



AMERICAN BENEFITS

COUNCIL

February 23, 2017

CC:PA:LPD:PR (REG-107424-12)
Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 2044

RE: Update to Minimum Present Value Requirements for Defined Benefit Plan Distributions

Dear Sir or Madam:

On behalf of the American Benefits Council (the "Council"), I am writing regarding the proposed regulations under Code Section 417(e) with respect to the minimum present value requirements for defined benefit plans, as published in the Federal Register on November 25, 2016.

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 preamble to the regulation describes the purpose of the proposed regulation as follows:

[T]he proposed regulations would update the regulations for changes made by PPA '06 and to eliminate certain obsolete provisions. The proposed regulations also contain a few other clarifying changes.

We support the clarifications and updating provided in the proposed regulations,

but we would note that the proposed regulation could inadvertently impose some major and costly new obligations. Specifically, as discussed below:

- The possibility of requiring lump sums to be based on a subsidized early retirement benefit would be in effect a major government-required benefit increase, which is inconsistent with current law.
- The proposed treatment of social security level income options and post-normal retirement age benefits would similarly impose major new obligations on employers, without a basis in the law.
- The treatment of employee-derived benefits is, as noted in the preamble, inconsistent with prior guidance and would impose material costs to plans.

In addition, important clarifications are needed to the proposed regulations, as discussed below, regarding:

- The designation of lookback months and stability periods, and
- Ensuring compliance with the rule requiring qualified joint and survivor annuities (“QJSAs”) to be at least as valuable as any other optional form of benefit.

REQUEST FOR COMMENTS ON ASSUMPTIONS WHERE A PLAN PROVIDES A SUBSIDY

The preamble to the proposed regulations requests comments on:

whether, in the case of a plan that provides a subsidized annuity payable upon early retirement and determines a single-sum distribution as the present value of the early retirement annuity, the present value determination should be required to be calculated using the applicable interest rate and applicable mortality table applied to the early retirement annuity (or whether the requirement to have a minimum present value that is equal to the present value of the annuity payable at normal retirement age determined in accordance with Section 417(e)(3) provides the level of protection for the participant that is required by Section 417(e)(3)).

Under current law, there are different views on how to value the lump sum in this situation. In our view, the lump sum may be determined as the greater of (1) the lump sum value of the early retirement benefit, using any permissible assumptions specified under the plan, or (2) the lump sum value of the normal retirement benefit using the 417(e)(3) assumptions. This view is based on the regulations, which state that “the present value of any optional form of benefit cannot be less than the present value of the

normal retirement benefit determined in accordance with [the Section 417(e)(3) assumptions].”

We understand that, on the other hand, the IRS may have informally taken the position that in this situation the early retirement benefit must also be valued using Section 417(e)(3) assumptions.

We strongly believe that the regulations should confirm our view of the law. Employers have made binding decisions regarding benefit and subsidy levels based on their view of the rule. Collective bargaining agreements have been entered into based on this well-founded view. Any change would be in effect a government-required benefit increase never contemplated by any party, and could have severe effects on funding levels, business decisions made based on current law funding levels, and the applicability of benefit restrictions under Code Section 436 (which could prohibit the very lump sums being “protected”).¹

QJSA MOST VALUABLE ISSUE

Regulation §1.401(a)-20 Q&A-16 provides as follows:

A plan does not fail to satisfy the [requirement that in the case of a married participant, the QJSA must be at least as valuable as any other optional form of benefit] merely because the amount payable under an optional form of benefit that is subject to the minimum present value requirement of Section 417(e)(3) is calculated using the applicable interest rate (and, for periods when required, the applicable mortality table) under Section 417(e)(3).

Under the proposed regulation, pre-retirement mortality is taken into account in applying the applicable mortality table. We would ask you to clarify that for purposes of the exception to the “at least as valuable as the QJSA” rule (“QJSA Value Rule”), pre-retirement mortality may be disregarded. If this clarification is not adopted, employers that provide the more valuable lump sum could find themselves in violation of the QJSA Value Rule with no way to cure that violation (since anti-cutback relief is not available). We assume that Treasury did not intend to mandate impermissible benefit decreases, so we ask that this clarification be provided.

This same clarification is needed for all plans that have grandfathered to any extent prior law interest rates or mortality tables to avoid reducing lump sums to participants. See, e.g., IRS Notice 2008-30 Q&A-16 on grandfathering pre-Pension Protection Act interest and mortality assumptions.

¹ For those employers who amended their plans to follow the informal IRS guidance, we ask for anti-cutback relief to allow them to use the rule we advocate for in the text.

A similar clarification is needed for hybrid plans that pay the account balance or accumulated percentage, as permitted under Code Section 411(a)(13)(A).

APPLICABILITY OF ANTI-CUTBACK RELIEF

Background for First Issue

Code Section 417(e) provides a ceiling on the interest rates that can be used to value distributions, such as lump sum distributions. But employers are permitted to establish lower interest rates by, for example, providing that distributions will be valued using the lesser of the “applicable interest rate” (as defined in Code Section 417(e)(3)(C)) or a specified other rate.

Some employers have used this ability to use a lower interest rate to, for example, grandfather benefits from changes in the applicable interest rate under Code Section 417(e). Specifically, the Retirement Protection Act of 1994 (“RPA”) changed the Section 417(e) rate from a rate based on the PBGC interest rate to the 30-year Treasury rate. Subsequently, the Pension Protection Act of 2006 changed the Section 417(e) rate to the first, second, and third segment rates. To avoid reducing benefits, some employers grandfathered existing benefits from these changes. Plans maintained by such employers may provide that (1) benefits earned before the effective date of a change in the law are valued using the greater of the value under the plan’s old assumptions or the value under the new assumptions under Section 417(e)(3), and (2) benefits earned on or after the effective date of the change in the law are valued using the new Section 417(e)(3) assumptions. And many employers went further by applying the “greater of” approach in #1 above to participants’ entire benefit.

Other companies have simply picked a different set of assumptions and provide a value equal to the greater of the value using the plan’s assumptions or the value under the assumptions under Section 417(e)(3).

First Issue

Employers in these situations may want to change the date for determining their non-417(e)(3) interest rates, such as the PBGC-based interest rate and/or the 30-year Treasury rate to, for example, an earlier date so as to facilitate communications to participants well before the beginning of the plan year. The change would be to a lookback month that is permitted under Proposed Regulation §1.417(e)-1(d)(4)(iv). Under specified circumstances, this is permitted for the “applicable interest rate” under Proposed Regulation §1.417(e)-1(d)(9)(ii).

We would ask you to amend the regulation to provide that the option to change the

lookback month is permitted for not just the segment rates, but also the 30-year Treasury rate, PBGC-based rates, or any other rates used by the plan.

In conjunction with the change above, we also ask that if the lookback period for a non-417(e)(3) rate, such as the PBGC or 30-year Treasury rate, is changed, there be no requirement (as is currently in place when changing the applicable interest rate lookback month) that lump sums paid during the subsequent year be based on the greater of the old and new basis. This suggestion is in no way aimed at reducing benefits. Our concern is the complexity of the one-year rule requiring multiple calculations. So, one approach would be to require that a change in the lookback period have a one year delay in effective date. This would reduce administrative complexity, and similarly protect employees from changes for a year.

Please consider that not allowing the added flexibility outlined above, especially in the third preceding paragraph, would actually penalize employers that have taken the pro-participant step of (1) grandfathering benefits under the often more generous assumptions in effect when the benefits were earned, (2) grandfathering these assumptions for all benefits, or (3) providing an alternative valuation methodology that can only provide equal or greater benefits.

Second Issue

We also ask that all anti-cutback relief regarding lookback months and stability periods be extended beyond distribution options subject to Section 417(e) and be applicable with respect to any use of a plan's 417(e) interest and mortality assumptions. For example, a plan might use its Section 417(e) actuarial factors to convert cash balance accounts into annuities. We see no reason why a change in the lookback month or stability period for this purpose or any other non-417(e) purpose should not have the same anti-cutback relief as is applicable to Section 417(e) distribution options. There is no opportunity to game the system, since there is no way to predict future interest rate patterns, for example.

SOCIAL SECURITY LEVEL INCOME OPTIONS

We see no basis in the law for the position in the proposed regulations, which would apply Section 417(e)(3) to the entire social security level income option ("SSLI"). Section 417(e)(3) should only apply to the value of the social security leveling portion of the benefit, not the underlying ongoing lifetime annuity benefit. In other words, the determination of the level annuity amount payable before and after social security benefits commence should be made based on otherwise applicable plan actuarial factors, not Section 417(e)(3). There is no justification for applying Section 417(e) to this benefit, which is effectively a level annuity that qualifies for the exception from Section 417(e)(3). Then the value of the excess benefit payable until social security benefits

commence should be valued using Section 417(e)(3).

The recently finalized regulations on bifurcated benefits included this logical approach but specifically limited to lump sums. The suggestion here would be to also allow the same logical approach for SSLIs (or any other option).

Without this type of adjustment to the proposed regulations, plans would be required to adjust benefits in a way that does not make sense. For example, one of our members, an actuarial firm, has sent us the following example of the effect of the proposed position:

The benefit under a plan is \$5,000, as a life annuity at age 62 using plan actuarial equivalents. If the plan has an SSLI and Section 417(e)(3) is applied to the SSLI, the life annuity is \$7,554 until 65 and then \$5,054.

In other words, by electing an SSLI, the participant would not only receive a pre-65 enhanced benefit, the participant would also receive a higher level of post-65 benefits. This illustrates clearly the inappropriateness of the proposed position.

LATE RETIREMENT BENEFITS

The requirement to take pre-retirement mortality into account could have very concerning effects after normal retirement age. This issue is not directly addressed in the proposed regulations, but we fear that the logical extension of the proposed regulations could affect late retirement benefits.

Except to the extent that the exceptions for employee-derived benefits or suspension of benefits apply, the requirement to take pre-retirement mortality into account could mean that plans must actuarially increase benefits for mortality after normal retirement age, even if the plan provides a full pre-retirement death benefit. This would have the effect of raising benefits for plans across the country, purely by reason of a new interpretation of the law that had never been formally discussed before.

If a plan provides that the accrued benefit will be paid at death pre-retirement, then why shouldn't that plan term be taken into account in determining the amount of any lump sum that is payable? In other words, the issue is whether the lump sum should be increased post-normal retirement age to reflect the fact that the participant ran the risk of not receiving his or her accrued benefit by delaying receipt of the lump sum. Where the accrued benefit is actually payable upon death, the participant is not running that risk. And the fact that the right to the death benefit has not technically accrued does not negate the fact that the accrued benefit is payable on death. This should be taken into account in determining the present value of benefits, so that the lump sum is not increased for pre-retirement mortality.


We ask that the mortality discount portion of the regulation (including the heading to Regulation §1.417(e)-1(d)(2)) be clarified so that that portion only applies to pre-normal retirement age benefits.

EMPLOYEE-PROVIDED BENEFITS

We understand the change reflected in the proposed regulations for employee-provided benefits. But we would highlight the point made in the preamble that this is a new and significant rule that is inconsistent with prior guidance, i.e., Revenue Ruling 89-60. In this context, again, the proposed regulations break new ground in imposing new benefit obligations on employers. This is inconsistent with the stated purpose of simply updating and clarifying the regulations. The position in Revenue Ruling 89-60 should be preserved.

We thank you for your consideration of the issues addressed in this letter.

Sincerely,

A handwritten signature in black ink, appearing to read "Jan Jacobson", written in a cursive style.

Jan Jacobson
Senior Counsel, Retirement Policy

cc: Lisa Beard-Niemann
Kyle Brown
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