AMERICAN BENEFITS COUNCIL

COALITION TO PRESERVE THE DEFINED BENEFIT SYSTEM

Filed electronically via regulations.gov

December 18, 2014

CC:PA:LPD:PR (REG-111839-13)
Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Transitional Amendments to Satisfy the Market Rate of Return Rules for Hybrid Retirement Plans

Dear Sir or Madam:

This letter is submitted on behalf of the American Benefits Council (the "Council") and the Coalition to Preserve the Defined Benefit System (the "Coalition") with respect to the proposed hybrid plan regulations published on September 19, 2014.

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.

Both the Council and the Coalition request the opportunity to testify at the public hearing scheduled for January 9, 2015. Separate outlines of topics will be provided by the organizations.

We commend the Treasury Department and the Internal Revenue Service for the excellent work that went into these proposed regulations, as well as the final regulations published on the same day. Both the proposed and final regulations reflected a great deal of thought and consideration of the issues raised by stakeholders. Below, we offer a number of suggested changes, but we thank you for establishing a workable framework for hybrid plans, which help provide retirement security to millions of Americans.

We have the following overarching comments on the proposed regulations, as well as numerous important technical points discussed below.

- The structure of the proposed regulations is overly restrictive and would result in harm to participants. A more flexible approach with additional safe harbors would be more protective of participants, preferred by plan sponsors, and more consistent with the law.

- Any new positions with respect to issues unique to pension equity plans should not be applied retroactively, through either guidance or enforcement. It would be unfair to apply new rules retroactively to plan sponsors that have been asking for guidance since the inception of these plans.

- Participant-directed plans are left in legal limbo by the final regulations. This legal limbo needs to be resolved before any such plans are required to make plan amendments.

- The final regulations included two new restrictive rules – dealing with early retirement subsidies and with plans that still include whipsaw calculations – that were never included in any prior or proposed guidance and we believe are inconsistent with the statute. Those rules should be withdrawn and, at most, proposed in the next set of proposed hybrid plan regulations.

OVERALL APPROACH

In general, the proposed regulations establish very specific rules for determining the types of cutbacks that are permitted with respect to interest crediting rates that do not satisfy the final market rate of return rules, as opposed to permitting plan sponsors to determine the crediting rate adjustment best suited to their situation. We believe that the proposed approach is based on three fundamental misconceptions and should be modified.

The proposed approach is not pro-participant and will in many cases actually hurt participants. The proposed approach may have been viewed as pro-participant in that it contains specific rules to restrict cutbacks. But in reality, the specific rules will in many cases compel employers to adopt interest crediting rates that are less favorable to participants. Here are two examples, but there are many additional examples.

- A plan credits interest based on 30-year Treasuries, subject to an annual minimum of 5.5%. Under the proposed regulations, the interest crediting rate could be changed to either (1) the 30-year Treasury rate with an annual minimum of 5%, or (2) a fixed rate of 6%. Certainly, the former would have a clear anti-participant effect. So why shouldn't plan sponsors have the option to avoid such a clear adverse effect on participants by, for example, preserving the current rate but capping it at the third segment rate? There is no question that this would not exceed a market rate of return -- since it cannot exceed an approved market rate -- and it would, as a practical matter, be more pro-participant.

- A plan credits interest at 30-year Treasuries plus 100 basis points. Under the proposed regulations, the 100 basis point margin would have to be eliminated. This is even more sharply anti-participant. Again, why not permit the preservation of the current rate, subject to a cap of the third segment rate? This is again conceptually consistent with the market rate rules and is more favorable to participants.

Plan sponsors need clear rules, but restrictive rules are not helpful. It is absolutely true that plan sponsors need a clear road map to move from an impermissible rate to a permissible rate. But there may be a misconception that plan sponsors would benefit from a lack of flexibility. In fact, it has been suggested that plan sponsors would prefer a lack of flexibility because flexibility could lead to lawsuits based on options not selected. Based on the input we have received, that is not an accurate reflection of plan sponsors' perspective.

If the regulations were to provide, for example, five safe harbor methods of modifying an impermissible interest crediting rate, this would not expose the plan sponsor to any more potential liability than if the regulations were to provide a single method. The choice of which method to select would clearly be a settlor act, just as the selection of the original rate was a settlor act. So the only possible lawsuit challenging the interest crediting rate would be a lawsuit challenging the validity of the regulations, which could also occur if the proposed regulations were finalized in their current form. In fact, in light of the examples set forth above and many other examples where the proposed regulations require an anti-participant result, a challenge to the regulations seems far more likely under the proposed regulations than if the regulations were to be changed to provide employers with flexibility to attain a more pro-participant result.

The proposed approach is not compelled in any way by current law, and in fact is inconsistent with current law. Some may argue that flexibility for plan sponsors is not consistent with the regulatory requirement that a reduction in rates only be permitted to the extent necessary. We find this argument unpersuasive. As illustrated above, the proposed regulations clearly permit reductions beyond those that are necessary. So if a strict "to the extent necessary" test applied, the proposed regulations would fail that test.

We believe that the inflexible "one right answer approach" is not only anti-participant and inconsistent with the law, but it is also conceptually flawed. Any effort to find a single perfect solution for every situation will result in either (1) hundreds of pages of detailed rules to address every conceivable situation, or (2) a fundamentally flawed rule that forces the elimination of valuable participant rights.

Greater flexibility is needed. We strongly believe that more alternative safe harbor transition methods are needed to address the above flaws in the proposed regulations. For example:

- The proposed regulations appear to position the third segment rate as the highest permissible non-investment rate. As such, we believe that any plan with a noncompliant non-investment based rate (including the composite rates that are addressed in the proposed regulations) should have the option of bringing the rate into compliance by either (1) changing to the third segment rate, or (2) limiting the existing rate to no more than the third segment rate. Adding these provisions would address many composite rates that are currently used but are not specifically mentioned in the regulations as well as adding some additional flexibility and pro-participant fairness to situations that are addressed in the proposal. These changes could avoid the difficulty and uncertainty of choosing a similar compliant bond rate, and also could avoid reductions to rates actually credited to participants. We note that moving to the third segment rate is an approach that will sometimes, but not always, be permissible in two steps with the first step being bringing the rate into compliance under the proposal and the second step being a permitted move to the third segment rate (under certain circumstances) under the final regulations. We believe that this should be permitted in a single step.

- We also see no reason not to permit a plan to modify a noncompliant investment-based rate by (1) changing it to the third segment rate, or (2) capping it at the third segment rate where the noncompliance is attributable to an impermissible minimum rate. For example, assume that an investment-based rate is impermissible due to the application of an annual minimum rate of return. Eliminating the annual minimum would give rise to more volatility, which may or may not be appropriate for the plan. This plan should have at least three choices:
    - Elimination of the minimum rate should be permitted.
    - In order to preserve the stable nature of the current rate, switching to the third segment rate should be permitted, with or without the same annual minimum rate.
    - As an alternative way to preserve the stable nature of the current rate, the current rate could be capped at the third segment rate, with the minimum rate preserved.
    - With respect to the prior two sub-bullets, we urge you to reconsider the lower ceiling on minimum rates applied to segment rates under the final regulations. As discussed fully in prior letters, the premise in the regulations that reasonable minimum rates must be taken into account in determining compliance with the market rate of return rules is inconsistent with the statute and could not withstand a legal challenge.
- We also believe that the highest permissible fixed rate of return should be permitted to be used in the preceding two rules in lieu of the third segment rate. So, any impermissible rate described above could be replaced by, or capped at, the highest permissible fixed rate.
- We see no reason why any impermissible investment rate of return could not in all cases be modified to be based on the rate of return on plan assets or on a subset of plan assets.

The above suggestions do not reflect a comprehensive list of additional safe harbors, but they do provide core examples of the types of new safe harbors that should be added.

INTERACTION BETWEEN FINAL AND PROPOSED RULES

In a number of situations, the effectiveness of the transitional rule is dependent on there being greater clarity with respect to the final regulations. Set forth below are examples of this.

Rounding of interest crediting rates: Some cash balance plans round their interest crediting rates to the nearest multiple of 10 or 25 basis points to simplify participant communication. The market-rate rules are silent on rounding, leaving it unclear whether such rounding is permissible, or whether the resulting rate is considered above market when the rate is rounded up. This is also a consideration for plans crediting the actual return on all or a subset of plan assets: how many decimal places must be used in the rate of return calculation?

We ask that further guidance clarify this issue one way or the other, but preferably to provide that it is permissible to round to the nearest multiple of 10 or 25 basis points because, over time, the rate will be rounded down as often as it is rounded up and therefore cumulative interest credits are not expected to be above market rate. We also ask that anti-cutback relief be provided to conform to whatever rounding rule is adopted.

Eligible cost-of-living indices: The regulations permit interest crediting rates based on an eligible cost-of-living index described in Regulations section 1.401(a)(9)-6, A-14(b). This section describes what the eligible indices are, but does not discuss the period over which the index change can be measured. Regulations section 1.401(a)(9)-6, A-14(a) is the section that permits increases based on the change in these indices over a 12-month period. It would be helpful for guidance to clarify that an increase over the 12-month period ending in the specified lookback month (including plans that describe this as the rate as of the last day of that month) is an acceptable interest crediting rate. The transition guidance should permit modifications to conform to the clarified rule.

Rolling cumulative floor: To satisfy the anti-backloading requirements of Code section 411(b)(1), some cash balance plans provide for a rolling cumulative floor rate determined over a fixed, multi-year period. These designs were expressly approved by IRS during the determination letter review process following the IRS moratorium on cash balance plan determination letters.

This plan design can produce annual floors in excess of the prescribed ceiling on minimum interest rates, even though over time the effective minimum rate is at or below the legal ceiling. This raises two questions: (1) if the cumulative effective minimum rate over time can be shown to be at or below the legal ceiling, is the floor permissible, and (2) what is the prescribed correction for rolling cumulative floors that exceed the minimum rate?

We believe that the final rules should explicitly permit rolling cumulative floor rates determined over a fixed, multi-year period in combination with corporate-bond or safe-harbor rates described in Regulations section 1.411(b)(5)-1(d)(3) or (4), provided the cumulative floor does not exceed the maximum permissible annual floor rate compounded over the fixed period. Plans with rolling cumulative floor rates in excess of the maximum permissible rate should have anti-cutback relief for plan amendments reducing the cumulative floor to the maximum permissible annual floor rate compounded over the rolling period.

The final rules should also provide anti-cutback relief for any plan amendment replacing a rolling cumulative floor with a mathematically equivalent annual floor.

ADDITIONAL COMMENTS ON PROPOSED REGULATIONS

Transitional rule for plan termination provisions: The anti-cutback relief contained in the proposed regulations is narrowly targeted at specific changes to the interest crediting rates described in the proposal. However, sponsors will also need to incorporate the plan termination provisions of the final regulations into their plans and these modifications could potentially result in reductions to interest crediting rates and other factors upon plan termination. We request that the anti-cutback relief be expanded to address the plan termination amendments as well as any other changes required by the final regulations.

Interest Crediting Rates Not Satisfying Timing Rules: Section 1.411(b)(5)-1(e)(3)(vi)(C)(*1*) of the proposed regulations provides that, if a plan does not satisfy the timing rules relating to how interest credits are determined and credited as set forth in Regulations section 1.411(b)(5)-1(d)(1)(iv), then the plan must be amended to correct the aspect of the plan's interest crediting rate that does not comply with those timing rules. However, the proposed regulations are unclear with respect to the flexibility available to the plan sponsor when making this change. For example, suppose that a plan credits interest for a given plan year based on a 12-month average of the 30-year Treasury rate for the preceding plan year. A 12-month average would not comply with the timing rules, as it would not satisfy the lookback requirements under Regulations section 1.417(e)-1(d)(4). While the proposed regulations would require that the plan be amended so that the interest crediting rate satisfies those requirements, there are multiple ways in which the plan could potentially be amended to accomplish this. The plan could be amended to credit the 30-year Treasury rate for a single permissible lookback month or an average of the 30-year Treasury rate for up to five consecutive permissible lookback months. Other choices exist as well. A similar issue exists with regard to a noncompliant stability period. It is unclear whether the proposed regulations would allow a noncompliant lookback or stability period to be changed to any permissible lookback or stability period, or whether there are limitations. We believe the proposed regulations should be clarified to explicitly state that a plan amendment to bring a plan's interest crediting rate into compliance with the timing rules can use any permissible lookback and stability period to determine interest credits following the amendment.

Effective date: We would like to raise two points with respect to the effective date of the final regulations. First, many plan sponsors will need at least a year to evaluate the regulations, analyze different ways to comply that affect core plan design issues, make decisions regarding those plan design changes, prepare their systems to implement those changes, and implement and communicate the changes. Accordingly, if the proposed regulations cannot be finalized very shortly after the hearing in January, we may need a delay in the effective date of the final regulations.

Second, we note that plan sponsors may need to negotiate with unions regarding needed changes to collectively bargained hybrid plans. In this regard, a delayed regulatory effective date for collectively bargained plans is needed. This is consistent with the fact that the original effective date of the market rate of return rule in the Pension Protection Act of 2006 included a delayed effective date for collectively bargained plans. Not to include a similar delay here would be inconsistent with Congressional intent.

PENSION EQUITY PLANS

No retroactivity: In the context of the final regulations and the proposed transition rules, it is important to focus on one of the key sets of outstanding issues: the issues unique to pension equity plans ("PEPs"). We have one core comment on which we feel very strongly. Regarding the issues unique to PEPs, the government should not take any steps – in guidance or enforcement -- to apply new adverse positions retroactively.

From the beginning when PEPs were first launched, the industry has been asking for guidance on how the rules apply to PEPs. No such guidance has been issued on issues unique to PEPs. In this context, it would be extremely disappointing for guidance to be issued that suddenly announces a new adverse position that is retroactive over the entire period for which we have asked for guidance. If new innovations are suddenly and retroactively punished 20 years after the fact, not only would it be patently unfair, but also innovation would understandably be stifled. And innovation is how the industry finds important new ways to encourage savings and provide better benefits.

One answer that we have heard is that the law is and has always been clear, and the industry should have known better. We do not agree, nor do our plan sponsors, which are the backbone of our voluntary system. If plan sponsors cannot have the confidence to move forward with different plan designs or provisions without fear of adverse retroactive guidance and enforcement, that is not a fair system, nor is it conducive to plan creation and maintenance.

We also would like to offer one more thought in support of the notion the law is not clear with respect to PEP-specific rules, so that any new positions should only applied prospectively. Earlier this month, IRS PEP guidance to the field was publicly released. The guidance included an explanation of PEP issues, including the most prominent PEP-specific issue, which arises under Code section 411(b)(1)(G). Set forth below is an excerpt from the explanation:

> Section 411(b)(1)(G) of the Code provides that a plan fails to satisfy the accrued benefit rules if a participant's accrued benefit is reduced on account of any increase in his age or service. As shown in the explanation to line c, fewer years of interest are projected to NRA as a participant ages. Thus, a plan violates section 411(b)(1)(G) of the Code unless the additional PEP credits for the year offset the loss of a year of future interest (the "trade-off" between gaining an additional PEP credit and losing a year of interest). Specifically, the accrual in any given year that is considered under section 411(b)(1)(G) is (1) the increase in the PEP formula due to the accrual of additional PEP credits minus (2) one year's interest on the PEP accumulated benefit as of the end of the prior year (because interest is not credited if the participant continues to accrue benefits). In any year that item (2) is larger than item (1), there is an impermissible reduction in the participant's accrued benefit.
>
> ***Note that section 411(b)(1)(G) of the Code does not preclude an increase or decrease in the dollar amount of a participant's benefit due to fluctuations in the participant's final average compensation, the rate used to project interest, or in the rates used to determine the annuity conversion factor.*** [emphasis added]

The core issue under section 411(b)(1)(G) is whether the rule is violated due to the fact that final average compensation goes down, stays flat, or does not increase sufficiently, so that the net result is that a participant's accrued benefit decreases. The above IRS guidance to the field resolves this issue favorably, noting that fluctuations in such final average compensation cannot cause a violation of section 411(b)(1)(G). (One could argue that final average pay staying flat or increasing insufficiently is not a "fluctuation," but that would be an extremely tenuous and unnatural reading of the language.) This provides powerful support for any negative guidance on this issue to only apply prospectively. It would be extremely hard to argue that 20 years ago plans and plan advisors should have anticipated a negative answer if after 20 years of study, the IRS officially releases guidance providing a favorable answer.

Clarification: We request clarification of the treatment as lump sum-based benefit formulas of PEPs that do not explicitly credit interest, and instead convert the account balance to a deferred annuity upon separation from service. Whipsaw relief and the ability to use the account-based age discrimination safe harbors are based on the formula's ability to meet the definition of a lump sum-based benefit formula.

PARTICIPANT-DIRECTED PLANS

At the outset, we would like to express our appreciation for the language in the preamble to the final regulations recognizing the need for anti-cutback relief for participant-directed plans. This is an important first step with respect to addressing the needs of these plans and their participants.

However, more steps are needed. Participant-directed plans are in a difficult limbo based on other elements in the preamble. The preamble raises significant concerns about such plans, but does not resolve those concerns, leaving plan sponsors unable to plan for the future of the plans and subject to uncertainties regarding the present. This is not a workable situation and needs to be resolved promptly.

We strongly urge Treasury and the IRS to address these uncertainties by resolving the status of participant-directed plans as part of the final transition guidance, so that plan sponsors and participants are not forced to go through multiple changes that can disrupt long-term planning in this area. This would be the best result as it would eliminate the uncertainties hanging over these plans.

Our second choice would be to delay the application of the final market rate of return regulations for a brief period solely with respect to participant-directed plans. For example, a one-year delay would give the government time to resolve the issues regarding the fundamental validity of these plans. This would result in certainty, albeit a year later, and allow plans and participants to avoid the disruption of multiple plan changes.

In the alternative, sponsors of participant-directed plans need clear guidance. First, Treasury should explicitly provide that, pending further guidance, a plan with participant direction will not be in violation of any qualification rule by reason of such participant direction. Plan sponsors that have openly requested guidance on this issue for years should not be left in a state of legal uncertainty for an indefinite period. In addition, sponsors of participant-directed plans will need clear and explicit guidance in the transition regulations on how to make changes necessary to comply with the market rate of return rules:

- The preamble leaves it unclear regarding whether the final rules apply to each rate available under a participant-directed plan. If such rules are intended to apply, this would need to be clarified.

- Assuming that the final rules do apply to each rate available under a participant-directed plan, substantial additional guidance is needed for such plans. For example:

    - It would need to be clarified that there is no need to preserve the same number of options. For instance, assume that a plan has investment-based options A and B, which are permissible, and investment-based options C and D, which are impermissible. Assume further that the final transition rules permit plans using rates C or D to be replaced by B. In such case, it should be clarified that the plan may simply eliminate C and D. Alternatively, at the option of the plan sponsor, the plan could replace C and/or D with one or two permissible rates other than A or B.

    - The same issues noted in the previous sub-bullet also apply to non-investment-based options.

    - Would the plan be permitted to add additional permissible options?

    - How do the final plan termination rules apply to a participant-directed plan?

    - Participant-directed plans may allow investment in employer stock as one of their investment options (e.g., in plans where investment options mirror a 401(k) investment menu). In such cases, we believe that it should, at the very least, be permissible for the employer to change the interest crediting rate on that option to the rate of return on any otherwise permissible investment-based equity rate, such as an S&P 500 fund or the rate of return on all or a subset of plan assets. Moreover, as noted in the first sub-bullet above, if the replacement rate is already offered under the plan, there should be no requirement that the employer preserve the same number of options.

        - In addition, a "phase-in period" for transitioning from a non-compliant employer stock investment option to the compliant option should be permitted. An employee who has been using the employer stock investment option should be able to switch gradually over a period of time to other compliant options rather than switching all at once. A participant who may have previously made a long-term investment decision to choose the employer stock fund investment option with its inherent potential investment volatility should not be forced to exit that option entirely at a particular point in time. Instead, a transition/phase-in period would provide more time for the participant to exit the position in an orderly fashion.

    - Both inside and outside the context of participant-directed plans, some plans base rates of return on investments available under the employer's 401(k) plan. This structure is accommodated in the regulations with respect to broad-based mutual funds available under a 401(k) plan. The final regulations provided that an interest crediting rate will not be deemed to be in excess of a market rate of return if it is equal to the rate of return on a regulated investment company, as defined in section 851, that is reasonably expected to be not significantly more volatile than the broad United States equities market or a similarly broad international equities market (a "Qualified RIC"). However, here is the problem. Many large employer 401(k) plans use collective investment trusts or separate accounts instead of RICs as investment vehicles in order to realize lower investment management expenses for a particular investment option than might be incurred in connection with the use of a public RIC.

- A collective investment trust, separate account, or other investment vehicle that otherwise meets the volatility and diversification requirements of a Qualified RIC but for the fact that it is not structured as a RIC should be a permissible investment vehicle from which to determine crediting rates (a "Qualified Collective Investment"), regardless of whether the hybrid plan invests in such Qualified Collective Investment. If a Qualified Collective Investment vehicle is sufficiently diversified to be permitted to be used if it is a subset of defined benefit plan assets, there is no reason to treat it as an above market rate of return when it exists in a 401(k) plan and is used as a crediting rate by a hybrid plan that is not similarly invested. Forcing the hybrid plan to modify well-established investment policies to create a new subset of plan assets serves no policy purpose and has no basis in the statute.

- It should be permissible to use an interest crediting rate equal to the yield from time to time on a "stable value fund" under the employer's 401(k) plan that is structured as a collective investment trust. By definition, such a return should never be deemed to be in excess of a market rate of return.

OTHER CLARIFICATIONS

Changes in stability period and lookback month: The regulations permit changes in the stability period or lookback month for interest crediting rates with a one-year "hold harmless" period. We believe that such changes should also be permitted for the annuity conversion basis and request confirmation of this.

RIC changes: The final regulations contain provisions that permit a plan that credits interest based on the rate of return on a RIC to change to a similar RIC if the RIC ceases to exist. We request that the IRS and Treasury provide guidance regarding other situations where such a change would be permitted without violating anti-cutback rules, such as underperformance of the RIC, manager changes, explicit change in investment direction or style drift, fee increases, etc. Please note that changes in such situations will often be in the best interests of participants but plan sponsors will likely be reluctant to make changes without anti-cutback protection as that would present one-sided risk and administrative complexity.

NEED FOR PROPOSED RULES

The final regulations introduce two new restrictive provisions that had never appeared before during the eight years of guidance on the hybrid plan rules enacted in 2006. First, the final regulations make the new age discrimination safe harbor inapplicable to plans that have not eliminated whipsaw. This was done without any advance notice, opportunity for comment, or anti-cutback relief. Also, there is no basis in the statute for this rule. All hybrid plans are covered by the statutory age discrimination safe harbor. We do not believe there is authority to exclude some hybrid plans. This rule should be permanently withdrawn as inconsistent with the statute. At a minimum, this provision should be withdrawn and folded into the next set of proposed regulations that Treasury and the IRS are working on.

Second, the final regulations create a new class of early retirement subsidies that are not disregarded from age discrimination testing. We are receiving many questions from members asking how this rule works, when it is triggered, and how to treat subsidies subject to this new rule. We do not have answers, underscoring the same point made above. This provision either needs to be deleted -- as inconsistent with the statute -- or, at the least, withdrawn and folded into the next set of proposed hybrid plan regulations.

We very much appreciate the opportunity to comment on these critical issues. If further information on any of these issues would be helpful, please contact Kent Mason (kamason@davis-harman.com, 202-347-2230, for the Coalition) or Lynn Dudley (ldudley@davis-harman.com, 202-289-6700, for the Council).

Coalition to Preserve
the Defined Benefit System

American Benefits Council