

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

September 14, 2016

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, Conference of Consulting Actuaries, Society of Actuaries and ASPPA College of Pension Actuaries. Attending from the Intersector Group at this meeting were Tom Finnegan, Ted Goldman, Eli Greenblum, Eric Keener, Judy Miller, Heidi Rackley, Maria Sarli, and Josh Shapiro. Matthew Mulling, 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.

1. Guidance timing and priorities
 - a. 2017 mortality tables
 - b. "Partial credibility" rules for use of adjusted mortality tables
 - c. Automatic approvals for changes in funding method and discount rate election (Rev. Proc. 2000-40 and 2000-41 updates)
 - d. What else might we expect in next six months?

2017 mortality tables were published Sept. 6 after the Intersector Group had submitted the agenda to IRS.

IRS and Treasury representatives indicated they had done substantial work on both partial credibility and automatic approvals for certain changes in funding method and remain hopeful both will be published this year.

Other items likely to be published in the next six months include nondiscrimination testing relief for closed plans. [IRS [Notice 2016-57](#), extending the relief provided in Notice 2014-5, was published Sept. 19.] In addition, IRS chief counsel is looking at the possibility of issuing private letter rulings to cover one-off situations, such as hybrid plans with complex interest crediting rates that aren't certain which transition rules to follow [see item 9 below].

2. Instructions for 2015 Form 5500 Schedule H/I line 4L and Form 5500-SF line 10f—Thanks for clarification of instructions, but we still have questions:
 - a. Scope of reporting and amount to report—questions have arisen in a variety of situations where benefits may have been paid late, including:
 - i. Reasonable administrative delay

- ii. Missing participant located and “caught up” by plan year-end (e.g., required beginning date was April 1, 2015, but due to delay locating participant, benefits actually started October 1, 2015, and participant received six months’ back payments with interest)
- iii. Plan requires terminated vested participants to start benefits at normal retirement date
- iv. Plan requires automatic de minimis cashouts
- v. Operational errors that resulted in underpayment of benefits have been discovered but not yet corrected
- vi. Qualified domestic relations order requires alternate payee to start benefits at a specified date

Of the six scenarios presented, IRS representatives indicated that only number (v.)—an operational error resulting in underpayment of benefits has been discovered but not corrected at plan year-end—would trigger reporting.

- b. Reasonable estimates of “total amount”

IRS representatives indicated plan administrators should “make their best guess” as to the total underpaid amounts. The only consequence of reporting an incorrect number would likely be a request to file an amended Form.

- c. What does the agency plan to do with plans that answer “Yes” and report an amount? Do “compliance checks” automatically trigger audits?

IRS representatives stated that answering “Yes” will not automatically trigger an audit. It may trigger a “compliance check” letter from the [Employee Plans Compliance Unit](#) asking whether the failure was corrected. The plan administrator’s failure to respond to the compliance check letter may trigger an audit.

- d. Reasonable efforts to locate missing participants—proposed 2019 instructions would require plans to use *all* the methods listed in Field Assistance Bulletin (FAB) 2014-01, but many large plans go straight to commercial locator services. Also, the recent IRS guidance indicated that a sponsor can apparently currently satisfy the Schedule H, Line 4l “reasonable efforts” standard for locating missing participants without strictly following FAB 2014-01. In particular, it appears that using only **one** of the search methods in the FAB might be acceptable.

IRS representatives agreed that using only one of the search methods in the DOL Field Assistance Bulletin would be sufficient. They noted [Revenue Procedure 2013-12](#) states the IRS position on locating missing participants. The IRS representatives also noted the Department of Labor would be concerned if search costs are charged to the participant.

Supplemental Note: Revenue Procedure 2013-12 provides:

“Reasonable actions must be taken to find all current and former participants and beneficiaries to whom additional benefits are due, but who have not been located after a mailing to the last known address. In general, such actions include, but are not limited to, a mailing to the individual’s last known address using certified mail, and, if that is unsuccessful, an additional search method, such as the use of the Social Security letter forwarding program, a commercial locator service, a credit reporting agency, or Internet search tools. Depending on the facts and circumstances, the use of more than one of these additional search methods may be appropriate. A plan will not be considered to have failed to correct a failure due to the inability to locate an individual if reasonable actions to locate the individual have been undertaken in accordance with this paragraph;

provided that, if the individual is later located, the additional benefits are provided to the individual at that time.”

3. Updating outdated mortality tables—411(d)(6) presents a barrier to updating old tables in some cases. Often the new table is better for almost all purposes, but not for some (such as late retirement increases, extreme participant/spouse age differences). Any possibility of getting anti-cutback relief to replace mortality tables that are no longer reasonable with tables that are reasonable (perhaps in conjunction with rules updating 430 base mortality tables and projection scales)?

IRS noted that the rules are focused on the statutory protection of accrued benefits. However, IRS and Treasury representatives listened to the Intersector Group’s concerns, including why plans cannot make such a change under current regulations allowing the elimination of 411(d)(6)-protected benefits that are burdensome and of de minimis value. The group also discussed how plans can easily update their early retirement factors so that they no longer overcharge participants for early commencement, but face a difficult challenge in correcting late retirement factors that are providing unreasonable increases to participants who delay receipt of their benefits.

4. Current processing time for approvals of shortfall and other funding method requests

IRS is continuing to process approvals—they are not being held up pending publication of a Revenue Procedure providing for automatic approvals. Cases presenting unique issues will take longer to process. Practitioners with approval requests that have been pending for more than a year are encouraged to contact the person indicated in the IRS acknowledgment letter to find out what is holding up processing.

5. Valuation of variable-annuity plans for funding, 417(e), etc. (Academy documents in process)

The Intersector Group indicated the Academy’s Pension Committee is finalizing a practice note on valuing variable annuities and is also working on a letter to IRS and Treasury detailing the areas where guidance is needed. Specifically, in the letter the committee is asking to value variable benefits using a discount rate equal to the plan’s hurdle rate. IRS and Treasury representatives asked that the letter address how this approach fits under the discount rate provisions of the statute. The agency representatives expressed concerns whether the statute gives IRS sufficient latitude to provide the requested guidance.

6. Multiemployer Pension Reform Act (MPRA) suspensions
 - a. What sponsors can do in applications to best meet IRS expectations
 - b. Concerns that the degree of conservatism apparently required to get approval translates into much larger benefit cuts
 - c. MPRA suspension denial citing failure to comply with actuarial standards of practice (ASOPs) seems to be new territory for IRS

The Intersector Group explained plan trustees’ concern: “Why apply if we are not likely to get approval?” The IRS and Treasury representatives explained that this program is being administered by Treasury—IRS is not involved (administration is being retained at Treasury, unlike most matters where Treasury promulgates rules but IRS administers them). The requirements for approval are set out in the statute: The suspension must be reasonably expected to avoid insolvency, but must not materially exceed this level. The government representative recognized that actuaries are not accustomed to IRS policing assumptions. However, the focus on assumptions for suspensions is stronger because, unlike annual funding valuations, the suspension process is not self-correcting. It is a one-time event, with no required true-up if cuts were larger or smaller than necessary. Treasury wants to avoid situations where the plan goes insolvent despite the cuts or has to come back for another round of cuts.

The regulations focused on the actuarial assumption used to demonstrate compliance. Treasury has identified the following particular areas of concern with applications received to date:

- a. Open group valuation assumptions—in particular, whether the age distribution for future hires is reasonable based on recent plan experience. In the representatives' view, a single assumed entry age would rarely be appropriate.*
- b. Mortality assumption—the degree of credibility given to small participant populations.*
- c. Investment return assumptions—must take into account a plan's negative cash flow position, which magnifies the impact of short-term expectations relative to long-term expectations.*
- d. Estimating contribution base units—this is much more difficult to predict and support, but the plan and actuary need to provide support for the assumption selected.*

The Intersector Group expressed concerns with Treasury letters rejecting suspension applications that state the plan's actuary failed to follow ASOPs. These concerns are especially strong where Treasury is evaluating under final rules applications that were submitted under proposed rules, which had different requirements regarding assumptions. The Intersector Group also noted that the increased emphasis on short-term expectations, while reasonable, is a deviation from established practice that in the current environment has the effect of requiring plans to impose larger benefit cuts on participants. The group also urged that there should be more back-and-forth with the actuary when evaluating filings submitted before final regulations were issued, to give the actuary the opportunity to support or revise assumptions.

7. Church plan litigation—consequences of court rulings counter to current IRS ruling position

IRS and Treasury representatives do not comment on pending litigation and how it may or may not affect IRS' positions, but are closely tracking developments. In particular, representatives could not comment on whether any changes in IRS position resulting from litigation would be applied retroactively.

8. Treating early retirement factors as benefits, rights, and features for nondiscrimination testing—rather than simply reflecting those factors in the average benefits percentage test and in the most valuable accrual rates of the general test—and the resulting serious adverse implications for closed plans and a range of ongoing plan designs

IRS and Treasury representatives indicated this was not a new position and that benefits, rights, and features testing is necessary because "most valuable" amounts testing looks at just a single age, not the entire schedule of early retirement factors.

9. Some hybrid plans with unusual above-market crediting rates remain confused as to how to come into compliance with the final rules. Combined with the recent changes to the determination letter program for individually designed plans, the consequences of "guessing wrong" could be potentially catastrophic if not discovered until the plan terminates many years down the road. The Intersector Group urged IRS to offer a special one-time determination letter opportunity within the next two years, solely for hybrid plans forced to change their interest crediting rate to comply with the final rules. This would involve a relatively small number of plans, and the scope of the determination letter could be limited to whether the new interest crediting rate satisfies the final rules, whether the change in the rate satisfies the final transition rules, and whether the plan as amended satisfies accrual rules.

The Intersector Group discussed possible ways plan sponsors could gain comfort that they have properly come into compliance with the final rules for hybrid plans. The group suggested that IRS provide guidance addressing the following relatively common problem areas:

- a. Pension Equity Plans with above-market implicit interest credits*

- b. Plans with fixed conversion factors, which under the final rules have no path to come into the "lump sum based formula" definition, even if they change to floating conversion prospectively*
- c. PEPs that lock in the annuity conversion at the date the participant terminates employment, rather than the annuity starting date*
- d. Whether a PEP that freezes accruals may lock in the annuity conversion at the freeze date*

For cash balance plans with complex interest crediting rates, either opening the determination letter program in the near future or allowing these plans to request private letter rulings would be more appropriate because each plan's issues tend to be unique.