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Comments on Proposed Regulations Relating to Measurement of Assets and Liabilities for Pension Funding Purposes

March 31, 2008

Department of Treasury
Internal Revenue Service
26 CFR Part 1
[REG-139236-07]

The American Society of Pension Professionals & Actuaries (ASPPA) appreciates this opportunity to comment on the proposed regulations regarding the measurement of assets and liabilities for pension funding purposes under Internal Revenue Code (Code) §430 as issued by the IRS and Treasury on December 31, 2007 (REG -139236-07) (Proposed Regulations). All references in this letter to a Section (§) are references to the Code.

ASPPA is a national organization of more than 6,000 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines, including consultants, administrators, actuaries, accountants and attorneys. Our large and broad-based membership gives ASPPA unique insight into current practical applications of ERISA and qualified retirement plans, with a particular focus on the issues faced by small- to medium-sized employers. ASPPA's membership is diverse but united by a common dedication to the employer-sponsored retirement plan system.

While the Proposed Regulations are a welcome step for practitioners who must apply the new funding rules, ASPPA requests clarification on several issues addressed in the Proposed Regulations, as well as guidance for additional issues not covered.

This comment letter was prepared jointly by ASPPA and the College of Pension Actuaries (COPA) working cooperatively together. Accordingly, both ASPPA and COPA are submitting identical comment letters. Because of the number of issues that need to be addressed, and questions that will no doubt arise when responses to issues raised in this first set of comments are known, ASPPA requests that there be an opportunity to comment on revised proposed regulations for §§ 430 and 436 before regulations are finalized. In addition, ASPPA requests that the IRS hold a public hearing on this proposed rule, *Measurement of Assets and Liabilities for Pension Funding Purposes*.

Should the IRS schedule a public hearing, ASPPA respectfully requests the opportunity to testify at the hearing.

Summary of Recommendations

The following is a summary of ASPPA's recommendations. These are described in greater detail in the Discussion of Issues section.

A. Allocation between Funding Target and Target Normal Cost

Final Regulations should detail how the cost of benefit changes resulting from factors that are not a direct result of changes in service or compensation (such as increases in Social Security, Social Security Covered Compensation, Floor Offset arrangements or §415 modifications) are allocated between funding target and target normal cost.

B. Amendment Issues Including Coordination with §436

1) Final regulations should align funding interest and mortality rates with the operational rates used by the plan and specifically carve out an exception for transitional minimum lump sum benefits.

2) Final regulations under §§ 430 and 436 should confirm that the remedial amendments are subject to §412(d)(2) and illustrate the interplay with §436(c).

3) Final regulations should clarify that the discounted value of §436 contributions made for amendments to which a §412(d)(2) election applies is included in the market value of plan assets for §430 purposes. Similarly, final regulations should also include the discounted value of §436(e) contributions in the market value of assets for purposes of §430.

4) Final regulations should provide that fleeting restrictions under §436 are ignored and permanent restrictions under §436 are recognized in the §430 valuation.

C. Insured Plans

1) Final regulations should clarify the definition of "value" for insurance contracts to be recognized in the §430 valuation.

2) Final regulations should clarify that if the plan trustees have the right to surrender insurance contracts for cash; such contracts are not eligible for the special funding exceptions available to irrevocable contracts.

D. Transition Interest Rates

The Service should repair the dissonance between the Proposed Regulations and the current method for publishing transition rates by changing the methodology for publishing rates.

E. §417(e) Benefits

1) Final regulations should provide that for plans using generational mortality, the proper mortality table when valuing §417(e) benefits should be a 50/50 male/female blend of the blended annuitant/non-annuitant rates, not just a 50/50 male/female blend of the annuitant rates.

2) Final regulations should require that plans recognize the difference between §417(e) and §430 interest rates in valuing §417(e) benefits to the extent the difference is due to the phase in of the yield curve under §430 or the phase in of the yield curve under §417(e), but only if such recognition has a material impact on the determination of the funding target.

3) Final regulations should provide that the use of the segment rates on the valuation date to value §417(e) benefits is a safe harbor, not a requirement.

4) Final regulations should provide "reasonable assumption" safe harbors for future variable interest credits under cash balance and other hybrid plans for §430 purposes.

F. Funding Method

1) Final regulations should provide several additional automatic approvals for funding method changes mandated by PPA, mandated by final regulations, mandated by demographic changes and due to a change in actuary.

2) Final regulations should provide that in any situation in which the plan's funding target is zero, the plan's Funding Target Attainment Percentage (FTAP) is 100%.

3) Final regulations should confirm that current year changes to funding method do not mandate changes to the prior year determination of the Adjusted FTAP (AFTAP).

4) Final regulations should allow the plan's administrator broad reliance on certifications and funding target determinations for plan administration purposes where those items are prepared by an actuary who is replaced by a second actuary who completes Schedule SB. The new actuary should not be constrained by the prior actuary's work or assumptions in preparing the Schedule SB for the year.

5) Final regulations should provide, for purposes of at-risk liability, the most valuable benefit is the benefit that produces the greatest liability, regardless of the associated annuity starting date or retirement date.

G. Timing of establishment of assumption and methods

Final regulations should provide that, for plans not required to file Form 5500, the plan's assumptions and methods will be deemed established 9 ½ months after the end of the plan year.

Discussion of Issues

A. Allocation between Funding Target and Target Normal Cost

The Proposed Regulations define the funding target and the target normal cost as the cost of benefits that are earned as of the first day of the plan year and the cost of benefits that are earned or expected to be earned during the plan year, respectively. The distinction between benefits in existence on the first day of the plan year versus benefits earned during the year is clear when the benefits being valued are either the accrued benefit, a function of the accrued benefit or a benefit that is a function of service or participation.

The Proposed Regulations are clear that benefit increases that occur as a result of increased compensation (even when such an increase is attributable to past service) is part of target normal cost. However, clarification is needed about how certain changes in benefits that are not service-related are to be allocated between funding target and target normal cost. Examples of these are changes in benefits as a result of adjustments made to benefits subject to the limitations set forth under §415, cost of living adjustments that may be made from time to time, changes to projected social security benefits, changes due to floor-offset arrangements and changes in covered compensation.

ASPPA recommends the final regulation provide that all changes in the cost of accrued benefits, other than those directly related to an increase in service or compensation, are treated as part of the funding target. That is, the funding target reflects benefits accrued as of the end of the prior plan year plus additional accruals attributable to prior service arising from amendments or plan adjustments triggered on the first day of the current plan year. Final regulations should also clarify that in the case of ancillary benefits that are not a function of the accrued benefit or are not service-based, a participant or beneficiary who has met all of the requirements for entitlement to a specific benefit as of the beginning of the plan year would have the entire cost of this benefit assigned to funding target. Before the triggering event, only the expected cost of the benefit for the current year would be reflected in target normal cost.

B. Amendment Issues Including Coordination with §436

1) Minimum funding under §430 ignores a plan amendment adopted after the plan's valuation date in the absence of a §412(d)(2) election. An election to take an amendment into account can only be made if the amendment is adopted within 2 ½ months after the end of the plan year. In light of PPA §1107, many plan sponsors will not adopt changes to the new segment rates or other PPA refinements (such as changes to the rules for hybrid plans) until the end of the 2009 plan year. In applying the regulations proposed at §1.430(d)-1(f)(4)(iii)(B) dealing with the use of funding segment rates to value lump sums and other distributions subject to §417(e)(3), it is not clear whether the instructions should be read relative to current plan provisions or the PPA provisions operationally in effect. In addition, in light of recent pronouncements about extending current GATT §417(e)(3) rates on a temporary basis and the usual one-year transition for shifting to new lookback or stability periods, §1.430(d)-1(f)(4)(iii)(C) should be clarified to explain whether the requirement to reflect "other" assumptions includes such a temporary basis.

   ASPPA recommends that the final regulations align funding interest and mortality rates with the operational rates used by the plan and specifically carve out an exception in §1.430(d)-1(f)(4)(iii)(C) for temporary minimum benefits. For other PPA changes that are permitted to be implemented operationally, ***ASPPA recommends*** that the Service and Treasury permit plans to reflect the changes as if adopted within the §412(d)(2) timeframe.

2) Remedial amendments to address qualification failures are subject to the same minimum funding treatment as discretionary amendments based on §412(d)(2). While discretionary amendments must be adopted within the plan year effective (Rev. Proc. 2007-44), the same rule is not applicable for remedial amendments. These can be adopted years after the date they must be effective under the new remedial amendment Cycles and as we see with cash balance plans held in abeyance under the moratorium.

   Many remedial amendments will escape the §436(c) test in that the underlying change is made to address a nonforfeiture requirement (such as modifications to cash balance plans to address the accrual rules). For other amendments, plan sponsors will need to know the relevant timeframe for assessing §436(c). Arguably, the point of §401(b) is to allow a change retroactive to the date of the defect for all qualification purposes – which would include §§ 401(a)(29) and 436. Thus, a remedial amendment in 2008 that is retroactive effective to 1999 for a cash balance moratorium plan would not be subject to §436(c) at all. A remedial amendment for a post PPA date will be subject to §436(c) but will not be known until perhaps many years later. It is impractical to set a requirement based on the effective date of such an amendment.

Similarly, a "corrective" amendment under §1.401(a)(4)-11(g) raises questions about when it is reflected for §§ 430 and 436. That regulation specifically indicates that a corrective amendment is not considered for §§404 and 412 (assuming §412(d)(2) does not allow otherwise). Consideration of such an amendment under §436(c) should be addressed. Is an amendment adopted in 2008 for 2007 assessed as a 2008 change under §436(c) to align it with its connection to the change in funding paradigm, or is it considered a 2007 change to align §436 with other qualification requirements?

ASPPA recommends that the final regulations under §§ 430 and 436 confirm that remedial amendments are indeed subject to §412(d)(2) and illustrate the interplay with §436(c). Final regulations should confirm that remedial and corrective amendments reaching back prior to PPA are not subject to §436(c) while such amendments for benefit improvements that are subject to §436(c) are evaluated as of the date adopted.

3) A sponsor of a plan that is less than 80% funded must pay for the increase in funding target that would result from an amendment for the amendment to take effect. But the funding target for MRC purposes must also reflect the amendment if a §412(d)(2) election is made. Unless the assets for §430 purposes (i.e., for calculating the MRC) are increased by the amount of the §436 contribution made, the funding target increase attributable to the amendment will be funded twice.

   ASPPA recommends that final regulations include the discounted value of any §436 contribution made as a result of a plan amendment (for which a §412(d)(2) election is made) in the market value of assets for purposes of §430. A similar double-counting problem exists when a plan sponsor makes a §436 contribution to a plan that is less than 60% funded to enable benefit accruals. Final regulations should also include the discounted value of §436(e) contributions in the market value of assets for purposes of §430.

4) The Proposed Regulations state that benefit restrictions under §436 are to be ignored for purposes of determining the funding target under §430. Interpreted broadly, this would require funding for amendments that would never be given effect and the continuation of target normal costs in frozen plans. IRS and Treasury representatives have indicated that the Proposed Regulations were not meant to be interpreted so broadly.

   The benefit restrictions under §436, which have the potential to affect funding, fall into three areas; (a) restrictions on accelerated forms of benefit payments, (b) restrictions on amendments which increase the plan's funding target, and (c) restrictions on continued plan benefit accruals[1]. Each of these restrictions has a different impact on the benefits payable from defined benefit plans and that

[1] Funding is also ultimately affected by shutdown and other unpredictable contingent event benefits, but ASPPA is not commenting on the impact of this restriction.

impact may be either temporary or permanent.. ASPPA believes that these two situations should be handled differently.

a) **Accelerated Distributions.** IRC 411(d)(6) provides that a plan may not be amended to remove a form of benefit with respect to past accruals. If the plan which had been restricted later becomes adequately funded, lump sum and other accelerated forms will resume automatically. This is a fleeting restriction in that it disappears as the plan's funding improves. It should be ignored for purposes of §430.

b) **Restricted Amendments.** An amendment cannot go into effect unless certain funding levels are achieved or contributions are made. If an amendment is not given effect at its proposed effective date, but once effective will be applied retroactively, then this is a fleeting amendment and should be taken into account for purposes of §430. If the amendment will not be applied retroactively, then the restriction would be permanent in regard to the current plan year and the amendment should not be taken into account for purposes of §430.

Proposed regulations do not address whether, in the absence of specific plan language, a restricted amendment will be applied retroactively once the plan meets the 80% threshold. Consider an amendment adopted in 2008 with a 2008 effective date. The plan first meets the 80% funded threshold in 2013. It is not clear from the §436 Proposed Regulations if, in 2013, the amendment is applied retroactive to 2008, or if the amendment has only prospective effect (or no effect). If the amendment is effective retroactive to 2008, the restriction is fleeting and the amendment should be taken into account for purposes of §430. If application would not be retroactive, the MRC determination should not reflect the amendment until the year the threshold is met.

c) **Benefit Accruals**. Plans that are less than 60% funded must freeze benefit accruals. The plan may provide that once frozen in this manner,

- the freeze is permanent, or
- benefits will begin to accrue prospectively once the plan is adequately funded to allow continuing accruals, or
- benefits will be retroactively restored to the original freeze date once the plan is adequately funded

The first two bullets represent permanent changes to the plan that should be recognized in the determination of the MRC. The benefits not allowed to accrue in the frozen years will never accrue and thus need not be funded

The third bullet represents a fleeting benefit freeze, in that once the funding problems are dealt with, the accruals will be revived, retroactively. Thus, since benefits under the plan that will eventually be funded, no benefits are

ever "lost." This temporary freeze should not be recognized for §430 purposes.

ASPPA recommends that final regulations recognize the difference between fleeting and permanent benefit restrictions and provide that for purposes of determining the plan's funding target, permanent restrictions are recognized, while fleeting restrictions are ignored. Furthermore, final regulations should clarify how a restricted amendment is applied when the plan reaches the 80% threshold one or more years after the amendment's stated effective date. However, contrary to the general rule that the funding target for §436 reflect the same benefit structure as §430, funding targets used to assess §436(c) should not include the amendment to be evaluated even if included for §430 in light of a §412(d)(2) election.

C. Insured Plans

1) Plan benefits provided through insurance contracts are to be reflected in the funding target and the target normal cost. The plan assets are required to reflect the "value" of the corresponding contracts.

   ASPPA recommends that final regulations specify what the value of the contract is (even if by reference to prior guidance) so there is uniform treatment for recognizing the value.

2) The Proposed Regulations provide an exception to the normal funding rules for certain benefits provided by insurance contracts. The regulation allows for the exclusion of benefits from the funding target and target normal cost and a corresponding exclusion of the value of insurance contracts from plan assets, to the extent that the participant (or participant's beneficiary) has an "irrevocable contractual right" to receive such benefits from the contract. Under the exception, it is clear that retiree annuities and other fully-paid-for guaranteed contracts can be excluded from the valuation as well as the associated benefit.

   The Proposed Regulations imply that the benefit payable under a contract on a reduced-paid-up basis can be excluded, provided there is an irrevocable obligation to provide the benefit. An irrevocable obligation to provide the benefit may exist on the part of the insurer, but the trustee of the plan normally has discretion (assuming the plan is the owner of the contract) to surrender the contract. If the obligation is not irrevocable by the contract owner, as well as the insurer, the participant's (and his or her beneficiaries') irrevocable right to benefits under the contact is compromised.

   ASPPA recommends that the value of the benefits and the recognition of the value of the contract as an asset should be included for §430 valuation purposes regardless of the values that would be available on a "paid up" basis if the trustee has discretion to surrender the contract.

D. Transition interest rates

The published yield curve rates blend the current liability interest rate for the specified month with the yield curve for that month. However, both the law and the Proposed Regulations indicate that the correct technique is to blend the current liability rate for that plan year with the yield curve for the applicable month. There is a difference. For example, a plan year beginning January 1, 2008 using a two-month look-back would have a different rate than a plan year beginning February 1, 2008 having a three-month look-back. The rates should be published differently to conform to the law and regulations.

ASPPA recommends that the Service expand the publication of rates to include all allowable combinations of current liability and yield curve rates.

E. §417(e) Benefits

The Proposed Regulations provide a methodology for valuing §417(e) benefits. The yield curve is applied from the valuation date to the expected payment dates using the underlying normal form annuity paired with the §417(e) mortality table for periods after commencement. A second option is provided for plans using generational mortality.

1) **Mortality Table.** The Proposed Regulations state that in the first of the two options set forth in the item above, the base mortality rates are blended 50/50 male and female based on the annuitant rates. The gender-neutral table for §417(e) is a 50/50 male/female blend of the combined static table and not a blend of the annuitant rates for the static table.

   ASPPA recommends that, for consistency, any optional generational mortality table should be a blend of 50/50 male/female rates, after combination of the Non-Annuitant and Annuitant rates using the weighting factors for small plans as specified in Proposed Regulation §1.430(h)(3)-1.

2) **Yield curve**. The Proposed Regulations provide that the valuation interest rates under §430(h)(2) are to be used to value §417(e) benefits. The rationale is that the yield curve represents the best estimate of future interest rates. However, unless one assumes that the yield curve will be flat in the future, this "best guess" is on its face wrong. If the first segment rate for 417(e) twenty years from the valuation date were in fact equal to the current third segment, it is most likely the second and third segments would be higher, not equal to, that projected first segment rate. The availability of safe harbor rates is important, but the actuary should be able to use other interest assumptions if, in the actuary's judgment, alternative assumptions would be more reasonable.

ASPPA recommends that final regulations provide that the use of the §430(h)(2) rates on the valuation date to value §417(e) benefits is a safe harbor, not a mandate.

3) **Interest Rate Phase-in**. The Proposed Regulations provide the actuary with the option to recognize in the valuation the difference between interest rates for §430 purposes and interest rates for §417(e) purposes to the extent the difference is due to the phase- in between PFEA interest rates and PPA rates in 2008 and 2009, or due to the phase-in between GATT and PBGC rates in 2008 through 2011. There is no requirement that these phase-ins be recognized, although the impact can be significant for benefits assumed to be payable during the phase-in period. This could lead to significant funding shortfalls in future years if large cashouts at the higher phase-in rates are permitted during the intervening period.

   ASPPA recommends that the phase-ins be required to be taken into account in valuations to the extent the phase-in has a material impact on the plan's funding target.

4) **Future Interest Credits.** The proposed regulation states that, to satisfy the requirement to take into account lump sum payments for "applicable defined benefit plans" described in §411(a)(13)(C), future interest credits or equivalent amounts must be projected "using reasonable actuarial assumptions."

   ASPPA recommends that safe harbors be permitted for plans with variable interest credits. Such safe harbors should include the assumed continuation of the most recent annual interest credit rate as well as the plan termination rule (i.e., the average of the five most recent annual rates).

F. Funding Method

1) Proposed Regulation §1.430(g)-(1)(f) provides for automatic approval of changes in actuarial funding method which are not inconsistent with §430 in the first year in which §430 applies. ASPPA agrees this is necessary, but certain other changes in actuarial funding method also should be permitted without the Commissioner's approval.

   ASPPA recommends the following changes in funding method be automatically approved:

   a) If upon final issuance of §430 regulations, an actuary determines that a portion of his funding method is not consistent with the final §430 regulations, the actuary should be able to change to a funding method consistent with the final §430 regulations without applying to the Commissioner.

   b) Automatic approval should be available for certain changes in actuarial firms and actuarial software, similar to Revenue Procedure 2000-40.

c) The proposed regulation provides for automatic approval for a change in valuation date if the change is required by §430 due to a plan's participant count increasing to over 100 participants. ASPPA suggests that there be a similar approval when the participant count goes below 100 participants so that an actuary may change the valuation date to any date allowed by §430.

d) Automatic approval should be available to change certain unreasonable funding methods. For example, the proposed regulation provides that certain participants may be excluded unless a plan's experiences make such exclusion unreasonable. If an actuary determines that such exclusion is no longer reasonable, automatic approval should be available to change this element of the funding method.

2) Proposed Regulation §1.430(i)-1(b)(5)(i)) provides that the funding target attainment percentage and the at-risk funding target attainment percentage are 100% for years prior to a plan's existence.

ASPPA recommends that the funding target attainment percentage should be 100% when the funding target is zero, including for years prior to the plan's existence.

3) If a plan changes any portion of its funding method, such as its asset valuation method or valuation date, guidance is needed as to whether the prior year's funding target attainment percentage should be re-determined on the new basis.

ASPPA recommends the prior year's funding target attainment percentage should not be affected by a change in funding method for the current year. This position would be consistent with how funded current liability percentages were determined under old law.

4) The final regulations should address issues arising due to a mid-year change in actuarial firm. The change in actuary may be voluntary or required by the prior actuary's death or disability. For instance, if the prior actuary has already certified the AFTAP for a particular year, the new actuary should be able to rely on the funding target determined by the prior actuary for subsequent measurement dates during the year, to the extent the subsequent certifications do not require a redetermination of the funding target. For instance, if a subsequent certification is provided (despite the fact that it may not be required) simply to account for an additional prior year contribution, there would be no need for a redetermination of funding target.

ASPPA recommends that final regulations specifically allow the new actuary and the plan administrator to rely on certifications and the funding target determined by the prior actuary, except in situations that require a redetermination of the funding target. Further, there should be no consequences to the plan or the new

actuary, if the § 430 liabilities certified by the new actuary on the Schedule SB for the year materially differ from the liabilities reflected in the AFTAP certification prepared by the previous actuary due to changes in assumptions or methods.

5) The proposed regulation provides additional actuarial assumptions concerning certain participants' retirement age for determining the at-risk funding target. Proposed Regulation §1.430-1(c)(3)(iii) provides that the actuary shall assume that a participant elects the most valuable optional form of payment at the date of assumed retirement. In determining the at-risk funding target, additional guidance is needed on how to determine the most valuable option form of payment when the most valuable option form of payment may involve deferring receipt of the benefit for a period of years. For example, if under 1.430(i)-1(c)(3)(ii) a participant is assumed to retire at age 55, but due to the plan's early retirement factors the most valuable option is a deferred 50% joint and survivor annuity payable at age 60, should the actuary assume that the individual commences his benefit at age 55 or age 60?

   ASPPA recommends the most valuable optional form of payment be determined as the benefit that produces the greatest liability, even if the benefit would not be payable at the earliest possible annuity starting date.

G. Timing of establishment of assumption and methods

The filing of the first actuarial report (Schedule SB to Form 5500) for a plan year under §6059 that reflects the use of actuarial assumptions and a funding method is treated as the establishment of those assumptions and the funding method for that plan year. However, for plans not required to file a Form 5500, the method and/or assumptions are deemed established seven months after the end of the plan year. This due date is problematic, since it sets an earlier deadline than the date that the contribution needs to be determined for minimum funding purposes. The date could also cause confusion, since it is earlier than the date for Form 5500 filers.

ASPPA recommends final regulations provide the establishment date is 9 ½ months after the end of the plan year - the due date, including extensions, for filing a Form 5500. This will put all plans on the same footing.

These comments were prepared by ASPPA's Defined Benefit subcommittee of the Government Affairs Committee in cooperation with COPA. ASPPA was represented by Thomas J. Finnegan, MSPA, CPC, QPA, David M. Lipkin, MSPA, Maureen J. DeSensi, QPA, Marjorie R. Martin, MSPA, Karen Nowiejski, MSPA, and Kurt F. Piper, MSPA. Please contact us if you have any questions or comments regarding the matters discussed above. Thank you very much for your consideration of these comments.

Sincerely,

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