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April 28, 2005

CC:PA:LPD:PR (REG-152914-04)
Courier's Desk
Internal Revenue Service
1111 Constitution Avenue, NW.
Washington, DC 20044

Re: Relative Value Regulation

Sir/Madam:

The American Benefits Council (the "Council") appreciates the opportunity to comment on the Revised Regulations Concerning Disclosure of Relative Values of Optional Forms of Benefit, which were issued as proposed regulations on January 27, 2005. The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans. The Council respectfully requests that a public hearing be held on this matter and would like to testify at that hearing.

The Council commends the Department of Treasury and Internal Revenue Service (collectively referred to as "Treasury") for delaying the effective date of the relative value regulations with respect to certain distributions. However, in addition to delaying the effective date of the relative value regulations, the proposed regulations would expand the scope of an entirely different set of rules, the rules governing the valuation of certain distributions under Section 417(e). In particular, the proposed regulations provide that the valuation rules under Section 417(e) apply to the distribution of a social security level income option. The Council is concerned that this extension of Section 417(e) is inconsistent with the text of Section 417(e) and unnecessarily burdens the defined benefit plan system. Furthermore, if Treasury is inclined to adopt this expansion, the issue should

be considered when addressing the scope of Section 417(e) and not in unrelated regulations.

In addition, the Council is concerned that the relative value rules could require a plan to provide to a participant hundreds or thousands of calculations, which would neither assist the participant in making a distribution election nor serve the rules' purpose of making the distribution election more understandable. To ensure that QJSA explanations are understandable, the Council requests clarification regarding the following issues: (1) whether the "series of examples" under Regulation § 1.417(a)(3)-1(d)(2) may be based on commonly elected forms of benefit, (2) whether a simple mathematical formula may be used to describe the financial effect of an optional form, (3) what the effect of a qualified domestic relations order ("QDRO") is on the explanation of the qualified joint and survivor annuity ("QJSA"), and (4) whether the QJSA explanation may show the relative values and financial effects of optional forms separately with respect to separate portions of a benefit when the election to waive the QJSA with respect to one portion is made independently of the election to waive the QJSA with respect to the other portion.

Expansion of Section 417(e)

The relative value regulations were originally effective with respect to QJSA explanations for distributions with annuity starting dates on or after October 1, 2004. In Announcement 2004-58, the IRS provided that the effective date would be delayed, except with respect to distributions subject to Section 417(e). In a parenthetical, the IRS explained that distributions subject to 417(e) include, "single sums, distributions in the form of partial single sums in combination with annuities, or installment payment options." The proposed regulations modify the effective date of the relative value rules in accordance with Announcement 2004-58. However, when explaining that the distributions subject to 417(e) retain the rules' original effective date, the proposed regulations provide in a parenthetical that distributions subject to Section 417(e) include "single sums, *social security level income options*, distributions in the form of partial single sums in combination with annuities, or installment payment options" (emphasis added).

If adopted, the proposed regulation would expand the scope of Section 417(e) beyond what the statute provides. Section 417(e) (and its parallel provision in section 205(g) of the Employee Retirement Income Security Act of 1974 ("ERISA")) specify actuarial assumptions that must be used for determining the "present value" of the qualified joint and survivor annuity that the plan may "immediately distribute."

A social security level income option, however, is not an immediate distribution of the present value of a benefit and therefore is not subject to the valuation requirements of Section 417(e). The text of the statute and legislative history clearly indicate that Congress intended Section 417(e) to apply only to lump sum distributions. A social security level income option is not a lump sum distribution. Instead, a social security level income option closely parallels a non-decreasing annuity and a social security supplement, which

are not subject to the special valuation rules in Section 417(e). Reg. § 1.417(e)-1(d)(6). When taking into account a participant's social security benefits, the social security level income option produces an annuity benefit that does not decrease. Furthermore, when considering solely the benefit paid from the plan, there is a one-time decrease in the plan benefit in an amount that does not exceed the amount of the participant's social security benefit, which is precisely how the prototypical social security supplement operates (although for other purposes a social security level income option may be distinct from a social security supplement). Treasury should therefore clarify that a social security level income option is properly treated in the same manner as a non-decreasing annuity and a social security supplement under Code § 417(e) and ERISA § 205(g).

Such treatment is consistent with the treatment of a social security level income option under the eligible rollover rules under Section 402. Reg. § 1.402(c)-2, Q&A-5(b). Moreover, the Pension Benefit Guaranty Corporation ("PBGC") treats social security level income options similarly to nondecreasing annuities and differently than lump sums. The PBGC guarantees social security level income options and nondecreasing annuities but not lump sum payments. PBGC Reg. § 4022.21(a)(2)(iii).

Treasury's adoption of the rule proposed in Prop. Reg. § 1.417(a)(3)-1(f)(2)(ii) subjecting a social security level income option to Section 417(e) would further complicate the administration and funding of defined benefit plans offering social security level income options.¹ In addition, applying Section 417(e) to social security level income options could increase the liability of the PBGC. As noted above, the PBGC guarantees payment of social security level income options and may therefore be required to pay increased amounts under Section 417(e) when it assumes responsibility for a plan that offers social security level income options.

If Treasury is inclined to extend Section 417(e) to social security level income options, this issue should be considered in a separate rulemaking process in which the scope of Section 417(e) is thoroughly considered and reviewed. The proposed regulations address the disclosure of the relative values of optional forms of benefit; it should not also address in a parenthetical how optional forms of benefit must be calculated.

Furthermore, if Treasury is inclined to extend Section 417(e) to social security level income options in this rulemaking process, Treasury should consider transition relief. Many plans have for years (if not decades) offered social security level income options and calculated

¹ During the past year, at least 20 percent of defined benefit plans in the United States were frozen (either for new hires or for all employees) or terminated. Testimony of Dallas L. Salisbury, President & CEO, Employee Benefit Research Institute, before Joint Committee Forum (*Private-Sector Retirement Savings Plans: What Does the Future Hold?*) of Senate Committee on Finance & Senate Committee on Health, Education, Labor & Pensions (Mar. 15, 2005). Additional regulatory burdens will only hasten the decline of this important source of retirement income.

these options using assumptions that, while reasonable, are not Section 417(e) assumptions. In fact, many of these plans have received determination letters from the IRS, on which plan sponsors have relied. Thus, at the very least, Treasury should not extend Section 417(e) to social security level income options retroactively. Instead, the new rule, if applied at all, should apply only to the distribution of benefits that are accrued after the rule is finalized. This would preserve the expectations of participants and plan sponsors alike, and it would not have an immediate, negative effect on any plan's liabilities or funding status.

Clarification of Relative Value Rules

The purpose of the relative value rules is to enable participants to make informed comparisons of distribution forms that are available to them. In some cases, this purpose could be undermined by providing a participant with a QJSA explanation that includes hundreds or even thousands of items of data, many of which vary only slightly. Such an explanation might overwhelm or confuse a participant. To ensure that participants receive meaningful QJSA explanations, a plan should be permitted to reduce the potential number of calculations in the following ways:

1. Series of Examples

The relative value rules require the disclosure of the relative value and financial effect of each optional form of benefit that is presently available to a participant. The plan may, instead, initially disclose generally applicable information by, for instance, including a chart showing the relative value and financial effect of optional forms "in a series of examples." If a participant requests, the plan subsequently provides participant-specific information.

Some pension plans offer hundreds of different optional forms of benefit, although many differ only slightly from each other. For example, a plan might offer joint and survivor annuities in 1% increments, e.g., a joint and 1% survivor annuity, a joint and 2% survivor annuity, etc. In such a case, Treasury should clarify that the plan provides a "series of examples" if it shows the relative value and financial effect of the most commonly selected optional forms of benefit.² For example, these might be, in the case of a plan that offers joint and survivor annuities in 1% increments: the joint and 50% survivor annuity, the joint

² In small plans and new plans, it might be difficult to determine what is a commonly selected option. The determination of whether an option is commonly selected may be made in light of the plan's actual experience, and, in some cases, a small or new plan will not be able to determine which optional forms are commonly selected. In such a case, a plan should be permitted to show in a series of examples a reasonable range of options without showing every possible calculation.

and 75% survivor annuity, and the joint and 100% survivor annuity. This would simplify the disclosure while enabling a participant to understand the range of options available. A participant, of course, could request (and would receive) additional information regarding any particular option or set of options. If, on the other hand, a plan is required to show initially every possible calculation, the participant may be overwhelmed by the QJSA explanation and less likely to understand the options available.

2. Mathematical Formulas

The relative value regulations define “financial effect” to mean “the amount payable” during and after the participant’s lifetime. In some plans, a participant may elect to split his or her benefit among different optional forms. For example, a participant might elect to receive 50% of his or her benefit in a lump sum and 50% in a single life annuity. Treasury should clarify that the QJSA explanation discloses the financial effect of an optional form if the explanation initially provides a simple mathematical formula to determine the amount of the benefit payable. If a participant requests, the plan would subsequently calculate the amount of any particular optional form.

Thus, for example, if a participant may elect to receive his or her benefit in a lump sum, in a single life annuity, or 50% in a lump sum and 50% in a single life annuity, the QJSA explanation adequately discloses the financial effect of each optional form by: (a) disclosing the amount of the lump sum if the benefits are paid entirely in a lump sum, (b) disclosing the amount of the single life annuity if the benefits are paid entirely in a single life annuity, and (c) explaining that, if the participant elects to split the distribution between the single life annuity and the lump sum, the amount of the single life annuity would be equal to 50% of the single life annuity amount listed in the explanation and the amount of the lump sum would be equal to 50% of the lump sum amount listed in the explanation. In addition, the plan would inform the participant that he or she may request the plan to calculate the amount of any split distribution.

This clarification is important because the number of permutations of benefits forms expands dramatically when a participant is permitted to split distributions.

3. QDROs

A QJSA explanation should satisfy the relative value rules if the optional forms are described without regard to any qualified domestic relations order (“QDRO”) or offset, provided that a participant is informed that (a) the explanation does not take into account any QDRO or offset and (b) the plan will, if the participant requests, provide an explanation that does take into account a QDRO or offset. This will permit plans to provide explanations sooner and with less administrative expense.

4. Separate Portions of a Benefit

In some cases, a participant may make elections regarding optional forms of benefit independently with respect to one portion of his or her benefit than another. In such a case, a plan should be permitted to provide a QJSA explanation separately for each portion of the benefit to enable the participant to understand the effect of each independent election.

If, under such circumstances, a plan is not permitted to provide separate QJSA explanations for each portion of the participant's benefit, the information required to be included in the QJSA explanation could be voluminous and uninformative. For example, Company B might purchase Company A and merge Company A's pension plan into Company B's plan. Participant P's benefit is equal to the sum of (a) the benefit accrued as of the date of the plan merger under Company's A plan, plus (b) the benefit accrued after the date of the merger under Company B's plan. There are 10 optional forms available to Participant P with respect to the his benefit under Company A's plan and a different 10 optional forms available to Participant P with respect to his benefit under Company B's plan. If the resulting plan is permitted to provide separate QJSA explanations with respect to the Company A benefit and the Company B benefit, Participant P would receive 20 separate calculations of financial effect and relative value. If on the other hand, the resulting plan must combine all benefits into a single QJSA explanation, Participant P would receive 100 separate calculations of financial effect and relative value. To complicate the situation further, if Company A's plan included Participant P's prior accrued benefit from Company C, for which there were another 10 optional forms, the number of calculations in separate explanations increases to 30, but the number of calculations in a combined statement increases to 1,000. Many large plans have even more complicated structures; the number of calculations in some plans, for some participants, could be several thousand.

Again, we appreciate the opportunity to comment on these proposed regulations and would like to testify at a public hearing. If additional information from us would be helpful, please do not hesitate to contact me.

Sincerely,

A handwritten signature in black ink, appearing to read "Jan Jacobson". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Jan M. Jacobson
Director, Retirement Policy
American Benefits Council