

Intersector Group Meeting with the Internal Revenue Service and U.S. Department of Treasury Notes

March 9, 2016

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 discuss regulatory and other issues affecting pension practice. 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. Attending from the Intersector Group at this meeting were Tom Finnegan, Eli Greenblum, Tonya Manning, Judy Miller, Heidi Rackley, Josh Shapiro, and Lawrence Sher. Eric Keener and Maria Sarli participated by phone. Ted Goldman and Matthew Mulling, Academy staff members 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 topics were submitted to the IRS in advance of the meeting and are shown in regular typeface below; the discussion summary is in italics.

1. Reasonable actuarial equivalence—Code Section 411(d)(6) protection makes implementing a change in plan-specified basis complicated, so many plans have not changed for 20-30 years (e.g., 8%, UP-84); some hybrid plans have adopted bases to make annuitization attractive; others have adopted bases that reflect the actual cost to annuitize hybrid benefits (annuity cost is often 125% - 150% of account balance) and may not look reasonable on the surface.

Plans updating actuarial equivalence factors must follow one of the standard approaches for Section 411(d)(6)-protected benefits—"wear-away" or "greater of both"—even if that means the end result is no longer reasonable. Changes in mortality tables and interest rates since the plan's basis was set may result in "unfair" early or late retirement adjustments, from the participant's and plan's perspectives, respectively. IRS is not policing what is and is not reasonable. Plans paying early retirement or optional form benefits that are less than the reasonable actuarial equivalent of the accrued benefit payable at normal retirement age could face class-action lawsuits. Actuarial guidance is important—both within the profession and with sponsors.

2. Issues related to uncashed checks at plan terminations (both defined benefit and defined contribution plans).

A subcommittee of the American Bar Association (ABA) was working on this issue two years ago. The actuarial organizations may want to conduct outreach to check on status. Should checks be canceled? Should the administrator move monies to a special account? Do state escheat laws apply? No clear agency reaction was provided.

3. Additional guidance under Code Sections 430 and 436—wish list
 - a. For plans using end-of-year valuation dates—provide extra time to elect to reduce carryover/prefunding balance, guidance on 436 calculations.

- b. Clarify 430 calculations for special plan designs—plans that determine lump sums as the greater of Section 417(e) lump sum or plan basis, variable annuity plans.
- c. Clarify how partial restrictions are applied when a beneficiary is owed a lump sum following a participant's death (e.g., under cash refund annuity or life annuity with term certain that pays commuted value of remaining payments)—informal guidance indicates payments to participant and beneficiary are aggregated, but unclear exactly how such aggregation works.
- d. Clarify scope of Worker, Retiree, and Employer Recover Act exception for benefits that can be cashed out without the participant's consent, such as lump sums up to \$5,000 (e.g., does it apply to ancillary post-retirement lump sum death benefits not subject to consent rules).
- e. Allow new plans with nonzero funding targets to make contributions during their first year that would be recognized when determining whether accelerated benefits can be paid.
- f. Expand correction options when lump sum or partial lump sum is paid in error—administrators can't "turn on a dime" and errors are inevitable.
- g. Clarify adjusted funding target attainment percentage (AFTAP) calculation following midyear merger or spinoff.
- h. Allow the "keep up with wages" exception to amendment restrictions to be applied based on hourly wage rates, not total pay, so employers have assurance they can implement what is negotiated.
- i. Make posting security to avoid 436 restrictions potentially useful by not requiring security to be in place by the valuation date for the plan year (when you don't know how much, if any, security you need).

Finishing these follow-on rules has been an outstanding project for years, but it is not a high priority.

With respect to item f., IRS representatives pointed out a recent change to the Employee Plans Compliance Resolution System (EPCRS) addressed improper lump sums and no longer requires the plan to get the money back from the participant. The actuaries indicated EPCRS requires the sponsor to make an additional contribution to restore plan assets to what they would have been if the lump sum had not been paid, ignoring the fact that the improper lump sum also extinguished the associated benefit liability. The required sponsor contribution thus puts the plan in a better position than—rather than the same position as—it would have been if the lump sum restriction had been properly administered. Furthermore, EPCRS does not address the tax effect on the participant: The improper lump sum cannot be rolled over, and if it had been, it would need to be removed from the rollover vehicle in order to avoid serious tax consequences.

- 4. Automatic approvals for changes in funding method and discount rate election—wish list
 - a. Change in asset method when prior method has been in effect for at least five years
 - b. Method for determining average value of assets following a change in plan year or the merger of plans with different plan years/valuation dates (including acceptable methods for estimating market value of assets on valuation date minus 1 and minus 2 if historical asset information is not available, such as interpolating between nearest end-of-quarter values available)
 - c. Change in asset method and discount rate election caused by the merger of plans that previously used different methods or had different elections in effect
 - d. Method of determining the ongoing plan's contribution following midyear merger (adding appropriate pro-rata portion of the disappearing plan's target normal cost and shortfall amortizations)
 - e. Method of determining both the ongoing and newly created plan's contribution following a midyear spinoff (based on allocation of beginning-of-year values)
 - f. Simplified rules for de minimis mergers or spinoffs

A replacement for Rev. Proc. 2000-40 is well underway and progress has been good. Timing is always difficult to predict, but IRS and Treasury representatives will be very disappointed if the

new guidance isn't published by 2016 year-end. Plans needing approval for 2016 changes may want to hold off submitting requests until late in the year because automatic approval may then be available.

There has been extensive dialogue between IRS staff processing requests for approval and IRS staff writing the automatic approval guidance. In this process, the agency has established positions on a variety of changes, which has improved the turnaround time for simple requests. Simple requests are currently being processed in about four months; only 18 requests were in inventory on the meeting date.

With respect to item b. above, automatic approval for estimates is unlikely.

5. EPCRS wish list—Provide a simplified self-correction process for de minimis valuation errors discovered after Schedule SB has been filed or AFTAP has been certified. If funding target and target normal cost are within 5 percent of correct values, allow sponsor to self-correct by making an additional contribution in the amount of the error adjusted for interest at the effective rate (not applied toward minimum required contribution or added to prefunding balance). No amended Schedules SB would have to be filed, no AFTAPs would have to be recertified, and no IRS filing would be required.

Actuaries provided examples and articulated why a simple solution is desirable—this should be the subject of a voluntary compliance program, and result in a true-up on the next filing.

IRS has a project on the business plan to provide a voluntary compliance program for non-EPCRS issues and will pass along this suggestion (EPCRS is for qualification defects, not contribution shortfalls). In the meantime, a [December 2013 Employee Plans News article](#) describes how sponsors may use Voluntary Closing Agreements to correct issues that cannot currently be addressed under EPCRS. If there is a reasonable way to estimate the excise tax without revising past valuations, IRS would consider it.

6. Mortality basis change and “partial credibility” rules for use of adjusted mortality tables

Again, good progress is reportedly being made, but clearly there are concerns about the extent to which sponsors will want to use flexibility to adopt “custom” tables. There was discussion of blue collar populations as a likely trigger, and the relative merits of generational projection using MP-2015 vs. MP-2014.

7. Vested terminated participants over normal retirement age, or beyond the required beginning date—coordination with Department of Labor enforcement initiative

As long as a plan is following its terms—the plan allows terminated participants to wait until the required beginning date to start benefits, requires participants to claim benefits, and provides the required actuarial increase for late retirement—IRS is not concerned if the administrator waits until the required beginning date to start payments (but action must be taken at that time to track down participants). However, if the plan requires participants to start benefits at their normal retirement date, the plan must take action at normal retirement date.

8. MPRA suspensions
 - a. Three applications posted to date; hesitation by other plans until final regulations (or reliance provided for proposed regs)
 - b. Lessons learned from applications to date, including those rejected

The biggest issues so far have to do with disconnects between what those drafting the regulatory language intended and how those preparing applications have interpreted the proposed rules. Put another way, the “readers” misunderstood what the “writers” intended—no specifics provided—and the final regulations will contain clarifications. All of this is high priority, with plenty of ongoing

work and interagency meetings. (Note: IRS issued [final regulations](#) on MPRA suspensions April 28 and additional [suspension ordering rules](#) on May 5.)

9. Some hybrid plans need additional guidance before they can adopt plan amendments to comply with final market-rate rules and the “lump sum-based benefit formula” definition, for example:
 - a. Plans that don’t meet the “lump sum based benefit formula” definition, which changed from proposed to final regulations with no opportunity for comment—unclear if these plans can use special age discrimination rules for “indexed benefits.”
 - b. Plans with interest credits of the form 50 percent of X rate plus 50 percent of Y rate, with the result subject to a minimum—unclear which “silo” the plan fits in if X is an investment-based rate and Y is a bond-based rate. Is the plan required to remove the minimum? Or must the plan retain the current rate and cap it at the third segment rate, subject to a 4 percent minimum?
 - c. Plans that project cash balance account to normal retirement date, convert to an annuity and then reduce for early commencement, where the immediate annuity for a younger person may be larger than for an older person—appears to satisfy age discrimination per regulation, but preamble suggests it does not. This approach is fairly common. If it fails age discrimination, IRS needs to provide anti-cutback relief to reduce the early retirement subsidy or otherwise clarify the path to compliance.
 - d. Combination formulas that include both lump sum-based formulas and “similar effect” formulas.

Actuaries explained each item. With respect to item a., the IRS representatives said they hoped to clarify that cash balance plans with whipsaw may use the special age discrimination rule for indexed plans (note: IRS subsequently released a [Chief Counsel Advice memorandum](#) on April 22 clarifying this point). Otherwise, it appeared the agency was not prepared to discuss these issues. The IRS representatives recognize there is interest in projection issues; the actuaries emphasized the need for several thousand small cash balance plan sponsors to make decisions and amendments in regard to these issues by year-end. The agency is looking for more details on what is falling through the cracks. A letter from the Academy or other organizations would be useful to identify these issues and get superiors’ attention.

10. Post-Gray Book interaction with actuarial community and plan sponsors

IRS dropped the Gray Book primarily due to resource/budget constraints (which is also the cause for the phase-out of the determination letter program). The expenditure of 300+ hours preparing Gray Book for the Enrolled Actuaries Meeting is a very significant investment that was deemed a “distraction”—there were years in which guidance projects ground to a halt in February to deal with the Gray Book. The agency is also troubled by court cases and comment letters on regulations that have cited the Gray Book. IRS is not singling out actuaries. They have also stopped a similar ABA Q&A book. However, the benefits community and actuarial professionals “should not question their commitment,” as (for example) staff in the Employee Plans unit cannot participate in meetings involving travel at this time because they cannot accept reimbursement and do not currently have a travel budget. But Treasury and IRS Office of Chief Counsel staff can accept reimbursement and will continue to speak at conferences when appropriate.