

Comments on Proposed Modifications to Minimum Present Value Regulations for Partial Annuity Distribution Options Under Defined Benefit Plans

May 2, 2012

Department of Treasury
Internal Revenue Service

26 CFR Part 1
[REG-110980-10]

The American Society of Pension Professionals & Actuaries (ASPPA) appreciates this opportunity to comment on a proposed change to existing regulations under Internal Revenue Code (“IRC” or “Code”) section 417(e) dealing with the present value requirement for defined benefit plans as issued by the Internal Revenue Service (“IRS”) and Department of Treasury (“Treasury”) on February 3, 2012 (REG-110980-10).

ASPPA is a national organization of more than 8,500 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines, including consultants, investment professionals, administrators, actuaries, accountants and attorneys. Our large and broad-based membership gives ASPPA unique insight into current practical applications of ERISA and qualified retirement plans, with a particular focus on the issues faced by small- to medium-sized employers. ASPPA’s membership is diverse but united by a common dedication to the employer-sponsored retirement plan system. All credentialed actuarial members of ASPPA are members of the ASPPA College of Pension Actuaries (ASPPA COPA), which has primary responsibility for the content of comment letters that involve actuarial issues.

References are to the Internal Revenue Code of 1986 and Treasury regulations unless otherwise specified.

Summary

The following is a summary of ASPPA COPA’s recommendations which are described in greater detail in the **Discussion** section below.

I. Implications of Regulatory Effective Date - Final regulations should specify that the addition of specific rules for bifurcated benefits at this time is not intended to call into question approaches for handling bifurcated benefits for periods prior to the effective date of the amended regulation.

II. Multiple Annuity Starting Dates - Final regulations should specifically confirm that similar rules apply in the case of bifurcated benefits with different annuity starting dates.

III. Grandfathered Lump Sum Distribution Forms - Final regulations should include an example demonstrating that the regulation is intended to apply to situations in which the reason for the partial lump sum distribution is the grandfathering of the option in connection with an amendment eliminating the optional form of distribution (as contrasted with a service-based change in benefit structure). The example should illustrate the principle supported by the proposed rule that a subsidy provided by the partial lump sum can have a non-proportional effect on the participant's remaining accrued benefit. In addition, the example should emphasize that the partial distribution rule applies where the remainder benefit is paid at a different date.

IV. Conforming Changes - Final regulations should incorporate modifications to the qualified joint and survivor annuity ("QJSA") notice and election rules and the relative value regulation confirming that separate notices, disclosures and elections are permitted for the separate portions of bifurcated benefits.

V. Other Forms of Payment - Final regulations should indicate that similar rules apply for other forms of benefit that are subject to IRC section 417(e), such as period certain annuities.

Discussion

I. Implications of Regulatory Effective Date

ASPPA COPA applauds the addition of specific rules for dealing with bifurcated benefit distributions. However, final regulations should acknowledge that plan sponsors and plan administrators have had to develop plan language and administrative procedures to address bifurcated benefits in light of the minimum present value requirements ever since those specific requirements were added to the Code in 1984, and the absence of specific formal guidance has led to divergent practices. As has been apparent from practitioner questions over the years, the concept of the minimum present value requirement applying to a participant's entire accrued benefit when any portion of the benefit is payable in non-annuity form is not universally accepted, and so has often not been applied in practice. This is especially true of the view that the minimum value of the normal retirement benefit would create a floor for a current annuity portion of a distribution.

Current regulation §1.417(e)-1(d)(6) provides an exception from the minimum present value requirements of section 417(e) and § 1.417(e)-1(d) for "***the amount of a distribution*** paid in the form of an annual benefit that ..." (emphasis added). Because this language does not refer to the entire accrued benefit, but focuses on "the amount of a distribution", it can be read as addressing the partial distribution situation as well as the situation where the entire benefit is paid in the excepted forms.

The view that the current regulation does not require imposing a minimum present value requirement on a partial distribution in an excepted form is supported by the 2009 final regulations on benefit restrictions for underfunded plans. Regulation §1.436-1(d)(3)(ii)(B) states "The rules of 1.417(e)-1 are applied separately to the separate optional forms for the unrestricted portion of the benefit and the remainder of the benefit (the restricted portion)." If a different

result was required by the existing 417(e) regulation, the new 436 regulation arguably would have introduced this thought with “Notwithstanding the requirements of 1.417(e)-1....”

ASPPA COPA recommends that final regulations specify that the addition of specific rules for bifurcated benefits at this time is not intended to call into question approaches for handling bifurcated benefits that commenced prior to the effective date of the amended regulation.

II. Multiple Annuity Starting Dates

In addition to the possibility of a current distribution with separate forms of payment for portions of the total benefit, there are situations where a portion of the benefit is payable currently (perhaps due to a grandfathered distribution right) with the balance of the benefit (determined using the 417(e) rate at the time of the first payment if the third proposed option is used) payable at a future date. The legal rights of participants and the math are no different for such a situation than for the situation where bifurcated benefits are paid at a common annuity starting date. As a result, there appears to be no inherent bar to a bifurcation of this type, but a clear statement confirming this conclusion would be helpful. Examples of existing regulations that acknowledge and accommodate multiple annuity starting dates include §1.401(a)-20, Q&A 9 and §1.401(a)(9)-6, Q&A 13.

ASPPA COPA recommends that final regulations specifically confirm that similar rules apply in the case of bifurcated benefits with different annuity starting dates.

III. Grandfathered Lump Sum Distribution Forms

Arguably the most common reason for partial lump sum distributions is that a plan amendment (including an amendment in conjunction with a plan merger) prospectively eliminates the option for future accruals while observing the anti-cutback requirement of IRC §411(d)(6). While ASPPA COPA reads the proposed regulation to cover this situation in the category “Single sum with separate election for remainder”, a specific statement or example would eliminate any doubt.

In addition, ASPPA COPA recommends that the final rule illustrate the math of the third option for the situation where the grandfathered lump sum reflects a subsidy that can (but need not) be carved out of the remainder benefit via a “wearaway” approach according to the proposal. Consider a plan participant who is entitled to a \$1,000 monthly benefit of which \$250 can be cashed out due to such grandfathering. Assume the pre-amendment plan determined the lump sum based on a fully subsidized benefit at age 62. Further assume an age 62 immediate annuity 417(e) factor of 12.821 and a deferred to age 65 annuity factor of 9.982. The grandfathered lump sum is \$38,463 ($250 * 12.821 * 12$) and the lump sum defined in proposed §1.417(e)-1(d)(7)(v)(C)(1) is \$119,784 ($1,000 * 9.982 * 12$). The resulting minimum remainder accrued benefit for the amount not paid as a lump sum is \$678.90 [$1,000 * (1 - 38,463 / 119,784)$]. This minimum would be adjusted for time and form of payment based on the plan’s early/late retirement and optional form factors either at the same annuity starting date as the lump sum or at any other later annuity starting date permitted by the plan.

ASPPA COPA recommends that final regulations specifically include an example demonstrating that the regulation is intended to apply to situations in which the reason for the partial lump sum

distribution is grandfathering of the option in connection with an amendment eliminating the optional form of distribution (as contrasted with a service-based change in benefit structure). The example should illustrate the principle supported by the proposed rule that a subsidy provided by the partial lump sum can have a non-proportional effect on the participant's remaining accrued benefit. In addition, the example should emphasize that the partial distribution rule applies where the remainder benefit is paid at a different date.

IV. Conforming Changes

The welcomed clarity for the minimum present value rule should be enhanced by similar specificity for companion issues such as notice and election requirements and options for communicating relative values of distribution options. While the relative value regulation at 1.417(a)(3)-1(c)(5)(iii) allows for separate disclosures about separate parts of benefits, it does not explain what options are suitable for those disclosures. For example, is a plan permitted to use different sets of interest and mortality assumptions that are appropriate to the separate parts of benefits?

Of greatest importance for rules in this area is the effect those rules will have on helping participants understand their rights and benefit values under the plan. Where a participant has a right under the plan to split benefits in two or more pieces, it is our view that participants are best served by bifurcated notices, elections and disclosures. This is especially true in the case where the participant is permitted to commence distribution of the parts at different dates. Indeed, we are aware of plans that have taken this approach in the absence of guidance effectively explaining what the rules should be in the case of bifurcated benefits.

Under the suggested approach, consider the case of a plan offering a typical array of annuity options with some portion available in lump sum form. While the general QJSA notice and explanation of the consequences of a failure to defer may or may not be provided as a single explanation, the listing of distribution options and relative values would be provided separately and the assumptions for valuing the options might be different. For example, the values compared to the lump sum portion of the benefit would be compared using 417(e) interest and mortality while the remaining portion would be compared using the plan's actuarial assumptions for determining annuity options.

The correspondence with the plan participant would include two separate election forms and two separate spousal consent sections. Spousal consent to waive the QJSA would only be needed for the portion of the benefit the participant is not choosing to have paid in the form of a suitable joint and survivor option with the spouse as the survivor.

We are not suggesting that this would be the only approach to communicating and making elections for bifurcated benefits. Other approaches may be suitable depending on the rights and restrictions in specific plans. However, final regulations should affirmatively recognize the issue and state any boundaries that must be observed.

ASPPA COPA recommends that the final regulations incorporate modifications to the QJSA notice and election rules and the relative value regulation confirming that separate notices, disclosures and elections are permitted for the separate portions of bifurcated benefits.

V. Other Forms of Payment

The third category of bifurcated accrued benefit defined in the proposed regulation is specifically limited to lump sum distributions. While we anticipate that lump sums are the predominant form of payment affected by this rule, we see no reason to bar the treatment for other forms of payment subject to the minimum present value rules, such as period certain options.

ASPPA COPA recommends that the final regulations indicate that similar rules apply for other forms of benefit that are subject to IRC 417(e) (e.g., period certain annuities).



These comments were prepared by ASPPA's Defined Benefit Subcommittee of the Government Affairs Committee and the ASPPA College of Pension Actuaries. Please contact Judy A. Miller, MSPA, Chief of Actuarial Issues at (703) 516-9300 if you have any comments or questions on the matters discussed above.

Thank you for your time and consideration.

Sincerely,

/s/

Brian H. Graff, Esq., APM
Executive Director/CEO

/s/

Judy A. Miller, MSPA
Chief of Actuarial Issues

/s/

Craig P. Hoffman, Esq., APM
General Counsel

/s/

Mark Dunbar, MSPA, Co-Chair
Gov't Affairs Committee

/s/

Ilene H. Ferenczy, Esq., APM, Co-Chair
Gov't Affairs Committee

/s/

James Paul, Esq., APM, Co-Chair
Gov't Affairs Committee