March 27, 2008

CC:PA:LPD:PR (REG-139236-07)
Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Dear Sir or Madam:

This letter is submitted on behalf of the American Benefits Council with respect to the proposed regulations regarding the measurement of assets and liabilities for pension funding purposes. We very much appreciate the opportunity to comment on this very important topic.

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.

This letter addresses the following issues:

- The bulk of the letter addresses the proposed rule regarding asset smoothing. Among our members, there is broad consensus that the proposed rule would effectively repeal asset averaging, thus undoing a clear Congressional decision, and would render part of the statute meaningless. We strongly urge you to reconsider this rule.
- The regulations should be clarified to provide that shutdown benefits and other unpredictable contingent event benefits are not taken into account for purposes of determining the funding target until the shutdown or other triggering event occurs.
- Full yield curve election.

- Employers should be permitted to elect to use the full yield curve as of a specific date so as to facilitate liability-matched investments.
  - The regulations should be clarified to provide that the election to use the full yield curve applies for purposes of the deduction and benefit restriction rules, in addition to the funding rules.
  - The right to elect the full yield curve without IRS consent should be extended through the end of the 2010 plan year.
- It should be clarified that for purposes of the proposed regulations, the age and service eligibility requirements for a disability benefit are not treated as satisfied with respect to a participant until the projected date of disability.
- It should be clarified that a benefit increase adopted in a prior year but effective after the valuation date of the current year is part of the current year's funding target (not part of the current year's target normal cost).
- The regulations should be clarified with respect to the treatment of hybrid plans that base their interest crediting rate on the return on the plan's assets.

We request a public hearing on these proposed regulations and we request the opportunity to testify at that hearing.

Asset averaging.

Background. As noted above, the proposed regulations provide an asset averaging rule that is inconsistent with the Pension Protection Act of 2006 (the "PPA") and is effectively unusable. Set forth below is a detailed explanation of our views.

New Code section 403(g)(3) and new ERISA section 303(g)(3) provide the following rules with respect to the valuation of plan assets for purposes of the new funding rules:

> For purposes of this section –
>
> "(A) IN GENERAL. – Except as provided in subparagraph (B), the value of plan assets shall be the fair market value of the assets.
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> "(B) AVERAGING ALLOWED. – A plan may determine the value of plan assets on the basis of the averaging of fair market values, but only if such method –
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> > "(i) is permitted under regulations prescribed by the Secretary of the Treasury,
> >
> > "(ii) does not provide for averaging of such values over more than the period beginning on the last day of the 25th month preceding the month in which the valuation date occurs and ending on the valuation date (or a similar

> period in the case of a valuation date which is not the 1st day of a month), and
>
> "(iii) does not result in a determination of the value of plan assets which, at any time, is lower than 90 percent or greater than 110 percent of the fair market value of such assets at such time.
>
> Any such averaging shall be adjusted for contributions and distributions (as provided by the Secretary of the Treasury).

A review of the legislative history with respect to the PPA indicates very clearly that:

1. Congress intended Treasury to exercise its regulatory authority to permit asset "averaging".
2. Congress intended that the statutory reference to "averaging" be interpreted to mean "smoothing".
3. Congress intended the current-law smoothing rules - - as reflected in Revenue Procedure 2000-40 - - to continue to apply, subject to the reduction in the smoothing period and the contraction of the corridor around fair market value.

This letter addresses these three points as well as three further points: (1) the appropriate mechanics of smoothing in the context of the new funding rules, (2) an explanation of the proposed rule, including why it is unusable and inconsistent with the statute, and (3) an analysis of why the Congressional reports cited below constitute legislative history with respect to the PPA.

Pre-PPA law. Under pre-PPA law, Code section 412(c)(2)(A) and ERISA section 302(c)(2)(A) provided as follows:

> For purposes of this section, the value of the plan's assets shall be determined on the basis of any reasonable actuarial method of valuation which takes into account fair market value and which is permitted under regulations permitted by the Secretary of the Treasury.

Treasury Regulation § 1.412(c)(2)-1 provides further guidance under the above provision. In general, the regulation permits any actuarial asset valuation method that: (1) is consistently applied, (2) is specified in detail in the plan's actuarial report, (3) uses consistent valuation dates, (4) is based on either fair market value or average value (as defined in the regulations), (5) is not designed to produce a result consistently above or

below fair market value and average value, and (6) does not result in a value that is more than 120% or less than 80% of fair market value.[1]

Revenue Procedure 2000-40, 2000-2 C.B 357, provides further guidance with respect to asset smoothing. Generally, Revenue Procedure 2000-40 describes certain asset smoothing methods that can, under certain circumstances, be adopted by a plan without further IRS approval. Specifically, Revenue Procedure 2000-40 permits the use of fair market value, average value, or "smoothed market value". In practice, plans generally use either fair market value or smoothed market value; use of average value is relatively uncommon. Watson Wyatt's "2005 Survey of Actuarial Assumptions and Funding" indicates, for example, that in the case of final average pay plans, 64% use smoothed market value, 15% use fair market value, 6% use average value (as defined under the Revenue Procedure), and the remaining 15% use other valuation methods permitted under the regulations.[2]

Revenue Procedure 2000-40 describes "smoothed market value" as follows. The "smoothing" period can be up to five years; for illustrative purposes, we assume a five-year period is chosen. A plan using a smoothed market value recognizes 20% of any unexpected gain or loss each year for five years. For example, assume that on January 1, 2000, a plan has $100 of assets. Assume further that the plan's interest rate for valuation purposes - - i.e., the plan's expected rate of return - - is 8%. For convenience of presentation, assume that there are no contributions or disbursements with respect to the plan during 2000. In that case, plan assets are "expected" to be $108 as of January 1, 2001. If the fair market value of plan assets were, for example, $118 on January 1, 2001, there would be an unexpected gain of $10; only $2 (i.e., 20%) of this unexpected gain would be reflected in the plan's smoothed market value as of January 1, 2001, for an asset value of $108 + $2 = $110. As of January 1, 2002, another $2 of that unexpected $10 gain would be recognized in the plan's smoothed market value. This would continue in 2003, 2004, and 2005 until all $10 were included.

If instead the fair market value of plan assets were, for example, $103 on January 1, 2001, there would be an unexpected "loss" of $5 (compared to the plan's expected rate of return), only $1 of which would be reflected in the plan's smoothed market value as of January 1, 2001, for an asset value of $108 - $1 = $107. As with gains, an additional $1 of loss would be recognized during each of the next four years.

Congressional intent. The PPA legislative process began with H.R. 2830, which was reported out of the House Education and the Workforce Committee (the "E & W Bill"). See House Report 109-23 - Part 1, September 22, 2005. The E & W Bill included

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[1] The regulations provide an alternative permitted corridor around average value, substituting 115% and 85% for 120% and 80%, respectively. However, pursuant to section 9303(c) of the Omnibus Budget Reconciliation Act of 1987, this alternative corridor only applies to multiemployer plans.

[2] This survey is based on responses from 412 U.S. plans covering 1,000 or more active participants. The information is based on plan valuations for 2003 (13%), 2004 (49%), and 2005 (38%).

new ERISA section 303(g)(3) and new Code Section 430(g)(3), which provided the following rules with respect to the valuation of plan assets for purposes of the new funding rules:

> For purposes of this section, the value of plan assets shall be determined on the basis on any reasonable actuarial method of valuation which takes into account fair market value and which is permitted under regulations prescribed by the Secretary of the Treasury, except that –
>
> (A) any such method providing for averaging of fair market values may not provide for averaging of such values over more than the 3 most recent plan years (including the current plan year), and
>
> (B) any such method may not result in a determination of the value of plan assets which, at any time, is lower than 90 percent or greater than 110 percent of the fair market value of such assets at such time.

This provision is broader than the version enacted by the PPA; this provision would have authorized any reasonable valuation method permitted by Treasury. However, in one critical respect, this provision is the same as the PPA provision; this provision specifically refers to "averaging" as a valuation method that Treasury may permit. Thus, the E & W Bill Committee report can provide valuable guidance with respect to the meaning of 'averaging" under the PPA provision.

The Committee report makes it clear that the Committee viewed the term "averaging" as equivalent to "smoothing":

> In general, smoothing refers to averaging of interest rates used to calculate plan liabilities as well as the averaging of plan assets. [report at 79, n. 19]
>
> Under current law, interest rates used to calculate pension assets and liabilities are "smoothed," or averaged, over approximately five years for assets and four years for liabilities. [report at 60]

Also, the Committee report leaves no doubt that Treasury is intended to use its authority to permit smoothing as under current law, except that the smoothing period is reduced to three years and the 20% valuation flexibility is reduced to 10%:

> Asset smoothing is also reduced to a maximum of three years; however, the smoothed value of plan assets may not vary by more or less than 10 percent of the fair market value of such assets. [report at 60]

The House Ways and Means Committee issued its report on H.R. 2830 on December 6, 2005 (House Report 109-232 - Part 2). The legislative language with respect to asset smoothing was not changed from the E & W Bill. And the Committee report is completely consistent with the E & W Bill report:

> The Committee believes that . . . slightly reducing the smoothing periods under present law would improve accuracy while maintaining predictability. Thus, the Committee bill incorporates smoothing techniques in applying the modified yield curve and in determining asset values. However, the bill also generally reduces by one year the period over which smoothing is permitted . . . [A] valuation method may not provide for averaging of fair market values over more than the three most recent plan years (including the current year). [report at 71, 82].

The Senate-passed bill (S. 1783), which was a compromise between the Finance Committee bill and the HELP Committee bill, was similar to the House bill, with two exceptions. First, like the PPA provision, the Senate bill only permitted the use of fair market value or Treasury-approved averaging; the Senate bill did not permit flexibility to use any method approved by Treasury. Second, the Senate limited the averaging period to 12 months. But it is also clear that the Senate used the term "averaging" to mean smoothing. The September 28, 2005 Finance Committee summary of the Finance/HELP compromise states:[3]

> *Current Law:* For funding purposes, plans may measure assets either by using the market value of assets or by using an actuarial smoothing method that allows smoothing over 5 years as long as the ultimate value is between 80% and 120% of the market value.
>
> *Finance Bill:* The Finance bill requires use of either the market value of assets or, pursuant to Treasury guidance, the market value averaged over the prior 3 months and one day.
>
> *HELP Bill:* The HELP bill allows use of either the market value or a smooth value. It restricts the smoothing to 3 years and a 90% to 110% range.

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[3] Although the summary does not have the same force as a Committee report, it is the best available information regarding the Senate-passed bill and is clearly relevant legislative history under the applicable legal principles discussed at the end of this letter.

S. 1783: The compromise adopts that Finance structure but allows smoothing (unweighted) over 12 months.

The final version of the PPA followed the Senate structure in only permitting the use of fair market value or Treasury-approved averaging. The PPA compromised on the averaging period - - setting a maximum period of 24 months - - and adopted the House rule regarding the corridor around fair market value. The key point is that throughout the legislative process, Congress was consistent: the bill language referred to averaging, and the Committee reports and summaries made it very clear that the intent was to preserve present-law smoothing, as specifically modified.

The above legislative history also demonstrates an additional point. Congress viewed present-law smoothing as coextensive with the smoothing permitted under Revenue Procedure 2000-40. In other words, under current law, neither the statute nor the regulations limit the smoothing period to five years; the five-year limit is solely a product of the Revenue Procedure. Yet, by consistently referring to the five-year rule as present law, the legislative history is clear that the version of current-law smoothing that is intended to be retained is the version reflected in the Revenue Procedure, subject, of course, to the shortening of the smoothing period and the narrowing of the corridor around fair market value. Thus, Treasury has the authority to narrow the scope of the valuation techniques permitted under current law, but it is clear that Congress' intent was that that authority is to apply to valuation methods other than the smoothing method approved by Revenue Procedure 2000-40. Congress clearly intended that the Treasury regulations retain that smoothing method, subject to the two modifications described above.

Mechanics of smoothing. The next question relates to the mechanics of asset smoothing under the PPA. The PPA eliminated the relevance of a plan's expected rate of return for other purposes. The question is whether this concept is retained for smoothing purposes. (As discussed above with respect to Revenue Procedure 2000-40, a plan's expected rate of return is a key concept with respect to present-law smoothing.) The answer is that a plan's expected rate of return is clearly an integral part of smoothing under the PPA, for three reasons:

1. As discussed at length above, the PPA legislative history indicates a clear intent to adopt current-law smoothing (as reflected in Revenue Procedure 2000-40), as specifically modified with respect to the smoothing period and the corridor around fair market value.
2. Any other approach would systematically understate or overstate the value of plan assets, which was clearly not the intent of Congress.
3. It is clear that the PPA was not intended to preclude all discretion in the operation of the funding rules. Thus, there is no argument that the use of a plan's expected rate of return introduces an element of prohibited discretion.

Moreover, any concerns regarding actuarial discretion can be addressed without disturbing the fundamental concepts underlying smoothing.

As noted above, it is clear from the legislative history cited previously that the intent was to preserve pre-PPA smoothing with the specified modifications. This means that smoothing is to be based on a comparison with a plan's expected rate of return.

Some might argue that a plan's expected rate of return is a concept that no longer exists for any other purpose and thus should not exist for this purpose. In our view, this argument does not logically follow. If Congress' intent was to preserve the use of a plan's expected rate of return for purposes of asset smoothing, and smoothing only works effectively based on this concept, it is not relevant that the concept is not used for other purposes.

The use of the 3-segment corporate bond yield curve for purposes of valuing liabilities - - in lieu of a plan's expected rate of return under the current-law non-DRC funding rules - - does not imply in any way that that same rate should be used for asset smoothing purposes. The use of a corporate bond yield curve is a movement in the direction of measuring liabilities on a termination basis; there is no suggestion at all that it is intended to be a proxy for a plan's expected rate of return. And asset smoothing only works in a rational manner if it is based on a plan's expected rate of return, as discussed below.

As noted, the next question is whether smoothing makes sense if it is not based on a plan's expected rate of return. We believe the answer is clearly no. Assume, for example, that a plan's expected rate of return is 8%. Assume further that smoothing is based on the plan's "effective interest rate" (i.e., the single rate of interest that creates the same plan liability as the 3-segment corporate bond yield curve), which is assumed here to be 5.5%. (As referred to above, in the absence of any statutory benchmark to use as the expected rate of return for asset smoothing, some have inquired as to whether the rate used for a different purpose - - i.e., the determination of liabilities - - should be used for asset smoothing.) In that case, smoothing would systematically understate the value of plan assets. Such systematic understatement of plan assets is inconsistent with the fundamental premise of smoothing, which is to "mitigate short-run changes in the fair market value of assets"[4], not to create a consistently lower valuation.[5]

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[4] Treasury Regulation § 1.412(c)(2)-1(a)(4)(ii).

[5] Some plans may invest in the types of bonds that make up the yield curve and thus will have an expected rate of return generally equal to the effective interest rate. However, such plans will have little or no need for asset smoothing, thus making this segment of the plan population an inappropriate basis for creating smoothing rules. Plans that invest at least partially in equities - - with higher expected rate of returns and more uncertainty - - are the ones that need smoothing; for such plans, the expected rate of return is generally higher than the effective interest rate.

Systematic undervaluation of assets would be contrary to the express regulatory provisions of current law, which prohibit a valuation method that "is designed to produce a result which will be consistently above or below [fair market value and average value]". Treasury Regulation § 1.412(c)(2)-1(b)(5). Under section 3.4.1 of the Actuarial Standard of Practice, "Selection and Use of Asset Valuation Methods for Pension Valuations" (adopted by the Actuarial Standards Board, September 2007), such a systematic undervaluation would also require that an actuary, when issuing an actuarial report, disclose that the asset valuation method has a "significant systematic bias" toward understatement of asset values.

The understatement of value would indeed be significant. Assume, for example, that a plan has $100 of assets and the plan has an expected rate of return of 8% based on an objective analysis of historical returns. Assume further that over a three-year period, the plan makes 8% per year. If smoothing is based on a 5.5% return, the smoothed value of assets would be almost 2.5% below market value (assuming no contributions or disbursements). <u>This would be the case despite the fact that the plan has earned exactly what it was projected to earn and thus there were no unexpected returns to smooth</u>. In effect, basing smoothing on the effective interest rate would not be smoothing in any economically sound sense. Such a system would produce a distorted value that is consistently and unjustifiably below market value. There is no evidence of any Congressional intent to require such a skewed and artificial version of smoothing.

Basing smoothing on a plan's expected rate of return requires actuarial discretion in determining that rate. This is not contrary in any way to the structure of the PPA, since it is clear that the PPA was not intended to eliminate all actuarial discretion with respect to the funding rules. For example, the funding target of plans that are not at-risk is based on certain critical assumptions that are subject to actuarial discretion, such as the future retirement rate and the forms of distribution projected to be elected. In addition, the test for at-risk status turns in part on this same calculation of a plan's funding target. And even for at-risk plans, there is an element of the retirement rate that is subject to actuarial discretion. Also, in the case of any plan with a subsidized qualified joint and survivor annuity, assumptions regarding marital status are needed. In short, any argument that the PPA was intended to eliminate all actuarial discretion is in direct conflict with the very clear provisions of the PPA.

In the absence of this argument, the questions become: (1) what did Congress intend with respect to asset smoothing, and (2) how should the asset smoothing rules be structured to work properly? Those issues are addressed in the preceding portions of this letter.

But there is a remaining issue. Since Treasury has regulatory authority over asset smoothing, is there a way to address any concerns regarding actuarial discretion without doing violence to the essential components of asset smoothing? The answer to this question is yes. For example, the regulations under Code section 401(a)(4) establish

a "standard interest rate" that is used in converting account balances to annuity benefits generally payable at normal retirement age. This regulatory rule reflects a projection of an expected rate of return. If there is a desire to minimize actuarial discretion, Treasury could provide that a plan's expected rate of return for asset smoothing purposes must be based on reasonable historical data and may not exceed the highest standard interest rate permitted. This would establish a workable rule that strikes a reasonable balance between the fundamental concept underlying asset smoothing and a desire to control actuarial discretion. There are certainly other ways to control actuarial discretion (if that is desired), but it is critical that any applicable rule permit expected rates of return that are consistent with historical returns.

The proposed regulations. The proposed regulations do not permit any asset smoothing. Instead, the proposed regulations only permit assets to be averaged over a two-year period, with adjustments for contributions and disbursements.

This methodology will, overtime, systematically understate the value of plan assets by an amount equal to the plan's average rate of return. For example, if a plan earns 8% on average, the use of the proposed rule would understate the value of plan assets by an average of 8%. The use of such an artificially low asset value will, of course, result in artificially high funding obligations.

This means in turn that the only companies that will use this methodology will be companies that want to overfund their plans so as to maximize their deductions. For all other plans, asset averaging is effectively repealed.

It also goes without saying that the use of the proposed rule would, under the Actuarial Standard of Practice cited above, would require disclosure that the asset valuation method has a "significant systematic bias" toward understatement of asset values.

The only possible argument in favor of the proposed rule is as follows.

> Congress may have meant to refer to smoothing, but the statute refers to "averaging". Therefore, it is up to Congress to change the statute if the intent was to permit smoothing.

Even on its face, this argument is weak. The legislative history is clear that asset smoothing was to be preserved. And it is a cardinal principle of statutory construction that no part of a statute should be interpreted to have no effect; under the proposed rule, the reference to asset averaging would have no effect except to permit artificially large deductible contributions.

In addition, the proposed rule does not simply provide for an arithmetic "average". The proposed rule recognizes that a pure arithmetic average would not

make sense. Accordingly, the proposed regulations do not follow a literal interpretation of the statutory words, but rather take into account contributions and disbursements in order to avoid rendering the rule unworkable. Unfortunately, taking into account only contributions and disbursements does not avoid unworkability. In order to make the rule workable, a plan's expected rate of return must be taken into account. An averaging rule that takes into account contributions, disbursements, and a plan's expected rate of return is workable, and is consistent with Congressional intent and with the statute.

The following example illustrates how an appropriate averaging rule - - which takes into account contributions, disbursements, and expected rate of return - - would work. Such a rule would have the same effect as smoothing, as clearly intended by Congress.

Assume the following facts with respect to a defined benefit plan with a calendar year plan year and a January 1 valuation date.

	2010	**2011**	**2012**
Fair market value of assets as of 1/1	$100,000	$115,000	$128,000
Contributions (not included in current year's assets)	$10,000	$11,000	
Distributions (including expenses)	($7,000)	($6,000)	
Expected total return on assets	$6,000	$6,900	
Actual total return on assets	$12,000	$8,000	

Assume further that the plan's average asset value is determined by averaging the adjusted fair market values as of the current valuation date and the two preceding valuation dates.

Under these facts, the average value of the plan's assets as of January 1, 2012 would be determined as follows:

	2010	**2011**	**2012**
Fair market of assets as of 1/1	$100,000	$115,000	$128,000
Net adjustments:			
Contributions	$21,000	$11,000	
Distributions	($13,000)	($6,000)	
Expected return	$12,900	$6,900	
TOTAL	$120,900	$126,900	$128,000

As of January 1, 2012, the average value would be the average of $120,900 and $126,900 and $128,000, i.e., $125,267.

PPA legislative history. Because of the unusual fashion in which the PPA was enacted, some have raised the question as to whether the Committee documents cited earlier constitute legislative history with respect to the PPA. The PPA was technically based on H.R. 4, which was introduced in the House on July 28, 2006 and passed by the House and Senate without any amendments. There were no Committee reports with respect to H.R. 4; this is the basis of the argument that there is technically no legislative history with respect to the PPA.

However, the law does not support the technical argument set forth above. H.R. 4 was drafted based on the conference negotiations with respect to H.R. 2830 and S. 1783, the bills discussed above as containing relevant legislative history. And the law on this subject is quite clear. In interpreting a statute, legislative history clearly includes all relevant Congressional history, without regard to whether the history relates to the precise bill that was enacted. *See, e.g., United States v. States of La., Tex., Miss., Ala., and Fla.*, 363 U.S. 1, 18 n. 16 (1960) ("The legislative history of all the bills considered prior to enactment of the Submerged Lands Act in 1953 is directly relevant to the latter Act, since the purposes and phraseology of such bills, and the objections raised against them were substantially similar."); *Wilderness Society v. Morton*, 479 F.2d 842, 856 (D.C. Cir. 1973) (In describing the reasoning for looking at the legislative history of similar prior bills, the court stated the following: "The Mineral Leasing Act of 1920 . . . was not part of a single Congress. Other versions of the Act, substantially similar to the one finally adopted and containing provisions virtually identical with [the relevant section at issue], were introduced, reported out of Committee, and debated on the floor of Congress . . . . The legislative history of the bill that was finally enacted into law . . . contains no discussion of the [relevant provision] in either the reports, the hearings, or the floor debates. The legislative history of similar bills in prior Congresses, however, is very revealing."). *See also United States v. Plesha*, 352 U.S. 202, 204-06 (1957) (The Supreme Court examined the history of the Soldiers' and Sailors' Civil Relief Act of 1918, specifically, the Committee hearings on the 1918 bill, to interpret the meaning of a provision in the Soldiers' and Sailors' Civil Relief Act of 1940, stating that "Article IV of the 1940 Act substantially reenacted the insurance provisions of the [1918 Act]" and that the 1940 Act had little independent legislative history, which "is of little, if any, help" and they, "therefore, must examine the history of the 1918 bill." In addition, in stating its affirmation of the Court of Appeals' decision, the Supreme Court broadly noted that its affirmation rested on the "language of the 1940 Act, *its legislative history* and its administrative interpretation," indicating that the Court considered the Committee hearings of the 1918 bill as also the legislative history of the 1940 Act.); *United States v. Laub*, 253 F. Supp. 433, 457 (E.D.N.Y. 1966) (stating that since the enactment of 8 U.S.C. § 1185 in 1952 has no independent legislative history and since the relevant section is cast in language almost identical to that of the Acts of May 22, 1918 and June 21, 1941, the intent of the Congress may be ascertained from the history of those earlier acts.)

Secondary sources are similarly quite clear on this point. Justice Frankfurter, in his discussion on the interpretation of statutes and the use of legislative history in his

Columbia Law Review article, *Some Reflections on the Reading of Statutes*, stated that "[i]f the purpose of construction is the ascertainment of meaning, nothing that is logically relevant should be excluded."[6] "Legislative history" was described in another Columbia Law Review article as "a catch-all for extrinsic evidence of congressional intent."[7]

In addition, the book, *Legislative History, Research for the Interpretation of Laws*, specifically states that "[t]he legislative history of a predecessor act, or *of an earlier bill which failed of enactment*, is also sometimes used as an aid to construction of a later act.[8] *Legislative History, Research for the Interpretation of Laws* also describes certain situations in which research in legislative history is more complicated, including circumstances in which the history of prior bills, and bills on the same general subject considered during the same period, must be examined:

> Examination of the reports or debates may reveal that the bill in question was the same as, or a modification of, a bill which had been introduced in a former Congress, on which hearings were held, but which failed of enactment. In such a case it will be necessary to trace the history of both the prior and the later proposals, noting any statements as to the purpose of the original proposal and of any changes made at the various stages of both proposals. . . . Where reports or debates on a measure indicate it was one of a number of bills on the same general subject considered during the same period, the enactment of one in preference to another may be significant. In this situation, it may be necessary to . . . trace the history of the several bills, examining comparable provisions in each with care to note any reasons stated for selection of the provision finally enacted.[9]

<u>Conclusion.</u> In conclusion, the legislative history of the PPA is very clear that Congress intended to preserve pre-PPA asset smoothing - - as reflected in Revenue Procedure 2000-40 - - subject to a reduction of the smoothing period and a contraction of the permissible corridor around fair market value. We respectfully request that the Treasury Department modify the regulations in accordance with this legislative history.

<u>Election of asset smoothing.</u>

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[6] Felix Frankfurter, *Some Reflections on the Reading of Statutes*, 47 COLUM. L. REV. 527, 541 (1947).
[7] Note, *A Re-Evaluation of the Use of Legislative History in the Federal Courts*, 52 Colum. L. Rev. 125, 128 (1952).
[8] Gwendolyn B. Folsom, LEGISLATIVE HISTORY, RESEARCH FOR THE INTERPRETATION OF LAWS 17 (The University Press of Virginia) (1972) (Emphasis added).
[9] *Id.* at 61-62.

As discussed above, we strongly urge you to modify the regulations to permit asset smoothing, as intended by Congress. In the meantime, however, many companies may feel compelled to elect to use the fair market value of plan assets, since the proposed asset averaging rule would systematically undervalue assets by a material amount. If the regulations are modified to permit asset smoothing, we ask that you correspondingly permit companies to elect asset smoothing for 2009 or 2010 without approval from the Commissioner. Otherwise, companies that made one election based on one set of choices could be unfairly trapped by the election when the choices are subsequently changed in a very material way. See Proposed Regulation § 1.430(g)-1(f)(4).

Unpredictable contingent event benefits.

Consistent with the statute, the proposed regulations generally define a plan's funding target as "the present value of all benefits that have been earned or accrued under the plan as of the first day of the plan year", subject to the at-risk rules. We urge you to clarify that for this purpose, unpredictable contingent event benefits are not "earned or accrued" until the specified event occurs.

We view this clarification as no more than a confirmation that the natural meaning of the statutory language applies. If a benefit is not payable unless a specified event occurs, and that event has not occurred, the benefit clearly has not been "earned or accrued". The fact that the contingent right to such benefit cannot be deleted from a plan by reason of section 411(d)(6) does not affect the fundamental point that the benefit is not payable unless the event occurs and thus is not earned until that point.

Unpredictable contingent event benefits have never been taken into account for funding purposes. And there is no hint in the PPA legislative history that Congress intended to change that result. The absence of any indication of Congressional intent to make such a change is very significant in light of the dramatic effect of such a change. If unpredictable contingent event benefits had to be included in a plan's funding target, it would require an evaluation of the likelihood of all such events. That likelihood, expressed as a percentage, would be multiplied by the value of the benefits if provided: that product would presumably be included in the funding target.

This would be a radical change in the law and could force both fiduciaries and the IRS to reevaluate the employer's determination of the likelihood of the event occurring. This is so because both fiduciaries and the IRS must determine if an employer has met its funding obligations. It is entirely unclear how fiduciaries or the IRS would perform this determination with respect to, for example, the likelihood of a national employer shutting down each plant in the country.

In light of the statutory language and the absence of any indication of a Congressional intent to change prior law, we ask that you clarify that unpredictable contingent event benefits are not included in the funding target until the event occurs.

Election to use full yield curve.

We have three comments with respect to the proposed rule under Proposed Regulation § 1.430(h)(2)-1(e) permitting use of the full yield curve. First, we ask that it be clarified that the full yield curve, properly elected, would apply for all purposes including the benefit restrictions and deductibility. The preamble is clear on this point, but the proposed regulations itself states that the election only applies. "[f]or purposes of determining the minimum required contributions under section 430".

Second, we ask that a plan sponsor be permitted to elect the corporate bond yield curve either for the specified month or for a specific day within that month. (Either election would, of course, be part of the plan's funding method and thus would only be permitted to be adopted or changed under the rules applicable to such adoptions or changes.) This would permit liability-matched investing. See also IRS Notice 2007-81, which would need to be conformed to this revised rule. Using the average of the yield curve during a month would not permit such liability-matched investing. Also, we see no reason why such an election need have any effect on the valuation of a lump sum distribution or other distribution subject to section 417(e). The use of a mandatory monthly average three-segment yield curve for section 417(e) purposes can be retained. The funding rules and the section 417(e) rules are generally not consistent and there is no reason not to permit this inconsistency, which serves such an important funding purpose.

Third, many plan sponsors are still evaluating the use of liability-matched investing and are not prepared to adopt this approach for 2008. But some such plan sponsors may decide to use liability-matched investing in the near future, including, for example, 2009 or 2010. Accordingly, we ask that you extend through 2010 the rule automatically approving any new election under Proposed Regulation § 1.430(h)(2)-1(e). Under the extension, any initial election to use the full yield curve or not to use the transition rule in Proposed Regulation § 1.430(h)(2)-1(g)(3) would be treated as having been approved by the Commissioner. See Proposed Regulation § 1.430(h)(2)-1(g)(4).

Disability benefits

We ask that you clarify the regulations as they apply to disability benefits. For example, assume that a plan provides continued accruals through age 65 (or a later age in some cases) to any participant who becomes totally and permanently disabled while employed. It should be clarified that, for purposes of Proposed Regulation § 1.430(d)-1(c)(l)(ii)(C), a participant will not be treated as having met the "age and service eligibility requirements for the [disability] benefit" until the projected date of disability.

Such a rule is appropriate since the employee must still be employed on the date of disability in order to qualify for the benefit. Thus, the "service" requirement is not satisfied until that date.

If the regulations are not clarified in the manner described above, we fear that the net result could be a reduction in the disability benefits offered under plans. Since disability benefits are not protected benefits, an onerous new funding regime could cause employers to have to reevaluate their ability to provide such benefits.

Another possible alternative would be to provide that disability benefits have not been "earned or accrued" with respect to a participant until the participant becomes disabled. Thus, until a participant becomes disabled, no amount should be reflected in the plan's funding target or target normal cost attributable to the participant's disability benefit. In any year in which a participant is expected to become disabled, the value of all future expected disability accruals with respect to the participant would be included in target normal cost – i.e., the "term cost" of disabilities during the valuation year. For participants who are already disabled, the full value of the disability benefits would be reflected in the funding target. This value would be appropriately adjusted for the probability that the participant is assumed to remain disabled.

Mid-year amendments.

Assume, for example, that in 2009 a flat dollar plan is amended to increase benefits, effective April 1, 2010. Assume further that the increase applies to participants' past service. Also assume that the plan year is the calendar year and that the plan's valuation date is January 1.

The issue is whether the increase in benefits attributable to participants' pre-2010 service ("pre-2010 increase") is part of the plan's funding target for 2010 or whether it is part of the plan's target normal cost for 2010. The answer under the proposed regulations is unclear. A review of Proposed Regulation § 1.430(d)-1(b)(1), (b)(2), and (d) provides very reasonable arguments for both conclusions. Conceptually, the right answer is that the "pre-2010 increase" should be treated as part of the plan's funding target for 2010. The funding target is intended to reflect amounts earned by reason of pre-valuation date service, other than amounts earned by reason of increases in compensation during the current year. Target normal cost should include amounts earned by reason of current-year service and compensation. Under this structure, the "pre-2010 increase" clearly should be treated as part of the 2010 funding target in the above example. We ask that you clarify the regulations in this manner.

Hybrid plan issue.

The proposed regulations provide a special rule for applicable defined benefit plans described in section 411(a)(13)(C), under which the present value of future

benefits is determined by projecting the future interest credits or equivalent amounts under the plan's interest crediting rules to the expected date of payment *using reasonable actuarial assumptions.* The final regulations under section 430 should provide that, in the case of an applicable defined benefit plan that provides interest credits based on the actual return on plan assets, it shall be deemed reasonable to project the future interest credits for this purpose using the applicable segment rates under section 430(h)(2)(B).

The preamble to the proposed hybrid plan regulations indicates that it may be permissible for an applicable defined benefit plan to credit participants' hypothetical accounts based on the return on an asset portfolio that reflects the actual plan assets. We agree that this market rate approach would be desirable and consistent with Congressional intent - this would clearly be a market rate. We also believe that many employers would find this design desirable and in the interest of participants. To facilitate this market rate approach, the final regulations under section 430 should acknowledge that it is appropriate to determine the funding target for an applicable defined benefit plan with this design solely with reference to the current hypothetical account balance. This is because any subsequent changes to the plan's liability associated with the current account balance due to future interest credits will be offset entirely by corresponding changes in the value of plan assets. In other words, the plan's unfunded liability associated with the current account balance can never increase or decrease on account of subsequent interest credits. Use of the applicable segment rates under section 430(h)(2)(B) to project future interest credits for funding purposes would appropriately make the current account balance the funding target for this particular plan design, and so should be deemed reasonable under the funding regulations.

Thank you for this opportunity to present our views.

Sincerely,

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