July 24, 2017

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Re: Interest Crediting Rates for Testing Purposes for Variable Rate Cash Balance Plans

Dear Ms. Judson and Mr. Neis:

The ASPPA College of Pension Actuaries (ACOPA) is writing to recommend an alternative for projecting variable interest credit rates in cash balance plans (and variable indexes for variable annuity plans) for purposes of the general test under 401(a)(4) (including the determination of gateways), rates used in the IRC 410(b) average benefits percentage test, the meaningful benefit analysis under 401(a)(26), projections of the maximum benefit limitations under Section 415 and the anti-backloading rules under Section 411(b).

ACOPA is part of the American Retirement Association. The American Retirement Association is a national organization of more than 20,000 retirement plan professionals who provide consulting and administrative services to American workers, savers and sponsors of retirement plans and IRAs. ARA members are a diverse group of retirement plan professionals of all disciplines including financial advisers, consultants, administrators, actuaries, accountants, and attorneys. All credentialed actuarial members of the American Retirement Association are members of ACOPA, which has primary responsibility for the content of comment letters that involve actuarial issues.

Background and Issue

Treasury has taken the position (see, for example, preamble to TD 9693, the 2014 final hybrid plan regulations and Rev. Rule 2008-7) that the most recent value of the index or rate must be projected as remaining constant for purposes of assessing the 133 1/3% rule (subject to a zero percent floor in revised regulations). Treasury has taken the informal position that the same

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approach must be used for purposes of coverage, nondiscrimination, participation and maximum benefits, though no particular official rule exists for these purposes.

The 2014 final hybrid regulations allow for the use of interest credit rates derived from investment based rates of return. If the projection of the most recent value of the interest credit rate is required to be reflected when evaluating testing standards such as those above, the volatility of rates derived from the actual return on plan assets, the rate of return on RICs or the rate of return on annuity contracts makes it nearly impossible to design a plan that will meet the qualification requirements regardless of a given year's interest credit rate. In keeping with the logic applied in concluding that a zero percent floor is appropriate for accrual testing under 411(b) (that is, Congress contemplated that a plan's rate could potentially be negative so a rule is needed to prevent creating a "catch 22"), a reasonable rule is appropriate for other tests as well to avoid putting them in an impossible or illogical situation.

Recommendation

To allow plans to meet the 415, minimum participation, nondiscrimination and coverage test qualification requirements while using investment based rates of return as interest credit rates, ACOPA believes that the Service should permit the use of a different, less volatile rate as a proxy for such a plan's interest credit rate. In fact, for market rate plans, the Service should consider whether the current methodology should even be allowed.

In the 2014 final hybrid plan regulations, in the case of plans that used investment based interest credits, for purposes of projecting the hypothetical balance to retirement at plan termination, rather than projecting the 5-year average of the actual investment-based interest credit, plans are to use "*the second segment that applied in the period (other than cumulative floors under paragraph (d)(6)(iii) of this section), <u>but without regard to other reductions that applied in the period</u>. Thus, for example, if the actual interest crediting rate in an interest crediting period is equal to the rate of return on plan assets, but not greater than 5 percent, then the substitution rate for that interest crediting period is equal to the lesser of the applicable second segment rate for the period and 5 percent. However, if the actual interest crediting rate for an interest crediting period is equal to the rate of return on plan assets minus 200 basis points, then the substitution rate for that interest crediting period is equal to the applicable second segment rate for the period." (underline added)*

ACOPA recommends that the same approach be adopted as a safe harbor here with one modification. To more accurately reflect adjustments inherent in a plan's interest credit rate, any adjustment to the interest credit rate from the list of approved rates would be reflected in a similar adjustment to the proxy rate. Thus, for example, if the actual interest crediting rate in an interest crediting period is equal to the rate of return on plan assets, but not greater than 5 percent, then the substitution rate for that interest crediting period is equal to the lesser of the applicable second segment rate for the period and 5 percent. Similarly, if the actual interest crediting rate for an interest crediting period is equal to the rate of return on plan assets minus 200 basis points, then the substitution rate for that interest crediting period would equal to the applicable second segment rate for the period minus 200 basis points.

We believe that this safe harbor approach would also be beneficial to plans using an interest crediting rate that is variable, but not investment based, to address volatility.

Supporting Argument

In addition to the key point that plans should not be subjected to an unreasonable rule that effectively makes a permitted plan design unavailable, we believe the use of the modified plan termination rate is a more logical and accurate rate. A plan can be terminated at any time. That termination aligns the crediting rate to the substitution rate. In that sense, it is the actual rate earned by the participants if the plan is terminated. If the plan is not terminated, then just the current year's rate affects the actual accrual because of the potential for plan termination in any subsequent year.

Accrual Testing under 411

In order for a plan to receive a favorable determination letter, it must preclude the possibility of failing the 411(b) accrual rules in any future year. For cash balance plans with a variable interest credit rate using the 133 1/3% Rule, this means that the plan must demonstrate compliance at all possible interest credit rates under the plan. Plans crediting bond rates will usually do this by guaranteeing an interest credit of the greater of the bond rate or some flat percentage chosen to allow the plan to meet the 133 1/3% Rule. Since investment-based plans cannot use an annual minimum, they are forced to test for 133 1/3% Rule using the 0% minimum permitted by the regulations.

This yields an interesting result clearly contrary to public policy. As you are aware, the rate of benefits actually earned each year, expressed as an annuity commencing at NRA, in a cash balance plan with level pay credits, declines each year by the amount of the interest credit for the prior year. Cash balance plans have often used graded pay credit schedules to soften or eliminate this decline. However, under the current rules an investment based plan would be forced to test the accruals using a 0% interest credit rate, with the result that the pay credit in any year cannot be more than 133 1/3% of the pay credit in the lowest earlier year. Consider an investment based cash balance plan that provides 25 year olds a pay credit of 2% of pay. The employer is looking to provide an increased pay credit to those 50 and older so that their accruals are as high as those of 25 year olds. Under current rules, the maximum pay credit for a 50 year old would be 2.66% of pay. Yet the pay credit needed to equalize the NRA annuity benefit between the two ages would be over 5.0% of pay (assuming the actual interest credits averaged just 4%). This means that the current rule forces investment based plans to provide declining rates of monthly retirement benefit accrual as employees age. While PPA confirmed that this is an acceptable result for cash balance plans, it is clearly against public policy to REQUIRE it.

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These comments were prepared by the ACOPA Government Affairs Committee. Please contact Judy A. Miller, MSPA, ACOPA Executive Director at (703) 516-9300 if you have any comments or questions on the matters discussed above.

Thank you for your time and consideration.

Sincerely,

/s/
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Executive Director
ASPPA College of Pension Actuaries

/s/
Craig P. Hoffman, Esq., APM
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/s/
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Cc: Harlan Weller
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