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**Re: End of Year Valuation and Benefit Restriction Guidance Needed**

The American Society of Pension Professionals & Actuaries (ASPPA) is writing to request guidance on matters related to end of year valuations and certain issues pertaining to application of benefit restrictions under IRC §436. It is our understanding that future guidance on these issues will be in the form of final regulations, and so we are submitting these unsolicited comments as a supplement to our earlier comments on the proposed regulations.

ASPPA is a national organization of more than 6,500 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines, including consultants, investment professionals, administrators, actuaries, accountants and attorneys. Our large and broad-based membership gives ASPPA unique insight into current practical applications of ERISA and qualified retirement plans, with a particular focus on the issues faced by small- to medium-sized employers. ASPPA's membership is diverse but united by a common dedication to the employer-sponsored retirement plan system. All credentialed actuarial members of ASPPA are members of the ASPPA College of Pension Actuaries (ASPPA COPA), which has primary responsibility for the content of comment letters that involve actuarial issues.

### **Summary of Recommendations**

The following is a summary of ASPPA COPA's recommendations which are described in greater detail in the Discussion of Issue section. Section references are to the Internal Revenue Code and proposed regulations thereon.

- I. End of year valuations:
  - A. Final regulations should provide that, for purposes of determining the adjusted funding target attainment percentage (AFTAP) for a plan year, a plan with an end of year valuation date should use the Funding Target

(FT) plus Target Normal Cost (TNC) as of the immediately preceding valuation date and plan assets as of the last day of the preceding plan year, including contributions for that preceding plan year (either discounted or increased reflecting the effective rate). This methodology should be available without regard to whether or not there is a change in the valuation date from an alternate to beginning of year date in a subsequent year.

- B. Final regulations should apply a uniform methodology for determining the adjustment for late payment of quarterly contribution installments regardless of whether an alternate valuation date is used.

## II. Restriction on accelerated benefit payments

Final regulations should clarify that, in the event that the partial lump sum option required by IRC §436(d) is not normally offered as an immediate distribution option under the plan, the plan will not fail to satisfy IRC §411(a) or IRC §417(e) simply because any partial annuity benefit required by IRC §436(d) does not take into account IRC §417(e) rates and the minimum present value requirement when determining the amount of any optional form payable in satisfaction of the restricted portion of the benefit.

## III. Recognition of IRC §436 benefit restrictions for purposes of IRC §430

Final regulations should provide a clear rule for determining whether benefit restrictions under IRC §436 are permanent or fleeting, and recognize only fleeting amendments for IRC §430 purposes. The restriction on accelerated payments would always be fleeting. Other restrictions would vary, depending on the terms of the plan.

## IV. Conflict created by measurement date in proposed regulations §1.436-1(h)(1)(i)

Final regulations should eliminate the designation of the first day of the plan year as an IRC §436 measurement date in proposed regulations §1.436-1(h)(1)(i).

# Discussion of Issues

## I. End of year valuations:

- A. Notice 2008-21 provided that a calendar year plan with an end of year (EOY) valuation date could base its 2007 AFTAP (on which restrictions could be based before October 1, 2008) on valuation results for December 31, 2006. Under this notice, to take advantage of this relief, the plan must have an EOY valuation date for 2006, 2007 and 2008. (Notice 2008-73 removed the requirement that the plan have an end-of-year valuation date

for 2008 in order to base the 2007 AFTAP on December 31, 2006 results.) In notice 2008-21, the Service said it would issue similar rules for 2008 (permitting the use of December 31, 2007 valuation results to determine the 2008 AFTAP) if it had authority to do so. The Worker, Retiree and Employer Recovery Act of 2008 (WRERA) provided the necessary authority. It is our understanding that final regulations may include guidance on this issue without opportunity for comment. It is important that the final regulations mirror the relief provided in Notice 2008-21, but without the restriction on use in the event of a change in valuation date.

***ASPPA COPA recommends*** that final regulations provide that, for purposes of determining the adjusted funding target attainment percentage (AFTAP) for a plan year, a plan with an end of year valuation date should use the Funding Target (FT) plus Target Normal Cost (TNC) as of the immediately preceding valuation date and plan assets as of the last day of the preceding plan year, including contributions for that preceding plan year (either discounted or increased reflecting the effective rate). This methodology should be available without regard to whether or not there is a change in the valuation date from an alternate to beginning of year date in a subsequent year, similar to the provision in Notice 2008-73.

- B. IRC §430(j)(3)(A) describes the additional 5 percent interest charge that is to be applied to late quarterly contribution installments for the period between the due date and actual payment date. The proposed regulations provide guidance for the adjustments for interest when the due date for the quarterly contribution is after the valuation date, but reserves guidance for any period of underpayment which occurs prior to the valuation date.

The preamble to the proposed regulation mentions that final regulations may provide that the minimum required contribution would be increased when a quarterly installment due before the valuation date is late, and for late quarterly installments due after the valuation date the statutory language (a reference to IRC §430(j)(2), which refers to interest “between the valuation date and the payment date”) would continue to be followed.

Based on the preamble, we are concerned that there may be unnecessary complexity in the final regulations with regard to application of the additional 5 percent interest charge to underpayment of quarterly installments for EOY valuation date plans. We suggest that separate methodology for installment due dates before and after the valuation date is unnecessary and will only lead to misunderstanding, miscommunications and miscalculations.

***ASPPA COPA recommends*** that final regulations apply a uniform methodology for determining the adjustment for late payment of quarterly

contribution installments regardless of whether an alternate valuation date is used.

The 5% interest adjustment in IRC §430(j)(3)(A) is an additional charge for the period of underpayment, which should be assessed regardless of whether the valuation date is beginning of year or an alternate date. Uniform application of this charge could be assessed in a straightforward manner by requiring the value of the late installment to be discounted to the due date at the effective rate plus 5 percent, then adjusting the value of the installment to the valuation date at the effective rate of interest.

Consider a plan with a December 31, 2008 valuation date, but with all contributions for the year paid on September 15, 2009. Determination of the amount due September 15, 2009 is illustrated in the following table. The values in item 1.c. are the quarterly installments of \$33,981 discounted at the effective rate plus 5% (11.3%) from September 15, 2009 to the payment due dates. The values are then increased at the effective rate to the valuation date, and those values are shown in 1.e. The difference in the minimum required contribution payable on the valuation date, considering the late payments, is then determined and adjusted to the payment date with interest. This illustration uses daily interest calculations although other compounding (monthly, for instance) has been seen in other examples listed in regulations and could be used.

This treatment is consistent with the statutory language calling for the additional 5% interest charge on late installments between the due date and actual payment date. The same worksheet could be used regardless of a plan's valuation date.

<b>Valuation date</b>	<b>12/31/2008</b>				
<b>Quarterly installments</b>	<b>33,981</b> each				
<b>Effective interest rate</b>	<b>6.30%</b>				
<b>Quarterly installments adjusted for late quarterly payments:</b>					
	a.	b.	c.	d.	e.
	<b>Installment due date</b>	<b>Number of days from due date to pmt date</b>	<b>Quarterly Installment discounted for days in b. at 11.30%</b>	<b>Days from due date to valuation date</b>	<b>Value of late payments in c. adjusted to valuation date using 6.30%</b>
1.	4/15/2008	518	29,194.19	260	30,491.86
	7/15/2008	427	29,983.37	169	30,843.05
	10/15/2008	335	30,802.91	77	31,202.21
	1/15/2009	243	31,644.85	-15	31,565.55
2.	<b>Total adjusted value:</b>		121,625.31		\$ 124,102.66
<b>Required Contribution at payment date:</b>					
3.	<b>Required minimum contribution due 12/31/08 unadjusted for timing of payment:</b>				\$ 151,025
4.	<b>Additional pmt due as of val'n date: (3.e. – 2.e.)</b>				\$ 26,922
5.	<b>Adjusted to pmt date at effective rate:</b>			258	
	4.e.*1.063^(5.d./365.25)				\$ 28,110
6.	<b>Four quarterly installments deposited 9/15/2009:</b> (4 * 33,981)				<u>135,924</u>
7.	<b>Total payment due 9/15/2009: 5.e.+ 6.e.</b>				\$ 164,034

## II. Restriction on accelerated benefit payments

In light of current economic conditions and the expectation that many plans will soon be subject to the IRC §436 restrictions on accelerated distributions, guidance is urgently needed on how plan administrators should approach the minimum present value rules of IRC §417(e) in connection with distributions during a restricted period.

In the event a plan currently offering full lump sum cash outs has an AFTAP of between 60 and 80%, the plan is restricted from making any accelerated distributions to participants and, instead is required to offer a lump sum of half the participant's accrued benefit and an annuity of the remaining benefit in any non-

restricted form offered by the plan that would be available for settlement of the participant's entire accrued benefit. It is not clear from the proposed regulation whether a plan must consider IRC §417(e) rates and the minimum normal retirement value to determine the optional annuity forms available on the restricted portion of the benefit.

ASPPA COPA urges the Service to immediately communicate the range of acceptable approaches to implementing the benefit restrictions for plans with AFTAPs in the 60 to 80% range to avoid any requirement to revise benefits at a later date. Plans should be permitted to communicate to participants that all benefit options are split 50-50 (or in proportion to the relevant PBGC benefit maximum) if the restrictions of IRC §436 apply and should not be forced to recalculate option rates and display separate option combinations for relative value purposes.

***ASPPA COPA recommends*** that the Service clarify that, in the event that the partial lump sum option required by IRC §436(d) is not normally offered as an immediate distribution option under the plan, the plan will not fail to satisfy IRC §411(a) or IRC §417(e) simply because any bifurcated partial annuity benefit required by IRC §436(d) does not take into account IRC §417(e) rates and the minimum present value requirement when determining the amount of any optional form payable in satisfaction of the restricted portion of the benefit.

This interpretation is consistent with Congressional intent. In designing the IRC §436 restrictions, the goal was to improve funding of plans by avoiding the diminution of assets due to lump sum payments and to avoid the benefit subsidy inherent in the IRC §417(e) requirements for accelerated distributions. Providing an IRC §417(e) subsidy on the annuity portion of the bifurcated benefit would directly contradict this goal.

### III. Interaction of funding rules under IRC §430 with benefit restrictions under IRC §436

IRC §436 as added by PPA, applies restrictions on the forms of benefits payable under qualified defined benefit plans, limits a plan's ability to increase benefits via amendment, and suspends or eliminates the accrual of benefits under defined benefit plans. Each of these restrictions is tied to the plan's funding level or AFTAP.

The proposed regulations under IRC §430 indicated that any benefit restrictions under IRC §436 should be ignored for purposes of the determination of the minimum required contribution (MRC).

Given that it is possible for benefit accruals to be permanently eliminated by the restriction under IRC §436(e), it seems that this interpretation is unreasonable. In an earlier comment letter, ASPPA and COPA recommended that the restrictions under IRC §436 be characterized as either permanent restrictions or fleeting restrictions and that

only permanent restrictions be taken into account in determining the MRC under §430. ASPPA COPA further recommends that whether an amendment is permanent or fleeting be determined as follows:

- A. **Limitation on accruals.** A permanent restriction is a restriction that has a permanent impact on the accrued benefit under the plan. Regardless of future funding levels in the plan, the benefits lost due to the restriction cannot be restored absent action by the plan sponsor, such as an amendment. A clear example of the distinction between a permanent or fleeting restriction is the elimination of benefit accruals under §436(e) for plans with an AFTAP of below 60%.

A plan can be written to handle this restriction in either of two ways. The first method is to retroactively restore the missed benefit accruals once the plan is adequately funded such that the restrictions do not apply. The second method provides that once the plan is adequately funded to avoid the restriction, benefit accruals recommence, but are not restored retroactively. Using the first method, the benefit is only limited temporarily during the period of underfunding. Once the underfunding is resolved, the benefit is restored to the level it would have reached had the restriction never occurred. Thus using the first method, the restriction is fleeting. Using the second method, however, the benefit accruals scheduled for the period of restriction are permanently lost and should not be considered for purposes of the valuation. This is a permanent restriction.

- B. **Limitation on accelerated benefit distributions.** The restrictions on accelerated benefit payments under §436(d) are always fleeting restrictions. The PPA funding rules are designed to ensure that a plan will reach adequate funding in only a few years. Thus, all benefit options under the plan will be available with respect to all plan accrued benefits once the funding levels have been met. These temporary restrictions should not be recognized for funding purposes.

- C. **Limitation on plan amendments.** The coordination of the funding rules with the restrictions on plan amendments under §436(c) is more complicated. The proper funding treatment of restricted amendments will depend on the rules for recognizing restricted amendments for purposes of determining the accrued benefit. PPA provides that an amendment increasing benefits will not be given effect unless the plan would have an AFTAP of at least 80% after the amendment. It is not clear whether the amendment will be given effect at a later date once plan funding improves. If the amendment will be given effect once funding improves, then the benefit restriction is fleeting and should be ignored for funding purposes. The plan amendment should be considered for funding in all years after its stated effective date. If however an amendment adopted while the plan is subject to the restriction under §436(c) is never given effect or is only given prospective effect, then it should be treated as a permanent restriction and ignored for funding.

IV. Conflict created by measurement date in proposed regulation §1.436-1(h)(1)(i)

Proposed regulation § 1.436-1(h)(1)(ii) provides that for plans with preceding year certifications issued during the preceding year the plan's presumed adjusted funding target attainment percentage, as certified, is maintained through the first day of the 4th month (or 10<sup>th</sup> month if applicable) of the current plan year. However, §1.436-1(h)(1)(i) defines the first day of the plan year as a §436 measurement date if a restriction on benefits applied to the plan on the last day of the preceding plan year.

A potential conflict arises because Proposed Regulation §1.436-1(a)(5) deems plan sponsors to have made an election *as of each § 436 measurement date* to reduce prefunding or funding standard carryover balances to the extent necessary to eliminate a restriction on the plan's ability to pay accelerated benefits. Treatment of the first day of the year as a measurement date for certain plans under §1.436-1(h)(1)(i) triggers the deemed election to reduce prefunding or carryover balances, and potentially modifies a plan's adjusted funding target attainment percentage as of the first day of the plan year, notwithstanding the clear intent of the statute and proposed regulation §1.436-1(h)(1)(ii) to maintain the preceding year's adjusted funding target attainment percentage through the first day of the 4th month of the current plan year.

***ASPPA COPA recommends*** that final regulations eliminate the designation of the first day of the plan year as a §436 measurement date in proposed regulations §1.436-1(h)(1)(i). Further, Example 1 of §1.436-1(g)(7) should be modified to reflect the resolution of this conflict.

It should be pointed out that the facts as specified in Example 1 could easily lead to plan disqualification. Specifically, the Example states that the plan in question must recognize a participant's rights to full accelerated benefit distributions with an annuity starting date on or after the first day of the plan year. However, in order to determine that the restrictions no longer applied as of the first day of the plan year, the actual market value of assets as of the first day of the plan year must be determined. In the vast majority of plans, it is simply impossible to determine the value of a plan's assets as of the first day of the year on the first day of the year. Accordingly, there is a delay, sometimes brief, but more frequently lasting months, between the first day of the year and the date when the market value of assets as of the first day of the year is known. Therefore, if a single participant applies for a benefit after the first day of the plan year and before the plan sponsor can perform the necessary calculations to determine the participant's rightful eligibility for an accelerated benefit, the plan would be disqualified.

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These comments were prepared by ASPPA's Defined Benefit subcommittee of the Government Affairs Committee and the ASPPA College of Pension Actuaries, and were primarily authored by Thomas J. Finnegan, MSPA, CPC, QPA, Mark Dunbar, MSPA,



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Thank you for your consideration of these comments.

Sincerely,

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