



AMERICAN BENEFITS
COUNCIL

February 28, 2014

CC:PA:LPD:PR
Notice 2014-5
Room 5203
Internal Revenue Service
POB 7604
Ben Franklin Station
Washington, DC 20044

RE: IRS Notice 2014-5

Dear Sir or Madam:

The American Benefits Council (the "Council") would like to thank Treasury and the Internal Revenue Service for issuing Notice 2014-5. We believe that the Notice was a major step forward in addressing a critical problem with respect to the inadvertent effects of the nondiscrimination rules on plans that attempt to grandfather participants from changes in a defined benefit ("DB") plan.

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

As discussed in more detail in this letter, here are our comments on the Notice:

- There are several nondiscrimination testing problems that arise when a plan grandfathers a group of employees from changes in a DB plan. These problems can effectively force a plan sponsor to eliminate all grandfathering and to completely freeze the DB plan. The Notice provides an excellent solution for 2014 and 2015 for the primary problem facing plans.

- We have worked with the major consulting firms to conduct a survey of the scope of the long-term problems, and of the effects of the possible long-term solutions described in the Notice.
- The survey indicated that far more than 600,000 participants are potentially affected by these problems, and the total number is likely in the millions. In other words, if these problems are not resolved in a workable way, far more than 600,000 participants who are currently accruing benefits in a DB plan potentially could have those benefits completely frozen.
- Unfortunately, based on the survey, while some plans would be helped by the possible long-term solutions described in the Notice, we would not expect any of the solutions in the Notice to prevent hundreds of thousands of participants from losing benefits by reason of the nondiscrimination rules.
- The solutions previously suggested by the Council (1) would prevent substantially all participants from having their benefits frozen by reason of the nondiscrimination rules, (2) is more restrictive than the approach used in the Notice for the temporary relief, and (3) is more restrictive than the approach used in an analogous provision in the current regulations. Thus, as discussed further below, we urge Treasury and the IRS to reconsider the Council's approach.

BACKGROUND

In general

Many companies are transitioning away from a traditional DB plan benefit formula in one of various ways. This can arise, for example, by reason of (1) closing the plan to new hires, (2) converting the plan from a traditional plan to a hybrid plan, or (3) moving acquired employees from disparate benefit formulas to a uniform benefit formula. In the context of such transitions, it is not unusual for companies to grandfather some or all of the existing employees under the benefit formula in effect. A prime example is closing a traditional DB plan to new hires (who often receive an additional contribution under the company's defined contribution ("DC") plan), but allowing existing employees to continue to participate in the DB plan.

These "grandfathering" arrangements are very helpful to the older longer service employees who (1) often have made retirement plans based on the benefit formula previously in effect, and (2) as discussed further below, would lose the higher benefits provided by DB plans at the end of a career, without having benefited from higher DC plan contributions in earlier years. However, these grandfather arrangements can, over time, cause nondiscrimination testing problems.

Closed plan issue

For example, assume that a DB plan is closed to new entrants but a grandfathered group of participants continues to accrue benefits under the plan. At some point, the DB plan will likely need to be combined with the employer's DC plan and tested on a benefits basis in order to satisfy the coverage and nondiscrimination rules. However, the DB/DC combined plan needs to meet one of three requirements (referred to in this letter as the "cross-testing requirements") in order to be tested together on a benefits basis:

- (1) The combined plan must be "primarily defined benefit in character." A combined plan will automatically fail this test if half or more of the nonhighly compensated employees ("NHCEs") benefiting under the combined plan receive half or more of their benefits under the DC plan;
- (2) The DB plan and the DC plan must each be a "broadly available separate plan", i.e., each plan tested separately must satisfy the nondiscriminatory classification test (and section 401(a)(4)); or
- (3) In most cases, all NHCEs must have an allocation rate of at least 5% and, in many cases, must have an allocation rate of at least 7.5% (the "minimum aggregate allocation gateway test"). Any rate in that range is very high, and is prohibitively expensive for many companies.

Eventually, plans will very likely fail the first two requirements. The reason for these failures is not attributable to any actions of the employer. On the contrary, the failures occur because the grandfathered group naturally becomes more highly compensated due to two factors. First, generally, turnover among NHCEs is higher than among highly compensated employees ("HCEs"), so that the grandfathered group will become more heavily populated with HCEs. Second, over time, many grandfathered employees who start out as NHCEs will become HCEs by reason of greater experience and seniority.

In general, if the DB plan cannot satisfy those first two requirements in order to be tested with the DC plan on a benefits basis, this means that the DB plan will fail to satisfy the nondiscrimination testing rules unless one of three actions is taken: (1) the DB plan is re-opened to some additional NHCEs, (2) enough HCEs are removed from the DB plan in order to satisfy the cross-testing requirements, or (3) the DB plan is completely frozen and no one accrues any further benefits. The third option is selected the most often; even where the second option is chosen, it generally only works for a limited period of time. There is a fourth option technically – satisfying the minimum aggregate allocation gateway test under which in many cases all NHCEs must receive benefits of at least 7.5% of pay -- but this option is so expensive (and variable) that it is generally not realistically available.

In short, in the vast majority of cases, the only workable solution to the discrimination problem described above is to completely freeze the DB plan. This is a very unfortunate result for DB plan participants who can lose the most beneficial years of pension plan participation. In fact, by losing such beneficial years, older, longer service participants could experience the “worst of both worlds” by also not benefiting from higher DC plan allocations earlier in their career that they would have received had the higher allocations been in effect earlier.

Matching, ESOP, and 403(b) contributions

There can be serious nondiscrimination testing problems even where an employer makes very substantial DC plan contributions on behalf of NHCEs who are not covered by the DB plan. These problems can arise because the employer provides the contributions in a form – matching, ESOP, and/or 403(b) contributions – that are not permitted to be taken into account in applying the cross-testing requirements or in general nondiscrimination testing. Unless this issue is addressed, many DB/DC plans will fail to satisfy the nondiscrimination rules not because benefits are discriminatory, but solely because of the form in which the benefits are provided. Like the first issue, unfortunately, financial pressures generally compel plan sponsors to solve this problem through a complete freeze of the DB plan.

Three other important issues

There are three other important issues that were addressed in the Council’s prior letters (dated April 24, 2012; November 15, 2012; and May 29, 2013), are very briefly summarized here, and are discussed further below. The first issue (referred to below as the “BRF issue”) arises when (1) a DB plan has one or more benefit formulas, (2) one or more of those formulas is limited to a closed group, and (3) one or more benefits, rights, and features only apply to the closed group. The prime example is the following. When a traditional DB plan is converted to a cash balance plan and certain grandfathered participants continue to accrue benefits under the traditional formula, certain benefits, rights, and features of the traditional formula, such as an early retirement subsidy, will likely over time cause the plan to fail to satisfy the nondiscrimination testing rules because those benefits, rights, and features are only available to the grandfathered group.

Second, in some cases, a DB plan is completely frozen and the employer provides special nonelective contributions in a DC plan to make some or all of the participants in the DB plan whole for some or all of the loss of future DB plan benefits. These make-whole contributions will likely over time cause the DC plan to fail to satisfy the

nondiscrimination rules, again because they are only provided to the grandfathered group.

Finally, the closing or freezing of a DB plan will generally over time cause the DB plan to fail to satisfy the minimum participation requirement, which generally requires a plan to cover at least the lesser of 50 employees or 40% of the employer's employees. For large plans, this last issue is many years away, but for smaller plans, this is a very real current issue.

SURVEY

In the last several weeks, we worked with major consulting firms on a survey of the scope of the closed plan issue, and the possible effects of the long-term solutions suggested in the Notice. The effects of the proposed solutions are described below. But we also wanted to share some key overall data.

Many of the consulting firms were not able to gather the data during this short period of time. And generally the firms that were able to gather data were only able to collect incomplete data that did not fully reflect all clients' situations. *In this context, it was amazing to learn that based on incomplete data from only four consulting firms, roughly 650,000 participants are affected by this issue and could potentially have their benefits frozen if this issue is not resolved in a workable way. With full data, we suspect that the number of participants at risk by reason of this issue is well into the millions.*

So although the survey results below are not comprehensive, they do reflect a huge number of participants whose future benefits are seriously at risk.

CLOSED PLAN ISSUE

In general

Background with respect to this issue is provided above.

Temporary relief under the Notice

The temporary relief in the Notice addresses the closed plan issue very well for 2014 and 2015. Under the Notice, a DB/DC plan satisfies the cross-testing requirements for the 2014 and 2015 plan years if the plan amendment closing the plan to new entrants was adopted before December 13, 2013 and (1) the DB/DC plan satisfies the "primarily defined benefit in character" test or the "broadly available separate plans" test for the

2013 plan year, or (2) the DB plan satisfies the nondiscrimination and coverage tests for the 2013 plan year without being aggregated with the DC plan. In addition, the Notice points out that amendments to the DB plan to enhance it during the period of the temporary relief could cause the plan to fail to satisfy anti-abuse provisions under the nondiscrimination rules with respect to the timing of plan amendments. We thank you for providing this relief while taking the time needed to develop a long-term comprehensive solution.

We would make two points here. First, the temporary relief alone would not provide a workable long-term answer because it does not address all of the issues outlined above. Second, there is an important gap in the temporary relief. Some plan sponsors may not discover 2013 failures until all data is collected for 2013, which may not occur until sometime in 2014. Why should such plans have to retroactively correct for 2013 in light of the clear policy decision by Treasury and the IRS that these types of failures are the result of a set of rules that need to be revisited? We believe that the temporary relief should be modified to also apply for 2013.

Request for comments

The Notice also notes that the IRS and Treasury are exploring amending the nondiscrimination regulations to address the closed plan issue with respect to the period after the expiration of the temporary relief. In this regard, the Notice asks for comments on how to amend the regulations, specifically identifying the following possible approaches.

1. **Use of average nonelective contribution:** Under the current minimum aggregate allocation gateway test, every NHCE must receive the specified minimum, often 7.5%. Under one approach suggested by the Notice with respect to DC plans with age and/or service-graded contribution rates that provide a minimum contribution rate of 3%, each NHCE could be deemed to receive the average contribution rate for purposes of determining whether the gateway test is met. (It appears that the 3% is a required minimum but that is not clear. Regardless, that issue does not have a material effect on the analysis here.)
 - a. **Survey results:** Very few plans would be helped by this approach. First, most employers do not provide the type of age and/or service-graded contributions that are referenced. Second, even among those employers that do, the average nonelective contribution is not high enough to help many plans satisfy the minimum aggregate allocation gateway test.
2. **Use of average matching contribution:** Under the current minimum aggregate gateway test, matching contributions are disregarded. Under another approach suggested by the Notice, the average NHCE matching contribution could be

taken into account. So, for example, if the average NHCE matching contribution is 3%, that 3% could be taken into account in determining whether each NHCE received the minimum required by the minimum aggregate allocation gateway test.

- a. **Survey results:** Most plans would not be helped by this approach, In fact, the portion of plans helped could be rather small, especially when weighted by the number of participants.
3. **Lower interest rate:** The Notice asks for comments on a very different approach under which a DB/DC plan could be tested together on a benefits basis, despite not satisfying any of the cross-testing requirements, if the combined plan satisfies nondiscrimination testing using an interest rate lower than the current standard interest rate (which is permitted to be set between 7.5% and 8.5%).
 - a. **Survey results:** The survey results were not as conclusive with respect to this approach, in part because of the cost and time required to perform extensive testing on different bases. However, here is what we could draw from the survey. If the DB/DC plan could be tested together on a benefits basis as long as it can satisfy the testing rules using an 8% rate rather than an 8.5% rate, it is very possible that most plans would be helped by this proposal. If plans had to use a 7% interest rate for this purpose, it is unclear whether most plans would be helped. Regardless, at least a material number of plans would not be helped by this proposal, even using an 8% interest rate.
 - b. **Broader issue:** We also strongly oppose this approach for other reasons. The current interest rate rules – permitting a 7.5% to 8.5% range – are an integral part of the structure of the current nondiscrimination rules. Other aspects of the nondiscrimination rules that are not really workable in our view are rendered workable solely by reason of the current interest rate range. So if the current interest rate rules are revisited, it would need to be in the context of a broad restructuring of the nondiscrimination rules. We recognize that the Notice limits the revisiting of the interest rates to permitting DB/DC plans to be tested together on a benefits basis, but the precedent for revisiting other applications of the interest rate rule is far too troubling to pursue this, especially in light of the fact that the proposal itself likely would not help nearly enough.
4. **Disregarding HCEs:** Under the current minimum aggregate allocation gateway test, the allocation rate for each NHCE depends on the benefit provided to the HCE with the biggest benefit. Under another approach suggested by the Notice, plans could, on a plan-by-plan basis, make a request to the IRS that one or more HCEs be disregarded as outliers for this purpose. (The Notice is not entirely clear

as to whether only one HCE could be disregarded or up to 5% of HCEs could be disregarded. We assume the latter is intended.) This could in some cases result in the gateway test being satisfied by an allocation rate of less than 7.5% (but probably still at least 5%).

- a. **Survey results:** This would help very few plans (if any) for two reasons. First, disregarding 5% of HCEs would not help many plans at all. Second, a very similar requirement for IRS approval under current law is generally not viewed as a workable mechanism, since the approval process takes a very long time and there is a very large risk of not obtaining approval, resulting in nondiscrimination failures for multiple years requiring costly corrections. Plan sponsors are unlikely to view that as an acceptable risk and will likely freeze the plan to avoid it.

Council solution

As reflected in a series of letters from the Council to Treasury and the IRS, the last one dated May 29, 2013, we have a proposal that we believe would solve the closed plan issue very effectively. Very generally, if (1) the group (or groups) of grandfathered employees in the DB plan is permitted to be tested on a benefits basis with the DC plan as of the date the plan is closed (or a later date), and (2) neither the group (or groups) nor the benefits of the DB plan are enhanced (or reduced in a discriminatory manner) after the plan is closed, the two plans would continue to be permitted to be tested together on a benefits basis indefinitely. The prohibition on enhancement of the group (or groups) or the benefits would not apply to enhancements only applicable to NHCEs.

A reduction in coverage would be considered discriminatory for this purpose (but not for any other purpose) unless the ratio of highly compensated participants who cease to be covered compared to all highly compensated participants in the closed group or groups, is at least as great as the same ratio with respect to nonhighly compensated participants. A reduction in benefits would be considered discriminatory for this purpose (but not for any other purpose) unless it applies uniformly to a set of participants that meets the test in the preceding sentence. The determination of whether a reduction in coverage or benefits is discriminatory would be made at the time of the reduction, not on an ongoing basis.

We believe that this approach is the right answer for many reasons:

- (1) This approach would solve the problem for far more companies than the approaches suggested in the Notice, thus preventing hundreds of thousands of participants from having their benefits frozen.

- (2) It is hard to see why there would be any concerns with the Council's approach, since it is more restrictive than either the approach used for the temporary relief in the Notice or the approach used in an analogous area in the current regulations. See Regulation section 1.401(a)(4)-4(d)(1).

Concerns articulated in Notice regarding Council approach

The Notice indicates that Treasury and the IRS have significant concerns with the Council's recommended approach for two reasons. First, Treasury and the IRS fear that that approach could provide an incentive for DB plans to close. In fact:

- (1) The current rule creates an extremely powerful incentive for DB plans to freeze completely, which is less helpful to participants than closing.
- (2) In real-life situations, the most common debate within companies is whether to freeze or to close. It is very uncommon for employers to only consider closing or maintaining an open plan, and not consider freezing. In this context, the Notice's concerns seem misplaced. To protect participants, we need a rule – like the Council's approach -- that fully protects the employers that decide to close instead of freeze; otherwise, we will see widespread freezing.

Second, the Notice indicates concern that the Council approach would require the development of anti-abuse rules. The core concern regarding potential abuse, as we understand it, is as follows. If our solution were adopted without an anti-abuse rule, a business could, for example, establish (or enhance) a traditional DB plan and then, as part of a pre-arranged plan, shortly thereafter close the plan to new hires.

- (1) In fact, as discussed in our May 29, 2013 letter, no anti-abuse rule is needed with respect to plans that have already closed. If a plan closed before the relief is issued, it is not possible for the closing to be part of an abusive scheme to take advantage of the relief. So we are confused as to why a concern about anti-abuse rules would affect a class of plans where there is no possible potential for the closing to be an abuse.
- (2) With respect to plans that close after the relief is issued, our May 29, 2013 letter provides a lengthy discussion of how the existing anti-abuse rules in the regulations can very effectively be used to prevent abuse.
- (3) Use of anti-abuse rules is extremely common in the nondiscrimination rules. See, e.g., Regulation sections 1.401(a)(4)-1(c)(2), 1.401(a)(4)-4(c), and 1.401(a)(4)-5(a). An objection to the Council's proposal based on the need for anti-abuse rules is inconsistent with fundamental elements of the existing regulations. In fact, the

temporary relief in the Notice itself contains an explicit reference to an existing anti-abuse rule as a means to prevent post-closing abuse.

Use of matching, ESOP, and 403(b) contributions for testing purposes

In addition to the issue of whether a DB/DC plan qualifies to be tested together on a benefits basis, the Council requests that matching, ESOP, and 403(b) contributions be permitted to be taken into account in determining whether a DB/DC plan that so qualifies satisfies the nondiscrimination tests. The Notice indicates that Treasury and the IRS are looking at this issue with respect to matching contributions. (With respect to the matching contribution issue, it should not make a difference whether the DC plan also provides nonelective contributions.)

For many plans, this is a critical issue, especially with respect to matching contribution issue. For such plans, even if the DB/DC plan qualifies for combined testing on a benefits basis, the plan will fail the testing requirements not because benefits are discriminatory but simply because some benefits – matching, ESOP, and 403(b) contributions – cannot be taken into account. This is not fair or appropriate. Moreover, the likely result of such failures will again be a complete freeze of the DB plan, which eliminates the issue.

In addition, there is no statutory reason why the matching, ESOP, and 403(b) portions of a plan cannot be aggregated with the DB plan to help the latter satisfy the applicable rules. In fact, the regulations already permit aggregation of matching and ESOP contributions in one context – the average benefit percentage test. See Regulation § 1.410(b)-7(e)(1). There is no apparent reason not to permit the same aggregation for other coverage and nondiscrimination testing purposes.

Thus, we recommend that the regulations be amended to permit the matching, ESOP, and 403(b) portions of a plan to be aggregated with other plans to help such other plans satisfy the coverage and nondiscrimination tests on a benefits basis. This would only apply with respect to other plans to which the mandatory disaggregation rules do not apply; for example, this would not apply if the other plan were a 401(k) plan. Moreover, the aggregation could not be used in reverse to help the matching or ESOP portions of a plan satisfy the applicable rules.

We see no policy or statutory reason for not allowing such aggregation. If this is done and our proposal described above (regarding permitting combined DB/DC plan testing on a benefits basis) is also adopted, that would solve the closed plan problem.

We would also make one additional point. Our proposal would apply without regard to whether the “other plan” being helped is a DB plan or the nonelective portion of a DC plan. There is no conceptual reason to not structure the rule to cover the latter

situation. Moreover, doing so can help in the case of “make-whole” contributions discussed below.

Again, our solution would not permit discrimination. It would simply eliminate testing barriers that currently are hurting primarily long-service older employees.

Benefits, rights, and features issue

The benefits, rights, and features (“BRF”) issue generally arises when the benefit formula under a DB plan is modified for new hires and possibly a subset of existing employees, such as in the case of a conversion of a traditional defined benefit plan formula to a cash balance plan formula. Over time, for the same reasons noted above with respect to the closed plan issue, the grandfathered group of employees covered by the original benefit formula becomes too highly compensated, so that benefits, rights, and features that only apply to the original benefit formula, such as an early retirement subsidy, may fail to satisfy the current availability test of Regulation § 1.401(a)(4)-4. The Notice indicates that Treasury and the IRS are considering addressing the BRF issue “if appropriate conditions are satisfied.”

Under the Council’s proposal, very generally, if (1) the group (or groups) to whom the original benefit formula is available satisfies the current and effective availability tests of Regulation § 1.401(a)(4)-4 as of the date the formula is closed (or a later date), and (2) neither the group (or groups) nor the benefits are enhanced (or reduced in a discriminatory manner) after the formula is closed, any benefits, rights, and features available to the closed group (or groups) would be deemed to continue to satisfy the current and effective availability tests indefinitely. The prohibition on enhancement of the group (or groups) or the benefits would not apply to enhancements only applicable to NHCEs. The same rule described above with respect to the closed plan issue would apply with respect to what constitutes a discriminatory reduction in coverage or benefits.

This rule should apply to both DB and DC plans. Application with respect to DC plans could be important in cases where, for example, a DB plan is completely frozen and existing employees who have lost DB benefits receive a higher level of matching contribution.

Complete freeze with make-whole contributions in the DC plan

This issue arises when the DB plan is completely frozen and some or all of the existing employees receive “make-whole contributions” under the DC plan. The make-whole contributions are designed to make the existing employees whole, in sum or in part, for the loss of the future DB benefits. These make-whole contributions need to be

tested on a benefits basis in order to be nondiscriminatory, yet over time such testing generally becomes unavailable. This occurs because, in order to be tested on a benefits basis, the make-whole contributions generally need to qualify as a defined benefit replacement allocation (“DBRA”) under Regulation § 1.401(a)(4)-8(b)(1)(iii)(D). The make-whole contributions will generally not qualify as a DBRA for an extended period, in part because the group benefiting from the make-whole contributions will generally, over time, fail to satisfy the nondiscriminatory classification test because of the same demographic patterns described above with respect to the closed plan issue. See Revenue Ruling 2001-30 and our April 24, 2012 letter for more on this issue.

Under the Council’s proposal, very generally, if (1) the group (or groups) receiving the make-whole contribution satisfies the nondiscriminatory classification test as of the date the group (or groups) is closed (or a later date), and (2) neither the group (or groups) nor the contributions are enhanced (or reduced in a discriminatory manner) after such date, the contributions would continue to be permitted to be tested on a benefits basis indefinitely. The prohibition on enhancement of the group (or groups) or the contributions would not apply to enhancements only applicable to NHCEs. The same rule described above would apply with respect to what constitutes a discriminatory reduction in coverage or contributions.

As in the case of the closed plan issue, it is also important to permit matching, ESOP, and 403(b) contributions to be taken into account in determining whether the make-whole nonelective contributions satisfy the nondiscrimination rules.

Minimum participation issues

Grandfathered group: issue

The final regulatory issues arise under Code section 401(a)(26). Assume that an employer with 200 employees closes its DB plan to new hires but existing employees can continue to benefit under the plan. After several years, the number of employees benefiting under the plan falls under 50. That forces the employer to remove all HCEs from the plan. What policy goal is served by such a rule? Why should an employer be prohibited from grandfathering older, longer service employees (who may even grow into HCE status long after the closing of the plan occurs)? Why should pure attrition cause a plan to fail this test?

Hard freeze: issue

Assume that a company with 200 employees completely freezes its defined benefit plan. Over a number of years, (1) all employees entitled to benefits terminate employment and (2) the number of former employees still entitled to benefits falls under 50. At that point, under the regulations, the general rule, subject to one exception,

is that the plan is simply disqualified. See Regulation § 1.401(a)(26)-3(c). The employer did not do anything wrong in any sense. The vast majority – or even all – of the former employees still entitled to benefits may be NHCEs. Still, this plan is disqualified unless the plan can fit into one exception.

Generally, under that exception, there must be an actuarial report that the “plan does not have sufficient assets to satisfy all liabilities under the plan (determined in accordance with section 401(a)(2)).” See Regulation § 1.401(a)(26)-1(b)(3). In other words, if the plan has enough assets to terminate, it must be terminated, or it will be disqualified. This “terminate or be disqualified” rule does not seem to be appropriate. First, not a single employee is benefiting under the plan. What substantive harm would the threat of disqualification prevent? Second, why force termination? For example, assume interest rates are unusually low, as they are today. Why force companies to terminate at a very disadvantageous time? Third, the “terminate or be disqualified” rule is not only inappropriate but also very expensive and burdensome to apply, as it can require expensive actuarial work on an annual basis. (At a minimum, proxies, based on funded status, for the inability to terminate should be developed that make the rule less expensive to apply.)

Moreover, this rule is not conceptually consistent with the rest of the regulation. Assume that all former employees entitled to benefits were NHCEs. If just one NHCE were actively benefiting under the plan, the plan would satisfy section 401(a)(26). But if that one NHCE terminates employment and is no longer benefiting under the plan, the plan can be disqualified. Why?

Proposed solutions

Under the Council’s proposals, if no employee benefits under a plan, the plan satisfies the minimum participation test. Also, very generally, if (1) a defined benefit plan satisfies the minimum participation test as of the date the plan is closed (or a later date), and (2) neither the grandfathered group (or groups) nor the benefits are enhanced (or reduced in a discriminatory manner) after the closing, the plan would continue to be treated as satisfying the minimum participation test indefinitely. The prohibition on enhancement of the group (or groups) or the benefits would not apply to enhancements only applicable to NHCEs.

The same rule described above would apply with respect to what constitutes a discriminatory reduction in coverage or benefits.

Theoretical support for our proposal and our anti-abuse rules

During one of our meetings with Treasury and the IRS on this set of issues, we had a very helpful discussion of the theoretical underpinnings of our proposed solutions. The point was made that if the argument supporting our proposed solutions is the need to protect employee expectations, why should the rule apply if there have been any “substantial” changes to the DB plan’s benefit formula or coverage in the last five years prior to the plan closing? (Reference was made to a five-year rule found in Rev. Rul. 2001-30 that would render certain favorable treatment inapplicable if there have been any substantial changes to the defined benefit plan’s benefit formula or coverage in the five years preceding a similar event.) In other words, if there was a substantial decrease, then that is evidence that the company is comfortable not meeting employees’ expectations. If there has been a substantial increase, then that increase should not be protected, because the increase has not been in place long enough to create reasonable reliance.

In our judgment, the above concerns with our proposal unfortunately do not reflect the key issues at stake here. First, and most importantly, our proposal is not only about protecting expectations. The core point underlying our proposal is that employers should not be effectively forced to terminate accruals for hundreds of thousands of participants where there is no argument that the plan amendments have been adopted in order to avoid the purpose of the cross-testing restrictions in the nondiscrimination rules.

The “protecting expectations” argument also does not recognize another element of our proposal. Especially in a final average pay plan, the value of accruals for a young employee is very low and the value of accruals for an older employee is very high. DC plan allocations are generally more level over a working lifetime. So if an older employee is forced out of a DB plan late in his or her career (because our solution is not adopted), the older employee will get the “worst of both worlds” in terms of their level of benefits—low DB plan benefits in the early years without either enhanced DC allocations in those early years or large DB plan benefits in later years.

Transition issues

Finally, as noted in our prior letters, we would like to explore transition rules that may arise. Appropriate transition rules may be needed to ensure that our proposed solutions apply in an appropriate manner regardless of when the triggering event occurred and regardless of whether a plan sponsor was previously compelled to take action inconsistent with helpful rules that were developed later.

Again we thank you for the work you have done so far and we look forward to discussing these issues, which are so critically important to participants and plan sponsors across the country.

Sincerely,

A handwritten signature in black ink that reads "Lynn D. Dudley". The signature is written in a cursive, flowing style.

Lynn D. Dudley
Senior Vice President, Policy