



AMERICAN BENEFITS COUNCIL

May 3, 2012

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CC:PA:LPD:PR (REG-110980-10)
Room 5203
Internal Revenue Service
PO Box 7604
Ben Franklin Station
Washington D.C. 20044

Re: Notice of Proposed Rulemaking; Modifications to Minimum Present Value Requirements for Partial Annuity Distribution Options under Defined Benefit Pension Plans

Dear Sir or Madam:

The American Benefits Council (the “Council”) is pleased to submit these comments on the Department of the Treasury (“Treasury”) and Internal Revenue Service (“IRS”) proposed rulemaking relating to the minimum present value requirements for partial annuity distribution options under defined benefit pension plans.

The Council is a public policy organization principally representing 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 Council raised most of these issues in an October 1, 2010 joint letter with the National Coordinating Committee for Multiemployer Plans (“NCCMP”) sent to several senior Treasury and IRS officials.¹ We thank Treasury and IRS for considering the views expressed in that letter.

¹ A copy of the Council’s joint letter with NCCMP is available here:
http://www.americanbenefitscouncil.org/documents/annuities_417e-letter100110.pdf

The Council supports Treasury and the IRS’s proposed clarification of the current regulations. This project provides a much needed clarification of the treatment of optional forms of benefits paid in the form of a partial annuity distribution option under the section 417(e) regulations. The Council agrees with Treasury’s and the IRS’s view that participants would be well served by having the opportunity to elect to receive a portion of their retirement benefits in annuity form (providing financial protection against longevity risks), while receiving accelerated payments for the remainder of the benefit (providing increased liquidity during retirement). Clarifying that the regulations permit a plan to treat both portions of a partial annuity distribution option as two separate forms of benefit for purposes of applying the requirements of section 417(e)(3) is a significant step in assuring that more participants have the opportunity to elect to receive benefits in this manner.

As we pointed out in response to the Request for Information, the Council firmly believes in the value of defined benefit plans and urges the agencies to make policy decisions that will provide helpful guidance for defined benefit plan sponsors and plan participants. This project is consistent with that goal and we are happy to support it.

The Council urges Treasury and the IRS to apply the clarification prospectively only and to state that no inference should be drawn regarding current law. While the Council supports the approach taken under the proposed regulations, we disagree with the view stated in the preamble of the proposal that under the current section 417(e) regulations, where one portion is subject to the 417(e) factor is a “decreasing” benefit, both portions of the distribution are subject to the minimum present value requirements of section 417(e)(3).² The Council believes that it is not clear whether the current regulations apply to both distribution options.

In their current form, the regulations under section 417(e) require a plan to provide that the present value of any accrued benefit and the amount of any distribution, including a single sum, must not be less than the amount calculated using the applicable interest rates and mortality tables set forth in the regulation, subject to certain exceptions.³ One of the exceptions is for “*the amount of a distribution paid in a form of an annual benefit that [...] does not decrease during the life of the participant, or, in the case of a QPSA, the life of the participant’s spouse.*”⁴

² See 77 Fed. Reg. 5454, 5456 (Feb. 3, 2012).

³ See Treas. Reg. § 1.417(e)-1(d)(1), (6).

⁴ See Treas. Reg. § 1.417(e)-1(d)(6)(i) (emphasis added).

This language reasonably can, and has been, interpreted to mean that when a benefits are paid in two forms, only the amount paid in a form that does decrease is subject to the minimum present value requirements of section 417(e)(3).⁵ After all, the regulations make clear that the general rule in subsection (d) does not apply at all to the “amount” of the distribution paid in a form that does not decrease during the life of the participant or his or her spouse.⁶

Furthermore, the Council understands that some plans have received favorable determination letters from the IRS, despite containing language in the plan document that provides that the section 417(e)(3) factors are used only for the lump sum or other decreasing portion.⁷ Explaining that this clarifying proposal will apply on a prospective basis only – and that no inference is to be drawn regarding current law – is particularly important for these plans.

As we explained in more detail in our October 1, 2010 joint letter, the interpretation of the current regulations expressed in the preamble to the proposal can make a partial annuity feature artificially expensive and actually lead to less annuitization. This is because by simply offering benefits in a partial lump sum the cost of the partial annuity portion of the benefit is significantly increased vis-à-vis the fully annuitized benefit.⁸

In light of the ambiguity of current regulations with respect to the treatment of partial annuity distribution options and the issuance of favorable determination letters by the IRS to plans applying the section 417(e)(3) factors to the lump sum portion only, the Council respectfully requests that the proposed regulations, when finalized, apply

⁵ The Council is aware that this topic was discussed at an Enrolled Actuaries Meeting in 2008. See Q&A 38, GRAY BOOK, ENROLLED ACTUARIES MEETING (2008). These informal discussions, while very helpful to the benefits community, are not precedential. There, government officials responded to a question as to whether section 417(e)(3) would apply to nondecreasing annuity options from a distribution option offered simultaneously with a lump sum benefit. Treasury’s and the IRS’s response was that the total benefit under the plan was decreasing and thus subject to section 417(e)(3). The Council notes that the answer was qualified by statement that the response could be the subject of “future guidance.” The appearance of this topic in a Q&A and recognition that future guidance may be issued relating to the topic demonstrates the uncertainty in this area.

⁶ In other words, the general rule in Treas. Reg. section 1.417(e)-1(d)(1) is that the 417(e)(3) factors must be applied to “any distribution.” But subsection -1(d)(6) makes clear that the general rule does not, in fact, apply to “any distribution,” but only to the amount of a form of benefit that decreases.

⁷ The Council recognizes that the determination letter applies only to the employer and its participants on whose behalf the determination letter was issued. See IRS Pub’n 794 (2010). Nonetheless, the IRS endeavors not to issue a determination letter on a plan provision that is clearly inconsistent with the qualification requirements.

⁸ Our October 1, 2010 letter contained a detailed example of a plan that offers a participant the right to choose a 10% lump sum and 90% annuity. The annuity portion of the benefit commencing at age 55 that results is actually 7.4% larger than the annuity the participant would receive by fully annuitizing the benefit. For more detail, see our joint letter:

http://www.americanbenefitscouncil.org/documents/annuities_417e-letter100110.pdf

on a prospective basis and that Treasury and IRS clarify in the preamble to the final rule that no inference is to be drawn regarding the law prior to publication of the final rules.

The final regulations should clarify the rules for offering optional forms of benefit for plans providing separately determined benefits. The proposal would allow separate treatment of a benefit for 417(e) purposes if the plan provides one of three kinds of bifurcated benefits. The first type is for plans that provide separately determined benefits. This covers plans with separate benefit formulas, such as a plan that has converted from one formula to the next and provides participants with an “A+B” benefit.

Under the proposal, the plan must “permit[] a participant to select different distribution options with respect to each of those portions of the accrued benefit.” The proposal includes an example (Example 4) that illustrates the application of the rule, but the example does not explain what it means to permit a participant to “select different distribution options with respect to” each portion of the benefit.

Take a very common example. Assume a plan with a traditional formula converted to a cash balance formula, using an “A+B” transition. The plan offers participants the right to receive the accrued benefit in the form of a single life annuity, a qualified joint and 50% survivor annuity, a qualified optional survivor annuity, or a 10-year certain annuity. In addition, the plan allows the participant to elect to receive the cash balance benefit in a lump sum, but does not allow the participant to elect to receive the portion of the benefit attributable to the traditional formula in a lump sum. If the participant does not elect a lump sum for the cash balance benefit, the entire benefit is paid in one of the allowed annuity forms (with spousal consent, if applicable).

On one reading of the proposed regulation, this plan meets the requirements to offer a participant the right to select different distribution options with respect to each portion of the accrued benefit, because a participant can elect a lump sum for the cash balance benefit and an annuity for the traditional benefit. We think this is the proper reading. Another reading of the proposed regulation, however, is that the plan must offer the participant the right to select *any* of the available optional forms for *each* benefit portion. In other words, the plan in this example must permit the participant to select a single life annuity for the traditional benefit and a 10 year certain annuity for the cash balance portion.

Very few plans would have such a feature, because it significantly increases the calculations that need to be done, complicates the payout of the benefit, increases the possibility of error, and confuses participants. In the example above (which posits only four optional annuity forms), if the plan were forced to allow participants to “mix and match” distribution options, a participant would have *20 separate distribution choices* that would need to be calculated and explained to the participant. If the plan in our

example had six annuity options, a participant would have *42 separate distribution choices*. Put bluntly, forcing plans to make such a feature available would diminish any administrative simplification achieved by the proposal.⁹

Accordingly, we recommend that the final regulations clarify that the requirement to permit participants to select different distribution options for each portion of a separately determined benefit does not require a plan to allow participants to “mix and match” each optional benefit form.

On a separate but related issue, we are puzzled why the third category of bifurcated accrued benefit, namely a single sum with separate election for the remainder (paragraph (d)(7)(v)), applies only to single sums. It would seem to be appropriate to apply it where a plan allows any form of benefit that (a) is decreasing but the equivalent of the accrued benefit payable at normal retirement age and (b) is not available with respect to the entire accrued benefit. This could include, for example, installments and social security level income options. This would be a natural extension of this category. We note that without this change, a plan that prospectively eliminated a Social Security leveling income option, installment option, or other non-lump-sum 417(e) form (with no other change in the plan formula) would not appear to fit into any category under the regulation.

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Again, we appreciate the opportunity to comment on the notice of proposed rulemaking. We believe that the American Benefits Council offers an important and unique perspective of both the employer-sponsors of retirement plans and the service providers that assist them, and we look forward to working with you on these changes. We also look forward to further lifetime income guidance from Treasury, the IRS, and the Department of Labor that will assist in our shared goal of helping Americans best manage their savings in retirement. If you have any questions or would like to discuss these comments further, please contact me at 202-289-6700.

Sincerely,



Jan Jacobson
Senior Counsel, Retirement Policy
American Benefits Council

⁹ Plans in this scenario – which would be most plans with “A+B” benefit formulas – would be forced to use the “single sum with separate election for remainder” provision in subparagraph (d)(7)(v). But that creates an inappropriate result because the plan must apply the proportionality rule in subparagraph (d)(7)(v)(C) to the lump sum, even though the lump sum comes from the cash balance benefit.