is entitled. The plan administrator generally must provide the individual statement no later than 180 days after the end of the plan year in which the separation from service occurs. If the plan administrator fails to provide the individual statement, the Secretary of Labor or the participant may bring a civil action for appropriate relief.

Investment guidelines

Present law does not require that participants be given investment guidelines relating to retirement savings.

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[22] ERISA also permits the Secretary of Labor, a participant, a beneficiary, or a fiduciary to bring civil action to enforce any ERISA requirements.

[23] This information is based on an annual registration statement that the plan administrator is required to file under the Code with the Secretary of Treasury with respect to all participants who meet these requirements for the plan year. The annual registration statement is filed by means of Schedule SSA of the Form 5500. The Code also requires that the plan administrator furnish an individual statement to the participant.

Description of Proposal

Pension benefit statements

In general

The proposal would provide new benefit statement requirements under the Code and ERISA, depending in part on the type of plan and the individual to whom the statement is provided.

Requirements for defined contribution plans

In the case of an applicable pension plan, the plan administrator would be required under the Code and ERISA to provide a benefit statement (1) to an applicable individual who has the right to direct the investment of the assets in his or her account, at least quarterly, (2) to other applicable individuals, at least annually, and (3) to a beneficiary who is not an applicable individual, upon written request, but limited to one request during any 12-month period. An applicable pension plan would be defined (as under the proposal relating to notice of a transaction suspension period) as a qualified retirement plan or annuity, a tax-sheltered annuity plan, or an eligible deferred compensation plan of a governmental employer that maintains accounts for participants and beneficiaries (other than a one-person plan).[24] An applicable individual would be defined (as under the proposal relating to notice of a transaction suspension period) as (1) any plan participant and (2) any beneficiary who has an account under the plan with respect to which the beneficiary is entitled to exercise the rights of a participant.

The benefit statement would be required to indicate, on the basis of the latest available information, (1) the total benefits accrued, and (2) the vested accrued benefit or the earliest date on which the accrued benefit will become vested. In addition, the statement would have to include the value of investments allocated to the individual's account (determined as of the plan's most recent valuation date), including the value of any employer securities (without regard to whether the securities were contributed by the employer or acquired at the direction of the individual), and an explanation of any limitations or restrictions on the right of the individual to direct investments.

Requirements for defined benefit plans

Under the proposal, the administrator of a defined benefit plan would generally be required under ERISA either (1) to furnish a benefit statement at least once every three years[25] to each participant who has a vested accrued benefit and who is employed by the employer at the

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[24] The ERISA requirement would not apply to a plan that is exempt from ERISA, such as a governmental plan (including an eligible deferred compensation plan of a governmental employer) or a church plan.

[25] The Secretary of Labor would be authorized to provide that years in which no employer or former employee benefits under the plan need not be taken into account in determining the three-year period.

time the benefit statements are furnished to participants, or (2) to furnish at least annually to each such participant notice of the availability of a benefit statement and the manner in which the participant could obtain it. The notice could be included with other communications to the participant if done in a manner reasonably designed to attract the attention of the participant.

The administrator of a defined benefit plan would also be required to furnish a benefit statement to a participant or beneficiary upon written request, limited to one request during any 12-month period.

A benefit statement would be required to indicate, on the basis of the latest available information, (1) the total benefits accrued, and (2) the vested accrued benefit or the earliest date on which the accrued benefit will become vested. In the case of a statement provided to a participant (other than at the participant's request), information could be based on reasonable estimates determined under regulations prescribed by the Secretary of Labor.

Form of benefit statement

The benefit statement would be required to be written in a manner calculated to be understood by the average plan participant. It would be required to be provided in writing and could be provided in electronic or other form that is reasonably expected to result in receipt of the notice by the applicable individual.

The Secretary of Labor would be directed to develop one or more model benefit statements, written in a manner calculated to be understood by the average plan participant, that may be used by plan administrators in complying with the requirements of ERISA and the Code. The use of the model statement would be optional. It would be intended that the model statement include items such as the amount of nonforfeitable accrued benefits as of the statement date that are payable at normal retirement age under the plan, the amount of accrued benefits that are forfeitable but that may become nonforfeitable under the terms of the plan, information on how to contact the Social Security Administration to obtain a participant's personal earnings and benefit estimate statement, and other information that may be important to understanding benefits earned under the plan.

Investment guidelines

In general

Under the proposal, the plan administrator of an applicable pension plan would be required under the Code and ERISA to provide at least annually a model form relating to basic investment guidelines to applicable individuals.[26] "Applicable pension plan" and "applicable individual" would be defined as under the proposal relating to required benefit statements.

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[26] The ERISA requirement would not apply to a plan that is exempt from ERISA, such as a governmental plan or a church plan.

Model form

Under the proposal, the Secretary of the Treasury would be directed, in consultation with the Secretary of Labor, to develop and make available a model form containing basic guidelines for investing for retirement. Such guidelines would generally include (1) information on the benefits of diversification of investments, (2) information on the essential differences, in terms of risk and return, of pension plan investments, including stocks, bonds, mutual funds and money market investments, (3) information on how an individual's investment allocations under the plan may differ depending on the individual's age and years to retirement, as well as other factors determined by the Secretary, (4) sources of information where individuals may learn more about pension rights, individual investing, and investment advice, and (5) such other information related to individual investing as the Secretary determines appropriate. In addition, the Secretary would have the authority to vary the required information depending on the type of plan. For example, some information could be omitted in the case of a plan does not provide for investment direction by participants.

The model form would be required also to include addresses for Internet sites, and a worksheet, that an individual could use to calculate (1) the retirement age annuity value of the individual's vested benefits under the plan (determined by reference to varied historical annual rates of return and annuity interest rates), and (2) other important amounts relating to retirement savings, including the amount that an individual would be required to save in order to provide a retirement income equal to various percentages of his or her current salary (adjusted for historical growth prior to retirement). The Secretary of Labor would also be required to develop an Internet site to be used by an individual in making these calculations, the address of which would be included in the model form.

The Secretary of the Treasury would be directed to provide at least 90 days for public comment before publishing final notice of the model form and to update the model form at least annually.

The model form would be required (1) to be written in a manner calculated to be understood by the average plan participant and (2) to be provided in writing or any other form (including electronic form) to the extent such other form is reasonably accessible to applicable individuals.

Sanctions for failure to provide information

Excise tax

Under the proposal, an excise tax would generally apply in the case of a failure to provide a benefit statement or an investment guideline model form as required under the Code. However, a reporting penalty would apply in the case of a failure related to a governmental plan or a church plan.

The excise tax would generally be imposed on the employer if a required benefit statement or model form is not provided.[27] The excise tax would be $100 per day for each participant or beneficiary with respect to whom the failure occurs, until the benefit statement or model form is provided or the failure is otherwise corrected. If the employer exercises reasonable diligence to meet the benefit statement or model form requirement, the total excise tax imposed during a taxable year would not exceed $500,000. The $500,000 annual limit would apply separately to failures to provide required benefit statements and failures to provide the model form.

No tax would be imposed with respect to a failure if the employer does not know that the failure existed and exercises reasonable diligence to comply with the benefit statement or model form requirement. In addition, no tax would be imposed if the employer exercises reasonable diligence to comply and provides the required benefit statement or model form within 30 days of learning of the failure. In the case of a failure due to reasonable cause and not to willful neglect, the Secretary of the Treasury would be authorized to waive the excise tax to the extent that the payment of the tax would be excessive or otherwise inequitable relative to the failure involved.

The excise tax would not apply in the case of a failure to provide a benefit statement or model form with respect to a governmental plan or a church plan. In that case, on notice and demand by the Secretary, a penalty would apply of $100 per day for each applicable individual with respect to whom the failure occurs, until the benefit statement or model form is provided or the failure is otherwise corrected. The limitations and exceptions to the excise tax would apply also to the penalty.

ERISA civil penalty

The ERISA remedies that apply in the case of a failure or refusal to provide a benefit statement under present law would apply if the plan administrator fails or refuses to furnish a benefit statement or model form required under the proposals.[28] That is, the participant or beneficiary would be entitled to bring a civil action to recover from the plan administrator $100 a day, within the court's discretion, or such other relief that the court deems proper.

Effective Date

The proposal would generally be effective for plan years beginning after December 31, 2003. In the case of a plan maintained pursuant to one or more collective bargaining agreements, the proposal would be effective for plan years beginning after the earlier of (1) the later of December 31, 2004, or the date on which the last of such collective bargaining agreements

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[27] In the case of a multiemployer plan, the excise tax would be imposed on the plan. In the case of a tax-sheltered annuity program under section 403(b) that is not treated as established or maintained by the employer for purposes of ERISA, the excise tax would be imposed on the plan administrator.

[28] The civil penalty under ERISA would not apply to a governmental plan or a church plan because such plans are not subject to the requirements under ERISA.

terminated (determined without regard to any extension thereof after the date of enactment), or (2) December 31, 2005.

B. Information on Optional Forms of Benefit

Present Law

Under a defined benefit plan or a money purchase pension plan, benefits generally must be paid in the form of an annuity for the life of the participant unless the participant consents to a distribution in another form. In the case of a married participant, benefits must be paid in the form of a qualified joint and survivor annuity ("QJSA") unless the participant and his or her spouse consent to another form of benefit. A QJSA is an annuity for the life of the participant, with a survivor annuity for the life of the spouse which is not less than 50 percent (and not more than 100 percent) of the amount of the annuity payable during the joint lives of the participant and his or her spouse. The participant and his or her spouse may waive the right to a QJSA provided certain requirements are satisfied, including a requirement that a written explanation be provided of the effect of a waiver of the annuity.

Defined benefit plans generally provide that a participant may choose among other forms of benefit offered under the plan, such as a lump sum distribution. These optional forms of benefit generally must be actuarially equivalent to the life annuity benefit payable to the participant.

A defined benefit plan must specify the actuarial assumptions that will be used in determining optional forms of benefit under the plan in a manner that precludes employer discretion in the assumptions to be used. For example, a plan may specify that a variable interest rate will be used in determining actuarial equivalent forms of benefit, but may not give the employer discretion to choose the interest rate.

In addition, statutory actuarial assumptions must be used in determining the minimum value of certain optional forms of benefit, such as a lump sum. That is, the lump sum payable under the plan may not be less than the amount of the lump sum that is actuarially equivalent to the life annuity payable to the participant, determined using the statutory assumptions. The statutory assumptions consist of an applicable mortality table (as published by the Internal Revenue Service) and an applicable interest rate.

Description of Proposal

Under the proposal, the Secretary of the Treasury would be directed to issue (within 30 days of enactment of the proposal) regulations requiring the plan administrator of a defined benefit plan or a money purchase pension plan to provide a statement comparing the relative values of each form of benefit payable under the plan. The statement would be required to be written in a manner calculated to be understood by the average plan participant and to include such information as the Secretary determines appropriate to enable the average plan participant, spouse, or surviving spouse to make an informed decision as to what form of benefit to elect. For example, in the case of a plan that provides a subsidized early retirement annuity benefit, it would be intended that the information would include an explanation of whether the subsidy is included in determining other forms of benefit (e.g., a lump sum) payable at early retirement age.

Effective Date

The proposal would be effective on the date of enactment.

C. Fiduciary Duty to Provide Material Information Relating to Investment in Employer Stock

Present Law

ERISA imposes broad duties governing all plan fiduciaries. Among them are the requirements that plan fiduciaries discharge their duties with respect to plans solely in the interest of plan participants and beneficiaries for the exclusive purpose of providing benefits and that such fiduciaries act with reasonable care, skill, prudence, and diligence under the circumstances. Under ERISA, fiduciaries must also refrain from engaging in prohibited transactions. Despite these general fiduciary requirements, in the case of defined contribution plans that permit participants and beneficiaries to exercise control over the investment of assets in their accounts, plan fiduciaries are generally not liable for any losses resulting from the exercise of such control.

Description of Proposal

The proposal would amend ERISA to provide that the sponsor and administrator of a defined contribution plan have a duty to ensure that, in connection with the investment of assets in a participant's account in employer stock, a participant is provided with all material information that would generally be required to be disclosed by the employer to investors under applicable securities laws. The provision of misleading information by the employer or plan administrator would be a violation of this requirement. In the case of a failure to provide the information as required under the proposal, the Secretary of Labor would be authorized to assess a civil penalty of up to $1,000 per day.

Effective Date

The proposal would be effective with respect to plan years beginning after December 31, 2002.

D. Electronic Disclosure of Insider Trading

Present Law

ERISA contains broad rules governing the provision of information to participants and beneficiaries by plans and plan administrators. These reporting and disclosure rules are designed to ensure that participants and beneficiaries are advised of their rights and benefits under plans and applicable law, are given access to plan financial information, and are given adequate opportunity to prevent or redress any violations of their rights.

Description of Proposal

The proposal would amend ERISA to require that, an employer that sponsors an individual account plan that permits elective deferrals to be invested in employer stock or real property would be required to disclose to participants and beneficiaries any stock transaction by an officer, director, or affiliate of the employer that must be disclosed to the SEC. The disclosure would be required to be posted on the plan's website in a reasonably practicable timeframe after disclosure to the SEC (or provided upon request, in the case of a participant or beneficiary who does not have access to a plan website). The SEC would be permitted to accept this electronic disclosure in place of any form of disclosure otherwise required with respect to participants and beneficiaries.

Effective Date

The proposal would be effective with respect to plan years beginning after December 31, 2002.

IV. INDEPENDENT INVESTMENT ADVICE

A. Fiduciary Rules for Plan Sponsors Designating Independent Investment Advisors

Present Law

ERISA requires an employee benefit plan to provide for one or more named fiduciaries who jointly or severally have the authority to control and manage the operation and administration of the plan. In addition to fiduciaries named in the plan, or identified pursuant to a procedure specified in the plan, a person is a plan fiduciary under ERISA to the extent the fiduciary exercises any discretionary authority or control over management of the plan or exercises authority or control over management or disposition of its assets, renders investment advice for a fee or other compensation, or has any discretionary authority or responsibility in the administration of the plan. In certain circumstances, a fiduciary under ERISA may be liable for a breach of responsibility by a co-fiduciary.

Description of Proposal

In general

The proposal would amend ERISA by adding specific rules dealing with the provision of investment advice to plan participants by a qualified investment adviser. The proposal would apply to a defined contribution plan that permits a participant or beneficiary to exercise investment control over the assets in his or her account. Under the proposal, if certain requirements are met, an employer or other plan fiduciary would not be liable for investment advice provided by a qualified investment adviser.

Qualified investment adviser

Under the proposal, a "qualified investment adviser" would be defined as a person who is a plan fiduciary by reason of providing investment advice and who is also (1) a registered investment adviser under the Investment Advisers Act of 1940 or registered as an investment adviser under the laws of the State (consistent with section 203A of the Investment Advisers Act[29]) in which the adviser maintains its principal office, (2) a bank or similar financial institution, (3) an insurance company qualified to do business under State law, or (4) a comparably qualified entity under criteria to be established by the Secretary of Labor. In addition, any individual who provided investment advice to participants on behalf of the investment adviser (such as an employee thereof) would be required to be (1) a registered

[29] *See*, 15 U.S.C. 80b-3a. Nothing in the proposal would be intended to restrict the authority under current law of any State to assert jurisdiction over investment advisers and investment adviser representatives based on their presence in the State or the fact that they have clients in the State.

investment adviser under Federal or State law as described above,[30] (2) a registered broker or dealer under the Securities Exchange Act, (3) a registered representative under the Securities Exchange Act or the Investment Advisers Act, or (4) any comparably qualified individual under criteria to be established by the Secretary of Labor.

A qualified investment adviser would be required to provide the following documents to the employer or plan fiduciary: (1) the contract for investment advice services, (2) a disclosure of the fees to be received by the investment adviser, and (3) documentation that the investment advisor is a qualified investment adviser. A qualified investment adviser that acknowledges its fiduciary status would be a fiduciary under ERISA with respect to investment advice provided to a participant or beneficiary.

<u>Requirements for employer or other fiduciary</u>

Before designating the investment adviser and at least annually thereafter, the employer or other fiduciary would be required to obtain written verification that the investment adviser (1) is a qualified investment adviser, (2) acknowledges its status as a plan fiduciary that is solely responsible for the investment advice it provides, (3) has reviewed the plan document (including investment options) and determined that its relationship with the plan and the investment advice provided to any participant or beneficiary, including the receipt of fees or compensation, will not violate the prohibited transaction rules, (4) will consider any employer securities or employer real property allocated to the participant's or beneficiary's account in providing investment advice, and (5) has the necessary insurance coverage (as determined by the Secretary of Labor) for any claim by a participant or beneficiary.

In designating an investment adviser, the employer or other fiduciary would be required to review the documents provided by the qualified investment adviser. The employer or other fiduciary would also be required to make a determination that there is no material reason not to engage the investment adviser.

In the case of (1) information that the investment adviser is no longer qualified or (2) concerns about the investment adviser's services raised by a substantial number of participants or beneficiaries, the employer or other fiduciary would be required within 30 days to investigate and to determine whether to continue the investment adviser's services.

An employer or other fiduciary that complies with the requirements for designating and monitoring an investment adviser would be deemed to have satisfied its fiduciary duty in the prudent selection and periodic review of an investment adviser and would not bear liability as a fiduciary or co-fiduciary for any loss or breach resulting from the investment advice.

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[30] An individual who is registered as an investment adviser under the laws of a State would be a qualified investment adviser only if the State has an examination requirement to qualify for such registration.

Effective Date

The proposal would apply to advisers designated after the date of enactment of the proposal.

V. OTHER PROPOSALS RELATING TO PENSION PLANS

A. Studies

Present Law

Present law does not require studies specifically relating to the revitalization of defined benefit plans, floor-offset ESOPs, an insurance system for defined contribution plans, or fees related to the investment of defined contribution plan assets.

Description of Proposal

Study on revitalizing defined benefit plans

The Secretary of the Treasury would be required to undertake a study on ways to revitalize employer interest in defined benefit plans and to report the results thereof, with recommendations for legislative changes, within 18 months after the date of enactment of the proposal, to the House Committees on Ways and Means and the Senate Committee on Finance. In conducting the study, the Secretary would be required to consider (1) ways to encourage the establishment of defined benefit plans by small and mid-sized employers, (2) ways to encourage the continued maintenance of defined benefit plans by larger employers, and (3) legislative proposals to accomplish these objectives.

Study on floor-offset ESOPs[31]

The Pension Benefit Guaranty Corporation (the "PBGC") would be required to undertake a study to determine the number of floor-offset ESOPs still in existence and the extent to which such plans pose a risk to plan participants or beneficiaries or to the PBGC and to report the results thereof, with legislative proposals, within 12 months after the date of enactment of the proposal, to the House Committee on Ways and Means, the House Committee on Education and the Workforce, the Senate Committee on Finance, and the Senate Committee on Health, Education, Labor and Pensions.

Study regarding insurance system for individual account plans

The PBGC would be required, as soon as practicable after the date of enactment of the proposal, to undertake a study relating to the establishment of an insurance system for defined contribution plans and to report the results thereof, with recommendations for legislative

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[31] A floor-offset arrangement is an arrangement under which benefits payable to a participant under a defined benefit plan are reduced by benefits under a defined contribution plan. Generally, in the case of a floor-offset arrangement, ERISA prohibits the defined contribution plan from acquiring employer securities if, after the acquisition, more than 10 percent of the assets of the plan would be invested in employer stock. However, under a special transition rule, this prohibition does not apply to a defined contribution plan, including an ESOP, that is part of a floor-offset arrangement established on or before December 17, 1987.

changes, within two years after the date of enactment of the proposal, to the House Committee on Education and the Workforce and the Senate Committee on Health, Education, Labor and Pensions. In conducting the study, the PBGC would be required to consider the feasibility of such a system, the problem with insuring investments in employer securities, and options for developing such a system.

Study regarding fees charged by individual account plans

The Department of Labor (the "DOL") would be required to undertake a study of the administrative and transaction fees incurred by participants and beneficiaries in connection with the investment of assets in their accounts under defined contribution plans and to report the results thereof, with recommendations for legislative changes, within one year after the date of enactment of the proposal, to the House Committee on Education and the Workforce and the Senate Committee on Health, Education, Labor and Pensions. In conducting the study, the DOL would be required to consider how the fees compare to fees charged for similar services provided to investors not in individual account plans and whether participants and beneficiaries are adequately notified of the fees.

Effective Date

The proposal would be effective on the date of enactment.

B. Plan Amendments

Present Law

Plan amendments to reflect amendments to the law generally must be made by the time prescribed by law for filing the income tax return of the employer for the employer's taxable year in which the change in law occurs.

Description of Proposal

The proposal would allow certain plan amendments made pursuant to the pension proposals described herein or the provisions of title VI of the Economic Growth and Tax Relief Reconciliation Act of 2001 (or regulations issued thereunder) to be retroactively effective. If the plan amendment meets the requirements of the proposal, then the plan would be treated as being operated in accordance with its terms and the amendment would not violate the prohibition of reductions of accrued benefits. In order for this treatment to apply, the plan amendment would be required to be made on or before the last day of the first plan year beginning on or after January 1, 2005 (January 1, 2007, in the case of a governmental plan). If the amendment is required to be made to retain qualified status as a result of the changes in the law (or regulations), the amendment would be required to be made retroactively effective as of the date on which the change became effective with respect to the plan and the plan would be required to be operated in compliance until the amendment is made. Amendments that are not required to retain qualified status but that are made pursuant to the pension proposals described herein or the 2001 Act (or applicable regulations) could be made retroactive as of the first day the plan is operated in accordance with the amendment.

A plan amendment would not be considered to be pursuant to a pension proposal described herein or a provision of the 2001 Act (or applicable regulations) if it has an effective date before the effective date of the proposal or the provision of the Act (or regulations) to which it related. Similarly, relief from section 411(d)(6) would not apply for periods prior to the effective date of the relevant proposal or provision (or regulations) or the plan amendment.

The Secretary would be authorized to provide exceptions to the relief from the prohibition on reductions in accrued benefits. It would be intended that the Secretary would not permit inappropriate reductions in contributions or benefits that are not directly related to the pension proposals described herein or the provisions of the bill or the 2001 Act. For example, it would be intended that a plan that incorporates the section 415 limits by reference could be retroactively amended to impose the section 415 limits in effect before the 2001 Act.[32] On the other hand, suppose a plan incorporates the section 401(a)(17) limit on compensation by reference and provides for an employer contribution of three percent of compensation. It would

[32] See also, section 411(j)(3) of the Job Creation and Worker Assistance Act of 2002, which provides a special rule for plan amendments adopted on or before June 30, 2002, in connection with the Economic Growth and Tax Relief Reconciliation Act of 2001 (the "2001 Act"), in the case of a plan that incorporated the section 415 limits by reference on June 7, 2001, the date of enactment of the 2001 Act.

be expected that the Secretary would provide that the plan cannot be amended retroactively to reduce the contribution percentage for those participants not affected by the section 401(a)(17) limit, even though the reduction would result in the same dollar level of contributions for some participants because of the increase in compensation taken into account under the plan as a result of the increase in the section 401(a)(17) limit under the 2001 Act. As another example, suppose that under present law a plan is top-heavy and therefore a minimum benefit is required under the plan, and that under the provisions of the 2001 Act, the plan is not considered to be top-heavy. It would be expected that the Secretary would generally permit plans to be retroactively amended to reflect the new top-heavy provisions of the 2001 Act.

Effective Date

The proposal would be effective on the date of enactment.

VI. PROVISIONS RELATING TO EXECUTIVE COMPENSATION

A. Repeal of Limitation on Issuance of Treasury Guidance Regarding Nonqualified Deferred Compensation

Present Law

General tax treatment of nonqualified deferred compensation

The determination of when amounts deferred under a nonqualified deferred compensation arrangement are includible in the gross income of the individual earning the compensation depends on the facts and circumstances of the arrangement. A variety of tax principles and Code provisions may be relevant in making this determination, including the doctrine of constructive receipt, the economic benefit doctrine, the provisions of section 83 relating generally to transfers of property in connection with the performance of services, and provisions relating specifically to nonexempt employee trusts (sec. 402(b)) and nonqualified annuities (sec. 403(c)).

In general, the time for inclusion of nonqualified deferred compensation depends on whether the arrangement is unfunded or funded. If the arrangement is unfunded, then the compensation is generally includible in income when it is actually or constructively received (i.e., when it is paid or otherwise made available). Income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

If the arrangement is funded, then it is generally treated as a transfer of property under section 83, and income is includible for the year in which the individual's right to the property is transferable or is not subject to a substantial risk of forfeiture. Deferred amounts that are subject to the claims of general creditors are generally treated as unfunded and unsecured promises to pay money or property in the future, which are not includible in income under section 83 when deferred.

Special statutory provisions govern the timing of the deduction for nonqualified deferred compensation, regardless of whether the arrangement covers employees or nonemployees and regardless of whether the arrangement is funded or unfunded.[33] Under these provisions, the amount of nonqualified deferred compensation that is includible in the income of the individual performing services is deductible by the service recipient for the taxable year in which the amount is includible in the individual's income.

Rulings on nonqualified deferred compensation

In the 1960's and early 1970's, various IRS revenue rulings considered the tax treatment of nonqualified deferred compensation arrangements.[34] Under these rulings, a mere promise to

[33] Secs. 404(a)(5), (b) and (d) and sec. 83(h).

[34] The seminal ruling dealing with nonqualified deferred compensation is Rev. Rul. 60-31, 1960-1 C.B. 174.

pay, not represented by notes or secured in any way, was not regarded as the receipt of income for tax purposes. However, if an amount was contributed to an escrow account or trust on the individual's behalf, to be paid to the individual in future years with interest, the amount was held to be includible in income under the economic benefit doctrine. Deferred amounts were not currently includible in income in situations in which nonqualified deferred compensation was payable from general corporate funds that were subject to the claims of general creditors and the plan was not funded by a trust, or any other form of asset segregation to which individuals had any prior or privileged claim.[35] Similarly, current income inclusion did not result when the employer purchased an annuity contract to provide a source of funds for its deferred compensation liability if the employer was the applicant, owner and beneficiary of the annuity contract, and the annuity contract was subject to the general creditors of the employer.[36] In these situations, deferred compensation amounts were held to be includible in income when actually received or otherwise made available.

Proposed Treasury regulation 1.61-16, published in the Federal Register for February 3, 1978, provided that if a payment of an amount of a taxpayer's compensation is, at the taxpayer's option, deferred to a taxable year later than that in which such amount would have been payable but for his exercise of such option, the amount shall be treated as received by the taxpayer in such earlier taxable year.[37]

Section 132 of the Revenue Act of 1978

Section 132 of the Revenue Act of 1978[38] was enacted in response to proposed Treasury regulation 1.61-16. Section 132 of the Revenue Act of 1978 provides that the taxable year of inclusion in gross income of any amount covered by a private deferred compensation plan is determined in accordance with the principles set forth in regulations, rulings, and judicial decisions relating to deferred compensation which were in effect on February 1, 1978. The term, "private deferred compensation plan" means a plan, agreement, or arrangement under which the person for whom service is performed is not a State or a tax-exempt organization and under which the payment or otherwise making available of compensation is deferred. However, the provision does not apply to certain employer-provided retirement arrangements (e.g., a qualified retirement plan), a transfer of property under section 83, or an arrangement that includes a nonexempt employees trust under section 402(b). Section 132 was not intended to restrict judicial interpretation of the law relating to the proper tax treatment of deferred compensation or

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[35] Rev. Rul. 69-650, 1969-2 C.B. 106; Rev. Rul. 69-49, 1969-1 C.B. 138.

[36] Rev. Rul. 72-25, 1972-1 C.B. 127. *See also*, Rev. Rul. 68-99, 1968-1 C.B. 193, in which the employer's purchase of an insurance contract on the life of the employee did not result in an economic benefit to the employee if all rights to any benefits under the contract were solely the property of the employer and the proceeds of the contract were payable only to the employer.

[37] Prop. Treas. Reg. 1.61-16, 43 Fed. Reg. 4638 (1978).

[38] Pub. L. No. 95-600.

interfere with judicial determinations of what principles of law apply in determining the timing of income inclusion.[39]

Description of Proposal

The proposal would repeal section 132 of the Revenue Act of 1978. It is intended that the Secretary of the Treasury would issue guidance with respect to the tax treatment of nonqualified deferred compensation arrangements focusing on arrangements that improperly defer income. For example, it is intended that the Secretary would address what is considered a substantial limitation under the constructive receipt doctrine and situations in which an individual's right to receive compensation is, at least in form, subject to substantial limitations, but in fact is not so limited. It is also intended that the Secretary would address situations which in form appear to not be funded, but in substance should be treated as so. In addition, it is intended that the Secretary would address situations in which assets are in form subject to the claims of an employer's general creditors, but are in substance unable to be reached by creditors. Arrangements that the Secretary would be expected to address include the following: the ability to receive funds on account of financial hardship, the use of trusts or other arrangements under which the rights of general creditors to gain access to funds is limited, the use of triggers and third-party guarantees to fund arrangements, and the ability to receive funds subject to a forfeiture of some portion of the participant's deferred compensation (sometimes referred to as a "haircut").

It is not intended that the Secretary take the position (as taken in proposed Treasury regulation 1.61-16) that all elective nonqualified deferred compensation is currently includible in income.

No inference would be intended that the Secretary is prohibited under present law from issuing guidance with respect to nonqualified deferred compensation arrangements or that any existing nonqualified deferred compensation guidance issued by the Secretary is invalid. In addition, no inference would be intended that any arrangements covered by future guidance provide permissible deferrals of income under present law.

Effective Date

The proposal would be effective for taxable years beginning after the date of enactment.

[39] The legislative history to the provision states that the Congress believed that the doctrine of constructive receipt should not be applied to employees of taxable employers as it would have been under the proposed regulation. The Congress also believed that the uncertainty surrounding the status of deferred compensation plans of taxable organizations under the proposed regulation was not desired and should not be permitted to continue.

B. Taxation of Deferred Compensation Provided through Offshore Trusts

Present Law

The determination of when amounts deferred under a nonqualified deferred compensation arrangement are includible in the gross income of the individual earning the compensation depends on the facts and circumstances of the arrangement. A variety of tax principles and Code provisions may be relevant in making this determination, including the doctrine of constructive receipt, the economic benefit doctrine, the provisions of section 83 relating generally to transfers of property in connection with the performance of services, and provisions relating specifically to nonexempt employee trusts (sec. 402(b)) and nonqualified annuities (sec. 403(c)).

In general, the time for inclusion of nonqualified deferred compensation depends on whether the arrangement is unfunded or funded. If the arrangement is unfunded, then the compensation is generally includible in income when it is actually or constructively received (i.e., when it is paid or otherwise made available). If the arrangement is funded, then it is generally treated as a transfer of property under section 83, and income is includible for the year in which the individual's right to the property is transferable or is not subject to a substantial risk of forfeiture.

The application of section 83 to a funded nonqualified deferred compensation arrangement is based in part on the broad scope of section 83 (i.e., section 83 applies to any transfer of property in connection with the performance of services) and the broad definition of property under section 83.[40] Under section 83, the excess of the fair market value of property received in connection with the performance of services over the amount, if any, paid for the property is includible in the income of the person performing the services. Section 83 applies to a transfer of property to any service provider; its application is not limited to employees or even to individuals. A transfer of property occurs for purposes of section 83 when a person acquires a beneficial ownership interest in such property.

The term "property" is defined very broadly for purposes of section 83.[41] Property includes real and personal property other than money or an unfunded and unsecured promise to pay money in the future. Property also includes a beneficial interest in assets (including money) that are transferred or set aside from claims of the creditors of the transferor, for example, in a trust or escrow account. Accordingly, if, in connection with the performance of services, vested contributions are made to a trust on an individual's behalf and the trust assets may be used solely to provide future payments to the individual, the payment of the contributions to the trust constitutes a transfer of property to the individual that is taxable under section 83. Deferred

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[40] Depending on the design of a particular nonqualified deferred compensation arrangement (e.g., if it covers only employees), either the economic benefit doctrine or Code provisions dealing with nonexempt employee trusts and nonqualified annuities may be relevant as legal authority for this tax treatment in addition to section 83.

[41] Treas. Reg. sec. 1.83-3(e). This definition in part reflects previous IRS rulings on nonqualified deferred compensation.

amounts are generally not includible in income in situations where nonqualified deferred compensation is payable from general corporate funds that are subject to the claims of general creditors, as such amounts are treated as unfunded and unsecured promises to pay money or property in the future.

Rabbi trusts

A "rabbi trust" is a trust or other fund established by the employer to hold assets from which nonqualified deferred compensation payments will be made. The trust or fund is generally irrevocable and does not permit the employer to use the assets for purposes other than to provide nonqualified deferred compensation. However, the terms of the trust or fund provide that the assets are subject to the claims of the employer's creditors in the case of bankruptcy.

As discussed above, for purposes of section 83, property includes a beneficial interest in assets set aside from the claims of creditors, such as in a trust or fund, but does not include an unfunded and unsecured promise to pay money in the future. In the case of a rabbi trust, terms providing that the assets are subject to the claims of creditors of the employer in the case of bankruptcy have been the basis for the conclusion that the creation of a rabbi trust does not cause the related nonqualified deferred compensation arrangement to be funded for income tax purposes.[42] As a result, no amount is included in income by reason of the rabbi trust; generally income inclusion occurs as payments are made from the trust.

The Internal Revenue Service has issued guidance setting forth model Rabbi Trust provisions.[43] Revenue Procedure 92-64 provides a safe harbor for taxpayers who adopt and maintain grantor trusts in connection with unfunded deferred compensation arrangements. The model trust language requires that the trust provide that the all assets of the trust are subject to the claims of the general creditors of the company.

Since the concept of a rabbi trust was developed, techniques have developed that attempt to protect the assets from creditors despite the terms of the trust. For example, the trust or fund may be located in a foreign jurisdiction, making it difficult or impossible for creditors to reach the assets.

Description of Proposal

The proposal would provide that assets that are designated or otherwise available for the use of providing nonqualified deferred compensation and are located outside the United States (e.g., in a foreign trust, arrangement or account) are not treated as subject to the claims of general creditors. Therefore, amounts deferred in such cases would not be treated as unfunded and unsecured promises to pay. Such nonqualified deferred compensation amounts would be treated

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[42] This conclusion was first provided in a 1980 private ruling issued by the IRS with respect to an arrangement covering a rabbi; hence the popular name "rabbi trust." Priv. Ltr. Rul. 8113107 (Dec. 31, 1980).

[43] Rev. Proc. 92-64, 1992-2 C.B. 422, modified in part by Notice 2000-56, 2000-2 C.B. 393.

as property under section 83 and the value of the compensation deferred would be includible in income when the right to the compensation is no longer subject to a substantial risk of forfeiture, regardless of when the compensation is paid. No inference would be intended with respect to the treatment of such arrangements under present law.

The proposal would not apply to deferred compensation arrangements covering employees located in a foreign jurisdiction if substantially all of the services with respect to which the property was transferred are performed in such foreign jurisdiction.

The proposal would provide the Secretary of the Treasury authority to provide additional exceptions for specific arrangements which do not result in improper deferral of U.S. tax. For example, it is intended that the Secretary would provide exceptions for arrangements in which deferred amounts are readily accessible under U.S. bankruptcy laws.

Effective Date

The proposal would be effective for amounts deferred after the date of enactment.

C. Treatment of Loans to Executives

Present Law

In general, gross income includes all income from any source, including compensation for past, present or future services, unless an exclusion applies. The proceeds of a bona fide loan are not income for Federal tax purposes, because the recipient is obligated to repay the loan. The issue of whether a payment is a bona fide loan or represents income to the payee may arise in various contexts (including in an employment context) and depends on the facts and circumstances. In analyzing whether there is an obligation to repay an amount, relevant factors include the existence of (1) a promissory note or other evidence of indebtedness, (2) a schedule for repayment of the amount with interest, (3) collateral or security, and (4) the payee's ability to repay.

Under present law, below-market-rate loans between certain parties are recharacterized as an arm's length transaction in which the lender made a loan to the borrower in exchange for a note requiring the payment of interest at the applicable Federal rate. In the case of compensation-related loans, this rule results in the parties being treated as if: (1) the borrower paid interest to the lender at the applicable Federal rate which is includible in income by the lender, and (2) the lender paid compensation to the employee or other person performing services. A compensation-related loan is a below-market loan directly or indirectly between an employer and an employee or an independent contractor and a person for whom such independent contractor provides services.

In general, a below-market-rate loan is a demand loan, the interest on which is payable at less than the applicable Federal rate, or a term loan, if the amount of the loan exceeds the present value of all payments due under the loan, using a discount rate equal to the applicable Federal rate. A demand loan is any loan which is payable on demand of the lender; a term loan is any loan other than a demand loan.

Description of Proposal

In general

The proposal would treat certain loans to applicable individuals as compensation, and would increase the imputed interest rate on below-market rate loans for loans to applicable individuals with an outstanding loan balance in excess of $1 million. An applicable individual would be an employee (or independent contractor) who is an officer, director, or five-percent owner of the employer (or service recipient). In addition, the proposal treating certain loans as compensation would apply to any loan made to an employee or independent contractor if outstanding loans from the employer (or service provider) exceed $1 million.

Certain loans treated as compensation

Under the proposal, a direct or indirect loan made to an applicable individual (including, for example, a loan in connection with split-dollar life insurance arrangements) would be treated as compensation (and therefore includible in gross income and wages for payroll tax purposes) unless (1) there is a promissory note or other written evidence of indebtedness, (2) there is collateral or security for the debt, other than compensation-related property, and (3) there is a fixed schedule for payment of principal and interest,[44] not to exceed 10 years. Compensation-related property would mean any assets acquired by the applicable individual by reason of the performance of services by the individual for the employer (or service recipient), including any stock or capital or profits interest in the employer, any option or other contract to purchase such stock or interests, any restricted stock or ownership interest, or any nonqualified deferred compensation. For example, if an applicable individual uses stock acquired with a loan from the employer (or service recipient) as collateral for a loan, the stock would be considered compensation-related property, and the loan would be treated as compensation and wages under the proposal.

If the individual repays to the employer (or service recipient) an amount treated as compensation under the proposal, then the individual would be entitled to a deduction for the amount repaid as a miscellaneous itemized deduction (subject to the two-percent floor on such deductions) in the year of repayment to the extent the amount had been includible in gross income. The amount of wages taken into account for employment tax purpose for the year of the repayment would be reduced by the amount of the repayment previously included as wages. The employer (or other service recipient) would be required to include in income any payments of interest, and any repayment of loans treated as compensation for which a deduction was taken. Special rules would apply in determining the application of the below-market-rate loan rules to repayments of loans treated as compensation under the proposal.

Loans from qualified plans and relocation loans would not be subject to the proposal. A relocation loan would be a loan the proceeds of which are used by the employee to purchase a principal residence if the purchase is in connection with the commencement of work by an employee or a change in the principal work of an employee to which section 217 applies (relating to the deduction for moving expenses).

Treasury would be authorized to issue appropriate regulations to carry out the intent of the provision, including rules addressing situations such as the payment of a bonus that coincides with a payment under the loan agreement, and rules specifying the proper treatment of an arrangement treated as a loan when made if the employee subsequently fails to make scheduled payments when due.

Imputed interest rate for below-market-rate loans

If the amount of all outstanding loans of applicable individuals with respect to the same service recipient exceeds $1 million, then the interest rate imputed under the below-market-rate loan rules would be the applicable Federal rate plus three percentage points.

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[44] The below-market-rate loan rules (as modified by the proposal) would apply if sufficient interest is not required under the terms of the loan.

Effective Date

The proposal would be effective for loans made or refinanced after the date of enactment. Except as provided by the Secretary, modifications to a loan after the effective date would be considered a new loan.

D. Required Wage Withholding at Top Marginal Rate for Supplemental Wage Payments in Excess of $1 Million

Present Law

An employer must withhold income taxes from wages paid to employees; there are several possible methods for determining the amount of income tax to be withheld. The IRS publishes tables (Publication 15, "Circular E") to be used in determining the amount of income tax to be withheld. The tables generally reflect the income tax rates under the Code so that withholding approximates the ultimate tax liability with respect to the wage payments. In some cases, "supplemental" wage payments (e.g., bonuses or commissions) may be subject to withholding at a flat rate[45], based on the third lowest income tax rate under the Code (27 percent for 2002).[46]

Description of Proposal

Under the proposal, once annual supplemental wage payments to an employee exceed $1 million, any additional supplemental wage payments to the employee in that year would be subject to withholding at the highest income tax rate (38.6 percent for 2002), regardless of any other withholding rules and regardless of the employee's Form W-4.

This rule would apply only for purposes of wage withholding; other types of withholding (such as pension withholding and backup withholding) would not be affected.

Effective Date

The proposal would be effective with respect to wage payments made after December 31, 2002.

[45] See section 13273 of the Revenue Reconciliation Act of 1993.

[46] See section 101(c)(11) of the Economic Growth and Tax Relief Reconciliation Act of 2001.

JOINT COMMITTEE ON TAXATION
July 10, 2002
JCX-75-02

ESTIMATED REVENUE EFFECTS OF THE CHAIRMAN'S MODIFICATION TO THE "NATIONAL EMPLOYEE SAVINGS AND TRUST EQUITY GUARANTEE ACT," SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON JULY 11, 2002

Fiscal Years 2002 - 2012

[Millions of Dollars]

Provision	Effective	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2002-07	2002-12
Diversification of Defined Contribution Plan Assets	**generally pyba 12/31/02**						***Negligible Revenue Effect***							
Protection of Employees During Pension Plan Transaction Suspension Period														
1. Notice to participants or beneficiaries of transaction suspension periods	generally pyba 12/31/02						*Negligible Revenue Effect*							
2. Inapplicability of relief from fiduciary liability during suspension of ability of participant or beneficiary to direct investments	generally pyba 12/31/02						*No Revenue Effect*							
3. Clarification of participant access to remedies under ERISA	DOE						*No Revenue Effect*							
4. Increased maximum bond amount of plans holding employer securities	pyba 12/31/02						*No Revenue Effect*							
Total of Protection of Employees During Pension Plan Transaction Suspension Period							***Negligible Revenue Effect***							
Providing Information to Assist Participants														
1. Benefit statements and investment guidelines	generally pyba 12/31/03						*Negligible Revenue Effect*							
2. Information on optional forms of benefit	DOE						*Negligible Revenue Effect*							
3. Fiduciary duty to provide material information relating to investment in employer stock	pyba 12/31/02						*No Revenue Effect*							
4. Electronic disclosure of insider trading	pyba 12/31/02						*No Revenue Effect*							
5. Fiduciary rules for plan sponsors designating independent investment advisors	DOE						*No Revenue Effect*							
Total of Providing Information to Assist Participants							***Negligible Revenue Effect***							
Other Proposals Relating to Pension Plans														
1. Studies	DOE						*No Revenue Effect*							
2. Plan Amendments	DOE						*No Revenue Effect*							
Total of Other Proposals Relating to Pension Plans							***No Revenue Effect***							
Provisions Relating to Executive Compensation														
1. Repeal of limitation on issuance of Treasury guidance regarding nonqualified deferred compensation	tyba DOE						*Negligible Revenue Effect*							

Provision	Effective	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2002-07	2002-12
2. Taxation of deferred compensation provided through offshore trusts	ada DOE	---	67	76	56	28	9	5	4	4	20	23	235	290
3. Treatment of loans to executives	lmora DOE	---	10	25	32	30	22	19	19	22	30	32	118	241
4. Required wage withholding at top marginal rate for supplemental wage payments in excess of $1 million	wpma 12/31/02	---	115	19	11	11	9	[1]	8	9	10	9	165	201
Total of Provisions Relating to Executive Compensation		---	**192**	**120**	**99**	**69**	**40**	**24**	**31**	**35**	**60**	**64**	**518**	**732**
NET TOTAL		---	**192**	**120**	**99**	**69**	**40**	**24**	**31**	**35**	**60**	**64**	**518**	**732**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.

Legend for "Effective" column:

ada = amounts deferred after
DOE = date of enactment
lmora = loans made or refinanced after
pyba = plan years beginning after
tyba = taxable years beginning after
wpma = wage payments made after

[1] Gain of less than $500,000.

Joint Committee on Taxation
July 11, 2002
JCX-76-02

ADDITIONAL CHAIRMAN'S MODIFICATIONS TO THE "NATIONAL EMPLOYEE SAVINGS AND TRUST EQUITY GUARANTEE ACT"[1]

I. MODIFICATIONS TO EXISTING PROVISONS

A. Diversification of Defined Contribution Plan Assets

Under the Chairman's modification, the diversification requirements for defined contribution plans are phased in with respect to employer matching and nonelective contributions (and earnings thereon) that are invested in employer securities acquired before the first plan year to which the diversification requirements apply. Under this phase-in, the applicable percentage of such amounts that are subject to diversification is 33 percent for the first year the provision is effective, 66 percent the second year, and 100 percent the third year.

Under the additional modification, this phase-in would not apply to plan participants who have three years of service and who have attained age 55 by the beginning of the first plan year beginning after December 31, 2002.

B. Clarification of Participant Access to Remedies under ERISA

The Chairman's modification clarifies that, in the case of a fiduciary breach with respect to a defined contribution plan, the relief under the general fiduciary provisions of ERISA would, to the extent the court deems appropriate, be apportioned to each individual account affected by the breach.

The additional modification would clarify that no inference is intended as to the scope of recovery available to participants under present law.

C. Optional Forms of Benefit

The Chairman's modification requires the Secretary of the Treasury to issue regulations requiring defined benefit and money purchase pension plan administrators to provide a statement comparing the relative values of each form of benefit payable under the plan. The statement is

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[1] A description of the Chairman's modifications may be found in Joint Committee on Taxation, *Description of Chairman's Modifications to the "National Employee Savings and Trust Equity Guarantee Act"* (JCX-74-02), July 9, 2002.

required to include such information as the Secretary determines appropriate to enable the average plan participant, spouse, or surviving spouse to make an informed decision as to what form of benefit to elect.

The additional modification provides that, for example, in the case of a plan that provides a subsidized early retirement annuity benefit, it is intended that the information would include, at a minimum, a quantification of how the subsidy is included in determining other forms of benefit (e.g., a lump sum) payable at early retirement age.

D. Treatment of Loans to Executives

The Chairman's modification provides that certain loans to officers, shareholders, five-percent owners, and employees who have outstanding loans from the employer in excess of $1 million would be treated as compensation.

The additional modification would clarify that it is not the intent that this proposal would impose tax on amounts otherwise includible in gross income.

II. ADDITIONAL PROVISIONS

A. Voluntary Early Retirement Incentive Plans Maintained by Local Educational Agencies and Other Entities

Present Law

Eligible deferred compensation plans of State and local governments and tax-exempt employers

A "section 457 plan" is an eligible deferred compensation plan of a State or local government or tax-exempt employer that meets certain requirements. For example, amounts that can be deferred under section 457 cannot exceed certain limits. Amounts deferred under a section 457 plan are generally includible in gross income when paid or made available (or, in the case of governmental section 457 plans, when paid). Amounts deferred under a plan that does not comply with section 457 (other than a qualified plan or similar arrangement) are includible in income when the amounts are not subject to a substantial risk of forfeiture. Section 457 does not apply to any bona fide vacation, sick leave, compensatory time, severance pay, disability pay, death benefit plan, or qualified governmental excess benefit plans that provide benefits in excess of those that are provided under a qualified retirement plan maintained by the governmental employer.

ERISA

ERISA provides rules governing the operation of most employee benefit plans. The rules to which a plan is subject depends on whether the plan is an employee welfare benefit plan or an employee pension benefit plan. For example, employee pension benefit plans are subject to reporting and disclosure requirements, participation and vesting requirements, funding requirements, and fiduciary provisions. Employee welfare benefit plans are not subject to all of these requirements.

Age Discrimination in Employment Act

The Age Discrimination in Employment Act ("ADEA") generally prohibits discrimination in employment because of age. An exemption is provided from certain restrictions in the ADEA for certain defined benefit plans that offer early retirement benefits or social security supplements.

Description of Proposal

Early retirement incentive plans of local education agencies and education associations

Under the proposal, certain plans would be treated as (1) bona fide severance plans for purposes of section 457 (and therefore not subject to the limits of that section), (2) severance pay arrangements for purposes of ERISA, and (3) defined benefit plans exempt from provisions of ADEA.

The proposal would apply to voluntary early retirement incentive plans maintained by a local educational agency or tax-exempt education association if the plan makes payments only to provide subsidized early retirement benefits or social security supplements that could otherwise be provided under a qualified defined benefit plan maintained by a State or agency thereof or such an association.

Special rules for employment retention plans of local education agencies and education associations

The proposal would provide that certain payments not in excess of the dollar limit on deferrals under a section 457 plan are not includible in gross income until paid. This treatment would apply with respect to a participant in an employment retention plan maintained by a local education agency or a tax-exempt education association, to the extent the plan provides for a participant who is eligible to retire to receive a payment (not in excess of the dollar limit).

Effective Date

The proposal would be effective for amounts deferred after the date of enactment.

No inference (including an inference as to whether a voluntary early retirement incentive plan maintained by a local education agency constitutes or constituted a defined benefit plan) would be intended with respect to the law applicable to plans or arrangements not described in the proposal or with respect to the law in effect prior to the effective date of the proposal.

B. Exclusion of Incentive Stock Options and Employee Stock Purchase Plan Stock Options from Wages

Present Law

Generally, when an employee exercises a compensatory option on employer stock, the difference between the option price and the fair market value of the stock (i.e., the "spread") is includible in income as compensation. In the case of an incentive stock option or an option to purchase stock under an employee stock purchase plan (collectively referred to as "statutory stock options"), the spread is not included in income at the time of exercise.[2]

If the statutory holding period requirements are satisfied with respect to stock acquired through the exercise of a statutory stock option, the spread, and any additional appreciation, will be taxed as capital gain upon disposition of such stock. Compensation income is recognized, however, if there is a disqualifying disposition (i.e., if the statutory holding period is not satisfied) of stock acquired pursuant to the exercise of a statutory stock option.

Federal Insurance Contribution Act ("FICA") and Federal Unemployment Tax Act ("FUTA") taxes are generally imposed in an amount equal to a percentage of wages paid by the employer with respect to employment.[3] The applicable Code provisions[4] do not provide an exception from FICA and FUTA taxes for wages paid to an employee arising from the exercise of a statutory stock option.

There has been uncertainty in the past as to employer withholding obligations upon the exercise of statutory stock options. On June 25, 2002, the IRS announced in Notice 2002-47[5] that until further guidance is issued, it would not assess FICA or FUTA taxes, or impose Federal income tax withholding obligations, upon either the exercise of a statutory stock option or the disposition of the stock acquired pursuant to the exercise of a statutory stock option.

Description of Proposal

The proposal would provide specific exclusions from FICA and FUTA wages for remuneration on account of the transfer of stock pursuant to the exercise of an incentive stock option or under an employee stock purchase plan, or any disposition of such stock. Thus, under the proposal, FICA and FUTA taxes would not apply upon the exercise of a statutory stock option.[6] The proposal would also provide that such remuneration is not taken into account for purposes of determining Social Security benefits.

Additionally, the proposal would provide that Federal income tax withholding is not required on a disqualifying disposition, nor when compensation is recognized in connection with an employee stock purchase plan discount. Present law reporting requirements would continue to apply.

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[2] Sec. 421.

[3] Secs. 3101, 3111 and 3301.

[4] Secs. 3121 and 3306.

[5] Notice 2002-47, 2002-28 I.R.B. 1.

[6] The proposal would also provide a similar exclusion for wages under the Railroad Retirement Tax Act.

Effective Date

The proposal would be effective on the date of enactment.

C. Capital Gain Treatment on Sale of Stock Acquired from Exercise of Statutory Stock Options to Comply with Conflict of Interest Requirements

Present Law

Statutory stock options

Generally, when an employee exercises a compensatory option on employer stock, the difference between the option price and the fair market value of the stock (i.e., the "spread") is includible in income as compensation. Upon such exercise, an employer is allowed a corresponding compensation deduction. In the case of an incentive stock option or an option to purchase stock under an employee stock purchase plan (collectively referred to as "statutory stock options"), the spread is not included in income at the time of exercise.[7]

If an employee disposes of stock acquired upon the exercise of a statutory option, the employee generally is taxed at capital gains rates with respect to the excess of the fair market value of the stock on the date of disposition over the option price, and no compensation expense deduction is allowable to the employer, unless the employee fails to meet a holding period requirement. The employee fails to meet this holding period requirement if the disposition occurs within two years after the date the option is granted or one year after the date the option is exercised. A disposition that occurs prior to the expiration of the applicable holding period(s) (a "disqualifying disposition") does not qualify for capital gains treatment. In the event of a disqualifying disposition, the income attributable to the disposition is treated by the employee as income received in the taxable year in which the disposition occurs, and a corresponding deduction is allowable to the employer for the taxable year in which the disposition occurs.

Sale of property to comply with conflict of interest rules

The Code provides special rules for recognizing gain on sales of property which are required in order to comply with certain conflict of interest requirements imposed by the Federal government.[8] Certain executive branch Federal employees (and their spouses and children) who are required to divest property in order to comply with conflict of interest rules can postpone the recognition of resulting gains by electing to reduce the basis of certain replacement property purchased within a 60-day period. Permitted replacement property is limited to any obligation of the United States or any diversified investment fund approved by regulations issued by the Office of Government Ethics. The rule applies only to sales under certificates of divestiture issued by the President or the Director of the Office of Government Ethics.

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[7] Sec. 421.

[8] Sec. 1043.

Description of Proposal

Under the proposal, an eligible person who, in order to comply with the Office of Government Ethics conflict of interest requirements, is required to sell shares of stock acquired pursuant to the exercise of a statutory stock option would be treated as satisfying the statutory holding period requirements, regardless of how long the stock was actually held. Because the sale would not be treated as a disqualifying disposition, the individual would be afforded capital gain treatment on any resulting gains. Under the proposal, such gains would be eligible for the deferral treatment under section 1043. An eligible person generally includes an officer or employee of the executive branch of the Federal Government (and any spouse or minor or dependent children whose ownership in property is attributable to the officer or employee).

The employer granting the option would not be allowed a deduction upon the sale of the stock by the individual.

Effective Date

The proposal would be effective for stock sales after July 1, 2002.

D. Interest Rate Range for Additional Funding Requirements

Present Law

In general

ERISA and the Code impose both minimum and maximum[9] funding requirements with respect to defined benefit pension plans. The minimum funding requirements are designed to provide at least a certain level of benefit security by requiring the employer to make certain minimum contributions to the plan. The amount of contributions required for a plan year is generally the amount needed to fund benefits earned during that year plus that year's portion of other liabilities that are amortized over a period of years, such as benefits resulting from a grant of past service credit.

Additional contributions for underfunded plans

Additional contributions are required under a special funding rule if a single-employer defined benefit pension plan is underfunded.[10] Under the special rule, a plan is considered underfunded for a plan year if the value of the plan assets is less than 90 percent of the plan's

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[9] The maximum funding requirement for a defined benefit plan is referred to as the full funding limitation. Additional contributions are not required if a plan has reached the full funding limitation.

[10] Plans with no more than 100 participants on any day in the preceding plan year are not subject to the special funding rule. Plans with more than 100 but not more than 150 participants are generally subject to lower contribution requirements under the special funding rule.

current liability.[11] The value of plan assets as a percentage of current liability is the plan's "funded current liability percentage."

If a plan is underfunded, the amount of additional required contributions is based on certain elements, including whether the plan has an unfunded liability related to benefits accrued before 1988 or 1995 or to changes in the mortality table used to determine contributions, and whether the plan provides for unpredictable contingent event benefits (that is, benefits that depend on contingencies that are not reliably and reasonably predictable, such as facility shutdowns or reductions in workforce). However, the amount of additional contributions cannot exceed the amount needed to increase the plan's funded current liability percentage to 100 percent.

Required interest rate

In general, a plan's current liability means all liabilities to employees and their beneficiaries under the plan. 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 30-year Treasury securities for the four-year period ending on the last day before the plan year begins.[12] The permissible range is from 90 percent to 105 percent. As a result of debt reduction, the Department of the Treasury does not currently issue 30-year Treasury securities.

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. The amount of each required installment is 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.[13]

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[11] Under an alternative test, a plan is not considered underfunded if (1) the value of the plan assets is at least 80 percent of current liability and (2) the value of the plan assets was at least 90 percent of current liability for each of the two immediately preceding years or each of the second and third immediately preceding years.

[12] The interest rate used under the plan must be consistent with the assumptions which reflect the purchase rates which would be used by insurance companies to satisfy the liabilities under the plan (section 412(b)(5)(B)(iii)(II)).

[13] No additional quarterly contributions are due once the plan's funded current liability percentage for the plan year reaches 100 percent.

PBGC premiums

Because benefits under a defined benefit pension plan may be funded over a period of years, plan assets may not be sufficient to provide the benefits owed under the plan to employees and their beneficiaries if the plan terminates before all benefits are paid. In order to protect employees and their beneficiaries, the Pension Benefit Guaranty Corporation ("PBGC") generally insures the benefits owed under defined benefit pension plans. Employers pay premiums to the PBGC for this insurance coverage.

In the case of an underfunded plan, additional PBGC premiums are required based on the amount of unfunded vested benefits. These premiums are referred to as "variable rate premiums." In determining the amount of unfunded vested benefits, the interest rate used is 85 percent of the interest rate on 30-year Treasury securities for the month preceding the month in which the plan year begins.

Special interest rate for 2002 and 2003

Section 405 of the Job Creation and Worker Assistance Act of 2002,[14] enacted March 9, 2002, provides a special interest rate rule applicable in determining the amount of additional contributions for plan years beginning after December 31, 2001, and before January 1, 2004 (the "applicable plan years"). The special rule expands the permissible range of the statutory interest rate used in calculating a plan's current liability for purposes of applying the additional contribution requirements for the applicable plan years. The permissible range is from 90 percent to 120 percent for these years.

Under a related special rule, the interest rate used in determining the amount of unfunded vested benefits for PBGC variable rate premium purposes is increased to 100 percent of the interest rate on 30-year Treasury securities for the month preceding the month in which the applicable plan year begins.

Description of Proposal

The proposal would expand the permissible range of the statutory interest rate used in calculating a plan's current liability for purposes of determining the amount of additional contributions for a plan year beginning in 2001 (the "2001 plan year") that must be contributed to the plan within 8½ months after the end of the plan year (e.g., by September 15, 2002, in the case of a plan that uses the calendar year as the plan year). The permissible range would be from 90 percent to 108 percent for this purpose.

In addition, with respect to the provision of the Job Creation and Worker Assistance Act of 2002 providing a special rule for the interest rate used in determining the amount of unfunded vested benefits for PBGC variable rate premium purposes, the proposal would make conforming changes so that the special rule would apply for purposes of notices and reporting required with respect to underfunded plans.

[14] Pub. L. No. 107-147.

Effective Date

The proposal would be effective as if included in section 405 of the Job Creation and Worker Assistance Act of 2002.

E. Automatic Rollovers of Certain Mandatory Distributions

Present Law

If a qualified retirement plan participant ceases to be employed by the employer that maintains the plan, the plan may distribute the participant's nonforfeitable accrued benefit without the consent of the participant and, if applicable, the participant's spouse, if the present value of the benefit does not exceed $5,000. Generally, a participant may roll over an involuntary distribution from a qualified plan to an IRA or to another qualified plan. Before making a distribution that is eligible for rollover, a plan administrator must provide the participant with a written explanation of the ability to have the distribution rolled over directly to an IRA or another qualified plan and the related tax consequences.

Revenue Ruling 2000-36[15] holds that a qualified retirement plan may provide that the default form of payment of an involuntary distribution is a direct rollover to an IRA, unless the participant elects a direct rollover to another qualified retirement plan or IRA or to receive the payment in cash. Under the plan, the plan administrator selects an IRA trustee, custodian or issuer, establishes the IRA on behalf of the participant, and makes initial investment choices for the account. Footnote 1 of Revenue Ruling 2000-36 states:

"The Department of Labor (the "DOL") has advised Treasury and the Service that, under Title I of the Employee Retirement Income Security Act ("ERISA"), in the context of a default direct rollover described in this ruling, where the distribution constitutes the entire benefit rights of the participant, the participant will cease to be a participant covered under the plan within the meaning of 29 CFR § 2510.3-3(d)(2)(ii)(B), and the distributed assets will cease to be plan assets within the meaning of 29 CFR § 2510.3-101. The DOL also noted that the selection of an IRA trustee, custodian or issuer and IRA investment for purposes of a default direct rollover would constitute a fiduciary act subject to the general fiduciary standards and prohibited transaction provisions of ERISA. In addition, plan provisions governing the default direct rollover of distributions, including the participant's ability to affirmatively opt out of the arrangement, must be described in the plan's summary plan description furnished to participants and beneficiaries."

Under section 657 of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), a direct rollover to an IRA must be the default option for an involuntary distribution that exceeds $1,000 and that is an eligible rollover distribution from a qualified retirement plan. That is, the distribution must be rolled over automatically to a designated IRA, unless the participant affirmatively elects to have the distribution transferred to a different IRA or a qualified plan or to receive it directly.

[15] 2000-2 C.B. 140.

This provision of EGTRRA also amended the fiduciary rules of ERISA so that, in the case of an automatic direct rollover, the participant is treated as exercising control over the assets in the IRA upon (1) the earlier of a rollover of all or a portion of the amount to another IRA, or one year after the automatic rollover is made, or (2) an automatic rollover made in a manner consistent with guidance provided by the Secretary of Labor.[16] EGTRRA directed the Secretary of Labor to prescribe regulations, not later than three years after the date of enactment of EGTRRA, providing safe harbors under which the designation of an institution and investment of funds in accordance with the automatic direct rollover provision are deemed to satisfy the requirements of section 404(a) of ERISA. The EGTRRA provisions apply to distributions made after the Department of Labor has adopted final regulations providing the required safe harbor.

Description of Proposal

The proposal would repeal the ERISA provision (section 404(c)(3) of ERISA) that was enacted by section 657 of EGTRRA. The proposal would thus clarify that amounts that are transferred from a qualified retirement plan to an IRA in an automatic rollover are no longer plan assets for ERISA purposes, consistent with the Department of Labor's position as described in Revenue Ruling 2000-36.

Effective Date

The proposal would be effective as if included in the provisions of EGTRRA.

F. Chief Executive Officer Required To Sign Corporate Income Tax Returns

Present Law

The Code requires[17] that the income tax return of a corporation must be signed by either the president, the vice-president, the treasurer, the assistant treasurer, the chief accounting officer, or any other officer of the corporation authorized by the corporation to sign the return.

The Code also imposes[18] a criminal penalty on any person who willfully signs any tax return under penalties of perjury that that person does not believe to be true and correct with respect to every material matter at the time of filing. If convicted, the person is guilty of a felony; the Code imposes a fine of not more than $100,000[19] ($500,000 in the case of a corporation) or imprisonment of not more than three years, or both, together with the costs of prosecution.

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[16] Sec. 404(c)(3) of ERISA. Section 411(t) of the Job Creation and Worker Assistance Act of 2002 made clerical corrections to the wording of this provision.

[17] Sec. 6062.

[18] Sec. 7206.

[19] Pursuant to 18 U.S.C. 3571, the maximum fine for an individual convicted of a felony is $250,000.

Description of Proposal

The proposal would require that the income tax return of a corporation must be signed by the chief executive officer of that corporation. Special rules would apply if the corporation did not have a chief executive officer or had multiple chief executive officers; otherwise, no other person would be permitted to sign the income tax return of a corporation.

Effective Date

The proposal would be effective for returns filed after the date of enactment.

G. Other Provisions Relating to Pensions

1. Employee Plans Compliance Resolution System

Present Law

A retirement plan that is intended to be a tax-qualified plan provides retirement benefits on a tax-favored basis if the plan satisfies all of the requirements of section 401(a). Similarly, an annuity that is intended to be a tax-sheltered annuity provides retirement benefits on a tax-favored basis if the program satisfies all of the requirements of section 403(b). Failure to satisfy all of the applicable requirements of section 401(a) or section 403(b) may disqualify a plan or annuity for the intended tax-favored treatment.

The Internal Revenue Service ("IRS") has established the Employee Plans Compliance Resolution System ("EPCRS"), which is a comprehensive system of correction programs for sponsors of retirement plans and annuities that are intended, but have failed, to satisfy the requirements of section 401(a), section 403(a), or section 403(b), as applicable.[20] EPCRS permits employers to correct compliance failures and continue to provide their employees with retirement benefits on a tax-favored basis.

The IRS has designed EPCRS to (1) encourage operational and formal compliance, (2) promote voluntary and timely correction of compliance failures, (3) provide sanctions for compliance failures identified on audit that are reasonable in light of the nature, extent, and severity of the violation, (4) provide consistent and uniform administration of the correction programs, and (5) permit employers to rely on the availability of EPCRS in taking corrective actions to maintain the tax-favored status of their retirement plans and annuities.

The basic elements of the programs that comprise EPCRS are self-correction, voluntary correction with IRS approval, and correction on audit. The Self-Correction Program ("SCP") generally permits a plan sponsor that has established compliance practices to correct certain insignificant failures at any time (including during an audit), and certain significant failures within a 2-year period, without payment of any fee or sanction. The Voluntary Correction Program ("VCP") program permits an employer, at any time before an audit, to pay a limited fee and receive IRS approval of a correction. For a failure that is discovered on audit and corrected,

[20] Rev. Proc. 2001-17, 2001-7 I.R.B. 589.

the Audit Closing Agreement Program ("Audit CAP") provides for a sanction that bears a reasonable relationship to the nature, extent, and severity of the failure and that takes into account the extent to which correction occurred before audit.

The IRS has expressed its intent that EPCRS will be updated and improved periodically in light of experience and comments from those who use it.

Description of Proposal

The proposal would clarify that the Secretary of the Treasury has the full authority to establish and implement EPCRS (or any successor program) and any other employee plans correction policies, including the authority to waive income, excise or other taxes to ensure that any tax, penalty or sanction is not excessive and bears a reasonable relationship to the nature, extent and severity of the failure.

The Secretary of the Treasury would be directed to continue to update and improve EPCRS (or any successor program), giving special attention to (1) increasing the awareness and knowledge of small employers concerning the availability and use of EPCRS, (2) taking into account special concerns and circumstances that small employers face with respect to compliance and correction of compliance failures, (3) extending the duration of the self-correction period under SCP for significant compliance failures, (4) expanding the availability to correct insignificant compliance failures under SCP during audit, and (5) assuring that any tax, penalty, or sanction that is imposed by reason of a compliance failure is not excessive and bears a reasonable relationship to the nature, extent, and severity of the failure.

Effective Date

The proposal would be effective on the date of enactment.

2. Extension to all governmental plans of moratorium on application of certain nondiscrimination rules applicable to state and local government plans

Present Law

A qualified retirement plan maintained by a State or local government is exempt from the rules concerning nondiscrimination (sec. 401(a)(4)) and minimum participation (sec. 401(a)(26)). All other governmental plans are not exempt from the nondiscrimination and minimum participation rules.

Description of Proposal

The proposal would exempt all governmental plans (as defined in sec. 414(d)) from the nondiscrimination and minimum participation rules.

Effective Date

The proposal would be effective for plan years beginning after December 31, 2002.

3. Notice and consent period regarding distributions

Present Law

Notice and consent requirements apply to certain distributions from qualified retirement plans. These requirements relate to the content and timing of information that a plan must provide to a participant prior to a distribution, and to whether the plan must obtain the participant's consent to the distribution. The nature and extent of the notice and consent requirements applicable to a distribution depend upon the value of the participant's vested accrued benefit and whether the joint and survivor annuity requirements (sec. 417) apply to the participant.

If the present value of the participant's vested accrued benefit exceeds $5,000,[21] the plan may not distribute the participant's benefit without the written consent of the participant. The participant's consent to a distribution is not valid unless the participant has received from the plan a notice that contains a written explanation of (1) the material features and the relative values of the optional forms of benefit available under the plan, (2) the participant's right, if any, to have the distribution directly transferred to another retirement plan or IRA, and (3) the rules concerning the taxation of a distribution. If the joint and survivor annuity requirements apply to the participant, this notice also must contain a written explanation of (1) the terms and conditions of the qualified joint and survivor annuity ("QJSA"), (2) the participant's right to make, and the effect of, an election to waive the QJSA, (3) the rights of the participant's spouse with respect to a participant's waiver of the QJSA, and (4) the right to make, and the effect of, a revocation of a waiver of the QJSA. The plan generally must provide this notice to the participant no less than 30 and no more than 90 days before the date distribution commences.

If the participant's vested accrued benefit does not exceed $5,000, the terms of the plan may provide for distribution without the participant's consent. In that case, the plan must provide that, if the amount of the distribution exceeds $1,000, the plan administrator will transfer the distribution to a designated IRA unless the participant elects to receive the distribution directly or have it directly transferred to another retirement plan or IRA. Before making a distribution, the plan administrator generally is required to provide to the participant a notice that contains a written explanation of (1) the participant's right, if any, to have the distribution directly transferred to another retirement plan or IRA, (2) the fact that a distribution that exceeds $1,000 will be transferred to a designated IRA unless the participant elects otherwise, and (3) the rules concerning the taxation of a distribution. The plan generally must provide this notice to the participant no less than 30 and no more than 90 days before the date distribution commences.

Description of Proposal

Under the proposal, a qualified retirement plan would be required to provide the applicable distribution notice no less than 30 days and no more than 180 days before the date

[21] The portion of a participant's benefit that is attributable to amounts rolled over from another plan may be disregarded in determining the present value of the participant's vested accrued benefit.

distribution commences. The Secretary of the Treasury would be directed to modify the applicable regulations to reflect the extension of the notice period to 180 days and to provide that the description of a participant's right, if any, to defer receipt of a distribution must also describe the consequences of failing to defer such receipt.

Effective Date

The modifications made or required by the proposal would be effective for years beginning after December 31, 2002. In the case of a description of the consequences of a participant's failure to defer receipt of a distribution that is made before the date 90 days after the date on which the Secretary of the Treasury makes modifications to the applicable regulations, the plan administrator would be required to make a reasonable attempt to comply with the requirements of the proposal.

4. Technical corrections to Saver Act

Present Law

The Savings Are Vital to Everyone's Retirement ("SAVER") Act initiated a public-private partnership to educate American workers about retirement savings and directed the Department of Labor to maintain an ongoing program of public information and outreach. The Act also convened a National Summit on Retirement Savings held June 4-5, 1998. A second National Summit on Retirement Savings was held February 27 through March 1, 2002, co-hosted by the President and the bipartisan Congressional leadership. The National Summit brings together experts in the fields of employee benefits and retirement savings, key leaders of government, and interested parties from the private sector and general public. The delegates are selected by the Congressional leadership and the President. The National Summit is a public-private partnership, receiving substantial funding from private sector contributions. The goals of the National Summits are to: (1) advance the public's knowledge and understanding of retirement savings and facilitate the development of a broad-based, public education program; (2) identify the barriers which hinder workers from setting aside adequate savings for retirement and impede employers, especially small employers, from assisting their workers in accumulating retirement savings; and (3) develop specific recommendations for legislative, executive, and private sector actions to promote retirement income savings among American workers.

Description of Proposal

Under the proposal, future National Summits on Retirement Savings would be held in 2006 and 2010. To facilitate the administration of future National Summits, the Department of Labor would be given authority to enter into cooperative agreements (pursuant to the Federal Grant and Cooperative Agreement Act of 1977) with any appropriate, qualified entity.

Six new statutory delegates would be added to future National Summits: the Chairman and Ranking Member of the Senate Finance Committee, the House Ways and Means Committee, and the Subcommittee on Employer-Employee Relations of the House Committee on Education and the Workforce. Further, the President, in consultation with the Congressional leadership, would be permitted to appoint additional Summit participants, not to exceed the lesser of 3 percent of all additional participants or 10 participants, from a list of nominees provided by the private sector partner in Summit administration. The proposal would also clarify that new delegates are to be appointed for each future National Summit (as was the intent of the original legislation) and would set deadlines for their appointment.

The proposal would also set deadlines for the Department of Labor to publish the Summit agenda, give the Department of Labor limited reception and representation authority, and specify that the Department of Labor consult with the Congressional leadership in drafting the post-Summit report.

Effective Date

The proposal would be effective on the date of enactment.

5. Missing participants

Present Law

The plan administrator of a defined benefit pension plan that is subject to Title IV of ERISA, is maintained by a single employer, and terminates under a standard termination is required to distribute the assets of the plan. With respect to a participant whom the plan administrator of a single employer plan cannot locate after a diligent search, the plan administrator satisfies the distribution requirement only by purchasing irrevocable commitments from an insurer to provide all benefit liabilities under the plan or transferring the participant's designated benefit to the Pension Benefit Guaranty Corporation ("PBGC"), which holds the benefit of the missing participant as trustee until the PBGC locates the missing participant and distributes the benefit.

The PBGC missing participant program is not available to multiemployer plans or defined contribution plans and other plans not covered by Title IV of ERISA.

Description of Proposal

The PBGC would be directed to prescribe rules for terminating multiemployer plans similar to the present-law missing participant rules applicable to terminating single-employer plans that are subject to Title IV of ERISA.

In addition, plan administrators of certain types of plans not subject to the PBGC termination insurance program under present law would be permitted, but not required, to elect to transfer missing participants' benefits to the PBGC upon plan termination. Specifically, the proposal would extend the missing participants program (in accordance with regulations) to defined contribution plans, defined benefit plans that have no more than 25 active participants and are maintained by professional service employers, and the portion of defined benefit plans that provide benefits based upon the separate accounts of participants and therefore are treated as defined contribution plans under ERISA.

Effective Date

The proposal would be effective for distributions made after final regulations implementing the proposal are prescribed.

6. Reduced PBGC premiums for small and new plans

Present Law

Under present law, the Pension Benefit Guaranty Corporation ("PBGC") provides insurance protection for participants and beneficiaries under certain defined benefit pension plans by guaranteeing certain basic benefits under the plan in the event the plan is terminated with insufficient assets to pay benefits promised under the plan. The guaranteed benefits are funded in part by premium payments from employers who sponsor defined benefit plans. The amount of the required annual PBGC premium for a single-employer plan is generally a flat rate premium of $19 per participant and an additional variable-rate premium based on a charge of $9 per $1,000 of unfunded vested benefits. Unfunded vested benefits under a plan generally means (1) the unfunded current liability for vested benefits under the plan, over (2) the value of the plan's assets, reduced by any credit balance in the funding standard account. No variable-rate premium is imposed for a year if contributions to the plan were at least equal to the full funding limit.

The PBGC guarantee is phased in ratably in the case of plans that have been in effect for less than five years, and with respect to benefit increases from a plan amendment that was in effect for less than five years before termination of the plan.

Description of Proposal

Reduced flat-rate premiums for new plans of small employers

Under the proposal, for the first five plan years of a new single-employer plan of a small employer, the flat-rate PBGC premium would be $5 per plan participant.

A small employer would be a contributing sponsor that, on the first day of the plan year, has 100 or fewer employees. For this purpose, all employees of the members of the controlled group of the contributing sponsor would be taken into account. In the case of a plan to which more than one unrelated contributing sponsor contributes, employees of all contributing sponsors (and their controlled group members) would be taken into account in determining whether the plan is a plan of a small employer.

A new plan would mean a defined benefit plan maintained by a contributing sponsor if, during the 36-month period ending on the date of adoption of the plan, such contributing sponsor (or controlled group member or a predecessor of either) had not established or maintained a plan subject to PBGC coverage with respect to which benefits were accrued for substantially the same employees as in the new plan.

Reduced variable-rate PBGC premium for new plans

The proposal would provide that the variable-rate premium is phased in for new defined benefit plans over a six-year period starting with the plan's first plan year. The amount of the variable-rate premium would be a percentage of the variable premium otherwise due, as follows: zero percent of the otherwise applicable variable-rate premium in the first plan year; 20 percent in the second plan year; 40 percent in the third plan year; 60 percent in the fourth plan year; 80 percent in the fifth plan year; and 100 percent in the sixth plan year (and thereafter).

A new defined benefit plan would be defined as described above under the flat-rate premium provision of the proposal relating to new small employer plans.

Reduced variable-rate PBGC premium for small plans

In the case of a plan of a small employer, the variable-rate premium would be no more than $5 multiplied by the number of plan participants in the plan at the end of the preceding plan year. For purposes of the proposal, a small employer would be a contributing sponsor that, on the first day of the plan year, has 25 or fewer employees. For this purpose, all employees of the members of the controlled group of the contributing sponsor would be taken into account. In the case of a plan to which more than one unrelated contributing sponsor contributes, employees of all contributing sponsors (and their controlled group members) would be taken into account in determining whether the plan is a plan of a small employer.

Effective Date

The reduction of the flat-rate premium for new plans of small employers and the reduction of the variable-rate premium for new plans would be effective with respect to plans first effective after December 31, 2002. The reduction of the variable-rate premium for small plans would be effective with respect to plan years beginning after December 31, 2002.

7. Authorization for PBGC to pay interest on premium overpayment refunds

Present Law

The PBGC charges interest on underpayments of premiums, but is not authorized to pay interest on overpayments.

Description of Proposal

The proposal would allow the PBGC to pay interest on overpayments made by premium payors. Interest paid on overpayments would be calculated at the same rate and in the same manner as interest charged on premium underpayments.

Effective Date

The proposal would be effective with respect to interest accruing for periods beginning not earlier than the date of enactment.

8. Rules for substantial owner benefits in terminated plans

<u>Present Law</u>

Under present law, the Pension Benefit Guaranty Corporation ("PBGC") provides participants and beneficiaries in a defined benefit pension plan with certain minimal guarantees as to the receipt of benefits under the plan in case of plan termination. The employer sponsoring the defined benefit pension plan is required to pay premiums to the PBGC to provide insurance for the guaranteed benefits. In general, the PBGC will guarantee all basic benefits which are payable in periodic installments for the life (or lives) of the participant and his or her beneficiaries and are non-forfeitable at the time of plan termination. The amount of the guaranteed benefit is subject to certain limitations. One limitation is that the plan (or an amendment to the plan which increases benefits) must be in effect for 60 months before termination for the PBGC to guarantee the full amount of basic benefits for a plan participant, other than a substantial owner. In the case of a substantial owner, the guaranteed basic benefit is phased in over 30 years beginning with participation in the plan. A substantial owner is one who owns, directly or indirectly, more than 10 percent of the voting stock of a corporation or all the stock of a corporation. Special rules restricting the amount of benefit guaranteed and the allocation of assets also apply to substantial owners.

<u>Description of Proposal</u>

The proposal would provide that the 60-month phase-in of guaranteed benefits applies to a substantial owner with less than 50 percent ownership interest. For a substantial owner with a 50 percent or more ownership interest ("majority owner"), the phase-in would occur over a 10-year period and would depend on the number of years the plan has been in effect. The majority owner's guaranteed benefit would be limited so that it cannot be more than the amount phased in over 60 months for other participants. The rules regarding allocation of assets would apply to substantial owners, other than majority owners, in the same manner as other participants.

<u>Effective Date</u>

The proposal would be effective for plan terminations with respect to which notices of intent to terminate are provided, or for which proceedings for termination are instituted by the PBGC, after December 31, 2002.

9. Benefit suspension notice

<u>Present Law</u>

Under present law (ERISA sec. 203(a)(3)(B)), a plan will not fail to satisfy the vesting requirements with respect to a participant by reason of suspending payment of the participant's benefits while such participant is employed. Under the applicable Department of Labor ("DOL") regulations, such a suspension is only permissible if the plan notifies the participant during the first calendar month or payroll period in which the plan withholds benefit payments. Such notice must provide certain information and must also include a copy of the plan's provisions relating to the suspension of payments.

In the case of a plan that does not pay benefits to active participants upon attainment of normal retirement age, the employer must monitor plan participants to determine when any participant who is still employed attains normal retirement age. In order to suspend payment of such a participant's benefits, generally a plan must, as noted above, promptly provide the participant with a suspension notice.

Description of Proposal

Under the proposal, the Secretary of Labor would be required to modify the regulations relating to the benefit suspension notice (1) to permit the information currently required to be set forth in a suspension notice generally to be included in the summary plan description, rather than in a separate notice, and (2) not to require that the notice include a copy of relevant plan provisions. However, individuals reentering the workforce to resume work with a former employer after having begun to receive benefits would still receive the notification of the suspension of benefits (and a copy of the plan's provisions relating to suspension of payments). Such notice would be required to be provided during the first calendar month, or during the first 4- or 5-week payroll period ending in a calendar month, in which the plan withholds payments.

Effective Date

The proposal would apply for plan years beginning after December 31, 2002.

JOINT COMMITTEE ON TAXATION
July 11, 2002
JCX-77-02

ESTIMATED REVENUE EFFECTS OF THE CHAIRMAN'S ADDITIONAL MODIFICATIONS TO S. 1971, THE "NATIONAL EMPLOYEE SAVINGS AND TRUST EQUITY GUARANTEE ACT," SCHEDULED FOR MARKUP BY THE COMMITTEE ON FINANCE ON JULY 11, 2002

Fiscal Years 2002 - 2012

[Millions of Dollars]

Provision	Effective	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2002-07	2002-12
Diversification of Defined Contribution Plan Assets	generally pyba 12/31/02	*Negligible Revenue Effect*												
Protection of Employees During Pension Plan Transaction Suspension Period														
1. Notice to participants or beneficiaries of transaction suspension periods	generally pyba 12/31/02	*Negligible Revenue Effect*												
2. Inapplicability of relief from fiduciary liability during suspension of ability of participant or beneficiary to direct investments	generally pyba 12/31/02	*No Revenue Effect*												
3. Clarification of participant access to remedies under ERISA	DOE	*No Revenue Effect*												
4. Increased maximum bond amount of plans holding employer securities	pyba 12/31/02	*No Revenue Effect*												
Total of Protection of Employees During Pension Plan Transaction Suspension Period		***Negligible Revenue Effect***												
Providing Information to Assist Participants														
1. Benefit statements and investment guidelines	generally pyba 12/31/03	*Negligible Revenue Effect*												
2. Information on optional forms of benefit	DOE	*Negligible Revenue Effect*												
3. Fiduciary duty to provide material information relating to investment in employer stock	pyba 12/31/02	*No Revenue Effect*												
4. Electronic disclosure of insider trading	pyba 12/31/02	*No Revenue Effect*												
5. Fiduciary rules for plan sponsors designating independent investment advisors	DOE	*No Revenue Effect*												
Total of Providing Information to Assist Participants		***Negligible Revenue Effect***												
Other Proposals Relating to Pension Plans														
1. Studies	DOE	*No Revenue Effect*												
2. Plan Amendments	DOE	*No Revenue Effect*												
Total of Other Proposals Relating to Pension Plans		***No Revenue Effect***												
Provisions Relating to Executive Compensation														
1. Repeal of limitation on issuance of Treasury guidance regarding nonqualified deferred compensation	tyba DOE	*Negligible Revenue Effect*												
2. Taxation of deferred compensation provided through offshore trusts	ada DOE	---	67	76	56	28	9	5	4	4	20	23	235	290

Provision	Effective	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2002-07	2002-12
3. Treatment of loans to executives	lmora DOE	---	10	25	32	30	22	19	19	22	30	32	118	241
4. Required wage withholding at top marginal rate for supplemental wage payments in excess of $1 million	wpma 12/31/02	---	115	19	11	11	9	[1]	8	9	10	9	165	201
Total of Provisions Relating to Executive Compensation		---	**192**	**120**	**99**	**69**	**40**	**24**	**31**	**35**	**60**	**64**	**518**	**732**
Additional Provisions														
1. Voluntary early retirement incentive plans maintained by local educational agencies and other entities	ada DOE	---	-1	-4	-7	-10	-10	-10	-10	-10	-10	-10	-32	-82
2. Exclusion of incentive stock options and employee stock purchase plan stock options from wages	DOE	*Negligible Revenue Effect*												
3. Capital gain treatment on sale of stock acquired from exercise of statutory stock options to comply with conflict of interest requirements	sa 7/1/02	---	[1]	[1]	1	1	1	[1]	1	1	[1]	[1]	2	5
4. Interest rate range for additional funding requirements for the 2001 plan year [2]	[3]	109	258	-43	-110	-91	-62	-92	-98	-55	-16	-1	62	-199
5. Automatic rollovers of certain mandatory distributions	[4]	*Negligible Revenue Effect*												
6. Chief Executive Officer required to sign corporate income tax returns	rfa DOE	*Negligible Revenue Effect*												
7. Other Provisions Relation to Pensions:														
a. Employee Plans Compliance Resolution System [5]	DOE	*Negligible Revenue Effect*												
b. Extension to all governmental plans of moratorium on application of certain nondiscrimination rules applicable to State and local plans	pyba 12/31/02	*Negligible Revenue Effect*												
c. Notice and consent period regarding distributions	yba 12/31/02	*Negligible Revenue Effect*												
d. Technical corrections to Saver Act [6]	DOE	*No Revenue Effect*												
e. Missing participants [6]	[7]	---	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]
f. Reduced PBGC premiums for small and new plans [6]	pfea 12/31/02 & yba 12/31/02	---	---	-3	-5	-6	-7	-7	-7	-8	-8	-8	-21	-59
g. Authorization for PBGC to pay interest on premium overpayment refunds [6]	iafpbnet DOE	---	-3	-3	-3	-3	-3	-3	-3	-3	-3	-3	-15	-30
h. Rules for substantial owner benefits in terminated plans [6]	noitta 12/31/02	---	---	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]	[8]
i. Benefit suspension notice	pyba 12/31/02	*No Revenue Effect*												
Total of Additional Provisions		**109**	**254**	**-53**	**-124**	**-109**	**-81**	**-112**	**-117**	**-75**	**-37**	**-22**	**-4**	**-365**
NET TOTAL		**109**	**446**	**67**	**-25**	**-40**	**-41**	**-88**	**-86**	**-40**	**23**	**42**	**514**	**367**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.

Legend for "Effective" column:

ada = amounts deferred after
DOE = date of enactment
iafpbnet = interest accruing for periods beginning not earlier than
lmora = loans made or refinanced after
noitta = notice of intent to terminate after
pfea = plans first effective after
pyba = plan years beginning after
rfa = returns files after
sa = sales after
tyba = taxable years beginning after
wpma = wage payments made after
yba = years beginning after

[Footnotes for JCX-77-02 appear on the following page]

Footnotes for JCX-77-02:

[1] Gain of less than $500,000.
[2] Includes estimated effects on PBGC variable-rate premiums provided by Congressional Budget Office.
[3] Effective as if included in section 405 of the "Job Creation and Work Assistance Act of 2002."
[4] Effective as if included in "Economic Growth and Tax Relief Reconciliation Act of 2001."
[5] Directs the Secretary of the Treasury to modify rules through regulations.
[6] Estimate provided by the Congressional Budget Office.
[7] Effective for distributions made from terminating plans that occur after the PBGC has adopted final regulations implementing provisions.
[8] Loss of less than $500,000.