Comments on Temporary and Final Section 401(a)(9) Regulations

October 21, 2002

CC:M&SP:RU

(REG-130477-00/REG-130481-00)

Room 5226, Internal Revenue Service
POB 7604, Ben Franklin Station
Washington, DC 20044

Re: Comments on Temporary and Final Section 401(a)(9) Regulations

The American Society of Pension Actuaries ("ASPPA") offers the following comments on the final and temporary regulations under Internal Revenue Code ("Code") section 401(a)(9), issued on April 17, 2002 ("Regulations").

ASPPA is a national organization of approximately 5,000 members who provide actuarial, administration, consulting, legal and other professional services for qualified and other retirement plans.

As indicated in the preamble to the Regulations, the section of the Regulations governing defined benefit plans and annuities has been issued as final and temporary regulations in order to allow taxpayers to comment on the changes made to the rules contained in the 2001 proposed regulations. After careful review of the temporary rules for defined benefit plans and annuity contracts, ASPPA believes that there are a number of important issues that Treasury and the Service should reconsider before January 1, 2003, the current proposed effective date for the Regulations.

1. Regulations require mandatory annuity distribution with respect to defined benefit plans not minimum required distributions.

It appears that the Regulations require that a participant in a defined benefit plan must begin an annuity form of distribution as of the required beginning date with no opportunity to elect a lump sum or other form of distribution at a later date, such as when a participant actually stops working or dies. In addition, the "default" form of distribution under the Regulations is a qualified joint and survivor annuity. Once required minimum distributions have begun, the Regulations seem to say that a participant or beneficiary cannot elect other forms of distribution at a later date, such as when the participant terminates employment or dies, even though such options are available under the terms of the plan. In other words, the Regulations require a mandatory annuity distribution as opposed to a minimum required distribution. This is because the Regulations specifically prohibit the annuity payments representing the minimum required distributions from increasing, thus foregoing a subsequent election to increase benefits by the participant. By contrast, the Regulations permit a subsequent election to increase benefits from a commercial individual annuity.

The mandatory annuity distribution requirement with respect to defined benefit plans contained in the Regulations results in a tremendous loss of flexibility and can produce some harsh results for participants and their families. For example, a married participant who is also a small business owner and who begins receiving required minimum distributions in the form of a QJSA cannot later elect installment payments in a larger amount when he or she actually stops working. If the participant dies, the spouse may be

only entitled to a survivor annuity, which may mean that a large portion of the participant's accrued benefit is forfeited. If the participant had been unmarried since the required beginning date, the entire benefit would be forfeited at death. A significant number of defined benefit plans, particularly those established by small and medium-sized businesses, provide for a lump sum form of benefit, including a death benefit payable to a surviving spouse or other designated beneficiary. In the case of a small business owner who must begin receiving required minimum distributions after attaining age 70-½, even though not yet retired, the Regulations seem to force an irrevocable annuity election upon the owner and deprive the owner of the various non-annuity forms of distribution available under the plan, including the lump sum option.

2. The mandatory annuity distribution requirement in the Regulations should be eliminated and instead required minimum distributions from a defined benefit plan should be based on, but should not require, an annuity form of distribution.

We believe that the required minimum distribution Regulations are intended to provide rules for calculating the "minimum" amount that a participant must begin receiving from the plan at his or her Required Beginning Date and continuing until the participant actually retires and elects a form of distribution from the options available under the terms of the plan. The required minimum distribution Regulations should not force an election of benefit form on the participant or beneficiary earlier than required under the plan terms and the rules should not lock a participant in to a specified annuity form at the required beginning date. In particular, the Regulations should not mandate an annuity distribution from a defined benefit plan while at the same time permitting subsequent different distribution forms from a commercial individual annuity. We cannot think of an important policy reason for having required minimum distributions supplant a participant's choice of distribution methods that would otherwise be available when the participant actually retires. Nor can we think of a significant policy reason for having the required minimum distribution rules act to prevent a participant from accelerating the rate of his or her distributions as permitted by the defined benefit plan. We can, however, think of several policy reasons why a deceased participant's spouse or family should be entitled to the full actuarial equivalent of the remaining pension benefit.

We appreciate the concerns of Treasury and the Service that required minimum distributions from a defined benefit plan not be so "backloaded" as to circumvent the intent of IRC section 401(a)(9). However, we believe these concerns can be dealt with in a manner that will not preclude a participant from a subsequent election to accelerate the level of distributions. We would propose simply that the minimum required distribution from a defined benefit plan would instead be "based" on the amount that would be paid had the participant elected a life annuity (or a QJSA in the case of a married participant) as of the required beginning date. This would in effect produce the same level of required minimum distributions from a defined benefit plan as proposed in the Regulations, but without restricting the ability of a participant to make a subsequent election permitted by the plan to distribute more than the minimum required distribution. We believe such a rule would more accurately reflect the true intent of IRC section 401(a)(9) by requiring a minimum level of distributions without mandating a form of distribution.

3. Cash balance plans should be permitted to continue use of the account balance method.

We understand that Treasury and the Service are in the process of developing comprehensive proposed regulations governing so-called "cash balance" plans that will address age discrimination, backloading, and other nondiscrimination issues respecting such plans. We very much look forward to the issuance of these proposed regulations and are hopeful that they will make a valuable contribution to sensible retirement policy and the revitalization of defined benefit plans. Cash balance plans, unlike traditional defined benefit plans as you know, are plans the benefits of which are expressed as a hypothetical account balance, not as an annuity. In fact, we assume that the proposed cash balance regulations will define "cash balance plan" with some reference to the manner in which the

benefit is expressed. This definition and the proposed regulations we expect will reflect that cash balance plans are in fact different than traditional defined benefit plans and as such should be treated differently for purposes of several qualified plan rules. We would propose that similarly, cash balance plans should be treated differently for purposed of the minimum required distribution rules.

In so doing we would propose that the Regulations, as finalized, provide for minimum required distributions from a cash balance plan to be determined using the account balance method permitted under the 2001 proposed regulations. Allowance of such method, will provide for greater simplicity both from the standpoint of the plan sponsor as well as the plan participant. Further, it will protect participants who want to utilize the account balance method from being forced to rollover their account balance to an IRA. Permitting participants to maintain their account balance in the cash balance plan will enable those participants to earn guaranteed interest credits on their account balances as opposed to uncertain investment returns with an IRA. Simply put, the account balance method just makes more sense from everyone's standpoint where the benefit is expressed in terms of an account balance.

4. Effective date of Regulations, when finalized, should be made optional for distributions beginning in 2003.

We believe that it is certainly not an understatement that the new rules in the Regulations governing minimum required distributions from defined benefit plans represent a significant change from generally accepted current practice, whether or not you accept the notion that current practice was permissible. Additionally, it is our general understanding that a significant number of both practitioners and plan sponsors are not fully aware of the changes proposed. Further, we hope that the Regulations, when finalized, will at least to some degree reflect some of the comments we have made by this letter, as well as other suggestions made by different commentators. Then, after the Regulations are finalized, new model amendments will have to be written to implement them. As such, given the amount of time left before the beginning of 2003, the current proposed effective date for the Regulations, we would expect both practitioners and plan sponsors alike to be woefully unprepared to deal with the new rules. As such, we would respectfully request that when the Regulations governing minimum required distributions from defined benefit plans are finalized, that they be optional for 2003, and then mandatory for distributions beginning in 2004.

These comments have been prepared by the Internal Revenue Service subcommittee of ASPPA's Government Affairs Committee with assistance from the Administration Relations Chair. We appreciate the opportunity to provide these comments, and are available to discuss them with you further.

Sincerely,

James C. Paul, Chair
Internal Revenue Service Committee

Bruce L. Ashton, Esq., APM, Co-Chair
Government Affairs Committee

Jeffrey C. Chang, Esq., APM
Administration Relations Chair

Brian H. Graff, Esq.
Executive Director

R. Bradford Huss, Esq., APM, Co-Chair
Government Affairs Committee

cc:
William F. Sweetnam, Treasury
Carol Gold, IRS
Paul Shultz, IRS

Return to ASPPA Government Affairs Visit the ASPPA web page