The ERISA Industry Committee

December 21, 2007

VIA COURIER

CC:PA:LPD:PR (REG-113891-07)
Room 5203
Internal Revenue Service
POB 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Benefit Restrictions for Underfunded Pension Plans (REG-113891-07)

Ladies and Gentlemen:

The ERISA Industry Committee ("ERIC") is pleased to submit the following comments on Proposed Regulations §§ 1.430(f)-1 and 1.436-1, regarding

- the prefunding balance and the funding standard carryover balance under § 430(f) of the Internal Revenue Code of 1986, as amended (the "I.R.C." or the "Code"), and

- the limits imposed by I.R.C. § 436 on the accrual and payment of benefits under defined benefit plans.

The proposed regulations were published in the Federal Register on August 31, 2007. 72 Fed. Reg. 50,543.

Sections 430(f) and 436 were added to the Code by the Pension Protection Act of 2006 (Pub. L. No. 109-280). In this letter, except where expressly indicated otherwise, "section" or "§" refers to a section of the Code.

ERIC is a nonprofit association committed to the advancement of the employee retirement, health, incentive, and welfare benefit plans of America's largest employers. ERIC's members provide comprehensive retirement, health care coverage, incentive, and other economic security benefits directly to some 25 million active and retired workers and their families. ERIC has a strong interest in proposals affecting its members' ability to deliver those benefits, their costs and effectiveness, and the role of those benefits in the American economy.

As the sponsors of many of the nation's largest single-employer defined benefit plans, ERIC's members are extremely concerned about the proposed regulations. Some of these concerns relate to the positions taken in the proposed regulations, while other concerns relate to the need for clarification or amplification of the regulations.

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ERIC's members have significant concerns regarding issues falling in the following categories:

- **Discrepancies Between Statutory and Regulatory Requirements**. There are significant discrepancies between the requirements that would be imposed by the proposed regulations and the requirements that are imposed by the text of the statute. Some of these discrepancies would result in the imposition of substantial additional administrative burdens on employers and rules that would make it extremely difficult for employers to communicate effectively with plan participants about changes in their plans. Other discrepancies would result in the imposition of restrictions on benefit distributions that are far more severe than the restrictions prescribed by the statute.

- **Unreasonable and Uncertain Administrative Requirements.** The proposed regulations fail to give an employer the time it needs to make the necessary changes in plan administration after the employer receives an unfavorable adjusted funding target attainment percentage ("AFTAP") certification. Employers need time to communicate with participants, to change plan administrative processes, and to make other necessary changes in plan operations. In addition, some of the proposed regulations' requirements are uncertain or unclear and require amplification or clarification before they can be evaluated, much less implemented.

- **Limitations on Benefit Increases Required By Existing Plan Provisions.** The regulations propose an overly broad definition of a plan amendment. If this over-broad definition is adopted, it will unnecessarily and inappropriately restrict changes in benefit payments that are required by the Code. In addition, the proposed regulations fail to exempt from the benefit limitations plan amendments that are designed to implement statutorily mandated changes.

I. Discrepancies Between Statutory and Regulatory Requirements

The following provisions of the proposed regulations are more restrictive than the corresponding statutory provisions:

A. Prohibition on Offering Accelerated Payments

Under the proposed regulations, it appears that a plan may not allow a participant to elect to receive accelerated payments during the restricted period if the plan's AFTAP is below a specified level. *See* Prop. Reg. § 1.436-1(d). By contrast, § 436(d)(1) states that the plan may not *pay* an accelerated payment in such circumstances, but § 436(d)(1) does not prohibit a participant from electing an accelerated payment. The regulations should be modified to allow a participant to elect an accelerated payment, even if a benefit restriction prevents the plan from making the elected payment immediately, without requiring the participant to make a second election when the restriction on benefit payments is lifted.

The final regulations should adopt the approach taken in Treas. Reg. § 1.401(a)(4)-5(b) (restricting the payment of benefits under certain conditions), which allows a participant to elect to receive a lump-sum payment, but limits the amount that the plan can pay until the plan has satisfied its benefit obligation to the participant or the restriction no longer applies. Under this approach, the plan may pay the balance of the lump sum as soon as the benefit limitation no longer applies.

The proposed regulations would unnecessarily complicate plan administration by denying a participant the right to elect to receive an accelerated payment during a restricted period. The statute does not mandate this restriction, and the restriction is not necessary to effectuate Congressional intent.

B. Presumption for Plans Already Subject to a Benefit Restriction

The proposed regulations do not accurately implement the AFTAP presumptions that apply when a plan is already subject to a benefit restriction. Section 436(h)(3) provides--

> In any case in which—
>
> (A) a benefit limitation under subsection (b), (c), (d), or (e) did not apply to a plan with respect to the plan year preceding the current plan year, but the adjusted funding target attainment percentage of the plan for such preceding plan year was not more than 10 percentage points greater than the percentage which would have caused *such subsection* to apply to the plan with respect to such preceding plan year, and
>
> (B) as of the first day of the 4th month of the current plan year, the enrolled actuary of the plan has not certified the actual adjusted funding target attainment percentage of the plan for the current plan year,
>
> until the enrolled actuary so certifies, such first day shall be deemed, for purposes of *such subsection*, to be the valuation date of the plan for the current plan year and the adjusted funding target attainment percentage of the plan as of such first day shall, *for purposes of such subsection*, be presumed to be equal to 10 percentage points less than the adjusted funding target attainment percentage of the plan for such preceding plan year. [Emphasis added.].

The proposed regulations deviate from the foregoing rule by failing to recognize that the presumption does not apply to a subsection that *already* restricts the benefits under the plan. Under the proposed rule, a plan with a prior-year AFTAP between 60 and 70 percent that is currently subject to the 50 percent limit on prohibited payments would be presumed to have an AFTAP below 60 percent. This would bar the plan from making any accelerated payments. By contrast, under the statute, the plan would not be subject to the underfunding presumption and would be permitted to continue to make limited accelerated payments under § 436(d)(3).

Prop. Reg. § 1.436-1(h)(2) should be changed to provide that for purposes of the limits in subsections (b) and (e), the prior year AFTAP is reduced by 10 percentage points if the prior year AFTAP is at least 60 percent but less than 70 percent, and that for purposes of the limits in subsections (c) and (d), the prior year AFTAP is reduced by 10 percentage points if the prior year AFTAP is at least 80 percent but less than 90 percent. These revisions will make the regulation consistent with the statute.

Section 436(h)(3) states that the adjustment required for "nearly underfunded plans" applies to each subsection. The proposed regulations should adopt the same formulation. An employer should be permitted to make a § 436 contribution for subsections (b), (c), and (e), but not for subsection (d). The regulations should recognize that a plan could have different AFTAPs for each of the specified groups of limits.

The statute does not specify the AFTAP for the first nine months of a plan year where the plan was neither underfunded nor nearly underfunded in the preceding year under § 436(h)(3). The approach taken by the contribution rules in the proposed regulations for subsections (b), (c), and (e) presume that the prior-year figure carries over. The final regulations should clarify that the presumption for the first three quarters of a plan year for a plan not subject to § 436(h)(1) or § 436(h)(3) is equal to the preceding year's AFTAP.

II. Unreasonable Administrative Requirements

If adopted in their proposed form, many provisions of the proposed regulations would create serious administrative obstacles that would be extremely difficult—if not impossible—for large employers to overcome. Clarification and revision of the proposed regulations' timing requirements are needed.

A. Unreasonable Limitations on Plan Year Amendments

The proposed regulations would create serious obstacles for employers who adopt plan amendments that become effective on the first day of the plan year. The final regulations should allow the plan's enrolled actuary to roll forward plan data from the valuation for the prior plan year for purposes of providing an estimate of the proposed amendment's impact on the plan's AFTAP.

Section 436(c)(2) permits an employer to make a contribution equal to:

- the amount of the increase in the plan's funding target that is attributable to the amendment if the plan's AFTAP is below 80 percent, or
- the amount needed to produce an AFTAP of 80 percent after the amendment if the amendment would have resulted in the AFTAP being less than 80 percent.

The final regulations should allow the employer to make a contribution under § 436(c)(2) based on the actuary's estimate. A contribution based on the actuary's estimate of the contribution required to avoid a benefit restriction under § 436(c)(1) should result in a presumed AFTAP for the plan year in excess of 80 percent. If the actuary underestimates the impact of the amendment, the employer should be allowed to eliminate the short-fall by making an additional contribution under § 436(c)(2) prior to the end of the plan year.

B. Use of Unaudited Data and Estimates

The final regulations should make clear that the plan's enrolled actuary may use unaudited trustee statements and estimated data on plan population and asset values to make the AFTAP certification. The unavailability of audited data until late in the year would give the actuary insufficient time—or in some cases, no time—to certify the plan's AFTAP. Given the conclusive presumption of underfunding after the last day of the ninth month of the plan year under § 436(h)(2), it is critical that actuaries be allowed to base their certifications on unaudited data.

C. Immediate Applicability of Benefit Restriction upon AFTAP Certification

The proposed regulations indicate that a benefit restriction becomes immediately applicable as of the date the actuary certifies the AFTAP. This rule would create severe administrative problems since it is virtually impossible for these events (*i.e.*, AFTAP certification and the change in benefit processing) to occur simultaneously. Employers and service providers need sufficient time to update and adjust plan systems and to prepare and distribute the appropriate communications to plan participants.

The final regulations should provide a reasonable interval between the date that the plan administrator receives the AFTAP certification from the actuary and the effective date of any resulting benefit restriction. The final regulations should also make clear that only a communication from the actuary to the plan that purports to be an AFTAP certification is an AFTAP certification for purposes of § 436. Actuaries must be free to communicate their proposed certifications to employers so that employers can make the contributions required to avoid the benefit restrictions. Only a communication that states that it is an AFTAP certification should be treated as an AFTAP certification.

D. Inclusion of Excess Contributions in the Plan Prefunding Balance

Under Prop. Reg. § 1.430(f)-1, if an employer fails to elect that a contribution is to be added to the prefunding balance, the amount is added only to the plan's assets. By contrast, under current law, excess contributions are automatically added to the plan's "credit balance." Under the proposed regulations, it appears that the election to apply an excess contribution to the prefunding balance must be made concurrently with or after the contribution is actually contributed, but in no event later than the due date of the Form 5500 (with extensions) for the plan year.

The final regulations should permit the employer to elect that in all years all contributions that exceed the minimum required contributions, other than those specifically designated as § 436 contributions, will automatically be added to the prefunding balance -- consistent with current law.

E. Consistent Definition of Annuity Starting Date

Section 436(d)(3) limits the payment of accelerated benefits to participants with annuity starting dates that occur during a restricted period. The term "annuity starting date" is defined by cross-reference to § 417(f)(2). This definition has long been established as an "as of" date, primarily constrained by the time when the qualified joint and survivor annuity notice is delivered to the participant. The proposed regulations would add a new constraint to the existing rules—the date of the participant's election—just for purposes of § 436. *See* Prop. Reg. § 1.436-1(d)(5)(ii).

There is no indication in the statute that Congress intended the definition of "annuity starting date" in § 436 to differ from the definition used in § 417(f)(2) -- the provision to which § 436(d)(3) refers. Adding a rule that does not apply for other purposes will create additional administrative complexity and impose a limitation that has no basis in the statute. ERIC recommends that the final regulations adopt, without modification, the § 417(f)(2) definition of annuity starting date.

III. Limitations on Benefit Increases Based Upon Existing Plan Provisions

The final regulations should clarify that benefit increases based on existing plan provisions are not subject to benefit restrictions under § 436(c). The proposed regulations carve out amendments related to changes in the vesting rules. Prop. Reg. § 1.436-1(c)(4). This exclusion should be broadened to include all statutorily mandated plan amendments and any benefit increases that result from a change in a provision of the Code that the plan incorporates by reference.

For example, plan amendments designed to reflect changes in the § 417(e)(3) interest rate and mortality assumptions should not be considered amendments for benefit limitation purposes. In addition, a plan may be required to include terms providing top-heavy minimum benefits if the plan becomes top-heavy under § 416. Also, a plan may provide automatic cost-of-living increases for purposes of applying the benefit and compensation limits under §§ 415 and 401(a)(17). The final regulations should clarify that increases of this sort are not treated as plan amendments for purposes of § 436(c).

ERIC recognizes that, in the past, the IRS has taken the position that increases in the § 415 limits are treated as plan amendments for minimum funding and maximum deduction purposes, as well as for § 411 vesting purposes. ERIC believes that the § 436 rules are fundamentally different. The benefit limitations imposed by § 436 are not voluntary, and requiring employers to calculate separately the AFTAP impact of such changes on annual basis will be disruptive, burdensome, and costly.

IV. Other Issues

The final regulations should clarify the following issues:

A. Coordination of §§ 430 and 436

The proposed regulations outline "methods to avoid benefit limitations." Prop. Reg. § 1.430(f)-1. If an employer makes a contribution under § 436(c)(2) for the current year (*e.g.*, to allow a benefit increase), the proposed regulations do not include the contribution and the increase in liability associated with the amendment in the presumed AFTAP for the next year. In addition, the regulations do not make clear whether the amendment and associated contribution are included in the § 430 target liability or in the normal cost for the year in which the amendment is effective.

The final regulations should coordinate §§ 430 and 436 so that the benefit liability and§ 436(c)(2) contribution associated with any benefit increase are included in the plan's § 430 target liability and assets for the year in which the amendment is adopted and the presumed AFTAP for the subsequent plan year. To avoid double charging, the final regulation should clarify that the cost of the amendment is not included in liability or normal cost if a § 436(c)(2) contribution is made or if the amendment is not implemented because the § 436(c)(2) contribution is not made.

B. Ineffective Plan Amendments

The proposed regulations do not address the effect of adopting an amendment when a plan is subject to a § 436(c) limitation and a § 436(c)(2) contribution is not made. An employer could adopt a plan amendment subject to the limitation because an error was made in determining the AFTAP or when the employer intends to make a § 436(c)(2) contribution but is later unable to do so. In some situations, a plan may communicate the amendment to participants and pay the increased benefits before realizing that the plan was subject to the limitation.

The final regulations should provide that a plan amendment was not effective if the plan initially treated the amendment as effective, but later determined that the amendment was not permitted under § 436(c). The final regulations should specify that in such circumstances, treating the amendment as not effective is not an impermissible reduction in accrued benefits under § 411(d)(6) and does not trigger the advance notification requirements of § 4980F (ERISA § 204(h)).

The final regulations should also clarify the date when such an amendment becomes effective when the plan is no longer subject to a § 436(c) limitation due to its improved AFTAP (rather than due to a § 436(c)(2) contribution).

ERIC also recommends that the Employee Plans Compliance Resolution System (EPCRS) include an appropriate correction for benefit overpayments that are made in such circumstances, similar to the corrections currently available for benefit overpayments to participants.

ERIC appreciates the opportunity to submit these comments. We will continue to solicit analysis and comment from our members on these important issues and reserve the right to submit additional comments. If we can be of any further assistance to the Department of the Treasury and the Internal Revenue Service., please let us know.

Sincerely,

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THE ERISA INDUSTRY COMMITTEE

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