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on behalf of
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Public Hearing on Proposed Additional Rules Regarding Hybrid Retirement Plans

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Good morning. My name is Thomas Finnegan, current president of the American Society of Pension Professionals and Actuaries (ASPPA). I am here today to testify on behalf of ASPPA and the ASPPA College of Pension Actuaries.

ASPPA is a national organization of more than 7,500 members who provide consulting and administrative services for qualified retirement plans. ASPPA members are retirement professionals of all disciplines, including, but not limited to, plan administrators and enrolled actuaries, enrolled agents, enrolled retirement plan agents, CPAs and attorneys. All credentialed actuarial members of ASPPA are members of the ASPPA College of Pension Actuaries (ASPPA COPA), which has primary responsibility for the content of comment letters that involve actuarial issues.

We appreciate the opportunity to speak about a number of issues that were raised in our comment letter filed January 12. In broad terms, our concerns are that plan sponsors who in good faith followed the rules as we knew them receive fair treatment under final regulations, that final regulations provide a clear framework for plan design moving forward, and that flexibility in plan design be appropriately balanced with the participant protections that defined benefit plan participants have enjoyed since the enactment of ERISA.

Early retirement benefit conversion options

The first issue I'd like to discuss today is early retirement conversion options. Many plans have provisions requiring that the benefit payable in an optional form be at least actuarially equivalent to the accrued benefit payable at normal retirement. Plans were written this way based on prior

IRS requirements that the accrued benefit be stated solely as the monthly annuity payable at normal retirement age, and the §411(a) requirement that all optional forms be at least actuarially equivalent to the normal retirement benefit (on the basis of reasonable actuarial assumptions). The proposed regulations (1.411(a)(13)-1(b)(3)) remove this "annuity whipsaw", but without §411(d)(6) relief, these plans are unable to take advantage of it.

ASPPA COPA recommends that §411(d)(6) relief be provided for plan amendments that change the amount payable under an optional form of payment from the actuarial equivalent of the projected annuity payable at normal retirement date to the actuarial equivalent of the current hypothetical account balance.

Decreases in benefits

In a hybrid plan with market rate interest credits, there are situations where a participant's monthly annuity benefit payable at an early retirement age can be greater than the monthly annuity benefit payable at normal retirement age. This appears to create a problem under §411(a)(9) which provides that the normal retirement benefit cannot be less than the early retirement benefit, and §411(b)(1)(G) which prohibits a decrease in benefit on account of increasing age or service.

ASPPA COPA recommends that final regulations clarify that decreases in benefits due to interest crediting rates decreasing or being negative are not a decrease in benefit due to increasing age or service. Similar clarification is needed for decreases in benefits due to variable assumptions (such as §417(e) assumptions) used to convert lump sum balances to annuities. We also need to know if the lump sum benefit payable in these situations is the account balance, or the account balance plus the §417(e) lump sum based upon the difference between the early retirement benefit and the otherwise calculated normal retirement benefits (as described in proposed regulation §1.411(a)(13)-1(b)(4)(ii)).

Required changes in RICs and use of an index

When an interest crediting rate is based on a RIC, or several RICs, the plan sponsor and plan participants expect the RICs will continue to exist with a consistent investment strategy, but that is not always the case. When there is a discontinuance of a RIC or a change in the investment strategy of the RIC, the plan sponsor should be allowed to replace that RIC with another RIC that provides the same (or similar) investment strategy and underlying expenses as the original RIC.

ASPPA COPA recommends that plan sponsors be allowed to replace an existing RIC with a similar RIC without considering the change an amendment that is subject to §411(d)(6) restrictions. Guidance could specify the type of documentation needed to implement the change, suggest plan language that would be suitable to avoid employer discretion about the substitution, and provide guidelines on what constitutes a similar RIC.

ASPPA COPA also suggests that this problem would be less likely to occur if the regulations permitted the use of a broadly used index instead of a RIC. A reduction could be required to adjust for the concern that the index itself does not reflect a true market rate of return because of transaction costs and timing differences. To reflect the reduced cost of investing in an index fund the adjustment should be relatively small – no more than 20 bps.

Actual investment return and accrued benefits

Assuming the diversification requirements are satisfied, the proposed regulations allow a plan to use an interest crediting rate based the actual rate of return on the aggregate assets of the plan. This raises a questions as to whether a change in investment policy, or individual investments being selected, would constitute a violation of anti-cutback rules under §411(d)(6) or an impermissible forfeiture under §411(a).

ASPPA COPA recommends that the final rule should clarify that changes in investment decisions made by the plan fiduciary for a plan using actual investment results for the interest crediting rate do not trigger the anti-cutback or impermissible forfeiture rules with respect to accrued, normal, or early retirement benefits as long as the diversification requirements continue to be satisfied.

Testing methodology with variable rates

The cash balance safe harbor testing method in current regulations (§1.401(a)(4)-8(c)(3)(v)(B)) provides that, if a cash balance plan uses a variable interest crediting rate, the rate specified in the plan that is used to project the account balance must be either the interest crediting rate for the current period, or an average of the rate for one or more prior periods not to exceed five years. Based on this regulation, practitioners believe it is reasonable to use a rate that meets this safe harbor to project benefits for purposes of §401(a)(4), §401(a)(26), §411, §415 and §416.

The proposed regulations acknowledge the difficulty inherent in projecting negative returns for purposes of §411, and permit an assumption of zero return when return is negative, but do not extend this approach to other code sections.

ASPPA COPA recommends that final regulations permit cash balance plans to project hypothetical balances for testing purposes, including §401(a)(4), §401(a)(26), §411, and §415, using the crediting rate for the most recent period or an average of prior periods, subject to minimum and maximum interest crediting rates. For example, for an equity fund, the cap could be the average of the S&P 500 over a 40-year period (a typical working lifetime). Placing a cap and floor on interest crediting rates used for projection would result in more realistic projections of hypothetical account balances than the current methodology based on a current rate or recent average.

ASPPA COPA further recommends that guidance provide safe harbor principle credit amounts that will be deemed to satisfy the meaningful benefit requirement of §401(a)(26). Because determination of an appropriate credit should consider the methodology adopted for projecting benefits, ASPPA COPA requests that there be an opportunity to comment further on this issue when further guidance is provided on applying variable interest crediting rates for testing purposes.

Participant choice

We have serious concerns about permitting participant choice of interest crediting rates. The defined benefit system has historically offered participants and spouses additional protections over the defined contribution system. Permitting the plan's actual rate of return to serve as the interest crediting rate under a cash balance plan shifts investment risk to participants and beneficiaries, but the responsibility for prudent investment management of the trust remains with the fiduciary.

ERISA 404(c) lays out rules under which a plan fiduciary can shift the responsibility for the difference in benefits that results from a participant's choice of investments to the participant for *an individual account plan only*. In these individual account plans, the fiduciary can pass responsibility for choices within the investment menu to the participant in exchange for meeting certain requirements, but the fiduciary still bears responsibility for the selection of the investment options. If participant choice is offered in a cash balance plan, the choice of options is not subject the same prudent standard and there are no disclosure requirements or other standards that protect participants.

Also, the duty of a defined benefit plan trustee to invest so as to manage volatility would seem to be at odds with the ability of participants to elect an aggressive interest crediting option. If participants make aggressive elections, either plan assets would have to be invested aggressively, leading to volatile returns, or the plan sponsor could expect additional volatility in contributions. Because the interest crediting rate is part of the accrued benefit, the benefit resulting from a newly elected interest crediting rate (if applied to an existing account balance) could not be less than would have been provided applying the previously chosen interest crediting rate without creating a forfeiture. If plans had to operate under this structure, participants would be encouraged to select one rate then change to another rate with different characteristics to achieve the greater of the two results.

Based on these concerns, if participant choice is offered in the defined benefit system, ***ASPPA COPA recommends*** that:

- Participants and their spouses should be provided disclosures on the interest crediting options similar to those for ERISA §404(c). However, cash balance plans should not be required to permit election changes more frequently than annually, and should be permitted to limit options to a range of life-cycle funds, or funds representing conservative and moderate investment mixes so as to limit volatility for individual

- Plans permitting participant choice should be required to provide the 3 percent aggregate minimum allowed for equity based interest credit rates for all hypothetical accounts under the plan. With this minimum guarantee, a change of election relating to an existing hypothetical account would not be treated as a plan amendment or impermissible waiver of accrued benefit under §411.

While PPA set capital preservation as the appropriate minimum in cash balance plans, if participant choice of interest crediting rates is permitted, a higher minimum is necessary to combine protection of accrued benefits with workable rules and to mitigate moral hazard. Since plan sponsors are not required to employ the prudent expert rule in determining the proper menu of funds for participant direction in cash balance plans, this minimum will also help to insure that sponsors choose funds of appropriate quality and risk characteristics.

This concludes our remarks. I look forward to your questions.