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Submitted via regulations.gov

CC:PA:LPD:PR (REG-125761-14)
Room 5203
Internal Revenue Service
POB 7604
Ben Franklin Station
Washington, DC 20044

Dear Sir or Madam:

The American Benefits Council (the "Council") would like to thank Treasury and the Internal Revenue Service for issuing proposed regulations providing nondiscrimination relief to closed defined benefit plans and closed defined benefit plan features. We believe that the proposed regulations are a major step forward in addressing a critical problem with respect to the inadvertent effects of the nondiscrimination rules on plans that attempt to grandfather participants from changes in a defined benefit ("DB") plan. We appreciate this opportunity to comment and request to testify at the hearing on May 19; we will be submitting an outline of topics to be discussed in our testimony.

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.

SUMMARY

The proposed regulations address the nondiscrimination testing issues that arise when a defined benefit plan or feature is closed to new entrants but some or all existing employees are grandfathered from the closing. The proposed regulations are a significant improvement over the current regulations, but they would exclude many deserving closed plans from the relief that is needed because, as occurs in almost every case, the grandfathered group becomes more highly compensated over time.

Thus, without extensive changes to the proposed regulations, many plans across the country will be effectively forced to totally cease benefit accruals, and this will cause thousands of participants to lose benefits they were counting on to fund a secure retirement. Moreover, the proposed regulations do not address the main challenge facing small plans in this situation—the minimum participation rule.

BACKGROUND

In general:

Many companies are transitioning away from a traditional defined benefit ("DB") plan benefit formula in one of various ways. This can arise, for example, by reason of (1) closing the plan to new hires ("closed plan" issue), or (2) closing a plan feature to new hires, such as closing an early retirement subsidy to new hires in the context of a conversion of a traditional formula to a hybrid formula for new hires ("closed feature" issue). In the context of such transitions, it is not unusual for companies to grandfather some or all of the existing employees under the benefit formula or feature in effect. A prime example of the closed plan issue is closing a traditional DB plan to new hires (who often receive an additional contribution under the company's defined contribution ("DC") plan), but allowing existing employees to continue to participate in the DB plan.

These "grandfathering" arrangements are very helpful to the older longer service employees who (1) often have made retirement plans based on the benefits previously in effect, and (2) as discussed further below, may lose the higher benefits provided by DB plans at the end of a career, without having benefited from higher DC plan contributions in earlier years. However, these grandfather arrangements can, over time, cause nondiscrimination testing problems. These nondiscrimination testing problems have caused many plans to have to freeze completely, eliminating benefits for many thousands of employees. Far more plans will have to freeze in the future unless these issues are addressed.

Past IRS guidance:

In late 2013, the IRS issued Notice 2014-5, which provided excellent temporary relief with respect to the closed plan situation for 2014 and 2015; the relief was later extended through 2016. Under the Notice (as modified), a DB/DC plan satisfies the cross-testing requirements for the 2014-2016 plan years if the plan amendment closing the plan to new entrants was adopted before December 13, 2013 and (1) the DB/DC plan satisfies the "primarily defined benefit in character" test (defined below) or the "broadly available separate plans" test (defined below) for the 2013 plan year, or (2) the DB plan satisfies the nondiscrimination and coverage tests for the 2013 plan year without being aggregated with the DC plan.

The IRS Notice did not address the closed feature issue, nor did it address the DB plan replacement and minimum participation issues discussed below.

Current IRS guidance:

On January 29, 2016, Treasury published proposed regulations to address the closed plan issue, the closed feature issue, and the DB plan replacement issue. Briefly:

- The proposed regulations establish an improved framework for dealing with the closed plan, closed feature, and DB plan replacement issues, but the proposed regulations still include too many unnecessary requirements that will force many employers to completely freeze their plans based on facts unrelated to any policy concerns.

- Effective for plan years beginning in 2017, these proposed regulations effectively serve as temporary regulations with respect to the closed plan issue, because the temporary relief provided by Notice 2014-5 expires. Thus, these proposed regulations, which generally can be relied on (subject to exceptions noted below), become the only way to address the closed plan and closed feature issues until final regulations are effective, possibly in 2018 or later. (Because the temporary relief did not apply to the closed feature issue or the DB plan replacement issue, the proposed regulations effectively serve as temporary regulations now with respect to those issues.)

- Notably, as discussed further below, the proposed regulations do not address the problems posed by the minimum participation rules of Code section 401(a)(26) for small businesses that are undergoing the same type of transitions.

PROPOSED REGULATIONS: CLOSED PLAN RULE

Closed plan issue: main rule

Under the proposed regulations, a DB/DC combined plan can be tested on a benefits basis without meeting the current-law requirements for such testing if the following requirements are satisfied:

- The testing year is on or after the fifth anniversary of the date that the plan was closed. In other words, there is no relief until the sixth year after closing. The theory underlying this delay in the applicability of relief may be that if the testing issue arises more quickly, there must be something abusive with respect to the plan.

- The theory underlying the five year delay in providing the relief is flawed because many benign situations would be excluded from the relief. For example, assume that a company makes an acquisition two years after the closing of the plan and that accelerates the timing of the testing problem. (This is a real-life example.) In that case, there is no relief. The five-year delay in the applicability of the relief should be deleted. The delay is contrary to the intended purpose of the relief in that it would only cause plans to accelerate freezing accruals. If the testing rules are satisfied as of the date of the closing, the relief should apply immediately in order to prevent unnecessary freezes.

- Subject to certain exceptions, the plan was in effect for five years ending on the closing date. Moreover, starting with the date five years before the closure and ending with the current plan year, there can have been no plan amendment that significantly changes the benefit formula or the coverage of the plan.

    - The following amendments are excepted from this test under the DB/DC relief:

        - Amendments during the five year period ending on the closing date that (i) do not increase any employee's benefit or future accruals, (ii) do not expand coverage, and (iii) are not discriminatory.

        - Amendments during the five year period preceding the closing date that extend the benefit formula to an acquired group of employees in a manner that treats similarly situated employees within that group consistently.

        - Amendments after the closing that are not discriminatory.

        - De minimis changes to the benefit formula.

        - Other amendments permitted by the IRS in the future.

    - The following amendments would, for example, in many cases violate this test for no apparent policy reason:

        - Within the five years preceding the closing, the plan was amended to offer an early retirement window benefit that enhanced benefits (such as by crediting additional years of service).

    - Within the five years preceding the closing, the plan was converted to a hybrid plan (which generally increases benefits for some employees).

    - Within the five years preceding the closing, the plan formula is modified in small ways that are more than de minimis, such as by including bonuses and overtime in compensation taken into account.

    - Within the five years preceding the closing, the plan alters the eligibility requirements to make it easier for part-time employees to become eligible.

    - Within the five years preceding the closing, the plan extends plan coverage to a division that had not previously been covered.

    - Within the five years preceding the closing, the plan is merged with another plan (other than a merger with an acquired group).

    - Within the five years preceding the closing, or after the closing, a portion of the plan is spun off to an unrelated employer.

- **Comment:** The amendment prohibition should not apply to any pre-closing amendments made before the issuance of the proposed regulations.

    - The rationale for the restriction on amendments before closing is apparently to prevent plans from adopting amendments to increase benefits shortly before closing the plan to take advantage of the relief. No plan sponsor could possibly have adopted an amendment to take advantage of a rule that did not exist before the proposed regulations were issued.

    - It is possible that the restriction on amendments before closing is intended to limit relief to plan benefits subject to longstanding employee expectations. If that is the rationale, it is not appropriate. The result of this restriction would simply be to force freezes in most cases where there have been recent amendments. No policy purpose is served by such a rule.

- **Comment:** For pre-closing amendments made on or after the date that the proposed regulations were issued, they should be subject to the existing rules of Regulation § 1.401(a)(4)-5(a) prohibiting amendments from being timed to discriminate significantly in favor of highly compensated employees ("HCEs"). That rule is perfectly suited to prevent possible abuse, leaving no reason for a prohibition on amendments that would force countless benign plans to be frozen.

  - **Comment:** The amendment prohibition should not apply to post-closing spinoffs from the plan to an unrelated employer. There does not appear to be any rationale for penalizing such spinoffs, which are a routine element of the business world without any nondiscrimination implications. Moreover, the spun-off plan should continue to be eligible for the relief with respect to the unrelated employer.

- For the five year period starting on the closure date, the combined DB/DC plan must meet one of the following three tests. Generally, the requirements below reflect certain current law testing requirements, so the idea is that the DB/DC plan must meet certain current rules for five years prior to being eligible to use the proposed new rule allowing the DB/DC plan to be tested on a benefits basis.

  - Each DB plan that is part of the DB/DC plan must satisfy the nondiscrimination in amounts test under section 401(a)(4) without being aggregated with a DC plan,

  - The DB/DC plan must satisfy the nondiscrimination in amounts test on the basis of contributions (not benefits), or

  - The DB/DC plan must satisfy the primarily DB in character requirement or the broadly available separate plans requirement.

  Comment: As noted above, the five year delay in providing relief should be eliminated. If it is not, at the least, a plan that qualifies for the temporary relief provided in IRS Notice 2014-5 for 2014, 2015, and/or 2016 should be treated as satisfying the above requirements for that year or years. A contrary result would retroactively punish employers that reasonably relied on relief provided and could not have known that such reliance would later cause them to lose future relief.

  Comment: In determining whether the DB/DC plan satisfies the current law testing requirements as of the closing date, the following rules should apply:

  - DB and DC plans using different plan years should be permitted to be aggregated. It is not uncommon for DC plans to be on a calendar year and DB plans to use a plan year based on the employer's fiscal year. There is no reason to force such employers to effectively freeze their DB plan, instead of closing it. This is especially true since the average benefit percentage test already allows plans with different plan years to be tested together, demonstrating that there are no administrative impediments to permitting this.

- The closing should not preclude reliance on the business transaction transition rule contained in Code section 410(b)(6)(C) with respect to a transaction that occurred prior to the closing. A contrary rule would in many cases provide a material incentive for a plan to freeze completely following a business transaction.

Closed plan issue: interest rate rule

The proposed regulations also provide a proposed new interest rate rule that would allow a DB/DC plan to be tested on a benefits basis. Under the proposal, a DB/DC plan could be tested together on a benefits basis, despite not satisfying any of the cross-testing requirements, if the combined plan satisfies nondiscrimination testing using a 6% interest rate, rather than the current "standard interest rate" (which is permitted to be set between 7.5% and 8.5%).

Comment: Using a 6% interest rate would have a material negative impact on the nondiscrimination testing results, as compared to a standard interest rate, because the DC plan contributions for younger NHCEs would give rise to much lower benefits. The Council performed an extensive survey in early 2014 on this type of approach, which was set forth in IRS Notice 2014-5. The survey results were not very conclusive about this approach, in part because of the cost and time required to perform extensive testing on different bases. Another reason that the results were not very conclusive was that the Notice simply described this type of approach in general terms, referencing that Treasury was considering permitting a DB/DC plan to be tested on a benefits basis if it could satisfy nondiscrimination testing using an interest rate lower than a standard interest rate (as defined above). So the Council had to speculate as to what that lower interest rate might be in its survey.

The survey determined that (1) at least a material number of plans would not be helped by this proposal using an 8% interest rate, and (2) if plans had to use a 7% interest rate for this purpose, it is unclear whether most plans would be helped. Thus, it seems likely that a very large group of plans would not be helped by the proposed 6% interest rate rule. So while we support inclusion of an alternative test, it should not be viewed as providing significant relief and thus should not be viewed as justifying not making the modifications to the main closed plan rule described above.

Closed plan issue: for gateway test, use of average NHCE allocations and use of matching contributions

The proposed regulations also provide new ways to satisfy the minimum aggregate allocation gateway test.

- *Averaging of NHCE allocations:* The proposal would permit each NHCE who benefits under a DC plan to be treated as having an allocation rate equal to the average of the allocation rates for all NHCEs benefiting under that DC plan.

- *Limits on averages:* The proposal includes a special rule to prevent very high allocation rates from skewing the NHCE average. Specifically, for purposes of the DC and DB averaging rules, there is a cap on allocation rates under a DC plan or equivalent allocation rates under a DB plan; the cap is 15%, or 25% if the sole reason for the rate exceeding 15% is that the DB or DC plan provides higher rates to older, longer service employees due to their age and/or service. It would appear, though it is not completely clear, that traditional DB formulas would trigger the 25% rule, since such formulas naturally favor older longer service employees. This point should be clarified.

- *Use of matching contributions:* Currently, matching contributions are not taken into account in determining whether the minimum aggregate allocation gateway test is satisfied. Under the proposed regulations, if an NHCE is eligible for a matching contribution under a DC plan that is part of a DB/DC plan, then the following can be added to the allocation rate of that NHCE for purposes of the minimum aggregate allocation gateway test: the lesser of 3% or the average matching contribution percentage of the group of eligible NHCEs in that plan.

    - **Comment:** The 3% cap on average matching contributions apparently reflects a governmental preference for nonelective contributions, where all eligible NHCEs receive an allocation. This does not make sense since nonelective contributions can be based on age and/or service, so that the allocation for a young new employee may be very low, undercutting the rationale for treating nonelective contributions more favorably. We see no reason for the 3% limit and recommend it be deleted.

    - **Comment:** Several aspects of the matching contribution rule need clarification. Specifically, how would the average matching contribution percentage be determined in the following situations:

        - The plan uses the prior year testing method. Which actual contribution percentage ("ACP") would be used – the prior year or the current year? If the prior year is used, would the 3% rule apply in the plan's first year?

        - The plan relies on a safe harbor from testing. Would the plan have to calculate an ACP solely for this purpose?

        - Are disproportionate matching contributions taken into account?

- Can qualified matching contributions, qualified nonelective contributions, and elective contributions be taken into account in determining the ACP for this purpose?

- If excludable employees are tested separately or excluded from testing, would the average be determined without regard to the excludable employees, assuming that such employees can be excluded with respect to the DB/DC plan?

- If the DB/DC plan includes more than one DC plan, is the ACP determined as if all DC participants were in a single DC plan?

- **Comment:** The Council survey referenced above did not cover the exact NHCE average and matching contribution proposals, but it did ask questions separately about the two main components of the above rules. The survey concluded that the averaging rule (even without the limit) would not help many plans satisfy the minimum aggregate allocation gateway test. The survey also found that most plans would not be helped by the matching contribution rule (even without the 3% cap). It is very unclear whether combining the two rules would help a large number of plans. So again while we support retaining the proposed rule with the changes and clarifications noted above, this rule should not be viewed as a justification for not addressing the major problems with the proposed main closed plan rule described above.

Closed plan issue: matching contributions, ESOPs, and 403(b) plans

There can be nondiscrimination testing problems even where an employer makes very substantial DC plan contributions on behalf of NHCEs who are not covered by the DB plan. These problems can arise because the employer provides the contributions in a form—matching, ESOP, and/or 403(b) contributions—that are not permitted to be taken into account in applying the general nondiscrimination testing.

Although the proposed regulations permit matches to be used to a limited extent to satisfy the minimum aggregate allocation gateway test, that just permits the DB/DC plan to be tested on a benefits basis. But when testing the plan on a benefits basis, matching contributions are disregarded (except for the average benefit percentage test). This can make passing the nondiscrimination testing rules very difficult for employers that enhanced matching contributions for new hires excluded from the closed DB plan. In short, there is nothing in the proposed regulations to address this critical part of the current-law problems, leaving a complete plan freeze as the only practical alternative for many employers.

In addition, the regulations already permit aggregation of matching and ESOP contributions in one context—the average benefit percentage test. See Regulation § 1.410(b)-7(e)(1). There is no apparent reason not to permit the same aggregation, including section 403(b) plans, for other coverage and nondiscrimination testing purposes.

Comment: Thus, the regulations should be amended to permit the matching, ESOP, and 403(b) portions of a plan to be aggregated with other plans to help such other plans satisfy the coverage and nondiscrimination tests on a benefits basis. This would only apply with respect to other plans to which the mandatory disaggregation rules do not apply; for example, this would not apply if the other plan were a 401(k) plan. Moreover, the aggregation could not be used in reverse to help the matching or ESOP portions of a plan satisfy the applicable rules.

This recommended approach should apply without regard to whether the "other plan" being helped is a DB plan or the nonelective portion of a DC plan. There is no conceptual reason to not structure the rule to cover the latter situation. Moreover, doing so can help in the case of the DB replacement plan issue discussed below.

PROPOSED REGULATIONS: BENEFITS, RIGHTS, AND FEATURES TEST FOR CLOSED FEATURE ISSUE

Background

Under the current regulations, the current availability of benefits, rights, and features ("BRFs") under a plan must satisfy the nondiscriminatory classification test. This test can pose a problem in the case of, for example, a conversion to a hybrid plan, where the existing employees are grandfathered from the conversion. In that case, there may be plan BRFs that are only available to the grandfathered group, such as an early retirement subsidy. As noted above, over time that grandfathered group is very likely to become so disproportionately highly compensated that the current availability of the BRF will fail to satisfy the nondiscriminatory classification test.

Applicability of new rule

As discussed below, the proposed regulations offer relief for BRF testing, but the proposed regulations restrict the availability of such relief to "closed defined benefit plans." That term is defined to mean a defined benefit plan that has been amended to (1) cease benefit accruals under a benefit formula for some or all previously covered employees, or (2) limit participation in the plan to some or all of the previously covered employees. This would certainly cover most of the problematic situations, such as the conversion amendment described above.

Comment: But this limitation on the scope of the relief is inappropriate, because it leaves out a key element: the closing of a BRF, which does not involve the closing of the plan or a benefit formula. For example, assume that a plan offers lump sums and calculates those lump sums based on an interest rate that is lower than the section 417(e) interest rate. Assume further that the plan sponsor amends the plan to apply the section 417(e) interest rate to all new hires, thus grandfathering existing employees from this amendment. This amendment clearly raises the exact same issues as a conversion amendment, but this amendment is not eligible for the relief described below. *The BRF relief should apply to any closing of a BRF, without regard to whether the plan or a benefit formula is closed.*

Relief for BRF testing

Under the proposed regulations, a BRF is treated as satisfying the current and effective availability requirements if the following requirements are satisfied:

- The plan year begins on or after the fifth anniversary of the date that the plan was closed. In other words, there is no relief until the sixth year after closing. As noted above with respect to the closed plan rule, the five-year delay in the applicability of the relief should be deleted. The delay does not serve any apparent policy purpose and would only cause plans to apply the new restrictions on a BRF more broadly, which helps no participant. If the testing rules are satisfied as of the date of the closing, the relief should apply immediately in order to prevent unnecessary BRF restrictions.

    - If the five-year delay is not deleted, a key clarification is needed to the rules on BRF testing. A recent private letter ruling implied that a lump sum option under a DC plan could not be aggregated with a lump sum option under a DB plan to help the DB option pass testing if the DB lump sum includes the value of a subsidy. There is no basis for such a position, which makes it hard to satisfy the BRF rules during the five-year period, especially in light of the difficulty in determining whether a benefit is "subsidized." If the five-year delay is not deleted, it should be clarified that DC lump sum options can help DB lump options pass BRF testing regardless of whether the DB option is subsidized.

- Subject to certain exceptions, starting with the date five years before the closure and ending with the current plan year, there can have been no plan amendment that affects the availability of the BRF (other than the closure amendment).

    - The following amendments are excepted from this test:

- Amendments during the five year period ending on the closing date that extend eligibility for the BRF to an acquired group of employees, provided that all similarly situated employees are treated in a consistent manner.

- Amendments adopted after the closure date that expand or restrict eligibility for the BRF, provided that the "ratio percentage" (defined in a later section of this document) of the eligible group is not reduced by the amendment.

- Amendments adopted after the closure date that replace the BRF with a BRF that is of inherently the same or lesser value.

- Amendments adopted after the closure date that replace the BRF with a BRF, and the difference in value between the old BRF and the new BRF is de minimis.

- Other amendments permitted by the IRS in the future.

o The following amendments would, for example, in many cases violate this test for no apparent policy reason. These examples are based on a BRF consisting of an early retirement subsidy. Other BRFs would raise similar issues.

  - Within the five years preceding the closing, the plan was amended to offer the subsidy to additional employees under an early retirement window benefit.

  - Within the five years preceding the closing, eligibility for the subsidy is modified in de minimis ways, such as by modifying the age and service requirements in small ways. (The de minimis exception in the proposal only applies to the value of the BRF, not its availability.)

  - Within five years preceding the closing, the plan extends plan coverage to a very small division that had not previously been covered.

  - Within the five years preceding the closing, the plan is merged with another plan (other than a merger before the closing with an acquired group).

  - Within the five years preceding the closing, or after the closing, a portion of the plan is spun off to an unrelated employer.

- **Comment:** The amendment prohibition should not apply to any pre-closing amendments made before the issuance of the proposed regulations.

  - The rationale for the restriction on amendments before closing is apparently to prevent plans from adopting amendments to enhance the BRF shortly before closing the plan or formula in order to take advantage of the relief. No one could possibly have adopted an amendment to take advantage of a rule that did not exist before the proposed regulations were issued.

  - It is possible that the restriction on amendments before closing is intended to limit relief to plan features subject to longstanding employee expectations. If that is the rationale, it is not appropriate. The result of this restriction would simply be to force BRFs to be completely eliminated prospectively (with anti-cutback protection) in most cases where there have been recent amendments. No policy purpose is served by such a rule.

- **Comment:** For pre-closing amendments made on or after the date that the proposed regulations were issued, they should be subject to the existing rules of Regulation § 1.401(a)(4)-5(a) prohibiting amendments from being timed to discriminate significantly in favor of highly compensated employees ("HCEs"). That rule is perfectly suited to prevent possible abuse, leaving no reason for a prohibition on plan amendments that would force countless BRFs to be completely frozen (with anti-cutback protection).

- **Comment:** The amendment prohibition should not apply to post-closing spinoffs from the plan to an unrelated employer. There does not appear to be any rationale for penalizing such spinoffs, which are a routine element of the business world without any nondiscrimination implications. Moreover, the spun-off plan should continue to be eligible for the relief with respect to the unrelated employer.

- **Comment:** In determining whether the plan satisfies the current law testing requirements as of the closing date, the closing should not preclude reliance on the business transaction transition rule contained in Code section 410(b)(6)(C) with respect to a transaction that occurred prior to the closing. A contrary rule would in many cases provide a material incentive for a plan to completely freeze a BRF following a business transaction.

    - **Comment:** In determining whether the plan satisfies the current law testing requirements as of the closing date, plans using different plan years should be permitted to be aggregated. There is no reason to force employers with such arrangements to freeze a BRF, instead of closing it. This is especially true since the average benefit percentage test already allows plans with different plan years to be tested together, demonstrating that there are no administrative impediments to permitting this.

- The closure amendment must have provided for a significant change in the type of benefit formula under the plan (such as a conversion to a hybrid plan).

    - **Comment:** There is no policy reason for this requirement. As noted above, this would clearly preclude the applicability of the relief to a plan amendment that grandfathers employees from an adverse modification of the BRF itself. In addition, for example, this provision bars relief if a DB plan is simply closed to new participants but provides ongoing accruals for existing employees, a very common scenario. While there are some special BRF testing rules that apply to aggregated DB/DC plans and permit certain BRFs to be deemed satisfied, those rules will not solve many such failures, as these special rules only apply to BRFs that are uniformly available under the closed DB plan and not to BRFs that satisfied testing before the plan was closed but were not uniformly available. For these reasons, the requirement that there be a significant change in the type of benefit formula should be deleted.

- The DB plan providing the BRF is the closed DB plan.

Special rule for matching contributions

There is a special BRF rule that applies where, in order to make up for lost DB accruals, the grandfathered group receives matching contributions under a DC plan. Since the right to matching contributions is a BRF, special treatment of a grandfathered group for this purpose is subject to testing. The proposed regulations provide relief in this situation if the following conditions are met:

- The relief only applies after the first five plan years, as above. As noted above with respect to other rules, the five-year delay in the applicability of the relief should be deleted. The delay does not serve any apparent policy purpose and would only force many plans to not to provide make-whole matching contributions to participants who have lost DB accruals. If the testing rules are satisfied as of the date of the closing, the relief should apply immediately in order to prevent unnecessary losses of make-whole contributions.

- The restrictions described above on amendments regarding the availability of the BRF only apply to amendments after the closure date, subject to the same exceptions noted above.

- The rate of matching contributions for the grandfathered group must be reasonably designed to replace some or all of the value of the lost DB accruals.

- The rate of matching contributions must be provided in a consistent manner to all similarly situated employees.

- The value of the accruals under the DB formula must have increased as employees aged or attained more years of service.

- Except as provided below in the case of a DB plan maintained by a former employer, for the plan year preceding the closure, the closed DB plan met the coverage and nondiscrimination requirements under sections 410(b) and 401(a)(4) without regard to the temporary business transaction relief under section 410(b)(6)(C) and without aggregating with any other plan.

- For the five-year period ending on the closure date, neither the benefit formula nor the coverage of the DB plan was significantly changed by plan amendment. The following amendments are excepted from this test:

    - Amendments during the five year period ending on the closing date that (i) do not increase any employee's benefit or future accruals, (ii) do not expand coverage, and (iii) are not discriminatory (as narrowly defined above).

    - If the DB plan was maintained by a former employer, the five-year period is a one-year period (and the preceding bullet (regarding aggregation, etc.) does not apply).

    - Amendments during the five-year period preceding the closing date that extend the coverage or benefit formula to an acquired group of employees in a manner that treats similarly situated employees within that group consistently.

    - Other amendments permitted by the IRS in the future.

Comment: For the reasons discussed above with respect to the closed plan rule and the main BRF rule, this prohibition on pre-closing amendments serves no apparent policy purpose and can only hurt participants. Thus, this prohibition should be deleted.

Comment: The amendment prohibition should not apply to post-closing spinoffs from the plan to an unrelated employer. There is no rationale for penalizing such spinoffs, which are a routine element of the business world without any nondiscrimination implications. Moreover, the spun-off plan should be continue to be eligible for the relief with respect to the unrelated employer.

Comment: In determining whether the group eligible for the special matching contributions satisfies the current law testing requirements as of the closing date, neither the freezing of the DB plan nor the adoption of the special matching contributions should preclude reliance on the business transaction transition rule contained in Code section 410(b)(6)(C) with respect to a transaction that occurred previously. A contrary rule would in many cases provide a material incentive for a plan not to provide make-whole matching contributions to older, longer service employees.

PROPOSED REGULATIONS: DEFINED BENEFIT PLAN REPLACEMENT ISSUE

Background

For numerous reasons, many plan sponsors have needed to completely freeze their defined benefit plan. However, some of these plan sponsors want to provide some or all of the existing employees in the defined benefit plan with make-whole contributions under a defined contribution plan. For example, assume that a traditional defined benefit plan is completely frozen and is replaced with a 3% nonelective contribution under a defined contribution plan. That 3% nonelective contribution is likely to be more valuable to younger employees than their defined benefit plan accrual would have been. However, for older employees, the accrual likely would have had more value.

Accordingly, the employer in this example may create a special schedule of additional contributions under the defined contribution plan that is designed to make some or all of the existing employees whole for the loss of the defined benefit plan accruals. Such make-whole contributions can be very helpful in ensuring a smooth transition from the defined benefit plan to a defined contribution plan, especially for older employees.

In order to satisfy section 401(a)(4), such a defined contribution plan must in many cases test contributions on the basis of an equivalent accrual rate in accordance with Regulation § 1.401(a)(4)-8(b). In order to be able to use that regulatory provision with respect to the type of make-whole contributions described above, the special schedule of additional contributions will in most cases need to qualify as "defined benefit replacement allocations" ("DBRA"). The proposed regulations would modify the requirements to qualify as a DBRA and the effects of so qualifying.

Under the proposed regulations, as under current law, in determining whether a DC plan has broadly available allocation rates (a means of qualifying to test contributions on the basis of equivalent benefits), DBRAs are disregarded to the extent that they are in addition to otherwise applicable allocation rates or to the extent that employees receive the greater of the DBRA or the otherwise applicable allocation rate. (Similar rules apply in determining whether a plan has a gradual age or service schedule, which can also qualify a plan to test contributions on the basis of equivalent benefits.)

One key question is what happens if the plan has a DBRA but has no other nonelective employer contributions, so the plan's broadly available allocation rate, after disregarding the DBRA, is 0%. In that case, it would appear that the plan does not have a broadly available allocation rate (nor does it have a gradual age or service schedule). Thus, the plan would not qualify to cross test. This does not appear to be the right result, since the intent seems to be to permit the DBRA to be cross tested. This issue should be clarified in a favorable manner in the final regulations.

Under the proposed regulations, allocations qualify as DBRAs only if the following requirements are satisfied:

- Until the plan year beginning on or after the fifth anniversary of the date that the DB plan was closed, the group receiving make-whole contributions must satisfy the nondiscriminatory classification test. As discussed above in analogous contexts, the five-year delay in the applicability of the relief should be deleted. The delay does not serve any apparent policy purpose and would only force many plans to not provide make-whole contributions. If the testing rules are satisfied as of the date of the closing, the relief should apply immediately in order to prevent unnecessary loss of make-whole contributions.

- The allocations are designed so that they are reasonably expected to replace some or all of value of the DB accruals. The specific reference to partial replacement is helpful.

- The allocations are provided in a consistent manner to all similarly situated employees.

- The value of the accruals under the DB formula increased as employees aged or attained more years of service.

- Except as provided below in the case of a DB plan maintained by a former employer, for the plan year preceding the closure, the closed DB plan met the coverage and nondiscrimination requirements under sections 410(b) and 401(a)(4) without regard to the temporary business transaction relief under section 410(b)(6)(C) and without aggregating with any other plan.

- For the five-year period ending on the closure date, neither the benefit formula nor the coverage of the DB plan was significantly changed by plan amendment. The following amendments are excepted from this test:

    - Amendments during the five year period ending on the closing date that (i) do not increase any employee's benefit or future accruals, (ii) do not expand coverage, and (iii) are not discriminatory.

    - Please see the discussion of the closed plan issue above for examples of the benign amendments that would cause a plan to fail to satisfy this rule.

- Allocations fail to qualify as DBRAs if the plan provisions establishing the DBRA are amended after they are both adopted and effective. The following amendments are excepted from this test:

    - De minimis amendments to the allocations under the DBRA (such as modifying the definition of compensation to include elective salary reductions to pay for certain transit passes or other transportation fringe benefits).

    - An amendment to the DBRA to add or remove a provision providing employees with the greater of the DBRA or the otherwise applicable plan allocation.

    - An amendment to the DBRA that is not discriminatory (as narrowly defined above).

    - If the DB plan was maintained by a former employer, the five-year period is a one-year period (and the preceding bullet (regarding no aggregation, etc.) does not apply).

    - Amendments during the five-year period preceding the closing date that extend the coverage or benefit formula to an acquired group of employees in a manner that treats similarly situated employees within that group consistently.

    - Other amendments permitted by the IRS in the future.

Comment: For all the reasons discussed above with respect to the closed plan rule, the prohibition on pre-closing amendments serves no apparent policy purpose and only serves to force many employers not to provide make-whole contributions to participants who lost DB accruals. The prohibition on pre-closing amendments should be deleted.

Comment: Similarly, the amendment prohibition should not apply to post-closing spinoffs from the DC plan to an unrelated employer. There is no rationale for penalizing such spinoffs, which are a routine element of the business world without any nondiscrimination implications. Moreover, the spun-off plan should continue to be eligible for the relief with respect to the unrelated employer.

Comment: In determining whether the DC plan satisfies the current law testing requirements as of the date that the DBRA is established, neither such establishment nor the freezing of the DB plan should preclude reliance on the business transaction transition rule contained in Code section 410(b)(6)(C) with respect to a transaction that occurred previously. A contrary rule would in many cases provide a material incentive for an employer not to provide make-whole contributions to older long-service employees.

PROPOSED REGULATIONS: MINIMUM PARTICIPATION RULES

The proposed regulations do not address the problems faced by small plans under the minimum participation rules of Code section 401(a)(26). This is a deficiency in the proposal. It is our understanding that Treasury and the IRS believe that they do not have the statutory authority to address this issue, but that is not correct, as discussed below.

Grandfathered group:

Assume that an employer with 200 employees closes its DB plan to new hires but existing employees can continue to benefit under the plan. After several years, the number of employees benefiting under the plan falls under 50. That forces the employer to at least remove all HCEs from the plan; because of the adverse employee relations effects of removing some employees and not others, many employers may well freeze the entire plan is this situation. What policy goal is served by such a rule? Why should an employer be prohibited from grandfathering older, longer service employees (who may even grow into HCE status long after the closing of the plan occurs)? Why should pure attrition cause a plan to fail this test?

Hard freeze

Assume that a company with 200 employees completely freezes its defined benefit plan. Over a number of years, (1) all employees entitled to benefits terminate employment and (2) the number of former employees still entitled to benefits falls under 50. At that point, under the regulations, the general rule, subject to one exception, is that the plan is simply disqualified. See Regulation § 1.401(a)(26)-3(c). The employer did not do anything wrong in any sense. The vast majority—or even all—of the former employees still entitled to benefits may be NHCEs. Still, this plan is disqualified unless the plan can fit into one exception.

Generally, under that exception, there must be an actuarial report that the "plan does not have sufficient assets to satisfy all liabilities under the plan (determined in accordance with section 401(a)(2))." See Regulation § 1.401(a)(26)-1(b)(3). In other words, if the plan has enough assets to terminate, it must be terminated, or it will be disqualified. This "terminate or be disqualified" rule is not appropriate. First, no employee is benefiting under the plan. What substantive harm would the threat of disqualification prevent? Second, why force termination? For example, assume interest rates are unusually low, as they are today. Why force companies to terminate at a very disadvantageous time? Third, the "terminate or be disqualified" rule is not only inappropriate but also very expensive and burdensome to apply, as it can require expensive actuarial work on an annual basis. (At a minimum, proxies, based on funded status, for the inability to terminate should be developed that make the rule less expensive to apply.)

Moreover, this rule is not conceptually consistent with the rest of the regulation. Assume that all former employees entitled to benefits were NHCEs. If just one NHCE were actively benefiting under the plan, the plan would satisfy section 401(a)(26). But if that one NHCE terminates employment and is no longer benefiting under the plan, the plan can be disqualified. Why?

Finally, this rule does not work for bona fide multiple employer plans ("MEPs"), with respect to which the minimum participation rules apply on an employer by employer basis. If one out of 1,000 employers fails the minimum participation test, the fact that the entire plan has enough assets to terminate does not have any relevance. There is no reason to terminate an entire plan to solve the minimum participation problems of one participating employer.

With respect to a related issue regarding MEPs, we would urge the minimum participation rule to be applied on a plan-wide basis, instead of an employer by employer basis. Alternatively, the failure of one or more employers to meet the minimum participation rule should not affect the qualification of the MEP if the portion of the MEP attributable to such employers is spun off.

Collectively-bargained single employer plans

These issues are exacerbated for single-employer plans that are the subject of collective bargaining. Specifically, some union-representatives and employers agreed to "freeze" ongoing participation in defined benefit plans to new participants, but allow continued benefit accruals for existing participants. It comes as a great surprise that, even though the plan is likely to never run afoul of the nondiscrimination rules under Code Sections 401(a)(4) and 410(b), that the continued viability of these collectively bargained benefits may be cut short by the minimum participation rules. Where the closure of a plan was the subject of good-faith bargaining, it does not make sense to subject the plan to a potential failure of the minimum participation rule as the active participant population naturally decreases over time.

Statutory authority

Without any direct statutory basis, Treasury and the IRS already exempt plans under which no employee benefits, as long as the 50/40% test is met with respect to former employees with meaningful benefits. Strictly speaking, Treasury and the IRS have no statutory authority to provide that regulatory exception, but it would be inappropriate not to provide that exception, so Treasury and the IRS did. It is equally inappropriate to disqualify a plan simply because the number of former employees with a benefit falls below the 50/40% threshold. Similarly, Treasury and the IRS have no direct statutory authority to exempt plans that do not benefit an HCE, but Treasury and the IRS provided such an exemption because it would not make sense not to.

Treasury and the IRS have broad authority to interpret the Code not to reach inappropriate results and have used that authority in significant ways under Code section 401(a)(26) to prevent completely benign situations from triggering qualification problems. We find it hard to draw a line between the benign situations that Treasury and the IRS have approved without direct statutory authority and the closed plan and hard freeze situations noted above.

As for collectively-bargained plans, Code section 401(a)(26) generally provides that a plan "may exclude from consideration" employees described under Code section 410(b)(3). This provides direct statutory authority for Treasury and IRS to provide rules to allow closed plans that solely benefit collectively bargained employees to automatically satisfy Code section 401(a)(26). This authority is substantially the same as that granted under Code section 410(b)(3)(A), which provides that employees covered by a collective bargaining agreement under which retirement benefits were the subject of good faith bargaining are excluded for purposes of the nondiscrimination requirements of Code section 410(b). Existing regulations under both Code sections 401(a)(4) and 410(b) provide that a plan that solely benefits collectively bargained employees automatically satisfies the nondiscrimination tests of these sections. While existing regulations under Code section 401(a)(26) do not provide for automatic satisfaction of the minimum participation rule for collectively bargained plans, the statute clearly permits rules that would allow these plans to automatically satisfy Code section 401(a)(26) for periods after they closed. The Council strongly believes that Treasury and the IRS have the statutory authority to provide relief to collectively-bargained plans that satisfied 401(a)(26) at the time the plan was closed and that that authority should be exercised.

Comment: Under the Council's minimum participation proposal, if no employee benefits under a plan, the plan satisfies the minimum participation test. Also, very generally, if a defined benefit plan satisfies the minimum participation test as of the date the plan is closed (or a later date), the plan would continue to be treated as satisfying the minimum participation test indefinitely. This rule would eliminate a strong current incentive to freeze completely, which is clearly detrimental to both HCEs and NHCEs.

PROPOSED REGULATIONS: EFFECTIVE DATE

In general, the proposed effective date of the new regulations is plan years beginning after the publication of the final rules in the Federal Register. Subject to certain exceptions, at the option of the plan, the proposed rules may apply for plan years beginning on or after January 1, 2014 and before the general effective date of the final rules specified above. If a plan elects such early application, is the plan giving up the temporary relief provided in IRS Notice 2014-5? Or could the plan apply the temporary relief for the 2014-2016 years and apply the proposed rules for 2017 (assuming that the final rules go into effect in 2018)? The latter should be the rule.

Technically, there is no effective date for the BRF rule, but, based on the preamble, it appears that that rule was intended to have the same final rule effective date and the same plan option to use the proposed rule before the effective date of the final rule. This should be clarified.

We look forward to discussing these issues, which are so critically important to participants and plan sponsors across the country.

Sincerely,

Lynn D. Dudley

Lynn D. Dudley
Senior Vice President,
Global Retirement and Compensation Policy