



THE ERISA INDUSTRY COMMITTEE

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Advocating the Benefit and Compensation Interests of America's Major Employers

August 24, 2005

Good morning. My name is John Vine. I appear this morning on behalf of The ERISA Industry Committee -- commonly known as "ERIC."

ERIC very much appreciates the opportunity to participate in today's hearing. ERIC has been actively engaged in the relative value rulemaking process for several years and supports the general objectives of the relative value regulations.

ERIC filed comments on the October 2002 proposed regulations. After those regulations were finalized in December 2003, ERIC submitted a written request that the regulations' effective date be postponed. ERIC appreciates the thoughtful consideration that the Treasury and the Service have given to ERIC's prior submissions. ERIC also filed comments on the proposed regulations that were issued in January and that are the subject of this hearing. Although ERIC's most recent comments address a variety of issues, I will focus this morning on a single issue: the proposed application of section 417(e) to social security level income options.

A social security level income option typically provides a benefit as a single life annuity for the life of the participant or as a joint and survivor annuity for the life of the participant and a survivor annuitant.

Unlike other life annuities, the level income option provides an income stream that is coordinated with the participant's expected social security benefit to provide an aggregate income stream that is roughly level throughout the participant's retirement. When the participant reaches social security retirement age, the retirement income provided by the plan decreases by an amount that approximates the participant's expected social security retirement benefit -- providing the participant with a roughly level retirement income when both the plan and social security are taken into account.

In practice, a social security level income option generally results in substantial payments throughout the participant's retirement, including the period after the participant attains social security retirement age. A study by one major plan found that over 60% of the participants who elected a social security level income option received a monthly payment after social security retirement age that exceeded 50% of the monthly payment before that age.

The proposed regulations say very little about social security level income options -- but what they do say is extremely significant.

When the Service first announced that the regulations' effective date would be delayed, the Announcement excluded from the delay optional forms of distribution that are subject to

417(e). A parenthetical phrase in the Announcement listed “single sums, distributions in the form of partial single sums, and installment payment options” as examples of optional forms that are subject to 417(e). In this respect, the proposed regulations are generally consistent with the Announcement – except that they include in the 417(e) list a form of distribution that was not mentioned in the Announcement: a social security level income option.

We believe that 417(e) does not apply to social security level income options, and we urge the Treasury and the Service to make this clear. Numerous authorities support this conclusion:

1. *First*, by its terms, 417(e) applies to an *immediate distribution of the present value* of a qualified joint and survivor annuity. Because a social security level income option is typically paid over the life of the participant, it is not an immediate distribution of the present value of the participant’s benefit.
2. *Second*, although the Treasury’s existing regulations provide that 417(e) covers a wide variety of distribution options, the existing regulations do not provide that 417(e) covers social security level income options. In fact, the regulations exempt from 417(e) both a non-decreasing annuity and an annuity that decreases solely because of the cessation of a social security supplement. A social security level income option resembles these forms of distribution much more closely than it resembles an immediate distribution of the present value of the benefit.
3. *Third*, any doubt about this issue is resolved by the Treasury’s 402 regulations – which treat a social security level income option as a series of substantially equal periodic payments. **The Treasury cannot have it both ways: it cannot treat a social security level income option as a series of substantially equal periodic payments for purposes of 402 and as a decreasing annuity for purposes of 417(e).**
4. *Fourth*, the recently finalized 411(d)(6) regulations treat an annuity with a social security level income feature as equivalent to an otherwise identical annuity – not to a lump sum or an installment form of distribution.
5. *Fifth*, the PBGC guarantees the benefits under a social security level income option – just as it guarantees the benefits under a conventional annuity and unlike lump sum and installment benefits, which PBGC does not guarantee.
6. *Sixth*, in practice, many plans with social security level income options do not apply 417(e) to those options. These plans have received favorable determination letters from the Service -- even though, by their terms, these plans do not apply 417(e) to benefits paid under social security level income options. This has given many employers good reason to believe that 417(e) does not apply to social security level income options.
7. *Seventh*, subjecting social security level income options to 417(e) will weaken defined benefit plans:
 - a. It will burden plans with substantial additional costs.
 - b. It will increase the PBGC’s unfunded liabilities.
 - c. It will discourage plans from allowing benefits earned in the future to be distributed under a social security level income option.
 - d. And because it will increase plan liabilities and complicate plan administration, it will give employers yet another reason to terminate, freeze, or curtail their plans.

If -- contrary to ERIC's position -- the Treasury wishes to consider applying 417(e) to social security level income options, the Treasury should address this issue in *a separate rulemaking that expressly and systematically considers the issue*. The Treasury should not change the law quietly, below the radar screen, in a parenthetical phrase in regulations that address a very different issue.

In any new rulemaking, ERIC would oppose expanding the coverage of 417(e) -- just as it has here. But if 417(e)'s coverage is to be expanded, *the expanded coverage should apply only to benefits accrued in the future*.

Let me close with the following observations. *The Treasury should interpret the law consistently*. Consistency is not merely a technical legal requirement; it is required to maintain the Treasury's credibility and authority. If the Treasury is not consistent, if the Treasury takes positions that are erratic or that do not adhere to its own precedents, the Treasury jeopardizes its own credibility and authority.

The Treasury has issued regulations under section 402 providing that a social security level income option provides a series of substantially equal periodic payments. The Treasury cannot turn around now and take the position, under 417(e), that an absolutely identical social security level income option provides payments that are not substantially equal.

If the Treasury takes inconsistent positions on this issue, the Treasury will weaken not only the pension system, but its own credibility and authority as well.

The Treasury should not jeopardize its stature over this issue.

Thank you. That completes my prepared statement. I will be happy to answer any questions that the members of the panel might have.