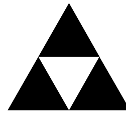

AMERICAN ACADEMY *of* ACTUARIES

May 10, 2005

Mr. Bruce Perlin
CC:PA:LPD:PR (REG-152914-04)
Room 5203
Internal Revenue Service
PO Box 7604
Ben Franklin Station
Washington, DC 20044

Subject: Relative Value Reproposed Regulations

Dear Mr. Perlin:

On behalf of the American Academy of Actuaries'[1] Pension Committee, I thank you for this opportunity to suggest further refinements to the relative value regulations. In our recent discussions with IRS and Treasury actuaries, and through observation of the responses to a number of questions posed about the relative value regulations at the 2005 Enrolled Actuaries Meeting, we would like to highlight some concerns and offer suggestions for simplifying the benefit communication material that must be offered to participants under the relative value rules.

Two concerns are preeminent.

First, it is anticipated that actuaries will play a significant role in the development of materials and calculations presented to plan participants in satisfaction of this rule. In keeping with our professional obligation to control our work product and take steps to ensure that it is not used to mislead, we are concerned with the option in the reproposed regulations to characterize benefit options as "equivalent" as long as those options have a value that is at least 95 percent of the value of the qualified joint and survivor annuity (QJSA). We are also concerned that the requirement to use "reasonable assumptions" will be interpreted as a requirement that assumptions be reasonable from the perspective of the individual participant rather than from the perspective of the plan. Selecting assumptions on an individual basis would be burdensome and costly for the plan. We suggest an alternative below.

Second, we are concerned that participants may be overwhelmed with unnecessary detail in certain cases because of requirements in the regulations. In response to the original proposed regulations, many observers had argued that the proposal called for much more than the simple direct statements that were anticipated when the call for action was advanced. Indeed, in addition to alerting participants that annuity forms of benefit might have a greater value than a lump sum cash-out under a particular plan, many advocated that participants should be alerted to subsidies that would become available with the advancement of age (e.g., disclosure of an early retirement subsidy beginning at age 55 to participants who had not yet attained that age.) While these simplified disclosures have been rejected in favor of a paradigm involving a great deal of specificity, we suggest a middle ground for certain of the more complex situations.

In addition to these two main concerns, we will identify technical areas where revisions might be needed in order to ensure that the rules operate as intended.

[1] The American Academy of Actuaries is the public policy organization for actuaries of all specialties within the United States. In addition to setting qualification standards and standards of actuarial practice, a major purpose of the Academy is to act as the public information organization for the profession. The Academy is nonpartisan and assists the public policy process through the presentation of clear actuarial analysis. The Academy regularly prepares testimony for Congress, provides information to federal and state elected officials, regulators and congressional staff, comments on proposed federal and state regulations and legislation, and works closely with state officials on issues related to insurance. The Academy also develops and upholds actuarial standards of conduct, qualifications and practice, and the Code of Professional Conduct for all actuaries practicing in the United States.

Conflict with Professional Standards

The "Equal Value" Issue
Precept 8 of the Code of Professional Conduct adopted by the five U.S. Actuarial Organizations requires actuaries to take reasonable steps to ensure that their services are not used to mislead other parties. We are concerned that the option included in the current relative value regulations paragraph (c)(2)(iii)(C), which allows a relative value explanation to describe a group of optional forms as "approximately equal in value to the QJSA" if they have "an actuarial present value that is at least 95 percent of the actuarial present value of the QJSA for a married participant," will make it extremely difficult to observe this precept.

It has been suggested that our objections are satisfied because use of the "approximately equal" approach is voluntary. For example, if a lump-sum settlement is worth 30 percent more than the value of a QJSA, the sponsor is not compelled to state that the two options are approximately equal in value. The sponsor is free to state that the lump-sum settlement is worth 30 percent more than the value of the QJSA. The voluntary nature of the approach does not overcome our objections. Actuaries are rarely the exclusive advisors in matters involving sponsorship of a retirement plan. Other advisors are not bound by the same code of conduct that applies to actuaries. Suppose other advisors disagree with the actuary over an appropriate approach, and these other advisors prevail. In such cases, it is inevitable that questions will arise over whether the actuary's work product was the ultimate source of the participant communication that the actuary felt was inappropriate. In some of these cases, despite the actuary's effort to control use of the work product, the actuary will risk exposure to the charge that the actuary has committed a material breach of the code of conduct.

Quite apart from issues involving the actuary's code of conduct, we believe participants are ill served by references to approximate equality that are misleading. We do not believe regulations should either encourage or permit this misleading usage.

Arguably, this "approximately equal" rule was included in the original final rule to avoid putting a plan sponsor in the position of having to show that some option under the plan had a greater value than the QJSA, despite the requirement that the QJSA be the most valuable option available to the plan participant. One of the proposed changes to the regulations would modify Sec. 1.401(a)-20, Q&A-16, to clarify the interaction of this "most valuable" rule with the requirement that certain optional forms of benefit be calculated using specified actuarial assumptions. Under that clarification, a plan would not fail to satisfy the requirements of Sec. 1.401(a)-20, Q&A-16, merely because the amount payable under an optional form of benefit is subject to the minimum present value requirement of Sec. 417(e)(3).

In light of the proposed clarification, concerns over the difference between values under the relative value rules and the values used to assess compliance with the "most valuable" rule need no longer be masked with the option of calling anything greater than 95 percent "approximately equal in value to the QJSA," a statement that could easily be viewed as misleading.

> *Recommendation: Modify the regulations to permit that only optional forms worth between 95 percent and 105 percent of the QJSA for a married participant may be described as "approximately equal." Further, harmonize the special grouping rule to identify the same range of values as being "approximately equal in value" for married and unmarried participants.*

Reasonable Assumptions
In certain circumstances, the proposed regulations permit the use of "reasonable assumptions." As with the Precept 8 issue raised above, with regard to not misleading participants, the actuary may have concerns about the selection of assumptions used for relative value comparison. This leads to the question "reasonable from whose standpoint?" We are concerned, for example, that an advocate for a participant suffering from a terminal illness will question the use of a mortality assumption that most practitioners would consider generally reasonable under normal circumstances but is clearly inappropriate for this individual participant. However, this must be balanced against the cost of preparing such a statement. It clearly is not feasible for a plan sponsor to make an intensive investigation of the financial, health, and moral attributes of every participant to whom relative value illustrations are to be provided. A restrictive definition in the relative value regulations will serve to limit reasonable expectations.

Recommendation: Clarify that, for optional forms other than those subject to Sec. 417(e)(3), reasonableness does not mean reasonableness from the individual participant's perspective. For example, the use of standard mortality tables, even unisex mortality tables, is permissible. Enhance the "based on average life expectancies" language in paragraph (c)(2)(v)(A) to make clear that life expectancies must be based on plan or general population statistics and do not in any way fully reflect individual circumstances. In addition, establish that Sec. 417(e)(3) rates will always constitute a safe harbor definition of reasonableness whether or not the options in question are subject to Sec. 417(e)(3). Finally, establish that in comparing options not subject to Sec. 417(e)(3), assumptions based on the plan's definition of actuarial equivalence (if defined using a stated interest rate and mortality table as opposed to simplified tables) will always constitute a safe harbor definition of reasonableness provided the plan's definition has not been adjudged to establish impermissible forfeitures.

Overwhelming Detail

As a preliminary matter, we applaud the simplification offered by the proposed change to the regulations that would allow the inclusion of participant-specific information and certain estimates under the generalized notice option. As a result, in a plan containing groups of participants with different optional forms from past acquisitions and mergers involving the plan sponsor, the QJSA explanation can provide:

i) Participant-specific information for generally available options, and
ii) For the sub-group options, only an indication that they exist with an offer to provide further information upon request, OR

i) Participant-specific information for commonly elected options, and
ii) Generally applicable comparative information for rarely elected options, OR

i) Participant-specific information for commonly elected, generally available options,
ii) Generally applicable comparative information for rarely elected, generally available options, and
iii) For the sub-group options, only an indication that they exist and an offer to provide further information upon request.

"30 values"
While the presentation of relative values may be helpful to some participants, we are sensitive to concerns that many participants will find the information confusing or that an overabundance of information will distract them from a few key plan differentials that are important to their decision and from the imperatives of their personal situations. For example, in question 20 of the Gray Book presented at this year's Enrolled Actuaries meeting, the IRS confirmed that relative values for separate segments of a participant's benefit payable at the same annuity starting date could not be disclosed separately for each segment, notwithstanding that there was no interrelationship between the segments. Thus, rather than 11 illustrations for separate portions of the benefit (five options for one portion and six for the other) the Q&A concluded that 30 line items would need to be disclosed. This level of detailed information adds nothing to help the participant understand the two distinct choices he/she must make.

Recommendation: The regulations should be modified to allow plan sponsors to segment relative value illustrations if there exists separately determined portions of benefits under the terms of the plan.

Open-Option Plans (hundreds of values?)
For plans with "open options" — for example, any joint and survivor (J&S) from 1 percent to 100 percent, or any number of years certain up to life expectancy, or in some cases, a combination of any percent J&S with any number of years certain — disclosures about each and every option may be burdensome and of limited use to plan participants. As an alternative, a reasonable approach in this situation would be to show a range of options. For example, a sponsor might show 25 percent, 50 percent, 75 percent and 100 percent J&S, and five, 10, 15, & 20 years certain, and explain that other J&S percents or numbers of years certain may be elected. The plan administrator would offer to calculate the financial effect and relative value of any particular option upon request. However, it isn't clear this would be satisfactory under the proposed regulations. While many plans may ultimately escape this intensive disclosure when the anti-cutback regulations are finalized, for those plans that choose to continue full flexibility for plan participants, a reasonable disclosure requirement is essential. In fact, the availability of a reasonable disclosure rule may be a factor in deciding whether to eliminate options.

> *Recommendation: Clarify that open-option plans may illustrate sample optional forms of payment if they offer to provide additional information upon request.*

Retroactive Annuity Starting Date (RASD)

Another example of unwarranted complexity concerns QJSA notice material where a participant is considering a RASD option. It is our understanding that one interpretation of the original final regulations would require the development of relative values of retroactive options as of a current annuity starting date and current rate. These current values would be compared to the values of options available at such a current annuity starting date. This interpretation focuses on the words "presently available" in the introductory paragraph (c), which states:

> A QJSA explanation satisfies this paragraph (c) if it provides the following information with respect to each of the optional forms of benefit presently available to the participant (i.e., optional forms of benefit with an annuity starting date for which the QJSA explanation applies).

But this interpretation appears to ignore the parenthetical language (which had not been included in the original proposed regulations) that clarifies that the relevant annuity starting date is intended. Given that it is entirely possible that a QJSA notice for a RASD might only include information on optional forms available at the RASD, such as when a participant has affirmatively elected the RASD, there seems to be little merit in requiring a different sort of information merely because information at two possible annuity starting dates is presented in a single envelope. Participants often ask for illustrations showing retirement results at an array of dates. Each illustration should be viewed as an independent QJSA notice. As with the first example, the additional information adds nothing to help the participant understand the choices that he/she must make.

That said, if indeed it is required that all the RASD information be valued and illustrated at a current annuity starting date, then the parenthetical language should be changed. Language should be added to specifically explain what is required where multiple dates are illustrated, as well as what is required where the notice merely provides optional form information at the RASD. (Are the values determined as of the RASD or the distribution date?) Suitable examples should be added for clarity.

> *Recommendation: More clearly clarify that relative values are determined separately for each illustrated start date. If, however, all the values are expected to be calculated at a single date, more clearly explain what that date is and how the rule is applied. Explain what date to use for RASD notices when options at the RASD are the only benefits illustrated.*

"All" the options in the 95 percent to 102.5 percent grouping

Paragraph (c)(2)(iii)(C) contains a special grouping rule that can be used if the value of optional forms is being compared to the value of the single life annuity. The special grouping rule is available if "all optional forms of benefit" have actuarial present values that are at least 95 percent, but not greater than 102.5 percent, of the actuarial present value of the single life annuity. This "all optional forms" restriction apparently does not apply when using the QJSA for a married participant. Moreover, this paragraph ends by providing that in the single life annuity case, the relative values can be disclosed by stating, "that all of **those** forms of benefit and the single life annuity are approximately equal in value." [emphasis added]

Is it intended that this 95 percent to 102.5 percent special grouping be available *only* if all options have values that fall within the 95 percent to 102.5 percent numerical corridor (as opposed to being available for *whichever* options have values that fall within the corridor)? If so, what is the scope of the word "all"? For example, does it mean all options presently available to the participant? Or, does it mean all options for which participant-specific information is being presented?

Actuaries were told at the 2004 Enrolled Actuaries Meeting that the rule was meant to encompass "whichever." In addition, paragraph (e) Example 3(ii) supports that view by specifically cross referencing "paragraph (c)(2)(iii)(C)" in a situation that involves comparisons to the life annuity form. However, more recently a contrary view has been suggested. Providing flexibility to support the development of understandable notices would seem the better choice.

> *Recommendation: Clarify that the plan is permitted to describe the relative value of optional forms of benefit that fit in the prescribed range by stating that all such forms are approximately equal in value, or that all such forms of benefit and the single life annuity are approximately equal in value.*

Technical Issues

Payment of Qualified Preretirement Survivor Annuity
Do the relative value rules (and/or the retroactive annuity starting date rules for that matter) apply to death benefits payable to the spouse of a plan participant?

The payment of a death benefit is distinguished from the selection of a QJSA or QPSA by the plan participant. Elections under the QPSA and QJSA rules are essentially life insurance choices that occur before death. After death, the spouse, who is the beneficiary under either a QPSA or QJSA, is entitled to a qualified survivor annuity. In some cases, plans offer the choice of a cashout of the survivor annuity. Reg. Sec. 1.417(a)(3)-1 specifically refers to written explanations ***to participants*** associated with the QPSA and QJSA ***elections*** but there is no mention of a requirement associated with explanations that need to be provided to a surviving spouse.

This is contrasted with Reg. Sec. 1.417(e)-1(b), which provides that some consent rules do apply to the survivor annuity by stating:

> *General rule.* Generally plans may not commence the distribution of any portion of a participant's accrued benefit in any form unless the applicable consent requirements are satisfied. No consent of the participant ***or spouse*** is needed for distribution of a QJSA or ***QPSA*** after the benefit is no longer immediately distributable (after the participant attains (***or would have attained if not dead***) the later of normal retirement age, as defined in section 411(a)(8), or age 62). [Emphasis added]

While the next paragraph continues with similar references to the requirements applicable to the spouse, the balance of the regulations, including the new material on retroactive annuity starting date, are silent about requirements for the payment of the survivor annuity. Given that the critical feature of asking the spouse for consent to retroactivity will be satisfied in these situations, is there a need for further mandates about the choices made available to the spouse, how they are expressed, or how they are calculated? What would those be?

Alternate Payees
Do the relative value rules (and/or the retroactive annuity starting date rules) apply to benefits payable to alternate payees?

“Same” Joint and Survivor Annuity
In the subject proposed regulations at paragraph (c)(2)(ii)(C), a clarification about what is meant by the “same” joint and survivor annuity being available to an unmarried participant would be helpful. Would restrictions placed on the survivor annuity percent that may be paid to a younger non-spouse beneficiary (to comply with 401(a)(9) rules) cause the J&S annuity offered to unmarried participants to fail to be "that same joint and survivor annuity" for purposes of substituting the joint and survivor annuity for unmarried individuals?

Combining Grouping Rules
Can the grouping rules of paragraph (c)(2)(iii) be combined? For example, if three forms have values of 93 percent, 95 percent, and 97 percent of the QJSA, the grouping rule in paragraph (c)(2)(iii)(A) permits them to be grouped with a representative relative value of 97 percent. Can the special rule for married participants in paragraph (c)(2)(iii)(C) then be applied to describe all three options as being approximately equal in value to the QJSA?

“Consistent Basis”
The second sentence of paragraph (c)(2)(iii)(B) contains the phrase "when measured on a consistent basis." This phrase is not used in paragraph (c)(2)(iii)(A), which spells out the grouping rules. Does this mean that the relative values of all the forms have to be measured in the same way (either as a percentage of the value of the QJSA, as a single sum, or as the QJSA that is equivalent to the optional form)? Or does this mean forms can only be grouped where the same actuarial assumptions have been used to determine the relative value? For example, if the relative value of the lump sum determined on the 417(e) basis is 92 percent and the relative value of the single life annuity determined on the plan actuarial equivalent basis is 93 percent — can those forms be grouped?

Money Purchase Assets Annuitized Through Define Benefit Plans
Paragraph (c)(4) provides instructions for money purchase plans. While most money purchase plans would use insurance company contracts to annuitize benefits, there also exist plans that annuitize using the plan sponsor's defined benefit plan. This section should be modified to accommodate that practice by explaining that the defined benefit plan's rates would be used to determine the annuity values.

"Generally Available"
In paragraph (d)(1), what does "generally available" mean? The preamble to the original proposed regulations included some discussion about what was intended here (hinting that generally available options do not include "optional forms from prior benefit structures for limited groups of employees"). However, that information was not carried over to the final regulations. This seems to be a very important concept, and one that warrants further elaboration when the regulations are refinalized.

Duplicative Language
Paragraph (d)(2)(iii) and the introductory portion of paragraph (d)(4) essentially repeat the same information. It appears that paragraph (d)(2)(iii) could be removed without changing any regulatory requirement.

Additional Information Under Generalized Option
Paragraph (d)(4)(i) explains the additional information that must be provided upon request to an individual who has received an initial statement under the "generally applicable information" option. A plan is required to provide the information described in paragraph (c)(1)(i) through (v) for the optional form the participant queries. The paragraph goes on to say, "In addition, the plan must comply with paragraph (c)(3)(iii) of this section."

It is not clear what additional information this would entail in that 1(c)(1)(i) through (v) would include all the relative value information available. What additional information would be required?

Typographical Error
In paragraph (e), Example (4)(ii), the second to last sentence preceding the charts says: "For each optional form generally available under the plan, the chart shows the financial effect and the relative value, using the grouping rules of paragraph (c)(2)(ii) of this section." It would appear that the reference to "paragraph (c)(2)(ii)" should refer to "paragraph (c)(2)(iii)".

We appreciate the opportunity to provide these comments, and we look forward to hearing from you. As mentioned in our April 28 letter, we look forward to an opportunity to testify on the issues we've addressed in this letter at the public hearing on the regulations. If you have any questions or would like to discuss this further, please contact Heather Jerbi, the Academy's senior pension policy analyst (202.785.7869; Jerbi@actuary.org).

Sincerely,

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