



September 16, 2008

CC:PA:LPD:PR (REG 100464-08)
Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Proposed Anti-backloading Regulations under Internal Revenue Code Section 411

Dear Sir or Madam:

I am writing on behalf of the American Benefits Council (the "Council") with respect to the recently proposed backloading regulations. Specifically, the proposed regulations address the application of the backloading rules to plans under which participants' benefits are determined based on whichever of two or more formulas yields the largest benefit ("greater of formula").

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.

Overview

At the outset, we want to thank the Treasury Department and the Internal Revenue Service (the "IRS") for issuing these proposed regulations. The proposed regulations address very effectively the concerns we have raised with respect to the application of the backloading rules to conversions from traditional defined benefit plans to hybrid defined benefit plans. We applaud Treasury and the IRS for their openness to a constructive dialogue on this issue and for their development of a workable solution.

We are, however, very concerned that the proposed regulations only address one aspect of the greater of issue, albeit a critical aspect. We urge you to broaden the proposed regulations in two ways:

- 1) Most importantly, it is critical that the “different basis” requirement be deleted.
- 2) The separate testing rule should apply for purposes of all three backloading rules, not just the 133 1/3% rule.

Public Hearing

With respect to the proposed regulations, we request a public hearing and we request the opportunity to testify at that hearing. Kent Mason, a partner with the law firm of Davis & Harman LLP, will testify for the Council. Set forth below is an outline of the topics we will address (with the time devoted to each topic).

- I. Deletion of different basis requirement (6 minutes)
- II. Plan amendment rule (2 minutes)
- III. Application of separate testing rule to all three backloading rules (2 minutes)

Different Basis

Under the proposed regulations, a plan that uses a greater of formula may, subject to one condition, demonstrate satisfaction with the 133 1/3% rule by demonstrating that each separate formula satisfies that rule. The one condition is that this “separate testing rule” only applies if each of the separately tested formulas uses a different basis for determining benefits.

This different basis requirement does not pose a problem in the context of a conversion from a traditional formula to a hybrid formula. But it presents a very large problem in other contexts, especially one where greater of formulas are commonly used. In the context of corporate acquisitions, it is very common for the acquiring company to provide the acquired employees with the greater of the benefit determined under their former company’s plan or the benefit under the acquiring company’s plan. Such greater of formulas may be permanent or temporary. Under the interpretation of the backloading rules reflected in Revenue Policy 2008-7, such arrangements, if temporary, would in many cases violate the backloading rules unless the different basis requirement is deleted.

An example illustrates why this result does not make sense. Assume, for example, that the acquired company’s plan provided benefits equal to 1 1/3% of career average compensation multiplied by years of service. Assume, further that the acquiring company’s plan has an identical formula except that 1% applies instead of 1

1/3%. In addition, assume that the greater of formula expires after three years, at which point only the acquiring company's formula applies. Under this example, an acquired employee with no prior benefit under the acquired company's plan would have the following accrual pattern:

Year:	1	2	3	4	5
Annual accrual (old formula)	1 1/3%	1 1/3%	1 1/3%	--	--
Annual accrual (new formula)	1%	1%	1%	1%	1%
Actual annual accrual	1 1/3%	1 1/3%	1 1/3%	0%	1%

In year 4, the employee does not earn any new accrual because he or she has already attained a "4% accrued benefit" under the old formula, and the ongoing formula does not yield any additional benefit until year 5. Under Revenue Ruling 2008-7, this accrual pattern would violate the 133 1/3% test because of the increase from 0% in year 4 to 1% in year 5, yet the reason for the 0% accrual in year 4 is that the greater of formula frontloads the first four years of the new formula benefits into three years. In other words, if the employees simply earned benefits under the new formula—1% per year—the 133 1/3% test would be satisfied. But because of the frontloading caused by the greater of formula, the employee earns no new benefit in year 4, thereby potentially triggering a violation of the backloading rules under the interpretation set forth in Revenue Ruling 2008-7.

Under a separate testing rule, this arrangement would appropriately be treated as satisfying the backloading rules. But the proposed separate testing rule is unavailable in this case due to the different basis requirement.

This result does not make sense. Simply put, the greater of formula creates frontloading, making a finding of backloading inappropriate. Moreover, the way to avoid such a backloading "violation" is not to provide "greater of" formulas. In this case, that would mean that only the new formula would apply, so any employee terminating employment prior to attaining four years of service would be worse off, and no one would be better off. There is no policy support for treating frontloading as backloading and causing benefit reductions for participants.

Moreover, the problems are by no means limited to the plan merger context. For example, we have heard from a large company that has for many years provided the greater of two final average pay formulas, one integrated with Social Security and one not integrated. The non-integrated formula was added to benefit lower paid workers. Again, the effect of this greater of formula is to frontload benefits and to benefit participants; it would be very unfortunate and inappropriate if the backloading rates required the company to cease providing this greater of formula because it creates frontloading.

Legislative history. The above result—based on combined testing rather than separate testing—also does not make sense technically and has been repeatedly rejected by the courts. We start with an examination of the applicable legislative history.

When it enacted the anti-backloading rules as part of ERISA, Congress was emphatic that plans are permitted to *frontload* benefit accruals. The ERISA Conference Report said this three times. First, the Conference Report made the following statement about the 3% test: “This test is to be applied on a cumulative basis (i.e., *any amount of ‘front loading’ is permitted*).”¹ The Conference Report also made a similar statement about the 133-1/3% test: “Under this alternative, the plan is to qualify if the accrual rate for any participant for any later year is not more than 133 1/3 percent of his accrual rate for the current year. Thus, (unlike the House bill) the conference substitute *permits an unlimited amount of ‘front loading’* under this test.”² The Conference Report made this point a third time in connection with the fractional rule: “This test is cumulative in the sense that *unlimited front loading is permitted*.”³

Congress was clearly emphatic about this point. Nor is it surprising that Congress sought to permit frontloading. The anti-backloading rules were designed to restrict the extent to which a plan may *defer* the accrual of benefits until late in a participant’s career, thereby thwarting the objectives of ERISA’s vesting standards. The *acceleration* of benefit accruals — through frontloading — advances the objectives Congress sought to achieve in enacting the anti-backloading rules: the accrual of pension rights *early* in a participant’s career.

The proposed regulations, in conjunction with Revenue Ruling 2008-7, would, in certain circumstances, penalize plans for frontloading benefit accruals — contrary to the intention of Congress and contrary to the objective of the anti-backloading rules: to restrict plans’ ability to *defer* the accrual of benefits. Although the anti-backloading rules were designed to limit backloading and to permit *unlimited* frontloading, the proposed regulations, in conjunction with Revenue Ruling 2008-7, would, in certain circumstances, apply the anti-backloading rules to penalize frontloading.

Regulatory structure. The separate testing regime (without a different basis requirement) is also consistent with the current regulatory structure. The current regulations provide that plans may include more than one benefit formula, but the accrued benefits under all such formulas must be “aggregated” to determine whether the plan satisfies the anti-backloading rules. Treas. Reg. § 1.411(b)-1(a). In the case of a

¹ H.R. (Conf.) Rep. No. 1280, 93d Cong., 2d Sess. 273 (1974) (emphasis added).

² Id. at 274 (emphasis added).

³ Id. at 274 (emphasis added).

plan with additive formulas, it is simple to determine how to “aggregate” the accrued benefits under the plan’s benefit formulas – you just add them up. How to “aggregate” the accrued benefits in a plan with a greater of formula, however, is far from straightforward. This is because, even though the plan includes multiple formulas, each participant will have his or her accrued benefit determined under only one formula, namely, the one that produces the greatest benefit. As a result, it is not possible to “aggregate” the accrued benefits under the plan’s formulas by adding them up. “Aggregate” necessarily means something different from simple addition in this case.

In Revenue Ruling 2008-7, the IRS interprets the term “aggregate” in the case of greater of formulas to require that the accrued benefits under all the plan’s formulas be combined and accumulated. Under this interpretation, a determination is made for each plan year as to which formula produces the greatest accrued benefit for the participant as of the end of that year. The results for all relevant plan years are then plugged into the particular anti-backloading test being applied. This interpretation is not the only possible interpretation, nor is it the appropriate one. We believe that the regulations should reflect an interpretation of the term “aggregate” that is consistent with the IRS’ long-standing practice of approving plans with alternative greater of formulas, and that comports with Congressional intent by not disqualifying plans as backloaded merely because they frontload benefit accruals. In our view, a plan with a greater of formula should satisfy the anti-backloading rules as long as it satisfies the basic rule set forth in the proposed regulations, i.e., each of the formulas individually satisfies the anti-backloading rules. Under this interpretation, the accrued benefits under all the plan’s formulas would be “aggregated” by requiring that *all the formulas* satisfy the anti-backloading requirements. This is a reasonable interpretation given the special character of greater of formulas. Contrary to the IRS’ current interpretation, it is not necessary to combine and accumulate benefits under “all” the plan’s formulas, since a participant’s benefit ultimately will be determined under only *one* of those formulas. See *Hurlic v. Southern California Gas Company*, 2008 WL 3852685 (9th Cir.); *Tominson v. El Paso Corporation*, 2008 WL 762456 (D. Colo.); *Wheeler v. Pension Value Plans for Employees of the Boeing Company*, 2007 WL 2608875 (S.D. Ill.). However, because participants in the aggregate might have their accrued benefits determined under *any* of the plan’s alternative formulas, each of those formulas must individually satisfy the anti-backloading rules.

This approach directly parallels the treatment of greater of formulas in the nondiscrimination safe harbors for defined benefit plans. Under Treasury Regulation § 1.401(a)(4)-3(b)(6)(xi), defined benefit plans that provide greater of formulas satisfy the nondiscrimination safe harbors as long as each formula individually satisfies a safe harbor. The approach is also similar to the interpretation the IRS adopted in Revenue Ruling 76-259, 1976-2 C.B. 111, which explained how the anti-backloading rules apply to defined benefit plans that are part of a floor-offset arrangement. Like defined benefit plans with greater of formulas, floor-offset arrangements provide participants with the

greater of the benefits determined under more than one formula — specifically, the benefit formula under a defined benefit plan and the allocation formula under a related defined contribution plan. Also like plans with greater of formulas, floor-offset arrangements are guaranteed to provide a benefit that is at least as frontloaded as the benefit formula under the defined benefit plan would provide on its own. Not surprisingly, the IRS ruled that the benefit formula under the defined benefit plan could be tested under the anti-backloading rules *without* taking into account the alternative formula under the defined contribution plan. The IRS reached this conclusion even though, tested on a combined and cumulative basis, the defined benefit plan was unlikely to provide *any* accruals to participants until late in their careers.

As further support for our proposed interpretation, the employees who benefit under each formula could be treated as different categories of employees. The current regulations state that “[a] plan may satisfy different methods with respect to different classifications of employees, or separately satisfy one method with respect to the accrued benefits for each such classification, provided that such classifications are not so structured as to evade the accrued benefit requirements of section 411(b) and this section.” Treas. Reg. § 1.411(b)-1(a)(1). Since each participant only receives benefits from one formula, the group of participants who benefit under each separate formula could be considered a separate classification. As long as each separate formula satisfies the anti-backloading rules on its own, the plan as a whole would satisfy the anti-backloading rules.

Where each formula individually satisfies the anti-backloading rules, the participant is guaranteed to receive an accrued benefit that satisfies the anti-backloading rules. Even if the formula that produces the greatest accrued benefit shifts during the participant’s career, the resulting pattern of accruals is mathematically certain to be more frontloaded than one of the formulas which indisputably satisfies the anti-backloading rules. Because ERISA permits and encourages plans to frontload benefit accruals without limit, the IRS can easily interpret the statute and existing regulations in the most appropriate way to find that such plans satisfy the anti-backloading rules, as it has for over three decades since the passage of ERISA.

Other statutory and regulatory uses of greater of formulas. In many circumstances, both Congress and the Treasury Department have required or encouraged the use of greater of formulas, such as:

- Employee Retirement Income Security Act of 1974 (“ERISA”), Pub. L. No. 93-406, § 2004(d)(2), 88 Stat. 829, 987 (1974) - permitting pre-ERISA defined benefit plans to provide the greater of (a) post-ERISA benefit formula subject to § 415(b) limits and (b) pre-ERISA benefit formula applied to all years of service but not subject to § 415(b) limits;
- Treas. Reg. § 1.415-4(b)(2), *obsoletedby* T.D. 9319 - same as above;

- ERISA § 204(h)(6)(A) -in case of certain failures to provide section 204(h) notice, participants must receive greater of benefits determined under pre-amendment terms of plan and post-amendment terms of plan;
- Treas. Reg. § 54.4980F-1, Q&A-14(a)(1) & Q&A-11(a)(4)(ii) - same as above, with specific rules for cash balance conversions;
- Treas. Reg. § 1.401(a)(4)-3(b)(6)(xi) - plans that provide “greater of” formulas satisfy nondiscrimination safe harbors as long as each formula individually satisfies a safe harbor;
- Treas. Reg. § 1.401(a)(4)-13(c)(4)(iii) - providing nondiscrimination transition relief for plans that provide greater of (a) new benefit formula applied to all years of service and (b) sum of prior benefit formula applied to prior years of service and new benefit formula applied to new years of service;
- Treas. Reg. § 1.401(a)(17)-1(e)(3) - same as above; and
- Notice 88-131, 1988-2 C.B. 546 (Alternative IID) - permitting nonhighly compensated employees to accrue greater of benefits under pre-TRA’86 formula and post-TRA’86 formula during 1989 plan year.

The IRS has not taken the position that a plan could be found to violate the anti-backloading rules merely because it observed these provisions in the statute and regulations. Moreover, Congress itself mandated the use of “greater of” formulas in the *anti-backloading* rules themselves. Code section 411(b)(1)(D) requires pre-ERISA defined benefit plans to provide participants with the greater of their accrued benefit determined under the plan’s pre-ERISA formula without regard to the anti-backloading rules and one-half the accrued benefit the plan would have provided for pre-ERISA years of participation had the anti-backloading rules been in effect during those years. The Treasury’s anti-backloading regulation implements this requirement. Treas. Reg. § 1.411(b)-1(c).

Meaning of different basis. The preceding discussion addresses why the different basis requirement should be deleted based on both technical and policy grounds. In addition, it should be deleted because it is unworkable due to the absence of any conceptual underpinnings.

Which of the following differences would constitute different bases: 3-year final average pay versus 5-year final average pay; use of base pay versus total pay; use of permitted disparity versus no such use (as in the actual greater of formula described previously); use of offsets versus no such use; use of different service crediting methods; accrual for periods of disability versus no accrual; different caps on

compensation or service; use of A plus B versus no such use; or hundreds of other common variations? The proposed regulations do not articulate any logic underlying the requirement, making its interpretation nearly impossible. Since the different basis rule is not supported by any articulated purpose and it can be interpreted in numerous ways, there is no way to distinguish correct interpretations from incorrect ones. Nor is there a way to determine if a plan is being structured to evade the different basis requirement; we just do not know what the requirement means.

In short, the different basis rule will lead to endless debate and confusion about what it means (and corresponding administrative burdens on the IRS). And it serves no technical or policy purpose. The rule should be deleted and all plans should be permitted to use the separate testing regime.

Given this lack of clarity in the different basis requirement, and the frontloading penalty caused by the guidance, the guidance as currently constituted would incent plan sponsors to move away from “greater of” formulas which would be to the ultimate detriment of plan participants. As one would suspect, “greater of” formulas are typically used to keep (either temporarily or permanently) a more generous benefit formula for a current participant population or acquired participant population. Congress surely did not intend that the application of the accrual rules encourage less favorable benefit structures for plan participants in circumstances where backloading was not an issue.

Plan amendment rule. We also note an alternative means of arriving at the right result. Where one benefit is replaced by a second formula under a plan, the first formula is disregarded by reason of the plan amendment rule. Code section 411(b)(1)(B)(i); Reg § 1.411(b)-1(b)(2)(ii)(A). In Revenue Ruling 2008-7, the IRS took the position that this rule only applies if the first formula ceases to apply immediately. There is no justification for the IRS position in this regard. In effect, where the plan provides the greater of the two formulas for a specified period, the effective date of the conversion to the new formula is simply delayed. It is still a plan amendment under the plain language of the statute and regulation. Accordingly, the IRS’ position is not sustainable. See *Hurlic v. Southern California Gas Company*, 2008 WL 3852685 (9th Cir.); *Tominson v. El Paso Corporation*, 2008 WL 762456 (D. Colo.); *Wheeler v. Pension Value Plans for Employees of the Boeing Company*, 2007 WL 2608875 (S.D. Ill.).

All Backloading Rules

Aside from the discussion above regarding the plan amendment rule, all of the analysis above applies equally to all three backloading rules. In brief, all three were intended to prohibit backloading, not frontloading, and should not be interpreted to create a backloading violation based on frontloading. Thus, the separate testing rule—without a different basis requirement—should apply to all three backloading rules.

Effective Date

If, contrary to our strong urgings, the different basis rule is retained, the effective date of the regulation needs to be modified in the case of collectively bargained plans that would not satisfy the different basis requirement. A new rule should not be made applicable to collectively bargained plans mid-bargaining cycle; the effective date for collectively bargained plans should not be earlier than the first plan year beginning after the expiration of the last collectively bargaining agreement pursuant to which the plan is maintained. See Reg. § 1.401(k) – 1(g)(3) for an example of an administrative application of a delay for collectively bargained plans.

Of course, in conjunction with the delay described above, the section 7805(b) relief provided by Revenue Ruling 2008-7 should, with respect to a collectively bargained plan, be extended through the last plan year prior to the effective date of the regulation with respect to the plan.

We appreciate your consideration of our views.

Sincerely,

A handwritten signature in black ink, appearing to read "Jan Jacobson", with a long horizontal flourish extending to the right.

Jan M. Jacobson