AMERICAN BENEFITS COUNCIL

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Dear Mark, Vicki, and Andy:

On behalf of the American Benefits Council (the "Council"), I am writing to request critically needed guidance regarding the funding stabilization provision contained in the recently enacted "Moving Ahead for Progress in the 21st Century Act" (the "Act").

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.

As indicated in our July 10 letter, in terms of timing, our highest priority regarding funding stabilization is publication of the 25-year averages. That remains urgently needed for the reasons discussed in our July 10 letter. We know that determining the 25-year average is a difficult task and that you have many other pressing priorities, but

the September 15th deadline is looming and plans will need more than a couple of weeks to implement the 25-year averages.

In terms of substance, as opposed to timing, one issue dwarfs all others. It is critical that guidance from Treasury and the Service not undo substantially all the effects of funding stabilization for a very large number of plans by modifying the current-law regulatory rules for valuing lump sum distributions for funding purposes. In this regard, we ask for no guidance, since current law works very well. Any different guidance would have a devastating effect on companies across the country, as explained further below, and be directly inconsistent with (1) Congressional intent, (2) the principles underlying the Pension Protection Act of 2006 ("PPA"), and (3) the principles underlying the final regulations.

The lump sum valuation issue is addressed first below. Set forth subsequently are other critical issues that need attention very quickly. While the timing is not as crucial as it is with respect to the 25-year averages, guidance on several of the substantive items is needed well in advance of September, as September contains the deadlines for 2011 contributions and 2012 certifications for calendar year plans of the plans' adjusted funding target attainment percentage ("AFTAP"). To the extent that guidance cannot be issued before September, we would ask you to treat compliance with a reasonable interpretation of the Act as compliance with the law for the 2012 plan year.

The reasonable interpretation standard will be especially important if any new issues are resolved adversely after the publication of the 25-year averages. As soon as the 25-year averages are published, companies will begin implementation for 2012 plan years with respect to these issues.

VALUING LUMP SUM DISTRIBUTIONS FOR FUNDING PURPOSES

In general. As noted, our request here is straightforward: we ask for no guidance beyond what currently exists. Consistent with the statute and current regulations, lump sum distributions (and other distributions subject to Code section 417(e)(3)) should continue to be valued for funding purposes based on the funding interest rates, not the rates used in determining the amount paid to participants.

We strongly believe that this issue is a non-issue that is addressed well by current law, and thus further guidance is neither needed nor appropriate. In fact, the only reason that we address the issue here is that if the current regulations are modified on this issue, it would (1) undo an enormous part of the stabilization intended by Congress, (2) almost certainly render the revenue estimate of the funding stabilization provision invalid, and (3) be a change from fundamental principles underlying the PPA and the current regulations.

This issue is best explained through an example. Assume that a traditional defined benefit plan offers lump sums. In such cases, a valuation of the plan's liabilities for funding purposes is required to take into account the likelihood of paying lump sums. This necessitates valuing both annuity payments and lump sum payments for purposes of determining the plan's funding target. Consider a lump sum that is projected to be paid in three years. Under the plan, the amount of the lump sum that is payable would be the present value of the immediate annuity payable at that time, determined using the Code section 417(e) mortality and interest rate assumptions. The question is what interest rates should be used to determine the value of that lump sum for funding purposes.

Under current law, the lump sum is valued as if the benefit were paid in an annuity form, except that the lump sum mortality table is used to value the annuity benefit. ***On the other hand, the funding interest rate is used for valuation purposes, not the lump sum interest rate. Treasury Regulation § 1.430(d)-1(f)(4)(iii).***

Pre-Act analysis continues to apply. The above structure made very good sense under pre-Act law because the difference between the lump sum interest rates and the funding interest rates was attributable solely to the difference between a one-month average of interest rates (used to determine lump sums) and a 24-month average of interest rates (used to determine funding). Over time, use of the funding interest rates, instead of the lump sum interest rates, does not produce either higher or lower valuations for funding purposes. On the contrary, it simply produces the predictability that Congress clearly intended in permitting plans to use a 24-month average for funding purposes. If plans were forced to use the lump sum interest rates, plans would lose this predictability and be forced into exactly the volatility that Congress specifically intended to prevent by adopting a 24-month average for funding purposes.

The above analysis continues to apply just as strongly post-Act. Over time, use of the stabilized funding interest rates, instead of the lump sum interest rates, does not produce either higher or lower valuations for funding purposes. On the contrary, again it simply produces the predictability that Congress clearly intended in permitting plans to use a stabilized 24-month average for funding purposes. If plans were forced to use any other interest rates, plans would lose this predictability and be forced into exactly the volatility that Congress specifically intended to prevent.

Spread between the rates. The only reason that this issue has arisen is a point unrelated to any technical analysis: the difference between the funding interest rates and the lump sum interest rates would temporarily be more pronounced under the Act. This fact should not affect the analysis for the following reasons.

- First, the fact that the difference between the two different types of interest rates is more pronounced does not have an effect under any statutory analysis.

- Second, even under current law, it is very possible that the difference between the two sets of rates could be very pronounced if the one-month interest rates suddenly jump up or down, such as occurred in the latter part of 2008. Yet the current regulations provide that the funding interest rates shall be used in all cases.

- Third, and much less importantly, the significant effects of the Act will be very short-lived; for example, when the corridor is 30%, it will be very unusual for the stabilized interest rates to yield a result different from current law.

- Fourth and more significantly, even if the Act had retained the 10% corridor indefinitely, it would still be true that, over time, use of the funding interest rates, rather than the lump sum interest rates, would not give rise to higher or lower valuations for funding purposes.

- Finally, in the past, there have been significant structural differences between the lump sum interest rate and the funding rate; the lump sum rate was systematically lower while the 30-year Treasury rate was being phased out for lump sums. For example, IRS Notice 2009-2 provides the permitted funding segment rates as well as the maximum lump sum segment rates for certain plans for plan years beginning in 2008 or 2009. ***Under the applicable transition rules, for the plan years beginning in 2008, the first, second, and third segment rates for funding purposes exceeded the corresponding segment rates for lump sum purposes by 233 basis points, 262 basis points, and 285 basis points, respectively.*** These were very large differences that were perfectly permissible under the regulations. Moreover, there have been many such instances of very large differences. ***So the notion that large differentials in the two sets of rates should affect the legal analysis is inconsistent with the law that has been in effect.***

In short, we do not see any technical or policy reason for the current law rules on valuing lump sums for funding purposes to be modified as a result of funding stabilization.

ELECTIONS NOT TO APPLY FUNDING STABILIZATION/OPTING OUT OF EXISTING ELECTIONS

With respect to the 2012 plan year, Act section 40211(c)(2)(A) permits plan sponsors to elect not to apply funding stabilization for (1) any purpose, or (2) solely for purposes of determining the plan's AFTAP in applying the benefit restrictions under Code section 436 and ERISA section 206(g). We, of course, need guidance as to how and when such elections are to be made.

Similar guidance is needed with respect to the election provided by Act section 40211(c)(2)(B) regarding opting out of an election to use the yield curve under (Code section 430(h)(2)(D)(ii) and ERISA section 303(h)(2)(D)(ii)).

We would propose that elections regarding the use of stabilized segment rates be permitted to be made on the plan's Form 5500 for the 2012 plan year. Of course, elections will need to be consistent with plan operations during the 2012 plan year.

BENEFIT RESTRICTIONS/TRANSITION ISSUES

The following benefit restriction issues are purely transitional issues generated by the mid-year passage of the Act.

Updated certifications that would create a "material change". Assume, for example, that a plan has been certified as having an AFTAP of 70% for 2012 based on pre-Act law. Accordingly, the payment of lump sum distributions (and other prohibited payments) under the plan has been restricted. Under the Act, assume that the plan has an AFTAP of 82% for 2012.

One can read the Act as creating an "all or nothing choice" with respect to the application of the stabilized segment rates for benefit restriction purposes for 2012. Under that interpretation, if the plan sponsor chooses to implement the Act for 2012 for benefit restriction purposes, the new AFTAP would apply for the entire year; at a minimum, this would require corrective action with respect to the past, and could raise qualification issues. Obviously, this is a problematic result. Alternatively, the plan sponsor could elect not to apply the stabilized rates for 2012, thus leaving the prohibited payment restriction in place for longer than necessary (and inappropriately having the 2013 presumption based on the "unstabilized" AFTAP).

Treasury and the Service have the power to avoid this "either/or result". There is no policy or technical reason for the law to require lump sum distributions (and other prohibited payments) to continue to be restricted for 2012 if an updated certification is provided with the intent of taking effect merely for the balance of 2012. That is, there would be no effect on benefits that had been processed prior to the certification of the stabilized AFTAP.

To facilitate this appropriate result, we ask that Treasury and the Service adopt the following rule. For the 2012 plan year, if a plan sponsor requests an updated certification of the AFTAP that reflects the new stabilized segment rates, any change in the AFTAP attributable to such stabilized segment rates that would otherwise be a "material change" should be treated as an "immaterial change" (under the Regulation of §1.436-1(h)(4)(C)) that applies prospectively from the date of the updated certification. In addition, consistent with section 40211(c)(2) of the Act, the rules should

provide that any election regarding whether to request an updated certification, regardless of how implemented or adopted, shall not be treated as a violation of the anti-cutback requirements of Code section 411(d)(6) or ERISA section 204(g). (This anti-cutback clarification should apply to all the benefit restriction issues addressed in this letter.)

Of course, the above requests apply equally to all benefit restrictions, not just the restrictions on prohibited payments. In addition, in other respects not addressed above, the current-law rules would continue to apply with respect to the prospective application of updated certifications reflecting immaterial changes.

Updated certification that would eliminate the need for a prior reduction of funding balances. Assume, for example, that a calendar year plan that offers lump sum distributions had, as of January 1, 2012, $83 of assets, $100 of liability, a pre-funding balance of $10, and a certified AFTAP of 73%. Accordingly, pursuant to Regulation §1.436-1(a)(5), the plan sponsor is treated as having made an election under Code section 430(f) and ERISA section 303(f) to reduce the pre-funding balance by $7 so as to avoid a restriction on lump sum distributions (and other prohibited payments). Assume further that, under the stabilized segment rates, the plan's liabilities for 2012 would have been $85 and that would have resulted in an AFTAP of 85.88% without any reduction of the pre-funding balance. Thus, there was no reason that the plan sponsor should have had to reduce the pre-funding balance. To require that deemed election—to reduce the pre-funding balance by $7— to stay in effect would be to deny full effect to the fact that the stabilized segment rates are applicable to the 2012 plan year.

To address this issue, we ask that Treasury and the Service adopt the following rules. For the 2012 plan year, in the case of a plan sponsor that requests a "stabilized" AFTAP certification, any AFTAP change that would not have affected plan operations shall be treated as retroactive to the effective date of any election—required or voluntary—to reduce the plan's pre-funding balance or funding standard carryover balance. In addition, in the case of such a retroactive AFTAP change, the reduction of the plan's pre-funding balance or funding standard carryover balance shall be retroactively voided to the extent that such reduction was in fact unnecessary. Thus, in the above example, if the plan sponsor requests and obtains an updated certification, the reduction of the pre-funding balance by $7 shall be rendered void because the reduction was in fact unnecessary to avoid the limitation on prohibited payments. This $7 would thus be available to offset minimum required contributions.

Updated certification that would eliminate the need for a prior section 436 contribution. Assume, for example, that a calendar year plan had, as of January 1, 2012, $57 of assets, $100 of liability, no pre-funding balance of funding standard carryover balance, and an AFTAP of 57% (which is certified). Assume that on March 17, 2012, an event occurred that triggered an unpredictable contingent event benefit ("UCEB") valued at $2. The plan's AFTAP is recertified as 56%. On April 25, 2012, the plan

sponsor made a contribution of $2 to the plan that is designated as a section 436 contribution to avoid the limitation on UCEBs.

Assume further that, under the stabilized segment rates and taking into account the UCEB, the plan's liabilities for 2012 would have been $87 and that would have resulted in an AFTAP of 66%. In that case, there would have been no need for a section 436 contribution, and there is no reason to continue to treat the $2 contribution made on April 25, 2012 as a section 436 contribution. The plan sponsor should be required to treat the $2 contribution made on April 25, 2012 as a non-section 436 contribution for either 2011 or 2012.

To address this issue, we ask that Treasury and the Service adopt the following rules. For the 2012 plan year, in the case of a plan sponsor that requests an updated AFTAP certification, any AFTAP change shall, to the extent not covered by the above rule regarding credit balances, be treated as retroactive to the date of a section 436 contribution. In addition, in the case of a retroactive AFTAP change, the section 436 contribution shall be treated as a non-section 436 contribution to the extent that such section 436 contribution was in fact unnecessary. Thus, in the above example, if the plan sponsor requests and obtains an updated certification, the $2 contribution would be a non-section 436 contribution, attributable to either 2011 or 2012, as subsequently designated by the plan sponsor.

Contributions for 2011. We view the following as current law, which works well, and we have no proposal in this regard.

Assume, for example, that as of January 1, 2012, a calendar year plan has $100 of liabilities, $67 of assets, no pre-funding balance or funding standard carryover balance, and an AFTAP of 67%. Assume further that application of the stabilized segment rates would reduce the plan's liabilities to $85, and that that would increase the plan's AFTAP to 78.82%. In this case, by contributing $1 for 2011 by September 15, 2012, the plan could increase the plan's 2012 assets to $68, which would make the plan's AFTAP 80% for 2012.

In this case, as we read the regulations, any request for an updated certification would be optional. Moreover, if an updated certification is provided, then such updated certification would result in an "immaterial change" under Regulation § 1.436-1(h)(4)(C)(1) that would be effective as of the date of the updated certification, thus lifting the restriction on prohibited payments as of that date (and applying for purposes of the 2013 presumptions).

Application of Stabilized Segment Rates

In general. We believe that the Act is clear that the stabilized segment rates apply for all purposes, other than those specifically enumerated as exclusions. For example, in addition to applying for purposes of the basic funding calculations and benefit restrictions, the stabilized segment rates would apply, for example, to: (1) asset averaging pursuant to Code section 430(g)(3)(B) and ERISA section 303(g)(3)(B), (2) determining the amount of shortfall amortization installments under Code section 430(c)(3)(C) and ERISA section 303(c)(2)(C), (3) discounting contributions under Code section 430(j)(2) and ERISA section 303(j)(2), and (4) the safe harbor interest crediting rate under Regulation § 1.411(b)(5)-1(d)(3).

It would be very helpful to have confirmation that, pursuant to the statute, stabilized segment rates apply wherever the segment rates are cross-referenced (except as specifically provided).

Hybrid plans: interest crediting rate. With respect to the safe harbor interest crediting rate, as referenced above, however, the issues are more complicated. First, employers that use the third segment rate as their interest credit rating obviously have not been crediting at the stabilized rates for 2012, creating at least a transition issue. Moreover, it is a settlor function to determine which type of third segment rate is used on an ongoing basis, as the cost differences could be material in the short term. So we ask that the law clarify that plans be permitted to use either the stabilized or "unstabilized" third segment rate as their interest crediting rate. In addition, there should be anti-cutback relief under Code section 411(d)(6) for the first post-Act amendment clarifying which rate applies. Such amendment need not provide that the same approach applies in each year. For example, an amendment could provide that the unstabilized rate applies for 2012 and that the stabilized rate applies thereafter. Finally, we ask that it be confirmed that an amendment clarifying the continued application of the unstabilized third segment rate would not require a section 204(h) notice.

Deductions. Another unclear issue relates to deductions. The stabilized rates do not apply for purposes of determining the deduction limits on contributions. This should not require two different calculations of the value of plan assets (e.g., because of different asset averaging rules)—one for purposes of determining minimum required contributions and one for purposes of deduction limits. For simplicity, we request that only one set of asset valuation rules apply for all purposes—the new section 430 rules.

High-25 rule. Finally, we would ask for clarification regarding how the stabilization segment rates may be used in applying the pre-termination restrictions in Regulation § 1.401(a)(4)-5(b) (the so-called "high-25" rule).

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We thank you for your consideration of the issues addressed in this letter. We look forward to discussing these issues with you further.

Sincerely,

Lynn D. Dudley
Senior Vice President, Policy
American Benefits Council