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Additional Rules Regarding Hybrid Retirement Plans; Final Rule

**DEPARTMENT OF THE TREASURY****Internal Revenue Service****26 CFR Part 1**

[TD 9693]

RIN 1545-B116

**Additional Rules Regarding Hybrid Retirement Plans****AGENCY:** Internal Revenue Service (IRS), Treasury.**ACTION:** Final regulations.

**SUMMARY:** This document contains final regulations providing guidance relating to applicable defined benefit plans. Applicable defined benefit plans are defined benefit plans that use a lump sum-based benefit formula, including cash balance plans and pension equity plans, as well as other hybrid retirement plans that have a similar effect. These regulations provide guidance relating to certain provisions that apply to applicable defined benefit plans that were added to the Internal Revenue Code (Code) by the Pension Protection Act of 2006, as amended by the Worker, Retiree, and Employer Recovery Act of 2008. These regulations affect sponsors, administrators, participants, and beneficiaries of these plans.

**DATES:** *Effective Date:* These regulations are effective on September 19, 2014.

*Applicability Date:* These regulations generally apply to plan years that begin on or after January 1, 2016. However, see the "Effective/Applicability Dates" section in this preamble for additional information regarding the applicability of these regulations.

**FOR FURTHER INFORMATION CONTACT:** Neil S. Sandhu or Linda S. F. Marshall at (202) 317-6700 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:****Background**

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under sections 411(a)(13), 411(b)(1), and 411(b)(5) of the Code. Generally, a defined benefit pension plan must satisfy the minimum vesting standards of section 411(a) and the accrual requirements of section 411(b) in order to be qualified under section 401(a) of the Code. Sections 411(a)(13) and 411(b)(5), which modify the minimum vesting standards of section 411(a) and the accrual requirements of section 411(b), were added to the Code by section 701(b) of the Pension Protection Act of 2006, Public Law 109-280 (120 Stat. 780 (2006)) (PPA '06). Sections 411(a)(13) and 411(b)(5), as well as certain effective date provisions

related to these sections, were subsequently amended by the Worker, Retiree, and Employer Recovery Act of 2008, Public Law 110-458 (122 Stat. 5092 (2008)) (WRERA '08).

Section 411(a)(13)(A) provides that an applicable defined benefit plan (which is defined in section 411(a)(13)(C)) is not treated as failing to meet either (i) the requirements of section 411(a)(2) (subject to a special vesting rule in section 411(a)(13)(B) with respect to benefits derived from employer contributions) or (ii) the requirements of section 411(a)(11), 411(c), or 417(e), with respect to accrued benefits derived from employer contributions, merely because the present value of the accrued benefit (or any portion thereof) of any participant is, under the terms of the plan, equal to the amount expressed as the balance of a hypothetical account or as an accumulated percentage of the participant's final average compensation. Section 411(a)(13)(B) requires an applicable defined benefit plan to provide that an employee who has completed at least 3 years of service has a nonforfeitable right to 100 percent of the employee's accrued benefit derived from employer contributions.

Under section 411(a)(13)(C)(i), an applicable defined benefit plan is defined as a defined benefit plan under which the accrued benefit (or any portion thereof) of a participant is calculated as the balance of a hypothetical account maintained for the participant or as an accumulated percentage of the participant's final average compensation. Under section 411(a)(13)(C)(ii), the Secretary of the Treasury is to issue regulations which include in the definition of an applicable defined benefit plan any defined benefit plan (or portion of such a plan) which has an effect similar to a plan described in section 411(a)(13)(C)(i).

Section 411(a) requires that a defined benefit plan satisfy the requirements of section 411(b)(1). Section 411(b)(1) provides that a defined benefit plan must satisfy one of the three accrual rules of section 411(b)(1)(A), (B) and (C) with respect to benefits accruing under the plan. The three accrual rules are the 3 percent method of section 411(b)(1)(A), the 133 $\frac{1}{3}$  percent rule of section 411(b)(1)(B), and the fractional rule of section 411(b)(1)(C).

Section 411(b)(1)(B) provides that a defined benefit plan satisfies the requirements of the 133 $\frac{1}{3}$  percent rule for a particular plan year if, under the plan, the accrued benefit payable at the normal retirement age is equal to the normal retirement benefit, and the annual rate at which any individual

who is or could be a participant can accrue the retirement benefits payable at normal retirement age under the plan for any later plan year is not more than 133 $\frac{1}{3}$  percent of the annual rate at which the individual can accrue benefits for any plan year beginning on or after such particular plan year and before such later plan year.

For purposes of applying the 133 $\frac{1}{3}$  percent rule, section 411(b)(1)(B)(i) provides that any amendment to the plan which is in effect for the current year is treated as in effect for all other plan years. Section 411(b)(1)(B)(ii) provides that any change in an accrual rate which does not apply to any individual who is or could be a participant in the current plan year is disregarded. Section 411(b)(1)(B)(iii) provides that the fact that benefits under the plan may be payable to certain participants before normal retirement age is disregarded. Section 411(b)(1)(B)(iv) provides that Social Security benefits and all other relevant factors used to compute benefits are treated as remaining constant as of the current plan year for all years after the current year.

Section 411(b)(1)(G) provides that a defined benefit plan fails to comply with section 411(b) if the participant's accrued benefit is reduced on account of any increase in the participant's age or service. Section 411(b)(1)(G) contains a limited exception to this requirement for any social security supplement.

Section 411(b)(1)(H)(i) provides that a defined benefit plan fails to comply with section 411(b) if, under the plan, an employee's benefit accrual is ceased, or the rate of an employee's benefit accrual is reduced, because of the attainment of any age. Section 411(b)(5), which was added to the Code by section 701(b)(1) of PPA '06, provides additional rules related to section 411(b)(1)(H)(i). Section 411(b)(5)(A) generally provides that a plan is not treated as failing to meet the requirements of section 411(b)(1)(H)(i) if a participant's accrued benefit, as determined as of any date under the terms of the plan, would be equal to or greater than that of any similarly situated, younger individual who is or could be a participant. For this purpose, section 411(b)(5)(A)(iv) provides that the accrued benefit may, under the terms of the plan, be expressed as an annuity payable at normal retirement age, the balance of a hypothetical account, or the current value of the accumulated percentage of the employee's final average compensation. Section 411(b)(5)(G) provides that, for purposes of section 411(b)(5), any reference to the accrued benefit of a

participant refers to the participant's benefit accrued to date.

Section 411(b)(5)(B) imposes certain requirements on an applicable defined benefit plan in order for the plan to satisfy section 411(b)(1)(H). Section 411(b)(5)(B)(i) provides that such a plan is treated as failing to meet the requirements of section 411(b)(1)(H) if the terms of the plan provide for an interest credit (or an equivalent amount) for any plan year at a rate that is greater than a market rate of return. Under section 411(b)(5)(B)(i)(I), a plan is not treated as having an above-market rate merely because the plan provides for a reasonable minimum guaranteed rate of return or for a rate of return that is equal to the greater of a fixed or variable rate of return. Section 411(b)(5)(B)(i)(II) provides that an applicable defined benefit plan is treated as failing to meet the requirements of section 411(b)(1)(H) unless the plan provides that an interest credit (or an equivalent amount) of less than zero can in no event result in the account balance or similar amount being less than the aggregate amount of contributions credited to the account. Section 411(b)(5)(B)(i)(III) authorizes the Secretary of the Treasury to provide by regulation for rules governing the calculation of a market rate of return for purposes of section 411(b)(5)(B)(i)(I) and for permissible methods of crediting interest to the account (including fixed or variable interest rates) resulting in effective rates of return meeting the requirements of section 411(b)(5)(B)(i)(I).

Sections 411(b)(5)(B)(ii), 411(b)(5)(B)(iii) and 411(b)(5)(B)(iv) contain additional requirements that apply if, after June 29, 2005, an applicable plan amendment is adopted. Section 411(b)(5)(B)(v)(I) defines an applicable plan amendment as an amendment to a defined benefit plan which has the effect of converting the plan to an applicable defined benefit plan. Under section 411(b)(5)(B)(ii), if, after June 29, 2005, an applicable plan amendment is adopted, the plan is treated as failing to meet the requirements of section 411(b)(1)(H) unless the requirements of section 411(b)(5)(B)(iii) are met with respect to each individual who was a participant in the plan immediately before the adoption of the amendment. Section 411(b)(5)(B)(iii) specifies that, subject to section 411(b)(5)(B)(iv), the requirements of section 411(b)(5)(B)(iii) are met with respect to any participant if the accrued benefit of the participant under the terms of the plan as in effect after the amendment is not less than the sum of: (I) The participant's accrued benefit for years of service before the

effective date of the amendment, determined under the terms of the plan as in effect before the amendment; plus (II) the participant's accrued benefit for years of service after the effective date of the amendment, determined under the terms of the plan as in effect after the amendment. Section 411(b)(5)(B)(iv) provides that, for purposes of section 411(b)(5)(B)(iii)(I), the plan must credit the participant's account or similar amount with the amount of any early retirement benefit or retirement-type subsidy for the plan year in which the participant retires if, as of such time, the participant has met the age, years of service, and other requirements under the plan for entitlement to such benefit or subsidy.

Section 411(b)(5)(B)(v) sets forth certain provisions related to an applicable plan amendment. Section 411(b)(5)(B)(v)(II) provides that if the benefits under two or more defined benefit plans of an employer are coordinated in such a manner as to have the effect of adoption of an applicable plan amendment, the plan sponsor is treated as having adopted an applicable plan amendment as of the date the coordination begins. Section 411(b)(5)(B)(v)(III) directs the Secretary of the Treasury to issue regulations to prevent the avoidance of the purposes of section 411(b)(5)(B) through the use of two or more plan amendments rather than a single amendment.

Section 411(b)(5)(B)(vi) provides special rules for determining benefits upon termination of an applicable defined benefit plan. Under section 411(b)(5)(B)(vi)(I), an applicable defined benefit plan is not treated as satisfying the requirements of section 411(b)(5)(B)(i) (regarding permissible interest crediting rates) unless the plan provides that, upon plan termination, if the interest crediting rate under the plan is a variable rate, the rate of interest used to determine accrued benefits under the plan is equal to the average of the rates of interest used under the plan during the 5-year period ending on the termination date. In addition, under section 411(b)(5)(B)(vi)(II), the plan must provide that, upon plan termination, the interest rate and mortality table used to determine the amount of any benefit under the plan payable in the form of an annuity payable at normal retirement age is the rate and table specified under the plan for this purpose as of the termination date, except that if the interest rate is a variable rate, the rate used is the average of the rates used under the plan during the 5-year period ending on the termination date.

Section 411(b)(5)(C) provides that a plan is not treated as failing to meet the requirements of section 411(b)(1)(H)(i) solely because the plan provides offsets against benefits under the plan to the extent the offsets are otherwise allowable in applying the requirements of section 401(a). Section 411(b)(5)(D) provides that a plan is not treated as failing to meet the requirements of section 411(b)(1)(H) solely because the plan provides a disparity in contributions or benefits with respect to which the requirements of section 401(l) (relating to permitted disparity for Social Security benefits and related matters) are met.

Section 411(b)(5)(E) provides that a plan is not treated as failing to meet the requirements of section 411(b)(1)(H) solely because the plan provides for indexing of accrued benefits under the plan. Under section 411(b)(5)(E)(iii), indexing means the periodic adjustment of the accrued benefit by means of the application of a recognized investment index or methodology. Section 411(b)(5)(E)(ii) requires that, except in the case of a variable annuity, the indexing not result in a smaller benefit than the accrued benefit determined without regard to the indexing.

Except to the extent permitted under section 411(d)(6) (or under another statutory provision, including section 1107 of PPA '06), section 411(d)(6) prohibits a plan amendment that decreases a participant's accrued benefits or that has the effect of eliminating or reducing an early retirement benefit or retirement-type subsidy, or eliminating an optional form of benefit, with respect to benefits attributable to service before the amendment. However, an amendment that eliminates or decreases benefits that have not yet accrued does not violate section 411(d)(6), provided that the amendment is adopted and effective before the benefits accrue.

Section 701(a) of PPA '06 added provisions to the Employee Retirement Income Security Act of 1974, Public Law 93-406 (88 Stat. 829 (1974)), as amended (ERISA), that are parallel to sections 411(a)(13) and 411(b)(5) of the Code. The guidance provided in these regulations with respect to sections 411(a)(13) and 411(b)(5) of the Code also apply for purposes of the parallel amendments to ERISA made by section 701(a) of PPA '06, and the guidance provided in these regulations with respect to section 411(b)(1) of the Code

also apply for purposes of section 204(b)(1) of ERISA.<sup>1</sup>

Section 701(c) of PPA '06 added provisions to the Age Discrimination in Employment Act of 1967, Public Law 90-202 (81 Stat. 602 (1967)), that are parallel to section 411(b)(5) of the Code. Executive Order 12067 requires all Federal departments and agencies to advise and offer to consult with the Equal Employment Opportunity Commission (EEOC) during the development of any proposed rules, regulations, policies, procedures, or orders concerning equal employment opportunity. The Treasury Department and the IRS have consulted with the EEOC prior to the issuance of these regulations.

Section 701(d) of PPA '06 provides that nothing in the amendments made by section 701 should be construed to create an inference concerning the treatment of applicable defined benefit plans or conversions of plans into applicable defined benefit plans under section 411(b)(1)(H), or concerning the determination of whether an applicable defined benefit plan fails to meet the requirements of section 411(a)(2), 411(c) or 417(e), as in effect before such amendments, solely because the present value of the accrued benefit (or any portion thereof) of any participant is, under the terms of the plan, equal to the amount expressed as the balance of a hypothetical account or as an accumulated percentage of the participant's final average compensation.

Section 701(e) of PPA '06 sets forth the effective date provisions with respect to amendments made by section 701 of PPA '06. Section 701(e)(1) specifies that the amendments made by section 701 generally apply to periods beginning on or after June 29, 2005. Thus, the age discrimination safe harbors under section 411(b)(5)(A) and section 411(b)(5)(E) are effective for periods beginning on or after June 29, 2005. Section 701(e)(2) provides that the special present value rules of section 411(a)(13)(A) are effective for distributions made after August 17, 2006 (the date PPA '06 was enacted).

Under section 701(e) of PPA '06, the 3-year vesting rule under section 411(a)(13)(B) is generally effective for years beginning after December 31, 2007, for a plan in existence on June 29, 2005, while, pursuant to the amendments made by section 107(c) of WRERA '08, the rule is generally

effective for plan years ending on or after June 29, 2005, for a plan not in existence on June 29, 2005. The market rate of return limitation under section 411(b)(5)(B)(i) is generally effective for years beginning after December 31, 2007, for a plan in existence on June 29, 2005, while the limitation is generally effective for periods beginning on or after June 29, 2005, for a plan not in existence on June 29, 2005. Section 701(e)(4) of PPA '06 contains special effective date provisions for collectively bargained plans that modify these effective dates.

Under section 701(e)(5) of PPA '06, as amended by WRERA '08, sections 411(b)(5)(B)(ii), (iii) and (iv) apply to a conversion amendment that is adopted on or after, and takes effect on or after, June 29, 2005.

Under section 701(e)(6) of PPA '06, as added by WRERA '08, the 3-year vesting rule under section 411(a)(13)(B) does not apply to a participant who does not have an hour of service after the date the 3-year vesting rule would otherwise be effective.

Section 702 of PPA '06 provides for regulations to be prescribed by August 16, 2007, addressing the application of rules set forth in section 701 of PPA '06 in the case of a conversion of a defined benefit pension plan to an applicable defined benefit plan that is made with respect to a group of employees who become employees by reason of a merger, acquisition, or similar transaction.

Section 1.411(a)-7(a)(1) of the Income Tax Regulations provides that, for purposes of section 411 and the regulations under section 411, the accrued benefit of a participant under a defined benefit plan is either (A) the accrued benefit determined under the plan if the plan provides for an accrued benefit in the form of an annual benefit commencing at normal retirement age, or (B) an annual benefit commencing at normal retirement age which is the actuarial equivalent (determined under section 411(c)(3) and § 1.411(c)-1) of the accrued benefit under the plan if the plan does not provide for an accrued benefit in the form of an annual benefit commencing at normal retirement age.

Section 1.411(b)-1(a)(1) provides that a defined benefit plan is not a qualified plan unless the method provided by the plan for determining accrued benefits satisfies at least one of the alternative methods in § 1.411(b)-1(b) for determining accrued benefits with respect to all active participants under the plan. Section 1.411(b)-1(b)(2)(i) provides that a defined benefit plan satisfies the 133 $\frac{1}{3}$  percent of section 411(b)(1)(B) for a particular plan

year if (A) under the plan the accrued benefit payable at the normal retirement age (determined under the plan) is equal to the normal retirement benefit (determined under the plan), and (B) the annual rate at which any individual who is or could be a participant can accrue the retirement benefits payable at normal retirement age under the plan for any later plan year cannot be more than 133 $\frac{1}{3}$  percent of the annual rate at which the participant can accrue benefits for any plan year beginning on or after such particular plan year and before such later plan year. Section 1.411(b)-1(b)(2)(ii)(A) through (D) sets forth a series of rules that correspond to the rules of section 411(b)(1)(B)(i) through (iv). Section 1.411(b)-1(b)(2)(ii)(D) provides that, for purposes of the 133 $\frac{1}{3}$  percent rule, for any plan year, social security benefits and all relevant factors used to compute benefits, for example, the consumer price index, are treated as remaining constant as of the beginning of the current plan year for all subsequent plan years.

Final regulations (TD 9505) under sections 411(a)(13) and 411(b)(5) (2010 final regulations) were published by the Treasury Department and the IRS in the **Federal Register** on October 19, 2010 (75 FR 64123).

Proposed regulations (REG-132554-08) under sections 411(a)(13), 411(b)(1), and 411(b)(5) (2010 proposed regulations) were also published by the Treasury Department and the IRS in the **Federal Register** on October 19, 2010 (75 FR 64197). The 2010 proposed regulations address certain issues under sections 411(a)(13) and 411(b)(5) that were not addressed in the 2010 final regulations. The 2010 proposed regulations also address one issue under the 133 $\frac{1}{3}$  percent rule of section 411(b)(1)(B) for defined benefit plans that adjust benefits using a variable rate that could be negative. The Treasury Department and the IRS received written comments on the 2010 proposed regulations, and a public hearing was held on January 26, 2011.

Notice 2011-85 (2011-44 IRB 605 (October 31, 2011)), (see § 601.601(d)(2)(ii)(b) of this chapter), announced delayed effective/ applicability dates with respect to certain provisions in the hybrid plan regulations. In particular, Notice 2011-85 provided that the provisions to be adopted under the regulations that finalize the 2010 proposed regulations would apply for plan years that begin on or after the date specified in those regulations, which would not be earlier than January 1, 2013. Notice 2011-85 also provided that the Treasury

<sup>1</sup> Under section 101 of Reorganization Plan No. 4 of 1978 (43 FR 47713), the Secretary of the Treasury has interpretive jurisdiction over the subject matter addressed by these regulations for purposes of ERISA, as well as the Code.

Department and the IRS intended to amend the hybrid plan regulations to postpone the effective/applicability date of § 1.411(b)(5)–1(d)(1)(iii), (d)(1)(vi) and (d)(6)(i) (the provisions that provide that the regulations set forth the list of the interest crediting rates and combinations of rates that satisfy the requirements of section 411(b)(5)(B)(i) to match the effective/applicability date of the new provisions in the regulations. Notice 2011–85 further provided that, when the 2010 proposed regulations are finalized, it was expected that relief from the requirements of section 411(d)(6) would be granted for a plan amendment that eliminates or reduces a section 411(d)(6) protected benefit, provided that the amendment is adopted by the last day of the first plan year preceding the plan year for which the 2010 proposed regulations, once finalized, apply to the plan, and the elimination or reduction is made only to the extent necessary to enable the plan to meet the requirements of section 411(b)(5). In addition, Notice 2011–85 extended the deadline for amending cash balance and other applicable defined benefit plans, within the meaning of section 411(a)(13)(C), to meet the requirements of section 411(a)(13) (other than section 411(a)(13)(A)) and section 411(b)(5), relating to vesting and other special rules applicable to these plans. Under Notice 2011–85, the deadline for these amendments was the last day of the first plan year preceding the plan year for which the 2010 proposed regulations, once finalized, apply to the plan.

Notice 2012–61 (2012–42 IRB 479 (October 15, 2012)), (see § 601.601(d)(2)(ii)(b) of this chapter), announced that the regulations described in Notice 2011–85 would not be effective for plan years beginning before January 1, 2014.

After consideration of the comments received, the provisions in the 2010 proposed regulations are adopted by this Treasury decision, subject to a number of changes that are summarized in this preamble. In addition, the Treasury Department and the IRS are issuing proposed regulations that would permit a plan with a noncompliant interest crediting rate to be amended so that its interest crediting rate complies with the market rate of return rules without violating the section 411(d)(6) prohibition on a plan amendment reducing a participant's accrued benefit. These proposed regulations are being issued at the same time as these final regulations.

## Explanation of Provisions

### Overview

In general, these regulations provide guidance with respect to certain issues under sections 411(a)(13) and 411(b)(5) that are not addressed in the 2010 final regulations and make certain other changes to the final regulations under sections 411(a)(13) and 411(b)(5). In addition, these regulations provide guidance with respect to one issue under the 133 $\frac{1}{3}$  percent rule of section 411(b)(1)(B) for defined benefit plans that adjust benefits using a variable rate that could be negative.

### *I. Section 411(a)(13): Scope of Relief of Section 411(a)(13)(A)*

#### A. Formulas To Which Relief Applies

Pursuant to the relief of section 411(a)(13)(A), the 2010 final regulations provide that certain rules otherwise applicable to benefits under a defined benefit plan are not violated solely because certain benefits determined under a lump sum-based benefit formula are based on the current lump sum amount under that formula. The 2010 final regulations define a lump sum-based benefit formula as a benefit formula used to determine all or any part of a participant's accumulated benefit under which the accumulated benefit provided under the formula is expressed as the current balance of a hypothetical account maintained for the participant ("cash balance" formula) or as the current value of an accumulated percentage of the participant's final average compensation ("pension equity plan" or "PEP" formula).

For plan years that begin on or after January 1, 2016 (or an earlier date as elected by the taxpayer), these regulations expand the definition of PEP formula to include a benefit formula that is expressed as a current single-sum dollar amount equal to a percentage of the participant's *highest* average compensation (with a permitted lookback period for determining highest average compensation, such as highest 5 out of the last 10 years).

In addition, for plan years that begin on or after January 1, 2016, these regulations provide that a benefit formula does not constitute a lump sum-based benefit formula unless a distribution of the benefits under that formula in the form of a single-sum payment equals the accumulated benefit under that formula (except to the extent the single-sum payment is greater to satisfy the requirements of section 411(d)(6)).

#### B. Protections With Respect to Current Account Balance or Current Value

The relief of section 411(a)(13)(A) generally permits a plan to treat the accumulated benefit under a cash balance formula ("cash balance account") or the accumulated benefit under a PEP formula ("PEP accumulation") as the present value of the portion of the accrued benefit determined under the cash balance or PEP formula. The 2010 proposed regulations contained three requirements that applied to the cash balance account or PEP accumulation. These requirements were structured as conditions on the availability of the relief of section 411(a)(13)(A). A number of commenters objected to treating these requirements as conditions for this relief. In response to those comments, the structure of the regulations under section 411(a)(13)(A) has been revised to clarify that two of the requirements are only intended to provide the same types of protections to the accumulated benefit under a cash balance formula and under a PEP formula as are afforded to the accrued benefit.

For example, these final regulations provide that the relief of section 411(a)(13) does not override the requirement for a plan that, with respect to a participant with an annuity starting date after normal retirement age, the plan either provide an actuarial increase after normal retirement age or satisfy the requirements for suspension of benefits under section 411(a)(3)(B). Accordingly, with respect to such a participant, a plan with a cash balance or PEP formula violates the requirements of section 411(a) if the cash balance account or PEP accumulation is not increased sufficiently to satisfy the requirements of section 411(a)(2) for distributions commencing after normal retirement age, unless the plan suspends benefits in accordance with section 411(a)(3)(B).

Like the 2010 proposed regulations, these final regulations provide that the cash balance account or PEP accumulation can only be reduced for certain limited reasons, which generally correspond to the limited reasons for which the accrued benefit can be reduced. Several commenters on the 2010 proposed regulations suggested that it was unclear whether the restrictions on reductions as applied to PEP formulas were intended to cover only reductions that reduced the accumulated percentage that applies to the participant's final average compensation or whether the restrictions were also intended to disallow reductions that were a result of decreases in the participant's final

average compensation. In response to those comments, the regulations clarify that a reduction in the PEP accumulation is permitted to the extent that it results from a decrease in the participant's final average compensation or from an increase in the integration level (in the case of a formula that is integrated with Social Security). The regulations also contain a provision allowing the Commissioner to add to the list of permitted reductions through guidance of general applicability.

Under the 2010 proposed regulations, a cash balance formula or PEP formula would have had to provide that the portion of the participant's accrued benefit that is determined under that formula must be actuarially equivalent (using reasonable actuarial assumptions) to the cash balance account or PEP accumulation upon attainment of normal retirement age in order to apply the relief of section 411(a)(13)(A). Under these final regulations, a cash balance formula or PEP formula is treated as a lump sum-based benefit formula to which the relief of section 411(a)(13)(A) applies if the portion of the participant's accrued benefit that is determined under that formula is actuarially equivalent (using reasonable actuarial assumptions) to the cash balance account or PEP accumulation either upon attainment of normal retirement age or at the annuity starting date for a distribution with respect to that portion.

If a formula is not a lump sum-based benefit formula, the plan must satisfy the rules that otherwise apply for purposes of determining benefits under a defined benefit plan, such as applying the minimum present value requirements of section 417(e) to the portion of the accrued benefit determined under that formula in order to determine the amount of a single-sum distribution option.

#### C. Subsidies and Benefits That are Less Than the Actuarial Equivalent of the Cash Balance Account or PEP Accumulation

The 2010 proposed regulations provided that the relief of section 411(a)(13)(A) applies to an optional form of benefit that is determined as of the annuity starting date as the actuarial equivalent, using reasonable actuarial assumptions, of the cash balance account or PEP accumulation. In response to comments that subsidized benefits should be permissible, the rules in the regulations under section 411(a)(13) have been revised to clarify that the relief of section 411(a)(13)(A) also applies to a subsidized optional form of benefit under a lump sum-based benefit formula, including an early

retirement subsidy or a subsidized survivor portion of a qualified joint and survivor annuity. In particular, these final regulations provide that, with respect to benefits under a lump sum-based benefit formula, if an optional form of benefit is payable in an amount that is greater than the actuarial equivalent, determined using reasonable actuarial assumptions, of the cash balance account or PEP accumulation, then the plan satisfies the requirements of section 411(a)(2), 411(a)(11), 411(c) and 417(e) with respect to the amount of that optional form of benefit.<sup>2</sup>

By contrast, section 411(a)(13)(A) does not provide relief with respect to an optional form of benefit that is less than the actuarial equivalent of the cash balance account or PEP accumulation. Thus, the final regulations provide that if an optional form of benefit is not at least the actuarial equivalent, using reasonable actuarial assumptions, of the cash balance account or PEP accumulation, then the relief under section 411(a)(13)(A) does not apply in determining whether the optional form of benefit is the actuarial equivalent of the portion of the accrued benefit determined under the cash balance or PEP formula. As a result, payment of that optional form of benefit must satisfy the rules applicable to payment of the accrued benefit generally under a defined benefit plan (without regard to the special rules of section 411(a)(13)(A) and the regulations), including the requirements of section 411(a)(2) and, for optional forms subject to the minimum present value requirements of section 417(e)(3), those minimum present value requirements.

#### D. Clarifications Relating to Statutory Hybrid Formulas With an Effect Similar to a Lump Sum-Based Benefit Formula

Under the 2010 final regulations, a formula that is not a lump sum-based benefit formula that has an effect similar to a lump sum-based benefit formula is nevertheless a statutory hybrid benefit formula. As a result, such a formula is subject to the 3-year vesting rule of section 411(a)(13)(B) and the rules of section 411(b)(5), including the market rate of return and conversion protection requirements. However, because it is not a lump sum-based benefit formula, such a formula is not eligible for the relief of

section 411(a)(13)(A). In general, a defined benefit formula that is not a lump sum-based benefit formula has an effect similar to a lump sum-based benefit formula if the formula provides that a participant's accumulated benefit is expressed as a benefit that includes the right to adjustments for a future period and the total dollar amount of those adjustments is reasonably expected to be smaller for the participant than for a similarly situated, younger individual who is or could be a participant in the plan.

These regulations clarify certain of the rules with respect to the determination as to whether a formula constitutes a formula with an effect similar to a lump sum-based benefit formula. In particular, these regulations clarify that the right to adjustments for a future period is broadly defined to mean the right to any change in the dollar amount of benefits over time, regardless of whether those adjustments are denominated as interest credits. Thus, for example, an increase in the dollar amount of benefits over time (such as an actuarial increase or the unwinding of an actuarial reduction for early retirement) is treated as an adjustment.

However, this broad definition does not cause a defined benefit formula to be treated as having an effect similar to a lump sum-based benefit formula with respect to a participant merely because the formula provides for a reduction in the benefit payable at early retirement due to early commencement (with the result that the benefit payable at normal retirement age is greater than the benefit payable at early retirement), provided that the benefit payable at normal retirement age to the participant cannot be less than the benefit payable at normal retirement age to any similarly situated, younger individual who is or could be a participant in the plan. This exception has the effect of excluding traditional defined benefit formulas (and other formulas that provide for mere actuarial reduction for early commencement) from treatment as a formula with an effect similar to a lump sum-based benefit formula, notwithstanding the treatment of actuarial increases in benefits over time as adjustments.

Under the 2010 final regulations, a variable annuity benefit formula was defined as any benefit formula under a defined benefit plan which provides that the amount payable is periodically adjusted by reference to the difference between the rate of return on plan assets (or specified market indices) and a specified assumed interest rate. In addition, the 2010 final regulations contained a special rule that provided

<sup>2</sup> As set forth later in this preamble, the regulations under section 411(b)(5) provide rules under the age discrimination safe harbor that limit the amount of the subsidized early retirement benefit so that it does not exceed the benefit available to a similarly situated, older participant with the same cash balance account or PEP accumulation who is currently at normal retirement age.

an exception from treatment as a formula with an effect similar to a lump sum-based benefit formula for a variable annuity benefit formula with an assumed interest rate of 5 percent or higher.

In order to clarify this exception, both the definition and the exception have been revised under these regulations. In particular, the definition of variable annuity benefit formula has been broadened. Thus, these regulations provide that a variable annuity benefit formula means any benefit formula under a defined benefit plan which provides that the amount payable is periodically adjusted by reference to the difference between a rate of return (not limited to the rate of return on plan assets or specified market indices) and a specified assumed interest rate. The exception has been revised so that it is available in the case of any variable annuity benefit formula that adjusts the amounts payable by reference to any rate of return that is permissible as an interest crediting rate under the regulations, including the rate of return on plan assets (or a subset of plan assets), as described in section III.C.2 of this preamble, or the rate of return on an annuity contract for an employee issued by an insurance company licensed under the laws of a State. The rule in the regulations that provides that this exception is only available if the specified assumed interest rate is 5 percent or higher has been retained.

A variable annuity benefit formula that does not fall within the exception must be tested to determine whether it has an effect similar to a lump sum-based benefit formula. Such a formula is not a statutory hybrid benefit formula if the specified assumed interest rate is high enough in relation to the reasonable expectation of the rate of return to which it is compared, such that the adjustments under the formula are not reasonably expected to be positive. However, if the specified assumed interest rate is too high in relation to the reasonable expectation of the rate of return to which it is compared, a variable annuity benefit formula risks violating section 411(b)(1)(G).

#### E. Formulas That Express the Accumulated Benefit as a Single-Sum Dollar Amount at Normal Retirement Age

As discussed earlier in this preamble, the 2010 final regulations define a lump sum-based benefit formula as a benefit formula used to determine all or any part of a participant's accumulated benefit under which the accumulated benefit provided under the formula is

expressed as the current balance of a hypothetical account maintained for the participant or as the current value of an accumulated percentage of the participant's final average compensation. Under this rule, a benefit formula is a lump sum-based benefit formula if it expresses the accumulated benefit as a current single-sum dollar amount, regardless of whether interest credits are provided.

With respect to a plan that does not provide interest credits, there may be a question as to whether the accumulated benefit is a current single-sum dollar amount or is a single-sum dollar amount at normal retirement age. Accordingly, the 2010 proposed regulations included a comment request with respect to whether a defined benefit plan that expresses the participant's accumulated benefit as a current single-sum dollar amount and that does not provide for interest credits should be excluded from the definition of a statutory hybrid plan. Commenters suggested that a benefit formula that expresses the participant's benefit as a current single-sum dollar amount (for example, a PEP formula) should be treated as a statutory hybrid benefit formula, regardless of whether interest credits are provided. Because the statutory language with respect to a cash balance formula and a PEP formula does not specify that interest credits must be provided, the Treasury Department and the IRS agree with this recommendation. As a result, the definition of lump sum-based benefit formula continues not to require that interest credits be provided.

Commenters also recommended that plans that express the accumulated benefit as a single-sum dollar amount at normal retirement age, rather than as a current single-sum dollar amount, should not be treated as statutory hybrid plans. The Treasury Department and the IRS generally agree with this recommendation. Accordingly, the definition of lump sum-based benefit formula continues to require that the benefit be expressed as a current single-sum dollar amount. Thus, a benefit formula that expresses the accumulated benefit as a single-sum dollar amount at normal retirement age is not a statutory hybrid benefit formula unless the formula includes the right to adjustments such that the formula has an effect similar to a lump sum-based benefit formula pursuant to § 1.411(a)(13)-1(d)(4)(ii) (see section I.D of this preamble).

The Treasury Department and the IRS believe that this treatment under the regulations is consistent with the intent of Congress to treat as statutory hybrid plans generally only those defined

benefit plans that either express the accumulated benefit as a current single-sum dollar amount or that provide for adjustments such that the participant's benefit at normal retirement age is less than that of a similarly situated, younger individual who is or could be a participant. This is because a defined benefit plan that expresses the accumulated benefit as a single-sum dollar amount at normal retirement age (and that does not provide a larger benefit to the participant than to a similarly situated, older participant) is identical to a traditional defined benefit plan for age discrimination purposes, and differs in substance from a traditional defined benefit plan only because the benefit at normal retirement age is expressed as a single-sum dollar amount rather than as an annuity.

Under these rules, a defined benefit plan that expresses the accumulated benefit as a single-sum dollar amount can be designed to express that accumulated benefit as either a current single-sum dollar amount or a single-sum dollar amount at normal retirement age. In the former case, the formula would be a lump sum-based benefit formula, and therefore would be eligible for the relief of section 411(a)(13)(A) (and subject to the rules of sections 411(a)(13)(B) and 411(b)(5)(B)). In the latter case, the formula would not be a lump sum-based benefit formula, and therefore would not be eligible for the relief of section 411(a)(13)(A).

Because a formula that expresses the accumulated benefit as a single-sum dollar amount at normal retirement age is not eligible for the relief of section 411(a)(13)(A), the accrued benefit under such a formula is often determined under the terms of the plan by applying section 417(e) factors to the single-sum dollar amount. The rules of sections 411(a)(13)(B) and 411(b)(5)(B) would generally not apply to such a formula (unless it is treated under the regulations as having an effect similar to a lump sum-based benefit formula). Instead, all of the rules that apply to defined benefit formulas that are not statutory hybrid benefit formulas would apply to such a formula. For example, if a defined benefit plan is amended to change the benefit formula under the plan to a formula that expresses the accumulated benefit as a single-sum dollar amount at normal retirement age (and the formula does not fall within the definition of a benefit formula with an effect similar to a lump sum-based benefit formula), the amendment is not subject to the rules that apply with respect to a conversion amendment under section 411(b)(5)(B)(ii). Furthermore, the mere existence of an

early retirement subsidy that meets applicable rules would not affect this determination.

## *II. Section 411(b)(1): Special Rules With Respect to Variable Interest Crediting Rates*

The 2010 proposed regulations contain a special rule regarding the application of the 133 $\frac{1}{3}$  percent rule of section 411(b)(1)(B)<sup>3</sup> to a statutory hybrid plan that adjusts benefits using a variable interest crediting rate that can potentially be negative in any given year. Under this rule, for plan years that begin on or after January 1, 2012, a plan that determines any portion of the participant's accrued benefit pursuant to a statutory hybrid benefit formula (as defined in § 1.411(a)(13)–1(d)(4)) with a variable interest crediting rate that was negative for the prior plan year would not be treated as failing to satisfy the requirements of the 133 $\frac{1}{3}$  percent rule for the current plan year merely because the section 411(b)(1)(B) backloading calculation is performed assuming that the variable rate is zero for the current plan year and all future plan years.

One commenter on the 2010 proposed regulations suggested that a special rule under the 133 $\frac{1}{3}$  percent rule of section 411(b)(1)(B) should not be provided for variable interest crediting rates that can potentially be negative. Other commenters suggested that the interest crediting rate to be used for purposes of the 133 $\frac{1}{3}$  percent rule in the case of a variable interest crediting rate that can potentially be negative should be assumed to be a reasonable rate of return (such as, for example a long-term average of the rate of return), regardless of the actual rate of return provided as of the current year. However, this would be inconsistent with section 411(b)(1)(B)(iv), which provides that for purposes of the 133 $\frac{1}{3}$  percent rule all "relevant factors used to compute benefits shall be treated as remaining constant as of the current year for all years after the current year."

The special rule in the 2010 proposed regulations provides for the use of an assumed interest crediting rate other than the interest crediting rate used to compute benefits as of the current year only to the extent necessary to permit a statutory hybrid plan to use an interest crediting rate that can potentially be negative. Without such a rule, a statutory hybrid plan that uses a variable interest crediting rate would not satisfy the 133 $\frac{1}{3}$  percent rule of section 411(b)(1)(B) if the variable

interest crediting rate as of the current year is negative, even if the plan does not provide for principal credits (sometimes referred to as pay credits) that are an increasing percentage of pay with increasing years or service. The preservation of capital rule of section 411(b)(5)(B)(i)(II) provides that interest crediting rates under a statutory hybrid plan cannot result in the benefit provided being less than the sum of principal credits. Thus, Congress contemplated a statutory hybrid plan's use of a variable interest crediting rate that can potentially be negative. Accordingly, the special rule is finalized as proposed, except that the rule has been modified to permit a taxpayer to elect to apply it at an earlier date (so that the rule is applicable for plan years that begin on or after January 1, 2012, or an earlier date as elected by the taxpayer).

## *III. Section 411(b)(5): Special Age Discrimination Rules, Including Rules With Respect to the Market Rate of Return Limitation*

### *A. Section 411(b)(5) Age Discrimination Safe Harbor*

Pursuant to section 411(b)(5)(A), the 2010 final regulations provide that a plan is not treated as failing to meet the age discrimination requirements of section 411(b)(1)(H)(i) with respect to an individual who is or could be a participant if, as of any date, the accumulated benefit of the individual would not be less than the accumulated benefit of any similarly situated, younger individual who is or could be a participant. In general, this safe harbor is available only if the accumulated benefits being compared are expressed under only one type of formula (that is, cash balance formulas, PEP formulas, or annuities payable at normal retirement age). These regulations clarify that the age discrimination safe harbor for cash balance formulas and PEP formulas under section 411(b)(5) applies only for formulas that are lump sum-based benefit formulas.<sup>4</sup>

Under the 2010 final regulations, the safe harbor is available with respect to a participant in the case of a plan that determines some or all participants' benefits as the sum-of, greater-of, or choice-of two or more types of formulas only if the participant's benefit under the plan is not less valuable than the

benefit of a similarly situated, younger individual who is or could be a participant in the plan. In order to clarify that certain limitations on benefits (such as those that are required in order to comply with section 415) would not necessarily preclude a plan from satisfying the age discrimination safe harbor, these regulations extend the application of the safe harbor so that the safe harbor is also available to a plan that expresses a participant's accumulated benefit as the lesser of benefits under two or more formulas. In addition, the regulations under section 411(a)(13) have been revised to clarify that, in the case of lesser-of formulas, the relief of section 411(a)(13)(A) applies only to benefits determined under a cash balance or PEP formula, and to provide for a special rule with respect to the application of the limitation on benefits under section 415(b) to a lump sum-based benefit formula.

Section 411(b)(5)(A)(iii) provides for a disregard of the subsidized portion of an early retirement benefit for purposes of the section 411(b)(5) age discrimination safe harbor. This is similar to the disregard of the subsidized portion of an early retirement benefit that applies under section 411(b)(1)(H)(iv) for purposes of the general age discrimination test of section 411(b)(1)(H). The 2010 final regulations provided certain guidance as to what constitutes the subsidized portion of an early retirement benefit for purposes of the section 411(b)(5) age discrimination safe harbor. These final regulations revise and clarify such guidance. In particular, in order to facilitate phased retirement, these final regulations remove the requirement that a subsidized portion of an early retirement benefit must be contingent on a participant's severance from employment. In addition, these final regulations provide that an early retirement benefit includes a subsidized portion only if it provides a higher actuarial present value on account of commencement before normal retirement age. These final regulations also provide for a disregard of the subsidized portion of an early retirement benefit for purposes of the special age discrimination test under section 411(b)(5)(E) that applies for indexed benefits.

However, these final regulations provide that, for plan years that begin on or after January 1, 2016, if the annual benefit payable before normal retirement age is greater for a participant than the annual benefit under the corresponding form of benefit for any similarly situated, older individual who

<sup>3</sup> The 133 1/3 percent rule is the accrual rule most commonly used by statutory hybrid plans to satisfy the accrual rules of section 411(b)(1).

<sup>4</sup> Because the definition of lump sum-based benefit formula requires the benefit to be expressed under the terms of the plan as a cash balance formula or PEP formula, the existing language in these safe harbors that the benefit be expressed under the terms of the plan as a cash balance formula or PEP formula has been eliminated as redundant.



is or could be a participant and who is currently at or before normal retirement age, then that excess is not part of the subsidized portion of an early retirement benefit and, accordingly, is not disregarded for age discrimination purposes. Thus, if more than a subsidized portion of an early retirement benefit is provided to a participant, that additional benefit is not disregarded for purposes of the section 411(b)(5) age discrimination safe harbor (and, as a result, the safe harbor typically would not be satisfied). For purposes of determining whether the annual benefit payable before normal retirement age is greater for a participant than the annual benefit under the corresponding form of benefit for any similarly situated, older individual who is or could be a participant, social security leveling options and social security supplements are disregarded. In addition, a plan is not treated as providing a greater annual benefit to a participant than to a similarly situated, older individual who is or could be a participant merely because the reduction (based on actuarial equivalence, using reasonable actuarial assumptions) in the amount of an annuity to reflect a survivor benefit is smaller for the participant than for a similarly situated, older individual who is or could be a participant.

#### B. Conversion Amendments

The 2010 final regulations provide that a participant in a defined benefit plan whose benefits are affected by an amendment that converts the benefit formula under the plan from a formula that is not a statutory hybrid benefit formula to a statutory hybrid benefit formula (conversion amendment) generally must be provided with a benefit after the conversion that, in accordance with the requirements of section 411(b)(5)(B)(ii), is at least equal to the sum of benefits accrued through the date of conversion and benefits earned after the conversion, with no permitted interaction between the two portions. The 2010 final regulations provide for an alternative method of satisfying the conversion protection requirements that applies if an opening hypothetical account balance or opening accumulated percentage of the participant's final average compensation is established at the time of the conversion and the plan provides for separate calculation of (1) the benefit attributable to the opening hypothetical account balance (including interest credits attributable thereto) or attributable to the opening accumulated percentage of the participant's final average compensation and (2) the

benefit attributable to post-conversion service under the post-conversion benefit formula. Under this alternative, the plan must provide that, when a participant commences benefits, the participant's benefit will be increased if the benefit attributable to the opening hypothetical account or opening accumulated percentage that is payable in the particular optional form of benefit selected is less than the benefit accrued under the plan prior to the date of conversion and that was payable in the same generalized optional form of benefit (within the meaning of § 1.411(d)-3(g)(8)) at the same annuity starting date.

Several commenters requested that the regulations illustrate the application of the conversion rules for a plan that uses this alternative method of satisfying the conversion protection requirements, with respect to a participant who selects a single-sum distribution option of the participant's entire benefit under the plan after a conversion amendment. In order to respond to this request, a new example has been added to the regulations to illustrate that the participant must be provided with the benefit attributable to post-conversion service, plus the greater of the benefit attributable to the opening hypothetical account balance or the section 417(e) present value at the annuity starting date of the participant's pre-conversion benefit.

The 2010 proposed regulations included a proposed rule whereby certain plans could satisfy the conversion protection requirements by establishing an opening hypothetical account balance without a subsequent comparison of benefits at the annuity starting date. The proposed rule included a number of requirements intended to make it reasonably likely that the hypothetical account balance used to replicate the pre-conversion benefit (the opening hypothetical account balance and interest credits on that account balance) would in most, but not necessarily all, cases provide a benefit at least as large as the pre-conversion benefit for all periods after the conversion amendment.

Several commenters found the proposed rule overly burdensome, due to the many restrictions and requirements. One commenter strongly opposed any conversion alternative that could result in any participant receiving less than the sum of the benefit under the pre-conversion formula plus the benefit under the hybrid formula at the annuity starting date. The Treasury Department and the IRS agree that the proposed rule was complex and that it is not feasible to create a simple rule

while also ensuring that participants cannot receive less than is required under sections 411(b)(5)(B)(ii), 411(b)(5)(B)(iii) and 411(b)(5)(B)(iv). As a result, the final regulations only permit the conversion alternative that was included in the 2010 final regulations, where an opening hypothetical account balance or opening accumulated percentage of the participant's final average compensation is established and benefits are compared at the annuity starting date. Consequently, if in reliance on the 2010 proposed regulations, a plan sponsor used the proposed rule to satisfy the conversion protection requirements for plan years that begin on or after January 1, 2012, then the plan must be amended so that distributions with an annuity starting date in a plan year that begins on or after January 1, 2016 satisfy the rules in the final regulations with respect to conversion amendments.

#### C. Market Rate of Return

##### General Rules With Respect to Crediting Interest

Pursuant to section 411(b)(5)(B), the 2010 final regulations provide that a statutory hybrid plan satisfies the requirements of section 411(b)(1)(H) prohibiting age discrimination only if the plan does not credit interest at a rate that is greater than a market rate of return. Section 411(b)(5)(B)(i)(III) gives the Secretary the authority to provide by regulation for rules governing the calculation of a market rate of return and for permissible methods of crediting interest resulting in effective rates of return that are not greater than a market rate of return.

The 2010 final regulations set forth certain requirements that apply to a statutory hybrid plan that provides for interest credits. Under these requirements, such a plan must credit interest at least annually, and the plan terms must specify how interest credits are determined, including the timing of the crediting of interest credits. In addition, the 2010 final regulations contain a list of rates that satisfy the requirement that the plan not credit interest at an effective rate that is greater than a market rate of return, while not permitting other rates.

In evaluating whether a particular rate (or combination of rates) provides an effective rate of return that is not greater than a market rate of return for purposes of inclusion on the list of permitted rates under the 2010 final and proposed regulations, the Treasury Department and the IRS considered all fixed and variable components (taking into account any minimum rate of return and

the cumulative zero floor provided by the statutory preservation of capital rule). This approach was taken because of the age discrimination concerns with statutory hybrid plans that credit interest such that the effective rate of return is greater than a market rate of return (as occurs when, for example, the combination of a variable rate of return and a fixed minimum rate provides an effective rate of return that is greater than a market rate of return). In such a case, a younger participant is able to benefit from the above-market rate for a longer period—and therefore receive a more valuable benefit—than a similarly situated, older participant.

A number of commenters objected to the provision under the 2010 final regulations under which a plan that credits interest using an interest crediting rate not on the list of rates in the regulations does not satisfy the requirement that the interest crediting rate not be greater than a market rate of return. These commenters asked that the regulations provide a list of safe harbor interest crediting rates deemed to be not greater than a market rate of return for purposes of the requirements of section 411(b)(5)(B) and also permit the use of other interest crediting rates that do not exceed a market rate of return. However, this approach would require the IRS to evaluate the characteristics of an unrestricted set of interest crediting rates to determine whether the particular interest crediting rate under each plan exceeds a market rate of return. For example, a particular investment-based interest crediting rate available in the market might be so volatile that the combination of the rate and the statutory cumulative zero floor provides an effective rate of return that is greater than a market rate of return. As another example, an interest crediting rate based on an index determined with reference to current yields on bonds that are lower in quality than the bonds used to determine the third segment rate might provide a rate of return that is greater than a market rate of return because that rate of return is not adjusted downward to reflect the occurrence of defaults in those lower quality bonds. It is theoretically possible to adjust an otherwise above-market rate downward (for example, through the use of a maximum or the application of a percentage or basis points reduction applied to the variable rate of return) so that the resulting adjusted rate does not exceed a market rate of return. However, it would not be administratively feasible for the IRS to evaluate each combination of a particular variable rate of return and a minimum rate, a maximum rate, or

some other type of adjustment, to determine whether the combination provides an effective rate of return that exceeds a market rate of return. Accordingly, pursuant to the authority provided under section 411(b)(5)(B)(i)(III), the regulations continue to specify which interest crediting rates (including fixed rates, variable rates, and combinations of rates) satisfy the market rate of return requirements of section 411(b)(5)(B), while not permitting other rates.<sup>5</sup>

Although these final regulations continue to specify which interest crediting rates satisfy the market rate of return requirement, the list of rates has been expanded to include certain additional rates not permitted under the 2010 final and proposed regulations. In order to allow for the list of permitted rates to be further expanded in the future, these final regulations include a provision that permits the Commissioner, in guidance published in the Internal Revenue Bulletin, to increase the specific interest crediting rates set forth in the regulations (such as by increasing the maximum permitted margin that can be added to one or more of the safe harbor rates, increasing the maximum permitted fixed rate, or increasing a maximum permitted annual floor). In addition, these final regulations include a provision that permits the Commissioner, in guidance published in the Internal Revenue Bulletin, to provide for additional interest crediting rates that satisfy the requirement that they not exceed a market rate of return for purposes of section 411(b)(5)(B). Thus, for example, the Commissioner could in the future, in guidance published in the Internal Revenue Bulletin, permit a plan to use an annual floor in conjunction with an investment-based rate that is reduced so that the effective rate of return does not exceed a market rate of return. Such an annual floor would allow plans using plan assets or other investment-based market rates that may be negative in some periods to assure positive annual interest credits that could be used in determining benefits and in projecting them for purposes of section 411(b)(1)(B).

## 2. Use of Adjusted Segment Rates as Interest Crediting Rates

The 2010 final regulations provide that each of the three segment rates described in section 430(h)(2)(C)(i), (ii) and (iii) (which are generally used for

<sup>5</sup> As set forth in the “Effective/Applicability Date” section of this preamble, these provisions of the regulations apply for plan years that begin on or after January 1, 2016.

purposes of applying the minimum funding requirements for single-employer defined benefit plans) is a permissible interest crediting rate under a statutory hybrid plan. Section 40211(a) of the Moving Ahead for Progress in the 21st Century Act, Public Law 112–141 (126 Stat. 405 (2012)) (MAP–21), added section 430(h)(2)(C)(iv) to the Code, generally effective for plan years beginning on or after January 1, 2012. Section 430(h)(2)(C)(iv) provides that each of the three segment rates for a plan year is adjusted as necessary to fall within a specified range that is determined based on an average of the corresponding segment rates for the 25-year period ending on September 30 of the calendar year preceding the first day of that plan year. Section 2003 of the Highway and Transportation Funding Act of 2014, Public Law 113–159 (128 Stat. 1839 (2014)) (HATFA), modified the ranges set forth in section 430(h)(2)(C)(iv).

These final regulations provide that a statutory hybrid plan is permitted to credit interest using one of the unadjusted segment rates (without regard to section 430(h)(2)(C)(iv)) or one of the adjusted segment rates (as adjusted by application of section 430(h)(2)(C)(iv)), as specified under the terms of the plan. If future interest credits with respect to principal credits that have already accrued are determined using either an adjusted or an unadjusted segment rate, then any subsequent amendment to change to another interest crediting rate with respect to those principal credits (including a change from the adjusted rate to an unadjusted segment rate, or vice versa) must satisfy the requirements of section 411(d)(6).

## 3. Rate of Return on Plan Assets or a Subset of Plan Assets

The 2010 final regulations include a market rate of return rule that permits indexed benefits (such as those provided under a variable annuity benefit formula) to be adjusted using the actual rate of return on the aggregate assets of the plan, if plan assets are diversified so as to minimize the volatility of returns. Similar to the 2010 proposed regulations, these final regulations extend this rule to statutory hybrid plans generally, so that a plan may credit interest under a cash balance formula using an interest crediting rate equal to the actual rate of return on the aggregate assets of the plan, if plan assets are diversified to minimize the volatility of returns.

One commenter suggested that it should be permissible to adjust a participant's benefit under a statutory

hybrid benefit formula based on the rate of return on a subset of plan assets. There may be a number of reasons why a plan sponsor may find it useful to design a plan so that a participant's benefit is adjusted based on a subset of plan assets. For example, a plan sponsor may wish to credit interest based on a rate of return that differs for different groups of participants (such as using a more conservative, or less volatile, subset of plan assets for long service employees). Similarly, a plan sponsor may wish to credit interest based on a rate of return that excludes certain subsets of plan assets (for example, excluding assets associated with traditional defined benefit plan liabilities after a conversion amendment or otherwise excluding a residual subset of assets associated with liabilities for those participants whose benefits are not adjusted under the statutory hybrid benefit formula).

In order to permit these plan designs, these final regulations expand the list of permissible interest crediting rates by permitting a variable annuity benefit formula to provide adjustments (and a cash balance formula to credit interest) using the rate of return on a subset of plan assets, if certain requirements are satisfied. Specifically, these final regulations provide that an interest crediting rate equal to the actual rate of return on the assets within a specified subset of plan assets, including both positive and negative returns, is not in excess of a market rate of return if: (1) The subset of plan assets is diversified so as to minimize the volatility of returns (this requirement is satisfied if the subset of plan assets is diversified such that it would meet the diversification requirement that must be met in order for aggregate plan assets to be used as an interest crediting rate), (2) the aggregate fair market value of qualifying employer securities and qualifying employer real property (within the meaning of section 407 of ERISA) held in the subset of plan assets does not exceed 10 percent of the fair market value of the aggregate assets in the subset;<sup>6</sup> and (3) the fair market value of the assets within the subset of plan assets approximates the liabilities for benefits that are adjusted by reference to the rate of return on the assets within the subset, determined using reasonable actuarial assumptions. Under this rule, there can be a residual subset of plan assets for liabilities that are not adjusted by reference to a subset (such as a subset consisting of a

dedicated bond portfolio designed to satisfy liabilities with respect to retirees). In addition, if other applicable requirements are satisfied, this rule would permit a plan to base adjustments on the rate of return on different subsets for different groups of participants. The regulations include examples that illustrate the use of the rate of return on a subset of plan assets as a permitted interest crediting rate.

#### 4. Rate of Return on a RIC or Other Collective Investments

Like the 2010 proposed regulations, these final regulations also permit a statutory hybrid plan to credit interest using the rate of return on a regulated investment company (RIC) that meets certain standards. Specifically, these final regulations provide that an interest crediting rate is not in excess of a market rate of return if it is equal to the rate of return on a RIC, as defined in section 851, that is reasonably expected to be not significantly more volatile than the broad United States equities market or a similarly broad international equities market. For example, a RIC that has most of its assets invested in securities of issuers (including other RICs) concentrated in an industry sector or a country other than the United States generally would not meet this requirement. Likewise, a RIC that uses leverage, or that has significant investment in derivative financial products, for the purpose of achieving returns that amplify the returns of an unleveraged investment, generally would not meet this requirement. Thus, a RIC that has most of its investments concentrated in the semiconductor industry or that uses leverage in order to provide a rate of return that is twice the rate of return on the Standard & Poor's 500 index (S&P 500) would not meet this requirement. On the other hand, a RIC that has investments that track the rate of return on the S&P 500, a broad-based "small-cap" index (such as the Russell 2000 index), or a broad-based international equities index would meet this requirement. The requirement that the RIC's investments not be concentrated in an industry sector or a specific foreign country is intended to limit the volatility of the returns, as well as the risk inherent in non-diversified investments. Similarly, the requirement that the RIC not provide leveraged returns is intended to limit the volatility of the returns provided. Subject to these requirements, the rule is intended to provide plan sponsors with greater flexibility in choosing a permissible rate of return than would be provided if the regulations were to list

particular RICs or indices that satisfy the market rate of return requirement.

Several commenters suggested that it should be permissible for a statutory hybrid plan to credit interest using the rate of return on any investment available in the plan sponsor's defined contribution plan. Because the combination of a rate of return on an investment available in the plan sponsor's defined contribution plan and the statutory cumulative zero floor may provide an effective rate of return that is greater than a market rate of return, these final regulations do not provide that the rate of return on an investment is a permissible interest crediting rate merely because the investment is available in the plan sponsor's defined contribution plan. However, a subset of plan assets of a statutory hybrid plan could be comprised of investments that are options under the plan sponsor's defined contribution plan (which could be owned through a collective investment vehicle). In such a case, if the requirements set forth earlier are satisfied with respect to that subset, the rate of return on that subset would be a permissible interest crediting rate. In addition, if an investment available in the plan sponsor's defined contribution plan is a RIC that meets the requirements of the preceding paragraph, the rate of return on that RIC would also be a permissible interest crediting rate.

#### 5. Permitted Fixed Rate

Section 411(b)(5)(B)(i)(III) authorizes the Treasury Department to issue regulations permitting a fixed rate of interest under the rules relating to a market rate of return. However, reconciling a plan's ability to provide a fixed interest crediting rate with the requirement under section 411(b)(5)(B)(i)(I) that an interest crediting rate "*for any plan year* shall be at a rate which is not greater than a market rate of return" [emphasis added] presents unique challenges because, by definition, fixed rates do not adjust with the market. As a result, the use of any fixed rate will result in an interest crediting rate that is above a then-current market rate of interest during any period in which the current market rate falls below the fixed rate.

In light of this fact, the Treasury Department and the IRS believe that, in order to satisfy the market rate of return requirement, any fixed interest crediting rate allowed under the rules must not be expected to exceed future market rates of interest, except infrequently, by small amounts, and for limited durations. Prior to the publication of the 2010 proposed regulations, the Treasury

<sup>6</sup>The 10 percent limitation is similar to the limitation that applies with respect to aggregate plan assets under section 407 of ERISA.

Department and the IRS modeled the difference between account balances credited with interest credits determined using various fixed interest rates and account balances credited with interest credits determined using long-term investment grade corporate bond yields, based on a stochastic distribution of those yields that reflects the historical distribution of those yields. Based on that modeling, a maximum fixed interest crediting rate of 5% per year was included in the proposed regulations.

This analysis was undertaken again prior to the publication of these regulations, using additional historical data. Based on the additional historical data, the Treasury Department and the IRS have determined that a fixed interest crediting rate of up to 6 percent satisfies these criteria and that any higher fixed rate would result in an effective rate of return that is in excess of a market rate of return. In addition to satisfying the market rate of return requirements, a fixed 6 percent rate of interest is deemed to be not in excess of the third segment rate described in section 417(e)(3)(D) or 430(h)(2)(C)(iii) (and, therefore, a plan that uses such a rate is permitted to use the special rule described in section III.E of this preamble to switch to the third segment rate without providing section 411(d)(6) protection).

#### 6. Permitted Annual and Cumulative Floors

As part of the historical modeling of rates done prior to the publication of the 2010 proposed regulations, the Treasury Department and the IRS modeled the historical distribution of rates of interest on long-term investment grade corporate bonds to determine the additional value added by various fixed floors used in conjunction with these rates. Based on this modeling, the 2010 proposed regulations would have provided that a fixed floor up to 4 percent was permissible in connection with any of the permissible bond-based interest crediting rates. Several commenters requested that the fixed floor used in conjunction with the bond-based rates be increased by at least 100 basis points. Prior to the publication of these regulations, the Treasury Department and the IRS undertook the same analysis as was undertaken prior to the publication of the 2010 proposed regulations, using additional historical data. In addition, the Treasury Department and the IRS modeled the historical distribution of the 30-year

Treasury rate with fixed floors of various values compared to the historical distribution of rates of interest on long-term investment grade corporate bonds. The rates permitted under Notice 96-8 (“Notice 96-8 rates”), including the government bond-based rates such as the 30-year Treasury rate, are generally expected to be lower than the rate of interest on long-term investment grade corporate bonds. As a result, the annual floor used in conjunction with the Notice 96-8 rates can be increased to some extent without adding so much additional value that the effective rate of return is greater than a market rate of return. Accordingly, the final regulations provide that it is permissible for a plan to utilize an annual floor of up to 5 percent in conjunction with any of the Notice 96-8 rates.<sup>7</sup> Like the 2010 proposed regulations, these regulations continue to provide that a plan can utilize an annual floor of up to 4 percent in conjunction with the third segment rate (the rate of interest on long-term investment grade corporate bonds), or in conjunction with the first or second segment rates.

In contrast, because of the volatility of a rate of return that reflects changes in the price level of underlying investments (“investment-based rate”), adding an annual floor to an investment-based rate often provides an effective rate of return on a cumulative basis that far exceeds the rate of return provided by the investment-based rate without such a floor. Also, commenters on both the 2007 proposed regulations and the 2010 proposed regulations generally did not request that such an annual floor be permitted. Accordingly, the final regulations do not allow the use of an annual floor in conjunction with any of the permissible investment-based rates (i.e., the rate of return on plan assets, a subset of plan assets, or a RIC).

On the other hand, if, instead of applying a floor on each year’s rate of return, a cumulative floor is applied to an investment-based rate, the effective rate of return is not necessarily substantially greater than the rate of return provided without the floor. Specifically, the Treasury Department and the IRS have determined that, based on the modeling of long-term historical returns, a 3 percent floor that applies cumulatively (in the aggregate from the date of each principal credit until the annuity starting date, without a floor on the rate of return provided in any interim period) could be combined with a permissible investment-based rate (or

any other permissible rate), without increasing the effective rate of return to such an extent that the effective rate of return would be in excess of a market rate of return. As a result, like the 2010 proposed regulations, the regulations provide that a plan that determines interest credits using any particular interest crediting rate that satisfies the market rate of return limitation does not provide an effective interest crediting rate in excess of a market rate of return merely because the plan provides that the participant’s benefit, as of the participant’s annuity starting date, is equal to the greater of the benefit determined using the interest crediting rate and the benefit determined as if the plan had used a fixed annual interest crediting rate equal to 3 percent (or a lower rate) for all principal credits that are made during the guarantee period. For this purpose, the guarantee period is the prospective period that begins on the date the cumulative floor begins to apply to the participant’s benefit and that ends on the date on which that cumulative floor ceases to apply to the participant’s benefit.

These regulations provide that the determination of the amount payable pursuant to the guarantee provided by any cumulative floor with respect to the participant’s benefit is made only as of an annuity starting date on which a distribution of the participant’s entire benefit as of that date under the plan’s statutory hybrid benefit formula commences. These final regulations provide special rules in the case of a participant who has multiple annuity starting dates, in order to ensure that prior annuity starting dates are taken into account in determining the guarantee provided by a cumulative floor. These special rules in the case of a participant who has multiple annuity starting dates are largely substantively unchanged from rules in the 2010 proposed regulations, except that language has been clarified to provide that the comparison involves a comparison of the accumulated benefit to which the guarantee applies to the sum of principal credits to which the guarantee applies (and to conform to similar changes made to the rules with respect to the application of the preservation of capital requirement to a participant who has multiple annuity starting dates, as described later in section II.C.8 of this preamble, except that the new special rule for participants with 5 or more 1-year breaks in service applies only to the preservation of capital requirement).

<sup>7</sup> These regulations conform the names of the government bond-based rates that are permitted to

be used pursuant to this rule to the names of the rates set forth in Notice 96-8.

Variable rate	Maximum permitted floor
Notice 96–8 rate (for example, the yield on 30-year Treasury Constant Maturities) .....	5 percent annual.
1st, 2nd, or 3rd segment rate .....	4 percent annual.
Investment-based rate (for example, the rate of return on aggregate plan assets) .....	3 percent cumulative.

**7. Permitted Margins on Government Bond-Based Rates**

A number of commenters suggested that the permitted margins used in conjunction with the permitted government bond-based interest crediting rates be increased to make these rates more equivalent to the third segment rate. As clarified in these regulations, the permitted government bond-based rates and margins are the same as those that were permitted under Notice 96–8. These rates and margins have largely been maintained for the convenience of plan sponsors, so that a plan that has been using a Notice 96–8 rate can continue to do so.

The Treasury Department and the IRS understand that very few plans with government bond-based rates have margins in excess of those provided under Notice 96–8. Moreover, there are several methods by which a plan can credit interest based on a bond-based rate that is expected to be greater than a Notice 96–8 rate. For example, a plan that is using a Notice 96–8 rate can be amended to switch to the third segment rate for purposes of determining all future interest credits without the need to preserve the Notice 96–8 rate with respect to benefits accrued before the applicable amendment date if, on the effective date of the amendment, the third segment rate is not lower than the Notice 96–8 rate that would have applied in the absence of the amendment (and the other requirements of § 1.411(b)(5)–1(e)(3)(ii), which are described in section III.E of this preamble, are satisfied). In addition, because a plan can provide for a rate of return that is the lesser of a permitted rate and any other rate, a plan could adopt an interest crediting rate with respect to future pay credits that is the lesser of the third segment rate and a government bond-based rate described in Notice 96–8 with a margin, even if that margin exceeds the margin permitted under these final regulations.

**8. Other Rules With Respect to Crediting Interest**

Like the 2010 proposed regulations, these final regulations include a rule that provides that a plan is not treated as failing to meet the interest crediting requirements merely because the plan does not provide for interest credits on

amounts distributed prior to the end of the interest crediting period. Thus, if a plan credits interest at annual or more frequent period intervals, the plan is not required to credit interest on amounts that were distributed between the dates on which interest under the plan is credited to the account balance. Also, the rule in the 2010 proposed regulations that allows plans to credit interest taking into account increases or decreases to the participant’s accumulated benefit that occur during the period has been finalized as proposed.

The 2010 final regulations provide that a statutory hybrid plan does not provide an effective interest crediting rate that is in excess of a market rate of return merely because the plan determines an interest credit by applying different rates to different predetermined portions of the accumulated benefit, provided each rate would be a permissible rate if the rate applied to the entire accumulated benefit. With respect to this provision, some commenters suggested that the regulations should be explicit that a single rate that is a specified blend of multiple rates that applies to the entire cash balance account is permissible, as is applying different rates to different specified subaccounts of the cash balance account. The Treasury Department and the IRS believe that the current rule accommodates such a blended rate, since the predetermined portion to which a rate applies can either be a specified percentage of the cash balance account or a specified subaccount. As a result, the rule with respect to blended rates remains unchanged in the regulations.

These final regulations make some clarifying changes to the preservation of capital requirement that was included in the 2010 final regulations. In particular, these final regulations clarify that the preservation of capital requirement involves a comparison of the accumulated benefit to the sum of all principal credits and that the requirement is applied only as of an annuity starting date with respect to which a distribution of the participant’s entire vested benefit under the plan’s statutory hybrid benefit formula as of that date commences.

Like the 2010 proposed regulations, these final regulations provide special

rules in the case of a participant who has multiple annuity starting dates, in order to ensure that prior annuity starting dates are taken into account in determining the amount of the guarantee provided under the preservation of capital requirement. Although the preservation of capital requirement applies only as of an annuity starting date with respect to which a distribution of the participant’s entire vested benefit under the plan’s statutory hybrid benefit formula as of that date commences, all prior annuity starting dates (including annuity starting dates with respect to partial distributions) are taken into account when applying the preservation of capital requirement as of that annuity starting date.

The special rules with respect to the preservation of capital requirement for a participant who has multiple annuity starting dates remain largely unchanged from the rules in the 2010 proposed regulations, except that these rules have been revised to reflect corresponding changes in the regulations that explicitly permit certain subsidies under statutory hybrid plans.

One commenter requested that the special rules with respect to the preservation of capital requirement for a participant who has multiple annuity starting dates not apply in the case of a participant who has experienced a break in service. In response to this comment, a new rule has been added to the regulations. Under this new rule of administrative convenience, a plan is permitted to provide that, in the case of a participant who receives a distribution of the entire vested benefit under the plan and thereafter completes 5 consecutive 1-year breaks in service, the preservation of capital requirement is applied without regard to the prior period of service. Thus, in the case of such a participant, the plan is permitted to provide that the preservation of capital requirement is applied disregarding the principal credits and distributions that occurred before the breaks in service. Application of this rule could result in a participant receiving a greater benefit (but never less) than would otherwise be provided without such a rule.

Because section 411(a)(13)(A) does not override the requirement that a defined benefit plan either provide an

actuarial increase after normal retirement age or satisfy the requirements for suspension of benefits, a statutory hybrid plan that does not suspend benefits in accordance with section 411(a)(3)(B) will have to provide for adjustments in excess of the benefits determined using the plan's interest crediting rate if the interest crediting rate is insufficient to provide the required actuarial increases. However, without a special rule, that greater benefit could cause the market rate of return requirements to be violated. Thus, like the 2010 proposed regulations, these final regulations provide for a special rule that allows for any required adjustments after normal retirement age to be provided as interest credits without violating the market rate of return requirements.

#### D. Plan Termination

Like the 2010 proposed regulations, the regulations provide special rules that apply for purposes of determining interest crediting rates and certain other plan factors under a statutory hybrid benefit formula after the plan termination date of a statutory hybrid plan, including guidance with respect to 5-year averaging of rates under section 411(b)(5)(B)(vi). The terms of a statutory hybrid plan must reflect these rules.

The regulations provide guidance as to the interest crediting rate used to determine benefits after the plan termination date. Several commenters on the 2010 proposed regulations suggested that additional guidance is needed as to the rules that apply with respect to the annuity conversion interest rates and factors that apply after the plan termination date, as well as the mortality table that is used after the plan termination date. In response to these comments, these regulations provide additional guidance as to annuity conversion rates, factors, and mortality tables.

Similar to the 2010 proposed regulations, the regulations provide that a plan satisfies the plan termination requirements only if the interest crediting rate used to determine a participant's accumulated benefit for interest crediting periods that end after the plan termination date is equal to the average of the interest rates used under the plan during the 5-year period ending on the plan termination date. Pursuant to section 411(d)(5)(B)(vi), the actual interest crediting rate (taking into account minimums, maximums, and other adjustments) used under the plan for the interest crediting period generally is used for purposes of determining the average of the interest rates. However, section 411(b)(5)(B)(vi)

does not provide a rule for periods in which an investment-based rate of return, rather than a variable interest rate, is used under the plan to determine interest credits. In addition, the trailing 5-year average of an investment-based rate of return may be unreasonably high or unreasonably low and, unlike the trailing 5-year average of an interest rate, will have little, if any, correlation to the actual future investment-based rate of return. As a result, the Treasury Department and the IRS do not believe it is appropriate for the trailing 5-year average of an investment-based rate of return to be used to determine benefits after plan termination.

The 2010 proposed regulations would have substituted the third segment rate generally for interest crediting rates that are not based on interest rates. A number of commenters suggested that the substitution of the third segment rate would make plan termination unduly costly for plans that used investment-based interest crediting rates. While the future return of an investment that includes an equity component may be expected to be higher than the third segment rate, the Treasury Department and the IRS note that the third segment rate is normally higher than the rate used under defined benefit plans for other purposes, including funding, and agree that the third segment rate is inappropriately high for purposes of substituting a fixed rate of return for periods after the plan's termination date. Consistent with the statutory language of section 411(b)(5)(B)(vi)(I), the Treasury Department and the IRS continue to believe it is appropriate to substitute a rate of interest used under the plan for those periods in which an investment-based rate of return was used to determine interest credits. However, in lieu of the third segment rate, the final regulations provide that the second segment rate under section 430(h)(2)(C)(ii) (determined without regard to section 430(h)(2)(C)(iv)) for the last calendar month ending before the beginning of the interest crediting period, generally must be substituted for an investment-based rate of return that applied for that interest crediting period. For many plans, the second segment rate is close to the effective interest rate that is used for funding purposes, and thus the substitute interest rate frequently will approximate the plan's funding discount rate (without being affected by the specific plan demographics).

The regulations contain certain rules of application with respect to these plan termination rules, including rules with respect to section 411(d)(6) protected

benefits. The regulations also include examples to illustrate the application of these plan termination rules. In response to a commenter's request, the regulations include an example illustrating the application of these plan termination rules in the case where the plan uses the section 417(e) segment rates for annuity conversion.

#### E. Rules Relating to Section 411(d)(6) and Interest Crediting Rates

The 2010 final regulations provided that the right to interest credits in the future that are not conditioned on future service constitutes a section 411(d)(6) protected benefit. One commenter expressed concern that this rule was overbroad. In response to this comment, these final regulations clarify that the right to future interest credits determined in the manner specified under the plan and not conditioned on future service is a factor that is used to determine the participant's accrued benefit for purposes of section 411(d)(6). Thus, if a plan is amended so that it could potentially provide smaller future interest credits on the then-current accumulated benefit than would have been provided prior to the amendment, the plan must otherwise provide for increased benefits such that the potentially smaller interest credits cannot result in a smaller accrued benefit (or a smaller payment under any optional form of benefit) as of any future date than the accrued benefit (or payment under the optional form of benefit) as of the applicable amendment date. See section I.B of this preamble for a discussion of the additional rule under the regulations pursuant to which the relief of section 411(a)(13) does not permit the accumulated benefit under a lump sum-based benefit formula to be reduced in a manner that would be prohibited if that reduction were applied to the accrued benefit.

The 2010 final regulations contain a rule under which a plan is not treated as providing for smaller interest credits in the future in violation of section 411(d)(6) merely because of an amendment that changes the plan's interest crediting rate from one of the Notice 96-8 rates (or the first or second segment rates) to the third segment rate, if three requirements are satisfied. Specifically, the rule is only available if the change applies to interest credits to be credited after the effective date of the amendment, the effective date of the amendment is at least 30 days after adoption and, on the effective date of the amendment, the new interest

crediting rate is not lower than the interest crediting rate that would have applied in the absence of the amendment. The 2010 final regulations do not specify how a plan with a fixed annual floor used in connection with the pre-amendment rate should account for the floor when changing to the third segment rate. These final regulations add a fourth requirement to this rule, which provides that, for plan years that begin on or after January 1, 2016, any fixed annual floor that was used in connection with the pre-amendment rate must be retained after the amendment to the maximum extent permissible under the market rate of return requirement in the final regulations. Thus, for example, if prior to the amendment a plan was using a fixed annual floor of 4.5 percent in connection with the yield on 30-year Treasury Constant Maturities, then, if the plan is amended to change the rate to the third segment rate it must provide a fixed annual floor of 4 percent.

Because section 411(d)(6) requires that a plan amendment not result in a reduction to the accrued benefit, changes in interest crediting rates would be difficult to implement without special market rate of return rules. Thus, like the 2010 proposed regulations, the regulations contain a special market rate of return rule that applies in the case of an amendment to change the plan's interest crediting rate. This rule provides that the market rate of return rule is not violated merely because the plan provides that the benefit of active participants after the interest crediting rate change can never be less than the benefit under the old rate (without future principal credits), subject to an anti-abuse rule. This rule does not extend to participants who are not active participants as of the date of amendment because such an extension would cause those participants effectively to receive a rate of return on their entire account balance that is the greater of the old and the new rate, which would be an impermissible above-market interest crediting rate under the regulations (unless the resulting greater-of rate is otherwise permitted under the regulations). These final regulations also contain a special rule that provides both section 411(d)(6) relief and relief under the market rate of return rules for changing the lookback month or stability period used to determine interest credits (for a plan using a bond-based interest crediting rate), subject to an anti-abuse rule.

A comment request that was included in the preamble to the 2010 proposed regulations asked how section 411(d)(6)

applies in the case of a plan that credits interest using an interest crediting rate equal to the rate of return on a RIC if the RIC ceases to exist. Commenters generally suggested that section 411(d)(6) should be treated as satisfied in such a case if the plan sponsor replaces the RIC that ceases to exist with a RIC with similar characteristics (such as risk and expected return). The Treasury Department and the IRS generally agree with these comments. As a result, these final regulations provide for a special rule that applies in the case of a statutory hybrid plan that credits interest using an interest crediting rate equal to the rate of return on a RIC that ceases to exist, whether as a result of a name change, liquidation, or otherwise. In such a case, the plan is not treated as violating section 411(d)(6) provided that the rate of return on the successor RIC is substituted for the rate of return on the RIC that no longer exists, for purposes of crediting interest for periods after the date the RIC ceased to exist. In the case of a name change or merger of RICs, the successor RIC means the RIC that results from the name change or merger involving the RIC that no longer exists. In all other cases, the successor RIC is a RIC selected by the plan sponsor that has reasonably similar characteristics, including characteristics related to risk and rate of return, as the RIC that no longer exists.

Prior to the first day of the first plan year that begins on or after January 1, 2016, a statutory hybrid plan that uses an interest crediting rate that is not permitted under the final regulations must be amended to change to an interest crediting rate that is on the list of permitted interest crediting rates under the regulations. This is because, after that date, the final regulations set forth the list of interest crediting rates that satisfy the requirement of section 411(b)(5)(B)(i) that the plan not provide an effective rate of return that is greater than a market rate of return. However, an amendment that reduces the interest crediting rate with respect to benefits that have already accrued would ordinarily be impermissible under section 411(d)(6). A comment request that was included in the preamble to the 2010 proposed regulations solicited comments with respect to guidance needed to resolve this conflict between the market rate of return rules of section 411(b)(1)(B)(i) and the anti-cutback rules of section 411(d)(6) in order to permit a plan to change its interest crediting rate to comply with the final regulations. After consideration of the comments received, proposed regulations that

would permit a plan with a noncompliant interest crediting rate to be amended so that its interest crediting rate complies with the market rate of return rules are being issued concurrently with these final regulations.

#### F. Requests To Introduce "Self-Directed Investment" Into Statutory Hybrid Plans

In response to stakeholder suggestions, the preamble of the 2010 proposed regulations requested comments as to whether a statutory hybrid plan should be able to offer participants the opportunity to choose from a menu of hypothetical investment options. If such an approach were adopted, it could introduce into defined benefit pension plans that constitute statutory hybrid plans a form of participant involvement in the selection of interest crediting rates that would be somewhat analogous to the self-directed investment practices that are typical of section 401(k) retirement savings plans. Under such an approach, participants could choose from among hypothetical investment options that would determine the interest crediting rate. The menu of hypothetical investment options might include various equity or fixed income investment alternatives, potentially including options similar to balanced or target date funds.<sup>8</sup> The 2010 preamble also requested comments on the plan qualification issues that might arise under such a plan design, such as the treatment of forfeitures, the application of the anti-cutback rules under section 411(d)(6), compliance with the market rate of return requirement, and other section 411(b)(5) issues. In addition, comments were specifically requested as to whether events such as the following would raise issues: (1) A participant elects to switch from one investment option to another; (2) a RIC underlying one of the investment options ceases to exist; (3) the plan is amended to eliminate an investment option; (4) a participant elects to switch from an investment option with a cumulative minimum to an investment option without a cumulative minimum (or vice versa); or (5) the plan is terminated and, pursuant to the special rules that apply upon plan termination, the interest crediting rate that applies to determine a participant's benefit after plan termination must be fixed.

Several commenters expressed serious concerns about the possibility of giving

<sup>8</sup> A target date investment option under a statutory hybrid plan would transition participants incrementally at certain ages from a blended rate that is more heavily equity-weighted to a rate that is more heavily weighted in fixed income.

statutory hybrid plan participants the ability to choose from a menu of hypothetical investment options. These comments reflect a general concern that adding participant choice of investment options to a statutory hybrid plan would constitute a further departure of these plans from the fundamental nature of defined benefit pension plans.

Underlying this general concern appears to be a view that participant choice of investment options is a practice that has developed uniquely in the context of certain types of defined contribution retirement savings vehicles (such as section 401(k) and section 403(b) plans) and is not readily reconcilable with the statutory and regulatory regime applicable to defined benefit pension plans. For example, commenters questioned the advisability of shifting retirement security risks to participants in defined benefit pension plans in a manner similar to self-directed investing in section 401(k) plans. In this regard, commenters have raised questions as to whether participants in general have the knowledge, experience, and discipline to deal as effectively as plan fiduciaries and other investment professionals with the different risk and return characteristics of various investment options and to formulate and adhere systematically to methodical investment practices and strategies (such as appropriate risk diversification and regular rebalancing).

Commenters also raised concerns regarding potential hazards for trustees and plan sponsors of statutory hybrid plans that provide investment choices to participants. Commenters suggested that if plan assets were invested to track participant elections of equity-heavy interest crediting options or frequent participant-directed investment changes that might not be prudent, section 404(c) of ERISA might not be available to limit plan fiduciary liability and help protect participants. In the alternative, concerns have been expressed that, if plan assets were invested according to a traditional defined benefit plan investment strategy not correlated with participants' elections, a well-funded plan might quickly become underfunded in a period when equity-heavy interest crediting options perform well (which could lead to additional exposure for the PBGC and put participants at risk for shortfalls in anticipated benefits).

In addition, because the interest crediting rate is part of a participant's accrued benefit and all related future interest credits are accrued at the time a participant accrues a pay credit, some commenters suggested that a change in the interest crediting rate might be

treated as a plan amendment for section 411(d)(6) anti-cutback purposes (similar to rules preventing participants from waiving all or any part of their accrued benefit). This section 411(d)(6) interpretation would require preserving the prior interest crediting rate with respect to benefits previously accrued. Under this interpretation, participants would be encouraged to select one rate and subsequently change to another rate with different characteristics to achieve the greater of the two interest crediting rates. In addition, the resulting greater-of rate that is required under this section 411(d)(6) interpretation raises issues under the section 411(b)(5) rules that provide that an interest crediting rate cannot exceed a market rate of return.

Other commenters suggested that the regulations should permit statutory hybrid plans to provide for participant choice among hypothetical investment options. For example, they noted that if statutory hybrid plans were permitted to allow participant-directed investments, this plan design might be more popular among participants and employer sponsors, in an era in which adoption and retention of defined benefit plans generally have been waning. The commenters also argued that permitting investment-based rates of return in statutory hybrid plans suggests that participants should be permitted to direct the investment of their hypothetical accounts on the theory that participants should have the option to elect a less volatile investment, particularly as they near retirement, as in the case of a target date fund or managed account. These commenters argued that a choice among investment options is dissimilar, for purposes of applying the anti-cutback rule of section 411(d)(6), to a waiver of accrued benefits (because, at the time of a change, the value of an investment dollar in any market-based investment option is the same as the value of an investment dollar in any other market-based investment option). They contended that the anti-cutback rule may protect a participant's right to choose among interest crediting measures, but would not protect the accrued benefit determined under a participant's particular choice among interest crediting measures.

Some commenters that advocated that the regulations permit a statutory hybrid plan to provide for participant choice among investment options also requested transition relief in the event that regulations do not permit this type of plan design. For example, they suggested that participant choice be permitted during the interim period

between the statutory and regulatory effective dates. They also suggested that, even after the regulatory effective date, a participant in a plan that previously provided for participant choice be permitted to continue to direct the investment of the account balance credited to that participant as of the regulatory effective date and/or that anti-cutback relief be provided so that plan sponsors can move to a different method of matching investment risk to individual participant circumstances (such as basing interest crediting rates on the performance of target date funds or managed accounts, without participant choice).

Because of the significant concerns relating to the use of statutory hybrid plan designs that would permit participants to choose among a menu of investment options specified in the plan document, the Treasury Department and the IRS continue to study these issues. It is possible that the Treasury Department and the IRS will conclude that such plan designs are not permitted. In that event, it is anticipated that any statutory hybrid plans that permitted participant choice among a menu of investment options on September 18, 2014 pursuant to plan provisions that were adopted by September 18, 2014 would receive anti-cutback relief that would permit any such plans to be amended to provide for one or more appropriate alternative replacement interest crediting measures.

Some commenters raised concerns regarding whether it would be consistent with the fiduciary, disclosure, and other requirements of Title I of ERISA if a statutory hybrid plan were to permit participant choice among a menu of investment options. Concerns raised by these plan designs under Title I of ERISA are within the jurisdiction of the Secretary of Labor. See Reorganization Plan No. 4 of 1978, 5 U.S.C. App. at 672 (2006).

#### **Effective/Applicability Dates**

Except as otherwise provided, the new rules under these final regulations apply to plan years that begin on or after January 1, 2016. (The rules in these final regulations that merely clarify provisions that were included in the 2010 final regulations apply to plan years that begin on or after January 1, 2011, in accordance with the general effective/applicability date of the 2010 final regulations). In addition, these regulations amend § 1.411(b)(5)-1 to provide that § 1.411(b)(5)-1(d)(1)(iii), (d)(1)(vi) and (d)(6)(i) (which provide that the regulations set forth the list of interest crediting rates and combinations of interest crediting rates



that satisfy the market rate of return requirement under section 411(b)(5) apply to plan years that begin on or after January 1, 2016.<sup>9</sup>

The final regulations reflect the statutory effective dates set forth in section 701(e) of PPA '06. Pursuant to section 701(e)(1) of PPA '06, the amendments made by section 701 of PPA '06 are generally effective for periods beginning on or after June 29, 2005. However, sections 701(e)(2) through 701(e)(6) of PPA '06, as amended by WRERA '08, set forth a number of special effective/applicability date rules that are described earlier in the Background section of the preamble of these regulations.

For periods after the statutory effective date and before the regulatory effective date, the relief of sections 411(a)(13) and 411(b)(5) applies and the requirements of sections 411(a)(13) and 411(b)(5) must be satisfied. As provided in the 2010 final regulations, a plan is permitted to rely on the provisions of the final regulations for purposes of applying the relief and satisfying the requirements of sections 411(a)(13) and 411(b)(5) for periods after the statutory effective date and before the regulatory effective date. For such periods, a plan is also permitted to rely on the provisions of the 2010 proposed regulations, the 2007 proposed regulations and Notice 2007-6 for purposes of applying the relief and satisfying the requirements of sections 411(a)(13) and 411(b)(5).

The regulations should not be construed to create any inference concerning the applicable law prior to the effective dates of sections 411(a)(13) and 411(b)(5). See also section 701(d) of PPA '06. In addition, the regulations should not be construed to create any inference concerning the proper interpretation of sections 411(a)(13) and 411(b)(5) prior to the effective date of the regulations. Thus, for example, if prior to the effective date of these final regulations a plan provided an interest crediting rate that is not provided for under the final regulations, the plan's interest crediting rate for that period could nonetheless satisfy the statutory requirement that an applicable defined benefit plan not provide for interest credits (or equivalent amounts) for any plan year at an effective rate that is greater than a market rate of return.

<sup>9</sup> The 2010 final regulations provide that these particular provisions apply to plan years that begin on or after January 1, 2012. The intention to delay the effective/applicability date of these provisions was announced in Notice 2011-85 and Notice 2012-61. Notice 2012-61 announced that these provisions would not be effective for plan years beginning before January 1, 2014.

### Special Analyses

It has been determined that these regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the proposed regulations preceding these final regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### Drafting Information

The principal authors of these regulations are Neil S. Sandhu and Linda S. F. Marshall, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in the development of these regulations.

### List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

### Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

### PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 continues to read in part as follows:

**Authority:** 26 U.S.C. 7805 \* \* \*

■ **Par. 2.** Section 1.411(a)(13)-1 is amended by:

■ 1. Revising paragraphs (b)(2), (b)(3), (b)(4), (d)(3)(i), (d)(4)(ii)(A), (d)(4)(ii)(C), (d)(6), and (e)(2)(ii).

■ 2. Adding paragraph (d)(4)(ii)(E).  
The revisions and addition read as follows:

#### § 1.411(a)(13)-1 Statutory hybrid plans.

\* \* \* \* \*

(b) \* \* \*

(2) *General rules with respect to current account balance or current value*—(i) *Benefit after normal retirement age.* The relief of section 411(a)(13) does not override the requirement for a plan that, with respect to a participant with an annuity starting date after normal retirement age, the plan either provide an actuarial increase

after normal retirement age or satisfy the requirements for suspension of benefits under section 411(a)(3)(B). Accordingly, with respect to such a participant, a plan with a lump sum based benefit formula violates the requirements of section 411(a) if the balance of the hypothetical account or the value of the accumulated percentage of the participant's final average compensation is not increased sufficiently to satisfy the requirements of section 411(a)(2) for distributions commencing after normal retirement age, unless the plan suspends benefits in accordance with section 411(a)(3)(B).

(ii) *Reductions limited.* The relief of section 411(a)(13) does not permit the accumulated benefit under a lump sum-based benefit formula to be reduced in a manner that would be prohibited if that reduction were applied to the accrued benefit. Accordingly, the only reductions that can apply to the balance of the hypothetical account or accumulated percentage of the participant's final average compensation are reductions as a result of—

(A) Benefit payments;

(B) Qualified domestic relations orders under section 414(p);

(C) Forfeitures that are permitted under section 411(a) (such as charges for providing a qualified preretirement survivor annuity);

(D) Amendments that would reduce the accrued benefit but that are permitted under section 411(d)(6);

(E) Adjustments resulting in a decrease in the balance of the hypothetical account due to the application of interest credits (as defined in § 1.411(b)(5)-1(d)(1)(ii)(A)) that are negative for an interest crediting period;

(F) In the case of a formula that expresses the accumulated benefit as an accumulated percentage of the participant's final average compensation, adjustments resulting in a decrease in the dollar amount of the accumulated percentage of the participant's final average compensation—

(1) Due to a decrease in the dollar amount of the participant's final average compensation; or

(2) Due to an increase in the integration level, under a formula that is integrated with Social Security (for example, as a result of an increase in the Social Security taxable wage base or in Social Security covered compensation); or

(G) Other reductions to the extent provided by the Commissioner in revenue rulings, notices, or other guidance published in the Internal

Revenue Bulletin (see § 601.601(d)(2)(ii)(b)).

(3) *Payment of benefits based on current account balance or current value—(i) Optional forms that are actuarially equivalent.* With respect to the benefits under a lump sum-based benefit formula, the relief of paragraph (b)(1) of this section applies to an optional form of benefit that is determined as of the annuity starting date as the actuarial equivalent, using reasonable actuarial assumptions, of the then-current balance of a hypothetical account maintained for the participant or the then-current value of an accumulated percentage of the participant's final average compensation.

(ii) *Optional forms that are subsidized.* With respect to the benefits under a lump sum-based benefit formula, if an optional form of benefit is payable in an amount that is greater than the actuarial equivalent, determined using reasonable actuarial assumptions, of the then-current balance of a hypothetical account maintained for the participant or the then-current value of an accumulated percentage of the participant's final average compensation, then the plan satisfies the requirements of sections 411(a)(2), 411(a)(11), 411(c) and 417(e) with respect to the amount of that optional form of benefit. However, see § 1.411(b)(5)–1(b)(1)(iii) for rules relating to early retirement subsidies.

(iii) *Optional forms that are less valuable.* Except as otherwise provided in paragraph (b)(4)(i) of this section, if an optional form of benefit is not at least the actuarial equivalent, using reasonable actuarial assumptions, of the then-current balance of a hypothetical account maintained for the participant or the then-current value of an accumulated percentage of the participant's final average compensation, then the relief under section 411(a)(13) (permitting a plan to treat the account balance or accumulated percentage as the actuarial equivalent of the portion of the accrued benefit determined under the lump sum-based benefit formula) does not apply in determining whether the optional form of benefit is the actuarial equivalent of the portion of the accrued benefit determined under the lump sum-based benefit formula. As a result, payment of that optional form of benefit must satisfy the rules applicable to payment of the accrued benefit generally under a defined benefit plan (without regard to the special rules of section 411(a)(13)(A) and paragraph (b)(1) of this section), including the requirements of section 411(a)(2) and,

for optional forms subject to the minimum present value requirements of section 417(e)(3), those minimum present value requirements.

(4) *Rules of application—(i) Relief applies on proportionate basis with respect to payment of only a portion of the benefit under a lump sum-based benefit formula.* The relief of paragraph (b)(1) of this section applies on a proportionate basis to a payment of a portion of the benefit under a lump sum-based benefit formula, such as a payment of a specified dollar amount or percentage of the then-current balance of a hypothetical account maintained for the participant or then-current value of an accumulated percentage of the participant's final average compensation. Thus, for example, if a plan that expresses the participant's entire accumulated benefit as the balance of a hypothetical account distributes 40 percent of the participant's then-current hypothetical account balance in a single payment, the plan is treated as satisfying the requirements of section 411(a) and the minimum present value rules of section 417(e) with respect to 40 percent of the participant's then-current accrued benefit.

(ii) *Relief applies only to portion of benefit determined under lump sum-based benefit formula.* The relief of paragraph (b)(1) of this section generally applies only to the portion of the participant's benefit that is determined under a lump sum-based benefit formula and generally does not apply to any portion of the participant's benefit that is determined under a formula that is not a lump sum-based benefit formula. The following rules apply for purposes of satisfying section 417(e):

(A) *“Greater-of” formulas.* If the participant's accrued benefit equals the greater of the accrued benefit under a lump sum-based benefit formula and the accrued benefit under another formula that is not a lump-sum based benefit formula, a single-sum payment of the participant's entire benefit must be no less than the greater of the then-current accumulated benefit under the lump sum-based benefit formula and the present value, determined in accordance with section 417(e), of the benefit under the other formula. For example, assume that the accrued benefit under a plan is determined as the greater of the accrued benefit attributable to the balance of a hypothetical account and the accrued benefit equal to a pro rata portion of a normal retirement benefit determined by projecting the hypothetical account balance (including future principal and interest credits) to normal retirement age. In such a case, a single-sum

payment of the participant's entire benefit must be no less than the greater of the then-current balance of the hypothetical account and the present value, determined in accordance with section 417(e), of the pro rata benefit determined by projecting the hypothetical account balance to normal retirement age.

(B) *“Sum-of” formulas.* If the participant's accrued benefit equals the sum of the accrued benefit under a lump sum-based benefit formula and the accrued benefit under another formula that is not a lump-sum based benefit formula, a single-sum payment of the participant's entire benefit must be no less than the sum of the then-current accumulated benefit under the lump sum-based benefit formula and the present value, determined in accordance with section 417(e), of the benefit under the other formula. For example, assume that the accrued benefit under a plan is determined as the sum of the accrued benefit attributable to the balance of a hypothetical account and the accrued benefit equal to the excess of the benefit under another formula over the benefit under the hypothetical account formula. In such a case, a single-sum payment of the participant's entire benefit must be no less than the sum of the then-current balance of the hypothetical account and the present value, determined in accordance with section 417(e), of the excess of the benefit under the other formula over the benefit under the hypothetical account formula.

(C) *“Lesser-of” formulas.* If the participant's accrued benefit equals the lesser of the accrued benefit under a lump sum-based benefit formula and the accrued benefit under another formula that is not a lump-sum based benefit formula, a single-sum payment of the participant's entire benefit must be no less than the lesser of the then-current accumulated benefit under the lump sum-based benefit formula and the present value, determined in accordance with section 417(e), of the benefit under the other formula. For example, assume that the accrued benefit under a plan is determined as the accrued benefit attributable to the balance of a hypothetical account, but no greater than an accrued benefit payable at normal retirement age in the form of a straight life annuity of \$100,000 per year. In such a case, a single-sum payment of the participant's entire benefit must be no less than the lesser of the then-current balance of the hypothetical account and the present value, determined in accordance with section 417(e), of a benefit payable at normal retirement age in the form of a straight life annuity of \$100,000 per

year. If the formula that is not a lump sum-based benefit formula is the maximum annual benefit described in section 415(b), then the single-sum payment of the participant's entire benefit must not exceed the then-current accumulated benefit under the lump sum-based benefit formula.

\* \* \* \* \*

(d) \* \* \*

(3) *Lump sum-based benefit formula*—(i) *In general.* A lump sum-based benefit formula means a benefit formula used to determine all or any part of a participant's accumulated benefit under a defined benefit plan under which the accumulated benefit provided under the formula is expressed as the current balance of a hypothetical account maintained for the participant or as the current value of an accumulated percentage of the participant's final average compensation. A benefit formula is expressed as the current balance of a hypothetical account maintained for the participant if it is expressed as a current single-sum dollar amount equal to that balance. A benefit formula is expressed as the current value of an accumulated percentage of the participant's final average compensation if it is expressed as a current single-sum dollar amount equal to a percentage of the participant's final average compensation or, for plan years that begin on or after January 1, 2016 (or any earlier date as elected by the taxpayer), a percentage of the participant's highest average compensation (regardless of whether the plan applies a limitation on the past period for which compensation is taken into account in determining highest average compensation). Whether a benefit formula is a lump sum-based benefit formula is determined based on how the accumulated benefit of a participant is expressed under the terms of the plan, and does not depend on whether the plan provides an optional form of benefit in the form of a single-sum payment. However, for plan years that begin on or after January 1, 2016, a benefit formula does not constitute a lump sum-based benefit formula unless a distribution of the benefits under that formula in the form of a single-sum payment equals the accumulated benefit under that formula (except to the extent the single-sum payment is greater to satisfy the requirements of section 411(d)(6)). In addition, for plan years that begin on or after January 1, 2016, a benefit formula does not constitute a lump sum-based benefit formula unless the portion of the participant's accrued benefit that is determined under that formula and the then-current balance of

the hypothetical account or the then-current value of the accumulated percentage of the participant's final average compensation are actuarially equivalent (determined using reasonable actuarial assumptions) either—

(A) Upon attainment of normal retirement age; or

(B) At the annuity starting date for a distribution with respect to that portion.

\* \* \* \* \*

(4) \* \* \*

(ii) *Effect similar to a lump sum-based benefit formula*—(A) *In general.* Except as provided in paragraphs (d)(4)(ii)(B) through (E) of this section, a benefit formula under a defined benefit plan that is not a lump sum-based benefit formula has an effect similar to a lump sum-based benefit formula if the formula provides that a participant's accumulated benefit is expressed as a benefit that includes the right to adjustments (including a formula that provides for indexed benefits under § 1.411(b)(5)–1(b)(2)) for a future period and the total dollar amount of those adjustments is reasonably expected to be smaller for the participant than for any similarly situated, younger individual (within the meaning of § 1.411(b)(5)–1(b)(5)) who is or could be a participant in the plan. For this purpose, the right to adjustments for a future period means, for plan years that begin on or after January 1, 2016, the right to any changes in the dollar amount of benefits over time, regardless of whether those adjustments are denominated as interest credits. A benefit formula that does not include adjustments for any future period is treated as a formula with an effect similar to a lump sum-based benefit formula if the formula would be described in this paragraph (d)(4)(ii)(A) except for the fact that the adjustments are provided pursuant to a pattern of repeated plan amendments. See § 1.411(d)–4, A–1(c)(1).

\* \* \* \* \*

(C) *Exception for certain variable annuity benefit formulas.* If a variable annuity benefit formula adjusts benefits by reference to the difference between a rate of return on plan assets (or specified market indices) and a specified assumed interest rate of 5 percent or higher, then the variable annuity benefit formula is not treated as being reasonably expected to provide a smaller total dollar amount of future adjustments for the participant than for any similarly situated, younger individual who is or could be a participant in the plan, and thus such a variable annuity benefit formula does not have an effect similar to a lump

sum-based benefit formula. For plan years that begin on or after January 1, 2016 (or any earlier date as elected by the taxpayer), the rate of return on plan assets (or specified market index) by reference to which the benefit formula adjusts must be a rate of return described in § 1.411(b)(5)–1(d)(5) (which includes, in the case of a benefit formula determined with reference to an annuity contract for an employee issued by an insurance company licensed under the laws of a State, the rate of return on the market index specified under that contract).

\* \* \* \* \*

(E) *Exception for certain actuarial reductions for early commencement under traditional formula.* A defined benefit formula is not treated as having an effect similar to a lump sum-based benefit formula with respect to a participant merely because the formula provides for a reduction in the benefit payable at early retirement due to early commencement (with the result that the benefit payable at normal retirement age is greater than the benefit payable at early retirement), provided that the benefit payable at normal retirement age to the participant cannot be less than the benefit payable at normal retirement age to any similarly situated, younger individual who is or could be a participant in the plan. Thus, for example, a plan that provides a benefit equal to 1 percent of final average pay per year of service, payable as a life annuity at normal retirement age, is not treated as having an effect similar to a lump sum-based benefit formula by reason of an actuarial reduction in the benefit payable under the plan for early commencement.

\* \* \* \* \*

(6) *Variable annuity benefit formula.*

A variable annuity benefit formula means any benefit formula under a defined benefit plan which provides that the amount payable is periodically adjusted by reference to the difference between a rate of return and a specified assumed interest rate.

\* \* \* \* \*

(e) \* \* \*

(2) \* \* \*

(ii) *Special effective date.* Paragraphs (b)(2), (b)(3) and (b)(4) of this section apply to plan years that begin on or after January 1, 2016.

\* \* \* \* \*

■ **Par. 3.** Section 1.411(b)–1 is amended by adding paragraph (b)(2)(ii)(G) and adding and reserving paragraph (b)(2)(ii)(H) to read as follows:

**§ 1.411(b)-1 Accrued benefit requirements.**

\* \* \* \* \*

- (b) \* \* \*  
 (2) \* \* \*  
 (ii) \* \* \*

(G) *Variable interest crediting rate under a statutory hybrid benefit formula.* For plan years that begin on or after January 1, 2012 (or an earlier date as elected by the taxpayer), a plan that determines any portion of the participant's accrued benefit pursuant to a statutory hybrid benefit formula (as defined in § 1.411(a)(13)-1(d)(4)) that utilizes an interest crediting rate described in § 1.411(b)(5)-1(d) that is a variable rate that was less than zero for the prior plan year is not treated as failing to satisfy the requirements of paragraph (b)(2) of this section for the current plan year merely because the plan assumes for purposes of paragraph (b)(2) of this section that the variable rate is zero for the current plan year and all future plan years.

(H) *Special rule for multiple formulas.*  
 [Reserved]

\* \* \* \* \*

■ **Par. 4.** Section 1.411(b)(5)-1 is amended by:

- 1. Revising paragraphs (b)(1)(i)(B), (b)(1)(i)(C), (b)(1)(ii), (b)(1)(iii), and (b)(2)(i).
- 2. Revising paragraph (c)(3)(i).
- 3. Removing paragraph (c)(3)(iii).
- 4. Adding *Example 8* to paragraph (c)(5).
- 5. Revising paragraphs (d)(1)(iv)(D), (d)(2)(i), (d)(2)(ii), (d)(3), (d)(4)(ii), (d)(4)(iv), (d)(5)(ii), (d)(5)(iv), (d)(6)(ii), (d)(6)(iii), (e)(2), (e)(3)(ii)(B), (e)(3)(ii)(C), (e)(3)(iii), (e)(4), and (f)(2)(i)(B).
- 6. Adding paragraphs (d)(1)(viii), (d)(4)(v), (e)(3)(ii)(D), (e)(3)(iv), (e)(3)(v), and (e)(5).
- 7. Revising the last sentence of paragraph (d)(1)(v).
- 8. Revising the first and fourth sentences of paragraph (e)(3)(i).

The revisions and additions read as follows:

**§ 1.411(b)(5)-1 Reduction in rate of benefit accrual under a defined benefit plan.**

\* \* \* \* \*

- (b) \* \* \*  
 (1) \* \* \*  
 (i) \* \* \*

(B) The current balance of a hypothetical account maintained for the participant if the accumulated benefit of the participant is the current balance of a hypothetical account.

(C) The current value of an accumulated percentage of the participant's final average compensation if the accumulated benefit of the participant is the current value of an

accumulated percentage of the participant's final average compensation.

(ii) *Benefit formulas for comparison—*  
 (A) *In general.* Except as provided in paragraphs (b)(1)(ii)(B), (C), (D) and (E) of this section, the safe harbor provided by section 411(b)(5)(A) and paragraph (b)(1)(i) of this section is available only with respect to a participant if the participant's accumulated benefit under the plan is expressed in terms of only one safe-harbor formula measure and no similarly situated, younger individual who is or could be a participant has an accumulated benefit that is expressed in terms of any measure other than that same safe-harbor formula measure. Thus, for example, if a plan provides that the accumulated benefit of participants who are age 55 or older is expressed under the terms of the plan as a life annuity payable at normal retirement age (or current age if later) as described in paragraph (b)(1)(i)(A) of this section and the plan provides that the accumulated benefit of participants who are younger than age 55 is expressed as the current balance of a hypothetical account as described in paragraph (b)(1)(i)(B) of this section, then the safe harbor described in section 411(b)(5)(A) and paragraph (b)(1)(i) of this section does not apply to individuals who are or could be participants and who are age 55 or older.

(B) *Sum-of benefit formulas.* If a plan provides that a participant's accumulated benefit is expressed as the sum of benefits determined in terms of two or more benefit formulas, each of which is expressed in terms of a different safe-harbor formula measure, then the plan is deemed to satisfy paragraph (b)(1)(i) of this section with respect to the participant, provided that the plan satisfies the comparison described in paragraph (b)(1)(i) of this section separately for benefits determined in terms of each safe-harbor formula measure and no accumulated benefit of a similarly situated, younger individual who is or could be a participant is expressed other than as—

- (1) The sum of benefits under two or more benefit formulas, each of which is expressed in terms of one of those same safe-harbor formula measures as is used for the participant's "sum-of" benefit;
- (2) The greater of benefits under two or more benefit formulas, each of which is expressed in terms of any one of those same safe-harbor formula measures;
- (3) The choice of benefits under two or more benefit formulas, each of which is expressed in terms of any one of those same safe-harbor formula measures;

(4) A benefit that is determined in terms of only one of those same safe-harbor formula measures; or

(5) The lesser of benefits under two or more benefit formulas, at least one of which is expressed in terms of one of those same safe-harbor formula measures.

(C) *Greater-of benefit formulas.* If a plan provides that a participant's accumulated benefit is expressed as the greater of benefits under two or more benefit formulas, each of which is determined in terms of a different safe-harbor formula measure, then the plan is deemed to satisfy paragraph (b)(1)(i) of this section with respect to the participant, provided that the plan satisfies the comparison described in paragraph (b)(1)(i) of this section separately for benefits determined in terms of each safe-harbor formula measure and no accumulated benefit of a similarly situated, younger individual who is or could be a participant is expressed other than as—

(1) The greater of benefits determined under two or more benefit formulas, each of which is expressed in terms of one of those same safe-harbor formula measures as is used for the participant's "greater-of" benefit;

(2) The choice of benefits determined under two or more benefit formulas, each of which is expressed in terms of one of those same safe-harbor formula measures;

(3) A benefit that is determined in terms of only one of those same safe-harbor formula measures; or

(4) The lesser of benefits under two or more benefit formulas, at least one of which is expressed in terms of one of those same safe-harbor formula measures.

(D) *Choice-of benefit formulas.* If a plan provides that a participant's accumulated benefit is determined pursuant to a choice by the participant between benefits determined in terms of two or more different safe-harbor formula measures, then the plan is deemed to satisfy paragraph (b)(1)(i) of this section with respect to the participant, provided that the plan satisfies the comparison described in paragraph (b)(1)(i) of this section separately for benefits determined in terms of each safe-harbor formula measure and no accumulated benefit of a similarly situated, younger individual who is or could be a participant is expressed other than as—

- (1) The choice of benefits determined under two or more benefit formulas, each of which is expressed in terms of one of those same safe-harbor formula measures as is used for the participant's "choice-of" benefit;

(2) A benefit that is determined in terms of only one of those same safe-harbor formula measures; or

(3) The lesser of benefits under two or more benefit formulas, at least one of which is expressed in terms of one of those same safe-harbor formula measures.

(E) *Lesser-of benefit formulas.* If a plan provides that a participant's accumulated benefit is expressed as a single safe-harbor formula measure and no accumulated benefit of a similarly situated, younger individual who is or could be a participant is expressed other than as a benefit that is determined under the same safe-harbor formula measure or as the lesser of benefits under two or more benefit formulas, at least one of which is expressed in terms of the same safe-harbor formula measure, then the plan is deemed to satisfy paragraph (b)(1)(i) of this section with respect to the participant only if the plan satisfies the comparison described in paragraph (b)(1)(i) of this section for benefits determined in terms of the same safe-harbor formula measure. Similarly, if a plan provides that a participant's accumulated benefit is expressed as the lesser of benefits under two or more benefit formulas, each of which is determined in terms of a different safe-harbor formula measure, then the plan is deemed to satisfy paragraph (b)(1)(i) of this section with respect to the participant only if the plan satisfies the comparison described in paragraph (b)(1)(i) of this section separately for benefits determined in terms of each safe-harbor formula measure and no accumulated benefit of a similarly situated, younger individual who is or could be a participant is expressed other than as the lesser of benefits under two or more benefit formulas, expressed in terms of all of those same safe-harbor formula measures (and any other additional formula measures).

(F) *Limitations on plan formulas that provide for hypothetical accounts or accumulated percentages of final average compensation.* For plan years that begin on or after January 1, 2016, a benefit measure is a safe harbor formula measure described in paragraph (b)(1)(i)(B) or (C) of this section only if the formula under which the balance of a hypothetical account or the accumulated percentage of final average compensation is determined is a lump-sum based benefit formula.

(iii) *Disregard of certain subsidized benefits.* For purposes of paragraph (b)(1)(i) of this section, any subsidized portion of an early retirement benefit that is included in a participant's accumulated benefit is disregarded. For

this purpose, an early retirement benefit includes a subsidized portion only if it provides a higher actuarial present value on account of commencement before normal retirement age. However, for plan years that begin on or after January 1, 2016, if the annual benefit payable before normal retirement age is greater for a participant than the annual benefit under the corresponding form of benefit for any similarly situated, older individual who is or could be a participant and who is currently at or before normal retirement age, then that excess is not part of the subsidized portion of an early retirement benefit and, accordingly, is not disregarded under this paragraph (b)(1)(iii). For purposes of determining whether the annual benefit payable before normal retirement age is greater for a participant than the annual benefit under the corresponding form of benefit for any similarly situated, older individual who is or could be a participant, social security leveling options and social security supplements are disregarded. In addition, a plan is not treated as providing a greater annual benefit to a participant than to a similarly situated, older individual who is or could be a participant merely because the reduction (based on actuarial equivalence, using reasonable actuarial assumptions) in the amount of an annuity to reflect a survivor benefit is smaller for the participant than for a similarly situated, older individual who is or could be a participant.

(2) *Indexed benefits—(i) In general.* Except as provided in paragraph (b)(2)(iii) of this section, pursuant to section 411(b)(5)(E) and this paragraph (b)(2)(i), a defined benefit plan is not treated as failing to meet the requirements of section 411(b)(1)(H) with respect to a participant solely because a benefit formula (other than a lump sum-based benefit formula) under the plan provides for the periodic adjustment of the participant's accrued benefit under the plan by means of the application of a recognized index or methodology. An indexing rate that does not exceed a market rate of return, as defined in paragraph (d) of this section, is deemed to be a recognized index or methodology for purposes of the preceding sentence. In addition, for plan years that begin on or after January 1, 2016 (or an earlier date as elected by the taxpayer), any subsidized portion of any early retirement benefit under such a plan that meets the requirements of paragraph (b)(1)(iii) is disregarded in determining whether the plan meets the requirements of section 411(b)(1)(H).

However, such a plan must satisfy the qualification requirements otherwise applicable to statutory hybrid plans, including the requirements of § 1.411(a)(13)–1(c) (relating to minimum vesting standards) and paragraph (c) of this section (relating to plan conversion amendments) if the plan has an effect similar to a lump sum-based benefit formula, pursuant to the rules of § 1.411(a)(13)–1(d)(4)(ii).

\* \* \* \* \*

(c) \* \* \*

(3) \* \* \* (i) \* \* \* Provided that the requirements of paragraph (c)(3)(ii) of this section are satisfied, a statutory hybrid plan under which an opening hypothetical account balance or opening accumulated percentage of the participant's final average compensation is established as of the effective date of the conversion amendment does not fail to satisfy the requirements of paragraph (c)(2) of this section merely because benefits attributable to that opening hypothetical account balance or opening accumulated percentage (that is, benefits that are not described in paragraph (c)(2)(i)(B) of this section) are substituted for benefits described in paragraph (c)(2)(i)(A) of this section.

\* \* \* \* \*

(5) \* \* \*

*Example 8. (i) Facts involving establishment of opening hypothetical account balance.* A defined benefit plan provides an accrued benefit expressed as a straight life annuity commencing at the plan's normal retirement age (age 65), based on a percentage of average annual compensation multiplied by the participant's years of service. On January 1, 2009, a conversion amendment is adopted that converts the plan to a statutory hybrid plan. Participant A, age 55, had an accrued benefit under the pre-conversion formula of \$1,500 per month payable at normal retirement age. In conjunction with this conversion, the plan provides each participant with an opening hypothetical account balance equal to the present value, determined in accordance with section 417(e)(3) of the participant's pre-conversion benefit. Participant A's opening hypothetical account balance was calculated as \$121,146. The opening account balance (along with any subsequent amounts credited to the hypothetical account) is credited annually with interest credits at the rate of 5.0 percent up to the annuity starting date of each participant.

(ii) *Facts relating to changes between establishment of opening hypothetical account balance and age 65.* Upon attainment of age 65, Participant A elects to receive Participant A's entire benefit under the plan as a single sum distribution. At the annuity starting date, Participant A's hypothetical account balance attributable to Participant A's opening account balance has increased to \$197,334. However, under the terms of the plan and in accordance with section 417(e)(3), the present value at the

annuity starting date of Participant A's pre-conversion benefit of \$1,500 per month is \$221,383.

(iii) *Conclusion.* Pursuant to paragraph (c)(3)(ii)(A) of this section, Participant A must receive the benefit attributable to post-conversion service, plus the greater of the benefit attributable to the opening hypothetical account balance and the pre-conversion benefit (with the determination as to which is greater made at the annuity starting date). Accordingly the single-sum distribution must equal the benefit attributable to post-conversion service plus \$221,383.

\* \* \* \* \*

- (d) \* \* \*
- (1) \* \* \*
- (iv) \* \* \*

(D) *Debits and credits during the interest crediting period.* A plan is not treated as failing to meet the requirements of this paragraph (d) merely because the plan does not provide for interest credits on amounts distributed prior to the end of the interest crediting period. Furthermore, a plan is not treated as failing to meet the requirements of this paragraph (d) merely because the plan calculates increases or decreases to the participant's accumulated benefit by applying a rate of interest or rate of return (including a rate of increase or decrease under an index) to the participant's adjusted accumulated benefit (or portion thereof) for the period. For this purpose, the participant's adjusted accumulated benefit equals the participant's accumulated benefit as of the beginning of the period, adjusted for debits and credits (other than interest credits) made to the accumulated benefit prior to the end of the interest crediting period, with appropriate weighting for those debits and credits based on their timing within the period. For plans that calculate increases or decreases to the participant's accumulated benefit by applying a rate of interest or rate of return to the participant's adjusted accumulated benefit (or portion thereof) for the period, interest credits include these increases and decreases, to the extent provided under the terms of the plan at the beginning of the period and to the extent not conditioned on current service and not made on account of imputed service (as defined in § 1.401(a)(4)-11(d)(3)(ii)(B)), and the interest crediting rate with respect to a participant equals the total amount of interest credits for the period divided by the participant's adjusted accumulated benefit for the period.

\* \* \* \* \*

(v) \* \* \* Similarly, an interest crediting rate that always equals the lesser of the yield on 30-year Treasury

Constant Maturities and a fixed 7 percent interest rate is not in excess of a market rate of return because it can never be in excess of the yield on 30-year Treasury Constant Maturities.

\* \* \* \* \*

(viii) *Increases to existing rates and addition of other rates—(A) Increases to existing rates.* The Commissioner may, in guidance published in the Internal Revenue Bulletin, see § 601.601(d)(2)(ii)(b) of this chapter, increase an interest crediting rate set forth in this paragraph (d), so that the increased rate is treated as satisfying the requirement that the rate not exceed a market rate of return for purposes of this paragraph (d) and section 411(b)(5)(B). For this purpose, these increases can include increases to the maximum permitted margin that can be added to one or more of the safe harbor rates set forth in paragraph (d)(4) of this section, increases to the maximum permitted fixed rate set forth in paragraph (d)(4)(v) of this section, or increases to a maximum permitted annual floor set forth in paragraph (d)(6) of this section.

(B) *Additional rates.* The Commissioner may, in guidance published in the Internal Revenue Bulletin, see § 601.601(d)(2)(ii)(b) of this chapter, provide for additional interest crediting rates that satisfy the requirement that they not exceed a market rate of return for purposes of this paragraph (d) and section 411(b)(5)(B) (including providing for additional combinations of rates, such as annual minimums in conjunction with rates that are based on rates described in paragraph (d)(5) of this section but that are reduced in order to ensure that the effective rate of return does not exceed a market rate of return).

\* \* \* \* \*

(2) *Preservation of capital requirement—(i) General rule.* A statutory hybrid plan satisfies the requirements of section 411(b)(1)(H) only if the plan provides that the participant's benefit under the statutory hybrid benefit formula determined as of the participant's annuity starting date is no less than the benefit determined as if the accumulated benefit were equal to the sum of all principal credits (as described in paragraph (d)(1)(ii)(D) of this section) credited under the plan to the participant as of that date (including principal credits that were credited before the applicable statutory effective date of paragraph (f)(1) of this section). This paragraph (d)(2) applies only as of an annuity starting date, within the meaning of § 1.401(a)-20, A-10(b), with respect to which a distribution of the participant's entire vested benefit under

the plan's statutory hybrid benefit formula as of that date commences. For a participant who has more than one annuity starting date, paragraph (d)(2)(ii) of this section provides rules to account for prior annuity starting dates when applying this paragraph (d)(2)(i).

(ii) *Application to multiple annuity starting dates—(A) In general.* If the comparison under paragraph (d)(2)(ii)(B) of this section results in the sum of all principal credits credited to the participant (as of the current annuity starting date) exceeding the sum of the amounts described in paragraphs (d)(2)(ii)(B)(1) through (d)(2)(ii)(B)(3) of this section, then the participant's benefit to be distributed at the current annuity starting date must be no less than would be provided if that excess were included in the current accumulated benefit.

(B) *Comparison to reflect prior distributions.* For a participant who has more than one annuity starting date, the sum of all principal credits credited to the participant under the plan, as of the current annuity starting date, is compared to the sum of—

- (1) The remaining balance of the participant's accumulated benefit as of the current annuity starting date;
- (2) The amount of the reduction to the participant's accumulated benefit under the statutory hybrid benefit formula that is attributable to any prior distribution of the participant's benefit under that formula; and
- (3) Any amount that was treated as included in the accumulated benefit under the rules of this paragraph (d)(2) as of any prior annuity starting date.

(C) *Special rule for participants with 5 or more breaks in service.* A plan is permitted to provide that, in the case of a participant who receives a distribution of the entire vested benefit under the plan and thereafter completes 5 consecutive 1-year breaks in service, as defined in section 411(a)(6)(A), the rules of this paragraph (d)(2) are applied without regard to the prior period of service. Thus, in the case of such a participant, the plan is permitted to provide that the rules of this paragraph (d)(2) are applied disregarding the principal credits and distributions that occurred before the breaks in service.

\* \* \* \* \*

(3) *Long-term investment grade corporate bonds.* For purposes of this paragraph (d), the rate of interest on long-term investment grade corporate bonds means the third segment rate described in section 417(e)(3)(D) or 430(h)(2)(C)(iii) (determined with or without regard to section 430(h)(2)(C)(iv) and with or without

regard to the transition rules of section 417(e)(3)(D)(ii) or 430(h)(2)(G)). However, for plan years beginning prior to January 1, 2008, the rate of interest on long-term investment grade corporate bonds means the rate described in

section 412(b)(5)(B)(ii)(II) prior to amendment by the Pension Protection Act of 2006, Public Law 109–280 (120 Stat. 780 (2006)) (PPA '06).

(4) \* \* \*

(ii) *Rates based on government bonds with margins.* An interest crediting rate

is deemed to be not in excess of the interest rate described in paragraph (d)(3) of this section if the rate is equal to the sum of any of the following rates of interest for bonds and the associated margin for that interest rate:

Interest rate bond index	Associated margin
The discount rate on 3-month Treasury Bills .....	175 basis points.
The discount rate on 12-month or shorter Treasury Bills .....	150 basis points.
The yield on 1-year Treasury Constant Maturities .....	100 basis points.
The yield on 3-year or shorter Treasury Constant Maturities .....	50 basis points.
The yield on 7-year or shorter Treasury Constant Maturities .....	25 basis points.
The yield on 30-year or shorter Treasury Constant Maturities .....	0 basis points.

\* \* \* \* \*

(iv) *Short and mid-term investment grade corporate bonds.* An interest crediting rate equal to the first segment rate is deemed to be not in excess of the interest rate described in paragraph (d)(3) of this section. Similarly, an interest crediting rate equal to the second segment rate is deemed to be not in excess of the interest rate described in paragraph (d)(3) of this section. For this purpose, the first and second segment rates mean the first and second segment rates described in section 417(e)(3)(D) or 430(h)(2)(C), determined with or without regard to section 430(h)(2)(C)(iv) and with or without regard to the transition rules of section 417(e)(3)(D)(ii) or 430(h)(2)(G).

(v) *Fixed rate of interest.* An annual interest crediting rate equal to a fixed 6 percent is deemed to be not in excess of the interest rate described in paragraph (d)(3) of this section.

(5) \* \* \*

(ii) *Actual rate of return on plan assets—(A) In general.* An interest crediting rate equal to the actual rate of return on the aggregate assets of the plan, including both positive returns and negative returns, is not in excess of a market rate of return if the plan's assets are diversified so as to minimize the volatility of returns. This requirement that plan assets be diversified so as to minimize the volatility of returns does not require greater diversification than is required under section 404(a)(1)(C) of Title I of the Employee Retirement Income Security Act of 1974, Public Law 93–406 (88 Stat. 829 (1974)), as amended (ERISA), with respect to defined benefit pension plans.

(B) *Subset of plan assets.* An interest crediting rate equal to the actual rate of return on the assets within a specified subset of plan assets, including both positive and negative returns, is not in excess of a market rate of return if—

(1) The subset of plan assets is diversified so as to minimize the volatility of returns, within the meaning of paragraph (d)(5)(ii)(A) of this section (thus, this requirement is satisfied if the subset of plan assets is diversified such that it would meet the requirements of paragraph (d)(5)(ii)(A) of this section if the subset were aggregate plan assets);

(2) The aggregate fair market value of qualifying employer securities and qualifying employer real property (within the meaning of section 407 of ERISA) held in the subset of plan assets does not exceed 10 percent of the fair market value of the aggregate assets in the subset; and

(3) The fair market value of the assets within the subset of plan assets approximates the liabilities for benefits that are adjusted by reference to the rate of return on the assets within the subset, determined using reasonable actuarial assumptions.

(C) *Examples.* The following examples illustrate the application of paragraph (d)(5)(ii)(B) of this section:

*Example 1.* (i) *Facts.* (a) Employer A sponsors a defined benefit plan under which benefit accruals are determined under a formula that is not a statutory hybrid benefit formula. Effective January 1, 2015, the plan is amended to cease future accruals under the existing formula and to provide future benefit accruals under a statutory hybrid benefit formula that uses hypothetical accounts. For service on or after January 1, 2015, the terms of the plan provide that each participant's hypothetical account balance is credited monthly with a pay credit equal to a specified percentage of the participant's compensation during the month. The plan also provides that hypothetical account balance is increased or decreased by an interest credit, which is calculated as the product of the account balance at the beginning of the period and the net rate of return on the assets within a specified subset of plan assets during that period. Under the terms of the plan, the net rate of return is equal to the actual rate of return adjusted to reflect a reduction for specified plan expenses. The plan does not provide for interest credits on amounts that are

distributed prior to the end of an interest crediting period.

(b) As of the effective date of the amendment, there are no assets in the specified subset of plan assets. Under the terms of the plan, an amount is added to the specified subset at the time each subsequent contribution for any plan year starting on or after the effective date of the amendment is made to the plan. The amount added (the formula contribution) is the amount deemed necessary to fund benefit accruals under the statutory hybrid benefit formula. Investment of the specified subset is diversified so as to minimize the volatility of returns, within the meaning of paragraph (d)(5)(ii)(A) of this section, and no qualifying employer securities or qualifying employer real property (within the meaning of section 407 of ERISA) are held in the subset. Benefits accrued under the statutory hybrid benefit formula are paid from the specified subset. However, if assets of the specified subset are insufficient to pay benefits accrued under the statutory hybrid benefit formula, the plan provides that assets of the residual legacy subset of plan assets (from which benefits accrued before January 1, 2015 are paid) are available to pay those benefits in accordance with the requirement that all assets of the plan be available to pay all plan benefits. Except as described in this paragraph, no other amounts are added to or subtracted from the specified subset of plan assets.

(c) The formula contribution for each plan year that is added to the specified subset of plan assets is an amount equal to the sum of the target normal cost of the statutory hybrid benefit formula for the plan year plus an additional amount intended to reflect gains or losses. This additional amount is equal to the annual amount necessary to amortize the difference between the funding target attributable to the statutory hybrid benefit formula portion of the plan for the plan year over the value of plan assets included in the specified subset of plan assets for the plan year in level annual installments over a 7-year period. For this purpose, target normal cost and funding target are determined under the rules of § 1.430(d)–1 as if the statutory hybrid benefit formula portion of the plan were the entire plan and without regard to special rules that are applicable to a plan in at-risk status, even if the plan is in at-risk status for a plan year. If the formula contribution for a plan year exceeds the

amount of the actual contribution to the plan for a year (such as could be the case if all or a portion of the contribution is offset by all or a portion of the plan's prefunding balance), then an amount equal to the excess of the formula contribution over the actual contribution is transferred from the residual legacy subset of plan assets to the specified subset of plan assets on the plan's due date for the minimum required contribution for the year.

(ii) *Conclusion.* The specified subset is diversified so as to minimize the volatility of returns (within the meaning of paragraph (d)(5)(ii)(A) of this section). The aggregate fair market value of qualifying employer securities and qualifying employer real property (within the meaning of section 407 of ERISA) held in the specified subset do not exceed 10 percent of the fair market value of the aggregate assets in the subset. The fair market value of the assets within the specified subset of plan assets approximates the liabilities for benefits that are adjusted by reference to the rate of return on the assets within the subset, determined using reasonable actuarial assumptions, within the meaning of paragraph (d)(5)(ii)(B)(3) of this section. Therefore, the interest crediting rate under the statutory hybrid benefit formula portion of Employer A's defined benefit plan is not in excess of a market rate of return.

*Example 2.* (i) *Facts.* (a) Pursuant to a collective bargaining agreement, Employer X, Employer Y and Employer Z maintain and contribute to a multiemployer plan (as defined in section 414(f)) that is established as of January 1, 2015 under which benefit accruals are determined under a variable annuity benefit formula. The plan provides that, on an annual basis, the benefit of each participant who has not yet retired is adjusted by reference to the difference between the actual return on the assets within a specified subset of plan assets and 4 percent. A participant's benefits are fixed at retirement and thereafter are not adjusted.

(b) As of the effective date of the plan, there are no assets in the specified subset. Under the terms of the plan, any amount contributed to the plan by a contributing employer is added to the specified subset at the time of the contribution. Investment of the specified subset is diversified so as to minimize the volatility of returns, within the meaning of paragraph (d)(5)(ii)(A) of this section, and no qualifying employer securities or qualifying employer real property (within the meaning of section 407 of ERISA) are held in the subset. The plan provides that, at the time of a participant's retirement, an amount equal to the present value of the liability for benefits payable to that participant is transferred to a separate subset of plan assets (the retiree pool). The retiree pool is invested in high-quality bonds in an attempt to achieve cash-flow matching of the retiree liabilities. Benefits are paid from the retiree pool. However, if assets of the retiree pool are insufficient to pay benefits, the plan provides that assets of the specified subset are available to pay benefits in accordance with the requirement that all assets of the plan be available to pay all plan benefits. Except as described in this paragraph, no other amounts are added to or

subtracted from the specified subset of plan assets.

(ii) *Conclusion.* The specified subset is diversified so as to minimize the volatility of returns (within the meaning of paragraph (d)(5)(ii)(A) of this section). The aggregate fair market value of qualifying employer securities and qualifying employer real property (within the meaning of section 407 of ERISA) held in the specified subset do not exceed 10 percent of the fair market value of the aggregate assets in the subset. The fair market value of the assets within the specified subset of plan assets approximates the liabilities for benefits that are adjusted by reference to the rate of return on the assets within the subset, determined using reasonable actuarial assumptions, within the meaning of paragraph (d)(5)(ii)(B)(3) of this section. Therefore, the methodology used to adjust participant benefits under the plan's variable annuity benefit formula, which is a statutory hybrid benefit formula under § 1.411(a)(13)-1(d)(4), is not in excess of a market rate of return.

\* \* \* \* \*

(iv) *Rate of return on certain RICs.* An interest crediting rate is not in excess of a market rate of return if it is equal to the rate of return on a regulated investment company (RIC), as defined in section 851, that is reasonably expected to be not significantly more volatile than the broad United States equities market or a similarly broad international equities market. For example, a RIC that has most of its assets invested in securities of issuers (including other RICs) concentrated in an industry sector or a country other than the United States generally would not meet this requirement. Likewise a RIC that uses leverage, or that has significant investment in derivative financial products, for the purpose of achieving returns that amplify the returns of an unleveraged investment, generally would not meet this requirement. Thus, a RIC that has most of its investments concentrated in the semiconductor industry or that uses leverage in order to provide a rate of return that is twice the rate of return on the Standard & Poor's 500 index (S&P 500) would not meet this requirement. On the other hand, a RIC with investments that track the rate of return on the S&P 500, a broad-based "small-cap" index (such as the Russell 2000 index), or a broad-based international equities index would meet this requirement.

(6) \* \* \*

(ii) *Annual or more frequent floor—*  
(A) *Application to segment rates.* An interest crediting rate under a plan does not fail to be described in paragraph (d)(3) or (d)(4)(iv) of this section for an interest crediting period merely because the plan provides that the interest

crediting rate for that interest crediting period equals the greater of—

(1) An interest crediting rate described in paragraph (d)(3) or (d)(4)(iv) of this section; and

(2) An annual interest rate of 4 percent or less (or a pro rata portion of an annual interest rate of 4 percent or less for plans that provide interest credits more frequently than annually).

(B) *Application to other bond-based rates.* An interest crediting rate under a plan does not fail to be described in paragraph (d)(4) of this section for an interest crediting period merely because the plan provides that the interest crediting rate for that interest crediting period equals the greater of—

(1) An interest crediting rate described in paragraph (d)(4)(ii) or (d)(4)(iii) of this section; and

(2) An annual interest rate of 5 percent or less (or a pro rata portion of an annual interest rate of 5 percent or less for plans that provide interest credits more frequently than annually).

(iii) *Cumulative floor applied to investment-based or bond-based rates—*

(A) *In general.* A plan that determines interest credits under a statutory hybrid benefit formula using a particular interest crediting rate described in paragraph (d)(3), (d)(4), or (d)(5) of this section (or an interest crediting rate that can never be in excess of a particular interest crediting rate described in paragraph (d)(3), (d)(4) or (d)(5) of this section) does not provide an effective interest crediting rate in excess of a market rate of return merely because the plan provides that the participant's benefit under the statutory hybrid benefit formula determined as of the participant's annuity starting date is equal to the benefit determined as if the accumulated benefit were equal to the greater of—

(1) The accumulated benefit determined using the interest crediting rate; and

(2) The accumulated benefit determined as if the plan had used a fixed annual interest crediting rate equal to 3 percent (or a lower rate) for all principal credits that are credited under the plan to the participant during the guarantee period (minimum guarantee amount).

(B) *Guarantee period defined.* The guarantee period is the prospective period that begins on the date the cumulative floor described in this paragraph (d)(6)(iii) begins to apply to the participant's benefit and that ends on the date on which that cumulative floor ceases to apply to the participant's benefit.

(C) *Application to multiple annuity starting dates.* The determination under



this paragraph (d)(6)(iii) is made only as of an annuity starting date, within the meaning of § 1.401(a)-20, A-10(b), with respect to which a distribution of the participant's entire vested benefit under the plan's statutory hybrid benefit formula as of that date commences. For a participant who has more than one annuity starting date, paragraph (d)(6)(iii)(D) of this section provides rules to account for prior annuity starting dates when applying paragraph (d)(6)(iii)(A) of this section. If the comparison under paragraph (d)(6)(iii)(D) of this section results in the minimum guarantee amount exceeding the sum of the amounts described in paragraphs (d)(6)(iii)(D)(1) through (d)(6)(iii)(D)(3) of this section, then the participant's benefit to be distributed at the current annuity starting date must be no less than would be provided if that excess were included in the current accumulated benefit.

(D) *Comparison to reflect prior distributions.* For a participant who has more than one annuity starting date, the minimum guarantee amount (described in paragraph (d)(6)(iii)(A)(2) of this section), as of the current annuity starting date, is compared to the sum of—

(1) The remaining balance of the participant's accumulated benefit, as of the current annuity starting date, to which a minimum guaranteed rate described in paragraph (d)(6)(iii)(A)(2) of this section applies;

(2) The amount of the reduction to the participant's accumulated benefit under the statutory hybrid benefit formula that is attributable to any prior distribution of the participant's benefit under that formula and to which a minimum guaranteed rate described in paragraph (d)(6)(iii)(A)(2) of this section applied, together with interest at that minimum guaranteed rate annually from the prior annuity starting date to the current annuity starting date; and

(3) Any amount that was treated as included in the accumulated benefit under the rules of this paragraph (d)(6)(iii) as of any prior annuity starting date, together with interest annually at the minimum guaranteed rate that applied to the prior distribution from the prior annuity starting date to the current annuity starting date.

(E) *Application to portion of participant's benefit.* A cumulative floor described in this paragraph (d)(6)(iii) may be applied to a portion of a participant's benefit, provided the requirements of this paragraph (d)(6)(iii) are satisfied with respect to that portion of the benefit. If a cumulative floor described in this paragraph (d)(6)(iii) applies to a portion of a participant's

benefit, only the principal credits that are attributable to that portion of the participant's benefit are taken into account in determining the amount of the guarantee described in paragraph (d)(6)(iii)(A)(2) of this section.

(e) \* \* \*

(2) *Plan termination—(i) In general.* This paragraph (e)(2) provides special rules that apply for purposes of determining certain plan factors under a statutory hybrid benefit formula after the plan termination date of a statutory hybrid plan. The terms of a statutory hybrid plan must reflect the requirements of this paragraph (e)(2). Paragraph (e)(2)(ii) of this section sets forth rules relating to the interest crediting rate for interest crediting periods that end after the plan termination date. Paragraph (e)(2)(iii) of this section sets forth rules for converting a participant's accumulated benefit to an annuity after the plan termination date. Paragraph (e)(2)(iv) of this section sets forth rules of application. Paragraph (e)(2)(v) of this section contains examples. The Commissioner may, in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin, provide for additional rules that apply for purposes of this paragraph (e)(2) and the plan termination provisions of section 411(b)(5)(B)(vi). See § 601.601(d)(2)(ii)(b) of this chapter. See also regulations of the Pension Benefit Guaranty Corporation for additional rules that apply when a pension plan subject to Title IV of ERISA is terminated.

(ii) *Interest crediting rates used to determine accumulated benefits—(A) General rule.* The interest crediting rate used under the plan to determine a participant's accumulated benefit for interest crediting periods that end after the plan termination date must be equal to the average of the interest rates used under the plan during the 5-year period ending on the plan termination date. Except as otherwise provided in this paragraph (e)(2)(ii), the actual annual interest rate (taking into account minimums, maximums, and other adjustments) used to determine interest credits under the plan for each of the interest crediting periods is used for purposes of determining the average of the interest rates.

(B) *Special rule for variable interest crediting rates that are other rates of return—(1) Application to interest crediting periods.* This paragraph (e)(2)(ii)(B) applies for an interest crediting period if the interest crediting rate that was used for that interest crediting period was a rate of return described in paragraph (d)(5) of this

section. This paragraph (e)(2)(ii)(B) also applies for an interest crediting period that begins before the first plan year that begins on or after January 1, 2016, if the interest crediting rate that was used for that interest crediting period had the potential to be negative. For this purpose, a rate is not treated as having the potential to be negative if it is a rate described in paragraph (d)(3) or (d)(4) of this section or is any other rate that is based solely on current bond yields.

(2) *Use of substitution rate.* For any interest crediting period to which this paragraph (e)(2)(ii)(B) applies, for purposes of determining the average of the interest rates under this paragraph (e)(2)(ii), the interest rate used under the plan for the interest crediting period is deemed to be equal to the substitution rate (as described in paragraph (e)(2)(ii)(C) of this section) for the period.

(C) *Definition of substitution rate.* The substitution rate for any interest crediting period equals the second segment rate under section 430(h)(2)(C)(ii) (determined without regard to section 430(h)(2)(C)(iv)) for the last calendar month ending before the beginning of the interest crediting period, as adjusted to account for any minimums or maximums that applied in the period (other than cumulative floors under paragraph (d)(6)(iii) of this section), but without regard to other reductions that applied in the period. Thus, for example, if the actual interest crediting rate in an interest crediting period is equal to the rate of return on plan assets, but not greater than 5 percent, then the substitution rate for that interest crediting period is equal to the lesser of the applicable second segment rate for the period and 5 percent. However, if the actual interest crediting rate for an interest crediting period is equal to the rate of return on plan assets minus 200 basis points, then the substitution rate for that interest crediting period is equal to the applicable second segment rate for the period.

(D) *Cumulative floors.* Cumulative floors under paragraph (d)(6)(iii) of this section that applied during the 5-year period ending on the plan termination date are not taken into account for purposes of determining the average of the interest rates under this paragraph (e)(2)(ii). However, the rules of paragraph (d)(6)(iii) of this section continue to apply to determine benefits as of annuity starting dates on or after the plan termination date. Thus, if, as of an annuity starting date on or after the plan termination date, the benefit provided by applying an applicable cumulative minimum rate under

paragraph (d)(6)(iii)(A)(2) of this section exceeds the benefit determined by applying interest credits to the participant's accumulated benefit (with interest credits for interest crediting periods that end after the plan termination date determined under this paragraph (e)(2)), then that cumulative minimum rate is used to determine benefits as of that annuity starting date.

(iii) *Annuity conversion rates and factors*—(A) *Conversion factors where a separate mortality table was used prior to plan termination*—(1) *Use of a separate mortality table.* This paragraph (e)(2)(iii)(A) applies for purposes of converting a participant's accumulated benefit to an annuity after the plan termination date if, for the entire 5-year period ending on the plan termination date, the plan provides for a mortality table in conjunction with an interest rate to be used to convert a participant's accumulated benefit (or a portion thereof) to an annuity. If this paragraph (e)(2)(iii)(A) applies, then the plan is treated as meeting the requirements of section 411(b)(5)(B)(i) and paragraph (d)(1) of this section only if, for purposes of converting a participant's accumulated benefit (or portion thereof) to an annuity for annuity starting dates after the plan termination date, the mortality table used is the table described in paragraph (e)(2)(iii)(A)(2) of this section and the interest rate is the rate described in paragraph (e)(2)(iii)(A)(3) of this section.

(2) *Specific mortality table.* The mortality table used is the mortality table specified under the plan for purposes of converting a participant's accumulated benefit to an annuity as of the termination date. This mortality table is used regardless of whether it was used during the entire 5-year period ending on the plan termination date. For purposes of applying this paragraph (e)(2)(iii)(A)(2), if the mortality table specified in the plan, as of the plan termination date, is a mortality table that is updated to reflect expected improvements in mortality experience (such as occurs with the applicable mortality table under section 417(e)(3)), then the table used for an annuity starting date after the plan termination date takes into account updates through the annuity starting date.

(3) *Specific interest rate.* The interest rate used is the interest rate specified under the plan for purposes of converting a participant's accumulated benefit to an annuity for annuity starting dates after the plan termination date. However, if the interest rate used under the plan for purposes of converting a participant's accumulated benefit to an annuity has not been the same fixed rate

during the 5-year period ending on the plan termination date, then the interest rate used for purposes of converting a participant's accumulated benefit to an annuity for annuity starting dates after the plan termination date is the average interest rate that applied for this purpose during the 5-year period ending on the plan termination date.

(B) *Tabular factors.* If, as of the plan termination date, a tabular annuity conversion factor (i.e., a single conversion factor that combines the effect of interest and mortality) is used to convert a participant's accumulated benefit (or a portion thereof) to an annuity and that same fixed tabular annuity conversion factor has been used during the entire 5-year period ending on the plan termination date, then the plan satisfies the requirements of this paragraph (e)(2)(iii) only if that same tabular annuity conversion factor continues to apply after the plan termination date. However, if the tabular annuity conversion factor used to convert a participant's accumulated benefit (or a portion thereof) to an annuity is not described in the preceding sentence (including any case in which the tabular annuity conversion factor was a fixed conversion factor that changed during the 5-year period ending on the plan termination date), then the plan satisfies the requirements of this paragraph (e)(2)(iii) only if the tabular annuity conversion factor used to convert a participant's accumulated benefit (or a portion thereof) to an annuity for annuity starting dates after the plan termination date is equal to the average of the tabular annuity conversion factors used under the plan for that purpose during the 5-year period ending on the plan termination date.

(C) *Factor applicable where a separate mortality table was not used for entire 5-year period prior to plan termination.* If paragraph (e)(2)(iii)(A) of this section does not apply (including any case in which a separate mortality table was used in conjunction with a separate interest rate to convert a participant's accumulated benefit (or a portion thereof) to an annuity for only a portion of the 5-year period ending on the plan termination date), then the plan is treated as having used a tabular annuity conversion factor to convert a participant's accumulated benefit (or a portion thereof) to an annuity for the entire 5-year period ending on the plan termination date. As a result, the rules of paragraph (e)(2)(iii)(B) of this section apply to determine the annuity conversion factor used for purposes of converting a participant's accumulated benefit (or portion thereof) to an annuity

for annuity starting dates after the plan termination date. For this purpose, if a separate mortality table and separate interest rate applied for a portion of the 5-year period, that mortality table and interest rate are used to calculate an annuity conversion factor and that factor is treated as having been the tabular annuity conversion factor that applied for that portion of the 5-year period for purposes of this paragraph (e)(2)(iii).

(D) *Separate application with respect to optional forms.* This paragraph (e)(2)(iii) applies separately with respect to each optional form of benefit on the date of plan termination. For this purpose, the term optional form of benefit has the meaning given that term in § 1.411(d)-3(g)(6)(ii), except that a change in the annuity conversion factor used to determine a particular benefit is disregarded in determining whether different optional forms exist. Thus, for example, if, for the entire 5-year period ending on the plan termination date, the plan provides for a mortality table in conjunction with an interest rate to be used to determine annuities other than qualified joint and survivor annuities, but for specified tabular factors to apply to determine annuities that are qualified joint and survivor annuities, then paragraph (e)(2)(iii)(A) of this section applies for purposes of annuities other than qualified joint and survivor annuities and paragraph (e)(2)(iii)(B) of this section applies for purposes of annuities that are qualified joint and survivor annuities. In addition, if the annuity conversion factor used to determine a particular qualified joint and survivor annuity has changed in the 5-year period ending on the plan termination date, the different factors are averaged for purposes of determining the annuity conversion factor that applies after plan termination for that particular qualified joint and survivor annuity.

(iv) *Rules of application*—(A) *Average of interest rates for crediting interest*—(1) *In general.* For purposes of determining the average of the interest rates under paragraph (e)(2)(ii) of this section, an interest crediting period is taken into account if the interest crediting date for the interest crediting period is within the 5-year period ending on the plan termination date. The average of the interest rates is determined as the arithmetic average of the annual interest rates used for those interest crediting periods. If the interest crediting periods taken into account are not all the same length, then each rate is weighted to reflect the length of the interest crediting period in which it applied. If the plan provides for the

crediting of interest more frequently than annually, then interest credits after the plan termination date must be prorated in accordance with the rules of paragraph (d)(1)(iv)(C) of this section.

(2) *Section 411(d)(6) protected accumulated benefit.* In general, the interest rate that was used for each interest crediting period is the ongoing interest crediting rate that was specified under the plan for that period, without regard to any interest rate that was used prior to an amendment changing the interest crediting rate with respect to a section 411(d)(6) protected benefit. However, if, as of the end of the last interest crediting period that ends on or before the plan termination date, the participant's accumulated benefit is based on a section 411(d)(6) protected benefit that results from a prior amendment to change the rate of interest crediting applicable under the plan, then the pre-amendment interest rate is treated as having been used for each interest crediting period after the date of the interest crediting rate change (so that the amendment is disregarded).

(B) *Average annuity conversion rates and factors—(1) In general.* For purposes of determining average annuity conversion interest rates and average tabular annuity conversion factors under paragraph (e)(2)(iii) of this section, an interest rate or tabular annuity conversion factor is taken into account if the rate or conversion factor applied under the terms of the plan to convert a participant's accumulated benefit (or a portion thereof) to a benefit payable in the form of an annuity during the 5-year period ending on the plan termination date. The average is determined as the arithmetic average of the interest rates or tabular factors used during that period. If the periods in which the rates or factors that are averaged are not all the same length, then each rate or factor is weighted to reflect the length of the period in which it applied.

(2) *Section 411(d)(6) protected annuity conversion factors.* In general, the annuity conversion interest rate or tabular annuity conversion factor that was used for each period is the ongoing interest rate or tabular factor that was specified under the plan for that period, without regard to any rate or factor that was used under the plan prior to an amendment changing the rate or factor with respect to a section 411(d)(6) protected benefit. However, if, as of the plan termination date, the participant's annuity benefit for an annuity commencing at that date would be based on a section 411(d)(6) protected benefit that results from a prior amendment to change the rate or factor

under the plan, then the pre-amendment rate or factor is treated as having been used after the date of the amendment (so that the amendment is disregarded).

(C) *Blended rates.* If, as of the plan termination date, the plan determines interest credits by applying different rates to two or more different predetermined portions of the accumulated benefit, then the interest crediting rate that applies after the plan termination date is determined separately with respect to each portion under the rules of paragraph (e)(2)(ii) of this section.

(D) *Participants with less than 5 years of interest credits upon plan termination.* If the plan provided for interest credits for any interest crediting period in which, pursuant to the terms of the plan, an individual was not eligible to receive interest credits (including because the individual was not a participant or beneficiary in the relevant interest crediting period), then, for purposes of determining the individual's average interest crediting rate under paragraph (e)(2)(ii) of this section, the individual is treated as though the individual received interest credits in that period using the interest crediting rate that applied in that period under the terms of the plan to a similarly situated participant or beneficiary who was eligible to receive interest credits.

(E) *Plan termination date—(1) Plans subject to Title IV of ERISA.* In the case of a plan that is subject to Title IV of ERISA, the plan termination date for purposes of this paragraph (e)(2) means the plan's termination date established under section 4048(a) of ERISA.

(2) *Other plans.* In the case of a plan that is not subject to Title IV of ERISA, the plan termination date for purposes of this paragraph (e)(2) means the plan's termination date established by the plan administrator, provided that the plan termination date may be no earlier than the date on which the actions necessary to effect the plan termination—other than the distribution of plan benefits—are taken. However, a plan is not treated as terminated on the plan's termination date if the assets are not distributed as soon as administratively feasible after that date. See Rev. Rul. 89-87 (1989-2 CB 2), (see § 601.601(d)(2)(ii)(b) of this chapter).

(v) *Examples.* The following examples illustrate the rules of this paragraph (e)(2). In each case, it is assumed that the plan is terminated in a standard termination.

*Example 1. (i) Facts.* (A) Plan A is a defined benefit plan with a calendar plan year that expresses each participant's accumulated benefit in the form of a

hypothetical account balance to which principal credits are made at the end of each calendar quarter and to which interest is credited at the end of each calendar quarter based on the balance at the beginning of the quarter. Interest credits under Plan A are based on a rate of interest fixed at the beginning of each plan year equal to the third segment rate for the preceding December, except that the plan used the rate of interest on 30-year Treasury bonds (instead of the third segment rate) for plan years before 2013. The plan is terminated on March 3, 2017.

(B) The third segment rate credited under Plan A from January 1, 2013, through December 31, 2016, is assumed to be: 6 percent annually for each of the four quarters in 2016; 6.5 percent annually for each of the four quarters in 2015; 6 percent annually for each of the four quarters in 2014; and 5.5 percent annually for each of the four quarters in 2013. The rate of interest on 30-year Treasury bonds credited under Plan A for each of the four quarters in 2012 is assumed to be 4.4 percent annually.

(ii) *Conclusion.* Pursuant to paragraph (e)(2)(ii) of this section, the interest crediting rate used to determine accrued benefits under the plan on and after the date of plan termination is an annual rate of 5.68 percent (which is the arithmetic average of 6 percent, 6.5 percent, 6 percent, 5.5 percent, and 4.4 percent). In accordance with the rules of paragraph (d)(1)(iv)(C) of this section, the quarterly interest crediting rate after the plan termination date is 1.42 percent (5.68 divided by 4).

*Example 2. (i) Facts.* The facts are the same as *Example 1*. Participant S, who terminated employment before January 1, 2017, has a hypothetical account balance of \$100,000 when the plan is terminated on March 3, 2017. Participant S commences distribution in the form of a straight life annuity commencing on January 1, 2020. For the entire 5-year period ending on the plan termination date, the plan has provided that the applicable section 417(e) rates for the preceding August are applied on the annuity starting date in order to convert the hypothetical account balance to an annuity. Based on the 5-year averages of the first segment rates, the second segment rates, and the third segment rates as of the plan termination date, and the applicable mortality table for the year 2020, the resulting conversion rate at the January 1, 2020 annuity starting date is 166.67 for a monthly straight life annuity payable to a participant whose age is the age of Participant S on January 1, 2020.

(ii) *Conclusion.* In accordance with the conclusion in *Example 1*, the interest crediting rate after the plan termination date is 1.42 percent for each of the 12 quarterly interest crediting dates in the period from March 3, 2017, through December 31, 2019, so that Participant S's account balance is \$118,436 on December 31, 2019. As a result, using the annuity conversion rate of 166.67, the amount payable to Participant S commencing on January 1, 2020 is \$711 per month.

*Example 3. (i) Facts.* The facts are the same as *Example 1*. In addition, Participant

T commenced participation in Plan A on April 17, 2014.

(ii) *Conclusion.* In accordance with the conclusion in *Example 1* and the rule of paragraph (e)(2)(iv)(D) of this section, the quarterly interest crediting rate used to determine Participant T's accrued benefits under Plan A on and after the date of plan termination is 1.42 percent, which is the same rate that applies to all participants and beneficiaries in Plan A after the termination date (and that would have applied to Participant T if Participant T had participated in the plan during the 5-year period preceding the date of plan termination).

*Example 4.* (i) *Facts.* (A) Plan B is a defined benefit plan with a calendar plan year that expresses each participant's accumulated benefit in the form of a hypothetical account balance to which principal credits are made at the end of each calendar year and to which interest is credited at the end of each calendar year based on the balance at the end of the preceding year. The plan is terminated on January 27, 2018.

(B) The plan's interest crediting rate for each calendar year during the entire 5-year period ending on the plan termination date is equal to (A) 50 percent of the greater of the rate of interest on 3-month Treasury Bills for the preceding December and an annual rate of 4 percent, plus (B) 50 percent of the rate of return on plan assets. The rate of interest on 3-month Treasury Bills credited under Plan B is assumed to be: 3.4 Percent for 2017; 4 percent for 2016; 4.5 percent for 2015; 3.5 percent for 2014; and 4.2 percent for 2013. Each of these rates applied under Plan B for purposes of determining the interest credits described in clause (A) of this paragraph (i), except that the 4 percent minimum rate applied for 2017 and 2014. The second segment rate is assumed to be: 6 percent for December 2016; 6 percent for December 2015; 6.5 percent for December 2014; 6 percent for December 2013; and 5.5 percent for December 2012.

(ii) *Conclusion.* Pursuant to paragraph (e)(2)(ii) of this section, the interest crediting rate used to determine accrued benefits under the plan on and after the date of plan termination is 5.07 percent. This number is equal to the sum of 50 percent of 4.14 percent (which is the sum of 4 percent, 4 percent, 4.5 percent, 4 percent, and 4.2 percent, divided by 5), and 50 percent of 6 percent (which is the average second segment rate applicable for the 5 interest crediting periods ending within the 5-year period, as applied pursuant to the substitution rule described in paragraphs (e)(2)(ii)(B) and (C) of this section).

*Example 5.* (i) *Facts.* The facts are the same as in *Example 4*, except that the plan had credited interest before January 1, 2016, using the rate of return on a specified RIC and had been amended effective January 1, 2016, to base interest credits for all plan years after 2015 on the interest rate formula described in paragraph (i) of *Example 4*. In order to comply with section 411(d)(6), the plan provides that, for each participant or beneficiary who was a participant on December 31, 2015, benefits at any date are

based on either the ongoing hypothetical account balance on that date (which is based on the December 31, 2015 balance, with interest credited thereafter at the rate described in the first sentence of paragraph (i) of *Example 4* and taking principal credits after 2015 into account) or a special hypothetical account balance (the pre-2016 balance) on that date, whichever balance is greater. For each participant, the pre-2016 balance is a hypothetical account balance equal to the participant's December 31, 2015 balance, with interest credited thereafter at the RIC rate of return, but with no principal credits after 2015. There are 10 participants for whom the pre-2016 balance exceeds the ongoing hypothetical account balance at the end of 2017 (which is the end of the last interest crediting period that ends on or before the January 27, 2018, plan termination date).

(ii) *Conclusion.* Because Plan B credited interest prior to 2016 using the rate of return on a RIC (a rate described in paragraph (d)(5) of this section), for purposes of determining the average interest crediting rate upon plan termination, the interest crediting rate used to determine accrued benefits under Plan B for all participants during those periods (for the calendar years 2013, 2014, and 2015) is equal to the second segment rate for December of the calendar year preceding each interest crediting period. In addition, because the pre-2016 balances exceeded the ongoing hypothetical account balance for 10 participants in the last interest crediting period prior to plan termination, for purposes of determining the average interest crediting rate upon plan termination, the interest crediting rate used to determine accrued benefits under Plan B for 2016 and 2017 for those participants is equal to the second segment rate for December 2015 and December 2016, respectively. For all other participants, for purposes of determining the average interest crediting rate upon plan termination, the interest crediting rate used to determine accrued benefits under Plan B for 2016 and 2017 is based on the ongoing interest crediting rate (as described in *Example 4*).

(3) \* \* \* (i) \* \* \* The right to future interest credits determined in the manner specified under the plan and not conditioned on future service is a factor that is used to determine the participant's accrued benefit, for purposes of section 411(d)(6). \* \* \* Paragraphs (e)(3)(ii) through (e)(3)(vi) of this section set forth special rules that apply regarding the interaction of section 411(d)(6) and changes to a plan's interest crediting rate. \* \* \*

(ii) \* \* \* (B) The effective date of the amendment is at least 30 days after adoption of the amendment;

(C) On the effective date of the amendment, the new interest crediting rate is not lower than the interest crediting rate that would have applied in the absence of the amendment; and

(D) For plan years that begin on or after January 1, 2016, if prior to the amendment the plan used a fixed annual floor in connection with a rate described in paragraph (d)(4)(ii), (iii) or (iv) of this section

(as permitted under paragraph (d)(6)(ii) of this section), the floor is retained after the amendment to the maximum extent permissible under paragraph (d)(6)(ii)(A) of this section.

(iii) *Coordination of section 411(d)(6) and market rate of return limitation—(A) In general.* An amendment to a statutory hybrid plan that preserves a section 411(d)(6) protected benefit is subject to the rules under paragraph (d) of this section relating to market rate of return. However, in the case of an amendment to change a plan's interest crediting rate for periods after the applicable amendment date from one interest crediting rate (the old rate) that satisfies the requirements of paragraph (d) of this section to another interest crediting rate (the new rate) that satisfies the requirements of paragraph (d) of this section, the plan's effective interest crediting rate is not in excess of a market rate of return for purposes of paragraph (d) of this section merely because the plan provides for the benefit of any participant who is benefiting under the plan (within the meaning of § 1.410(b)-3(a)) on the applicable amendment date to never be less than what it would be if the old rate had continued but without taking into account any principal credits (as defined in paragraph (d)(1)(ii)(D) of this section) after the applicable amendment date.

(B) *Multiple amendments.* A pattern of repeated plan amendments each of which provides for a prospective change in the plan's interest crediting rate with respect to the benefit as of the applicable amendment date will be treated as resulting in the ongoing plan terms providing for an effective interest crediting rate that is in excess of a market rate of return. See § 1.411(d)-4, A-1(c)(1).

(iv) *Change in lookback month or stability period used to determine interest credits—(A) Section 411(d)(6) anti-cutback relief.* With respect to a plan using an interest crediting rate described in paragraph (d)(3) or (d)(4) of this section, notwithstanding the general rule of paragraph (e)(3)(i) of this section, if a plan amendment changes the lookback month or stability period used to determine interest credits, the amendment is not treated as reducing accrued benefits in violation of section 411(d)(6) merely on account of this change if the conditions of this paragraph (e)(3)(iv)(A) are satisfied. If the plan amendment is effective on or after the adoption date, any interest credits credited for the one-year period commencing on the date the amendment is effective must be determined using the lookback month and stability period provided under the plan before the amendment or the lookback month and stability period after the amendment, whichever results in the larger interest credits. If the plan amendment is adopted retroactively (that is, the amendment is effective prior to the adoption date), the plan must use the lookback month and stability period resulting in the larger interest credits for the period beginning with the effective date and ending one year after the adoption date.

(B) *Section 411(b)(5)(B)(i)(I) market rate of return relief.* The plan's effective interest crediting rate is not in excess of a market rate

of return for purposes of paragraph (d) of this section merely because a plan amendment complies with the requirements of paragraph (e)(3)(iv)(A) of this section. However, a pattern of repeated plan amendments each of which provides for a change in the lookback month or stability period used to determine interest credits will be treated as resulting in the ongoing plan terms providing for an effective interest crediting rate that is in excess of a market rate of return. See § 1.411(d)-4, A-1(c)(1).

(v) *RIC ceasing to exist.* This paragraph (e)(3)(v) applies in the case of a statutory hybrid plan that credits interest using an interest crediting rate equal to the rate of return on a RIC (pursuant to paragraph (d)(5)(iv) of this section) that ceases to exist, whether as a result of a name change, liquidation, or otherwise. In such a case, the plan is not treated as violating section 411(d)(6) provided that the rate of return on the successor RIC is substituted for the rate of return on the RIC that no longer exists, for purposes of crediting interest for periods after the date the RIC ceased to exist. In the

case of a name change or merger of RICs, the successor RIC means the RIC that results from the name change or merger involving the RIC that no longer exists. In all other cases, the successor RIC is a RIC selected by the plan sponsor that has reasonably similar characteristics, including characteristics related to risk and rate of return, as the RIC that no longer exists.

(4) *Actuarial increases after normal retirement age.* A statutory hybrid plan is not treated as providing an effective interest crediting rate that is in excess of a market rate of return for purposes of paragraph (d) of this section merely because the plan provides that the participant's benefit, as of each annuity starting date after normal retirement age, is equal to the greater of—

(i) The benefit based on the accumulated benefit determined using an interest crediting rate that is not in excess of a market rate of return under paragraph (d) of this section; and

(ii) The benefit that satisfies the requirements of section 411(a)(2).

(5) *Plans that permit participant direction of interest crediting rates.* [Reserved]

\* \* \* \* \*

(f) \* \* \*

(2) \* \* \*

(i) \* \* \*

(B) *Special effective date.* Paragraphs (d)(1)(iii), (d)(1)(iv)(D), (d)(1)(vi), (d)(2)(ii), (d)(4)(v), (d)(5)(ii)(B), (d)(5)(iv), (d)(6), (e)(2), (e)(3)(iii), (e)(3)(iv), (e)(3)(v) and (e)(4) of this section apply to plan years that begin on or after January 1, 2016 (or an earlier date as elected by the taxpayer).

\* \* \* \* \*

**John Dalrymple,**

*Deputy Commissioner for Services and Enforcement.*

**Mark J. Mazur,**

*Assistant Secretary of the Treasury (Tax Policy).*

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