



SOCIETY OF ACTUARIES

Intersector Group report to the Society of Actuaries'¹ Pension Section Council

Meeting with the
Internal Revenue Service/Treasury
March 12, 2014

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¹ The Society of Actuaries is an educational, research and professional organization dedicated to serving the public and Society members. The SOA's vision is for actuaries to be the leading professionals in the measurement and management of risk.

**Notes from Intersector Meeting with IRS/Treasury
March 12, 2014**

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: Tom Finnegan, Eli Greenblum, Judy Miller, Heidi Rackley, Maria Sarli, Don Segal, and Larry Sher. David Goldfarb, 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 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.

Discussion items:

1. Update from IRS.

IRS and the Treasury Department are working on many guidance projects, but it is difficult to predict when anything will emerge from the end of the process. Pension funding seems to go to the bottom of each reviewer's pile; post-Windsor and cash balance guidance are closer to the top. IRS will be soliciting suggestions for the guidance plan in April-May and deciding which guidance projects to include in next year's guidance plan during May-June. IRS confirmed that rollover guidance is in the works.

2. Hybrid plans.

- a. The USA Retirement Funds Act of 2014 (S 1979) introduced Jan. 30 by Sen. Tom Harkin, would modify the market-rate rules for statutory hybrid plans, generally allowing higher fixed and minimum interest crediting rates and a broader range of market-based return than the 2010 proposed regulations. Does the IRS have any reaction to the bill? Will its introduction have any effect on the timing or content of final regulations currently in the works?

IRS and the Treasury Department have reviewed the proposed legislation and recognize that certain hybrid plan provisions overlap with comments IRS has received on the proposed market-rate rules. IRS and the Treasury Department have no position on the Act, nor any particular section within the Act. Those favoring the hybrid plan provisions included in the USA Retirement Funds Act should not count on the final hybrid regulations including similar provisions and therefore must decide whether to continue to advocate for legislation regarding acceptable market rates of return.

- b. Agenda item added by IRS: IRS is working on a project to bring cash balance plans into the pre-approved determination letter program. What flexibility is needed in developing that program? That is, what plan features should be permitted in the program to make it useful for providers? In particular, how should the cash balance benefit formula section be structured to ensure that plan sponsors can only choose cash balance formulas that meet the backloading rules?

Intersector group members believe that essential features include:

- Multiple formulas for different categories of plan participants
- Floor-offset formulas for companion profit sharing plans: offset must be based on account balance at determination date — annual cash balance credits cannot be reduced by profit sharing contributions for the same year. (The Intersector Group indicated that a large proportion of new small plans use floor-offset designs.)
- Age- or service-graded plans designed around the plan's minimum interest crediting rate. (The Intersector Group indicated that larger plans are much more likely to be age/service weighted, and that many small plans currently use a fixed 5% interest credit)
- Formulas for plans crediting the actual return on plan assets — contingent on getting reasonable guidance on backloading and nondiscrimination testing for such formulas. We expressed the view that it was not reasonable to test for backloading or discrimination assuming either: (i) no future interest credits, or (ii) the current year's crediting rate continues forever. The Intersector Group also expressed the view that many plan sponsors would prefer to use the actual return and would move in that direction if these uncertainties were favorably resolved.

IRS asked if a pre-approved pension equity plan (PEP) design was needed, given approximately 600 PEPs are in inventory for determination letters (although some number of those are the individual employers in a single multiple-employer PEP plan). We indicated the need would depend on future PEP guidance and that IRS should not slow down development of a pre-approved cash balance plan to include PEP formulas.

3. **Partial sunset of PPA rules for multiemployer plans.**

The Intersector Group asked: What can IRS and the Treasury Department do to quell plan sponsor, contributing employer, and practitioner fears that a potential 2015 sunset will be unworkable for red- and yellow-zone plans due to loss of ability to make changes to remedial plans, loss of enforcement mechanisms, and possible deficiency excise taxes? Given resource constraints, what public indications or "soft guidance" might be possible to indicate Code Sections 432, 4971(g), 4971(e)(2) and 412(b)(3) and the ERISA sections covered in PPA Section 202 will remain in effect for a plan operating under a Funding Improvement or Rehabilitation Plan? How can we (the actuarial organizations) help you with that?

We indicated that uncertainty about the implications of the sunset — including as to whether recovery plans can be amended after the sunset and the risk that IRS might impose excise taxes — may cause some contributing employers to bolt from multiemployer plans before year-end. Any signal that IRS will not take a draconian view on these issues — even "soft" newsletter guidance, or comments made at presentations at upcoming professional meetings such as the Enrolled Actuaries Meeting or National Coordinating Committee for Multiemployer Plans Lawyers and Administrators Meeting — would help to quell these concerns.

The IRS and Treasury Department representatives indicated a letter from one of the professional organizations saying why this is a concern would help elevate this issue up the priority chain, though they appear to understand the issues. The joint Treasury Department, Department of Labor, and PBGC report in early 2013 identified several areas where clarity or policy changes would be useful and suggested that Congress should address them. Since that hasn't happened to this point, IRS would need to go through a process to reach a consensus view on what the sunset means from legal,

administrative, and policy perspectives; this process will take time. If the process were to start now, guidance might be available by the end of the summer.

We also discussed a second multiemployer plan issue: electronic submission of PPA zone status certifications. Practitioners would like confirmation that the electronic submission has been received. This could be as simple as an automated reply email “Thank you for submitting your certification.”

4. **Lump sum windows.**

We understand IRS and the Treasury Department have concerns about de-risking transactions that involve offering lump sums to participants who previously did not have a lump sum option and that additional guidance may be forthcoming in some form. Can you share with us the general nature of those concerns? Are the concerns related solely to participants in pay status, or to all participants given lump sum options after separation from service (including terminated vested participants)? Do the same concerns apply to second elections offered to participants who could not elect a lump sum (which was part of the plan) at their annuity starting dates because accelerated benefit distribution limitations under Code Section 436(d) were in effect, or to distributions from terminating plans?

The IRS and Treasury Department representatives indicated the overriding policy concern is about the capability of individuals to handle risks associated with providing for lifetime income. They do not agree with the term “de-risking”—risks are not being eliminated, they are merely being transferred from the employer to individuals (in the case of lump sums) or to an annuity carrier (in the case of annuity buyouts), so “risk transfer” is more appropriate. They indicated that insurance carriers are in the business of managing risk, so there is no real concern there, but individuals aren’t necessarily able to manage that risk, and they have greater concern regarding older individuals. The Intersector Group indicated that plan sponsors had less incentive to offer older retirees a lump sum because the opportunity for anti-selection is greater, which will tend to increase plan costs. Other plan sponsors may want to limit the group to avoid settlement accounting, and not include older retirees, or retirees with larger benefits, for that reason.

The policy concern exists whenever a plan makes a lump sum distribution, including in the case of a plan that offers a lump sum at a participant’s initial annuity starting date as a permanent plan feature. While the high percentage of participants electing to receive lump sums under such plans may be troubling from a policy perspective, there isn’t much IRS/Treasury can do about it absent statutory changes. Likewise, IRS probably can’t do anything about lump sum offers on plan termination, given long established precedent.

The IRS and Treasury, however, do have legal concerns in addition to policy concerns in cases where a lump sum is offered to a participant who has already started receiving lifetime annuity payments. These legal concerns include:

- Spousal consent and qualified domestic relations order (QDRO) issues when a participant obtains a divorce between the original annuity starting date and the lump sum distribution date. The former spouse’s consent at the original annuity starting date and any subsequent QDRO — or the former spouse’s decision not to obtain a QDRO — did not contemplate the subsequent lump sum offer.
- Case law involving disputes among survivors raises questions about whether anything can change once payment has started in an annuity form.
- Calculation of the 417(e) minimum lump sum amount — a lump sum equal to the present value of future annuity payments may not be sufficient in cases where the reduction for early

retirement exceeds the reduction that would have been determined using 417(e) assumptions, or where the participant elected a joint and survivor payment form, but the joint annuitant has died. IRS is considering whether an alternative lump sum calculation should be required, based on the value of the accrued benefit adjusted for payments received. Members of the Intersector group expressed the view that at the time of a lump sum cashout of an annuitant in pay status, the normal retirement benefit was no longer a benefit available to that participant under the plan, so that no second calculation should be required.

IRS analysis of these legal concerns must take into account lump sums offered at plan terminations and second elections offered following the lifting of Code Section 436(d) accelerated distribution restrictions. We pointed out that placing restrictions on lump sum windows offered under ongoing plans that did not apply to lump sum offers on plan terminations would simply induce sponsors into spin-off terminations.

The Intersector Group expressed the view that many of the issues discussed are simply implementation issues, while the first question to be addressed is whether there is any statutory reason why cashouts of retirees should be entirely barred. The IRS and Treasury Department representatives indicated that all three agencies (IRS, Pension Benefit Guaranty Corporation, and Department of Labor) have concerns, and that fact may in and of itself cause plan counsel to look more closely at proposed transactions. Types of concerns include policy, litigation risk, retiree relations, Title I, and qualification rules. IRS/Treasury believes that people are not fully aware of some of the relevant case law and would be more cautious if they were.

We also discussed whether, following an annuity buyout, an annuity carrier could offer annuitants a lump sum (e.g., a cash surrender rider that is often included in insurance and annuity policies) that didn't meet the 417(e) minimum present value rules, and whether the answer depended on whether the qualified plan had previously offered a lump sum. The IRS and Treasury Department representatives indicated an annuity purchased from a qualified plan is viewed as a continuation of the qualified plan and must comply with 417(e) minimum present value rules just as it must meet qualified joint and survivor annuity rules.

The IRS and Treasury Department representatives also indicated proposed regulations on qualified longevity annuity contracts (QLACs) under defined contribution plans and partial lump sum options in defined benefit plans were nearing finalization. They indicated that they are being sensitive to how things have been done in the past under IRC 417(e). IRS is also providing input to DOL on the topic of providing illustrations of lifetime income from DC plans. The Intersector Group also raised the possibility of allowing deeply deferred annuities under DB plans (i.e., DB plan longevity insurance). The IRS and Treasury representatives agreed this was worth discussing further, and the Intersector Group indicated willingness to work on related initiatives. Lifetime income is an IRS priority, and they are thinking about many issues surrounding lifetime income but they have limited resources in terms of staff that are fluent in both DB and DC plans.

5. **Late retirement issues:**

a. **Follow up to last meeting.**

In our last meeting, we discussed apparent inconsistencies in how reviewers are handling various problems that may occur when participants continue working beyond their normal retirement dates (such as the correction of failures to provide suspension notices, method of calculating actuarial increases for late retirement). Since that meeting, has there been any outreach to staff

involved with Employee Plans Compliance Resolution System (EPCRS)? Is there agreement on how things should work post-65?

The field audit position when reviewing submissions to the Voluntary Compliance Program (VCP) on late retirement issues (such as failure to suspend benefits) is that the late retirement benefit should be determined using a “year-by-year, greater-of” calculation method. This method determines the late retirement benefit at each plan year-end up and the late retirement date as the greater of (i) the formula benefit counting all service and salary to date or (ii) the actuarial equivalent of the benefit determined at prior plan year-end (or normal retirement date, if later). The “greater-of” calculation means the actuarial increase is offset against continued accruals under the plan formula. They do not require the actuarial increase to be provided in addition to accruals under the plan formula, even when the plan was silent on whether the late retirement increases offset continued accruals. (The most common problem VCP is seeing in this area is plans that are completely silent as to what happens when a participant remains in service beyond normal retirement age – that is, the plan doesn’t provide for either a suspension or an actuarial increase.) While a document used by field agents indicates it may be acceptable in certain situations, they generally will *not* permit a “one-shot” calculation, which determines the late retirement benefit as the greater of (i) the formula benefit counting all service and salary to date or (ii) the actuarial equivalent of the benefit at normal retirement date. IRS is providing additional training for VCP staff and telling them to go through an actuary whenever they encounter issues involving late retirement benefit calculations. If a plan calls for the “one-shot” calculation, has a determination letter, and the plan sponsor was following the plan document, a plan examiner may not raise the issue.

We also briefly discussed cash balance plans and at what level the interest credits alone provided sufficient actuarial increases. While no conclusions were reached, the IRS and Treasury representatives expressed the view that all plans (with both traditional and hybrid formulas) may need to provide mortality increments in the deferral period, even if there is no forfeiture on death. They expressed the view that there was still a forfeiture of *retirement* benefits (that were then replaced with *death* benefits), and said that at younger ages that may be less important because the definition of “reasonable actuarial increases” is nebulous enough that many interest credit rates at younger deferral ages might be considered to cover both a reasonable interest and mortality increment, but at older ages the mortality increment is so significant that would not be possible.

b. Issues that arise when late retirement increases cause the benefit to bump up against Section 415 high-three pay limit.

We discussed whether a requirement to start in-service distributions in this situation was a benefit, right or feature (BRF) that required testing under 401(a)(4), and if so how and when it would be tested. For example, would it be tested only if and when a highly-compensated employee (HCE) was forced to start benefits? Or is it always tested because an HCE could conceivably be forced to start benefits in the future? If always tested, how can a sponsor address the fact that HCEs would likely be forced to start earlier than non-highly-compensated employees (NHCEs) in integrated plans and career average pay plans? How could a failure be corrected? No conclusions were reached.

c. Interaction of Qualified Domestic Relations Order (QDRO) and suspension rules.

When a plan suspends benefits for participants working beyond normal retirement age, how is the alternate payee under a separate interest QDRO affected when the participant works past normal retirement age? Can the plan suspend the alternate payee’s benefit, or reduce the participant’s

benefit to cover the increased cost of the AP's benefit? Or must the plan pay the alternate payee even though doing so increases the total cost to the plan of the participant's benefits?

We discussed whether plans that suspend benefits at normal retirement age could require QDROs to provide that if the alternate starts benefits while the participant is still in service, the alternate payee's benefit would be actuarially reduced from April 1 after the participant's 70½ year, with the amount adjusted at the participant's actual retirement date. No conclusions were reached.

6. Notice 2014-5 nondiscrimination relief for closed plans.

Have comments received in response the notice provided a sense of direction? How do you expect the project to proceed?

IRS received a dozen or so comments. They found survey results particularly helpful. But it is too soon to say what direction the project will take. IRS and Treasury Department remain concerned about sponsors "designing into" nondiscrimination relief that would not otherwise be available to an ongoing plan. They hope to get proposed regulations out by Oct. 15, so the regulations can be finalized before the temporary relief expires in 2015.

7. Updated mortality tables.

What is the expected process and timing for providing funding and lump sum mortality tables for 2016 and later plan years? Have you developed preliminary views on use of generational mortality? Do you expect to have different rules for small plans?

Updating the underlying table and methodology will require issuing proposed regulations for comment. IRS won't begin to work on a regulation or consider the generational/small plan issues until the Society of Actuaries finalizes the RP-2014 mortality tables and MP-2014 projection scale. One year is an aggressive schedule to complete the process of doing proposed and final regulations. If the Society of Actuaries does not produce combined mortality tables and IRS decides to do so, the process will take longer, as they will likely ask for input on how to combine the tables. If the RP-2014 tables and scale are finalized in late 2014, as anticipated, then regulations would not be in final form until at least very late 2015. Therefore, in order to give plans and practitioners time to adjust systems, etc. it seems probable that IRS 2016 mortality tables will be a continuation of the current approach, with new tables based on RP-2014 and MP-2014 taking effect in 2017.