AMERICAN BENEFITS COUNCIL

June 22, 2004

CC:PA:LPD:PR (REG-128309-03)
Courier's Desk
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C.

Dear Sir or Madam:

This letter sets forth comments on proposed regulations issued in March 2004 relating to the conditions under which a plan may eliminate or reduce section 411(d)(6)(B) protected benefits.[1] These comments are submitted by the American Benefits Council (the Council). 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.

We would like to start by applauding the Treasury Department and the Internal Revenue Service (the Service) for addressing a number of fundamental issues related to the scope of section 411(d)(6). We particularly appreciate that the regulations address and reconcile case law. We also appreciate the relief contained in the proposed regulations with respect to the elimination of optional forms of distribution.

We are, however, concerned that the proposed regulations are overly stringent and will be of limited use to plan sponsors. The declining state of our defined benefit pension system and the need for administrative simplification are well-documented. The proposed regulations begin down the path of simplifying administrative burdens, by reducing the need to offer and communicate numerous and rarely elected optional forms of distribution. However, these proposals do not go far enough and we

[1] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1986, as amended.

strongly recommend simplifying, and building greater flexibility into, the regulations. Our specific comments are listed below.

1. Contingent-Event Benefits. The proposed regulations would provide that contingent-event benefits are protected as retirement-type subsidies if they continue beyond retirement age. Alternatively, if a contingent benefit is a plant shutdown benefit that does not continue beyond retirement age, the proposed regulations would include the benefit in the definition of ancillary benefits that can be reduced or eliminated without violating 411(d)(6). Comments were requested on how to determine whether a benefit continues past retirement and whether contingent-event benefits that do not continue past retirement may be included in a pension plan.

Contingent-event benefits are a well-established feature of pension plans, particularly collectively bargained plans. A typical contingent-event benefit provides for the payment of an amount equal to the participant's normal retirement benefit upon the occurrence of an unforeseen termination of employment due, for example, to a plant shutdown. The primary purpose of almost all contingent-event benefits is to provide an economic bridge between termination of employment and commencement of normal retirement benefits. For this reason, future guidance should recognize that contingent-event benefits provide benefits before retirement and do not provide benefits that continue after retirement.[2]

Consider, for example, a plant shutdown benefit that provides for payment of an affected participant's normal retirement benefit upon the occurrence of a plant shutdown. If the affected participant is age 60 and has a normal retirement benefit of $10,000 payable at age 65, the contingent-event benefit is $10,000 per year from age 60 to age 65 and the normal retirement benefit is $10,000 commencing at age 65. The fact that some contingent-event benefits provide for immediate commencement of a reduced early retirement benefit does not change the analysis. If, in the example above, the contingent-event benefit was based on a 3 percent per year actuarial reduction instead of the plan's 5 percent reduction for non-contingent early retirement benefits, the contingent-event benefit would be $8,500 from age 60 to age 62, followed by commencement of the actuarially reduced normal retirement benefit of $8,500 at age 62. Under either type of contingent-event benefit, the economic value of the benefit that is attributable to the occurrence of the contingency, i.e., the difference between the benefit with and without the event, does not continue past retirement age.

---

[2] On the other hand, an example of a contingent-event benefit that continues past retirement might be a benefit that provides for additional years of service credit, e.g., five years imputed service credit, in the event of a plant shutdown.

The protections for early retirement benefits and retirement-type subsidies were added to 411(d)(6) in the Retirement Equity Act of 1984 (REA). The legislative history to REA, cited in the proposed regulations, clearly anticipates a class of contingent-event benefits that do not continue past retirement and that are both ancillary and permissible features of a pension plan. Contingent-event benefits were common at that time and the most plausible reading of the REA legislative history is that contingent-event benefits of the type described above are permitted, but not protected from elimination under 411(d)(6). One approach to clarifying that most contingent-event benefits are not protected benefits would be to provide that plan sponsors may specify in their plans whether a contingent-event benefit continues past retirement age. For example, a plan sponsor might specify that a benefit that is triggered by a plant shutdown is paid first in the form of a contingent-event benefit and then by the participant's normal retirement benefit. This would allow plan sponsors to designate whether or not contingent-event benefits are protected benefits and would ensure that participants have appropriate expectations regarding the benefits that are protected.

To the extent future guidance concludes that some or all contingent-event benefits are protected benefits, the regulations indicate that the Service will not treat a plan as failing to satisfy the qualification requirements merely because of a plan amendment that eliminates or reduces a contingent-event benefit, if the amendment was adopted and effective prior to both the event and publication of the final regulations. While the Council appreciates this relief, these regulations will be authoritative guidance under the anti-cutback rule of ERISA as well as the Internal Revenue Code and we urge you to address the effect of an impermissible elimination of a contingent-event benefit. Specifically, the final rule should provide that an impermissible elimination of a contingent-event benefit prior to the effective date of these regulations is treated as a permissible amendment that freezes accruals under the contingent-event benefit. This would mean that participants would not be entitled to continued accruals under the contingent-event benefit after the "elimination" amendment if its total elimination is later found to be ineffective. Such an approach would be consistent with the sponsor's clear intent as well as the expectations of participants who have been notified that the contingent-event benefit has been entirely eliminated.

2. Ancillary Benefits. The proposed regulations include a list of ancillary benefits and request comments on other ancillary benefits permitted in a pension plan. The list should be expanded to include post-retirement death benefits that are unrelated to the normal retirement benefit, e.g., a flat $5,000 death benefit. The regulations should also clearly state that contingent-event benefits that do not continue past retirement age are ancillary benefits. Contingent-event benefits serve a purpose related to retirement (providing a

bridge to retirement) and have long been recognized by the Treasury Department, the Service, and Congress as permissible features of pension plans.

3. Elimination of Optional Forms of Benefits. The regulations provide two approaches to eliminating optional forms of benefits: the 90-day approach and the four-year approach. The 90-day approach allows for the elimination of redundant forms (that are not "core" forms as described below) with a 90-day delayed effective date. Benefit forms are redundant if they are part of the same "family" grouping of benefits forms. The proposed regulations identify the following six families of benefit forms: joint and contingent options with continuation percentages of 50 percent to 100 percent; joint and contingent options with continuation percentages below 50 percent; term certain and life annuities with a term of 10 years or less; term certain and life annuities with a term of more than 10 years; level installment payment options over a period of 10 years or less; and level installment payment options over a period of more than 10 years. The regulations, however, also contemplate additional families.

In contrast, the four-year approach allows for the elimination, after a four-year delayed effective date, of any or all other forms of distribution if certain requirements are met and the plan continues to have four core forms of distribution. The four core forms are: a level single life annuity, a 75 percent joint and contingent annuity, a 10-year term certain life annuity, and the most valuable form for a participant with a short life expectancy (such as a lump-sum payment). Apart from their very different delayed effective dates, the two approaches are similar (at least with respect to actuarially equivalent optional forms) and the differences between the families and the core forms are limited. For this reason, we believe the regulations could be meaningfully simplified without significantly reducing participant choice if the two approaches were conformed.

Specifically, we recommend providing an exclusive list of families under the 90-day approach and basing the list of families on the core forms. All forms that are either not within the exclusive list or that are redundant could be eliminated with a 90-day delayed effective date. The core families would be joint and contingent annuities, term certain annuities, single life annuities and the most valuable form for participants with a short life expectancy. Under this approach, sponsors would have to retain any core forms that are currently offered, i.e., retain any currently available 75 percent joint and contingent annuity, any 10-year term certain life annuity and any level single life annuity. The current protections for leveling and employee contribution refund features would be preserved and single-sum options would continue to be protected. In addition, the regulations could require that at least one retained form in the joint and contingent annuity family provide a 50 percent or greater survivor benefit and that at least one retained form in the term certain annuity family provide a 10-year or longer term. This approach would ensure that participants have access to a wide range of optional forms, covering all personal circumstances, and would greatly simplify the regulations. The four-year approach would continue to be available for use with the expected transition period rule and for eliminating leveling and employee contribution refund features.

We are not aware of any policy value to, or practical need for, the named families that are not based on core forms. Joint and contingent annuities with continuation percentages below 50 percent or term certain annuities with less than 10-year terms are not common optional forms. The simplification value associated with an exclusive list of families based on the core options would be substantial.

4. De Minimis Test. The proposed regulations restrict the elimination of an optional form under the 90-day and four-year approaches to forms that have a value that is not more than a de minimis amount greater than the retained form. The proposed regulations should clarify that the de minimis test is applied on a snapshot basis. For example, in determining whether the elimination of a 7 percent discount rate from an early retirement benefit has a de minimis effect where the retained discount rate is based on an index, it should be permissible to use the current discount rate under the index. As a result, even though a 7 percent discount rate may become more favorable at some time in the future, the 7 percent discount rate could be eliminated now based on the current rate.

There are two alternative grounds for establishing that an amendment has a de minimis effect. The "2 percent of subsidy" rule provides that an amendment has no more than a de minimis effect if the difference between the retained form and the eliminated form is no more than 2 percent of the value of the eliminated subsidy. The "1 percent of compensation" rule provides that an amendment has a de minimis effect if the difference between the retained form and the eliminated form is no more than 1 percent of the participant's compensation within the meaning of Code section 415(c)(3). Both rules are far too stringent, do not adequately address the full range of employment situations, and are practically useless for terminated, vested participants. The 1 percent of compensation rule is entirely inapplicable to terminated, vested participants who have not commenced distributions because they do not have current compensation and the 2 percent of subsidy rule is too limited to be usable. For this reason, we strongly recommend adopting a rule that would accommodate changes in the optional forms of distribution available to terminated, vested participants. Unless changes may be made with respect to terminated, vested participants, the regulations will be of only limited value.

The final regulations should allow sponsors to test options that would be banded together under the "5 percentage point rule" in the relative value regulations and therefore to treat any lost value within the bands as de minimis. We also recommend adding some flexibility to the 2 percent rule by expanding it to 2 percent of the value of the retained form.

Finally, we also recommend that the 1 percent of compensation rule take into account participants who have reduced 415(c) compensation, such as participants on leave of absence or who have reduced work schedules. The regulations should allow plans to apply the 1 percent of compensation rule using either a participant's highest 415(c)(3) compensation during any year the participant accrued a benefit or the section 415(b)(1)(B) limit (average compensation for the participant's highest three years).

5. Different Approaches for Different Participants. The final regulations should clarify that a plan may use the 90-day approach for some participants while using the four-year approach for other participants, where appropriate. For example, if an optional form is subsidized for only some participants, e.g., those with a spouse more than 10 years younger, it should be permissible to amend the plan to eliminate the subsidized form on an expected transition basis under the four-year approach, while using the 90-day approach for all other participants. Similarly, under the four-year approach, the final regulations should clarify that the de minimis rule and the expected transition rule may be applied to different participants in the same plan.

6. Expected Transition Rule. As an alternative to the de minimis test, the expected transition rule provides for a simplified wear-away of subsidized, optional forms of distribution. Under the expected transition rule, participants continue to accrue benefits under the disappearing form until the delayed effective date, which is the end of the longest expected wear-away and must be at least four years after the date the amendment is adopted. If a participant terminates employment during the transition period, the participant is entitled to the form without regard to wear-away, but the form is eliminated if the participant remains employed for the entire transition period.

The expected transition rule appears to be prohibitively expensive because it requires that the expected transition be estimated without taking into account expected compensation increases (increased compensation has the effect of reducing the wear-away period because the participant will accrue additional benefits). We believe that this ignores economic reality and recommend allowing plans to assume that compensation will increase at a conservative rate, such as the average historic CPI.

We urge that the final regulations should clarify the manner in which the expected transition rule applies. Specifically, the expected transition rule may be applied on the basis of representative examples, taking into account the longest likely wear-away period. Any system that requires plans to calculate the wear-away period for every participant, including participants who may have atypical employment patterns, e.g., phased retirement or extended leaves of absence, would be too expensive and administratively impracticable.

7. Retained Form. If the 90-day rule is retained in its current form, the final regulations should clarify the retained form requirement under the 90-day rule. The proposed regulations require that the plan retain at least one optional form of benefit within each fund family previously contained in the plan. As currently drafted, it is unclear whether there must be a single retained form for each eliminated, redundant optional form or whether it is sufficient for two or more retained forms to satisfy the requirements of the regulations when considered together. For example, if a plan offers a subsidized 50 percent joint and contingent annuity with and without leveling and an unsubsidized 100 percent joint and contingent annuity with and without leveling, it is not clear whether the subsidized 40 percent joint and contingent annuity with leveling may be eliminated. The Council recommends clarifying that the requirements may be satisfied in tandem through one or more retained forms. Thus, in the example above, the 50 percent joint and contingent annuity without leveling would satisfy the de minimis test while the 100 percent joint and contingent annuity with leveling would satisfy the requirement to retain an option with leveling.

8. Leveling and Refund of Employee Contributions Features. The proposed regulations provide much needed relief by allowing plan sponsors to limit a plan's optional forms to one uniform leveling feature. However, the regulations also include special protections for leveling and refund features. Under the four-year approach, one core option must be retained that includes a leveling feature and employee contribution refund option if other forms with those features are eliminated. However, we urge the Treasury Department to consider eliminating the special protections for leveling and refund features if the plan offers a single-sum payment option. Participants do not have a reasonable expectation of access to these features given the delayed effective date and we cannot see any public policy favoring leveling features where a single-sum option is available. In addition, the proposed regulations should clarify that the plan sponsor may, but is not required to, include features such as pop-ups, leveling, and refunds of employee contributions in its core options.

9. Utilization Test. Utilization is the clearest indicator of an optional form's value to participants and a utilization test should be included in the final regulations. This approach could be coordinated with the 90-day approach by applying the test on a family of forms basis. A utilization approach might look at participants retiring under the plan for a look-back period (e.g., the preceding 12 months or longer if the sample size is too small) and compare the number of participants who would have elected a form if all optional forms were selected a proportionate number of times. The utilization test would then permit the elimination of forms rarely elected relative to the baseline described above, unless the form is a core form. This rule could be applied to small plans by extending the look-back period in 12-month increments if there were too few retirees or by mandating a minimum number of eligible participants. Another approach would be to simply provide that, if over a specified period, a plan had a minimum number of retirements, it would be permissible to eliminate any option (with a delayed effective date of 90 days) if 4 percent or fewer of the eligible participants choose that form during the specified period.

10. Replacing Actuarial Assumptions. The proposed regulations provide that a de minimis retirement-type subsidy may only be eliminated if the elimination simplifies the administration of the plan. The regulations specifically state that if one set of actuarial assumptions is replaced with a new set of actuarial assumptions, the amendment will not be permitted because it does not simplify the administration of the plan. This, however, completely ignores the fact that the existing set of assumptions may create administrative complexity. Many plans include a tabular list of factors for actuarial equivalence (largely because these factors were adopted when benefit calculations were done by hand). These factors often include simplifications (e.g., banding) that result in subsidies for particular participants. These factors present administrative complexities because of difficult disclosure requirements, including requirements under the relative value regulations. Newly revised factors could be more fair and accurate to participants and eliminate unfair and difficult to explain anomalies between participants while still meeting legal requirements. We urge the Treasury Department and the Service to provide that plans may update their actuarial assumptions by replacing outdated assumptions so long as the difference in value is de minimis. To the extent that there may be abuse concerns, i.e., a series of amendments satisfying the de minimis standard or a single amendment that satisfies the de minimis standard for the purpose of reducing cost, we believe that this issue is more appropriately addressed through anti-abuse rules.

11. Anti-Abuse Rules. The anti-abuse rules are too broad and may create problems in the context of mergers and acquisitions. For example, suppose that Plan B is merged into Plan A, and that Plan A is amended to add the retirement-type subsidies previously available to Plan B. The plan sponsor should not be prevented from later eliminating those subsidies, as it appears the proposed regulations would. Otherwise, the plan sponsor will likely not amend Plan A to allow the retirement-type subsidies and simply grandfather the subsidy for former participants in Plan A (greatly complicating plan administration).

12. 204(h) notice. The final regulations should clarify whether the 204(h) notice for an amendment that utilizes the expected transition approach is required prior to the date the amendment is adopted or prior to the effective date of the amendment. Our recommendation is to require the notice prior to the date the amendment is adopted to give participants advance notice (so they can plan).

13. Post-Termination Accruals. The regulations conclude that benefits are protected whether they accrue during or after employment. This is contrary to Board of Trustees of the Sheet Metal Workers' National Pension Fund v. CIR, which held that benefits accrued after termination of employment such as cost-of-living adjustments are not protected benefits. Participants should not have the same expectation in benefits accrued after termination of employment and these benefits should not be treated as protected benefits because these benefits are not "earned" during employment. The regulations should permit sponsors to specify in their plans (and communicate to retirees) whether post-termination accruals are protected against future elimination. This will encourage sponsors to provide post-termination accruals while ensuring that participants have appropriate expectations with respect to post-termination accruals.

14. Interaction with 411(a)(11). The proposed regulations reserve on the interaction of the vesting and anti-cutback rules pending resolution of Central Laborers' Pension Fund v. Heinz, which was decided by the Supreme Court earlier this month. Heinz holds that a change in the definition of disqualifying employment for purposes of suspending benefit payments is a prohibited cutback. This holding is contrary to the Service's longstanding informal position on the issue. However, the Supreme Court invited the Service to issue regulations explicitly allowing amendments that enlarge the scope of disqualifying employment. Employers need the flexibility to limit the circumstances in which individuals can simultaneously receive both salaries and pension benefits (particularly early retirement benefits) and we urge the Service to issue regulations affirming its historic position.

15. <u>MRD Coordination.</u> The recently-issued final regulations concerning required minimum distributions under section 401(a)(9) for defined benefit plans provide that certain forms are impermissible, e.g., a single life annuity with cost-of-living adjustments of more than 6 percent. The Service should provide (in the final regulations or otherwise) that plans have authority to eliminate options inconsistent with section 401(a)(9).

*   *   *

If you have any questions, please do not hesitate to contact the undersigned at (202) 289-6700. Thank you for consideration of this comment letter.

Respectfully submitted,

Jan Jacobson