Finally Final!
Hybrid Regulations
and What They Mean

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ASPPA COLLEGE OF PENSION ACTUARIES

Today's Agenda

1. Background and History
2. Age Discrimination
3. Interest Crediting Rules
4. More on 2014 Regs, including Relief
5. 415 Limits & Miscellaneous Items
6. What's Missing from the Regs
7. Questions

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What is Cash Balance?

- Defined Benefit Plan
- Benefit = Notional Account
  - Assets are not divided into individual accounts
  - Account is on paper only
- Interest credit on Notional Account
  - E.g., 4% annual interest credit
- Interest credit may (or may not) match investment return on Plan assets

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Cash Balance Example

- 1/1/2014 Account Balance: $100,000
- Annual principal credit: $25,000
- Annual interest credit:
  - 2014: $100,000 * 4% = $4,000
- 12/31/2014 Account Balance: $129,000

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Cash Balance: Heavily Regulated

- Why are CB Plans so heavily regulated?
  - 174 pages of regulation issued in Oct 2010
  - 132 pages of regulations issued in Sept 2014
  - Based on law passed in 2006
- Why does anyone care enough to spend:
  - Eight years, and
  - So many trees,

…to regulate this type of plan?

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Cash Balance: History

- 1990's: Defined benefit plans unpopular
  - High and volatile costs
  - Punitive financial accounting
  - Opaque and under-appreciated benefits
- Employers sought design alternatives
  - Many conversions to cash balance in 1990's
  - Other employers exited DB plans altogether

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Cash Balance: History (cont')

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- Rising employee anger
  - Conversions usually reduced employer costs
  - After plan freezes, employees without a pension
- Court cases against cash balance plans
  - Attack on statutory & regulatory flaws in designs
  - Xerox case: lump sum not the account balance
  - IBM case: cash balance is age-discriminatory

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Cash Balance: History (cont')

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- Xerox issue: lump sum calculation
  - Under some cash balance designs, plans had to pay benefits higher than the account balance
    - Called "whipsaw"
  - Congress fixed in 2006 through PPA legislation
  - No retroactivity to change

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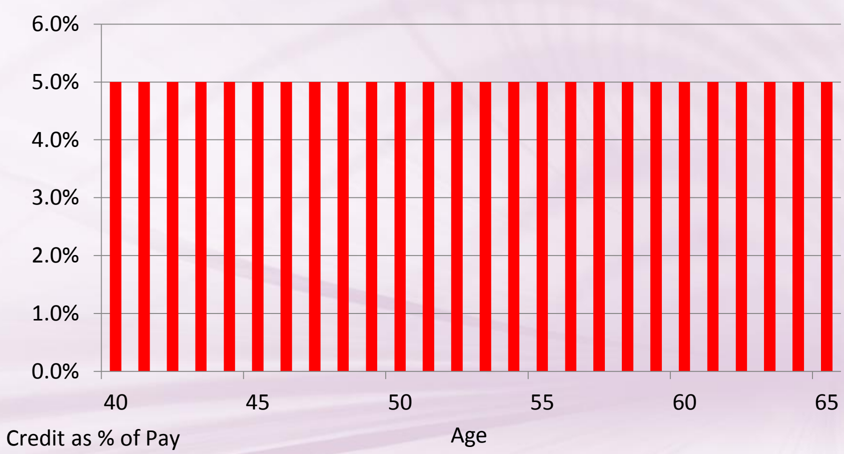
Cash Balance: History (cont')

- IBM issue: Age Discrimination
  - Court: Cash balance plans are age-discriminatory
  - Because younger employees have more time to earn interest through their retirement date
    - Employee A: age 25, so 40 years to age 65
    - Employee B: age 55, so 15 years to age 65
  - District Court concluded that plan discriminates against Employee B in favor of Employee A

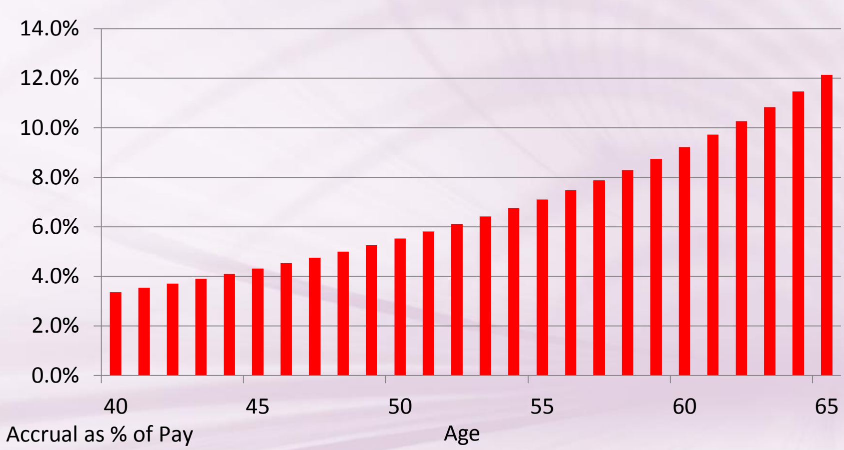
Typical Pattern of Cash Balance Pay Credits



Cash Balance: History (cont’)

- Pattern doesn’t <u>seem</u> to Discriminate…
  - Flat annual pay credits
- <u>Until</u> we consider the typical pattern of accruals for a traditional DB Plan
  - Career average 1% of pay DB plan
  - Steeply rising single-sum accruals

Typical Pattern of Traditional DB Plan Single-Sum Accruals



Cash Balance: History (cont')

- Courts: Age discrimination claims were reversed on Appeal
- Congress on age discrimination
  - Passed PPA 2006: Two compliance tracks:
    1. Traditional plans:
       - Compliance based on annual benefit at NRA
    2. Single-sum plans:
       - Compliance based on single-sum value

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Age Discrimination

- PPA 2006: Two separate compliance regimes
  - How to tell the difference?
  - In other words, when is a plan "traditional", and when is it "single-sum based"?
- Congress: Two ways to draw the line:
  1. Form: how plan is described in document
  2. Substance: what benefits are delivered

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Age Discrimination

- Single-Sum plans: what are they?
  - Congress: "applicable defined benefit plans"
  - IRS: "statutory hybrid plans"
- Traditional plans apparently remain nameless
  - Plans not described as "statutory hybrid plans" will be called "traditional" plans in this webcast

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Statutory Hybrid Plans

- How to spot a "statutory hybrid plan"?
  - ***Looks** like a duck*:
    If plan document states current benefit as either:
    1. Account balance, or
    2. Percent of final average compensation
       - Example: 10% of average pay times service
  - ***Acts** like a duck*:
    If adjustments to NRA annuity favor the young

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Statutory Hybrid Plans

- Example of "Statutory Hybrid Plan"
  - Career average: 1% of pay annuity payable at NRA
  - Adjustments: if plan assets return more than 3%, annuity at NRA is increased
    - If plan assets are invested in blend of equities and fixed-income, reasonable to assume future returns above 3%
    - Younger participants will likely have more increases in NRA annuity than older participants
    - Young participants favored over older participants!
    - Conclusion: statutory hybrid plan!

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Statutory Hybrid Plans

- Form over Substance?
  - If a Plan <u>looks</u> like a duck, is it a duck?
  - Congress: YES!
    - If benefit stated in plan document as account balance (or current value is stated as percent of FAE), then Plan is a statutory hybrid plan
    - Even if Plan benefit value is identical to traditional plan
    - Consider IRC 401(a)(26) minimum in cash balance plan
      - 0.5% of pay as an NRA annuity benefit

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Statutory Hybrid Plans

- Form over Substance?
  - If a traditional Plan acts like a hybrid plan, is it a statutory hybrid plan?
  - Consider a traditional DB Plan
    - Career average: 0.5% of pay
    - Normal retirement: age 65
    - Early retirement: 1% reduction before age 65…

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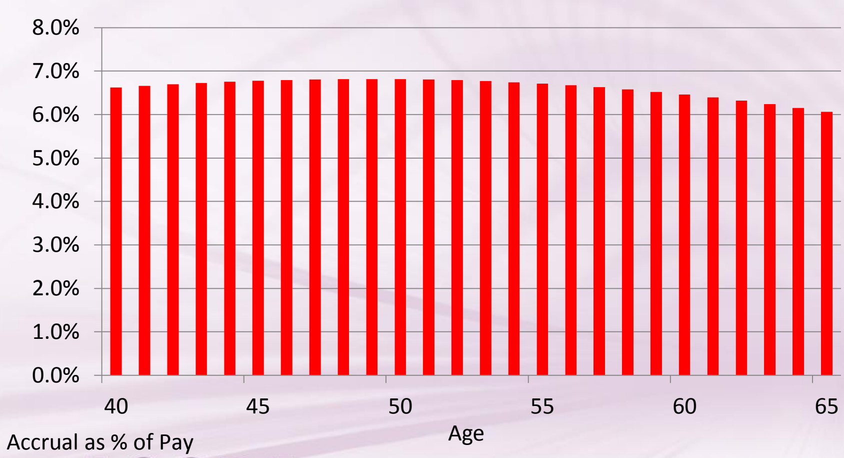
CAE Plan Accruals as Single-Sums



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Statutory Hybrid Plans

- Form over Substance?
  - Do early retirement subsidies make a traditional Plan <u>act</u> like a statutory hybrid plan?
  - IRS: No!
    - Consider only annuity at NRA
    - If adjustments to NRA annuity likely higher for younger participants, then statutory hybrid plan
    - Early retirement subsidies that do not adjust the NRA benefit are ignored: NOT statutory hybrid!

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Statutory Hybrid Plans

- IRS Nomenclature
  1. Statutory hybrid plans:
     a. "Lump sum-based formula": defines benefit in plan document as account balance (or accumulated percent of FAE)
        - Even if no lump sum payment form is offered
     b. Effect similar to lump sum-based formula: defined benefit in plan document traditionally, but NRA benefit adjustments favor the young
  2. Traditional plans

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Lump Sum-Based Formulas

- LS-Based Formulas subject to:
  1. Whipsaw: lump sum = account balance
     - Deemed to satisfy IRC 417(e) (minimum present value)
     - Effective for 2016+ plan years:
       - If lump sum made available, lump sum must equal account balance (or accumulated percent of FAE)
       - Exception: if lump sum of top-heavy minimum benefit, or other preserved benefit, is higher

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Lump Sum-Based Formulas

- LS-Based Formulas subject to:
  2. Three-year cliff vesting
  3. Prohibition on wear-away plan amendments
     - When converting to LS-based formula, must add current and future accruals to frozen accrued benefit
     - Cannot simply take greater of frozen and new benefits
  4. Market-based limits on interest credits
  5. Preservation of capital

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Effect of Lump Sum-Based Formulas

- Traditional formulas with Effect of LS-Based:
  - Subject to same set of requirements
    - Except whipsaw: must still apply 417(e)!
  - Adjustments to NRA annuity subject to:
    - Limitations on interest credits
    - Preservation of capital

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Age Discrimination

- Age Discrimination Compliance: Two methods:
  1. General rule:
     - Benefit accruals generally cannot slow down due to age
     - Based on annuity benefit at NRA (or current age if later)
  2. Safe Harbor:
     - "Accumulated benefit" not less than "similarly situated" younger individual who is or could be a participant
     - Accumulated benefit = annuity at NRA, account balance, or accumulated percent of FAE

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Age Discrimination

- Cash Balance on Age Discrimination:
  - Annuity at NRA:
    - Account balance + future years of compounded interest
  - Since more interest compounded for younger participants, common to fail the general rule
    - Pass only with increasing pay credits
    - Example: 401(a)(26) minimum as pay credit
  - Otherwise, use safe harbor

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Age Discrimination

- Safe Harbor:
  - Older participants must have as large a benefit value as similarly-situated younger participants
    - Includes all theoretically possible younger participants
  - Benefit value determined based on how benefit is stated in plan document:
    1. Annuity at NRA ("traditional")
    2. Cash balance account
    3. Accumulated percent of FAE

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Age Discrimination

- Cash Balance Example:
  - 3% of pay to 10 years of service
  - 4% of pay for service between 10 and 20 years
  - 5% of pay for service over 20 years
- Pass on age discrimination
  - Fails general rule: front-loaded due to interest
  - What about safe harbor?

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Age Discrimination

- Cash Balance Example (cont'):
  - "Similarly situated" participants have same characteristics, except age
    - Service is a named factor in regs
    - When comparing accumulated benefits between younger and older participants, keep service constant
    - In example, comparisons on age are always between participants within same service band (3%, 4%, or 5%)
    - PASS the safe harbor!

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Interest Credits

- Age Discrimination started with interest credits
  - District court: cash balance plans discriminate
    - Younger participants have more interest credits at NRA
  - Appeals Courts & Congress: no age-discrimination
  - But what if interest credits really high, like 15%?
    - At some point, higher interest credits become discriminatory against older participants
    - Congress: limited interest credits in PPA 2006

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Interest Credits

- Statutory limit on interest credits:
  - Cannot exceed "market rate of return"
  - Possible regulatory approaches:
    1. Define the term and provide conditions that practitioners could meet in defining their interest basis;
    2. Issue prescriptive list of compliant rates
  - 2014 Reg preamble:
    - Impractical for IRS to assess all the combinations of rates, floors and caps under (1) to ensure compliance

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Interest Credits

- Regulation of interest credits: Prescriptive
  - Interest rates outside IRS list **cannot** be used
  - 2014 regs: IRS delegated the ability to issue future guidance to expand list of acceptable interest rates
    - We may see gradual expansions of possibilities

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Cash Balance Interest Rates

- Acceptable Interest Rates:
  1. Fixed: **up to 6.0%**
     - 2010 regs: up to 5.0%
     - 2014 regs increase the acceptable upper limit
  2. Treasury yields:
     - Yields + fixed basis points
     - E.g., 5-year Treasury yield + 25 basis points
     - Similar to IRS Notice 96-8

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Cash Balance Interest Rates

- Acceptable Interest Rates:
  3. Segment rates:
     - MAP-21 (as adjusted by HATFA) or Unadjusted
     - First, second or third segment rates
  4. Investment return on plan assets:
     - 2010 regs: return on all plan assets
     - 2014 regs: return on all, or on subset, of assets

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Cash Balance Interest Rates

- Acceptable Interest Rates:
  5. Investment return on a mutual fund:
     - Must be broad-based
     - Not significantly more volatile than US markets
     - E.g., no industry sector
  6. Annuity contract rates:
     - Helpful if contract written for specific plan

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Cash Balance Interest Rates

- Acceptable Minimum Interest Rates:
  a. Treasury yields: up to 5.0% annually
    - E.g., Max of 30-year Treasury and 5.0%
    - Minimum applies on annual basis
  b. Corporate bond yields: up to 4.0% annually
    - E.g., Max of MAP-21 1st segment rate & 4.0%
    - Minimum applies on annual basis

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Cash Balance Interest Rates

- Acceptable Minimum Interest Rates:
  c. Return on Plan Assets: up to 3.0% cumulatively
    - E.g., Return on plan assets, not less than 3.0%
    - Does NOT apply annually
    - Applies on cumulative basis
    - Applies at distribution only
  d. Return on mutual funds:
    - Same as for Return on Plan Assets

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Cash Balance Interest Rates

- Blended Interest Rates
  - Can blend any collection of acceptable rates:
    - 50% Vanguard 500 + 50% Russell 2000 return
    - But does this make sense?
    - Would rather combine segment and/or style funds, such as small cap, or technology, for more sophisticated blend
      - Since each fund must comply with broad-based requirement by itself, this appears to be impossible
      - Stuck with broad-based single funds?

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Cash Balance Interest Rates

- Blended Interest Rates (cont')
  - Alternative solution:
    - Set blended rate as desired:
      - E.g., 50% Vanguard 500 + 50% QQQ
    - Cap blended rate by a compliant interest rate
      - E.g., limit to 6.0%
      - Or limit by MAP-21 3rd segment rate

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Cash Balance Interest Rates

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- Blended Interest Rates (cont')
  - In 2014 final reg preamble, states that IRS "could" in the future allow:
    - Credit investment return on plan assets,
    - With annual floor (not just cumulative floor),
    - With reduction in plan asset return, to adjust for "cost" of the annual floor
    - E.g., max (3%, return on plan assets minus 10 bp)

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Cash Balance Interest Rates

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- Things we <u>cannot</u> do:
  1. Credit the greater of two compliant rates:
     - E.g., can't credit max (return on plan assets, 5%)
     - Can credit the <u>lesser</u> of two compliant rates
  2. Credit outside the IRS's exclusive list
     - E.g., can't credit based on LIBOR (without a cap)
  3. Credit a multi-year average of returns
     - Must use return over one year or less

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Investment Direction?

- Can Investment Direction be provided?
  - Suggested by IRS in 2010 regulations
- 2014 regulations:

  "It is possible that the Treasury Department and the IRS will conclude that such plan designs are not permitted."

  This follows 4 pages of criticism of investment direction.

  We take this as "No."   *But we could be wrong*…

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Sub-Pools of Assets

- New option in 2014 regs:
  - Credit investment return on sub-pool of plan assets
  - Allows plan sponsor to segment liabilities and invest to match those liability characteristics
    - Plan can maintain LDI (liability-driven investing) for portion of liability (e.g., retirees)
    - Participants with cash balance accounts (actives & DVTs) credited with return of remaining sub-pool

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Sub-Pools of Assets

- IRS Examples in Regs:
  1. Sub-pool option intended to accommodate cash balance conversions:
     - Sub-pool 1: traditional defined benefit
     - Sub-pool 2: new cash balance benefit
  2. Or matching of assets with liabilities:
     - Sub-pool 1: active participants
     - Sub-pool 2: retirees with annuities

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Sub-Pools of Assets

- Requirements for Sub-Pools:
  1. Sub-pool must be diversified:
     - ERISA standard applies
  2. 10% limit in sub-pool on qualified employer securities
  3. Market value of assets in sub-pool must approximate the liabilities for benefits to which the sub-pool relates
     - Restrictions on funding of the sub-pool

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Sub-Pools of Assets

- Asset Sub-Pools: Other Applications
  1. Asset allocation sub-pools:
     - Each sub-pool is a separate investment policy
     - Participants assigned to a particular sub-pool
     - Assignment is one-time at design inception
     - Does this heighten the 401(a)(26) risk?
       - With sub-pools assigned by investment policy, does the Plan and its likely cost allocation act like "separate arrangements," which would disqualify?

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Sub-Pools of Assets

- Asset Sub-Pools: Other Applications
  2. Transitional design sub-pools:
     - Cash balance plan transitions from yield rate to market-return
     - Sub-pool 1: match yield rate on existing balances
     - Sub-pool 2: credit actual return on new accruals
  3. Lifestyle cash balance plan?
     - Segment participants by age
     - Each sub-pool is a lifestyle fund
     - Age discrimination a risk?

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Changes to Interest Crediting

- Can we change the Interest Crediting Rate?
  - Interest crediting is a right to which participant is entitled, from now until any future point, once the contribution credit has been accrued
    - Once the 2014 pay credit is accrued, the right to interest on it for all years through distribution is accrued
    - Cannot cut back interest, even before it's credited!
    - Except in narrow relief provided in 2014 regs…

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Changes to Interest Crediting

- 2014 Relief for Interest Crediting changes
  - Can change look-back and/or stability periods for:
    - Treasury yield rates (+ margins, if applicable)
    - Segment rates
  - Rules similar to 417(e) changes:
    - Must credit higher of old and new interest crediting rate from one-year period beginning on later of amendment's adoption and effective dates

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Changes to Interest Crediting

- What if mutual fund basis for interest crediting rate ceases to exist?
  - IRS: plan sponsor may select new mutual fund with "reasonably similar characteristics, including characteristics related to risk and rate of return"
  - Is this a narrow application, or an indication of general thinking at the IRS?
    - If crediting market-rate interest, be careful about changing plan investment policy?

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IRS Proposed Relief

- What if Interest Crediting is non-compliant?
  - General rule: correct in most straightforward way
  - Examples:
    1. Credits 7%: cut back to 6%
    2. Credits S&P 500: credit Vanguard 500 return
    3. Credits 30-year Treasury yield, with floor of 6%: reduce floor to 5%
  - Special rules apply for more complicated situations
  - Effective January 1, 2016

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Preservation of Capital

- At annuity starting date, must distribute at least sum of contribution credits
  - Cumulative floor of zero
  - Applies only at annuity starting date
  - Not clear if part of accrued benefit structure
  - If past distributions under cash balance formula, generally include past distributions in assessment
  - Allowed to exclude distributions following a 5-year break-in-service for this purpose

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Actuarial Equivalence

- Actuarial Equivalent Issues
  1. Account balance requirements
  2. Rules on subsidies
  3. Post-NRA actuarial increases

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Actuarial Equivalence

- Accrued benefit: must be actuarial equivalent to the account balance:
  1. At normal retirement date, or
  2. At annuity starting date
- Satisfies at least (1) if
  - Account balance is converted to accrued benefit annuity at NRA using post-retirement AE interest rate, and
  - Post-retire AE rate is "reasonable actuarial assumption"

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Rules on Subsidies

- Regs limit annuity subsidies in cash balance plans
- Why subsidize annuities?
  - Especially since most distributions are lump sums
- Consider 415 limit:
  - Reduction in 415 limit pre-age-62 is based on plan's pre-age-62 annuity values, not lump sum
  - Higher pre-age-62 limit with a subsidized annuity?

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415 Limits & Cash Balance

- Example of 415 Limits:
  - Age 55
  - First year of service in 2014
  - Age 62 NRA
  - Interest crediting rate: 3rd segment rate, currently 6.0%
  - Annuity conversion: 5.0%
  - 2014 417(e) Mortality
  - 2014 cash balance formula credit: $200,000

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415 Limits & Cash Balance

- Example:
  1. Limit Accrued Benefit as annuity: $21,000
     - Convert $21,000 annuity to current account balance
     - $21,000 * a_{62} / 1.06^$^{(62\text{-}55)}$ = $181,933
     - Must the formula credit of $200,000 be reduced?
     - EA Gray Book 2014-29:

     "Section 415 requires the plan to limit the accrued benefit and optional forms of benefit, not the hypothetical account balance."

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415 Limits & Cash Balance

- Example: (continued)
  2. Limit benefit at annuity starting date
     - \$21,000, reduced by lesser of 415 and Plan factors
     - 415 factors: $(a_{62}\ /\ 1.05^{\wedge(62\text{-}55)}\ /\ a_{55}) = 0.621$
     - Use Plan factors without subsidy:
       Plan factors: $(a_{62}\ /\ 1.06^{\wedge(62\text{-}55)}\ /\ a_{55}) = 0.581$
     - Plan assumptions apply (because of 6.0%)
     - Annuity limit = \$21,000 * 0.581 = \$12,201

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415 Limits & Cash Balance

- Example: (continued)
  2. Limit benefit at annuity starting date (continued)
     - Convert immediate annuity limit to account value using 415 lump sum assumptions
     - Either small employer, or 417(e) rates are too low to apply, so use 5.5%
     - \$12,201 * a_{55} (5.5%) = \$172,479
     - Current distribution cannot exceed \$172,479
     - Current formula balance is still \$200,000

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415 Limits & Cash Balance

- To increase 415 Limits, define subsidized annuity
  - Annuity = project to NRA at interest crediting rate (6% in this example) and discount at 5%
- Back to Example:
  - Age 55 plan reduction = now same as 415 = 0.621
  - 415 limit at 55: \$21,000 * 0.621 * a_{55} (5.5%) = \$184,354
  - Higher limit: \$184k with annuity subsidy vs \$179k without
- Now consider 2014 Regs restrictions…

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Rules on Subsidies

- 2014 Regs on Age Discrimination:
  - Rule: similarly-situated younger participants generally cannot exceed benefits available to older participants
  - For this purpose, can generally exclude subsidies
  - But only if the subsidies do not result in the annual early retirement benefit exceeding the annual early retirement for a similarly-situated older participant
- Consider immediately-commencing annuity benefits created in cash balance example…

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Annual Early Retirement Benefit Accruals in Example Plan

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Rules on Subsidies

- Example Plan: Fails!
  - Annual early retirement benefit at age 40 is higher than annual early retirement benefit at ages 43 to 48
  - Failure is small
  - What if 3rd segment rate were 6.5% (instead of 6.0%)?
  - FAIL at nearly every age
- Difficult to employ this strategy now
  - This rule effective January 1, 2016

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Cash Balance & Late Retirement

- DOL concerned about preservation of benefit value after Normal Retirement Age ("NRA")
  - If not in pay status by NRA, continued deferral causes loss of value (because of shorter expected lifespan)
- Example:
  - $100 per month payable at age 65 (the NRA)
  - Participant defers payment to age 67
  - Two fewer years of payment of that $100 per month
  - In the DOL's eyes, that's a loss of benefits

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Cash Balance & Late Retirement

- Four solutions:
  1. Notify participants of loss of value
     - Distribute "suspension notice" upon attainment of NRA
  2. Gross up the benefit
     - Increase the $100 at age 65 to, say, $114 at age 67
  3. Offset gross-up by continued accruals
     - If $100 at age 65 becomes $125 at age 67 due to ongoing accruals, then no loss of value
  4. Force distributions to start at NRA

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Cash Balance & Late Retirement

- Grossing up Benefit Value
  - Increase benefit for shortened future lifespan

    New benefit = (NRA benefit * a_{NRA}) * (1 + int) / a_{AA}
  - For a Cash Balance Plan, this is mathematically the SAME as crediting interest at the rate of "int"
    - Assumes we can ignore mortality adjustment
  - Can "int" be the Plan's interest crediting rate?
    - If yes, then we comply automatically
    - If no, we have more work to do…

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Cash Balance & Late Retirement

- 2014 Final Regulations Preamble:

  "A [cash balance] plan that does not suspend benefits … will have to provide adjustments in excess of the benefits determined … <u>if the interest crediting rate is insufficient to provide the required actuarial increases</u>." (emphasis added)
- In other words, at least some interest crediting rates are not sufficient for post-NRA actuarial increases

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Cash Balance & Late Retirement

- Post-NRA Actuarial Increase
  - Standard for actuarial increase: reasonableness
- Are these reasonable:
  a. 30-year Treasury rate
  b. 5-year Treasury rate (current rate: 1.8%)
  c. 1-year Treasury rate (current rate: 0.1%)
  d. Actual return on assets (could be negative)

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Cash Balance & Late Retirement

- Consider DOL "suspension" notice
  a. If CB Plan document already provides for suspension of benefits notice, but these notices have not been distributed in the past, can start distributing the notices
     - Distributing notice now covers only future increases
     - What about past increases?
  b. If no CB Plan document language on suspensions:
     - Use wear-away to extend notice coverage to existing account balance and still preserve accrued benefit

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Cash Balance & Late Retirement

- Consider DOL "suspension" notice
  - c. Suspension notices do NOT work after age 70-1/2
    - Force distributions starting at age 70-1/2?
    - Or credit additional interest?
  - d. Suspension notices do NOT work if the participant works less than 40 hours per month
    - Force distributions if hours fall below this threshold?
    - Hours measurements can be painful

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Accrual Rules

- Accrual Rules:
  - Ensure Plan provides sufficient accruals at ages prior to NRA
  - Cash balance accruals = pay credit + future interest credits
    - Example: 2014 accrual = 2014 pay credit + interest on 2014 pay credit for all years until participant attains NRA
  - With interest compounding over all years to NRA, cash balance plans are <u>usually</u> front-loaded and pass easily
    - If pay credits escalate with age, may not pass
    - What if interest credits are negative?

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Accrual Rules

- 2014 Regs
  - Same as 2010 regulations on accrual rules:
    - In assessing 133-1/3% accrual rule, may assume that current and future interest credits are not less than zero
    - No relief for fractional rule or 3% method
  - Provided that pay credits do not increase more than 33-1/3% over years to NRA, cash balance plan Passes!
- Disconnect between accrued benefit for accrual rules, and accrued benefit for all other purposes

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Plan Termination

- Plan Termination: Statute
  - Interest = 5-year average of interest crediting rates
- Plan Termination: 2010 Regs
  - If crediting return on assets or mutual funds, Interest = 5-year average of **3rd** segment rates
- Plan Termination: 2014 Regs
  - If crediting return on assets or mutual funds, Interest = 5-year average of **2nd** segment rates

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Plan Termination

- In determining 5-year average:
  - Determination of whether any rate used in average is a market rate is based on time rate applied and not year of termination
  - Minimums, maximums, etc. recognized
    - But not cumulative minimums
  - Per PBGC guidance, if final year is a short year, ignore final year rate in average
    - Still use final year rate for crediting to termination date

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Plan Termination

- Example: plan used lesser of 30-year rate for preceding October or 4% for interest crediting
  - October 2013 3.68%
  - October 2012 2.90%
  - October 2011 3.13%
  - October 2010 3.87%
  - October 2009 4.00% (actual 4.19%)
  - October 2008 4.00% (actual 4.17%)
- Plan terminates April 1, 2014
  - Interest used post termination would be 3.58% (average 2.90, 3.13, 3.87, 4.00, 4.00)
  - Oct 2013 rate ignored in average, since 2014 is not a full plan year (But used in interest crediting up to termination date)

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Cash Balance Conversions

- Cash Balance Conversions
  - Converting from a traditional defined benefit to a cash balance design is highly regulated
  - 2010 Regs proposed a narrow slice of relief:
    - “Set and forget”
  - Because this relief is so limited, 2014 Regs retract it
    - Special rules for those who used “set and forget”
  - Only two options:
    1. “Set and check”: check opening balance against 417(e)
    2. “A+B”: Maintain traditional and cash balance separately

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What’s Missing from Regs

- How to Project the Interest Credit
  - Accrued benefit: interest projected to NRA
  - Accrued benefit is the basis for compliance:
    - Non-discrimination testing
    - IRS benefit limits (“415” limits)
    - Accrual rules
  - Most significant compliance item is still unknown!

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What's Missing from Regs

- Projection of Interest Credit
  - IRS (verbal) position:
    - Project interest at current rate
    - Does it make sense to project an equity portfolio's returns for all future years at current rate of return?
      - 2013 S&P 500 return: 30%
      - Project for all years after 2013 at 30%?
      - Note: the IRS rejects this position in the preamble to these regulations, stating that a 5-year average of returns is not indicative of future returns on equity portfolios

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Questions?

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