Comments on IRS Revenue Procedure 99-45, Modifications to Revenue Procedure 95-51, Approval for Changing the Funding Method Used to Determine the Minimum Funding Standard

May 18, 2000

Ms. Carol Gold
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, D.C. 20224

RE: Comments on IRS Revenue Procedure 99-45, Modifications to Revenue Procedure 95-51, Approval for Changing the Funding Method Used to Determine the Minimum Funding Standard

Dear Ms. Gold:

ASPPA is a national organization of approximately 3,700 members who provide actuarial, consulting, administrative, legal and other professional services for about one-third of the qualified retirement plans in the United States, the majority of which are maintained by small businesses. ASPPA's mission is to educate pension actuaries, consultants, administrators and other benefits professionals and to preserve and enhance the private retirement system as part of the development of a cohesive and coherent national retirement income policy. Its large and broad based membership gives it unusual insight into current practical problems with ERISA and qualified retirement plans, with a particular focus on the issues faced by smaller employers.

ASPPA is pleased at the issuance of Revenue Procedure 99-45 but concerned that our earlier comments on Revenue Procedures 95-51 and 98-10 may not have been adequately considered. We are also concerned with how IRS field actuaries seem to have been interpreting Section 4.02 of Revenue Procedure 95-51 as required changes rather than optional changes.

Revenue Procedure 99-45

Revenue Procedure 99-45 is short but positive. In our earlier comments we had asked that automatic approval be granted to either predecessor plan's method in a merger. Revenue Procedure 99-45 grants automatic approval in the case of certain de minimis mergers and with conditions when not de minimis. ASPPA hopes that, with experience, the Service will simplify the conditions, especially opening the automatic approval to plans which use methods other than the limited number of methods allowed under Section 3 of Revenue Procedure 95-51.

Additional Comments

We were encouraged by the initial issuance of Revenue Procedure 95-51, which continued the practice of allowing certain automatic changes in funding method as allowed previously by Revenue Procedures 79-50, 80-50, 91-29, and 85-29. The ability to automatically change a plan's funding method not only reduces the financial and administrative burden upon a plan sponsor but, also, reduces the work burden upon the Service and the expense to taxpayers. The ability of the plan administrator to choose an actuarial funding method, and then change the method when necessary, is essential to the health of the voluntary private pension system.

ASPPA was pleased with Revenue Procedure 85-29. We did not, and still do not, understand the reasons for the major additional restrictions imposed by 95-51 and feel that 99-45 has done little to lessen these restrictions. The only examples of abuse, which were offered by the Service, were instances, which violated the requirements of Revenue Procedure 85-29 and existing regulations. Therefore, rewriting the procedure to limit changes does not appear to have been necessary.

We have restated our earlier suggestions and expanded on certain of them in light of, and as comment on, Revenue Procedures 98-10 and 99-45 and our experience with them.

1. Section 3 - - Missing Funding Methods

Two widely used funding methods are missing from the list in Section 3 of Revenue Procedure 95-51. Revenue Procedure 80-50, section 3.01(3), and Revenue Procedure 81-29, section 4.04, allowed the use of Aggregate and Frozen Initial Liability (FIL) methods which spread future normal costs using tabular normal costs, over either individual Entry Age Normal (EAN) normal costs or Individual Level Premium (ILP) normal costs. (Revenue Procedure 85-29 allowed a change to these and any other reasonable funding method.) These two methods are known as Tabular FIL and Tabular Aggregate.

Inasmuch as the above two above methods are widely used and there have been no reports of any abuses of these methods, we are perplexed as to why they continue to be left out of the Revenue Procedures.

For smaller employers it is more important to budget the pension expense as a fixed dollar amount, rather than an amount that is a fixed percentage of covered payroll. This is especially true when the owner is close to retirement and the rank-and-file employees are not. In such case to spread future normal costs as a percentage of payroll can easily underfund the plan.

Since these are very stable and widely used methods, we ask that the Service add them to the list in Section 3.

2. Section 3.08(3)(d) and 3.09(3)(c) -- Definition of Assumed Entry Age

The definition of assumed entry age under Section 3.08(3)(d) and 3.09(3)(c) is too restrictive. What if the plan's funding method includes all employees, rather than those who have already met the plan's eligibility requirements- The actuarial valuation will produce erroneous results because these employees' attained ages will be before their entry ages.

We think alternate definitions of "entry age" should be allowed as follows:

1. Age at the valuation following participant's actual entry date.
2. Age at the valuation following participant's entry date assuming the current plan provisions were always in effect.
3. Age at the valuation following participant's hire date.

3. Section 3.13 -- Change in Valuation Date

Section 3.13 only grants approval for a change in the valuation date to the first day of the plan year. We ask that a change to the last day of the plan year be allowed.

4. Section 3.14 -- Change in Method for Valuing Ancillary Benefits

Section 3.14 grants approval to change the method used for valuing ancillary benefits to the funding method used for valuing retirement benefits if the prior method for valuing ancillary benefits had been the one-year term method. We ask that the reverse be allowed, i.e. changing the method from the funding method used for valuing retirement benefits to the one-year term method where permissible by the regulation.

5. Section 4.02(1) - Special Approval to Remedy Negative Individual Aggregate Normal Costs

Section 4.02(1) allows the reallocation of assets to avoid negative normal costs for participants under Individual Aggregate. It has come to our attention that, in at least one instance, the IRS field actuary has interpreted this section to require that this Section 4.02(1) be used when there are negative normal costs for one or more participants but an overall positive normal cost.

Our understanding is that the Revenue Procedure permits these changes in section 4.02 but does not require them. To require them would require a change in existing regulations. We ask the IRS to clarify this issue.

It should also be understood that some varieties of FIL and Individual Aggregate include appropriate procedures for dealing with negative normal costs or negative unfunded liabilities.

6. Section 4.02(2) -- Special Approval to Remedy Negative FIL Normal Costs

Section 4.02(2) allows a reestablishment of the unfunded liability to avoid the calculation of a negative normal cost. This is only permitted if the normal cost under the plan's funding method is either determined as a level percentage of compensation or as a level dollar amount. Assuming the same definition of "level dollar amount" as used in Section 3.07, this would exclude the Tabular FIL as described in our comment number 1. If so, then plans using Tabular FIL would have no choice but to live with negative normal costs.

Assuming this result was not intended, we ask that the section be clarified to allow the reestablishment of the unfunded liability as long as the funding method meets the requirement of a reasonable method as defined by the regulations.

We also ask that the section be changed to allow a full amortization of the amortization bases in addition to the option of re-establishing the bases.

7. Section 4.02(3) -- Special Approval for Fully Funded FIL or AAN Plans

This section permits a fully funded FIL or Attained Age Normal plan to switch to the Aggregate method after the full funding limit applies. In many cases, a subsequent amendment to the plan pulls the plan out of full funding. In such situations, it may be preferable to set up a liability base as contemplated by the method prior to the automatic change. The option of changing to the Frozen Initial Liability or Attained Age Normal method with a zero fresh start base should be permitted in these situations.

8. Section 4.03 -- Approval for Change in Funding Method for Fully Funding Terminated Plans

Section 4.03 allows for a change to a form of unit credit with optional changes in either valuation date to the plan termination date or first day of the plan year or asset valuation method to value assets at fair market value. The main condition for such change(s) is that as of the date of plan termination, the fair market value of the assets of the plan (exclusive of contributions receivable) is not less than the present value of all benefit liabilities (whether or not vested).

We ask that this restriction be eliminated.

Even underfunded plans may need a funding method change in the year of plan termination. If the valuation date currently is the last day of the plan year, there will be no valuation date for the plan year prior to the ending date for the minimum-funding requirement. This presents practical problems.

It is vital that all terminating plans be allowed to automatically change the valuation date to either the first day of the plan year or the plan termination date. It is the position of ASPPA that a plan sponsor terminating an underfunded plan with a last day of the plan year valuation date should not be required to bear the extra financial and administrative burden of filing for such a change with the Service. Usually they are already paying the Service a user fee for a final favorable determination letter. It would appear that absent any such automatic approval, the enrolled actuary is allowed under existing regulations to continue to use a last day of the year valuation date, even if such is after the plan termination date, and to make any adaptations and assumptions which he or she deem reasonable. For the Service to take a contrary position is the same as taking the position that such plan sponsors are required by regulation to file for a change in funding method in the year of plan termination and, hence, required to pay the Service a user fee in addition to the one for the final favorable determination letter.

Many plan sponsors seek to limit the final plan contribution to the amount needed to make the plan sufficient. If this restriction is retained, a plan that is marginally insufficient will be forced to either apply for a change in funding method or be forced into making a larger contribution that may then be refunded and subject to the reversion penalty. To address this problem, the Plan Termination change to the unit credit method should be permitted where assets, including all contributions for the current year that are required to meet the minimum funding standards under Internal Revenue Code §412, are not less than the present value of all benefit liabilities.

We ask that an underfunded terminating plan be able to change the funding method if the required contribution is not decreased as a result of the change.

9. Section 4.04 -- Approval for Takeover Plans

We are pleased that the Service included a special rule for takeover plans in Revenue Procedure 95-51 in recognition of the unknown differences that may exist in methods that have similar descriptions. It appears that section 4.04 essentially recognizes situations that are not changes in funding method due to de minimis differences in methodology.

We are concerned with the apparent lack of relief where the new actuary is unable to fit within the constraints of section 4.04, especially where the new actuary's judgement calls for the use of an entirely different funding method. In such situations the plan administrator should be permitted to use one of the methods in section 3 without regard to the limits in section 6.02(3) (single change every five years). The plan administrator's ability to make the best choices for the plan, including the choice of actuary, should not be inhibited by the penalty of the cost of a mandatory individual submission for what is viewed as a "standard" funding method.

We are also concerned with the implication that the change in the enrolled actuary and firm represents a change in funding method. The revenue procedure allows approval of this "change" as long as it is de minimis rather than stating that the de minimis difference is not a change in funding method at all. We submit that the latter description is closer to the mark. We also submit that this point should be clarified to apply to any change, even where there is not a change in actuary or actuarial firm. In other words, if any change in enrolled actuary, or the enrolled actuary's tools (such as software) can be shown to fall within the 5% corridor of prior cost, then no change in funding method has occurred.

10. Revenue Procedure 99-45 modified 98-10, which added a new section 4.05. Our concerns with section 4.05 are:

a. The corridor, which has been set, is 2%, not 5%. 2% is much too small to be of help to all but plans of large employers. A 2% corridor is essentially the same as no corridor at all for a small plan.

b. In our opinion, if the change is within a corridor of 5%, it should not be considered a change. We cannot over-emphasize the importance of this point. Software firms are constantly making changes in their valuation software. If such a change results in a difference of $1 in the net charges for a plan, and the plan administrator doesn't make use of Section 4.05, then in the opinion of the Service the enrolled actuary has violated the regulations and the law. In many instances, the cost of finding and disclosing a 2% change in the net charges may well exceed the actual change.

c. It is unreasonable to expect that the enrolled actuary will be able to run all valuations for a year on both the old software and the new software so as to be able to prove that the change in the net charges for all affected plans are within the corridor. No actuarial or administrative firm can afford to run their valuations on two different computer systems for a year to look for all greater-than-2% differences.

d. There is substantial concern that enrolled actuaries may be unable to change software when such a change is appropriate.

11. Section 6.01(4) -- Restriction if Plan is under an EP Examination

Section 6.01(4) prevents a plan from using the revenue procedure if the plan is under an EP examination for any plan year or if there has been verbal or written notification from EP/EO of an impending EP examination.

The fact that the plan is under examination for an earlier plan year or a later plan year does not change the problems faced by the enrolled actuary in the current plan year. What does a terminating plan do when a last day of the plan year valuation doesn't make sense? What does a takeover actuary do when he cannot duplicate the prior actuary's numbers exactly? What does a fully funded frozen plan do to avoid an unnecessary but required contribution? Neither 95-51, 98-10, nor 99-45 address these concerns.

Clearly what the plan sponsor must do is to shoulder the burden of additional administrative expenses of filing for a funding method change with IRS Headquarters office, with additional user fees payable to the IRS.

Consider the added problem of timing. What if the valuation has been run, the contribution has been made, the plan sponsor has filed its tax return, but the Schedule B has not yet been filed when the actuary finds out that an EP/EO audit is scheduled? What if changing the funding method back to the prior method results in a lower contribution? The plan sponsor has relied upon the automatic approval process in claiming a tax deduction and now must face not only re-filing its tax return but, moreover, penalties and interest solely because of a pending audit which might be due to a completely random process.

We ask that this section be deleted.

12. Section 6.02(3) -- Four-Year Limitation on Changes

Prior Revenue Procedures had a three-year limitation. Unless the Service can point out specific abuses, which would justify extending the limitation, we ask that the limitation be changed back to a three-year limitation.

13. The Definition of Funding Method "Change"

Our final comment is that the very definition of what change constitutes a change in the funding method has never been very clear. Some changes are obvious, such as a change in asset valuation method. Others are not so clear, such as a change in the assumed entry age.

Many assumptions and methods of calculation go into an actuarial valuation. Over the years we have heard actuaries from the IRS Headquarters Office assert that certain changes, such as a change in the computer valuation system, are funding method changes. We do not think this is a change in funding method at all.

ASPPA believes it is important that the authority of the Internal Revenue Service to approve changes in actuarial funding methods not undermine the ERISA authority granted to enrolled actuaries to choose actuarial assumptions. We believe that the issue of what constitutes a change in funding method as opposed to a change in actuarial assumptions needs to be discussed with and addressed. We believe that what constitutes an unreasonable variation of an otherwise acceptable funding method needs to be discussed. We suggest that the IRS discuss these issues with the Actuarial Standards Board (ASB).

ASPPA has been very pleased with the recent, significant efforts of the Service towards expanding programs of voluntary compliance. However, we believe that the issuance of Revenue Procedures 95-51, 98-10, and 99-45 is inconsistent with these efforts.

We recommend that the Service write rules regarding automatic changes in actuarial funding method in accordance with the following criteria:

1. The definition of what is part of the funding method and what is an actuarial assumption should be discussed with the Actuarial Standards Board (ASB) so that there can be mutual agreement;

2. Any requirements should not impose unwarranted financial and administrative burdens upon the voluntary sponsor of a qualified retirement plan;

3. Any requirements should minimize the work burden upon the Service and the expense to taxpayers;

4. Perceived abuse by one plan sponsor in ten thousand should not unreasonably restrict the rights of the others; and

5. Any requirements should reflect the real world limitations faced by enrolled actuaries, pension administration firms, software vendors, and, most importantly, voluntary sponsors of qualified retirement plans.

ASPPA would appreciate the opportunity to work with the Service in any way possible to accomplish these goals. We suggest that the IRS meet with the actuarial profession to develop workable regulations in this area.

These comments were written by Kurt F. Piper, Richard Block, Larry Deutsch, Jeffrey Wadle, and George Taylor, and are filed on behalf of ASPPA's Government Affairs Committee.

Sincerely,

Kurt F. Piper, MSPA, Chair, Regulations Committee

Brian H. Graff, Esq., ASPPA Executive Director

Bruce Ashton, APM, Co-Chair, ASPPA Govenmental Affairs Committee

Craig Hoffman, APM, Co-Chair, ASPPA Government Affairs Committee

R. Bradford Huss, APM, Co-Chair, ASPPA Governmental Affairs Committee

Theresa Lensander, CPC, QPA, Chair, ASPPA Administration Relations Committee

CC: Evelyn A. Petschek
Mark Iwry
Alan Tawshunsky
James E. Holland, Jr.
Martin Pippins