

Intersector Group Meeting with the Internal Revenue Service and the Department of the Treasury

April 16, 2015

Notes

The Intersector Group is composed of two delegates from each of the following actuarial organizations: American Academy of Actuaries, Society of Actuaries, Conference of Consulting Actuaries, and ASPPA College of Pension Actuaries. Twice a year the Intersector Group meets with representatives of the U.S. Department of Treasury (Treasury Department) and the Internal Revenue Service (IRS) to dialogue with them on regulatory and other issues affecting pension practice. Attending from the Intersector Group were: Tom Finnegan, Don Fuerst, Eli Greenblum, Eric Keener, Heidi Rackley, Maria Sarli, and Josh Shapiro. Matthew Mulling, Academy staff supporting the Intersector Group, also attended.

These meeting notes are not official statements of the Treasury Department or the IRS and have not been reviewed by its representatives who attended the meetings. The notes merely reflect the Intersector Group's understanding of Treasury Department/IRS representatives' views expressed at the meeting, and are not to be construed in any way as establishing official positions of the Treasury Department, the IRS, or any other government agency. The notes cannot be relied upon by any person for any purpose. Moreover, the Treasury Department and the IRS have not in any way approved these notes or reviewed them to determine whether the statements herein are accurate or complete.

Questions were submitted to IRS/Treasury in advance and are shown in bold typeface below.

1. Update from IRS/Treasury

- a. Working steadily on projects.
- b. The IRS/Treasury representatives indicated that they had given an extensive update at the Enrolled Actuaries Meeting earlier in the week.

2. Mortality tables—timing and process for 2016 tables, later years

We discussed mortality and the timing required for 2016 tables.

The Intersector Group indicated that since plans can use a five-month look-back for interest rates (to August for a calendar year stability period), election packages for January 2016 benefit commencements could be sent out as early as mid-September.

If the 2016 Code Section 417(e) mortality table is simply a new static table (e.g., the RP-2000 mortality table updated with another year's mortality improvement using Scale AA, or an RP-2014 based table with a static projection), having the rates by August should be sufficient for plan administrators.

But if the structure of the table were to change, much more lead time would be needed, particularly given the many spreadsheet programs used for benefit and relative value calculations.

The IRS/Treasury representatives indicated that a change away from the current RP-2000 tables with projection scale AA must come through regulation – IRS could extend current basis for 2016 without a regulation but would need at least a temporary regulation to change the underlying table and projection scale.

The IRS/Treasury representatives asked what percentage of plan sponsors currently uses generational mortality for funding. The Intersector group said it was uncommon for large plan sponsors and even less common for small plan sponsors.

3. Hybrid plan transition rules—timing of final regulations

- a. The Intersector Group mentioned a number of unclear issues in the final regulations:
 - i. whether plans with whipsaw or early retirement subsidies in the lump sums can pass age discrimination using rules for indexed benefit plans;
 - ii. whether plans with impermissible lookback periods must move to the “closest” permissible period;
 - iii. the consequences of too great an early retirement subsidy (the immediate annuity benefit for a younger worker being larger than for a similarly situated older worker);
 - iv. whether plans may round rates to the nearest multiple of 10 or 25 basis points;
 - v. various questions surrounding return-based plans, etc.

It will be very difficult for plan sponsors to come into compliance if the final regulations are not clarified at the same time the proposed transition regulations are finalized. Even if everything is made clear by June, it will be a challenge for sponsors of plans with noncompliant rates to analyze their choices, make decisions, and implement amendments by December 31, 2015. More time is needed.

The IRS/Treasury representatives seemed to believe enough time had already been given from when the proposed and final regulation package was released in September 2014.

The Intersector Group advocated for delaying the effective date of the final rules to give IRS time to provide needed guidance (even if informally, via Employee Plans News, Gray Book Q&As etc.) on the various unanswered questions under the final regulations.

- b. The IRS/Treasury representatives reiterated their belief that their closed approach to transition is the way to go (even if things that are clearly not above

market thus need to be changed) because everyone needs certainty around the rules.

The Intersector Group discussed the effects of the uncertainties listed above (and others) as to what the final rules mean (if not resolved) and suggested that if plan sponsors could not be comfortable that their plans would survive an audit five years hence because of an unclear issue, it was just another reason to consider freezing it.

4. Permanent nondiscrimination testing relief for closed plans

The IRS/Treasury representatives indicated that they are working on regulations that will provide a measure of permanent relief, and are making good progress on this. However, the permanent relief may be more limited than the temporary relief provided in Notice 2014-5 and extended by Notice 2015-28.

The IRS/Treasury representatives also indicated that they may be more limited in their statutory authority to provide relief from the Code Section 401(a)(26) minimum participation rules.

5. Pension equity plan (PEP) guidance and determination-letter (D-letter) status—is IRS moving ahead with D-letters based on field directive? Where does the guidance stand?

The IRS/Treasury representatives said PEP guidance is still planned but is not currently a priority.

The Intersector Group indicated that IRS D-letter examiners had begun moving on PEP D-letters based on last fall's field directive. They are generally requiring language to be added to the plan that "the plan will not violate Code Section 411(b)(1)(G)" retroactive to the date the plan became a PEP. But examiners are not identifying what exactly that means in terms of benefit calculations. Further, they are not requiring any other changes in plan terms to effectuate this requirement.

Thus there is a concern among practitioners and sponsors that plan sponsors who adopted their plan believing it did not violate Section 411(b)(1)(G), who may or may not at this point understand what changes to benefits they might have to make to satisfy the provision they have now added to their plan, may discover five years hence on audit—or when PEP guidance is issued—that they have a big liability for past benefit changes (which if they knew it now might lead them to freeze the plan and the uncertainty now could lead them to freeze the plan anyway to mitigate their exposure).

The IRS/Treasury representatives indicated that people should know how to comply with 411(b)(1)(G).

6. Treasury Regulations Section 1.401(a)(26)-2(d)(iii) says “In general. A defined benefit plan is treated as comprising separate plans if, under the facts and circumstances, there is an arrangement (either under or outside the plan) that has the effect of providing any employee with a greater interest in a portion of the

assets of a plan in a way that has the effect of creating separate accounts.” It appears that this regulation may preclude small plans from using the return on a subset of plan assets as the interest credit rate or indexing plan benefits to the return on a subset of plan assets. It would also require larger plans to ensure that each subset of plan assets controlled the benefits of at least 50 employees. Is this intended?

The Intersector Group indicated that in many instances upon audit since 1989, IRS field reviewers have indicated that any arrangement inside or outside the plan that tied the benefit of a participant to the rate of return on certain assets in the plan would fall under this regulation. Further, the Intersector Group mentioned that one of the driving forces behind this regulation was to prevent the merger of individual defined benefit plans (for partners in law firms for instance), which then allowed each partner to direct the investment of his/her own funds. Hence the question: If hybrid plan interest crediting rates are based on a subset of assets, does each subset have to satisfy 40(a)(26)?

The IRS/Treasury representatives noted that, if they remembered correctly, the legislative history of 401(a)(26) also pointed to a concern about well-funded plans for a small group of highly compensated employees designed to be comparable to a poorly funded plan for non-highly compensated employees.

The IRS/Treasury representatives indicated that they haven't really considered this issue, but would be concerned about using the ability to credit the rate of return on a portion of plan assets as a tool to turn cash balance plans into, essentially, supercharged defined contribution plans (i.e., without the \$52,000 defined contribution annual addition limit). They indicated that Congress had objected to one-person defined benefit plans because it is a “back door 401(k)”, and that this was a policy matter (i.e., reduction in taxable income due to better benefits).

7. Variable annuity plans—there is growing interest in these plans, but there is also concern that IRS regulations lock in valuation methodologies that are inconsistent with the economic reality of the benefit promise and will kill these designs. How do we get “ahead” of these emerging designs with appropriate guidance?

The Intersector Group said that practitioners understand the economic value of the benefit, but are uncertain whether they can get the funding target determined under IRS regulations to equal that economic value. Can you sign a Schedule SB listing the appropriate economic value as the funding target and be in compliance with the regulations? The same issues exist with respect to calculation of lump sums under IRC 417(e). The Intersector Group emphasized that we should try to encourage variable annuity plans since they are popular and provide lifetime income, but some IRS D-letter reviewers are requiring minimum interest rates that we think are inappropriate and result in age discrimination.

The IRS/Treasury representatives question whether this was simply a regulatory problem, or a statutory one. The IRS/Treasury representatives indicated they may have an opportunity to address variable annuity plans when the 430 and

436 regulations are updated to address remaining issues (although this project has been put on the back burner for now).

The Intersector Group indicated the Academy's Pension Committee is working on a practice note on the valuation of variable annuity plans; it will not tell actuaries how to value them, but will discuss the issues.

The IRS/Treasury representatives asked that the committee send them the practice note with a comment letter; they indicated that while they would find the practice note itself helpful, since IRS/Treasury is not the intended audience, the comment letter directed at them would be much more useful.

8. Qualified Lifetime Annuity Contracts (QLACs) in defined benefit plans—follow up on Academy letter about offering QLACs in defined benefit plans; large insurers' decisions not to offer them

The IRS/Treasury representatives have read the Academy letter but, due to other priorities, have not had an opportunity to convene a team and focus on the items raised in the letter.

The IRS/Treasury representatives expressed interest in whether anyone is using the QLAC guidance for 2012 or the guidance on transfer from defined contribution to defined benefit plans

The Intersector Group indicated the Academy's Pension Committee was working on another letter on QLACs as variable or equity-indexed annuities that could partially address current pricing issues and potentially provide added inflation protection.

9. Discussion of Multiemployer Pension Reform Act (MPRA) changes to “zone status” rules

- a. **Agency concerns with respect to 2015 status certification**
- b. **Adjustment of 2014 critical status certifications performed following enactment**

The Intersector Group raised issues such as whether “early critical plans” can be critical and declining” and whether the Service agrees that there may be a need to amend critical status certifications if done after enactment for a plan found to be “critical and declining.” The Intersector Group expressed its view that plans that elect early critical status cannot be critical and declining in the first year but that it isn't clear whether they can be in the second year.

The IRS/Treasury representatives indicated that their current focus is on “critical and declining” and suspensions...everything else is further back in line.

The IRS/Treasury representatives indicated they had no particular interest in the 2015 zone certifications—it was “just one of the sections listed” in their Request for Information (RFI); they expect to focus on the other sections. They also expressed no preference with respect to adjustment of 2014 critical status certifications shortly after the passage of MPRA with respect to whether or not a

plan is “critical and declining.” Some actuaries are just providing plan trustees with a letter as follow up to the 2014 critical status certification.

There is no code on the 2014 Schedule MB for “critical and declining.”

Treasury received roughly 1,500 responses to the RFI, about 98% of which were from individuals, and the rest from organizations (including the Academy). They do not yet know whether there will be additional issues they would like comments on.

10. Schedule MB—new line 4f: for a (critical status) rehabilitation plan, indicate the “plan year in which the plan is projected to emerge...[or] the insolvency is expected.” Different interpretations as to timing and source (plan document; actuarial models)

The Intersector Group inquired as to how the date is to be determined; is the date based on a plan provision/rehabilitation plan or some actuarial model?

The IRS/Treasury representatives indicated that they expected the basis for entries on line 4f of 2014 Schedule MB to be consistent with the “scheduled progress” certifications under PPA’06; in other words, to be based on an expected date when the plan will emerge or become insolvent.

However, the instructions provide little guidance on entering the information. Furthermore, as many of those certifications are performed by measuring current status (e.g., assets, credit balance) against the “annual standards” in the rehabilitation plan, many plans will not have a certified basis for an emergence or insolvency date. Instead, the actuary would generally complete that line based on other modeling, or simply report the stated goals of the rehab plan document.

Thus, the information gathered might not be reliable for agency tabulation across plans. It is likely too late to change any instructions for the 2015 Schedule MB.

11. Benefit Suspensions under MPRA

- a. **Update on progress of guidance**
- b. **Was request for information (RFI) process fruitful?**
- c. **Any topics that guidance will definitely address or not address?**
- d. **What concerns are there with respect to how actuaries may approach the duration of the Code Section 432(e)(9)(C)(i) solvency certification?**
- e. **What is the regulatory perspective on the practical need to base this solvency projection on a measurement date that precedes the effective date of suspensions, as well as a projection date that may not coincide with that effective date?**
- f. **Role of deterministic versus stochastic projections in the application process**

- g. Importance of prompt agency follow up, if application is not deemed complete**
- h. How should participant notices approach early retirement benefits and future benefit accruals?**
- i. How should the exclusion of disability benefits from suspensions apply to disability benefits that “convert” to normal retirement benefits?**

The IRS/Treasury representatives explained that Dave Gustafson has been detailed (on an 80% basis) to assist them with MPRA regulatory issues, and that currently the suspension guidance required under the statute (and that is holding up applications for suspension) has top priority. Several technical policy issues were discussed.

The maximum benefit suspension under MPRA that may be applied to any participant will reduce the accrued benefit to 110% of the PBGC guarantee, subject to certain other protections. The amount of this guarantee depends on the average accrual rate over a participant's career, which may be different at the point of benefit suspension than it is as the point of retirement due to post-suspension benefit accruals. Additionally, while the guarantee is not adjusted for early commencement or optional form of payment, to the extent that these factors affect the underlying plan benefit they flow through to the average accrual rate. The IRS/Treasury representatives asked how the implementation of the 110% guarantee should reflect these issues, mentioning that the RFI responses did not address this question. The Intersector Group responded that although it is conceivable that the plan could re-determine the 110% floor after the participant's accruals end, post-suspension accruals need not affect the calculations, as the suspension represents a change in the accrued benefit at a point in time that is independent of future benefit accruals. Early commencement and optional forms are different in that they are inseparable from the accrued benefit, and therefore the amount of the accrued benefit that is protected should be reevaluated at retirement in light of these factors. The IRS/Treasury representatives responded that we should send our thoughts on these issues to IRS.

The application for benefit suspensions will include projections of the plan's cash flows that will be based on asset and demographic measurements that precede the application date. Nothing in the statute spells out how the asset and demographic measurement dates are chosen. The IRS/Treasury representatives expressed concern that actuaries might deliberately select dates that achieve a particular objective, such as larger or smaller suspension amounts. The Intersector Group responded that actuaries will want to use measurements that are as current as is reasonably possible (e.g., asset values are generally available quarterly, and actuaries will want to use the most recent available), and that it is important that guidance does not impose requirements that are impractical. For example, requiring that the demographic measurement be as of the first day of the year of application would make it impossible for most plans to submit an application in the first half of a year, which may be an unnecessary and costly delay.

The IRS/Treasury representatives raised the issue of actuaries potentially using very low asset return assumptions in order to justify conservative (i.e., large) suspension amounts. They reported that this topic came up at a workshop session at the Enrolled Actuaries meeting, and some participants suggested they might want to use assumptions as low as 3 or 4 percent. The Intersector Group responded that it has not heard these views previously, nor does it understand why an actuary would be motivated to do so. The IRS/Treasury representatives expressed the view that subjectivity should be eliminated.

12. Plan termination issues:

- a. ***Post-termination mortality updates. Annuity carriers are taking different views of what is required vis-à-vis future 417(e) mortality updates post termination. Clarity regarding what is required is needed for traditional as well as statutory hybrid plans.***

The IRS/Treasury representatives indicated the answer may be different for “mandatory” uses of 417(e) mortality (such as lump sums and Social Security level income options) and “optional” uses such as to determine actuarially equivalent lifetime annuity options. For “mandatory” uses, 417(e) mortality must continue to be updated post-termination, including updates in future regulations (including a future move to RP-2014 mortality tables and MP-2014 improvement scale). For “optional” uses it becomes a plan interpretation issue.

- b. ***Post-termination amendments improving benefits in a statutory hybrid plan. Can terminating statutory hybrid plans be amended post-termination to temporarily override the use of five-year average interest crediting or annuity conversion rates if this improves participant’s benefits? For example, to protect expectations of participants retiring soon after the termination date, could the sponsor amend a plan post-termination to provide that the annuity conversion interest rate will not be less than the rate that would have applied if the plan had not terminated for annuity starting dates within one year after the termination date (reverting to the five-year average rate thereafter)?***
- i. **Can you provide a more generous conversion**
 - ii. **Can you do it for a window period**

The IRS/Treasury representatives did not provide an answer

- c. ***Post-termination benefits in a PEP with implicit interest credits. For participants who are actively employed on the plan termination date, how are post-termination benefits determined under a PEP that, pre-termination, determines an accrued benefit (life annuity starting at normal retirement age 65) at separation from service by dividing the PEP balance by a 417(e) deferred annuity factor? For example, for a participant age 50 at the plan termination date, is the benefit determined by dividing the PEP balance by an age-50, deferred-to-65 annuity factor, using five-year average segment rates and:***

- i. **The 417(e) mortality table in effect on the plan termination date?**
- ii. **The 417(e) mortality table in effect at the participant's separation from service date?**
- iii. **The 417(e) mortality table in effect at the participant's annuity starting date (the IRS field directive on PEPs suggests this alternative, but in our experience, few ongoing PEPs work this way)?**
- iv. **Some other approach?**

The IRS/Treasury representatives were not able to address these questions at this time.

- d. ***Annuity buyouts for statutory hybrid plans. Do the termination rules apply to an annuity buy-out of cash balance or other statutory hybrid plan benefits, when the buyout is *not* in connection with plan termination?***

The IRS/Treasury representatives indicated the termination rules do not apply in this case – the annuity buyout must continue to apply the variable rate as provided under the plan terms.

- e. ***Sample plan language. Will IRS be publishing sample plan language on post-termination interest credits and annuity conversion rates for statutory hybrid plans?***

The IRS/Treasury representatives indicated language has not been drafted at this time and were uncertain whether such language would be included in a future list of required modifications

13. Determination letter program — Reports have indicated IRS is considering new procedures under which determination letters for individually designed plans would be available only for the initial adoption and termination of a plan.

The IRS/Treasury representatives did not comment.