December 3, 2012

AMERICAN BENEFITS COUNCIL

COALITION TO PRESERVE THE DEFINED BENEFIT SYSTEM

ERIC
THE ERISA INDUSTRY COMMITTEE

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Dear Mark and George:

On behalf of the American Benefits Council, the Coalition to Preserve the Defined Benefit System, and The ERISA Industry Committee, we are writing to raise three additional issues with respect to the hybrid plan regulations.

The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

The Coalition is an employer organization with 75 member companies ranging from modest-sized enterprises to some of the largest corporations in the country, all of which sponsor hybrid pension plans. Together the Coalition members provide retirement benefits for more than 1.5 million American workers.

ERIC is a nonprofit association committed to the advancement of the employee retirement, health, incentive, and welfare benefit plans of America's largest employers. ERIC's members provide comprehensive retirement, health care, and other economic security benefits directly to tens of millions of active and retired workers and their families. ERIC has a strong interest in proposals affecting its members' ability to deliver effective and secure retirement benefits.

Lookback and stability periods. Under the regulation, if a plan uses a crediting rate specified in Treas. Reg. § 1.411(b)(5)-1(d)(3) or (4)—generally, the segment rates, the rates approved in IRS Notice 96-8, or certain cost of living indices—then the plan can determine interest crediting rates for a stability period based on the rate for a specified lookback month. The stability period and lookback month must, however, satisfy the rules of Treas. Reg. § 1.417(e)-1(d)(4).

We have three concerns here. First, there should be anti-cutback relief for any adjustments made to conform to the required lookback and stability periods. Plans could not have anticipated the specific rules referenced in the hybrid plan regulations, and some are using different lookback or stability periods. Amendments to conform to the regulatory requirements should be exempted from the anti-cutback rules.

In addition, we ask that you adopt an ongoing anti-cutback rule in the case of other changes to lookback and stability periods. In light of the new market rate rules, many companies may be considering changes to their interest crediting rates, including changes to the lookback or stability periods. Some of these changes may be needed to simplify interest crediting rates that have become overly complex due to, for example, the prior need to satisfy the whipsaw rules. We ask that, on an ongoing basis, the same anti-cutback relief provided in Treas. Reg. § 1.417(e)-1(d)(10)(ii) apply to changes in the lookback or stability periods used to determine a plan's interest crediting rate. This would generally allow such changes if participants receive the larger of the pre-amendment benefit or the post-amendment benefit for a year. This change would be entirely consistent with the current interest crediting rate rule, which, as noted, generally refers to the section 417(e) regulations for rules on the lookback and stability periods.

In short, the anti-cutback relief should be unconditional for lookback and stability period changes made to conform to the regulations. Further changes should be subject to the rule in the section 417(e) regulations. Both forms of relief should, of course, apply to participants' entire benefits.

Second, we would ask that lookback weeks be permitted, in addition to lookback months. Some plans have historically used lookback weeks. There clearly is no manipulation here, since it is not possible to predict "high" or "low" interest weeks. Permitting lookback weeks would avoid unnecessary complexities and changes in interest crediting rates.

Third, we believe that it would be appropriate to provide more flexibility with respect to stability periods. For example, if a quarter or year may be used, why not two or three quarters? We believe that any stability period between the minimum and maximum period should be permitted.

Plan asset returns. With respect to the rule prohibiting above-market rates of return, the proposed regulations permit an "interest crediting rate equal to the actual rate of return on the aggregate assets of the plan…if the plan's assets are diversified so as to minimize the volatility of returns." Prop Reg. § 1.411(b)(5)-1(d)(5)(ii). Even if we accept *arguendo* the appropriateness of a closed list of permissible interest crediting rates and the diversification requirement, we question why the interest crediting rate must be based on the return of all plan assets. If the plan identifies, for example, a subset of plan assets, the plan's interest crediting rate should be permitted to be based on the returns on that subset, as long as the subset meets the diversification standard.

The desire to use only a portion of plan assets can arise for a variety of reasons. For example, a conventional defined benefit plan might be converted into a hybrid plan only with respect to benefits accruing in the future. The plan sponsor might want to designate a conservatively invested pool of assets to determine the rate of return on hybrid plan benefits to avoid return volatility, while continuing to invest the balance of the plan in a manner appropriate for the plan as a whole, taking into account the conservatively invested pool. Unless that is permitted, the plan sponsor would either have to change its investment strategy for overall benefit funding or make the new hybrid plan an entirely separate stand-alone plan. Similarly, an existing hybrid plan may already own illiquid and hard-to-value plan investments that the plan sponsor might want to disregard in determining the plan crediting rate. In short, there does not seem to be any sound basis for prohibiting a plan or plan sponsor from designating in advance the plan asset pool that will be used to determine the plan crediting rate, and there are very good reasons for permitting that flexibility.

Coordinating with 401(a)(26). Treas. Reg. § 1.401(a)(26)-2(d)(1)(iii) provides in relevant part that a "defined benefit plan is treated as comprising separate plans, if under the facts and circumstances, there is an arrangement (either under or outside the plan) that has the effect of providing any employee with a greater interest in a portion of the assets of a plan that has the effect of crediting separate accounts."

This regulation should be clarified to reflect the recognition in the hybrid plan regulations that a plan's benefits can be based on the return on plan assets, such as by using such return as the plan's interest crediting rate. The section 401(a)(26) regulations need to be modified to clarify that basing benefits on plan asset returns does not violate the regulation.

We appreciate your consideration of these issues.

Sincerely,

American Benefits Council

Coalition to Preserve the Defined Benefit System

The ERISA Industry Committee