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Comments on the Proposed Regulations Regarding Distributions from a Pension
Plan Under a Phased Retirement Program

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Part 1: Comments on Proposals Regarding Selection of a Normal Retirement Age

February 2, 2005

Comments to the Department of the Treasury
Internal Revenue Service

26 CFR Part 1
[REG-114726-04]
RIN 1545-BD23

The American Society of Pension Professionals & Actuaries (ASPPA) offers comments on the proposed regulations regarding Distributions from a Pension Plan Under a Phased Retirement Program (REG-114726-04). ASPPA's comments are set forth in two separate documents. This document (Part 1) addresses proposed rules governing selection of a normal retirement age. A separate forthcoming document (Part 2) will address aspects of the proposed regulations other than those governing selection of a normal retirement age.

ASPPA is a national society of retirement plan professionals. ASPPA's mission is to educate pension professionals and to preserve and enhance the private pension system. Its membership consists of approximately 5,500 actuaries, plan administrators, attorneys, CPAs and other retirement plan experts who design, implement and maintain qualified retirement plans, especially for small to mid-size employers.

Overview

Phased retirement is an important emerging feature of pension plan design and administration. ASPPA commends the Treasury Department and the Internal Revenue Service for taking a forward-looking initiative in proposing regulations that have the potential for furthering and enhancing development of this feature.

However, the proposed regulations would add a new regulatory restriction on definitions of normal retirement age. This new restriction would have implications going far beyond issues involving the requirements of a bona fide phased retirement program.

The proposed restriction might be perceived as a step in reducing "leakage." Yet, the more significant aspect of leakage—what happens when a worker changes jobs—would go

untouched. ASPPA believes the whole question of leakage should be addressed separately. ASPPA believes the new restriction governing a plan's definition of normal retirement age should be deleted from the proposal.

Detailed Comments

Before enactment of ERISA, guidance on acceptable definitions of a normal retirement age was furnished in Rev. Rul. 71-147. This ruling stated that an age different from age 65 is acceptable, "provided that if it is lower than 65, it represents the age at which employees customarily retire in the particular company or industry...."

With enactment of ERISA, §411(a)(8) was added to the Code. At the time of enactment, this section defined "normal retirement age" as the earlier of (1) the time a plan participant attains normal retirement age under the plan, or (2) the later of (a) the time a plan participant attains age 65, or (b) the 10th anniversary of the time a plan participant commenced participation in the plan. The reference to the 10th anniversary was later changed to the 5th anniversary.

Recognizing that this provision of ERISA conflicted with the provisions of Rev. Rul. 71-147, Treasury and the Service modified Rev. Rul. 71-147 by publishing Rev. Rul. 78-120. This latter ruling states that "in the absence of any statutory prohibition or limitation, a plan may specify any age that is less than 65 as the normal retirement age." It goes on to discuss rules not relevant here regarding the application of Code §415.

A great many plan sponsors have relied on the provisions of ERISA §411(a)(8) and Rev. Rul. 78-120 by adopting definitions of normal retirement age that might have been in violation of Rev. Rul. 71-147, had it not been modified. These definitions might also violate the rules of the proposed regulations on phased retirement programs if those rules are adopted as proposed.

A plan's definition of normal retirement age has many implications totally unrelated to phased retirement rules. For example, the rules of Code §417(e)(3) govern the conversion of normal benefit forms to certain optional forms. These rules are keyed to benefits payable at normal retirement age.

The proposed regulation would amend Treas. Reg. §1.401(a)-1(b)(1)(i) to provide that the normal retirement age "cannot be earlier than the earliest age that is reasonably representative of a typical retirement age for the covered workforce." This restriction would affect many plan sponsors having no current interest in phased retirement. It would arguably be poor policy to require that these sponsors now change their definitions of normal retirement age. In many cases, a change in a plan's definition of normal retirement age would require changes in numerous other plan provisions in order to ensure that the plan continues to meet its sponsor's objectives. These changes would involve actuarial, legal and administrative expenses. They would also require employee communications campaigns that may be confusing to plan participants. In a few cases, plan sponsors might elect plan termination rather than accommodation of the new rules.

In considering any form of grandfather protection, it would be unfair to grandfather existing plans while requiring new plans that might be totally uninterested in phased retirement, to follow new rules.

Furthermore, the new restriction would be difficult for many sponsors and many examiners to interpret. This would be especially true with small plans, most of which will not be candidates for adoption of phased early retirement programs. In many cases, it would be virtually impossible to determine "the earliest age that is reasonably representative of a typical retirement age for the covered workforce." Retirement patterns are constantly changing with economic cycles and long-term social changes. In addition, many workforces are composed of diverse groups such that a single "representative" retirement age is not a workable standard.

The concept of ensuring that retirement savings are preserved to provide retirement income is very important. Steps to enhance this preservation--to avoid the problem of leakage--deserve serious attention. However, viewed solely from the standpoint of phased retirement rules, the proposed restriction appears to have very limited meaning. This meaning appears to extend solely to a continued demonstration that the phased early retiree has satisfied the reduced work hours requirement and, possibly, the benefit suspension notice rules.

Parenthetically, ASPPA believes that Congress should consider more steps to reduce a far more significant type of leakage that occurs when a worker changes jobs before retirement and withdraws retirement savings in the process.

ASPPA recommends that the proposed amendment to Treas. Reg. §1.401(a)-1(b)(1)(i) that would provide new restrictions on a plan's definition of normal retirement age not be adopted.

This letter was primarily authored by Edward E. Burrows, MSPA, of the Phased Retirement Task Force, which is chaired by Marjorie R. Martin, MSPA. Please contact us if you have any comments or questions regarding the matters discussed above.

Sincerely,

Brian H. Graff, Esq. APM Executive Director	Teresa T. Bloom, Esq., APM, Co-chair Gov't Affairs Committee
Ilene H. Ferenczy, Esq., CPC, Co-chair Gov't Affairs Committee	George J. Taylor, MSPA, Co-chair Gov't Affairs Committee
Sal L. Tripodi, Esq., APM, Co-chair Gov't Affairs Committee	Robert M. Richter, Esq., APM, Chair Administrative Relations Committee