ERIC

**The ERISA Industry Committee**

May 2, 2012

The Honorable Mark W. Iwry
Senior Advisor to the Secretary and Deputy Assistant Secretary (Retirement and Health Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable George H. Bostick
Benefits Tax Counsel
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**Re: Revenue Ruling 2012-4 (Defined Contribution to Defined Benefit Rollovers)**

Gentlemen:

We are writing to express concern regarding Revenue Ruling 2012-4, which sets forth requirements for defined benefit plans that accept rollovers from defined contribution plans ("DC-DB Rollovers"). The Ruling was issued on February 2, 2012.

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, and other economic security benefits directly to tens of millions of active and retired workers and their families. ERIC's members appreciate Treasury's and the Service's efforts to "reduc[e] regulatory barriers . . ., encourage innovation among stakeholders, and expand choices for individuals,"[1] and have a strong interest in rules affecting their ability to deliver effective and secure retirement benefits.

For the reasons set forth in this letter, we respectfully request that Revenue Ruling 2012-4 be withdrawn. Guidance on DC-DB Rollovers should be issued in the form of proposed regulations that invite comments from stakeholders. To encourage innovation and expand choices for individuals, the proposed regulations should allow reliance on the proposed rules.

Our most significant concern is the premise that an amount ***voluntarily*** rolled over from a defined contribution plan should be treated as a ***mandatory*** employee contribution to the defined benefit plan. As a result of this premise, Revenue Ruling 2012-4 states that the requirements of Code § 411(c)(2) apply to the amount rolled over.

Treating rollover contributions like mandatory contributions is inconsistent with the fact that rollover contributions are entirely voluntary. This treatment will have troubling consequences for existing floor-offset arrangements and other plans that already

[1] U.S. DEP'T OF THE TREASURY, TREASURY FACT SHEET: HELPING AMERICAN FAMILIES ACHIEVE RETIREMENT SECURITY BY EXPANDING LIFETIME INCOME CHOICES 2 (Feb. 2, 2012).

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allow DC-DB Rollovers. Providing relief under Code § 7805(b) for rollovers made before January 1, 2013, will mitigate some of the damage, but this relief is not sufficient. First, relief under Code § 7805(b) does not apply under Title I of ERISA. Second, as explained below, even prospective compliance will result in adverse consequences for many plans--particularly floor-offset arrangements.

In addition, we wish to bring to your attention several significant questions that the Revenue Ruling does not answer.

**Summary of Comments**

1. Imposing the mandatory employee contribution requirements of Code § 411(c)(2) on rollover contributions is inconsistent with the statute and other guidance. The benefit attributable to rollover contributions should be determined based on reasonable actuarial assumptions prescribed by the plan.

2. Revenue Ruling 2012-4 threatens long-standing floor-offset arrangements that have been approved by the Service--a result that we assume was not intended. At a minimum, the Code § 411(c)(2) requirements should not apply for floor-offset arrangements established before 2013.

3. Revenue Ruling 2012-4 leaves unanswered significant questions with respect to (a) benefits, rights, and features testing, (b) after-tax employee contributions, and (c) annuities with refund features.

In light of these concerns, we respectfully request that Revenue Ruling 2012-4 be withdrawn and replaced with proposed regulations.

**Discussion**

**1. Imposing Code § 411(c)(2) requirements on rollover contributions is inconsistent with the statute and other guidance.**

By its terms, Code § 411(c)(2) applies only with respect to "mandatory contributions made by the employee." Unlike other provisions of the Code, § 411(c) does not mention rollover contributions. Guidance and accepted practice over the last 35 years have reflected the logical understanding that voluntary rollover contributions are not mandatory, and that benefits attributable to rollover contributions are not subject to the same requirements as benefits attributable to mandatory contributions. For example:

- Both the annual benefit limit under Code § 415(b) and the annual addition limit under Code § 415(c) are determined without regard to benefits derived from rollover contributions. Code § 415(b)(2)(A), (B); *id.* § 415(c)(2). In contrast, mandatory contributions are treated as annual additions under Code § 415(c)(2)(B). Until recently, guidance under Code § 415(b) has stated that the benefit attributable to rollover contributions is determined "on the basis of reasonable actuarial assumptions."[2]

- Benefits attributable to rollover contributions may be disregarded for purposes of determining whether consent is required for a distribution. Code § 411(a)(11)(D). In contrast, benefits attributable to mandatory contributions must be taken into account.

- Under Treas. Reg. § 1.401(a)(4)-11(b)(1), benefits attributable to rollover contributions are disregarded for the nondiscriminatory amount requirement under Code § 401(a)(4). In contrast, mandatory contributions must be tested under Treas. Reg. § 1.401(a)(4)-6.

In other words, guidance and accepted practice for over 35 years have reflected the statute's distinction between mandatory contributions and voluntary rollover contributions. If Congress had intended the mandatory contribution requirements under Code § 411(c)(2) to apply for voluntary rollover contributions, it would have said so.

Formal guidance did not treat rollover contributions like mandatory contributions for ***any*** purpose until July 2007, when new regulations under Code § 415 went into effect. In that case, the assumptions required for rollover contributions were changed with little explanation--reversing a "reasonable assumptions" standard that had applied for over 30 years, even though the statute had not changed. Still, Treasury and the Service acknowledged that the assumptions used to convert a rollover contribution to an annuity might not be the same as the assumptions required for mandatory contributions.[3] In fact, final hybrid plan regulations published in October 2010 describe a "reasonable assumptions" standard for purposes of determining the benefit attributable to rollover contributions.[4]

Revenue Ruling 2012-4 attempts to justify the new rule by stating that rollover contributions are "required" as a condition for receipt of additional employer-derived benefits under the defined benefit plan--for example, if the employee lives longer than the applicable life expectancy. The Ruling cites Treas. Reg. § 1.411(c)-1(c)(4), but that regulation does not state that rollover contributions must be treated like mandatory contributions.

To the contrary, the regulation includes the following example to illustrate the meaning of "mandatory contributions:"

> "[I]f the benefit derived from employer contributions depends upon a specified level of employee contributions, employee contributions ***up to that level*** would be treated as mandatory contributions."

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[2] *See*, *e.g.*, Rev. Rul. 75-481, 1975-2 C.B. 188; Treas. Reg. § 1.415-3(b)(1)(iii) (superseded by T.D. 9319, 72 Fed. Reg. 16878 (Apr. 5, 2007)).

[3] Treas. Reg. § 1.415(b)-1(b)(2)(iii), (v).

[4] *See* Treas. Reg. § 1.411(a)(13)-1(d)(3)(ii) (benefit attributable to rollover contributions is disregarded for purposes of determining whether a formula is "lump sum-based," provided that the conversion factors used to calculate that benefit are "actuarially reasonable").

(Emphasis added.) In other words, contributions are subject to Code § 411(c)(2) only to the extent that employer-provided benefits under the plan are conditioned on a specified level of employee contributions. The determination of whether contributions are mandatory is made at the outset, without regard to how long the participant lives.

In the situation described in Revenue Ruling 2012-4, the employer-provided benefit determined by the plan's benefit formula is the same whether or not a rollover contribution is made. Assuming reasonable actuarial assumptions, a rollover contribution does not give rise to any additional employer-provided benefits.

In sum, neither the statute nor existing guidance compel treating rollover contributions like mandatory contributions. Absent a change to the statute, 35-plus years of accepted practice should not be undone without careful thought and the benefit of the notice and comment process.

We understand that Treasury and the Service might be concerned by the lack of formal guidance on actuarial reasonableness. If that is the case, this concern should be addressed through the rulemaking process, with the benefit of notice and comment. For the sake of certainty, guidance on this topic should have a safe harbor. The safe harbor should include Code § 417(e) assumptions, any standard interest rate and standard mortality table permitted by Treas. Reg. § 1.401(a)(4)-12, and other common assumptions.

**2. At a minimum, the Code § 411(c)(2) requirements should not apply for floor-offset arrangements established before 2013.**

The Service first approved floor-offset arrangements in Revenue Ruling 76-259. Under that ruling, a floor-offset arrangement must specify the actuarial basis for determining the benefit derived from the defined contribution part of the arrangement--*i.e.*, the amount of the offset. Neither Revenue Ruling 76-259 nor any guidance since that time has mandated assumptions for purposes of calculating the offset. Accordingly, existing floor-offset arrangements specify assumptions for calculating the offset, and those assumptions often are not the Code § 417(e) assumptions that are required for mandatory contributions.

Floor-offset arrangements often allow participants to roll over the defined contribution part of their benefit to the defined benefit plan, so that they can receive the full benefit in an annuity from the defined benefit plan. Typically, the actuarial assumptions used to convert the amount rolled over to an annuity are the same as the assumptions used to calculate the offset. For example, if the offset is calculated using an interest rate of 7% and a standard mortality table, the annuity attributable to the rollover would be calculated using the same assumptions. This approach ensures that the participant does not gain or lose value as a result of changing assumptions.

In contrast, if a rollover contribution is treated like a mandatory contribution, the annuity attributable to the rollover would have to be calculated using Code § 417(e) assumptions. If so, it will be impossible to avoid gain or loss caused solely by changing actuarial assumptions. We assume that this consequence was not intended.

We appreciate that the Revenue Ruling includes relief under Code § 7805(b) for rollovers before 2013 and allows actuarial assumptions that are more favorable than the Code § 417(e) assumptions. However, this flexibility is not sufficient for the following reasons:

- As noted above, relief under Code § 7805(b) does not apply under Title I of ERISA. Because the statute has not changed, the new interpretation described in Revenue Ruling 2012-4 can spawn new private claims. We believe courts will agree that the new interpretation is incorrect, but we are nevertheless concerned that the cost of defending new claims would be significant.

- For plans under which the offset is calculated using fixed assumptions, there is no way to ensure that the fixed assumptions will always be at least as favorable as the Code § 417(e) assumptions. As noted below, employers have made significant contributions to defined benefit plans in reliance on the expectation that the DC-DB Rollover will be valued using the defined benefit plan's stated assumptions. Changing the rules mid-stream to require something more will unfairly increase costs in a way that no one could have reasonably expected.

- The Revenue Ruling warns that if the assumptions used to convert the rollover to an annuity are more favorable than the Code § 417(e) assumptions, "there are other considerations which must be taken into account." Although the Ruling provides examples of the "other considerations," it leaves the door open for problems that are not listed. Moreover, the examples are alarming in their lack of clarity. For example, the Ruling warns that a rollover benefit may be disregarded for purposes of the nondiscriminatory amount requirement only if the rollover benefit is calculated using "reasonable actuarial assumptions." The Ruling implies that "reasonable" assumptions need not be Code § 417(e) assumptions, and it has long been understood that the standard interest rates and mortality tables permitted by Treas. Reg. § 1.401(a)(4)-12 are reasonable; but the Ruling does not state this point affirmatively.

The existing approaches to rollover contributions have been approved by the Service in many favorable determination letters. For over 35 years, employers have developed valuable benefit programs, and have made significant contributions to defined contribution plans, in reliance on the expectation that a DC-DB Rollover will be valued using the defined benefit plan's stated assumptions. Changing the rules now will unfairly and unnecessarily increase the cost of providing benefits; even if total benefits do not increase, administrative costs certainly will.

In its current form, Revenue Ruling 2012-4 reflects another unfortunate example of how increased regulation and rethinking of settled rules threatens the voluntary pension system.[5] The change is particularly inappropriate in a package of guidance for which the stated objectives were

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[5] The ongoing debate over hybrid plan regulations under the Pension Protection Act of 2006 is another example of this problem. *See, e.g.*, ERIC Comments on Proposed & Final Regulations on Hybrid Retirement Plans (Jan. 2011), *available at* http://www.eric.org/forms/uploadFiles/268C90000002B.filename.ERIC_Comments_on_Hybrid_Regulations_%28Jan_12%2C_2011%29.pdf; Hybrid Plan Regulations Follow-up On Critical Issues (Sept. 7, 2011), *available at* http://www.eric.org/uploads/doc/retirement/hybrids_group-submission090711.pdf; *cf. Cooper v. IBM Personal Pension Plan*, 457 F.3d 636, 642-43 (7th Cir. 2007) (Easterbrook, J.) (noting that litigation over pension benefits can "make everyone worse off"). We appreciate that Treasury and the Service are working to address these concerns. We hope that the same positive energy will be applied to address our concerns with Revenue Ruling 2012-4.

"***reducing*** regulatory barriers" and to "encourage innovation." If Treasury or the Service nevertheless believe that long-accepted practices should be revisited, the appropriate forum is the rulemaking process.

**3. Additional Unanswered Questions**

In addition to the concerns discussed above, Revenue Ruling 2012-4 leaves unanswered several other important issues that should be addressed in any guidance related to DC-DB Rollovers. Again, these issues should be addressed in the form of proposed regulations on which stakeholders have an opportunity to comment. The following are some of the additional issues that should be addressed:

- ***Testing Nondiscriminatory Availability of the Rollover Feature.*** Future guidance should confirm that the nondiscriminatory availability requirements for benefits, rights, and features do not restrict age and service conditions for DC-DB Rollovers. For example, many plans allow DC-DB Rollovers only for participants who are retirement-eligible and only at the time of the distribution. Future guidance should state expressly that this plan design is not subject to complicated annual nondiscrimination testing.

- ***After-Tax and Roth Contributions.*** Future guidance should address the tax treatment of DC-DB Rollovers from plans that allow after-tax contributions and/or designated Roth contributions. For example:

  - Future guidance should address apportionment for a participant who has made after-tax contributions and rolls over only part of his or her account balance. The rollover should be treated as coming first from his or her pre-tax balance.

  - Future guidance should include a simple rule for determining the non-taxable portion of annuity payments when part of the annuity is attributable to a rollover of after-tax contributions.

  - Sensible guidance is needed for rollovers from designated Roth accounts.

- ***Death After Annuity Starting Date.*** The Revenue Ruling states that if a participant dies after his or her annuity starting date, the sum of the payments made may be less than the amount rolled over. However, some employers might wish to encourage DC-DB Rollovers by including a cash refund feature for participants who die before receiving a minimum amount of annuity payments. Future guidance should recognize this feature.

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We appreciate Treasury's and the Service's efforts to promote DC-DB Rollovers. However, Revenue Ruling 2012-4 is inconsistent with more than 35 years of accepted practice, without any change to the relevant statute. The link to mandatory employee contributions is unnecessary, and will have drastic and unforeseen consequences for many floor-offset and other existing arrangements. In light of these consequences, we respectfully request that Revenue Ruling 2012-4 be withdrawn and that DC-DB Rollovers be addressed through the normal "notice and comment" regulatory process.

Sincerely,

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