



AMERICAN ACADEMY *of* ACTUARIES

CC:ITA:RU (REG-108697-02)
Room 5226
Internal Revenue Service
POB 7604
Ben Franklin Station
Washington, D.C. 20044

July 16, 2002

Dear Sir/Madam:

The Public Plans Task Force of the American Academy of Actuaries¹ would like to comment on the recently issued Required Minimum Distribution 1.401(a)(9) regulations. The task force's comments specifically concern defined benefit pension plans and temporary regulation 1.401(a)(9)-6T. Task force members serve as consulting actuaries to, or work directly for, many of the country's largest public employee retirement systems (PERS).

Temporary Regulation 1.401(a)(9)-6T A-1(a)(1) appears to require a plan's annual cost-of-living adjustment (COLA) to be no greater than the increase in the consumer price index (CPI). Many state PERS provide a fixed-percentage increase COLA, 3 percent for example, which could in any given year exceed the increase in the CPI. PERS in California, Florida, and Illinois, for instance, have fixed-percentage COLAs. Wisconsin provides a COLA based upon the plan's investment performance. Police and Fire PERS in Colorado have a COLA that provides increases based upon the increases in the wages of active workers. Even states (such as New York) that have CPI-based COLAs often have a minimum floor percentage that kicks in when the CPI is very low. This percentage may also exceed the CPI in a given year.

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.

As a part of the benefit structure, these COLAs may be constitutionally protected against diminishment under state law. Pensions are viewed as a contractual agreement, and the constitutional protection applies to both accrued and future benefits. PERS would be placed in the untenable position of not being able to conform to both state and federal statutes. It is not clear why the IRS needs to restrict COLAs in this manner. Furthermore employer choice would be dramatically reduced. We recommend this section be modified to allow for non-CPI-based forms of COLA.

We also have concerns about the new restrictions placed on the Joint and Survivor (J&S) form of benefit for non-spouse beneficiaries in which the beneficiary is more than 10 years younger than the participant (A-2(c)). It is not clear why this restriction is needed. Revenue Ruling 72-241 already requires that at least 50 percent of the present value of the benefit be distributed over the participant's expected lifetime. An option that violates this rule would not be provided. With average retirement ages in the 50s for many public systems, however, the above-described option can often be provided without even coming close to violating this 50 percent rule.

It has been our experience that this option is often chosen in the case of a retiring participant attempting to provide a future income for a disabled child. It is hard to believe the IRS would seek to take away this option in this circumstance. Public sector employees are generally not high networth individuals looking to defer receipt of benefits for tax purposes. They look to maximize receipt of benefits and will only suffer a reduction for an optional form of benefit if they have legitimate beneficiary protection concerns.

Section A-1(e) appears to forbid an optional form of benefit in which a lump-sum benefit is paid upon the death of the member in retirement. It is not clear why this form of benefit would be prohibited. With appropriate limits to the lump-sum amount, this optional form of benefit could be provided not only without violating the 50 percent rule but with reductions that are no greater than the reductions for acceptable forms of benefit (i.e. period certain and J&S benefits). A retiring participant may want to leave a lump sum at death to pay for burial expenses, or perhaps leave a lump-sum amount to a beneficiary in lieu of an annuity benefit.

We understand the IRS's goal of minimizing a retiree's ability to defer receipt of benefits and therefore defer payment of taxes. The -6T Temporary Regulation, however, seriously curtails options for defined benefit pension plan payouts. If the goal is to encourage defined benefit pension plans, these additional restrictions will certainly not help. Additionally the 50 percent rule already exists for this very purpose.

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The COLA restriction would pose an extreme difficulty for many of the PERS in this country, including many of the largest. The task force respectfully requests that this section be modified to allow for different forms of COLA benefits. Additionally the task force recommends that the restrictions on optional forms of benefit, which would also be interpreted as violations of state constitutional protections, be removed. Given the public sector's generally lower paid status, and average retirement ages well below 70 ½, these restrictions are simply not needed. If these restrictions cannot be removed, the Task Force recommends that the public sector be made exempt from these new rules.

Members of the task force would like to request a public hearing on the proposed regulations and would appreciate the opportunity to testify with respect to the issues outlined in this letter. Please call Heather Jerbi, the Academy's pension policy analyst, at (202) 223-8196 if you have any questions, or would like to discuss this matter further.

Sincerely,

Amy S. Timmons
Chair, Public Plans Task Force

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