AMERICAN ACADEMY of ACTUARIES

Mr. Lauson C. Green and Ms. Linda S. F. Marshall Nov. 29, 2007
Internal Revenue Service
Attn: CC:PA:LPD:PR (REG–113891–07)
Room 5203
P.O. Box 7604
Ben Franklin Station,
Washington, DC 20044.

RE: Comments on the Proposed Regulations under Sections 430(f) and 436

Dear Mr. Green and Ms. Marshall:

The American Academy of Actuaries[1] Pension Committee applauds the issuance of the proposed regulations under sections 430(f) and 436 of the Internal Revenue Code, as added by the Pension Protection Act of 2006 (PPA). The regulations provide guidance that is critically required by plan sponsors to ensure that their plans continue to be funded at appropriate levels and administered in accordance with qualification requirements. We eagerly await additional regulations from the Internal Revenue Service (IRS) that are also necessary for plan sponsors to achieve these goals and urge that such additional regulations be issued as soon as possible.

While these proposed regulations provide needed detail and clarity on many issues, they also leave many open questions. In addition, the lack of specific details in the regulations, particularly as they apply to timeframes and the process surrounding certifications, creates a great deal of uncertainty and potential exposure for plan sponsors and enrolled actuaries (EAs). We urge the IRS to provide guidance that is both workable and clear, so that all parties understand what is expected of them and what they can expect. We respectfully request your consideration of our comments and we are available to discuss them at your convenience.

Process and Timing Issues

The most pressing concern that we have with the proposed regulations revolves around the process and timing of benefit restrictions and certifications. In particular, plan sponsors and enrolled actuaries need to be able to apply the rules in a reasonable, practical manner and have confidence that their approaches are in compliance. We are greatly concerned that the proposed regulations do not reflect the realities of plan administration and actuarial valuation processes. For example, the proposed regulations could be interpreted as requiring the EA to certify results (i.e., the adjusted funding target attainment percentage (AFTAP)) the instant

[1] The American Academy of Actuaries is a national organization formed in 1965 to bring together, in a single entity, actuaries of all specializations within the United States. A major purpose of the Academy is to act as a public information organization for the profession. Academy committees, task forces and work groups regularly prepare testimony and provide information to Congress and senior federal policy-makers, comment on proposed federal and state regulations, and work closely with the National Association of Insurance Commissioners and state officials on issues related to insurance, pensions and other forms of risk financing. The Academy establishes qualification standards for the actuarial profession in the United States and supports two independent boards. The Actuarial Standards Board promulgates standards of practice for the profession, and the Actuarial Board for Counseling and Discipline helps to ensure high standards of professional conduct are met. The Academy also supports the Joint Committee for the Code of Professional Conduct, which develops standards of conduct for the U.S. actuarial profession.

the actuarial calculation is complete. The regulations can also be read to require the immediate application or cessation of benefit restrictions, as applicable, upon the certification of the AFTAP. Unless it is made clear that these are not the proper interpretations, many practical problems exist.

First, there is no guidance as to when a valuation is complete. This has traditionally been a judgment by the EA and plan sponsor that can be made and revised up until the actual filing of the Schedule B. Under the proposed regulations, the added importance of this decision places undue weight on both parties and inappropriately exposes them to potential liability. The regulations must provide some clarity and objective criteria and/or safe harbors on this issue.

To understand the difficulties created, it is important to realize that different constituencies will necessarily have directly opposite points of view as to whether imposing restrictions is desirable or undesirable. Based on the past and current AFTAPs, this may mean they will have directly opposite desires on the timing of certifications. Consider a lump sum restriction. A participant about to retire who wants a lump sum clearly will want the restriction to be avoided. This means delayed certification of the AFTAP if the restriction is not currently in place (assuming that the new certification would impose the restriction) and certification as soon as possible if the restriction is currently in place (assuming that the new certification would lift the restriction). Conversely, participants who will not retire for many years or who do not want a lump sum would prefer that lump sum restrictions apply so as to preserve the pool of assets available to pay their benefits. They would therefore want the exact opposite with regard to timing of certification. So, the deliberations of the EA and plan sponsor as to when to consider a valuation final could cause one or the other of these participants to claim that they were harmed by the timing of the decision.

Imagine that preliminary valuation results are very close to a restriction threshold. It is clearly reasonable for the sponsor and EA to perform further checks on the accuracy of the data and calculations and the reasonableness of the assumptions, etc., that drove the valuation. By taking this time to thoroughly ensure that they can support the results of the valuation, they are risking a claim by the participant who wants an earlier decision. By not taking this time, they risk a claim by a participant who wants a delay, who might claim that they did not exercise due diligence before certification. This is an untenable situation for EAs and sponsors and the IRS must provide guidelines or safe harbors to address it.

Second, the proposed regulation seems to call for restrictions to commence or cease as soon as the AFTAP is certified. Unless some reasonable time frame is allowed between the completion of the calculation and certification (or between certification and implementation), this is impractical. A plan sponsor will typically need several weeks to actually implement benefit restrictions. Implementing will require communication to plan participants, extensive communication and training for HR staff, modifications to and testing of administrative systems, procedures and forms, etc. Participants who have already made elections with regard to near-term annuity starting dates for which a restriction will now be imposed (or lifted) will have to have their elections revoked and will need to receive new benefit forms (with required Qualified Joint and Survivor Annuity (QJSA) notice periods) and make new elections. In some cases, instructions to asset custodians will have to be revoked. It will be impossible for all of this to happen instantaneously. In addition, the regulation itself allows for special current-plan-year contributions to avoid certain restrictions. The sponsor will need time to make a thoughtful decision on whether to make these contributions, not to mention the procedural steps necessary to actually implement the decision. Again, at any point in time different participants will have different views as to what's desirable in terms of the time taken for the implementation process.

The reality is that the plan sponsor always has had primary responsibility for seeing that the actuarial valuation is completed (beginning with the hiring of the EA and the providing of the necessary information for the EA to complete the work and culminating in final sign off on assumptions and results). PPA's benefit restriction rules add dates that potentially accelerate that process, but the responsibility still rests with the sponsor and the regulations should acknowledge this. Accordingly, we suggest that the IRS consider the following steps to address these concerns:

- The regulation should clarify that the final decision on when a valuation is complete belongs to the plan sponsor. This must be the case since it is the plan sponsor who selects the EA.

- Once the valuation is deemed complete by the plan sponsor, the certification should be provided by the EA only in response to a written request by the plan sponsor. This request would typically accompany the decision that the valuation is complete. The EA should not be permitted to issue a certification prior to such a request, other than a preliminary certification as discussed below.

- The EA could be asked to provide a preliminary certification to the sponsor, which in many cases may prove to be identical to the final certification. This preliminary certification would not be binding and would have no impact on benefit restrictions. The plan sponsor would use this information to initiate any further review of the valuation, to prepare for the implementation or cessation of benefit restrictions and to make decisions regarding special contributions to avoid restrictions.

Further, it would be helpful if the IRS would issue a model certification or prescribe a form. At a minimum, the IRS should describe in detail the information required to be in the certification. In addition, the proposed regulation should make clear that an EA can make such a certification contingent upon the accuracy of the plan document, demographic data, and asset information provided to the EA by other parties.

Events Early in the Plan Year

Another issue related to timing is an amendment or shutdown benefit taking place before the calculation is certified, perhaps on Jan.1. The proposed regulations seem to presume that asset information as of Jan.1 is available on that date; so that the EA can determine whether a shutdown benefit or a plan amendment is permissible. Unaudited asset information typically arrives a few weeks after the valuation date and audited asset information is generally not available until even later. In addition, the proposed regulations seem to presume that the impact of a plan amendment or shutdown benefit on valuation results can be evaluated as of its effective date. This is not the case, since even the affected population as of the effective date will generally not be known until some time after that effective date. This issue was raised in a recent American Benefits Council (ABC) call with IRS/Treasury officials who seemed to content that one could determine the permissibility of the amendment or shutdown benefit by using an estimate based on prior year data and/or prior year AFTAP. At the very least, such informal guidance must be made more formal. However, we suggest the guidance go further and call for *all such determinations* to be made based on the prior actuarial valuation until the current calculation is certified. It is simply not possible to know the impact of a shutdown or plan amendment as of the date it occurs.

Use of Current Year Assets

The regulations require the use of current-year asset values in applying the benefit restrictions and determining required credit balance reductions and/or special contributions required to avoid restrictions. This presents several problems. As discussed above, asset values will often not be available until several weeks (or months for atypical asset classes) after the start of the plan year. Plan sponsor elections regarding the funding standard carryover balance (FSCB) and prefunding balance (PFB), which affect plan assets, are not required to be made until months later. Audited asset statements may ultimately differ from unaudited statements. What is a sponsor to do in the absence of information? At a minimum, we suggest that the restrictions be determined based on prior year asset values and AFTAPs until such time as audited asset values are available or the current year valuation is certified. If audited assets are not to be required, then we suggest that it be made clear that any differences between unaudited and audited asset values will not cause a violation of benefit restriction rules.

More broadly, though, we question why current-year assets are used at all during periods when presumptions under (h)(1) and (h)(2) are in effect. Their inclusion creates many issues, such as those discussed above. Yet their inclusion seems to add nothing except complexity to the process. At first blush, it might appear that the use of current assets adds more current information. Further inspection shows, however, that this is not the case. These current assets are used with the presumed AFTAP from the prior year to create a fictitious funding target to be used in the benefit restriction test. This fictitious funding target has no meaning and, in fact, it may increase substantially as of the fourth month of the year when the presumed AFTAP goes down. These contrived calculations add confusion and delay and may not result in a more appropriate determination as to whether or not restrictions should apply.

If the idea is to allow for the reflection of expected-funded status changes in the calculation, this is a laudable goal. However, the process fails to do this. If asset values increase, either due to favorable experience or employer contributions, the assumed funding target will increase as well under the proposed process. So the AFTAP and the status of the plan with regard to benefit restrictions are effectively unchanged by the new asset value. If the new asset value was truly reflected, the AFTAP should improve. We would be happy to discuss methods under which actual asset values and liability estimates can be used in the process to better reflect current information. However, our understanding is that the IRS does not want to include estimates of any kind for this purpose. If that is, in fact, the position of the IRS, then the fictitious funding target estimates should also be eliminated. We recommend that the use of current year asset values be eliminated for all aspects of benefit restrictions that are tied to presumed funded status. Instead, all calculations should be performed with reference to the prior year certified AFTAP and the prior year funding target and asset values that went into that AFTAP.

Contributions Receivable

For 2008, the regulations allow for future contributions for the 2007 plan year to be included in assets in certifying the AFTAP if “they are reasonably expected to be made.” However, given the nature and consequences of the judgment to be made, we recommend that the

IRS prescribe a process upon which the EA may rely in determining what is reasonable to expect. "Reasonable" is a subjective term that is often colored by hindsight. It is easy to envision situations where the EA considers it reasonable to expect contributions to be made and those contributions ultimately are not made due to circumstances or facts that were not and could not be known at the time the certification was made, based on the content of normal actuarial work. Examples of such circumstances include an individual of proper authority expressing to the EA in writing an intent to make contributions but later leaving the plan sponsor, or the development of unanticipated financial difficulties for the plan sponsor. In such situations, the EA could be vulnerable if participants claimed they were adversely affected by restrictions not in place due to the EA's decision to include such contributions.

We suggest that it be explicitly indicated that contributions are reasonably expected to be made if an authorized representative of the plan sponsor (CFO, treasurer, controller, VP, HR, etc.) commits to make such contributions in writing to the plan administrator. The administrator would then provide a copy of the commitment to the EA. The EA will typically not have the knowledge and should not be expected to evaluate the plan sponsor's ability to fulfill this commitment. Alternatively, the regulation could state that the decision to include contributions receivable is the plan sponsor's and the EA could disclose that such amounts were included at the direction of the plan sponsor on the certification.

Beyond 2008, we see no reason why a commitment from the plan sponsor to the plan administrator to make future contributions for the prior plan year should not be considered assets of the plan on the same basis as they can for 2008.

Conditional Contributions

In the event that the actual current year AFTAP is not known by the date that benefit restrictions would apply (based on the presumed AFTAP), we suggest that a written commitment by the plan sponsor to make whatever contributions are necessary to avoid such restrictions once the valuation is certified should be sufficient to avoid such restrictions. More specifically, the regulations should specify that it is acceptable for an EA to issue a range certification based on a plan sponsor's written commitment to the plan administrator that the plan sponsor will make contributions sufficient to raise the plan's AFTAP to 60 percent, 80 percent or 100 percent, without specifying the dollar amount of such contribution. A similar rule should apply to credit balance reductions as well.

Extension of Range Certification

Similarly, consider a plan that is clearly overfunded, but is having difficultly finalizing the AFTAP by Oct. 1. Restrictions will begin to apply, even though such restrictions are clearly unnecessary and are harmful to participants.

To avoid such outcomes, plan sponsors need additional flexibility around the application of the benefit restriction rules related to the start of the 10th month of the plan year. We describe below an alternative set of rules that would provide sponsors with needed flexibility for this purpose:

a. Clarify that a best-estimate certification using best available data and subject to the no harm, no foul rule would be acceptable with respect to the 10th month certification. (Alternatively, extend the range certification concept to this measurement date.)

b. Require a final certification by year-end for purposes of the presumption rules at the start of the following year [Code section 436(h)(1)].
c. Allow for contributions to correct any shortfall based on the final funding target versus the prior best estimate. Such contributions, if made prior to the final certification date, could be added to plan assets in determining the AFTAP under the final certification. (We respect that this last point may require a technical correction to the statute and have requested such consideration in the Academy's letter to the House Ways and Means Committee.)

Such a set of rules will significantly reduce the compliance challenge faced by many plan sponsors, as well as lessen the number of well-funded plans that be ensnared by the benefit restriction rules.

Contributions in Excess of the Minimum Requirement

Currently, the proposed regulation describes several ways to avoid benefit restrictions. Among these are making contributions for the second prior plan year, which can improve the prior year AFTAP and therefore improve the presumed AFTAP for the current year. We suggest that an additional method be available, namely that the sponsor be able to adjust the presumed AFTAP to include contributions in excess of the minimum for the prior plan year and credit balance reductions as of the beginning of the current year. Under the regulations as written, these options are available only for the actual current year AFTAP after the current year calculation is completed. Due to the difficulty of completing the valuation by the start of the fourth month, we recommend that these options be available for the presumed AFTAP as well.

As an example, imagine a plan with an AFTAP for 2007 of 88 percent and no credit balance. Such a plan would become subject to the restriction on accelerated benefit distributions in April 2008, as the AFTAP is presumed to decline to 78 percent, unless the 2008 valuation was completed and certified to be over 80 percent. We suggest that the sponsor be permitted to make a 2007 plan year contribution in excess of the minimum for 2007 such that the present value of this contribution as of Jan. 1, 2008 would increase the presumed AFTAP from 78 percent to 80 percent. This option would be similar to having made a contribution for the second prior plan year, but it would give the sponsor more time to make such a contribution in the event that the sponsor was unable to complete the valuation by the start of the fourth month of the year.

Because of the short amount of time that was provided between publication of the proposed regulation and the due date for final 2006 plan year contributions, we believe that at a minimum such a provision should be in place for 2008.

Plan Amendment Issues

Mid-year Plan Amendments and Shutdown Events

Paragraph (g)(6) specifies that if multiple shutdown events or plan amendments occur during a plan year, the increase in funding target attributable to a later event or amendment is deemed to include the increase attributable to earlier events or amendments, for the purpose of determining whether benefits triggered by the later event can be paid or for determining whether the later amendment can take effect. The currently proposed language can be read to apply to amendments separately from shutdown events and vice versa. Under this reading, for example, the determination of whether a later amendment would take effect would not take an earlier shutdown event into account. In this example, we think that the IRS probably intends the earlier shutdown event to be taken into account. If this is the case, we recommend that the regulatory language makes it clear that the analysis for a plan amendment would take all earlier shutdown events in the plan year *and* amendments in the plan year into account, and that the analysis for a shutdown event would similarly take all earlier shutdown events *and* amendments into account.

Moreover, the regulations should specify what, if any, adjustment is made to the year's AFTAP to reflect such shutdown events and plan amendments for the purpose of determining the presumed AFTAP for the following year. As there is no provision for such an adjustment in the regulations as proposed, we believe that the only interpretation would be that once it is determined that shutdown or amendment benefits are permissible, the impact of these benefits is disregarded in carrying forward the AFTAP to the following year for the lookback calculations. As an example, assume a plan has a certified AFTAP of 90 percent for a plan year and that a mid-year amendment is adopted that would decrease the AFTAP to 75 percent. The sponsor chooses to make a special contribution to increase the AFTAP back to 80 percent so that the amendment is permitted to take effect. In applying the lookback rules in the following year, it would seem as if the AFTAP would still be 90 percent, as there is no provision for reflecting the amendment or the special contribution. This does not seem consistent with the intent of benefit restrictions and we recommend that the regulations require the AFTAP for the lookback rules reflect any changes to the AFTAP due to mid-year plan amendments, shutdown events, and associated contributions or security.

Testing Dates

We recommend the addition of examples that clarify that limitations on plan amendments are determined based on the actual effective date of each change in the plan that increases benefits, rates of accrual, and so forth. Testing for a limitation on a plan amendment does not occur on the adoption date *per se*, and funded status does not appear to prevent the adoption of an amendment—it appears only to prevent the amendment from going into effect. Consider, for example, an amendment adopted July 1, 2008 that provides for a "laddered" series of benefit increases effective July 1, 2009, July 1, 2010, and July 1, 2011. The plan's AFTAP as of July 1, 2008 is unaffected by this amendment and in no way prevents its adoption. Each actual increase (and that increase only) would appear to be tested against the rules on limitation of amendments as of the actual effective date of such increase. If, for some reason, the amendment contains a stated nominal effective date as of which no benefit changes actually occur, the nominal effective date should be ignored for purposes of amendment limitations. In the above example, if the amendment is adopted July 1, 2008 for an effective date of July 1, 2008 and provides the same laddered series of benefit increases effective July 1, 2009, July 1, 2010, and July 1, 2011, the amendment should not be tested for possible benefit limitations as of the nominal July 1, 2008 effective date, because that date does not actually trigger any changes in benefits. We recommend that the regulation contain these clarifications.

Beyond the requirement that an amendment that is prevented from taking effect based on presumed AFTAP must be made effective at its original intended effective date if the actual certified AFTAP would allow it, the proposed regulation does not address the issue of intended amendments becoming effective at future dates should the AFTAP improve. For example, imagine an amendment with an effective date in 2008 that was prevented from taking effect because of the presumed and actual AFTAPs. If the AFTAP improves in 2009, must the amendment become effective? If so, must it be retroactive to 2008? For all participants or just participants who are active in 2009? Can the amendment be removed from the plan if it is not allowed to become effective? We recommend that amendments that were prevented from becoming effective revert to that status only upon a restorative amendment to the plan. It would be a significant administrative burden for a plan sponsor to be required to test past amendments at all 436 measurement dates, and a financial hardship to the sponsor to have the effect of these amendments looming any time funded status improves. At the very least, it should be clarified that such amendments can be removed from the plan without violating anti-cutback rules.

Language Clarifications

In proposed regulation 1.436-1(a)(4), it is not completely clear when an "ad hoc" amendment is being envisioned (to restore benefits lost due to benefit restrictions that have *already* occurred and then ceased to apply) and when a more general amendment to provide automatically for restoration is being envisioned (to restore benefits after the *future* occurrence and cessation of a restriction). It appears that "ad hoc" amendments are envisioned in (a)(4)(ii)(A) and (iii), while an automatic amendment is envisioned in (a)(4)(ii)(B). We recommend that the intended distinctions be drawn more clearly. It is also not clear whether "restoration" means the prospective reinstatement of benefit accruals or retroactive make-up accruals.

In the example in Prop. Reg. 1.436-1(a)(4)(iv), the statement that restrictions on accelerated payment *begin* Jan. 1, 2011 is confusing, since it seems clear that the AFTAP was 75 percent for 2010 and that the restrictions were therefore already in place before the 2011 plan year began. We recommend that the example be re-worded to make this clear.

With regard to the exception for "keep-up-with-wages" amendments (Prop. Reg. 1.436-1(c)(3)), it is not clear whether one is required to calculate the increase in an average or the average increase. In (c)(3)(i), the wording seems to focus on the increase in an average, implying that an average wage rate is calculated over a group of participants as of a certain point in time, a second average is calculated as of a second point in time, and the two averages are compared. However, in (c)(3)(ii), the language seems to switch to the concept of calculating increases in wages over a period of time for each individual, and then averaging the increases. Depending on the approach that's intended, additional clarification may be needed with regard to individuals who first become participants during the period in question.

Increases in Limits

The proposed regulation should clarify whether or not automatic increases in 415 and 401(a)(17) limits are to be treated as amendments subject to potential restriction. We understand that it is the view of the IRS that while 415 is subject to potential restriction, 401(a)(17) is not . If so, this view should be confirmed. We would also request clarification of the same issue with respect to automatic cost of living adjustments (COLAs) that are part of the accrued benefit.

Quarterly Contributions and Credit Balance Reductions

The proposed 430(f) regulation describes the maximum addition to the PFB in great detail and also provides timeframes for making credit balance elections. However, there is no discussion regarding the satisfaction of quarterly contributions when a credit balance is present. Is having a funded credit balance that exceeds quarterly contribution requirements sufficient to satisfy those requirements, or is an explicit election required as of each quarterly due date to use this credit balance as an offset to the quarterly requirement? As an example, consider a plan with quarterly contributions of $100 per quarter and a funded FSCB of $400. Must the sponsor make a quarterly decision either to contribute $100 or to make an election to use $100 of the FSCB? Or, is the mere existence of the FSCB enough to satisfy the quarterly requirements, with any elections regarding a reduction to the FSCB to be made in the normal time frame of the 5500 date?

Interaction Between 2007 Certification and 2008 Elections with Regard to the FSCB

The proposed 436 regulation creates a strong incentive for certification of the AFTAP for the pre-effective (e.g., 2007) plan year by the last day of that plan year. Otherwise, the 2007 AFTAP is presumed to be less than 60 percent, and shutdown benefit and amendment restrictions appear to begin the first day of the first effective plan year (e.g., 2008). (However, see our earlier comments on this aspect of the proposed regulation.)

For purposes of this 2007 AFTAP calculation, assets are in many cases reduced for the credit balance as of the valuation date for the 2007 plan year. However, that reduction does not occur to the extent (on a present-value basis) that the employer elects to reduce the FSCB as of the first day of the 2008 plan year. Can we presume that such an election can be made before 2008 in order to reflect it in the 2007 AFTAP certification before the end of the 2007 plan year? More generally, is a FSCB created automatically as of Jan. 1, 2008 for a plan with a positive balance in its funding standard account as of the end of 2007, as is implied by the language in proposed regulation1.430(f)-1(b)(2)(i)? Or must the sponsor make an explicit election to maintain a FSCB, as seems to be the case under proposed regulation 1.430(f)-1(a)(1)? If the latter is the case, and for purposes of the 2007 AFTAP, is the impact of making no election to maintain a FSCB the same as electing to maintain one and electing to reduce it as of Jan. 1, 2008? Since in some cases, elections need to be made by Dec. 31, 2007 for purposes of the 2007 AFTAP, the timing and specific mechanisms for the election process must be quickly clarified.

Collective Bargaining Provisions

The proposed regulation contains special provisions for collective bargaining agreements that are difficult to interpret. First, it is not clear how these provisions apply to plans in which collective bargaining agreements cover some but not all participants. The standard contained in the proposed regulation is that such provisions apply to a plan if “at least 25 percent of the participants in the plan are members of collective bargaining units for which the benefit levels under the plan are specified under a collective bargaining agreement.” Should this standard be applied to all participants or just to active plan participants? We recommend that the 25 percent test be performed solely with respect to active participants.

Also, does it matter whether or not benefits are frozen for a group of active participants? Are they still considered participants for purposes of both the numerator and the denominator of the 25 percent test? We recommend that they be counted for purposes of this test, regardless of whether or not their benefits are frozen.

A second interpretive issue revolves around the effective date. The effective date for the regulations may be delayed if the plan is maintained pursuant to a collective bargaining agreement “ratified” before Jan. 1, 2008, but such delay does not extend beyond the termination date of the last collective bargaining agreement, disregarding any extensions agreed to after Aug. 17, 2006. For example, if the terms of the agreement are evergreen will the delay always apply? If an agreement was set to expire in 2007 and a modified agreement was adopted, is this a new agreement or an extension? Does the answer to the previous question depend on whether benefit or other provisions of the agreement have changed? We suggest that any agreement that contains any change to the previous agreement, regardless of whether the change affects plan benefits, not be considered an extension. The plan is thus eligible for the delayed effective date.

Payment Options Under Partial Lump Sum Restrictions

The proposed regulations present serious complications in plan administration for plans with partial lump sum restrictions, including the requirement to bifurcate the benefit into restricted and unrestricted components, each with separate benefit elections.

Since changes in the menu of options under benefit restrictions and elections are often made several months in advance (when it may be unclear what restrictions, if any, will apply at commencement), plan administrators and participants may need to process multiple sets of election forms to cover these contingencies. We have developed examples in which participants may be required to make four separate elections with respect to a single annuity starting date in order to receive benefits under a partial lump sum restriction. Additional elections that may be required after the restriction ends only complicate matters further.

We recommend an alternative that we feel is both closer to the original intent of the statute and more manageable for plan administrators and participants. Our proposal is to mirror the well-established rules for paying out restricted accelerated payments to top-25 employees under §1.401(a)(4)-5(b)(3). This application achieves the same result in terms of protecting plan assets during restrictions while only the current structure of payment options needs to be preserved and communicated. In the event a participant elects a prohibited payment, half of the benefit can be paid out immediately while the remainder is paid out in an amount no greater than the life annuity benefit. The restricted amount, originally half the lump sum benefit, is adjusted for interest and subsequent payments. When the restriction ends, the balance of the restricted amount is paid to the participant.

Compared with the approach taken in the regulations, this alternative (a) is based on a single election, (b) does not require multiple sets of 417(e) factors, (c) is more consistent with statutory language, (d) is as effective as the proposed regulations in protecting plan assets during partial lump sum restrictions, and (e) eliminates life contingencies related to the benefit election. This last point may be very important to a participant with a short life span, who might otherwise be unable to secure the full value of his retirement under benefit restrictions.

Level Income Options

Section (d)(3) of the proposed regulation provides that when the AFTAP is between 60 percent and 80 percent, a plan faces partial restrictions on accelerated distributions. Specifically, it states that a prohibited payment may be made only if the present value of the portion of such payment that is in excess of the life annuity (plus any temporary supplement, if applicable) does not exceed the lesser of 50 percent of the present value of the benefit or 100 percent of the Pension Benefit Guarantee Corporation (PBGC) guarantee amount. If the prohibited payment is not permitted, then the sponsor must provide the participant with the option to defer the payment or to bifurcate it into restricted and unrestricted portions.

The application of these provisions to accelerated distributions other than lump sums (such as level income and installment options) is unclear and requires further guidance. As an example, consider a participant in a plan with a 70 percent AFTAP who, without considering restrictions on accelerated payments, could receive a life annuity of $1,000 per month or a level income option that pays $1,400 per month until age 62 and $800 per month thereafter. We would suggest that the present value of $400 ($1,400 to $1,000) per month to age 62 would be compared to 50 percent of the present value of the $1,000 per month life annuity (or 100 percent of the PBGC guarantee, if less). If the present value of the $400 temporary benefit was the lower amount, then the benefit would be permitted to be paid, despite the restriction on accelerated distributions. On an ABC call, an IRS official suggested that the comparison would be based on a $600 temporary benefit ($1,400 to $800), instead. We believe that this is not the proper approach under the statute, as acceleration of payments should be measured against the life annuity that is otherwise available to the participant and not against the lower amount within a level income option. Regulations should include examples that illustrate the proper application of these provisions, including the development of the unrestricted and restricted amount when applicable.

In addition, it would be helpful if an example confirmed that the last sentence in 1.436-1(d)(3)(ii)(A) permits a plan to offer a level income option that is adjusted just enough so that the present value of the acceleration meets the “50 percent /PBGC” test and the full adjusted option is therefore permitted to be paid. In the example above, such an adjusted LIO would pay, say, $1,300 per month until age 62 and, say, $850 per month thereafter.

We recommend that the regulation explicitly state that the level income option is a form of accelerated payment potentially subject to the restrictions of 436(d). Based on comments by Treasury officials, we assume that it is, and we’ve based our comments above on that assumption. However, the proposed regulation does not seem to mention the LIO specifically, and in view of the past years of discussion over the LIO in other contexts, we recommend that this question be dealt with explicitly in the context of benefit restrictions.

Errors / New Information

The regulations should provide guidance regarding modifications to certifications and benefit limitation status due to errors that are detected after such certifications have taken place. While not at all common, it is certainly not unheard of for errors—such as changes to reported asset values or participant data— to be detected after a valuation has been completed (and, in the future, certified). This could result in a potentially retroactive change in status of benefit limitations, which could trigger qualification issues despite good faith efforts by all parties to adhere to the appropriate rules. We recommend that the regulations provide safe harbors within which calculations will not need to be revised, as well as reasonable time frames to make corrections without qualification issues being raised. There should be no requirement to retroactively change benefit restrictions as long as the certification was made in good faith.

Participant Notification

The PPA requires that participants be notified within 30 days after a plan becomes subject to limitations on accelerated distributions or shutdown benefits. The PPA also requires notification of a plan becoming subject to restrictions on benefit accruals within 30 days after the valuation date for the plan year in which the AFTAP is, or is presumed to be, less than 60 percent. Since calculations will rarely be completed within 30 days of the valuation date, this requirement is impractical. We recommend a clarification in the regulations that, for this purpose, the valuation date is the 436 measurement date on which such restrictions begin to apply. The regulation should also clarify whether further participant disclosure (i.e., a 204(h) notice) is required. We recommend that such notice not be required since it would be redundant.

Current Liability Definition

The proposed regulation uses current liability to determine the 2007 AFTAP. It does not specify which current liability to use if there is a difference between the “top-of-range” current liability used for the 2007 plan year for gateway purposes with regard to the additional funding charge under IRC section 412(l)(9)(C)(ii), and the current liability used by the plan more generally for minimum funding purposes under 412(l). This same question applies with regard to the pre-effective plan year funding ratio for purposes of determining whether a plan is at least 80 percent funded and can use FSCB against 2008 minimum funding requirements (Prop. Reg. 1.430(f)-1(h)(5)(ii)). We understand that in the view of IRS/Treasury officials, the plan’s general current liability, not the top-of-range current liability, is used for these purposes. The regulation should explicitly address this question.

Thank you for your consideration of these comments. We would be happy to discuss them more fully with you at your convenience. Please contact Samuel Genson, the Academy’s pension policy analyst (202.223.8196; Genson@actuary.org), if you have any questions or would like to discuss these items further.

Sincerely,

James F. Verlautz, MAAA, EA, FCA, FSA
Chairperson, Pension Committee
American Academy of Actuaries