January 12, 2011

COALITION TO PRESERVE THE DEFINED BENEFIT SYSTEM

CC:PA:LPD:PR (REG-132554-08)
Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Additional Rules Regarding Hybrid Retirement Plans

Dear Sir or Madam:

This letter is submitted on behalf of the Coalition to Preserve the Defined Benefit System (the “Coalition”) and the American Benefits Council (the “Council”) with respect to the proposed hybrid plan regulations published on October 19, 2010.

The Coalition is an employer organization with 75 member companies ranging from modest-sized enterprises to some of the largest corporations in the country, all of which sponsor hybrid pension plans. Together the Coalition members provide retirement benefits for more than 1.5 million American workers.

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.

Both the Coalition and the Council request the opportunity to testify at the public hearing scheduled for January 26. Separate outlines of topics will be provided by the organizations.

We commend the Treasury Department and the Internal Revenue Service for the enormous amount of work that went into these regulations. We share your view of the importance of this area, which affects the retirement benefits of millions of Americans. We have the following four overarching comments on the proposed regulations, as well as numerous important technical points discussed below.

- **Market rate of return in general.** The statute requires that interest-crediting rates not exceed a market rate of return. While we agree with the general approach taken in the proposed regulations to specify rates that will be deemed to satisfy that statutory requirement, we strongly disagree with the approach taken to deem all other rates to be

above market and thus in violation of the statute. This approach would, contrary to the statute, treat countless rates available in the market as being above market. There is no basis for this position in the statute. Moreover, as discussed below, this position would, contrary to the statute, force the reduction of many existing interest-crediting rates, to the detriment of participants.

- **Minimum rate and fixed rate.** The proposed 4% minimum and 5% fixed rates are artificially low given the language and intent of the statute and historical rates of return. These artificially low rates of return would have an immediate adverse effect on participants.
- **Application to pre-effective date accruals.** Under the statute, the market rate of return rule applies prospectively. Like the remainder of section 411(b)(5), the rule does not apply retroactively to benefits or interest credits accrued before the effective date. Yet the proposed regulations do not make this clear and leave open the possibility that interest credits accrued before the effective date would need to satisfy the market rate of return rule, a result unsupported by the statute or legislative history.
- **Effective date.** The regulations are proposed to be effective for plan years beginning on or after January 1, 2012. This deadline is not workable given that many hybrid plans would have to be materially changed and some completely redesigned. For example, many plans set their current minimum or fixed interest crediting rate at a level to satisfy the accrual rules (i.e., the anti-backloading rules). If that interest crediting rate must be reduced, the pay credit formula might have to be totally redesigned. The regulations should be effective for plan years beginning after the date that is 12 months after the later of (1) the publication of the final regulations, or (2) the issuance of the needed relief under section 411(d)(6) referenced in the regulatory preamble, in order to provide adequate time for sponsors to study their options and to develop employee communication materials.

It is critical that the above issues and the other issues discussed below be modified in the final regulations.

MARKET RATE OF RETURN.

In General. As noted above, the statute requires that interest crediting rates not be above a "market rate of return." The statute provides the Secretary with regulatory power in this regard. However, the statute ***does not*** authorize the Secretary to provide that only certain specified rates will qualify as market rates, effectively treating countless other rates of return that are available in the market as above market. For example, the proposed regulations treat the rates of return on all collective investment trusts and all separate accounts as being above market; such investment vehicles are clearly available in the market and, from an investment perspective, can be indistinguishable from mutual funds, which are approved in the proposed regulations. In fact, some of the regulations' designated "market rates" are, by design, below market, as they are based on the return on 30-year Treasury bonds, rather than the higher third segment rate; at a minimum, this should be corrected by updating the margins in Reg. § 1.411(b)(5)-1(d)(4)(ii) to reflect the switch from 30-year Treasury bonds to the third segment rate.

In short, we agree that the regulations should provide safe harbor rates based on the various bond yields and CPI; additional safe harbors based on widely recognized indices (e.g., the S&P 500 Index) would also be very appropriate and helpful. But the regulations should also provide general rules for acceptable rates based on returns available in the market, only one example of which is mutual funds.

Moreover, the proposed regulations are inconsistent with other regulatory guidance regarding market rates of returns. See, e.g., Reg. §§ 1.409A-1(o); 31.3121(v)(2)-1(d)(2). For example, such regulations permit rates of return based on the rate of return on a predetermined actual investment, without limiting the range of such investments. The only difference is that in the context of hybrid plans, Congress provided specific rules regarding minimum rates of return that would not cause a plan's rate of return to exceed a market rate.

The restrictive approach included in the proposed regulations will invalidate many interest crediting rates that are based on market rates, requiring participants' benefits to be reduced. As discussed below, this is especially true with regard to fixed rates of return and minimum rates of return. The regulations should be modified to follow the statute. Any rate of return available in the market, regardless of volatility, is by definition a market rate of return. In addition, as noted, we support the provision of regulatory safe harbors, including specific minimum rates of return and a specified fixed rate of return.

4% Minimum Rate. The statute provides that:

> A plan shall not be treated as failing to meet the requirements of this subclause merely because the plan provides for a reasonable minimum guaranteed rate of return or for a rate of return that is equal to the greater of a fixed or variable rate of return.

Congress clearly intended that this language be interpreted so that a reasonable minimum rate of return does not affect the ability of an otherwise market rate of return to qualify as a market rate of return. Instead, the proposed regulations interpret the above-quoted sentence as a virtual nullity, which is clearly contrary to the basic principles of statutory construction. See, e.g., TRW Inc. v. Andrews, 534 U.S. 19, 31 (2001) ("It is a cardinal principle of statutory construction that a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant." (internal quotation marks omitted)). The proposed regulations effectively interpret the above-quoted sentence to provide that if an interest crediting rate with a minimum is in the aggregate a market rate of return, the existence of the minimum will not cause the interest crediting rate to fail to be treated as a market rate. Under that interpretation, the above-quoted sentence would have no effect.

The regulatory preamble articulates the thinking behind the proposed 4% level, stating that the "Treasury Department and the IRS have modeled the historical distribution of rates of interest on long-term investment grade corporate bonds and have determined that those rates have only infrequently been lower than 4% and, when lower, were generally lower by small amounts and for limited durations." Such an approach is fundamentally inconsistent with the

concept of a reasonable minimum and instead creates an "immaterial" minimum based on the erroneous interpretation of the statute described above.

As noted, this statutory interpretation has led Treasury and the Service to create an artificially low minimum crediting rate of 4%. We recommend increasing the minimum to at least 5%. At 4%, Towers Watson, which has with a database of over 400 hybrid plans, estimated that over 50% of plans with a minimum rate of return will need to reduce their minimum interest credits under the proposed regulations. This will reduce interest credits and require plan redesigns that in this economic climate will almost certainly reduce future principal credits and may even result in plan freezes. So the artificially low minimum rate of return will have an immediate and adverse effect on participants.

Clearly, this is not what the statute calls for. We believe that a 5% or higher permissible minimum rate would better meet the "reasonable" concept in the statute. We offer several points in support of this view based on an historical analysis performed by Towers Watson.

- Since its initial publication, the third segment rate has averaged about 6.5%, rarely dropped below 6% and never dropped below 5%. The pattern of current liability rates was similar, although the rates were somewhat lower as would be expected due to the different definition. The application of a 5% minimum to the third segment rate would have had no effect, and the application of a 6% minimum would have had a minimal effect. Note that although the period of this analysis is relatively short, it is characterized by historically low interest rates. The effect during more typical historical periods would be even smaller.

- Towers Watson studied the average of annual long-term Aaa-rated and Baa-rated Corporate rates as a proxy for the third segment rate. This series had not been as low as 4% since the 1950s, and had not been as low as 5% since the 1960s. For January-October 2010, this average is 5.49% – the only year since the 1960s that it has been less than 5.50%.

- Towers Watson calculated the current balance of a hypothetical account, established with $100 in 1960, that had been credited interest for fifty years at this corporate rate. Towers Watson applied varying levels of minimum rates to determine the impact that they would have had.

    - No minimum $5,268
    - 4% minimum $5,268 (0.0% value to minimum)
    - 5% minimum $5,367 (applied in 6 years, 1.9% total value of minimum)
    - 5.5% minimum $5,528 (applied in 8 years, 4.9% total value of minimum)

The proposed regulations have based the 4% threshold on historical analysis. We believe that such an analysis would, on the contrary, support the establishment of a substantially higher threshold minimum level.

Towers Watson also used risk-neutral valuation, an accepted technique of financial economics, to value the subsidy that would have resulted from incorporating minimum interest rates in an interest credit that was based on long-term high-quality corporate bond yields.

Since an interest credit based on such corporate rates alone is deemed to be at market, the current value of an account with a notional balance of $100 is $100. Introducing minimum interest rates at higher levels could increase this value. The amount of the increment reflects the probability and magnitude of the effect of the minimum.

Towers Watson applied these minimum rates on an annual basis. Their value is larger if the account is to earn interest for longer period, so Towers Watson performed the analysis over several different time horizons:

	No minimum	4% minimum	5% minimum	5.5% minimum
5 years	$100	$100.02	$100.16	$100.37
10 years	$100	$100.19	$100.74	$101.33
15 years	$100	$100.50	$101.59	$102.65
20 years	$100	$100.88	$102.56	$104.11
25 years	$100	$101.24	$103.50	$105.54
30 years	$100	$101.62	$104.46	$107.00

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The minimum rate of interest that these results support as reasonable is, of course, a subjective issue, but the above analysis indicates strongly that 4% is generally immaterial. We believe that even over long periods a 5% or 5.5% minimum is consistent with the "reasonable" specification of the statute.

We and Towers Watson would be pleased to provide greater detail on the analytical techniques and the assumptions used. We would also be pleased to perform additional analyses using alternative assumption sets if that would be helpful to the deliberations.

5% fixed rate. We recommend increasing the level of the stand-alone fixed rate to 6% or higher consistent with our proposed increases to the minimum rate. Support for this recommendation follows.

The history of the third segment rate and current liability rates, as well as broader data on corporate bonds yields far exceeding 6% for decades, indicate that a fixed rate of 6% does not exceed a market rate. In our view, any analysis of relevant data will result in the conclusion that a 6% rate is not expected to be above long-term corporate yields for anything other than short periods of time.

Towers Watson repeated the analysis performed above to determine the value of an investment yielding a fixed credit for varying periods of time. The results are shown in the table below, with a value of $100 essentially indicating a market rate.

	5%	5.5%	6%	6.5%
5 years	$97.71	$100.05	$102.45	$104.89
10 years	$92.19	$96.67	$101.35	$106.24
15 years	$86.75	$93.16	$100.00	$107.32
20 years	$81.79	$89.95	$98.87	$108.62
25 years	$77.37	$87.13	$98.07	$110.31
30 years	$72.79	$83.94	$96.73	$111.40

These results strongly suggest that a fixed rate of at least 6% should meet the market rate criteria. If the 5% rate is retained, Towers Watson's database indicated that 30% of plans with a fixed rate of return will need to reduce their interest crediting rate, having the same immediate adverse effect on participants described above.

Application of Market Rate of Return Requirement to Pre-Effective Date Accrued Benefits. Under the statute, the market rate of return rule applies prospectively. Like the remainder of section 411(b)(5), the rule does not apply retroactively to benefits or interest credits accrued before the effective date. Yet the proposed regulations do not make this clear and leave open the possibility that interest credits accrued before the effective date would need to satisfy the market rate of return rule, a result unsupported by the statute or legislative history.

This expansion beyond the statute will reduce benefits never intended by Congress to be reduced. We strongly urge Treasury and the Service to clarify that the market rate of return rule only applies to interest credits on post-effective date accruals.

Participant-Directed Interest Credits. The preamble raises a number of questions regarding participant-directed interest credits, where participants can chose their interest crediting rate from a plan menu of available interest-crediting rates. First, there is the question as to whether a participant's election to change interest crediting rates on an existing account balance would cause an impermissible cutback under section 411(d)(6) or an impermissible forfeiture.

We strongly believe that elections by participants should be permitted. There should be no prohibited cutback or forfeiture for four reasons. First, participants were never promised a single interest credit rate. They were simply promised a choice, and nothing has been taken away when they exercise the choice. Second, it is clear that a participant can elect one optional form of benefit and thereby "waive" other protected optional forms of benefit. Why shouldn't the same analysis apply here? Third, there is not a violation of section 411(d)(6) because the change in interest rate is attributable to a participant's election, not to a plan amendment. Fourth, it is critical to remember that the anti-cutback and forfeiture rules were established to protect participants, not to restrict them. To interpret those rules to deprive participants of valuable rights to select their own crediting rate would do a great disservice to the purpose of the rules and to participants.

If each option offered under a participant-directed arrangement satisfies the market rate of return rule (as modified to reflect our comments), the arrangement should be treated as

satisfying such rule. The market offers an enormous array of market returns; there is no reason that a plan may not do the same.

Modifying Interest Crediting Bases. We believe that the regulations need to address situations where an interest crediting rate or option is changed. For example, an interest crediting rate or option might be deleted if (1) the basis ceases to exist, or (2) the plan sponsor decides that the interest-crediting basis should be deleted for other valid reasons (such as underperformance or a change in the investment policy underlying the basis). In such cases, the anti-cutback and forfeiture rules should be treated as satisfied if, with advance notice, the deleted basis is replaced with any permissible market rate basis that (1) is in the same general investment class, i.e., equity or fixed income, (2) has a similar risk profile, or, if the deleted basis had a very high risk profile, a slightly more conservative risk profile, (3) in the case of fixed-income bases, does not have a materially shorter duration, and (4) in the case of a basis with a floor or basis point margin, has the same or greater floor or margin, unless it is clear under the circumstances that such same floor or margin is not appropriate. This is a workable system that protects participants without creating a labyrinth of complex rules.

Modifying Above-Market Interest Crediting Rates. Under the regulatory standard, above market rates of return must be reduced to market, but may not be reduced more than necessary to be at market. As discussed above, we do not believe this should be an issue at all because the effective date (and no inference provisions) of the statute indicate that the market rate of return limitations apply only to post-effective date principal credits. Thus, we believe that the potential for enormous complexity can be avoided. If, nevertheless, the IRS and Treasury conclude that the market interest rate provisions do apply to pre-effective date accruals, we recommend that the regulations articulate the general rule that interest crediting rates may not be reduced more than is necessary to comply with the market rate of return rule. In addition, the law should set forth the following very simple safe harbors. If any rate of return is not specifically listed as a market rate of return under the regulations, such rate may be modified to be any of the following:

- The third segment rate (as defined in the regulations, i.e., the third segment rate described in section 417(e)(3)(D) or 430(h)(2)(C)(iii));
- The maximum fixed rate of return specified in the regulations; or
- Where the plan's minimum rate caused the rate to be above market under the regulations, the same rate of return as was in effect, but with the highest minimum rate of return permitted under the regulations.

In the case of participant-directed plans that have two or more rates that are not specifically listed as market rates of return, the regulations should permit plans a one-time option prior to the regulatory effective date to replace the participant-directed system with one of the first two safe harbor rates listed above. Where the market rate rules require numerous adjustments to a participant-directed arrangement, the rationale for having a participant-directed arrangement may be undermined.

In addition, where an interest-crediting rate must be reduced, it may be necessary or appropriate to modify the stability and/or lookback periods. The section 411(d)(6) relief should permit such modifications.

Finally, the section 411(d)(6) relief should clarify that there is no need to grandfather existing benefits based on the interest-crediting rate being replaced.

Past Periods. We urge Treasury and the Service to provide that a good faith interpretation of the statutory market rate of return rule shall be deemed to be in compliance with the law prior to the regulatory effective date. Due to the anti-cutback rules, plan sponsors with rates of return that were arguably at market could not reduce those rates without guidance. In that context, the law would be placing plan sponsors in an impossible position if such rates were not protected prior to the regulatory effective date.

Also, it should be clarified that any prospective interest crediting rate changes should not affect past compliance with the backloading or nondiscrimination rules.

Rate of Return on Plan Assets. In the case of a plan that uses the rate of return on plan assets as its interest-crediting rate, it should be clarified that modifications of the plan's investment strategy does not constitute a change in interest crediting rate subject to section 411(d)(6). Any other rule would render the regulatory provision unworkable since plan investment strategies are constantly being reviewed and adjusted. In addition, it should be clarified that a plan does not violate the definitely determinable requirement by reason of basing the interest-crediting rate on the rate of return on plan assets.

Averaging Over Time. We urge you to permit rates to be based on the average of otherwise permissible market rates over a prior period of up to 20 years. Such an approach has key advantages. First, rates become far more predictable both for participants and for plan sponsors. In this regard, it should be permissible not only to use averages of variable rates, but also to use stand-alone fixed rates that are based on extended lookback periods and that need only be reevaluated and reset periodically. Second, if extended averages used, brief market fluctuations and anomalies cannot materially distort interest crediting rates. Third, this approach can address the issue raised in the preamble regarding the backloading problems that can arise if an equity-based crediting rate is temporarily negative; it is far less likely for an averaged rate to be negative.

Backloading. We strongly urge you to adopt a long-term averaging approach for purposes of backloading testing and other qualification rules, even if it is not adopted for purposes of the market rate of return rules. If a plan's interest crediting rate has averaged 7% over 20 years, for example, but was -2% in the most recent year, it makes no sense to project the -2% or even a zero percent rate of return as the plan's return for backloading purposes and other qualification issues. At least, if the plan has a minimum crediting rate of, for example, 3%, the rate used for projection purposes should equal at least 3%. But we truly believe that an historical average provides the most appropriate basis for projecting returns.

A safe harbor rate of return would also be extremely helpful, as it would enable backloading testing to be done on a design basis, rather than on an operational basis. The safe harbor could be set at the lesser of 5% (our recommended minimum rate of return) or the plan's fixed or maximum rate of return.

Averaging Current Rates. The final regulations permit the use of different market rates with respect to different predetermined portions of an accumulated benefit. It should be clarified that this would similarly permit the use of a single blended rate consisting of two or more market rates, including, for example, a plan's effective interest rate for funding purposes, which is a blend of the first, second, and third segment rates. In addition, it should be clarified that using different permissible rates at different times should be permitted, such as a pension equity plan that provides post-termination of employment interest at the first segment rate for the first five years, at the second segment rate for the next 15 years, and at the third segment rate thereafter.

WHIPSAW ISSUES.

Early Retirement Subsidies. The proposed regulations contain criteria for whipsaw relief for non-single sum forms of benefit (i.e., benefits other than a single payment equal to the then-current balance of the hypothetical account or the accumulated percentage of the participant's final average compensation). First, it seems clear that Congress intended to eliminate whipsaw as it found its consequences to be highly problematic. We therefore object to the notion that whipsaw is required unless certain conditions for relief are satisfied. In that regard, the remainder of our whipsaw-related comments are based on the assumption that contrary to Congressional intent, the regulations retain conditions on whipsaw relief.

While we found the language in the proposed regulations to be unclear, our hope is that the primary intention of this section is to confirm that annuities prior to normal retirement can be determined directly from the account balance as opposed to requiring them to be based on the projected accrued normal retirement benefit. Such confirmation would be critical as the vast majority of hybrid plans determine benefits in this manner. However, the requirement in the proposed regulations that undefined reasonable assumptions be used and that the value of the optional form be equal to that of the account balance could have consequences that are not desirable in our view and, we suspect, were not intended.

The proposed regulations can be read to suggest that there is no ability to subsidize benefits at any age or in any form. The ability to encourage annuity elections is very good retirement policy that should be facilitated not discouraged by the IRS and Treasury.

Hybrid plans should be able to subsidize early retirement annuities relative to the normal retirement annuities, just like traditional plans. A traditional plan can, for example, pay an unreduced early retirement benefit and/or subsidize the qualified joint and survivor annuity (QJSA). The value of such a subsidy need not be reflected in any lump sum offered by the plan. Under the proposal as written, a hybrid plan would appear to have no ability to do this, especially if the reasonable assumption requirement is interpreted as requiring the same set of reasonable assumptions to demonstrate compliance for all forms and ages.

We respectfully suggest that the proposal be modified to clarify that subsidies are permitted and need not be included in the account balance or lump sum. This can be accomplished by simply modifying the proposal to require that optional forms and immediate annuities be at least the actuarial equivalent of the account using reasonable assumptions as opposed to equal to the actuarial equivalent. Alternatively, this could also be remedied by simply stating that it is permissible to determine early retirement benefits and optional forms from the account balance rather than the accrued benefit and rely on existing rules, which apply to all plans, regarding the relationships between such benefits and the accrued benefit to ensure compliance. Under the proposed regulations, the early retirement benefit would be limited to the accrued benefit (determined using reasonable actuarial assumptions about future interest credits and annuity conversions) regardless of what the account produced as an annuity. If precluding hybrid plans from subsidizing early retirement annuities or optional forms was indeed the intent, we would strenuously object as there is no basis in the statute or any good policy reason to impose such restrictions on hybrid plans. There is no reason, for example, that a plan should not be able to convert hybrid benefits into immediate annuities using an interest rate such as 8%.

The approach of relying on existing rules to limit subsidies would be preferable as early retirement subsidies can take many forms in hybrid plans. For example, some plans might convert the account into an annuity at early retirement ages using a higher interest rate than at normal retirement, subject to the limitation that the resulting annuity is never more than the accrued benefit. We believe that this approach should not be problematic; however, the higher interest rate, in isolation, might not be viewed as reasonable. We would disagree with this latter point and would characterize the excess of the interest rate over that used to convert the account at normal retirement as an early retirement subsidy that should be disregarded when determining if the resulting benefit is permissible.

Flat Factors. Some plans use "flat" factors (i.e., that do not change due to interest rate changes and may or may not vary by age) to convert accounts to immediate annuities for a variety of reasons including ease of understanding for plan participants, simplification of plan administration, benefit and cost predictability, and provision of subsidies for early retirement or for an annuity form of distribution. This is similar to providing an unreduced benefit and should be permitted, yet it might be difficult to find reasonable assumptions that could support this approach (and impossible to do so if the same reasonable assumptions were required to be used at all ages). We believe that regulations should accommodate the use of reasonable flat factors.

Reasonableness of Assumptions. For the majority of plans that can meet the reasonable assumption requirement, it is critical that the reasonableness of the factors be determined based on either the time adopted or over a long period. Fluctuations in economic conditions should not affect a plan's eligibility for the statutory whipsaw clarification.

Other rates that are prescribed in pension regulations should be deemed to be reasonable, such as the rate used to adjust section 415 limits and the rates used to normalize benefits for nondiscrimination testing. It would seem inappropriate to require the use of an interest rate for certain purposes yet view that rate as unreasonable for other closely related purposes.

Guidance on reasonable assumptions is particularly important for the issue of determining benefits at normal retirement. Since actuarial equivalence between the accrued benefit and the account at normal retirement is the key to whipsaw relief, sponsors will want assurances that the basis on which they perform this calculation will be viewed as reasonable. Clearly, the section 417(e) assumptions would be reasonable but the regulations allow for the use of any reasonable assumptions. We request guidance that will assist sponsors in evaluating what alternative assumptions would also be viewed as reasonable for this purpose. We would also request that the regulations provide anti-cutback protection when a plan changes assumptions that are no longer deemed reasonable to assumptions that are reasonable to avoid losing whipsaw relief.

Effect of Not Meeting Requirements. With respect to whipsaw relief being applicable separately to lump sums, early retirement annuities and optional forms, we request guidance on what it means for a plan to meet the requirements in one situation and not another. If our suggestions above are followed and the relief for annuities simply becomes a statement that it is acceptable to base these amounts on the account balance, then we believe that this issue no longer exists. If this is not the case, however, does failing to meet the relief criteria for any form of benefit mean that no benefit (regardless of form) can be paid without performing a whipsaw calculation? Would this apply to an individual or on a plan-wide basis, such that failure of any form for any individual would require whipsaw calculations to be performed for all participants? These results seem unreasonable and we would suggest that any requirements to perform whipsaw calculations be applied narrowly to those instances where the criteria are not met.

Plans That Eliminated Whipsaw But Do Not Meet New Criteria. Many plans have eliminated whipsaw calculations due to the Pension Protection Act of 2006 ("PPA") section 1107 deadline to do so with anti-cutback protection and the absence of any requirements for that relief other than being a lump-sum based plan. Some such plans may find that they have difficulty meeting the newly proposed requirements for that relief. Such plans should be afforded the ability to amend their plans to qualify for the relief with the provision that any required anti-cutback protection resulting from the change would not disqualify them for whipsaw relief. Furthermore, the final regulations should explicitly state that there are no compliance issues associated with plans eliminating whipsaw for the period prior to the effective date of the final regulations as they were not subject to the conditions in these proposed regulations and were covered with respect to section 411(d)(6) by PPA section 1107.

"Greater of" and "Sum of". We believe that examples illustrating the intent of these sections of the proposed regulations would be very helpful.

Extension of period to eliminate whipsaw. Many plan sponsors have refrained from amending their plans because they wanted to make needed changes all at one time after all the rules are known, so as to best assess their options. This is an eminently reasonable approach which should be accommodated by extending the period during which whipsaw calculations may be removed without violating the anti-cutback rules to the date the final regulations become effective.

PENSION EQUITY PLAN (PEP) ISSUES.

The preamble states that a PEP that does not credit explicit interest after termination and instead converts the then-current account into immediate and deferred annuities is a lump-sum based plan during the period of PEP accruals and is not a lump-sum based plan thereafter. As a result, the preamble says that such a plan will be eligible for whipsaw relief during the period of PEP accruals but ineligible for such relief afterwards. We urge Treasury and the Service to revisit this conclusion. The treatment of a plan as a lump-sum based plan is based on the plan's accrual pattern. A PEP that fully satisfies the statutorily required standards for treatment as a lump-sum based plan during the accrual period should not lose that status by reason of anything that happens during the post-accrual period that is not even referenced in the statute. Such a PEP would fit squarely within the statutory definition of an "applicable defined benefit plan", since the accrued benefit is based on "an accumulated percentage of the participant's final average compensation".

If Treasury and the Service retain their current position, however, we ask that you clarify that, of course, all relief applicable to lump-sum based plans, such as under section 411(b)(5), would apply to the accruals under a PEP that does not credit explicit interest post-termination of employment. Any other result would disregard Congress' clear intent. With respect to such a PEP, we could also ask that you confirm that a plan that does not credit explicit interest post-termination of employment is eligible for whipsaw relief if it pays the account balance within a reasonable period after termination of employment (assuming it otherwise meets the criteria for such relief). In this regard, we would also request clarification that such relief would not be lost if the plan afforded the participant a reasonable period within which to make a lump sum election (such as six months), during which time a lump sum equal to the PEP balance could be paid (and during which interest may or may not be credited).

We also request confirmation that, under a plan that does not credit explicit interest post-termination of employment, future annuities determined as the actuarial equivalent, using reasonable assumptions, of the account balance at separation are acceptable – that is, they are either covered by or do not require any whipsaw relief. We also request that you confirm that this situation applies even when the conversion process involves projecting an account to future dates with interest that is locked in at cessation of accruals. Such a plan does not explicitly credit interest nor maintain accounts after cessation of accruals so we believe this approach is no different than using an actuarial factor to convert the account into annuities and thus should be treated in the same way. In such a situation, we would also request confirmation that the actuarial factors being used in this process are subject to a reasonableness standard, but not the market return standard.

One of the proposed requirements for whipsaw relief is "…the balance of the hypothetical account or accumulated percentage of the participant's final average compensation may not be reduced except as a result of…". Please confirm that the requirement for PEPs is only that the percentage of the participant's final average compensation not be reduced, other than for permitted reasons. Declines in final average compensation can possibly cause declines in the dollar value of a PEP account but this should not be a reason to withhold whipsaw relief.

POST-NORMAL RETIREMENT ACCRUALS.

The proposed regulations provide that lump-sum based benefit formulas must provide actuarial increases, or properly suspend benefits, if the sum of interest credits and principal credits is not otherwise sufficient to provide "any required actuarial increases" under section 411(a)(2). We agree that statutory hybrid plans are subject to the same requirement to pay benefits at normal retirement date (NRD), to properly suspend them, or to provide actuarial increases, as other plans.

Regulatory guidance has not been provided with respect to many aspects of the suspension of benefits rules, most importantly including what level of increase would meet the "required actuarial increase", and thus actual practice varies, both with respect to lump-sum based benefit formulas and other formulas.

More specific guidance as to what constitutes a "required actuarial increase" would be helpful. However, any such guidance should be prospective only and subject to public comment, in recognition of the varying practices plan sponsors have adopted in a reasonable good faith effort to comply. In particular, plan sponsors whose plans provide that benefits will not begin before termination of employment, and who did not provide suspension of benefits notices because they reasonably believed that their plan design (e.g., continued interest credits and principal credits post-NRD) provided the required actuarial increases, but whose interest crediting rate is judged under final regulations not to provide a reasonable actuarial increase, should be permitted to begin issuing suspension of benefits notices prospectively, without a need to provide additional actuarial increases for periods before the final regulations become effective. In addition, should any plan, as a result of new guidance, be required to retroactively provide actuarial increases not previously provided by the plan (because they were reasonably expected not to be required), the plan should be permitted to provide only the greater of actuarial increases and continued accruals rather than providing both, merely because the plan document did not discuss actuarial increases, and therefore did not provide that continued accruals would be reduced by actuarial increases.

PLAN TERMINATIONS.

We have concerns about the workability of the proposed rule requiring the use of the third segment rate in certain circumstances. We would urge Treasury and the Service to determine the feasibility of obtaining annuities at a manageable cost based on such a rate. Establishing an unworkable standard will hurt the retirement plan system and can only add to PBGC's burden.

EFFECTIVE DATE.

The proposed regulations will require very significant amounts of work and planning. A large number of plans will have to reduce interest crediting rates, triggering difficult employee relations and communications issues. Some companies may look at replacing lost interest credits with other benefits.

For many other companies, far more work will be required. The entire plan will have to be redesigned—or may well be frozen—since the plan formula may depend on the interest-

crediting level to satisfy the backloading rules. To require that all of this be done in perhaps a few months is not workable.

A minimum of 12 months is needed to modify plans in accordance with these regulations. Accordingly, we ask that the effective date be plan years beginning after the date that is 12 months after the later of (1) the date final regulations are published or (2) the issuance of the section 411(b)(6) relief referenced in the regulatory preamble.

We very much appreciate the opportunity to comment on these critical issues. If further information on any of these issues would be helpful, please contact Jamey Delaplane (jmdelaplane@davis-harman.com, 202-347-2230, for the Coalition) or Jan Jacobson (jjacobson@abcstaff.org, 202-289-6700, for the Council).

Coalition to Preserve the Defined Benefit System American Benefits Council