AMERICAN ACADEMY *of* ACTUARIES

Nov. 1, 2007

The Honorable Charles B. Rangel
Chair, Committee on Ways & Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

The Honorable Jim McCrery
Ranking Member, Committee on Ways & Means
U.S. House of Representatives
1139-E Longworth House Office Building
Washington D.C. 20515

Dear Chairman Rangel and Ranking Member McCrery:

On behalf of the American Academy of Actuaries[1], we appreciate this opportunity to address important defined benefit pension plan matters in relation to benefit restrictions under the Pension Protection Act of 2006 (PPA). We are requesting some technical corrections that will clarify the law and alleviate unreasonable burdens on plan participants, plan administrators, and other service providers to the plan, while not affecting the intent of the law.

PPA added Section 436 to the Internal Revenue Code. This new Code section is intended to promote more timely identification of pension underfunding and place restrictions on participants' ability to receive or accrue benefits in the presence of such underfunding. Ideally, these rules will promote improved overall funding for plans.

In August of this year, the Department of Treasury issued proposed regulations §1.430(f)-1 (effect of prefunding balance and funding standard carryover balance) and §1.436-1 (limits on benefits and benefit accruals under single employer defined benefit plans), providing implementation guidance for the new Code section. The structure of these proposed regulations, however, places counterproductive timing demands on plan sponsors, particularly the suggestion of a "final" certification by the tenth month of the year. Also, the approach taken to paying out benefits during a restriction is needlessly complicated and burdensome.

The timing demands will produce situations where a sponsor makes a good faith effort to improve funding and avoid a restriction, only to find out possibly that the plan is just short. At this point, the complicated restriction rules take effect and the plan may be threatened with disqualification.

Even worse, extremely well-funded plans will feel the full force of benefit restrictions if they don't provide a "final" certification by the beginning of the tenth month of the plan year.

Of course, the brunt of the impact will fall on plan administrators, who must communicate and carry out the labyrinthine restriction provisions, and on plan participants, who may be forced to

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[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

choose among a battery of confusing contingent elections only to see their benefits frozen or their availability limited.

Presumption Of Underfunding After 10th Month [Code Section 436(h)(2)]
The statute calls for tight time frames for certifying plans' Adjusted Funding Target Attainment Percentage (AFTAP) for purposes of complying with benefit restriction rules. We recognize this to be part of the purpose of PPA. At the same time, it presents enormous logistical issues.

Treasury has introduced two notable concepts in its proposed regulations—a "range certification" and the "no harm, no foul" rule. The range certification option provides a means for well-funded plans to comply with the benefit restriction rules with a minimum of disruption. The no harm, no foul rule could potentially be used to disqualify plans that use inaccurate estimates in determining range certifications. Based on this set of rules, we see virtually no scope for, or danger of, abusing a range certification.

The proposed regulations, however, call for a standard that is higher than a range certification with respect to the required certification by the first day of the 10th month of the plan year. We fail to see either (1) a statutory basis for a different standard to apply with respect to the 10th month certification and (2) any advantage to this being in some sense a final certification.

It will be difficult and sometimes impossible to make a final certification by the first day of the 10th month in many cases, for a variety of reasons:

- Lack of final valuation data;
- Lack of final audited asset values;
- Decisions relating to the funding target measurement basis (e.g. PFEA-phase-in, full yield curve, look-back month);
- Decisions related to asset valuation method;
- Decisions related to other actuarial assumptions;
- Decisions related to prior year pre-funding balance elections;
- Decisions related to voluntary current year "burn" of funding standard account carryover balances and pre-funding balances;
- Decisions related to recognition of plan amendments adopted after the start of the plan year.

There is also the specter of the restrictions themselves, which entails significant complications for plan sponsors in terms of administration, systems, and employee communications, as well as creating uncertainty and fear among employees about the amount and availability of their benefits. Under the proposed regulations, all plans, regardless of funding level, that are unable to secure a final certification of valuation results by the start of the 10th month of the plan year will feel the full weight of these restrictions. Many of the negative consequences (lump sum availability, freeze on benefit accruals) will be borne by plan participants. Participants could decide to leave and take a lump sum because of a looming restriction for a plan that is, in fact, overfunded.

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.

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 get ensnared by the benefit restriction rules.

Payment options under partial lump sum restrictions

The proposed regulations require 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 the menu of options changes 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 intention 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.

Should you have any questions about the concerns expressed within this letter, we would appreciate the opportunity to meet with you in order to provide you with the fullest possible answers. If you have any specific questions or would like more information, please contact Samuel Genson, the American Academy of Actuaries’ pension policy analyst, at 202-223-8196. Thank you for your consideration of this matter.

Sincerely,

Thomas S. Terry, FSA, EA, MAAA, FCA
Vice President, Pension Practice Council
American Academy of Actuaries

James F. Verlautz, FSA, EA, MAAA, FCA
Chairperson, Pension Committee
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