Comments on Proposed Regulations Section 1.411(d)-3

Filed electronically
www.irs.gov/regs

December 10, 2004

The American Society of Pension Professionals and Actuaries (ASPPA) appreciates this opportunity to comment on the Code Section 411(d)(6) guidance proposed by the IRS and Treasury on March 24, 2004 (Proposed Regulations).

ASPPA is a national society of retirement plan professionals. ASPPA's mission is to educate pension professionals and to preserve and enhance the private pension system. Its membership consists of approximately 5,500 actuaries, plan administrators, attorneys, CPAs and other retirement plan experts who design, implement and maintain qualified retirement plans, especially for small to mid-size employers.

ASPPA commends the IRS and Treasury for their efforts to simplify the rules applicable to defined benefit plans. As you know, the complexity of defined benefit plans is an oft-cited reason for their lack of appeal to many plan sponsors. These efforts to simplify the application of the Code Section 411(d)(6) "anti-cutback" rules are a step in the right direction to preserve the defined benefit plan as a viable retirement plan option for employers. Below, ASPPA offers a number of suggestions that it believes will make these rules more effective and easier to apply.

Summary Of Issues

- The 4-year delayed effective date for the elimination of noncore options is unnecessary and should be conformed to the 90-day rule applicable to redundant options.
- The standards for determining whether the value of an eliminated optional form is *de minimis,* are too restrictive.
- The transition period applicable when eliminating a benefit form that is not *de minimis* is too difficult to administer and should be substantially simplified.
- The rules should be simplified to allow for a streamlined ability to eliminate forms that are different solely because of a retroactive annuity starting date feature.
- The retirement-type subsidy definition is overly broad.
- The Form 5300 should be revised to allow plan sponsors to ask for review of the proper elimination of a benefit form in the determination letter process.
- If the final regulations retain the level of detail in the Proposed Regulations, an introductory outline or flowchart should be added to help plan sponsors apply these rules to their plans.
- The effective date of the relative value disclosure rules should be postponed to a date that is at least 180 days after the date the Proposed Regulations are finalized.

Discussion

The Proposed Regulations generally permit the elimination of two different types of benefit forms: “redundant” optional forms and “noncore” optional forms. Prop. Reg. §1.411(d)-3(d). A different set of requirements apply to the permitted elimination of these different types of forms—the rules for “redundant” forms are generally contained in paragraph (c) of the Proposed Regulations, and the rules for “noncore” forms are generally contained in paragraph (d). In cases where an optional form may be considered “redundant” or ”noncore,” but where the form has a different annuity starting date or includes an early retirement benefit or

retirement-type subsidy, the form may be eliminated only if it can satisfy additional rules to show that the eliminated option is both "burdensome" and of "*de minimis*" value. Prop. Reg. §1.411(d)-3(d). Throughout ASPPA's comments below, we refer to the redundant, noncore, burdensome and *de minimis* requirements.

A. Eliminate the 4-Year Rule for Noncore Options

Under the Proposed Regulations, a noncore option may be eliminated only for annuity starting dates that occur at least four years after the amendment eliminating the option is adopted. This timing rule is unnecessary. Eliminating it would greatly simplify the rules as they apply to noncore options. The 4-year requirement would be difficult to explain to participants and would unnecessarily complicate plan administration.

ASPPA recommends that the 90-day delayed effective date requirement applicable to redundant options should also apply to noncore options. ASPPA shares the IRS's concern for protecting the expectations of participants close to retirement age, but we believe their significant rights are protected via the core options.

Example: Let's say that a plan has life only, 75% joint and survivor, 10, 15 and 20 years certain and life, and lump sum as options. All optional forms are calculated on an actuarial equivalent basis. Under the redundant rules, the 15 or 20 years certain and life option could be eliminated (but not both) with a 90-day delayed effective date. Under the noncore rule, both the 15 and 20 year certain and life benefit could be eliminated, but would be subject to the 4-year delayed effective date. Recognizing that these benefits are an actuarial equivalent to the other options provided, the transition does not need to be 4 years. This plan continues to provide to retiring participants significant "core" options that are equivalent in value to the eliminated option.

B. 2% / 1% De Minimis Rules

The Proposed Regulations generally provide that where the actuarial present value of the optional form of benefit that is being eliminated exceeds the actuarial present value of the redundant or core options that remain in the plan, as applicable, the benefit can be eliminated without satisfying an onerous transition period rule only if the actuarial present value of the difference between the eliminated option and the retained option is not more than the greater of: (1) 2% of the value of the retirement-type subsidy under the eliminated form (if any); or (2) 1% of the participant's compensation for the prior plan year. Prop. Reg. §1.411(d)-3(e)(5). These standards are too stringent.

- **2% of subsidy rule** . Basing this *de minimis* test on the value of a subsidy is problematic because 2% of the value of a subsidy is typically an amount so small that the test has no practical value. In Example 7 of the Proposed Regulations the total subsidy is 17% of the unsubsidized benefit and the reduction in the subsidy by the amendment is 0.3% of the unsubsidized benefit, yet the reduction is not considered *de minimis* under these rules.

ASPPA recommends that this *de minimis* test be revised to be based on a permitted level of change in the present value of the total benefit, not a change in the present value of the subsidy and that the permitted level be placed at 5%. In this regard, the final relative value regulations would allow two or more optional forms of benefit to be described as approximately equal if the present value of the two forms differs by no more than 5%. Treas. Reg. §1.417(a)(3)-1(c)(2)(iii). Presumably, the regulations' drafters considered a 5% difference in value to be insignificant enough that it need not be communicated to participants. Therefore, a 5% change relative to the participant's total benefit should be considered *de minimis.*

- **1% of compensation** . Compensation for this purpose should be based on an average of several years instead of the amount from the prior plan year. Since an employee's compensation may be reduced during his or her final years of employment, for example, if the employee works reduced hours in contemplation of retirement, it would mean that the 1% test would be based on unrepresentative compensation.

ASPPA recommends that compensation be determined over a period of years to avoid required use of an unrepresentative final year compensation amount.

C. Transition Period Where the *De Minimis* Rule Is Not Satisfied

Where a permitted elimination will not satisfy the *de minimis* rule, its effective date must be delayed until the end of the transition period that ends when it is reasonable to expect that the subsidy value of the form being eliminated is subsumed by another optional form that continues to be offered under the plan. Prop. Reg. §1.411(d)-3(e)(6). ASPPA has several comments with respect to this transition period.

- **Maintenance of options for participants terminating before the end of the transition period** . As currently drafted, the Proposed Regulations provide that a participant who terminates employment prior to the expiration of the transition period must be permitted to elect the eliminated form. Prop. Reg. §1.411(d)-3(e)(6)(iii). This will mean that any eliminated optional form will have to be maintained for a restricted group of participants. This protection seems unnecessary in light of the burden it will add to plan administration. Requiring that these optional forms be maintained for the restricted group means that not only must the plan retain the option, but the plan must keep track of the restricted group to whom the option is available. In some cases, a person who terminates prior to the end of the transition period might have 10-20 years before retirement, so the plan would have to maintain the option for a significant period of time.

ASPPA recommends that after the expiration of the transition period, the eliminated form itself could be eliminated so that the plan would not be required to monitor a small group of participants that remain eligible for the option for a possibly long period of time. This relief could be provided only where the distribution option is available to the participant during the transition period and with proper advance notice to the participants.

- **Actuarial assumptions** . The Proposed Regulations also provide that the most conservative actuarial assumptions must be used in measuring the transition period (*e.g.,* no increase in compensation may be assumed). This restriction on actuarial factors seems unnecessarily restrictive—it burdens plans with maintaining the option for a period of time that is longer than the period that would apply if the option were subject to normal wear-away.

ASPPA recommends that actuaries continue to be entrusted with developing reasonable assumptions in other contexts of plan administration, and be left to determine reasonable actuarial assumptions for this purpose. Participants would continue to be sufficiently protected if the transition period were based on reasonable assumptions, including the assumption that compensation will increase at a reasonable rate.

In addition, the regulations could specify certain actuarial assumptions that would be deemed reasonable. For example, they could specify a reasonable assumption about the increase in compensation, perhaps basing the increase on the CPI.

- **Measuring the expected transition period** . It appears that the expected transition period is determined on a participant-by-participant basis. Such an approach would be too expensive to administer to have any practical value. To avoid the burden of administering individual wear-away periods, a plan might choose to select the longest wear-away period applicable to any plan participant and use that as the expected transition period for all participants. However, this participant-by-participant approach would unnecessarily burden plan administration in order to protect a very small number of participants.

In light of the complexity and expense of determining the expected transition period, ASPPA believes that it would be preferable if a plan could select a representative sample on which to base the transition period. With a representative sample, it would be possible to achieve a better balance between relieving plans of the administrative burden of numerous optional forms of benefit and protecting participants' legitimate expectations.

ASPPA recommends that instead of, or in addition to, the expected transition period, the regulations drew a "bright line" for a transition period that would meet the *de minimis* requirement. Such a bright line would not only relieve plans of the burden of calculating the expected transition period, including calculating extensions as necessary, but could be established to protect the expectations of those participants closest to retirement. For example, the regulations could provide that a transition period of seven years (or some other stated number of years) would be deemed to meet the *de minimis* requirement. In light of today's mobile workforce, it is questionable whether there is much benefit in protecting the expectations of participants who are more than 7-10 years away from retirement.

  - **Application of transition period to early retirement subsidies** . Many long-standing early retirement subsidies, often implemented by employers over 20 years ago, are no longer consistent with the current goals and objectives of an employer and are out of place with the current human resource marketplace. For this reason, the ability of an employer to change its early retirement reduction factors must be more flexible under the final regulations. Because of the transition period requirement, the Proposed Regulations do not provide much more flexibility than current law in adjusting early retirement reduction factors.

ASPPA recommends that a standardized table be included in the regulations and that employers have the ability to change to that table within a fixed time frame (*e.g.,* five years) so that the plan sponsor can reach a point at which the new retirement factors are used with certainty for all participants.

- **Utilization test** . Determining the transition period will involve significant actuarial work and, for this reason, will be expensive. A more useful method would be a utilization test whereby benefits could be eliminated if they were rarely elected by plan participants. ASPPA understands that the IRS rejected this approach because it would be difficult to apply in the context of small plans where there might not be many retirees on which to base the utilization rate. However, the burden of administering numerous optional forms of benefit falls disproportionately on large plans that have been involved in numerous plan mergers. The administration of large plans would be greatly simplified if they could eliminate optional forms that are rarely elected.

ASPPA recommends that the IRS develop ways that the utilization test could be implemented to address IRS concerns. For example, the regulations could state that the utilization test method could not be used unless the percentage of participants retiring and electing benefits in any year was less than a specified floor, set forth in the regulations. Under such a rule, an option could be permanently eliminated if the number of retirees electing the option over a specified time period (*e.g.*, two years) was less than a specific percentage or number.

D. Retroactive Annuity Starting Dates

New regulations under Code Section 417(a)(3) have increased the complexity of offering a retroactive annuity starting date by, among other things, requiring an explanation to participants and spousal consent.

ASPPA finds that liberalization of the ability to eliminate a retroactive annuity starting date feature is appropriate because of the new complexities caused by the 417(a)(3) regulations and because a retroactive annuity starting date option is typically provided as matter of convenience to participants and is not intended as an integral or valuable plan benefit.

Under the Proposed Regulations, two forms of distribution that are identical, except for the fact that both a retroactive and current annuity starting date are permitted, are considered in the same "family." Prop. Reg. §1.411(d)-3(c)(3)(ii)(B). Thus generally, a retroactive annuity starting date feature can be eliminated under the rules, permitting the elimination of redundant optional forms. Unfortunately, however, where redundant forms have different annuity starting dates, including a retroactive annuity starting date, the onerous requirements of the burdensome and *de minimis* rules in paragraph (e) of the Proposed

Regulations must be satisfied. Prop. Reg. §1.411(d)-3(c)(1)(iii).

ASPPA provides two suggestions below to simplify the elimination of a plan's retroactive annuity starting date option.

- **Application of the burdensome test** . The current guidance states that, "[i]f the annuity starting dates under the plan considered in the aggregate are burdensome or complex, then elimination of any one of the annuity starting dates is presumed to eliminate Section 411(d)(6)(B) protected benefits that create signification burdens or complexities for the plan and its participants." Prop. Reg. §1.411(d)-3(e)(2)(ii). The rules do not provide much guidance on when different annuity starting dates may be "considered in the aggregate" as burdensome or complex. For example, is the existence of the new rules requiring spousal consent of a retroactive annuity starting date sufficient to create the necessary complexity where a plan also offers a current annuity starting date?

ASPPA recommends that the complexity standard include a safe harbor for the elimination of a retroactive annuity starting date. For example, it could provide that, in light of the new and unexpected requirements now attached to a retroactive annuity starting date, a retroactive annuity starting date would be presumed to be complex and burdensome if the plan also provided a non-retroactive, current annuity starting date.

- **Expand the use of "substantially the same annuity starting date" throughout the regulations.** The ability to simplify retroactive annuity starting dates could also be achieved by modifying Treas. Reg. §1.411 (d)-3(c)(1)(iii) to read as follows:

In any case in which the retained optional form of benefit for the participant does not commence on substantially the same annuity starting date as the optional form of benefit that is being eliminated, as described in paragraph (e)(4), or... (emphasis added).

ASPPA recommends that the same change should be made to Treas. Reg. §1.411(d)-3(d)(1)(iii). This change would reflect the right to treat annuity starting dates within six months of each other as being substantially the same. If the value of a benefit beginning on a retroactive annuity starting date that a sponsor wants to eliminate is no more than a *de minimis* amount more than the value of the benefit beginning on a retained annuity starting date, the retroactive annuity starting date could be eliminated without regard to the complex and burdensome test of paragraph (e).

E. Definition of Retirement-Type Subsidy

The Proposed Regulations define a retirement-type subsidy as the excess of the present value of a retirement-type benefit over the present value of the accrued benefit commencing at normal retirement age. This definition is too broad. For example, a plan sponsor may not have intended to provide a subsidized benefit at the time it established actuarial factors, but over time, the factors might result in a subsidy when compared to optional forms based on more recent actuarial factors. Under the Proposed Regulations definition, the value created by unanticipated changes in underlying "reasonable" actuarial assumptions inadvertently results in a retirement-type subsidy.

ASPPA recommends that a subsidy under the protection of Code Section 411 (d)(6) should be considered to exist only if the benefit at issue is reasonably expected to provide noticeable value to a well-informed participant at the time the feature is introduced in the plan.

Alternatively, the IRS may consider providing a table of reasonable actuarial assumptions that could be substituted for current factors stated in the plan without going through the rules about eliminating optional forms of benefit, provided there was a reasonable basis for the eliminated factors at the time of initial implementation. This table would assist plans in maintaining reasonable assumptions.

At a minimum, the retirement-type subsidy definition should be clarified to indicate that a subsidy occurs only if the different actuarial assumptions result in a higher present value for the majority of participants based on actual retirement

dates and based on reasonably expected differences in the age of spouses/beneficiaries. For example, if the different assumptions would result in a higher present value only at certain retirement ages, or with certain beneficiary age characteristics that occur only infrequently in actual operation, no retirement-type subsidy should be deemed to exist.

Contingent event benefits as retirement-type subsidies . The Proposed Regulations appear to turn all "post-retirement" contingent benefits into Code Section 411(d)(6) protected benefits. For example, the definition of "ancillary benefit" includes a plant shutdown benefit that "does not continue past *retirement* age." Prop. Reg. §1.411(d)-3(f)(1) (emphasis added).

ASPPA recommends that the final regulations should be clarified to include only contingent benefits that continue after *normal* retirement. Case law and legislative history support this position. See S. Rep. No. 98-575, at 30 (referencing a subsidy that continues after normal retirement as a retirement type subsidy); Arena v. ABB Power T&D Company, 2003 U.S. Dist. LEXIS 13166 (S.D. Ind. Jul 22, 2003) (shutdown benefit is a retirement-type subsidy because it continues beyond normal retirement age). Failure to switch the reference from "retirement" to "normal retirement" would change existing law to afford Code Section 411(d)(6) protection to most, if not all, shutdown benefits—even those that continue for only a short period of time after termination of employment—as they are nearly always tied to some sort of "retirement." It is not clear that such a drastic change in the law was intended by the Service, and, in any event, ASPPA believes that such a change is not warranted.

F. Modify Form 5300

ASPPA recommends that the IRS modify Form 5300 to allow plan sponsors to indicate whether they have eliminated an optional form of benefit in accordance with the regulations and if the plan sponsor would like the determination letter to address the elimination. Currently, Line 12a simply asks, "Does any amendment to the plan reduce or eliminate any section 411(d)(6) protected benefit...?" For example, one question could ask, "Are you seeking a determination regarding the elimination of an optional form of benefit that might be protected under Section 411(d)(6)?" This question could be followed by the question, "If not, does any amendment to the plan reduce or eliminate any Section 411(d)(6) protected benefit...?"

G. Add Outline or Flowchart to Regulations

The Proposed Regulations set forth a framework that is very detailed.

ASPPA recommends , if the current structure of these rules is retained, that they be revised to include an outline or flowchart [*e.g.*, the "QSLOB" regulations under Code Section 414(r) contain a flowchart that is very useful when navigating those detailed rules] that will assist taxpayers in understanding how to analyze whether, and how, a particular optional form may be eliminated.

H. Coordinate Effective Date of the Relative Value Rules with These Rules

ASPPA understands that the Service and Treasury intend to finalize these rules prior to the scheduled delayed effective date for the relative value disclosure rules (currently scheduled to be fully applicable for annuity starting dates that occur on or after February 1, 2006).

ASPPA strongly recommends , in the event that these rules are not finalized at least 180 days prior February 1, 2006, that the Service and Treasury to further postpone the effective date of the relative value rules to at least 180 days after the rules on the elimination of benefit forms are finalized. Plan sponsors will then be able to consider the 411(d)(6) regulations, eliminate optional forms where desired and permitted, and then prepare election forms in accordance with the relative value requirements that include only the desired optional forms.

These comments were prepared by ASPPA's IRS subcommittee of the Government Affairs Committee, Mark L. Lofgren, Esq., APM, Chair, and primary author. Please contact us if you have any comments or questions regarding the matters discussed above. Thank you for your consideration of these comments.

Sincerely,

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