ASPPA
WORKING FOR AMERICA'S RETIREMENT

Comments on Proposed Regulations Relating to Protected Benefits Under Code Section 411(d)(6)

November 10, 2005

Department of Treasury
Internal Revenue Service
REG-156518-04

The American Society of Pension Professionals & Actuaries (ASPPA) appreciates this opportunity to comment on the proposed regulations that provide guidance regarding protected benefits under Internal Revenue Code (IRC) §411(d)(6) (Proposed Regulations).

ASPPA is a national society of retirement plan professionals. ASPPA's mission is to educate pension professionals and to preserve and enhance the employer-sponsored 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.

The Proposed Regulations are welcome guidance in response to the US Supreme Court's decision in Central Laborers' Pension Fund v. Heinz, 541 US 739 (June 7, 2004). However, ASPPA requests that the Proposed Regulations be modified with respect to the issues described below.

Summary of Recommendations

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

A. Treasury should not expand the application of IRC §411(d)(6) to vesting schedule rules.

B. Treasury should expand the rules regarding the Utilization Test set forth in the Proposed Regulations so that a broader range of plans may be able to eliminate optional forms of benefits that are rarely, if ever, used.

Discussion of Recommendations

A. Application of IRC §411(d)(6) to Amendments Changing Vesting Schedules

The Proposed Regulations provide that a vesting schedule cannot be amended to prolong the vesting period with respect to benefits accrued as of the date of the amendment. However, IRC §411(a)(10) addresses both the cutback of existing vesting schedules and the rights of participants to continue to vest under a pre-amendment vesting schedule if the participant has at least three years of service:

CHANGES IN VESTING SCHEDULE

(A) GENERAL RULE. A plan amendment changing any vesting schedule under the plan shall not be treated as satisfying the requirements of paragraph (2) if the nonforfeitable percentage of the accrued benefit derived from employer contributions (determined as of the later of the date such amendment is adopted, or the date such amendment becomes effective) of any employee who is a participant in the plan is less than such nonforfeitable percentage computed

under the plan without regard to such amendment.

(B) ELECTION OF FORMER SCHEDULE. A plan amendment changing any vesting schedule under the plan shall be treated as not satisfying the requirements of paragraph (2) unless each participant having not less than 3 years of service is permitted to elect, within a reasonable period after the adoption of such amendment, to have his nonforfeitable percentage computed under the plan without regard to such amendment.

In the *Central Laborers'* decision, the Supreme Court provides broad language stating that "at the moment the condition is imposed, the accrued benefit becomes less valuable…" resulting in an impermissible cutback under Section §411(d)(6). Based on that assertion, Treasury is apparently applying the general accrued benefit cutback rules to amendments changing vesting schedules.

The Supreme Court and the Treasury recognize that the vesting rules of IRC §411 are separate from the anti-cutback rules of IRC §411(d)(6) and that both rules must be satisfied. The Proposed Regulations apply the reasoning of the *Central Laborers'* decision to provide that a permissible modification to a vesting schedule may result in a reduction of an accrued benefit under IRC §411(d)(6). However, the *Central Laborers'* case dealt with the application of an amendment to participants who had already retired under the pre-amendment early retirement provisions of the plan. Using the suspension of benefit rules in a defined benefit pension plan impacts the actuarial value of an accrued benefit and, under the *Central Laborers'* decision, amending the plan to broaden the suspension of benefit rules was determined to violate the anti-cutback rules of IRC §411(d)(6).

A distinction can be made, however, between general vesting rules under IRC §411(a) and the suspension of benefit rules that were the subject of the *Central Laborers'* decision. The application of the suspension of benefit rules permit a plan to cease benefit payments when a retiree engages in prohibited employment without providing a corresponding increase in later retirement benefits to reflect the missed payments during the period of suspension, resulting in a forfeiture of the value of the retiree's accrued benefit. The general vesting rules speak to the issue of when an employee obtains ownership over his or her accrued benefits, but otherwise do not affect the value of the benefit accrued.

- The committee report to IRC §411(d)(6) (1984 Retirement Equity Act, PL 98-397, 8/23/84) provides in part (emphasis added):

The bill generally protects the accrual of benefits with respect to participants who have met the requirements for a benefit as of the time a plan is amended and participants who subsequently meet the preamendment requirements. The bill does not, however, prevent the reductions of a subsidy in the case of a participant who, at the time of separation from service (whether before or after the plan amendment), has not met the preamendment requirements. *The provision does not change any rules under which accrued benefits become vested.*

More importantly, IRC §411 contains an explicit rule in subsection (a)(10) to deal with the protection of an employee's vesting rights when the vesting schedule is amended. Moreover, the Proposed Regulations broadly define "vesting schedule" for this purpose to encompass any plan provision that directly or indirectly affects the computation of the vesting percentage. This would include the addition of the rule of parity, for example. Under IRC §411(a)(10), the plan is required to protect the vesting percentage currently earned by the employee prior to the amendment, and, for those employees with at least three years of service, the plan must provide an opportunity to elect to stay on the old schedule if the old schedule at any point in the future is more favorable than the new schedule. It is clear in the statute that the concern is future increases in vesting, without distinguishing between benefits already accrued and benefits to be accrued in the future, and how those future vesting rights compare with the pre-amendment terms of the plan.

The position taken in the Proposed Regulations, whereby the *Central Laborers'* decision is interpreted to reach vesting schedule amendments, would effectively rewrite the language in IRC §411(a)(10)(A). Regardless of whether an employee with three or more years of service expressly chooses to move to the new

schedule, which is clearly intended by IRC §411(a)(10)(B), the Proposed Regulations would require the *future* vesting to be no slower than the pre-amendment schedule with respect to benefits already accrued. In addition, employees with fewer than three years of service, who were not given the election rights provided in IRC §411(a)(10)(B), would get the same level of future vesting protection on existing accrued benefits. This is an improper application of the *Central Laborers'*decision because IRC §411(a)(10)(A) requires only the preservation of the currently earned vesting percentage, and not the right to future vesting levels with respect to benefits accrued at the time of the amendment. This easily could have been included in the statutory mandate but was not.

- It has long been the understanding of plan administrators, supported by the statutory language, that the pre-amendment vesting rights are protected only to the extent *already earned* at the time of the amendment and, in the case of a participant with three or more years of service, can be continued with respect to future vesting rights only if so elected by the participant [or, if provided by the plan, by default if the participant does not make a timely election under IRC §411(a)(10)(B)]. The *Central Laborers'* decision does not provide compelling evidence that the principles of that decision should be applied to vesting amendments where the statute contains a clear rule for protecting vesting rights in this situation, and the failure to maintain future vesting under the pre-amendment schedule does not result in a direct reduction of the value of a participant's benefits, as does the addition or expansion of a plan's suspension of benefit rule.

ASPPA recommends that the final regulations provide that amendments to vesting schedules are only subject to the requirements of IRC §411(a)(10), and that the *Central Laborers'* decision be confined only to the addition or expansion of rules in the plan that are permitted by IRC §411 and that result in a reduction of the actuarial value of a participant's accrued benefit.

B. Expansion of the Utilization Test

The Utilization Test set forth in the Proposed Regulations provides that a plan may not be amended to eliminate core optional forms of benefits unless the form being eliminated was available to at least 100 participants included during the look-back period. The Proposed Regulations state that the Utilization Test will not be satisfied if "a plan does not have at least 100 participants who can be taken into account during the relevant five-year period." To be included, a participant must have been "eligible to commence payment of an optional form of benefit that is part of the generalized optional form being eliminated."

The Utilization Test is very restrictive and will preclude many plans from being able to use the relief available under the Proposed Regulation. Smaller plans will not even have 100 participants, much less 100 retirees. In addition, it is not unusual for larger plans to have fewer than 100 retirees within a five-year period. Furthermore, very large plans may never be able to satisfy the requirement that no participant has ever used the optional form of benefit that a plan sponsor wants to eliminate.

The Proposed Regulations also provide that in determining whether the 100 participant requirement has been met, a plan may not take into account retirees who elect a lump-sum benefit. Many participants elect lump-sum distributions, thereby making the 100 participant requirement even more difficult to satisfy. There does not appear to be any policy reason to carve out lump-sum elections in this calculation.

ASPPA recommends that the Utilization Test be broadened so that it is effectively available to a larger number of plans. In that regard, ASPPA recommends the following changes:

- 1. An alternative to the 100 participant requirement should be established to allow smaller plans the opportunity to qualify for the Utilization Test. ASPPA suggests that the rules be expanded to cover plans that have at least 10 participants (but fewer than 100 participants) in their look-back group. For these plans, the Utilization Test should be available as long as the number of participants in the look-back group is at least 3% of the total average active participant count during the look-

back period;

2. A special rule should be established to provide that the Utilization Test is met if the optional form of benefit being eliminated was used by fewer than 1% of retirees during the look-back period where the plan has more than 200 participants in its look-back group; and

3. Participants who elected lump-sum distributions should be taken into account in applying the Utilization Test.

These comments were prepared by ASPPA's IRS subcommittee of the Government Affairs Committee, Mark L. Lofgren, Esq., APM, Chair, and were primarily authored by A. Michael Marx, Esq., APM. Please contact us if you have any comments or questions regarding the matters discussed above. Thank you for your consideration of these comments.

Sincerely,

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