

Intersector Group Meeting with the U.S. Department of Treasury and Internal Revenue Service Notes

October 11, 2017

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 discuss regulatory and other issues affecting pension practice. The Intersector Group is composed of two delegates from each of the following actuarial organizations: American Academy of Actuaries (Academy), Conference of Consulting Actuaries (CCA), Society of Actuaries (SOA), and ASPPA College of Pension Actuaries (ACOPA). Attending from the Intersector Group at this meeting were Bruce Cadenhead (CCA), Tom Finnegan (ACOPA), Ted Goldman (Academy), Eric Keener (SOA), Tonya Manning (CCA), John Markley (ACOPA), Maria Sarli (SOA), and Josh Shapiro (Academy). Monica Konaté, the Academy staff member 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 their representatives who attended the meeting. 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.

The discussion topics shown in regular typeface were submitted to the IRS in advance of the meeting. The discussion summary is in italics.

Part I: Questions from the profession

- Mortality tables opt-out: The regulations say the opt-out applies based on the sponsor's determination. It doesn't seem that there's any basis for second-guessing a sponsor's determination. Is that really true?

The IRS / Treasury representatives indicated that criteria enabling plan sponsors to opt out of the new mortality tables for 2018 are not intended to be a challenging standard. There is no process for approval or review of a plan sponsor determination that the new table would result in a non-de minimis adverse business impact, nor is a plan sponsor required to provide a written notice to the actuary (the paperwork reduction rules can slow issuance of guidance down when written notices are required). It was anticipated that a note in the Schedule SB attachments would provide sufficient documentation of an opt-out election. One concern was raised from the regulators that it might be difficult to justify the delay for a plan that is significantly overfunded on all measurements (e.g., plan termination liabilities, PBGC variable-rate premium liabilities, funding target). It is unclear whether losing future funding flexibility (e.g., due to the creation of less prefunding balance) should be considered an adverse business impact. However, at the same time, it was reemphasized that the standard in the regulations is not intended to represent a difficult burden to meet.

The group discussed the fact that actuaries are unlikely to be in a position to make a determination of the business impact of the new mortality table, and that their role might be limited to providing information regarding the incremental cost. This incremental cost could consider both minimum funding requirements and PBGC premiums, as well as potential benefit restrictions. The other prong of the opt-out provision is if the application of the new mortality tables is administratively impracticable, which could be relevant to the benefit restrictions. However, this may be a difficult position to take, since plans must always be in a position to implement the restrictions if necessary.

The IRS / Treasury representatives asked if the implementation of the new mortality tables for the purpose of section 417(e) will pose significant challenges. The Intersector Group responded that in some circumstances it may be challenging. Different third-party administrators have reported widely disparate estimates of the time and effort necessary to program and test the new tables. Give that benefit packages for January 2018 commencements are already being prepared and distributed, some sponsors may face administrative difficulties.

The IRS / Treasury representatives also asked about the volume of plans that may apply for substitute mortality tables. The Intersector Group responded that the opt-out provision for 2018 may substantially reduce the number of 2018 applicants. Additionally, given the tight time frames involved, it is likely that the majority of the 2018 applications will be prepared as quickly as possible and be submitted earlier than the deadline. It is also likely that the 2019 volume will be significantly higher than 2018.

- Partial lump sum that satisfied section 417(e)(3) on a total benefits basis—does it also have to satisfy the bifurcation rules?

The Intersector Group reported that in a presentation titled “Minimum Present Value Requirements for Defined Benefit Plans” that is part of IRS’ new [video portal program](#), in which it prepares and posts presentations (rather than running live webinars), an IRS representative indicated that it was always necessary to comply with the bifurcation rules when there is a partial lump payment. The IRS / Treasury representatives confirmed that satisfaction of the bifurcation rules is optional when section 417(e) is satisfied on a total benefit basis.

The situation may be different when the partial lump sum and the annuity benefits have different annuity starting dates. In that situation, the IRS representatives suggested that, by definition, you are bifurcating the benefit and the bifurcation rules need to be satisfied. There was also a discussion of whether a participant can make a single election with respect to separate annuity starting dates. The feedback received here was that an individual cannot elect a lump sum now and an annuity to start in a particular form on a particular date in the future (more than the 180 days out that elections can generally be made).

The IRS / Treasury representatives also indicated that they are aware of comments indicating that the explicit bifurcation rules pose a problem when the residual annuity is bigger than it is required to be under those rules, because, unlike implicit bifurcation where the residual annuity must be “at least” a certain value, under explicit bifurcation, the residual annuity must equal a certain value. It was noted that when the partial lump sum is a refund of employee contributions and a full lump sum is available, so that explicit bifurcation must be followed, the proposed regulations that would require

ignoring pre-commencement mortality for employee contribution refunds would cause the explicit bifurcation rules to not be satisfied. IRS /Treasury indicated that they are aware of this issue and are considering it as they work on finalizing the proposed regulations.

- Clarify partial lump sums in model amendment 2017-44, Social Security level income option—immediate versus deferred.

The Intersector Group asked whether a Social Security Level Income payment option could be considered a bifurcated benefit with a temporary piece and a permanent piece. The IRS / Treasury representatives indicated that they do not see any reason why such a benefit could not demonstrate satisfaction of section 417(e) through the explicit bifurcation approach. However, they also noted that the model amendment in Notice 2017-44 is not clear on this point.

- Treatment of a spinoff from a plan subject to section 436 restrictions as a prohibited payment for section 436 purposes.

IRC section 436 prohibits spinoff transactions if the intent of the transaction is to circumvent the benefit restriction rules for certain participants. The Intersector Group asked how the regulators would view a transaction that is intended to achieve an objective that is separate and distinct from the section 436 benefit restrictions, but where a consequence of the transaction is that some participants would remain subject to the restrictions while others would not. Such a transaction might be part of a risk management strategy involving a partial termination of the plan. The IRS / Treasury representatives responded that intent matters, and this would be a very fact-specific determination, and might depend on whether circumvention of the section 436 restrictions is necessary to achieve the intent of the transaction. The boundaries of the regulation are not clearly defined, and the regulators emphasized that any situations would need to be carefully evaluated in light of the specific facts and circumstances.

For example, the group discussed a situation in which annuities could not be purchased for retirees in a plan because of section 436 restrictions, but by spinning off the retirees, the annuities could be purchased (either without additional funding or with a smaller amount of additional funding than would have been required to remove restrictions for the entire plan). Is funding up the spun-off plan an issue? IRS / Treasury representatives indicated it could be based on the facts and circumstances.

IRS / Treasury officials indicated that this could also implicate the “step transaction” prohibitions, and it isn’t clear how much of a time gap between the spinoff and the annuity purchase would avoid that issue.

There would also be questions as to whether there was even a legal basis to impose restrictions under the spun-off plan (as opposed to simply the pre-spinoff plan).

- Issue snapshot (9/8/2017) on partial plan terminations mentions the section 411(d)(3) language about nonvesteds becoming vested at partial plan termination “to the extent funded on that date,” but then goes on to lay out an analysis based purely on the reductions in headcounts and reasons therefor, and concludes that “the affected participants ... must be fully vested” without ever mentioning again that the requirement

doesn't apply unless the plan is funded enough (on a plan termination basis) to fund the additional vesting.

The IRS / Treasury representatives confirmed that issue snapshots are not intended to be sources of new guidance; any perceived inconsistencies between these documents and existing guidance is inadvertent, and existing guidance should be followed. The snapshots are primarily intended to be helpful resources to IRS agents. If current law and regulations provide that nonvested benefits must become vested only to the extent they are funded, then the issue snapshot makes no changes to this conclusion.

- Holding up determination letters over variable annuity plans—any position? Include variable adjustments?

This agenda item was not specifically addressed, as determination letters for variable annuity plans have recently begun to be issued. The IRS / Treasury representatives indicated that prior to the recent issuing of these letters, the determination letters were held up over concerns that the plans might experience failures with respect to the accrued benefit requirements of IRC section 411(b). While these concerns remain, it was decided that they should no longer prevent the issuance of determination letters, since an accrued benefit failure is an operational failure rather than a design failure. This represents a change in philosophy—unlike cash balance plan determination letters where IRS generally required that provisions be added to a plan that would prevent the possibility of a section 411(b) failure, they have decided that, if a plan is OK in form (in other words, if it might satisfy section 411(b) as written), they will issue the determination letter. They applied this newly changed philosophy to PEP determination letters as well, where they required language that says a plan will satisfy section 411(b)(1)(G) but did not require plan terms to exist that ensured that an operational failure could not occur. The recent issuance of determination letters should not be interpreted as a conclusion that the benefit accrual requirements will be satisfied, but rather a view that a potential operational failure should not prevent the issuance of favorable determination letters. The determination is on the form of the plan, not its operation.

- Multiemployer—revenue procedure updating application for MPRA suspensions.

The Intersector Group reviewed the contents of Revenue Procedure 2017-43, which updated the application process for benefit suspensions under MPRA. The revenue procedure greatly expands the amount of material related to actuarial assumptions that must be included in applications, which is consistent with the emphasis that Treasury has placed on the assumptions in its review of applications. The IRS / Treasury representatives indicated that the revenue procedure is not intended to communicate any changes in the criteria that Treasury will use to evaluate future applications, but it does demonstrate that actuarial assumptions have been, and will continue to be, a very significant part of the application review process. IRS / Treasury hope that the result will be that fewer applications will have to be rejected as a result of not using reasonable actuarial assumptions.

- Multiemployer—how to view suspensions in financially assisted or other merger.

Under the final regulations, benefit suspensions adopted under MPRA must be discontinued prospectively unless the actuary certifies that they remain necessary to prevent the insolvency of the plan. In the case of a merger between a deeply troubled

plan and a healthy plan, it may be necessary for the weaker plan to implement benefit suspensions in order for the merger to be financially viable. After such a merger, it is likely that the suspensions would no longer be necessary to avoid insolvency in the merged plan, suggesting that they would need to be immediately discontinued. The Intersector Group noted that if this interpretation is correct, then it will effectively be impossible for benefit suspensions to be used as part of a merger between a healthy and weak plan. The IRS / Treasury representatives confirmed that this is the correct interpretation of the regulations, and expressed the view that the language of the statute does not allow for any alternative interpretations.

- Status of mortality tables for blue collar industries

The IRS / Treasury representatives confirmed that for MPRA benefit suspension applications that cover blue collar workforces, the blue collar rates from the RP-2014 Mortality Tables Report will be considered an appropriate mortality assumption. However, any adjustments to those rates should be supported by credible experience from the plan population.

- Multiemployer—critical status plans: If sponsor has a “delayed emergence” rehab plan, does MPRA provide protection from excise taxes post-rehabilitation period?

The Intersector Group discussed the concern that the excise tax protection that applies to critical status plans with accumulated funding deficiencies might not remain in effect after the expiration of the rehabilitation period. The IRS / Treasury representatives indicated that they are aware of this potential concern, as well as other issues related to the excise tax exemption for critical status plans, but have not yet developed any views on the issue, and do not have any specific expectation with respect to future guidance.

- Automatic change in cost method—any update?

Revenue Procedures 2017-56 and 2017-57 were issued the day before the Intersector Group meeting. In response to a question from the Intersector Group, the IRS / Treasury representatives indicated that, while the guidance in these revenue procedures can be used for plan years prior to 2018, this does not change the fact that the filing of a Schedule SB represents a final choice with respect to the funding method for a particular year.

The Intersector Group discussed that automatic approval of a method change for a fully funded terminating plan excludes receivable contributions to which an irrevocable commitment applies, and suggested that such an irrevocable commitment might be sufficient to permit the inclusion of the receivables. The IRS / Treasury representatives indicated that this topic was not an area of focus in the guidance, and noted that prior guidance (Rev. Proc. 2000-40) also excluded receivables when determining whether a terminating plan was fully funded.

There was also a discussion of the extent to which a change in the data elements used in a valuation represents a change in funding method. The IRS / Treasury representatives indicated that as an example, if the valuation uses rate of pay as an input one year, and then actual prior-year pay as an input the next year, this would represent a change in funding method that may or may not require approval depending on the effect on the liabilities. The answer was not as clear if the change is less

pronounced, for example when one year all compensation is reported together, while in the next year base pay and bonuses are reported separately, but the total amount is consistent with the prior year.

The new revenue procedures also reduce the threshold for automatic approval of a funding method change when an actuary takes over a valuation from a prior actuary. In the past, differences within 5% received automatic approval, and this threshold has been reduced to 3%. The IRS / Treasury representatives indicated that this change is consistent with the belief that increasingly sophisticated and precise valuation systems have generally made matching results easier, suggesting that reasonable due diligence should result in a closer match than was the case in the past. They also indicated that since PPA better defined and greatly reduced the available funding methods, there should be less variation in how valuations are being done across actuaries and actuarial firms.

The Intersector Group noted that Rev. Proc. 2000-40 included an automatic approval for a merger in which the time between the last valuation of the disappearing plan and the first valuation of the merged plan exceeded 12 months, while Rev. Proc. 2007-56 does not. IRS representatives indicated that they are working on additional guidance for merger situations.

- Closed plans/discrimination: Notice 2017-45 extends temporary nondiscrimination relief for closed plans for an additional year. The notice states that IRS and Treasury expect that the final regulations will include a number of significant changes in response to comments. Can you provide any insight on the nature of those changes? Is there any updated or additional information that we can provide to assist in redrafting the rules to incorporate changes?

IRS / Treasury representatives indicated that they have received many detailed comments on this issue and are making good progress, but do not have any other information to share at this time.

- Notice 2014-49—Do the IRS and Treasury still intend to draft such a regulation with retroactive effect? If so, what is the timeframe for this and, if not, where does this issue stand?

IRS / Treasury representatives did not have any information to share on this topic.

- Model amendments for DB plans (Notice 2017-44)

This topic was addressed in the earlier item regarding section 417(e) bifurcation.

- Hurricane relief

The recent hurricane relief provisions do not require a documented election, as they are automatically in effect for qualifying plans. The Intersector Group noted that in certain circumstances, it may be possible for the relief provisions to technically have an adverse effect if the plan sponsor does not take affirmative steps to prevent it. For example, if a standing election to create prefunding balance with contributions in excess of the minimum required contribution is in effect, it automatically creates the prefunding balance on the date the wrap-up contribution is due. If relief automatically delays the due

date for the wrap-up contribution to January 31, then a December 31 election to reduce funding balance for a calendar year plan (e.g., to produce a desired FTAP and avoid a PBGC 4010 filing) will not be effective, since the funding balance will not have been created yet, and the funding balance would then be created on January 31, which is too late to reduce the funding balance. The IRS / Treasury representatives indicated that situations such as this were not contemplated in the guidance, and did not expect that there would be any such situations that would give rise to an enforcement action or other adverse result. The hurricane relief provisions are not intended to create any “gotcha” moments, but are solely intended to be helpful, and this would be kept in mind should any compliance issues arise. If a plan sponsor’s actions consistently indicate that they are not taking advantage of the relief, then that will be reflected throughout the calculations.

If a plan sponsor takes advantage of the relief and the wrap-up contribution is made later than the due date without relief, the plan sponsor should note with the Schedule SB that the contribution is not late because the sponsor qualifies for the relief.

Part II: Questions from the Agencies

Topics:

- Phased retirement

In discussing allocation of scarce IRS resources, the IRS / Treasury representatives asked how much bona-fide interest there was among the plan sponsor community related to phased retirement provisions. Proposed regulations were issued 12 years ago, but then PPA made distributions available beginning at age 62. The Intersector Group responded that there is still interest in these provisions among plans sponsors as part of a structured program leading to a defined full retirement date. While many plan sponsors see the value of allowing employees to draw a partial salary while also drawing a partial retirement benefit, the Intersector Group did not think it was important enough to plan sponsors to divert resources from projects like closed plan nondiscrimination guidance. The fact that many plan sponsors are still dealing with underfunded plans may be preventing this issue from being a higher priority in their eyes. It is possible that phased retirement programs could raise nondiscrimination issues (e.g., since it is not an early retirement window, do you test it based on who it is offered to, as you would for a window, or who takes advantage of it?), which is an additional area of concern. There would be value in a way for sponsors to obtain a qualification ruling on a proposed phased retirement program before moving forward with an implementation. The IRS / Treasury representatives were unsure if such a ruling would be possible, and indicated that it may be more of an examination issue, but encouraged interested sponsors to reach out for a pre-submission conference to explore the concept before spending time preparing a ruling request that they might not be prepared to rule on. Another possibility is a Chief Counsel Advice memorandum on a specific fact pattern—e.g., bullet points regarding a plan design—without actually ruling on the specific plan.

- Pension Equity Plans

There are many unanswered questions with respect to pension equity plans, and while guidance could certainly be helpful, it is also possible that guidance could create as many challenges as it solves. The Intersector Group commented that pension equity plans are not a big part of plan design discussions.

- Risk Sharing Designs

The group discussed the fact that defined benefit risk sharing designs are growing in popularity in other parts of the world (e.g., the Netherlands, and New Brunswick in Canada). In the U.S., variable annuity, market-based cash balance, and other risk sharing designs may create issues with respect to section 415 limits, accrual rule requirements, and minimum funding calculations. The IRS / Treasury representatives are aware of these concerns, and further guidance related to these designs remains on their agenda. An additional concern that was raised is the need for plan terms that are sufficiently clear and precise. While this is not a new concern, as many longstanding plans have provisions that are far from clear, it is especially important that new risk sharing designs do not contain any ambiguity with respect to when and how benefit levels will be adjusted.

Part III: Agency Deep Dive

- Goal of this segment is to improve the profession's understanding and knowledge of how the IRS/Treasury works so we can direct our efforts on behalf of the profession effectively.
- Examples: new staff, roles, changes in procedures/resources, operational changes, communication
- Proposed—underfunding of public plans
- Role of actuaries at the IRS

The IRS / Treasury representatives discussed the roles that actuaries play within the IRS. They commented that there is not a single actuarial group, but rather actuaries have various roles and responsibilities based on where their expertise can provide the greatest value. Some of the areas where actuaries provide significant contributions are in developing formal regulatory guidance, field guidance, revenue rulings and other similar documents to the extent that actuarial issues are involved, and also in determination letters and examinations of individual plans.

- Structure of the IRS

Division (TE/GE)—provides determination letters and some rulings and guidance, as well as working on other projects. Most actuaries are within Division.

Division Counsel (TE/GE)—works with Division on legal issues.

Counsel (Associate Chief Counsel Vicki Judson)—Includes subject matter experts, analogized to the national office of an accounting firm. They write Private Letter Rulings, Chief Counsel Advice memoranda, and handle technical questions. They don't do litigation. Split into Employee Plans and Exempt Organizations.

Office of Tax Policy—Secretary and Assistant Secretary. Both are generalists but have been around for a long time.