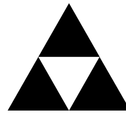

AMERICAN ACADEMY *of* ACTUARIES

October 23, 2002

CC:ITA:RU (Notice 2002-46)
Courier's Desk
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC

Re: Modifications to Section 411(d)(6)

Dear Sir/Madam:

Members of the Pension Committee of the American Academy of Actuaries[1] appreciate the opportunity to present our ideas on ways to eliminate certain optional forms of benefit payment in a defined benefit plan without violating the anti-cutback rules of IRC Section 411(d)(6). In the comments that follow, we suggest a framework that should ease the administrative burden for defined benefit plans without compromising the retirement security of their participants.

Reason for Change to Current Rules

The administration of many optional forms of benefits has become burdensome for plan sponsors for many reasons, including:

- Current plans may be the result of the merger of several other plans, each with grandfathered benefits and applicable optional forms. In some of these plans, calculating benefits can be quite difficult and plan administrators must maintain complex databases of prior grandfathered benefits, forms, and the equivalence factors used for those forms.
- Plan sponsors who use prototype plans also run into complexities if they want to change vendors and the new vendor's prototype does not allow some of the plan's optional forms of payment.

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.

- Plan designs and plan goals have changed over time. Optional forms of payment that made sense or were needed in the past may not be necessary any more. For example, plans may have several similar options (e.g., 5-, 10-, 15- and 20-year certain and continuous annuities), many of which are not elected by plan participants since these options may not be perceived as worthwhile by today's participants; however, the plan sponsor must calculate and communicate each of these options as participants commence their benefits.

Standard Test

First, the Academy suggests that there should be a standard test to identify whether an optional form of payment is "subsidized." This would be determined by comparing:

(a) The factor used to convert from the normal form of benefit payment to the optional form of benefit payment at the specified benefit commencement age, to
(b) The factor that would be used to convert from the normal form of benefit payment to the optional form of benefit payment at the specified benefit commencement age using actuarial equivalence as defined in IRC Section 417(e), or such other basis of reasonable assumptions as determined by the plan's enrolled actuary, under Actuarial Standards of Practice 27 and 35.

An optional form of payment would be deemed "subsidized" if (a) is greater than (b) by more than 5 percent. This also includes optional forms of payment that involve a temporary annuity on a subsidized basis (e.g., a Social Security leveling option in connection with a heavy early retirement subsidy where there are no pension plan payments after the assumed Social Security commencement date).

Determination of whether the optional form of payment is "subsidized" would occur at all early benefit commencement ages under the plan.

If an optional form of payment were "subsidized," then it could not be eliminated from the plan without either:

(a) offering an unlimited, immediate lump-sum payment option where the lump-sum payment includes the value of this subsidy, or
(b) including the value of this subsidy in the amount of the normal form of benefit payment.

The first alternative would be similar to a defined contribution plan distribution, with the rationale that the money could be rolled over to an IRA and a similar payment stream could be duplicated.

Non-excludable Payment Options

We suggest that certain forms of payment could never be eliminated from a defined benefit pension plan. These include:

(a) a straight life annuity option, or another such form that would be automatically paid to an unmarried participant under the plan.
(b) a qualified joint and survivor annuity (QJSA), which is deemed to be the most valuable optional form of payment under the plan and, therefore, could not be eliminated.
(c) a joint & survivor annuity option with a non-spouse beneficiary that offers the same post-death benefit continuation percentage as a QJSA with a spouse beneficiary.

Continuation Percentages & Certain Periods

If a plan provides several optional continuation percentages under joint and survivor options, we suggest that all options other than the highest and lowest continuation percentages could be eliminated. If a plan provides several optional certain periods under certain and continuous options, all options other than the highest certain period can be eliminated unless one of the options being eliminated is more subsidized than the option with the highest certain period. In that case, all options other than the option with the highest certain period and the option that is most subsidized could be eliminated.

Threshold

As a threshold matter, an option could be eliminated only if it satisfied either a low utilization test, a lump-sum test, or if the elimination wass the result of good faith bargaining between the employer and the collective bargaining unit covered by the plan. A low utilization test could be satisfied if a plan met a threshold such as:

(a) it had been elected by fewer than 5 percent of the participants who have commenced benefit payments during the 5-year period preceding the date of the change, and the plan had more than 50 retirements during that 5-year period, and/or
(b) it had been elected by fewer than 10 percent of the participants who have commenced benefit payments during the 5-year period preceding the date of the change, and the plan had less than 50 retirements during that 5-year period.

An option would satisfy the lump-sum test if the participant was offered an unlimited, immediate lump sum payment option where the lump-sum payment included the value of any subsidies in the eliminated option.

Participant Notification

Another suggested method for eliminating an option would be to provide notification of the elimination to all affected employees. This would be an alternative if the other requirements discussed above are not met. The notification should be required to explain the option being eliminated and that employees have 90 days from the date of the notice to object to the elimination. If the employer received no objections within that 90-day period, the option could be eliminated.

Members of the Academy's Pension Committee appreciate the opportunity to provide comments. We would be delighted to discuss our ideas with you at your convenience. Please contact Heather Jerbi, the Academy's pension policy analyst, at 202/223-8196, or me directly at 212/251-5317, if we can be of assistance.

Sincerely,

Donald J. Segal, FSA, MAAA
Chair, Pension Committee
American Academy of Actuaries

Members of the American Academy of Actuaries Pension Committee include:

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