February 23, 2017

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Room 5203
Internal Revenue Service
PO Box 7604
Ben Franklin Station
Washington, DC 20044

RE: Update to Minimum Present Value Requirements for Defined Benefit Plan Distributions

To Whom It May Concern:

The Pension Committee of the American Academy of Actuaries[1] respectfully requests your consideration of its comments and recommendations regarding the proposed regulations under Internal Revenue Code §417(e) relating to the minimum present value requirements applicable to certain defined benefit pension plans. The committee commends the Department of the Treasury and the Internal Revenue Service (IRS) for undertaking this much-needed update to regulations that predated the Pension Protection Act of 2006.

While we generally support the proposed regulations, the proposed rules on the treatment of preretirement mortality in §1.417(e)-1(d)(2)(ii) raise compliance concerns that we believe should be addressed in the final regulations. The proposed rules clarify that preretirement mortality is taken into account when determining the minimum present value of employer-provided accrued benefits but is ignored when determining the minimum present value of accrued benefits derived from participants' own contributions. Our comments focus on two areas:

- Potential compliance issues for plans that currently ignore preretirement mortality when valuing employer-provided accrued benefits; and
- Potential implications for distributions after normal retirement date.

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[1] The American Academy of Actuaries is a 19,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

Plans that currently ignore preretirement mortality in minimum present value calculations

Many plans that provide death benefits equal to the full value of participants' accrued benefits or provide the qualified preretirement survivor annuity (QPSA) at no cost to the participant currently ignore preretirement mortality when determining the minimum present value of employer-provided accrued benefits. The proposed clarification that preretirement mortality should be taken into account in this calculation without regard to a plan's death benefit provisions raises a compliance "catch-22" for these plans:

- Amending the plan to take preretirement mortality into account would appear to be a reduction in an optional form of payment that is prohibited under §411(d)(6) anti-cutback rules.
- Continuing to ignore preretirement mortality could violate the requirement in Treasury Regulations §1.401(a)-20, Q&A-16, that the qualified joint and survivor annuity (QJSA) for married participants must be at least as valuable as any other optional form of benefit payable under the plan at the same time. The exception to this "QJSA-most-valuable rule" for §417(e) payment forms apparently would not be available to these plans because the minimum present value calculated ignoring preretirement mortality would exceed the amount "calculated using the applicable interest rate (and, for periods when required, the applicable mortality table) under section 417(e)(3)."
- Furthermore, some plans may be operating under court orders requiring them to ignore preretirement mortality. It would be impractical for these plans to change their minimum present value calculations, even if anti-cutback relief were available.

Recommendation: While the proposed regulations are helpful to many plans that currently apply preretirement mortality when determining the minimum present value, we recommend the following changes to avoid introducing a compliance problem for plans that currently do not reflect preretirement mortality.

- Revise Treasury Regulations §1.401(a)-20, Q&A-16, to provide that plans do not violate the QJSA-most-valuable rule merely because the amount payable under an optional form subject to the minimum present value requirement of §417(e)(3) (hereafter abbreviated as "417(e)") is calculated using the applicable interest rate and applicable mortality table, regardless of whether preretirement mortality is ignored or taken into account.
- Provide anti-cutback relief for plan amendments to determine the §417(e) minimum present value of employer-provided accrued benefits reflecting preretirement mortality, if adopted by the last day of the plan year in which the final rule takes effect.

Distributions after normal retirement date

The proposed regulations provide that the present value of a §417(e) payment form "cannot be less than the present value of the accrued benefit payable at normal retirement age, except to the extent that, for an optional form of benefit payable after normal retirement age, the requirements for suspension of benefits under section 411(a)(3)(B) are satisfied." §1.417(e)-1(d)(2)(ii) further provides that "except as provided under paragraph (d)(2)(ii)(B) of this section, the probability of death under the applicable mortality table is taken into account for purposes of determining the

present value under this paragraph (d) without regard to the death benefits provided under the plan (other than a death benefit that is part of the normal form of benefit or part of another optional form of benefit, as described in §1.411(d)-3(g)(6)(ii)(B), for which present value is determined)." The proposed requirement to take preretirement mortality into account when valuing employer-provided benefits, regardless of the plan's death benefit provisions, could be interpreted to apply both before and after normal retirement date. It is unclear if this is the intent with respect to late retirement calculations.

The prevailing practice among traditional-formula plans that do *not* either suspend benefits[2] or require benefits to start at normal retirement age is to determine §417(e) payment forms at late retirement date in two steps:

1. A late retirement benefit in the plan's normal form of payment is calculated using the process laid out in the April 11, 1988, proposed regulations §1.411(b)-2(b)(4)(iii). The actuarial adjustment for late retirement is determined using the plan's specified interest and mortality assumptions. Preretirement mortality is often ignored when the plan provides ancillary death benefits without charge to the participant between normal and late retirement age, consistent with the rules for adjusting §415 limits for late retirement (Treasury Regulations §1.415(b)-1(e)(3)). Ignoring preretirement mortality for the period between normal and deferred retirement dates is particularly prevalent among plans that provide a death benefit equal to the full value of the participant's accrued benefit. Because the actuarial increase is provided to prevent a decline in the value of the accrued benefit, this adjusted benefit payable in the plan's normal form becomes the participant's accrued benefit at the late retirement date.
2. The §417(e) minimum present value is calculated by multiplying the result of step 1 by an immediate annuity factor at the participant's late retirement age determined using the §417(e) applicable interest and mortality assumptions. Because an immediate annuity factor is used in this calculation, there is no preretirement period in which to reflect or ignore mortality.

The proposed clarification in the rules could be interpreted as requiring plans to determine the minimum present value of late retirement benefits by using §417(e) applicable interest and mortality assumptions—taking preretirement mortality into account—in step 1 as well as in the optional payment form factor in step 2. This would be a significant change for many plans and raises a number of concerns:

- §417(e) interest and mortality assumptions, which change at least annually, are inherently forward-looking, in that they are current as of the annuity starting date and, in the case of the segment rates, apply to specific future periods. This structure does not lend itself to a logical application to periods prior to the annuity starting date, which is required when determining actuarial increases for late retirement. For example, consider a plan that uses a plan-year stability period to set §417(e) assumptions. Could the plan use the §417(e) assumptions in effect on the annuity starting date to determine the actuarial increase for the entire period from normal retirement date to late retirement date? If so, what interest rate should apply for the period from normal retirement date to annuity starting date? Or would the plan need to use the §417(e) assumptions in effect during each plan year to determine the actuarial increase for that plan year, and the assumptions in effect at the

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[2] Or after the §401(a)(9) required beginning date for plans that do suspend benefits.

late retirement date to determine the optional form factor? Requiring the latter would greatly complicate late retirement calculations and require extensive reprogramming of benefit calculation systems for plans that currently use a single set of assumptions to calculate the cumulative increase.

- Plans providing ancillary death benefits without charge to the participant between normal and late retirement date would be forced to pay for them twice: once by providing ancillary death benefit coverage to participants during this period (and thus paying benefits to surviving spouses or other beneficiaries of deceased participants), and a second time by providing survivorship credits to those who survive to their late retirement date. This situation differs fundamentally from benefits that commence prior to normal retirement age, where the death benefit coverage between the annuity starting date and normal retirement date hasn't yet been provided at the time benefits commence. In this situation, the plan could be amended to eliminate free death benefit coverage (by imposing a charge for participants who elect coverage), which supports the argument that the participant is not yet vested in that coverage and need not be compensated for its value when he or she receives an early distribution. In the late retirement case, the retiring participant has already received the death benefit coverage and as a result it is no longer forfeitable. Requiring late retirement adjustments to include a survivorship credit regardless of the plan's death benefit could lead these plans to drop ancillary death benefits, to the detriment of plan participants and their surviving spouses or other beneficiaries.
- A requirement to take preretirement mortality into account in late retirement adjustments regardless of whether benefits are forfeited on death would be inconsistent with IRS rules for calculating 415 limits (Treasury Regulations §1.415(b)-1(e)(3)).

While the proposed rules specifically address §417(e) minimum present value rules, we are concerned they may be interpreted as a shift in IRS' and Treasury's views regarding the actuarial increase required to prevent a forfeiture after normal retirement age under §411. As noted above, prevailing practice is to reflect preretirement mortality only to the extent benefits would be forfeited on death before payments start, as spelled out under Treasury Regulations §1.415(b)-1(e)(3). Any change that would require plans to reflect preretirement mortality in late retirement adjustments without regard to a plan's death benefit provisions would force plans that do not charge preretirement death benefit coverage to pay twice for any death benefits provided between normal and late retirement date, and could lead plans to drop these benefits.

Recommendation: The final regulations should make clear (and provide examples illustrating) that when a participant delays starting benefits until after normal retirement age and benefits are not suspended under §411(a)(3)(B), the accrued benefit at the participant's late retirement date reflects actuarial adjustments using the *plan's* actuarial equivalence assumptions, which may be different from §417(e) assumptions and which may ignore preretirement mortality to the extent benefits are not forfeited upon death, as provided in Treasury Regulations §1.415(b)-1(e)(3). The minimum present value of a late retiree's accrued benefit would then be the actuarial equivalent of the accrued benefit payable at the participant's late retirement date in the plan's normal form of payment, determined using the §417(e) applicable interest and mortality assumptions as of the late retirement date (rather than the present value of the accrued benefit payable at normal retirement age calculated using §417(e) assumptions). Preretirement mortality is not relevant for

late retirement calculations because the §417(e) and normal form benefits use the same annuity starting date.

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The Pension Committee appreciates the opportunity to provide input to the IRS on these important regulations. We would be happy to discuss any of these items with you at your convenience. Please contact Monica Konaté, the Academy's pension policy analyst (202-785-7868, konate@actuary.org) if you have any questions or would like to discuss these items further.

Sincerely,

Ellen Kleinstuber, MAAA, EA, FSA, FCA, FSPA
Chairperson, Pension Committee
American Academy of Actuaries