Internal Revenue Service
CC:PA:LPD:PR (REG-100464-08), Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

September 24, 2008

Re: Proposed Regulations (REG-100464-08) Providing Guidance on the Section 411(b) Accrual Rules

To Whom It May Concern:

On behalf of the American Academy of Actuaries[1] Pension Committee, I respectfully request your consideration of its comments regarding the proposed regulations providing guidance on the application of the accrual rule for defined benefit plans under section 411(b)(1)(B) of the Internal Revenue Code in cases where plan benefits are determined on the basis of the greatest of two or more separate formulas. The proposed regulations represent a positive step forward in addressing a design issue critical to many defined benefit plans.

Background

The accrual rules under Code section 411(b) are designed to prevent the "backloading" of benefits; otherwise, the vesting rules could be effectively circumvented. Three tests are available: the 3 percent method, the 133 1/3 percent rule, and the fractional rule.

Frequently when pension plans are changed, various grandfathering techniques are employed; often, employees nearing retirement are granted the greater of the old and new formulas. However, such multiple-formula situations have created confusion in terms of satisfaction of the accrual rules.

[1] The American Academy of Actuaries is a professional association with over 16,000 members, whose mission is to assist public policymakers by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

Separate testing should not be restricted to the 133 1/3 percent test

The proposed regulations help in these greater-of, multiple formula situations by permitting the separate testing of each formula. However, each formula must satisfy the 133 1/3 percent test independently; the other two accrual rules tests are not available.

This restriction is unnecessary and harmful. Certain formulas lend themselves to testing under the other rules. If, for example, a prior formula, which only satisfies the fractional accrual rule, is being replaced with an ongoing formula that satisfies the 133 1/3 percent rule, grandfathering the old formula – with the aggregated, fractional rule testing that would accompany it - may prove too difficult. In fact, Revenue Ruling 2008-7 points out that long term reliance on the fractional rule can be problematic for a better of formula involving a cash balance plan. As a result, simply freezing the old formula – and just having to test the ongoing formula – will be the easier route, even though it would be at the expense of the employees who may otherwise have been grandfathered.

We believe separate testing should be permitted without limiting it to one particular test and that each separate formula should not be required to use the same testing method. To prevent any potential abuse, the regulations should rely on an anti-abuse clause, as is included in the proposed regulations.

Different basis requirement should be clarified

In addition to separate satisfaction of the 133 1/3 percent rule, the proposed regulations also require each formula to be based upon a "different basis." This requirement is very unclear. We believe the different basis requirement has no basis in the Code and is unnecessary, particularly if the regulations contain an overriding anti-abuse clause.

If the different basis requirement is retained, additional clarification is requested. For example, if a traditional career average formula is operating along with a cash balance formula (which is also, arguably, a form of career average), is the basis sufficiently different?

We believe that the situation can be addressed by including in the final regulations language that effectively states, with respect to regulation 1.411(b)-1(b):

> *If a plan provides a benefit that is the greatest of two or more formulas and each formula by itself satisfies the requirements of this paragraph, then the plan shall be deemed to satisfy the requirements of this paragraph.*

Testing methodology under the 133 1/3 percent test – Interest rates

Beyond the multiple formula issue, the regulations should clarify testing procedures under the 133 1/3 percent rule. Most importantly, Revenue Ruling 2008-7 provided guidance, for the first time, about testing a cash balance plan. The ruling held that the

interest rate applicable for the current year is assumed to remain constant for all future years:

> Furthermore, the value of all relevant factors used to determine benefits for the current plan year is kept constant in determining the annual rates of accrual for future years. Thus, for example, for the plan year under consideration, which is 2002, the 3.87% interest crediting rate, the 5.48% applicable interest rate under § 417(e)(3), and the applicable mortality table under § 417(e)(3) are assumed to remain constant in determining the annual rate of accrual for each plan year after 2002.

This view is overly narrow, particularly in light of the Pension Protection Act (PPA). PPA clearly contemplates cash balance plans that will provide market-based returns. Further, those returns may, in any given year, be negative (even though there is a preservation of capital rule). If, in a given year, the crediting rate is negative and that negative return is presumed to continue indefinitely for testing purposes, backloading under the test can quickly result. However, clearly prolonged negative returns are an unrealistic expectation. Accordingly, testing should be based upon a realistic expectation of future interest crediting rates, not just the one more recent rate. For example, hybrid plans should be permitted to be tested using a long-term average of the index used for the interest crediting rate. Such an approach would be consistent with the existing regulation 1.411(b)-1(b)(2)(D):

> (D) Social security, etc. - For purposes of this paragraph, for any plan year, social security benefits and all relevant factors used to compute benefits, e.g., consumer price index, are treated as remaining constant **as of the beginning of the current plan year** for all subsequent plan years. [Emphasis added]

As of the beginning of a year, the return on a market-based index is unknown. It is the expectation of that return that is more relevant to the plan's design and value to the participant. A reasonable expected value of the interest crediting basis as of the beginning of the year would be more aligned with the existing regulation and with the clear intent of PPA.

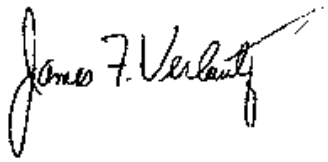
Testing methodology under the 133 1/3 percent test – Plan amendments

Revenue Ruling 2008-7 also provided, for the first time, guidance for testing cash balance conversions when a prior formula is continued for any period of time. The ruling clarifies that a pure wear-away design (i.e., when the cash balance formula with opening balance is subject to a minimum equal to the prior plan benefit frozen at conversion) does not cause a violation of the 133 1/3 percent test. We agree with that position since it is consistent with the amendment rule in IRC 411(b)(1)(B)(i). However, a temporary greater-of design, where benefits under the prior plan formula cease to accrue at a stipulated future date (e.g., five years after conversion), can cause a violation of the 133 1/3 percent test because the freeze of the prior formula must be anticipated in the testing. In light of the combination of the amendment rule and the deferred effective date rule in

IRC 411(b)(1)(B)(ii), as well as the explicit example in Regulation 1.411(b)-1(b)(2)(ii)(B) clearly demonstrating that future changes in accrual rates are to be ignored in current testing, we see no basis to treat these deferred wear-away situations any differently than the pure wear-aways. That is, before the deferred prior-plan formula freeze takes effect, testing should be performed as if the freeze will not take effect (per subparagraph (ii)); and once the freeze has occurred, testing should be done without regard to the prior plan formula (per subparagraph (i)). This is the same testing approach that would be required had the prior-plan freeze been implemented by a separate amendment immediately before it became effective, and the only approach that is consistent with the IRS's position regarding pure wear-away situations.

I thank you for this opportunity to share our thoughts on these proposed regulations. We request the opportunity to testify at the hearing on these proposed regulations scheduled for Oct. 15, 2008. Alternatively, we would be interested in meeting with you to answer any questions or discuss any of the concerns expressed in this letter. If you have any specific questions or would like more information, please contact Jessica Thomas, the American Academy of Actuaries' pension policy analyst, at 202-785-7868. Thank you for your consideration of this matter.

Sincerely,



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