ASPPA
WORKING FOR AMERICA'S RETIREMENT

4245 North Fairfax Drive, Suite 750
Arlington, VA 22203
P 703.516.9300 F 703.516.9308
www.asppa.org

Comments on Proposed Additional Rules Regarding Hybrid Retirement Plans

January 12, 2011

Department of Treasury
Internal Revenue Service
26 CFR Part 1
[REG-132554-08]

The American Society of Pension Professionals & Actuaries (ASPPA) appreciates this opportunity to comment on the proposed additional rules regarding hybrid retirement plans as issued by the IRS and Treasury on October 19, 2010 (REG -132554-08).

ASPPA is a national organization of more than 7,500 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines, including consultants, investment professionals, administrators, actuaries, accountants and attorneys. Our large and broad-based membership gives ASPPA unique insight into current practical applications of ERISA and qualified retirement plans, with a particular focus on the issues faced by small- to medium-sized employers. ASPPA's membership is diverse but united by a common dedication to the employer-sponsored retirement plan system. 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.

References are to the Internal Revenue Code of 1986 and Treasury regulations unless otherwise specified.

Summary of Recommendations

The following is a summary of ASPPA COPA's recommendations which are described in greater detail in the Discussion of Issue section.

I. Final regulations should provide §411(d)(6) relief for changing the method of calculating immediate annuity options.

II. Final regulations should provide a safe harbor definition of "reasonable assumptions".

III. Final regulations should provide additional guidance about statutory hybrid plans and §411(a)(9).

IV. Final regulations should include a "set and forget" conversion rule.

V. Final regulations should make it clear that general testing rules are not available to show compliance with §411 if the market rate of return and preservation of capital rules are not satisfied.

VI. Final regulations should clarify that a plan using segment rates can reference either current or prior stability period rates to determine the current stability period interest credit.

VII. Final regulations should clarify that partial interest credits are permitted on amounts distributed between interest crediting dates.

VIII. Final regulations should allow for the use of an interest crediting rate based on an index.

IX. Final regulations should provide that when certain events occur a plan would be permitted to substitute a comparable RIC or index based on the stated investment objectives of the original RIC, without concern for protected benefit rights under §411(d)(6).

X. Final regulations should clarify that, for plans that use a crediting rate equal to the trust's actual rate of return, changes in actual investments do not present issues under the §411(d)(6) anticutback rules.

XI. Final regulations should clarify that the annuity conversion rates for a terminated plan applicable at normal retirement also apply at a participant's early retirement date.

XII. Final regulations should provide additional §411(d)(6) relief and guidance for changes to interest crediting rates.

XIII. Final regulations should provide additional guidance on how the accrual rules apply to a floor offset arrangement that includes a cash balance plan.

XIV. Final regulations should provide guidance on the application of nondiscrimination, coverage, participation, accrual and maximum benefit rules when a plan uses a variable rate.

XV. If participant choice is permitted, regulations should provide new safeguards to participants in exchange for workable rules for plan sponsors.

Discussion of Issues

I. **Early retirement benefit conversion options.** 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), many plans contain provisions requiring that the benefit payable in an optional form be at least actuarially equivalent to the accrued benefit payable at normal retirement. Section 1.411(a)(13)-1(b)(3) of the proposed regulations removes 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.

II. **Reasonable assumptions.** In the proposed regulations, §1.411(a)(13)-1(b)(3) frequently uses the expression "reasonable assumptions." However, this expression is not defined. Given the broad range of plan designs and employee groups, it is difficult to contemplate a regulation adequately defining this term. For the benefit of plan sponsors, particularly small plan sponsors, it would be extremely helpful to have certain assumptions identified as "deemed reasonable".

ASPPA COPA recommends that certain assumptions should be deemed reasonable, but the term should not be defined. For example, interest rates that satisfy the definition of market-rate of return should be deemed reasonable interest rates. Additionally, ASPPA COPA recommends that the §417(e) mortality, and no pre-retirement mortality, be deemed reasonable mortality.

III. **Decreases in benefits**. Section 411(a)(9) provides that the normal retirement benefit cannot be less than the early retirement benefit. Section 411(b)(1)(G) provides that a participant's benefit may not be decreased on account of increasing age or service. In a hybrid plan that provides market rate interest credits, it is easy to construct examples where the participant's monthly annuity benefit payable at age 63 is greater than the monthly annuity benefit payable at normal retirement age. Practitioners are confused about how to apply these rules and plan sponsors and participants would be best served by having clear guidance.

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.
- That decreases in benefits due to variable assumptions (such as §417(e) assumptions) used to convert lump sum balances to annuities changing as described in the plan are not a decrease in benefit due to increasing age or service.
- That for purposes of §411(a)(9) an early retirement benefit is any immediate annuity payable prior to normal retirement age whether or not a plan labels it an early retirement benefit. Guidance should explain when early retirement benefits need to be determined (for example, annually based on plan or birth date, at the end of each interest crediting period, etc.).
- How lump sums should be calculated in the case of an account based plan where due to decreases in the hypothetical account balance the early retirement benefit exceeds the otherwise calculated normal retirement benefit. Should the plan pay the account balance or as described in proposed regulation §1.411(a)(13)-1(b)(4)(ii) the sum of the account balance and the §417(e) lump sum based upon the difference in the early retirement benefit and the otherwise calculated normal retirement benefit?

IV. **"Set and forget" conversion rule.** The alternative method for establishing an opening account balance in the proposed regulation requires ongoing testing and adjustments that are not workable administratively.

ASPPA COPA recommends that the Service reconsider this alternative. As suggested in our original comments submitted March 27, 2008, final regulations should allow plans without early retirement subsidies that establish opening hypothetical account balances no less than the single sum value of the accrued benefit using §417(e) mortality and interest to avoid future comparisons. This methodology would generally be cost effective for the small employer sponsored plans with little or no possibility of discrimination in favor of HCEs.

V. **Noncompliant interest crediting rates**. Section 411(b)(5)(B)(i) and (ii) state that an applicable defined benefit plan "shall be treated as failing" to comply with the requirements of §411(b)(1)(H) unless the market rate of return and preservation of capital requirements are met. The fact that these are requirements, not safe harbors, is not clearly stated in the proposed regulations, however, and the lack of a clear statement has led to some confusion.

ASPPA COPA recommends that final regulations make it clear that interest credits that do not conform with the market rate of return or the preservation of capital rules under §411(b)(5)(B)(i) may not use the general testing rule for age discrimination in §411(b)(1)(H) to show compliance with §411.

VI. **Lookback period**. Some plans have been drafted to base interest credits applied to hypothetical accounts using a lookback month during the current plan year while others have been drafted to use a rate determinable at the beginning of the plan year based on a lookback month during the prior plan year. For example, the 2010 interest credit under some plans is based on the November 2010 30-year rate while others define the rate for 2010 using the November 2009 rate. Both options apparently were acceptable under Notice 96-8.

Under §1.411(b)(5)-1(d)(1)(iv)(B) a plan would seem to be limited to using an interest crediting rate based on one of the lookback months from the prior year: "... a plan that is using one of the interest crediting rates described in paragraph (d)(3) or (d)(4) of this section can determine interest credits for a stability period based on the interest crediting rate for a specified lookback month with respect to that stability period. For purposes of the preceding sentence, the stability period and lookback month must satisfy the rules for selecting the stability period and lookback month under §1.417(e)-1(d)(4), although the interest crediting rate can be any one of the rates in paragraph (d)(3) or (d)(4) of this section and the stability period and lookback month need not be the same as those used under the plan for purposes of section 417(e)(3)."

We believe it should not be an imperative that the interest crediting rate under a cash balance rate be tightly tied to the period for which a credit is provided. It is necessary that the rate be definitely determinable and that the rate not be in excess of a market rate of return. But the use of a rate tied to the beginning of the period is no more "accurate" than a rate tied to the end of the period.

ASPPA COPA recommends that the final rule be clarified to accommodate both choices as long as the plan document describes the interest rate credit in a definitely determinable manner.

VII. **Crediting interest on distributions during the year.** Final regulation §1.411(b)(5)-1(d)(1) (iv)(C) provides that "Interest credits under a plan must be provided on an annual or more frequent periodic basis and interest credit must be credited as of the end of the period." Proposed regulation §1.411(b)(5)-1(d)(1)(iv)(D) provides that "A plan is not treated as failing to meet the requirements of this paragraph (d) merely because the plan does not provide for interest credits on amounts distributed prior to the end of the interest crediting period." The proposed regulation does not provide guidance that would be helpful for those plan sponsors who choose to credit interest on balances paid before the end of the period.

ASPPA COPA recommends that the final regulations clarify that it is permissible to prorate interest credit for the year of the participant's distribution for situations where payment is made prior to the next interest crediting date. Guidance should provide that if the actual crediting rate is not known, the rate used to project the hypothetical account balance to normal retirement age, a lesser rate, or a fixed rate could be used for this purpose. Guidance should also make it clear that the date through which interest is credited can be a date as of which the distribution is intended to be paid, and need not be the date the distribution actually is paid from the trust.

VIII. **Use of an index.** The proposed regulations do not endorse the use of an interest crediting rate that is based on an index, and generally requires that a Registered Investment Company (RIC) would have to be used for equity-based options. The apparent explanation for this requirement is that the use of the index itself will provide a return greater than a market rate of return because it does not reflect the underlying expenses inherent in actually investing funds. Also, a RIC that is based on an index will not exactly replicate the results of the index because when the makeup of an index changes, there is a lag before the RIC can adjust its holdings to match the index. The Service notes that a RIC can cease to exist or change its investment strategy and has asked for comments on how additional guidance should deal with these possibilities.

We agree that changes in RICs used as the basis to determine interest crediting rates can be problematic because the RIC may cease to exist or may be modified over time. We believe that this is much less likely to be a concern with broadly used indexes. 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, a set reduction could be required. To reflect the reduced cost of investing in an index fund as contrasted with managed funds, the adjustment should be relative small.

ASPPA COPA recommends that final guidance allow for the use of an interest crediting rate based on a widely acknowledged index. If indeed there is concern that such a rate would be greater than a market rate of return, final guidance could require a reduction in the rate by a minimum number of basis points (e.g., 20 bp).

IX. **Required changes in RICs**. The Service has asked for comments on how §411(d)(6) would apply if a selected RIC ceases to exist or if the RIC substantially changes its investment strategy.

When an interest crediting rate is based on a RIC, or several RICs, the plan sponsor and plan participants anticipate that each RIC will continue to be in existence and that the investment strategy in existence as of the date the RIC was selected will continue. However, this is not always the case and the discontinuance of a RIC or a change in the investment strategy of the RIC will upset those expectations. Under these circumstances the plan sponsor should be allowed to replace such RIC with another RIC that provides the same (or similar) investment strategy and underlying expenses as the original RIC. Such a change should not be viewed as an amendment to the plan that is subject to anticutback requirements. If the RIC no longer exists, the actual investment income is zero. If there is a change in investment strategy, the replacement RIC that brings the choice back to the originally selected strategy has the effect of protecting the original expectations. Neither circumstance represents a settlor-type decision to change the underlying promise of the benefit defined by the plan—which would be the type of change the anticutback rule addresses. Plan document language could specify the conditions under which the substitution would be made so as to restrict the plan sponsor's discretion about the time of the change or the selection of the new RIC.

ASPPA COPA recommends that plan sponsors should 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. Final regulations could specify the type of documentation needed to implement the change in the RIC, suggest plan language that would be suitable to avoid employer discretion about the substitution, and provide guidance on what constitutes a similar RIC.

X. **Actual investment return and accrued benefits.** Assuming the diversification requirements are satisfied, the proposed regulations allow a plan to provide an interest crediting rate based the actual rate of return on the aggregate assets of the plan. Fiduciaries need to be assured that a change in investment policy, or individual investments being selected, would not 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 a plan using actual investment results for the interest crediting rate is not constrained by anti-cutback or impermissible forfeiture rules, with respect to accrued, normal, or early retirement benefits, stemming from changes in investment decisions made by the plan fiduciary.

XI. **Annuity conversion rates for terminated plans.** Proposed regulation §1.411(b)(5) – 1(e)(2)(i)(B) provides guidance regarding the interest rate and mortality table used to calculate any benefit under the plan payable in the form of an annuity commencing *at or after normal retirement age*. Guidance is not provided on the conversion rates at earlier ages. Guidance is also not provided on how the five year average is to be determined if the plan is terminated mid-year.

ASPPA COPA recommends that the final regulations clarify that the annuity conversion rates required by this section also apply prior to normal retirement date. Guidance should also be provided on acceptable methods for determining the five year average interest credit for mid-year terminations such as dropping the rate applicable to the year of termination or annualizing the rate for the short period up to the plan termination date.

XII. **Anti-cutback relief**. In the final regulations, §1.411(b)(5)-1(e)(3)(ii) provides prospective §411(d)(6) protection for plans with an interest crediting rate that exceeds a market rate of return to modify the rate to the extent necessary to satisfy the market rate of return rules. However, plan administrators need additional relief and guidance for several situations such as the following:

- In an effort to comply with the Pension Protection Act (PPA), a plan administrator whose plan document specified an interest crediting rate in excess of a market rate of return operationally applied a lower interest crediting rate than specified in the plan document. The lower interest crediting rate was chosen by the plan administrator to be consistent with the plan administrator's interpretation of the requirements of PPA. Plan participants were provided an ERISA §204(h) notice that explained the change in the interest crediting rate. A retroactive plan amendment is needed to conform the document to operations as contemplated by §1107 of PPA.
- A plan document has an interest crediting rate in excess of market rate of return and plan operations reflected the documented rate. The final regulations provide that §411(d)(6) relief is available allowing the plan sponsor to prospectively change the interest crediting rate, but additional guidance is needed to address whether the interest crediting rate can be amended retroactively with §411(d)(6) protection to conform to the final regulations.
- A plan is using an interest crediting rate that satisfies the requirements of §1.411(b)(5)-1(d)(3) or §1.411(b)(5)-1(d)(4). However, the plan's method of applying this rule is not consistent with the requirements of §1.411(b)(5)-1(d)(1)(iv)(B) which are effective for plan years after 2010. For example, instead of using a look-back month, the plan chooses the rate based upon the rate in effect on a single day.

ASPPA COPA recommends that §1.411(b)(5)-1(e)(3) be amended to:

- Provide that a plan may be amended to conform its operational interest crediting rate for the first plan year beginning after the passage of PPA through the last day of the plan year ending after the final regulations are issued without a requirement to also provide the rate stated in the plan document, if greater, if the following conditions are met:
  - The plan operationally used the interest crediting rate.
  - The plan had a good faith belief that the plan as written did not conform to the requirements of PPA.
  - The plan had a good faith belief that the lower interest crediting rate satisfied the statutory requirements of the PPA.

- Provide guidance on retroactive amendments to interest crediting rates to conform to the requirements of PPA.
- Provide §411(d)(6) relief for plans with an acceptable interest crediting rate under §1.411(b)(5)-1(d)(3) or §1.411(b)(5)-1(d)(4) to amend the method of applying their interest credit rate to conform with §1.411(b)(5)-1(d)(1)(iv)(B). In amending to conform with §1.411(b)(5)-1(d)(1)(iv)(B) plan sponsors should be able to choose any acceptable options under § 417(e) for look back month, averaging, and stability period without regard to their current methodology and should be permitted to modify those methods without a requirement to provide the greater of two rates for the period prior to actual amendment of the plan.

XIII. **Floor offset arrangements.** Floor offset arrangements are specifically permitted in assessing age discrimination under §411(b)(5)(C) to the extent otherwise permitted under §401(a). Existing guidance on floor offset arrangements (principally Rev. Rul. 76-259) explains how an offset arrangement would apply where traditional plan benefits are offset by benefits provided from a true defined contribution account. Example 3 in the new final hybrid regulation at §1.411(a)(13)-1 illustrates the 3-year vesting rule in a situation where a traditional plan benefit is offset by the cash balance account in a separate plan, thus confirming that floor-offset arrangements can be constructed with defined benefit as well as defined contribution offsets.

Guidance is needed on how the accrual rules are applied to the plans where a cash balance account is used in a floor offset arrangement. As in the case of a defined contribution offset, the net benefit from the richer plan should not be required to independently show that it satisfies an accrual rule. As in the case of a defined contribution offset, the floor offset should be limited to the amount provided from the vested portion of the hypothetical account.

Guidance is also needed for floor offset arrangements that consist of a cash balance plan offset by allocations under a defined contribution plan. Arguably, rules for such plans are already in place in Rev. Rul. 76-259. However, some interpret current requirements to permit a plan design that offsets allocations against cash balance credits on an annual basis. We have concerns about the impact of such a design on the accrual rule that must be satisfied by the cash balance plan.

ASPPA COPA recommends that final regulations clarify that floor offset arrangements comprised of two defined benefit plans are tested under the accrual rules in aggregate and that the offset is limited to the vested portion of the offset benefit. This treatment would be comparable to the rule for defined contribution plans in Rev. Rul. 76-259.

In addition, ASPPA COPA recommends that regulations clarify that cash balance principal credits cannot be offset by defined contributions on an annual basis.

XIV. **Testing methodology with variable rates**. The cash balance safe harbor testing method in §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, which has not been updated for PPA, 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. Although the use of current, or recent, investment results to predict future returns has been the safe harbor, it does not reflect the fact that long-term returns are unlikely to be the same as recent returns – especially in times of irrational exuberance or bear markets. (In fact, the preamble to the proposed regulations notes that a five year average of equity rates is not a good predictor of future equity rates of return. Presumably a current year rate would also not be predictive.) 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. The proposed regulation does not extend this approach to other code sections.

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. A concern about permitting a floor in excess of zero is that existing hypothetical balances may reflect unusually high returns, a negative return may just be part of returns reverting to the long term norm, and using a minimum crediting rate when returns are negative will overstate projected balances. However, if there were also a cap on the crediting rate, the cap would have prevented the (probably more significant) overstatement of likely projected balances that resulted from projecting the prior hypothetical account at an irrationally high long term rate.

ASPPA COPA recommends that final regulations provide guidance on the application of nondiscrimination, coverage, participation, accrual and maximum benefit rules when a plan uses a variable interest crediting rate. Specifically guidance should:

- 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. The floor could be, for example, the average rate of return on 1-year Treasury constant maturities and the cap the average of the S&P 500 over a 40-year period (a typical working lifetime).
- 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.
- Clarify that the present value of accrued benefits for purposes of determining top heavy status is the hypothetical account balance as of the determination date.

XV. **Participant choice.** The preamble to the proposed regulations asks for comments on whether or not a statutory hybrid plan should be allowed to offer participants a menu of hypothetical investment options, including a life-cycle investment option under which participants are automatically moved into a less aggressive investment mix as they near retirement. ASPPA COPA has 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. However, the introduction of an alternative to 401(k) plans that provides a defined contribution allocation rather than elective deferral (pay credit), minimum guarantee, and automatic, though waivable, qualified joint and survivor benefits may be an option that many plan sponsors and plan participants value. If participant choice is offered in the defined benefit system, the additional protections need to be preserved, and a number of other issues will need to be addressed to assure these plans are workable administratively and not fraught with hidden liabilities for employers and fiduciaries.

A. **Choice of benefit structures.** The choice of interest crediting rates in a cash balance plan represents a participant being offered a choice between two different benefit structures. If participants are offered a menu of potential interest crediting rates, participants need to be provided with adequate information about how their choices will impact their potential monthly annuity benefit including how their choices will impact the assumptions used to convert their account balance to an annuity.

If participant choice of interest crediting rates is permitted, ***ASPPA COPA recommends*** that participants and their spouses should be provided information about the impact of their choices on their monthly annuity in advance of participants making interest credit choices.

B. **Disclosure.** Participant accounts in defined contribution plans either have the protection of the prudent expert rule or are subject to the rules of ERISA §404(c). Thus, unless the participants are given the disclosures and information required under ERISA §404(c) (and other protections, including the right to change investment elections at least quarterly), the trustees remain responsible for the investment performance of the participants' accounts. Similar protections for participants would not exist in a participant directed cash balance plan under current law. PPA's addition of the preservation of capital rule for cash balance plans does not adequately make up for the loss of protection.

Thus, while the selection of an investment menu offered to participants is clearly a fiduciary duty in a defined contribution plan, in a defined benefit plan it would be settlor function; simply a plan design choice. Absent requirements in the regulations to provide basic disclosure about the hypothetical investment menu and other ERISA §404(c)-type protections, the defined benefit plan that is supposed to provide greater security to the participant would have none of the protections extended to participants in the (supposedly less secure) defined contribution plans.

If participant choice of interest crediting rates is permitted, ***ASPPA COPA recommends*** that disclosure requirements similar to those for ERISA §404(c) be required of cash balance plans offering choice. However, unlike

ERISA §404(c), cash balance plans should not be required to permit election changes more frequently than annually. Also, a cash balance plan should be able 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 participants.

C. **Moral hazard.** With participant directed cash balance plans there are additional moral hazards for trustees and plan sponsors. 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 assets would have to be invested aggressively, leading to volatile returns, or the plan sponsor could expect additional volatility in contributions. It can be argued that it is always prudent to invest the assets in a defined benefit plan in such a way that the assets exactly track the increases and decreases in plan liabilities. This would effectively lead to permitting defined benefit plan assets to be invested to track participant elections (thus shifting all investment risks from the plan sponsor to the plan participant), but without a structure similar to ERISA 404(c) to protect the electing participants and the fiduciaries. In the alternative, if the plan's investments are invested according to a traditional defined benefit investment strategy which does not correlate to participants' aggressive elections, there is a possibility that a well-funded plan could become underfunded very quickly in a period when aggressive investments perform well. This could lead to additional exposure for the PBGC and put participants at risk for shortfalls in anticipated benefits.

Because the interest crediting rate is part of the accrued benefit, and all related future interest credits are accrued at the time a participant accrues a pay credit, some would argue that a change in the crediting rate would appropriately be treated as a plan amendment for §411(d)(6) purposes. A similar result arises from the notion that participants in a qualified retirement plan are not permitted to waive all or any part of their accrued benefit. An election of a different interest crediting rate would effectively be a waiver of any part of the benefit that would have been payable had the change not been made. In either view, the effect would be that the benefit resulting from the changed participant choice cannot be less than would have been provided applying the previously chosen interest crediting rate. If plans had to operate under this paradigm, participants would be encouraged to select one rate and subsequently change to another rate with different characteristics to achieve the greater of the two results. This moral hazard could be limited by placing restrictions on the ability to change investments. However, limiting the ability to change when an initial election is no longer (or never was) appropriate would eliminate a right available under a self-directed defined contribution plan (with quarterly or more frequent changes permitted), placing participants in a defined benefit plans at a relative disadvantage.

If participant choice of interest crediting rates is permitted, ***ASPPA COPA recommends*** that:

- Plans permitting participant choice be required to provide the 3 percent aggregate minimum allowed for equity based interest credit rates for all hypothetical accounts under the plan.
- A change of election relating to an existing hypothetical account 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 combination of a higher cumulative minimum and §411 relief would provide participants with greater protection than a defined contribution plan, while permitting flexibility in cash balance plan design.

D. **Other guidance required**. If choice of investment crediting rates is permitted, guidance would need to address the following concerns:

- *§401(a)(4).* Current regulations would already require that interest crediting rate options be available on a nondiscriminatory basis. Guidance should provide that changes in elections can only be prospective, and §401(a)(4) testing is based on the interest crediting rate in effect on the testing date.
- *§401(a)(26).* Guidance should provide that benefit projections are based on the interest crediting rate in effect on the determination date.
- *§411(a).* Guidance should provide that no forfeiture occurs as a result of a change in an interest crediting rate election.
- *§411(b).* As with other plan amendments, the application of the accrual rules would be based on the prospective interest crediting rate.
- *§411(b)(5).* The §411(b)(5) safe harbor regulations would have to be modified to provide that the similarly situated test is applied assuming a history of identical elections of investment choice for older and younger workers.
- *Alternative option*. Assuming the 3% cumulative minimum is required, and choices are available on a nondiscriminatory basis, plans should be permitted use the cumulative 3% account to apply the general nondiscrimination test of §401(a)(4), and to demonstrate compliance with §401(a)(26) and §411.

If the interest crediting rate in effect on the current testing date is a variable rate, the recommendations on testing methodology with variable rates in section IX above, including any averaging of returns for prior periods, would be applied based on the interest crediting rate in effect on that date.

XVI. **Ministerial Issues.**

A. Given that governmental plans are not subject to §411, references to the special PPA delayed effective date rule should not be included in final §411 regulatory effective date descriptions.

B. Regulation §1.411(b)(5)-1(d)(5)(ii) relating to the use of the actual rate of return on plan assets should be added to the list of sections in Prop. §1.411(b)(5)-1(f)(2)(i)(B) (dealing with the 2012 effective date).

* * * * * *

These comments were prepared by a task force of ASPPA's Defined Benefit Subcommittee of the Government Affairs Committee and the ASPPA College of Pension Actuaries. The task force was chaired by Kevin Donovan, MSPA, and the comments were primarily authored by Marjorie Martin, MSPA, Judy Miller, MSPA, Mark Dunbar, MSPA, Karen Smith, MSPA and Thomas Finnegan, MSPA. Please contact us if you have any comments or questions on the matters discussed above.

Thank you for your consideration of these comments.

Sincerely,

/s/
Brian H. Graff, Esq., APM
Executive Director/CEO

/s/
Judy A. Miller, MSPA
Chief of Actuarial Issues

/s/
Craig P. Hoffman, Esq., APM
General Counsel/Director of Regulatory Affairs

/s/
Mark Dunbar, MSPA
Co-chair, Government Affairs Committee

/s/
Ilene Ferenczy, Esq., APM
Co-chair, Government Affairs Committee

/s/
James Paul, Esq., APM
Co-chair, Government Affairs Committee

/s/
Karen Smith, MSPA
Co-chair, Defined Benefit Subcommittee