COMMENTS CONCERNING PROPOSED REGULATIONS
UNDER SECTIONS 401 AND 411 OF THE INTERNAL REVENUE CODE
AND ERISA SECTION 204 REGARDING THE INTERACTION OF AGE AND
BENEFIT ACCRUALS IN RETIREMENT PLANS

The following comments (the “Comments”) are the individual views of the members of
the Section of Taxation who prepared them and do not represent the position of the American
Bar Association or the Section of Taxation.

These Comments were prepared by individual members of the Committee on Employee
Benefits of the Section of Taxation of the American Bar Association (the “Section”). Principal
responsibility was exercised by Robert B. Stevenson, along with John F. Woyke. Substantial
drafting contributions were made by Robert B. Stevenson, Nancy Keppelman, John F. Woyke,
John Wendeln, Marc Sandberg, Robert Miller, R. David Danziger, David Ledermann and Keith
Mong. Other substantive contributions were made by Thomas H. Bergh, Mark A. Vogel and
Thomas A. Jorgensen. These comments were reviewed by Thomas R. Hoecker, James R.
Raborn and Taina E. Edlund of the Section’s Employee Benefits Committee, T. David Cowart of
the Section’s Committee on Government Submissions, and the Section’s Employee Benefits
Committee’s Quality Assurance Group, which is chaired by Diane J. Fuchs and whose members
consist of former chairs of the Employee Benefits Committee.

Although members of the Section who participated in preparing these Comments have
clients who would be affected by the federal tax and labor law principles addressed by these
Comments, or have advised clients on the application of such principles, no such member (or the
firm or organization to which such member belongs) has been engaged by a client to make a
government submission with respect to, or otherwise influenced the development or outcome of,
the specific subject matter of these comments.

Contact:
Robert B. Stevenson Phone: 734/747-7050 Fax: 734/747-8010
e-mail: ska-bob@ic.net

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I. Executive Summary

Sections 411(b)(1)(H) and 411(b)(2) of the Internal Revenue Code of 1986, as amended (the “Code”) generally prohibit discrimination on the basis of age in tax-qualified retirement plans. Sections 411(a) and 401(a)(9)(C)(iii) of the Code also require actuarial increases in defined benefit plans in certain circumstances for persons who work after attaining normal retirement age or age 70½, respectively.

Section 4(i) of the Age Discrimination in Employment Act (the “ADEA”) (29 USC § 623 (i)) and sections 204(b)(1)(H)(i) and 204(b)(2)(A) of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”) (29 USC §§ 1054(b)(1)(H)(i) and (b)(2)(A)) provide requirements comparable to those of sections 411(b)(1)(H) and 411(b)(2) of the Code.

The Equal Employment Opportunity Commission published proposed regulations interpreting section 4(i) of ADEA in 1987 (the “EEOC Proposed Regulations”). The Department of Treasury and the Internal Revenue Service published proposed regulations under sections 411(b)(1)(H) and 411(b)(2) in 1988 (the “1988 Proposed Regulations”). The EEOC Proposed Regulations and the 1988 Proposed Regulations did not address a number of important issues, among them a definition of “the rate of benefit accrual.” Also, these earlier regulations did not provide guidance specific to more recent benefit plan designs, such as cash balance plans.

On December 11, 2002, the Department of the Treasury and the Internal Revenue Service issued proposed regulations (the “2002 Proposed Regulations”) under section 401 and section 411 of the Code, which, among other things, provide rules for “eligible cash balance plans” and rules for converting existing defined benefit plans into cash balance plans.

The Department of Treasury and the IRS are to be commended for producing proposed regulations which are generally consistent with the statutory requirements, protect the interests of older workers, provide reasonable guidance to plan sponsors, permit reasonable plan designs and prohibit unreasonable designs. The 2002 Proposed Regulations provide a reasonable framework that should be helpful in preserving important retirement plan structures (such as defined benefit cash balance plans), while circumscribing age-based abuses.

Certain features of the 2002 Proposed Regulations, however, are problematic and others call into question the continued viability of a number of long-standing plan designs. In our view, the 2002 Proposed Regulations also place too much reliance on purely mathematical tests in order to determine whether benefit structures are age-discriminatory.

Our recommendations regarding the 2002 Proposed Regulations include the following:

1. Section 1.411(b)-2(b)(2)(iii)(E)(1) of the 2002 Proposed Regulations should be revised to provide that the Code section 417(e) interest rate and mortality table, and the interest rates in IRS Notice 96-8, are safe harbors that qualify as reasonable actuarial assumptions in calculating opening account balances. The regulation should also provide that other actuarial assumptions may be utilized, in which case the non-safe harbor assumptions would be tested under the general reasonableness standard.
2. Section 1.411(b)-2(b)(2)(iii)(E)(1) of the 2002 Proposed Regulations should be clarified to allow the employer to decide if a preretirement mortality assumption should be used.

3. The use of transition strategies in cash balance plans should be encouraged. Transition benefits should be excluded from the determination of the rate of benefit accrual under Section 1.411(b)-2(b)(2) of the 2002 Proposed Regulations. Alternatively, a transition structure should be excluded from the determination of the rate of benefit accrual under Section 1.411(b)-2(b)(2) of the 2002 Proposed Regulations if it does not exceed the value of the prior early retirement subsidy.

4. Section 1.411(b)-2(b)(2)(iii)(E)(3) of the 2002 Proposed Regulations should be changed to allow offsetting the value of benefits paid after normal retirement age from a participant’s opening account balance, which otherwise is to be determined as if the participant were at normal retirement age.

5. A converted cash balance plan should be allowed to continue the pre-conversion benefit formula for older workers where that is protective of participants’ benefit rights.

6. An eligible cash balance plan should not be required to provide interest credits on principal credits during the first year the principal credits accrue.

7. The 2002 Proposed Regulations require that eligible cash balance plans provide reasonable rates of interest credits. The applicable interest rate under Code section 417(e) and the deemed equivalent interest indices under IRS Notice 96-8, Section IV(A) should be safe harbor “reasonable” rates in Section 1.411(b)-2(b)(2)(iii)(B)(2) of the 2002 Proposed Regulations. Other rates should be permitted and tested under the general reasonableness standard.

8. Under Section 1.411(b)-2(b)(2)(iii)(B)(2) of the 2002 Proposed Regulations, the frontloaded interest requirement of cash balance plans should not be applied to pension equity plans, as they do not provide interest credits (or their equivalent) until a participant terminates employment. The frontloaded interest credits requirement should be modified for pension equity plans.

9. Section 1.411(b)-2(b)(2)(iii)(B)(2) of the 2002 Proposed Regulations should be clarified to state (if intended) that future pay and interest credits cannot be offset by either post-normal retirement age distributions or actuarial increases under Code section 411(b)(1)(H)(iii)(II). Also, as written, the 2002 Proposed Regulations appear to inappropriately require interest accruals on the portion of a hypothetical account balance which has already been distributed.

10. The 2002 Proposed Regulations may be read to apply retroactively to converted cash balance plans. We also understand, however, that a decision has not yet been made concerning how the final regulations will apply to pre-effective date conversions. Once that decision is made, section 1.411(b)-2(b)(2)(iii)(B)(2) of the 2002 Proposed Regulations may need to be modified to reflect the approach adopted.
11. Section 1.401(a)(4)-3(a)(1) of the 2002 Proposed Regulations should be modified to provide that an eligible cash balance plan may use the additions to the hypothetical account as the equivalent allocation rate when testing on a contributions basis.

12. Section 1.401(a)(4)-3(g) of the 2002 Proposed Regulations provides three ways for an eligible cash balance plan to test on a benefits basis. These tests are mechanical and restrictive. Many cash balance plans increase the rate of contribution credits for older employees in order to increase the benefits of those employees who have fewer years to retirement. These special nondiscrimination rules should be reconsidered. They may not accomplish any positive policy goal, and actually may operate to reduce the benefits for older workers.

13. If the mechanical tests of section 1.401(a)(4)-3(g) of the 2002 Proposed Regulations are not eliminated, a stand-alone eligible cash balance plan should be required to meet the gateway for a stand-alone profit sharing plan, rather than the gateway for aggregated defined benefit/defined contribution plans.

14. The effective date provisions of the regulations should be modified in certain respects. It should be clear that no rules added by the regulations will serve to disqualify a plan as a result of plan amendments or other transactions occurring prior to the date of the final regulations. Nor should the final regulations disturb beneficial structures added to plans prior to the effective date of the final regulations, such as supplemental accruals to ease the transition for certain employees in a converted cash balance plan. Also, once finalized, the regulations should have a delayed effective date to allow plan sponsors time to make any necessary adjustments in plan design. There should also be a typical delayed effective date for plans subject to collective bargaining and governmental plans.

15. Various features of sections 1.411(b)-2(a) and (b) of the 2002 Proposed Regulations provide a mathematical test which presents apparently unintended problems for certain well-accepted traditional defined benefit plans. We believe that the test for age discrimination should be a facial or design-based analysis of a plan’s benefit formula, not a rigid and complex mathematical test. If a mathematical test is applied in any case, it should be as an alternative to a facial analysis, and should reflect the same principles and flexibility as nondiscrimination testing under the Code section 401(a)(4) regulations.

16. The impact of actuarial increases on post-normal retirement age accruals should be applied at the point the benefit is ultimately payable, rather than incrementally and annually. This will greatly simplify plan administration and have no negative effect on protecting participants’ benefits.

17. Section 1.411(b)-2(d) of the 2002 Proposed Regulations, which involves age discrimination requirements with respect to optional forms of benefits, ancillary benefits and other rights and features, should be deleted.

18. Section 1.411(b)-2(a) and (c) of the 2002 Proposed Regulations should be revised to more specifically clarify what constitutes a prohibited reduction in defined contribution plan allocations or accruals by reason of age. The 2002 Proposed Regulation also should be clarified.
to reflect that “employer contributions” do not include elective deferrals by participants under Code Section 401(k).

The following comments sometimes refer to particular provisions of the 2002 Proposed Regulations by “Regulation Section.”

II. Cash Balance Plans

A. Introduction.

The formation of new defined benefit retirement programs has slowed to a crawl in recent years, and many American workers now rely exclusively, or at least primarily, on 401(k) plans for their retirement income needs. The result, of course, is that the retirement income available to American workers is subject to the investment risks associated with these programs.

Cash balance plans are viewed as a useful compromise between traditional defined benefit plans and defined contribution plans. Like traditional forms of defined contribution plans, participants may more easily understand the value of their benefits in a cash balance plan. Unlike traditional defined contribution plans, however, with a cash balance plan the employer bears the burden of investment losses.

In our current economic climate, we applaud the efforts in the 2002 Proposed Regulations to encourage cash balance plans and agree that appropriate cash balance designs should be encouraged. The specter of age discrimination challenges has retarded the formation and continuation of cash balance programs in recent years. We commend the Treasury and the IRS for the effort made to foster the future development of these plans and welcome the guidance provided by the 2002 Proposed Regulations. We offer the following comments in an effort to further improve these essential regulations.


(1) Issue.

If a traditional defined benefit plan is converted into a cash balance plan, Regulation Section 1.411(b)-2(b)(2)(iii)(E)(1) establishes the general rule that in order for the plan to be an “eligible account balance plan,” the opening account balance must not be less than the actuarial present value of the participant’s accrued benefit at retirement age, calculated in accordance with the traditional defined benefit plan formula. The present value is to be determined using reasonable actuarial assumptions. While the term “reasonable actuarial assumption” does afford a range of options, the specification of safe harbor assumptions would provide even greater comfort to plan sponsors.

(2) Comment.

The use of safe harbor assumptions has been common practice in the operation of cash balance plans ever since the release of IRS Notice 96-8. Under that notice, several standard
indices with adjustments were established, all of which were determined to be equivalent to the statutory standard of section 417(e) of the Code. See Section IV(A) of Notice 96-8.

The statutory interest rate and mortality table prescribed by section 417(e) of the Code should in all events be deemed to be safe harbor reasonable actuarial assumptions, since these factors are the minimum required under the accrued benefit rules for present values. The equivalent rates specified in IRS Notice 96-8 should be accorded the same protection.

(3) **Recommendation**.

The Code section 417(e) interest rate and mortality table (the “applicable interest rate” and the “applicable mortality table”) should be specified as safe harbor reasonable actuarial assumptions for the purposes of determining the opening account balance under Regulation Section 1.411(b)-2(b)(2)(iii)(E)(1). The safe harbor protection should be extended to the listed equivalent indices as specified under IRS Notice 96-8, Section IV(A). The regulations also should expressly provide that the use of a non-safe harbor assumption does not mean that the assumption(s) are necessarily unreasonable. Rather, if a non-safe harbor assumption is used, it should be tested for reasonableness.

C. **The Use of Preretirement Mortality Assumptions.**

(1) **Issue.**

As noted, Regulation Section 1.411(b)-2(b)(2)(iii)(E)(1) requires that the opening account balance in the participant’s account be no less than the actuarial present value of the participant’s accrued benefit payable in the normal form, with such present value being determined using reasonable actuarial assumptions. The same section provides that “the actuarial assumptions do not fail to be reasonable merely because preretirement mortality is not taken into account.” Because of the wording, it is somewhat unclear whether the use or non-use of preretirement mortality assumptions would in some way support an argument that the assumptions are not reasonable.

(2) **Comment.**

The use of the phrase “do not fail to be reasonable merely” could be read to imply that if an employer decided to not use preretirement mortality assumptions, the assumptions used to create the opening account balance may not be reasonable when combined with other assumptions. We do not believe that this is the intent of the regulation.

The language of Regulation Section 1.411(b)-2(b)(2)(iii)(E)(1) could easily be clarified by stating that an employer may choose whether to apply preretirement mortality assumptions in creating the opening account balance.

(3) **Recommendation.**

The regulations should be clarified to allow an employer to decide, in its discretion, if a preretirement mortality assumption should be used.
D. The Use of Transition Benefits in a Conversion.

(1) Issue.

Regulation Section 1.411(b)-2(b)(2)(iii)(E)(1) establishes a minimum benefit for the opening account balance in a converted plan. This minimum is the “actuarial present value of the participant’s accrued benefit payable in the normal form,” calculated in accordance with the provisions of the traditional defined benefit plan. Any amounts in excess of this minimum are included in the participant’s rate of benefit accrual. This rule will eliminate or greatly reduce the use of transition or other supplementary benefits designed to compensate participants for the loss of early retirement subsidies.

(2) Comment.

In the creation of the opening account balance, when the prior benefit was accrued in a traditional defined benefit plan, the retirement age assumption has not always been the normal retirement age assumption (e.g., age 65). In cases where the prior plan had meaningful early retirement subsidies, the age assumption can make a significant difference. For plans that had significant early retirement subsidies, there has been a tendency to use an earlier retirement assumption, but in a way to avoid significant windfalls to participants. For example, if the prior plan had a rich early retirement subsidy that became available at age 55, to reflect an age 55 retirement assumption for all participants would greatly increase opening balances, but only those who left at age 55 would get the proper subsidy. Those participants who terminated at a later date could end up with benefits worth much more than their prior plan benefits. Employers who were hesitant to provide these “windfalls” adopted provisions that either (1) apply specifically to the opening account balance (special interest credits or subsidized assumptions for the opening balance) or (2) provide transition pay credits for a period of time or service. These approaches serve to bridge the gap between the prior plan benefits and the cash balance benefits.

The assumptions used to establish the opening account balance are often subsidized to provide additional credits to certain classes of participants. Alternatively, higher interest credits may be granted to certain classes of participants. It is not clear whether transition benefits are disregarded when determining the rate of benefit accrual. The general rule for the establishment of the opening account balance specifies a minimum benefit (the section 411(d)(6) minimum), but does not specify whether these transition benefits may be provided in the opening account balance. The rule specified in Regulation Section 1.411(b)-2(b)(2)(iii)(E)(2) seems to say that anything in excess of the section 411(d)(6) minimum would end up in the participant’s rate of benefit accrual. This rule would in effect eliminate most transition provisions, which focus on protecting those participants (generally older) who are at the highest risk of losing early retirement subsidies.

Ongoing transition pay credits also may not fit within the general rule. Many of the plans currently in existence provide ongoing transition credits (those accrued after the establishment of the opening account balance) based on age, service or a combination thereof. What is clear is that under the proposed rules of Regulation Section 1.411(b)-2(b)(2)(iii), the transition credits will be included in the rate of benefit accrual. These transition pay credits are additional credits that are in excess of the “actuarial present value of the participant’s accrued benefit payable in
the normal form’ which are credited in future years. Therefore, these pay credits would also fall into the determination of the rate of benefit accrual.

Section 4(i)(6) of the ADEA provides that a plan shall not be treated as failing to meet the prohibition on the reduction in the rate of benefit accruals described in Section 4(i)(1) of the ADEA solely because the subsidized portion of any early retirement benefit is disregarded in determining benefit accruals. This is similar to the treatment found in Regulation Section 1.411(b)-2(d)(3)(i).

The restrictive safe harbor that is provided for cash balance plans would eliminate many of these transition approaches, which approaches are clearly designed to benefit older employees. This is an anomalous result. The main impetus for the 2002 Proposed Regulations was participant outcry over the loss of early retirement subsidies. The 2002 Proposed Regulations would eliminate most of the transition benefits targeted at benefiting those same participants. This is paradoxical in that a traditional defined benefit plan could provide early retirement subsidies which are disregarded in determining the rate of benefit accrual under Regulation Section 1.411(b)-2(b)(2)(iv)(B) but a cash balance plan cannot.

The decision that plan sponsors will be forced to make will be between giving the minimum accrued benefit or a subsidized accrued benefit, which may provide windfalls to older employees.

Depending on the application of these regulations once they are finalized (see comments on effective date provisions), the restrictive safe harbor for cash balance plans may also leave many plan sponsors who have previously adopted conversion strategies at risk, even though those sponsors adopted those strategies in good faith. A participant’s claim that a prior transition strategy violates these narrow rules would be strengthened merely by the fact that these types of strategies are not allowed prospectively under the rules.

The recognition that participants may be losing potential early retirement subsidies would suggest that rules permitting transition benefits should be added. As these are benefits in excess of the actuarial present value of the participant’s accrued benefit, the numerical standards of the determination of the rate of benefit accrual should not apply. Employers who wish to give their participants additional benefits should be allowed to do so. Without such relief, employers that switch to a cash balance plan will only credit the value of the accrued benefit at age 65. The standard should be that the transition benefits satisfy the basic rule of section 411(b)(1)(H) and Section 4(l)(6) of the ADEA.

(3) **Recommendation.**

The use of reasonable transition credits, benefits, or other strategies should be encouraged as long as they provide additional benefits to those participants most affected by a conversion from a traditional defined benefit plan to a cash balance plan. A simple rule should be adopted to exclude these benefits from the determination of the rate of benefit accrual under Regulation Section 1.411(b)-2(b)(2), whether the transition benefits are provided through the calculation of the opening account balance or through the delivery of additional interest or pay credits in future
years. This could be easily done by extending the reach of Regulation Section 1.411(b)-2(d)(3) to specifically mention cash balance plans.

As an alternative, the transition benefits should be excluded from the determination of the rate of benefit accrual under Regulation Section 1.411(b)-2(b)(2) to the extent that the transition benefits provided to a participant do not exceed the value of the participant’s foregone subsidized early retirement subsidy.

E. Calculation of Opening Account Balance for Employees Past Normal Retirement Age.

(1) Issue.

Regulation Section 1.411(b)-2(b)(2)(iii)(E)(3) requires that the opening account balance for a participant who has attained normal retirement age cannot be less than the account balance that would apply if the participant were at his or her normal retirement age. This requirement does not take into account the fact that in some defined benefit plans, participants may have commenced payment of benefits at normal retirement age.

(2) Comment.

If a participant continues to work after normal retirement age, or returns to work after normal retirement age, a defined benefit plan must do one of the following:

(a) Provide a suspension of benefit notice and permanently suspend the normal retirement benefits while the participant continues to work in “Section 203(a)(3)(B)” service. (Code section 411(a)(3)(B); DOL Regulations section 2530.203-3(c)(1));

(b) Begin or continue payment of normal retirement benefits during employment beyond normal retirement age; or

(c) Suspend the payment of normal retirement benefits until termination of employment, and then pay the greater of (i) the actuarially increased value of the normal retirement benefit as of the later (or second) retirement date, or (ii) the participant’s late retirement benefit accrued under the terms of the plan to the late retirement date.

In addition, some plans allow participants the choice to begin or continue retirement benefits at normal retirement age, and if the participant does not elect to receive retirement benefits while working, the plan pays the benefits as described in (c) above.

The 2002 Proposed Regulations apply to a plan which suspends benefits after normal retirement age, and also provides a floor for the opening account balance in a plan which applies option (c). However, the 2002 Proposed Regulations should not apply to a plan in which benefits are paid after normal retirement age. If a participant begins to receive benefits at normal retirement age, and the plan thereafter converts to a cash balance plan, the plan should determine the opening account balance either as the present value of future benefits the participant will continue to receive, or (i) the present value of the normal retirement benefits as if the participant
were at his or her normal retirement age, minus (ii) the actuarial present value of the benefits already paid after normal retirement age.

(3) **Recommendation.**

Regulation Section 1.411(b)-2(b)(2)(iii)(E)(3) should be revised to add that, where benefits have been paid after normal retirement age, the present value of such benefits already paid may be subtracted from the opening account balance determined as if the participant were at his or her retirement age.

**F. Providing Benefits Under a Mixed Formula.**

(1) **Issue.**

The new rule which permits separate plans for testing purposes (a cash balance plan and a traditional defined benefit plan) is tied to the requirement of section 410(a)(2) of the Code, which may invalidate many prior cash balance conversions.

(2) **Comment.**

This new rule establishes a standard that on its face appears quite reasonable. No plan may establish a plan formula which is unavailable to employees who have attained a certain age. In many prior conversions, the younger employees have been given the cash balance plan (or cash balance formula) and the older employees have been left in the traditional defined benefit plan (or formula). This practice has generally been used because the comparison of the accrued benefits between the cash balance plan and the traditional defined benefit plan have a very clear demarcation based on age. In those cases, offering a choice between the two would have been a fruitless exercise, as the value comparison was stark. Application of the Code section 410(a)(2) rule to these plans may jeopardize prior conversions, even where those conversions were previously blessed with a determination letter and actually protect older workers. Section 4(f)(1) of the ADEA provides that employment actions based upon “reasonable factors other than age” are insulated from age discrimination complaints, even if they would otherwise be prohibited under the ADEA. These approaches should fit under this rule.

The employers who have used these approaches have done so to protect their participants from making a poor choice. Applying the 410(a)(2) standard would have the opposite effect, forcing the employees to make these complex value decisions. The rule as stated does not seem to protect those employees who should be protected.

If an employer tried to limit participation in a way that would hurt an employee, the employee should still have recourse to file an age discrimination claim.

(3) **Recommendation.**

A converted cash balance plan should be allowed to continue the pre-conversion traditional defined benefit formula for older workers where that is protective of older participants’ benefit rights, since this action is based upon “reasonable factors other than age”.
G. **The Recognition of Right to Freeze Benefits.**

(1) **Issue.**

The definition of an “eligible cash balance plan” formula permits the structuring of plans using mixed benefit formulas which may freeze benefits for some participants.

(2) **Comment.**

The wear-away approach has been a common way of transitioning benefits in cases where future benefit accrual rates must be reduced by reason of changes in law or other compliance reasons. This technique has had IRS approval since at least the issuance of Rev. Rul. 81-12, 1981-2 C.B. 228, which permits a plan to freeze benefits in order to change actuarial factors. Other examples of Treasury guidance which has adopted wear-away as a means of transitioning benefits from one formula to another include: Treasury Regulations section 1.401(a)(4)-13(c)(4) (determining benefits under the nondiscrimination rules using a fresh start date); Treasury Regulations section 1.401(a)(17)-1(e)(5), example 1 (freezing the current accrued benefit to facilitate the limits on compensation); and Rev. Rul. 98-1, 1998-2 I.R.B. 5 (freezing benefits to facilitate compliance with the changes made to Code section 415(b)).

These examples suggest that wear-aways are consistent with the fundamental promise of a voluntary retirement system, i.e., that benefits accrued to date cannot be taken away by plan amendment or otherwise, but that employers have the right to amend plans to change future accruals.

Any amendment to change future accruals is likely to have a disparate impact on older employees the same as the wear-aways created by some cash balance conversions.

The definition of “eligible cash balance plan” formula under Regulation Section 1.411(b)-2(b)(2)(iii)(C)(1-4) recognizes this fundamental promise to employees.

(3) **Recommendation.**

We support the position taken by Treasury and suggest the retention of this feature of the Proposed Regulations.

H. **Rate of Benefit Accrual for Eligible Cash Balance Plan.**

(1) **Issue.**

Regulation Section 1.411(b)-2(b)(2)(iii)(A) provides that, in general, the rate of benefit accrual for eligible cash balance plans can be determined as the addition to the participant's hypothetical account for the plan year, and interest credits can be disregarded to the extent the participant had accrued the right to interest credits as of the close of the preceding plan year. There appears to be a technical defect with respect to interest credits accruing in the first year of participation or the first year of a plan. In such first year, it may be technically impossible for the plan to satisfy the condition that the right to any interest credits provided during the first plan
year must have accrued as of the close of the preceding plan year, when the participants were not even participating in the plan.

(2) **Comment.**

We are not aware of any conceptual basis for requiring interest credits in the first year of the plan or the first year of participation to be included in the rate of accrual solely because the right to such interest credits had not accrued as of the end of the preceding plan year. It appears that such a result was never intended and is merely a technical defect in the proposed language.

(3) **Recommendation.**

An exception to the general accrual rule should be provided for the first year of the plan or the first year of participation. In that first year, interest credits should be disregarded to the extent the right to any interest credits in the first year accrued as of the end of the first plan year of participation.

I. **Reasonable Rate of Interest Requirement for Eligible Cash Balance Plans.**

(1) **Issue.**

Regulation Section 1.411(b)-2(b)(2)(iii)(B)(2) essentially requires eligible cash balance plans to provide interest credits at a reasonable rate of interest that is not reduced, either directly or indirectly, because of the participant's attainment of any age. The 2002 Proposed Regulations do not provide any guidance with respect to what constitutes a reasonable rate of interest for this purpose. Although this reasonableness standard provides flexibility to plan sponsors in determining an appropriate interest crediting rate, it does not provide any certainty.

(2) **Comment.**

Although a general reasonableness standard should be retained to provide plan sponsors with some flexibility, the 2002 Proposed Regulations should also specify safe harbor interest rates that will be deemed to be reasonable in all cases. This approach was essentially adopted in IRS Notice 96-8, in which certain specified indexes (as adjusted therein) were determined to be equivalent to the applicable interest rate under section 417(e). Under this approach, plan sponsors that would like certainty that the interest crediting rate is reasonable could select a safe harbor interest rate. However, the regulations should make it clear that the use of a non-safe harbor rate does not mean that the interest rate used is necessarily unreasonable. Rather, the selection of a non-safe harbor interest rate would be assessed under the general reasonableness standard.

(3) **Recommendation.**

The applicable interest rate under Code section 417(e) and the deemed equivalent interest indexes specified under IRS Notice 96-8, Section IV(A), should be designated as safe harbor reasonable rates of interest for purposes of satisfying the reasonable interest rate requirement for eligible cash balance plans. The regulations also should expressly provide that the use of a non-safe harbor interest rate does not mean that the interest rate is necessarily unreasonable. Rather,
the selection of a non-safe harbor interest rate would be assessed under the general reasonableness standard.

J. **Frontloaded Interest Requirement for Eligible Cash Balance Plans - Application to Pension Equity Plans.**

(1) **Issue.**

Pension equity plans typically provide for a lump sum benefit equal to a certain percentage of the participant’s final average compensation. The percentage of final average compensation is generally based on the points a participant has accumulated during his or her period of participation in the plan. The points accrued each plan year are generally based on the participant’s years of service and age at the end of each such plan year (in many cases, more points are credited to older participants than to similarly-situated younger participants). Interest credits (or the equivalent) are generally not given under a pension equity plan until a participant terminates employment. As a result, pension equity plans do not satisfy the eligible cash balance plan requirement that participants must accrue the right to annual (or more frequent) interest credits for all future periods without regard to future service (i.e., the so-called “frontloaded interest requirement”) (see Regulation Section 1.411(b)-2(b)(3)(iii)(B)(2)). In addition, pension equity plans cannot satisfy the general age discrimination provisions because the interest credits, following termination of employment, must be taken into account and provide a higher rate of benefit accrual for a younger participant than an older participant (simply because the younger participant has a longer period between the date of termination of employment and normal retirement age than does an older participant).

(2) **Comment.**

Pension equity plans are hybrid pension plans similar to cash balance plans. A key difference between the two types of plans is that under a pension equity plan, a hypothetical cash balance is not maintained on an annual basis (with annual pay and interest credits). Instead, the participant’s lump sum benefit under a pension equity plan is a percentage of his or her average final compensation, with such percentage determined based on the total service and age points the participant accrues while participating in the plan. Because the benefit provided by a pension equity plan is based on final average compensation, which usually increases with age and years of service, and because many pension equity plans provide more service and age points for older participants, pension equity plans can be more favorable to older participants than eligible cash balance plans.

Like cash balance plans, pension equity plans represent a useful compromise between traditional defined benefit plans and defined contribution plans. Participants easily understand the value of their benefits in a pension equity plan, while employers bear the burden of any investment losses. Thus, pension equity plans should be encouraged. To this end, we urge that they be accorded treatment similar to that provided to cash balance plans.

(3) **Recommendation.**

The eligible cash balance plan requirement that causes the most problem for pension equity plans is the frontloaded interest requirement. Pension equity plans do not provide interest
credits (or the equivalent) until a participant terminates employment. The frontloaded interest requirement could be modified to include an exception for certain pension equity plans or a separate set of rules could be developed for “eligible pension equity plans.”

Under the first approach, the regulations could provide that a pension equity plan would satisfy the frontloaded interest requirement, and thereby qualify as an eligible cash balance plan (provided the other requirements are satisfied), if the pension equity plan provided interest credits in accordance with the frontloaded interest requirement for all periods after the participant terminates employment. The regulations could provide that a pension equity plan would be eligible for this special exception to the frontloaded interest requirement only if the benefits provided under the plan were expressed as a lump sum amount based on average final compensation and the total points accrued during participation, and the amount of points that are provided, do not decrease because of the attainment of any age.

Under the second approach, an entirely separate exception to the general age discrimination rules could be established for “eligible pension equity plans,” which would have to meet the requirements described in the preceding paragraph.

K. Frontloaded Interest Requirement for Eligible Cash Balance Plans - Adjustments for Post-Normal Retirement Age Distributions and Actuarial Increases

(1) Issue.

The last sentence in Regulation Section 1.411(b)-2(b)(2)(iii)(B)(2) provides that the frontloaded interest requirement is not satisfied if a plan provides for any adjustment for benefit distributions after normal retirement age, which is otherwise permitted by Code section 411(b)(1)(H)(iii)(I) and Treasury Regulations section 1.411(b)-2(b)(4) (emphasis added). In addition, the preamble to the 2002 Proposed Regulations provides, in pertinent part, that “an eligible cash balance plan cannot treat interest credits after normal retirement age as actuarial increases that are offset against the otherwise required accrual.” The 2002 Proposed Regulations do not otherwise address how the offset rules under section 411(b)(1)(H)(iii) of the Code, for both distributions and actuarial increases, apply with respect to eligible cash balance plans. There are a number of issues (as discussed further below) that need to be clarified.

(2) Comment.

The language in the 2002 Proposed Regulations regarding adjustments for post-normal retirement distributions is broadly drafted to include “any adjustment,” which raises a number of issues that need to be clarified. To begin, for purposes of determining interest credits for a particular plan year, an eligible cash balance plan should be allowed to reduce the hypothetical account balance of a participant to reflect distributions both before and after normal retirement age. In other words, an eligible cash balance plan should not be required to provide interest credits on amounts that have been previously distributed. We believe that the intent was to provide that future pay credits and future interest credits (on amounts not previously distributed) under an eligible cash balance plan cannot be reduced by the amount of any post-normal retirement age distributions. If so, the language in the 2002 Proposed Regulations should be clarified.
The language in the 2002 Proposed Regulations is presented under the section addressing the frontloaded interest requirement. The placement of the language in this section of the 2002 Proposed Regulations makes it unclear whether the prohibition on adjustments applies only with respect to the interest credits, or whether it applies to both pay and interest credits under the plan. In this regard, the preamble to the 2002 Proposed Regulations provides that the frontloaded interest requirement is not satisfied “if the plan provides that additions to the hypothetical account are reduced for the actuarial equivalent of any in-service distributions …” (emphasis added). In addition, based on informal discussions with representatives of the IRS, it is our understanding that the intent was to apply the prohibition to both pay and interest credits. If so, the language in the 2002 Proposed Regulations should be clarified.

The only discussion regarding offsets for post-normal retirement age actuarial increases appears in the preamble to the 2002 Proposed Regulations and provides that post-normal retirement age interest credits cannot be treated as actuarial increases that can be offset against the otherwise required accrual. The 2002 Proposed Regulations are silent with respect to whether post-normal retirement age actuarial increases can be used to offset any required pay credit accruals. Again, based on informal discussions with IRS representatives, it is our understanding that pay credits under an eligible cash balance plan cannot be reduced by any post-normal retirement age actuarial increases under the plan. If so, the 2002 Proposed Regulations should be clarified.

(3) **Recommendation.**

To the extent consistent with the intent of the regulations, the 2002 Proposed Regulations should be clarified in the following respects regarding post-normal retirement age distributions and actuarial increases:

(A) For purposes of determining the amount of interest credits for a particular plan year, the hypothetical account under an eligible cash balance plan can be reduced to reflect both pre- and post-normal retirement age distributions (i.e., an eligible cash balance plan is not required to provide interest credits on amounts that have previously been distributed).

(B) An eligible cash balance plan cannot reduce future pay credits or interest credits (on amounts not previously distributed) to reflect post-normal retirement age distributions, as would otherwise be permitted under section 411(b)(1)(H)(iii)(I) of the Code.

(C) An eligible cash balance plan cannot reduce future pay credits or interest credits (on amounts not previously distributed) to reflect post-normal retirement age actuarial increases, as would otherwise be permitted under section 411(b)(1)(H)(iii)(II) of the Code.

These clarifications should be provided in the text of the regulations, and possibly, in an example as well.
L. **Plan Amendments Adopting A Cash Balance Formula - Conversions Before the Effective Date of the Regulations.**

(1) **Issue.**

The 2002 Proposed Regulations are generally silent with respect to conversions that occur before the effective date of the final regulations (“pre-effective date conversions”). We understand that the IRS and Treasury have not decided how pre-effective date conversions should be handled under the final regulations and have requested comments on that issue. We have addressed this issue in another section of these Comments. Although pre-effective date conversions have not been expressly addressed, Regulation Section 1.411(b)-2(b)(2)(iii)(B)(3) provides that in the case of a plan that has been amended to adopt a cash balance formula (i.e., a converted cash balance plan), the plan will qualify as an eligible cash balance plan only if the plan, as amended, satisfies one of two alternative sets of requirements for converted cash balance plans (see Regulation Sections 1.411(b)-2(b)(iii)(D) or (E)). By including this condition in the requirements for an eligible cash balance plan, a plan that is (or was) converted to a cash balance plan before the effective date of the regulations, but which does not (or did not) satisfy either of the two alternative sets of requirements, would not qualify as an eligible cash balance plan (unless adjustments are made).

(2) **Comment.**

We understand that, to date, the IRS and Treasury have not decided how pre-effective date conversions will be handled under the final regulations. We have specifically addressed this issue in another section of these Comments. As currently drafted, the 2002 Proposed Regulations would appear to effectively require all converted cash balance plans, whether converted before or after the effective date of the final regulations, to conform to one of two alternative sets of requirements in order to qualify as eligible cash balance plans. However, this is not entirely clear in the 2002 Proposed Regulations because the section which prefaces the three requirements that must be satisfied in order to qualify as an eligible cash balance plan provides that a plan will qualify “for a plan year if it satisfies each of the following requirements for current accruals under the plan for that plan year.” (emphasis added) (see introductory language to Regulation Section 1.411(b)-2(b)(2)(iii)(B)). This language suggests that the requirements are applied on a plan year basis and only apply with respect to “current accruals.” However, the two alternative sets of requirements for converted cash balance plans refer back to the time of conversion (i.e., to either determine the sum of the benefits or to determine the opening account balance).

(3) **Recommendation.**

As currently drafted, the 2002 Proposed Regulations appear to apply retroactively to converted cash balance plans. It is our understanding that the IRS and Treasury have not decided how the final regulations will apply to pre-effective date conversions. Accordingly, when a final decision is made, Regulation Section 1.411(b)-2(b)(2)(iii)(B)(3) may have to be modified to reflect the approach adopted. For example, if there are special transition rules for pre-effective date conversions, this section may need to provide that a plan will qualify as an eligible cash balance plan if the special transition rules are satisfied.
M.  Changes to Nondiscrimination Regulations.

(1)  **Defining the Allocation Rate.**

   (a)  **Issue.**

   Treasury Regulations section 1.401(a)(4)-3(a)(1) as it will be amended by the 2002 Proposed Regulations will provide that a plan that satisfies the requirements of section 411(b)(1)(H) by using the rules for eligible cash balance plans must satisfy the additional rules of a new Regulation Section 1.401(a)(4)-3(g) in order to test on a benefits basis. There are no amendments to Treasury Regulations section 1.401(a)(4)-8, which deals with cross testing. Thus an eligible cash balance plan has two choices:

   • To test on a contributions basis, or
   • To test on a benefits basis, but satisfy the additional rules of Regulation Section 1.401(a)(4)-3(g)

   Because a cash balance plan is treated as a defined benefit plan, in order to test on a contributions basis it must meet the cross-testing rules of Treasury Regulations section 1.401(a)(4)-8. These rules require that the plan calculate equivalent allocation rates using a standard interest rate and a standard mortality table.

   (b)  **Comment.**

   It seems clear that the intent of the 2002 Proposed Regulation is to treat the additions to the hypothetical account as the equivalent allocation rate. The use of the additions to the hypothetical account as the allocation rate is explicit in the special rules of Regulation Section 1.401(a)(4)-3(g).

   (c)  **Recommendation.**

   The Proposed Regulations should provide that an eligible cash balance plan may use the additions to the hypothetical account as the equivalent allocation rate when testing on a contributions basis.

(2)  **Special Non-Discrimination Rules May Be Unnecessary.**

   (a)  **Issue.**

   If an eligible cash balance plan desires to test on a benefits basis it must satisfy the special rules of Regulation Section 1.401(a)(4)-3(g). There are three ways to do this:

   • Have allocation rates that are broadly available under the rules of 1.401(a)(4)-8(b)(1)(iii);
   • Have allocation rates that reflect a gradual age or service schedule under the rules of 1.401(a)(4)-8(b)(1)(iv); or
• Meet a modified version of the minimum allocation gateway included in 1.401(a)(4)-9(b)(2)(v)(D).

The first of these choices requires that each band of allocation rates is available to a fair cross section of employees. A plan that meets this rule would generally qualify if tested on a contributions basis. The second alternative establishes restrictions on the schedule of increases in contribution bands. The third alternative would require that the allocation rate for every non-highly compensated employee be no less than one third of that of the highly compensated employee with the highest rate or that the allocation rate of every non-highly compensated employee be at least 5% and the rate of every highly compensated employee be no greater than 25%.

Many cash balance plans increase the rate of contribution credits for older employees. This is done to increase the benefits of those employees, who have fewer years to retirement.

(b) **Comment.**

Testing for nondiscrimination involves different policy issues than testing for age discrimination. Often these policies are inconsistent. For example, the minimum allocation gateway was established in connection with “new comparability” plans. These are plans designed to benefit highly compensated employees (“HCEs”) to the maximum. They operate in situations where the HCEs are older than the other employees and the employer desires to maximize the benefits of the HCEs by testing on a benefits basis.

In a typical new comparability plan, if the employer desires to conform to the rule the employer must *increase* the allocation rates of the younger non-highly compensated employees in order to keep the allocation rate for the HCEs intact. Thus the policy has the effect of improving the benefits for the low-paid.

Cash balance plans, on the other hand, are often established by large corporations and are generally not designed to maximize benefits for HCEs. In such plans, the older employees may have more highly compensated employees among them, simply because such employees are generally more experienced and have a history of pay increases. Such a corporation is just as likely to comply by *reducing* the benefits for older employees as it would by increasing the benefits for the younger employees. Similarly, if the employer desires to comply with the gradual age or service schedule it would likely reduce the allocation rates for older employees.

In other words, requiring the special rules on nondiscrimination testing provides little incentive to improve benefits for lower-paid employees and may provide an incentive to reduce benefits for older employees.

(c) **Recommendation.**

The special nondiscrimination rules for eligible cash balance plans should be reconsidered. They may not accomplish any positive policy goal and actually may operate to reduce the benefits for older workers.
(3) **The Appropriate Gateway.**

(a) **Issue.**

In the event that a stand-alone eligible cash balance plan is required to meet a gateway test in order to demonstrate compliance with the nondiscrimination rules on a benefits basis, should the gateway requirements be based on those for certain aggregated defined benefit/defined contribution plans in Treasury Regulations section 1.401(a)(4)-9(b)(2)(v)(D) or those for defined contribution plans in Treasury Regulations section 1.401(a)(4)-8(b)(1)(vi)?

(b) **Comment.**

The existing nondiscrimination regulations provide two different versions of the gateway test for permitting certain plans to be tested on a benefits basis. One is for stand-alone defined contribution plans. For such plans, the allocation rate for nonhighly compensated employees must be at least equal to the lesser of 1/3 of the highest rate for any highly compensated employee or 5% of compensation. The second version of the gateway test is applicable if a defined benefit plan and a defined contribution plan are aggregated for testing purposes, and the combined plan is not primarily defined benefit in character. In that case, the minimum aggregate equivalent allocation rate for a nonhighly compensated employee covered by the aggregated plans can be as high as 7.5%, rather than 5%, if the highest normal aggregate allocation rate for any highly compensated employee exceeds 25%.

In drafting the 2002 Proposed Regulations restricting the ability of stand-alone eligible cash balance plans to demonstrate compliance with the Code section 401(a)(4) rules on a benefits basis, the gateway test which was cross-referenced was the one for aggregated defined benefit/defined contribution plans, rather than the one applicable to defined contribution plans tested on a stand-alone basis. From our perspective, it would appear that a stand-alone cash balance plan ought to be treated on a par with a stand-alone profit sharing plan. Consequently, it would seem more appropriate for the stand-alone defined contribution plan version of the gateway test to apply to a cash balance plan.

In this regard, it is worth noting that the 415 limit for defined contribution plans has been increased, so that the prior 25% of compensation limit can now be exceeded by such plans. Consequently, imposing the aggregated defined benefit/defined contribution plan gateway requirement on a cash balance plan would force it to bear a burden which a defined contribution plan would not bear even if it provided allocations to one or more highly compensated employees in excess of 25% of compensation.

(c) **Recommendation.**

In the event that a stand-alone eligible cash balance plan is required to meet a gateway test in order to demonstrate compliance with the nondiscrimination rules on a benefits basis, the gateway requirements should be based on those for defined contribution plans in Treasury Regulations section 1.401(a)(4)-8(b)(1)(vi) rather than those for aggregated defined benefit/defined contribution plans in Treasury Regulations section 1.401(a)(4)-9(b)(2)(v)(D).
N. Application of Final Regulations to Existing Cash Balance Plans.

(1) Issue.

Regulation Section 1.411(b)-2(f)(3), which provides the effective date for most of the 2002 Proposed Regulations’ content, reads as follows:

“Paragraphs (a) - (e) of this section are applicable with respect to plan years beginning on or after the date of publication of final regulations in the Federal Register.”

This section uses the term “applicable” rather than the more commonly used term “effective.” It is unclear whether a distinction is intended.

Regardless of whether the term “applicable” or “effective” is used in this section, in the case of an ongoing plan, there remains a lack of clarity on the meaning of these important regulations first being “applicable” or “effective” for plan years beginning on or after the date of final publication. For example, if a final pay plan converted to a cash balance plan in 1990 in a manner that would not be approved under the final version of these regulations, would that cash balance plan be disqualified for merely continuing to exist once the final regulations were published? Would it be subject to adjustments of remaining account balances? Would it be subject to retroactive adjustments? This confusion is compounded when one considers that a cash balance plan which converted in 1990 (for example) has likely received two or more favorable ruling letters since the conversion.

As another example, if a cash balance plan, prior to the publication of final regulations, created larger account balances than would be permitted under the final regulations, would those account balances be subject to adjustment? Would post-final regulation accruals based on those account balances be inappropriate?

As yet another example, although future accruals are not legally protected, many cash balance plan sponsors implemented supplemental accrual structures (sometimes called transition credits) for certain groups of employees at the time of a cash balance conversion (from a previous final pay format, for example). Such supplemental accruals were intended to avoid or limit any reduction in anticipated future accruals for certain groups of employees. Often, such supplemental accrual structures were intended to remain in place for specified periods of time, sometimes even for a participant’s remaining career with the plan sponsor. Would these supplemental accrual structures have to be abandoned, at least on a prospective basis, if they did not comport with the final regulations?

(2) Comment.

Plan designs (including, without limitation, cash balance conversions) which were adopted in accordance with law as it existed prior to the effective date of the final regulations should not be penalized by the subsequent adoption of the final regulations. For example, a cash balance plan which was converted from a final pay plan in the 1990s should not be subject to sanction or modification once the final regulations are adopted merely because the plan continues to exist after the final regulations are adopted. Similarly, pre-final regulation
supplemental accrual structures which were added to converted plans as a means of limiting the reduction in expected future accruals for certain participants should continue to be protected after the regulations are final in order to preserve these progressive structures for the benefit of participants. (See also discussion of Regulation Section 1.411(b)-2(b)(2)(D) and (E)(1).) To require a retroactive change in a conversion structure or a prospective change in a supplemental accrual structure, once in place for several years, would be administratively very difficult and would result in unintended consequences likely adversely affecting participants.

Plan sponsors have been operating plans in compliance with the guidance of the 1988 Proposed Regulations since 1988. The preamble to the 2002 Proposed Regulations states that sponsors should continue to rely on the 1988 Proposed Regulations until the 2002 Proposed Regulations are finalized. Retirement plans, especially defined benefit plans, are long-term benefit structures. Plan sponsors will need time to determine what, if any, plan changes will be required in order to comply with the final regulations, and how to fund such changes. Sponsors will need to consult with advisors, consider plan design options, obtain the approval of the Board of Directors or other appropriate governing body or official, and communicate the changes to employees. In some cases, plan sponsors will be forced to reduce the future rates of benefit accruals for financial reasons. This will require providing participants with a section 204(h) notice under ERISA, which must be provided at least 45 days before the effective date of the change. For these reasons, the final regulations should have a delayed effective date.

(3) **Recommendation.**

We would propose that the following framework be utilized in modifying Regulation Section 1.411(b)-2(f)(3):

(A) Paragraphs (a) — (e) should be effective for plan years beginning on or after 180 days after the publication of final regulations in the Federal Register, with respect to the following post-final regulation matters: (i) future benefit accruals (except ameliorative accruals, described below), (ii) newly established plans, (iii) new plan amendments, or (iv) plans which first adopt a cash balance formula. There should also be a delayed effective date for collectively bargained and governmental plans.

(B) To the extent that a post-final regulation benefit accrual would violate the final regulations solely by reason of the plan’s pre-final regulation conversion method, the accrual (to that extent) should not violate the final regulations.

(C) To the extent that a post-final regulation benefit accrual would violate the final regulations solely because of the effect of a supplemental accrual structure included in a cash balance plan as part of a pre-final regulation cash balance conversion, which supplemental accrual structure was intended to ameliorate or otherwise address any actual or potential reduction in the post-conversion rate of benefit accruals, subsidies, or other benefits, and which was nondiscriminatory within the meaning of Treasury Regulations section 1.401(a)(4) as of the time of conversion, the accrual should not violate the final regulations to that extent.

(D) A plan should be allowed to rely on the 1988 Proposed Regulations until final regulations are published.
III. Traditional Defined Benefit Plan Design Issues

A. Problems Created by Preretirement Mathematical or Numerical Test.

(1) Issue.

Regulation Sections 1.411(b)-2(b)(2) and (3) provide a numerical or mathematical test to determine compliance with section 411(b)(1)(H) of the Code for benefit accruals. The use of this rigid mathematical test for age discrimination based on the incremental annual increase in the normal or late retirement annuity benefit makes it unnecessarily difficult for many reasonable defined benefit plan designs to pass muster under the 2002 Proposed Regulations.

(2) Comment.

(a) Overview. The proposed regulations divide defined benefit plans into two categories. One category consists of “eligible cash balance plans” and the second includes all other defined benefit plans (for purposes of this discussion, “traditional defined benefit plans”). Traditional defined benefit plans span an extremely broad range of designs. Their formulas can be relatively simple or quite complex. They can be integrated with social security or other benefit programs (such as floor-offset arrangements) or provide a stand-alone benefit. They can be funded wholly by the employer, or also through employee contributions. Their benefits can be stated in terms of a normal retirement annuity, or in another manner, such as an immediate lump sum payment.

Despite the broad range of plan formulas and designs reflected in traditional defined benefit plans, the 2002 Proposed Regulations would require all of them to demonstrate compliance with one rigid, mathematical test for age discrimination. Each plan would be required to calculate the rate of the incremental, annual accrual of the normal (or post-) retirement annuity benefit for each actual (or hypothetical) participant and demonstrate that such rate could not be, even in the slightest degree, lower than the corresponding rate for any actual (or hypothetical) employee who has the same characteristics, but is any younger age.

As demonstrated below, many traditional defined benefit plans, including some with time-honored designs, will have significant difficulty satisfying this test. Furthermore, the adoption of any mathematical test, and particularly the strict version set forth in the 2002 Proposed Regulations, is unnecessary under the statutory terms, runs counter to the case law and undercuts the policy of encouraging sponsors to adopt and maintain qualified retirement plans.

(b) Problem Areas For Traditional Defined Benefit Plans Under the Age Discrimination Test. The following is a non-exclusive list of potential problem areas in applying the numerical test set forth in the 2002 Proposed Regulation to traditional defined benefit plans.

1. Fractional Accrual Plans.

In a typical fractional accrual plan, the formula generates the retirement annuity benefit payable at normal retirement date and each year the participant accrues a prorated portion of the projected normal retirement annuity benefit. The proration typically is done based on the
participant’s number of years of service or participation divided by the participant’s projected number of years of service or participation until normal retirement date. After normal retirement date, such a plan typically continues benefit accruals under the general formula, without any further projection or proration.

One would not ordinarily consider a fractional accrual plan to discriminate against older employees. An individual who is hired at an older age (closer to normal retirement age) will typically have a higher rate of accrual than one who is hired at a younger age, since the denominator in the accrual fraction is smaller. Nevertheless, such a plan is likely to fail the test prescribed by the 2002 Proposed Regulations. After normal retirement date, a participant’s benefit will be calculated based on the underlying benefit formula, without any projection or proration. Consequently, such participant’s accrual rate (as determined under the required methodology) could be lower than the rate for a comparable participant who was just below normal retirement age. This is simply the consequence of the project and prorate method allowing an employee hired at an older age to accrue the entire normal retirement benefit over a shorter period of service. Further, basing accruals after normal retirement age on the main formula merely keeps older and younger participants on a par. Yet, when viewed through the prism of the test imposed by the 2002 Proposed Regulations, such a plan would be discriminatory.

Fractional accrual plans also can run into difficulties in satisfying the 2002 Proposed Regulations if the rate under the main benefit formula increases for service after a given number of years. Although on its face such a provision would appear to reward longer service, the mathematical test would construe the result to involve prohibited age discrimination.

2. **Integrated Plans which Shift to a Non-integrated Formula.**

For decades, the law has permitted defined benefit plans to either be integrated with social security or not integrated with social security. Neither plan design would, in the ordinary sense, be considered to discriminate based on age. However, if an integrated plan is shifted to a non-integrated formula using prescribed transition approaches, the transition itself can result in age discrimination as determined under the 2002 Proposed Regulation.

In part, this result arises because, when viewed in terms of the annual accrual rate calculated under the proposed methodology, many integrated plans involve a tilt in favor of older employees. Under section 401(l) of the Code, a plan is permitted to use an integrated formula which provides a lower stated accrual rate for compensation below social security covered compensation than for compensation above that level. Since social security covered compensation is lower for older employees than for younger employees, the excess portion of the formula would, for purposes of the regulation, provide a somewhat higher accrual rate for older employees than younger employees with identical compensation and years of service.

The regulations under section 401(a)(4) of the Code provide defined benefit plans with several permissible options for transitioning from one formula to another. These approaches include “with wear-away,” “without wear-away,” and “with extended wear-away.” On their face, none of the transition approaches would seem to involve age discrimination. However, under either the with wear-away or with extended wear-away approaches, the incremental rate of
benefit accrual in the years after the change can differ for participants depending upon how their benefits for their entire career compare under the new formula versus the old formula.

If an integrated plan is converted to a non-integrated plan using a wear-away approach, then older participants with relatively high levels of compensation could have somewhat longer wear-away periods than would a younger employee with the same service and compensation history. This result would cause the entire plan to fail under the precise, year-by-year testing approach mandated by the 2002 Proposed Regulations. If an employer attempted to be more generous by using an extended wear-away approach, then the net result could be similar, except that the wear-away period would extend for an even longer time, causing the plan to fail section 411(b)(1)(H) of the Code for even more years.

3. **PIA Offset Plans.**

In a PIA offset plan, the benefit for a participant is calculated under a gross formula and is then offset by a percentage of the participant’s “primary insurance amount” (“PIA”) under social security. As with other integrated plans, the underlying philosophy of this design does not involve any age discrimination. Instead, the purpose is merely to take social security contributions or benefits (which in part are derived from employer contributions) into account in determining the qualified retirement plan contributions or benefits.

However, the 2002 Proposed Regulations would not view a PIA offset plan as being age neutral. Instead, the 2002 Proposed Regulations would view such plans as generating rates of accrual which would favor older employees in one respect, and disfavor them in two:

- For two participants with an identical service and compensation history who are both younger than social security normal retirement age, the PIA offset amount will be smaller for the older employee than for the younger one, because the covered compensation taken into account for the older employee will be slightly lower. Under the proposed methodology, this would mean that the accrual rates for participants at or under normal retirement age would actually favor older employees.

- On the other hand, after social security normal retirement age, the PIA offset amount will be larger for an older employee than for a younger one, because the social security benefit is actuarially increased. If the gross benefit for two employees is the same, then under the methodology set forth in the 2002 Proposed Regulations, the annual accrual for the older employee would be less than for the younger employee.

- In addition, in a plan with a uniform normal retirement age of age 65 which offsets the primary social security benefit payable at normal retirement age, for two participants in a plan with identical service and compensation history but with different social security retirement ages (one age 65 and the other 67), the rate of benefit accrual for the older employee will be less than the rate of benefit accrual for the younger employee. This will occur because the PIA offset amount will be larger for the older employee. The older employee will have a social security retirement age of age 65 and a non-prorated primary social security benefit offset amount payable at age 65. The younger employee, with a social security retirement age of age 67, would have a prorated and hence smaller primary social security benefit offset.
amount (13/15 prorated primary social security benefit) payable at age 65. Under the regulation’s methodology, this would mean that the older worker would have a lower accrual rate.

As a result of the last two items noted above, it would appear that most PIA offset plans are likely to fail the age discrimination test set forth in the 2002 Proposed Regulations.

4. **Code Section 401(l) Maximum Excess Allowance Plans.**

In a section 401(l) maximum excess allowance plan using rounding tables permitted by the IRS, the rounding within the tables results in situations where a participant’s covered compensation does not change based on one additional year of age, but the covered compensation of another participant (such as an older participant) will increase based on one more year of age. As a result, an older participant in this case would have a higher social security covered compensation than the younger participant and, hence, a lower accrual rate than the younger participant. Such a result would cause failure of the mathematical test in the 2002 Proposed Regulations, even though the difference in accrual rates would probably be minor, and at some ages older employees would be favored over some or all of the younger employees.\(^1\)

5. **Career Average Plans Which Increase Benefits Based on An Economic Index.**

Some traditional defined benefit plans accrue benefits based on the participant’s career average pay, but index the benefits based on some variable economic criteria other than the participant’s wage increases. Under such plans, if the normal retirement annuity benefit for two employees with identical service and compensation history is compared, the benefit for the younger employee will be higher, as it will receive more years of the indexed increases. Consequently, the younger employee would appear to have a higher accrual rate than an older employee, failing the test. Such a result would be inappropriate, since the increases which generate the failure merely represent a reasonable (even generous) manner of protecting all employees, old and young, against the impact of inflation.

6. **Variable Annuity Plans.**

In another time-honored design, a traditional defined benefit plan may accrue benefits which can be adjusted upwards based on the provisions of a variable annuity contract, which may provide for periodic payments that vary with investment experience or cost-of-living indices. Since a younger employee will have a longer period until normal retirement age, the younger employee will have a longer period in which the investment experience or cost of living increases may compound. This feature could generate a higher rate of accrual for a younger employee than for an older employee under the test set forth in the 2002 Proposed Regulations, causing a failure. Such a result would seem incorrect, for the same reasons noted above with

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\(^1\) The provisions of Regulation Section 1.411(b)-2(e)(3) do not appear to be worded broadly enough to avoid this result, since they merely seem to relate to “reductions” of accruals or allocations to satisfy the uniformity requirements of Regulation Sections 1.401(l)-2(c) or 1.401(l)-3(c). Perhaps the foregoing circumstance would encourage Treasury to provide a blanket exemption for plans which comply with Code section 401(l) and all related formal guidance issued by the IRS.
respect to indexed career average plans. All employees, young and old, are receiving the benefit of the variable annuity contract’s provisions. That a younger employee may receive that protection for a longer period of time than an older one should not be viewed as age discrimination.

7. **Floor-Offset Plans.**

In a floor-offset arrangement, the defined benefit plan provides a net benefit which is the excess, if any, of the benefit calculated under the plan’s gross formula and the value of the participant’s defined contribution plan account. Typically, the offset is calculated as the actuarial equivalent, in the normal annuity form at a normal retirement age, of the participant’s account (or in some other similar manner).

Prior to normal retirement age, such a plan would seem to provide a higher accrual rate (under the 2002 Proposed Regulations) for an older employee than for a younger employee with an identical gross benefit and account balance, since the account balance will have a longer time to grow prior to normal retirement age, and consequently will translate into a higher deferred annuity benefit for the younger employee. However, after normal retirement age, the situation may shift, since the same account balance will convert into a higher immediate annuity for an older employee than for a younger one. Unless the plan actuarially increases the gross benefit for delay in commencement, the plan is likely to fail the age discrimination test set forth in the 2002 Proposed Regulations.

On its face, taking into account increases in the employee’s age after normal retirement date (as before) in determining the factor for converting the account balance into the annuity offset amount is perfectly reasonable. It merely reflects economic reality, since the participant could purchase a higher annuity amount in a later year than an earlier year with an identical defined contribution account balance. Nor does the gross benefit of the arrangement involve any discrimination based on age. All that happens after normal retirement age is that the portion of the total benefit provided under the defined benefit plan versus the defined contribution plan may shift. Such a change should not be considered to generate an age discrimination issue. In fact, it has been held not to do so in *Lunn v. Montgomery Ward Co.*, 166 F.3d 880 (7th Cir. 1999). In that case, the court held that a floor-offset arrangement did not involve age discrimination for a participant who continued in employment after normal retirement age merely because the offset grew as he grew older.

Unfortunately, the rigid, mathematical test in the 2002 Proposed Regulations would cause floor-offset plans as currently designed to be treated as discriminatory against older employees. Floor offset plans should not be subject to disqualification, or have to be significantly reengineered, merely as a consequence of an attempt to apply a single, precise mathematical test to all defined benefit plan designs. If Treasury believes that a precise mathematical test is useful, it should serve only as a safe harbor.

8. **Participant Funded Plans.**

A participant funded plan is another traditional defined benefit plan design which fails the age discrimination test set forth in the 2002 Proposed Regulations. Pursuant to section
411(c) of the Code and its ERISA corollary, a participant funded defined benefit plan must satisfy strict rules in determining the portion of a participant’s benefit which is derived from the participant’s contribution. This process involves projecting the participant’s contributions with interest at statutory rates and converting the projected amount into a normal retirement annuity benefit using statutory factors. If the resulting benefit exceeds the benefit which would otherwise apply under the plan’s general formula, then the participant funded benefit must govern.

Due to the time value of money, a younger participant is more likely to have his benefit determined by the calculation of the participant funded benefit than is an older participant. If that does occur with respect to any actual participant (or merely could occur with a hypothetical one), then the accrual rate under the proposed regulations for such participant will be higher than for an older participant with otherwise similar characteristics whose benefit under the regular formula is the governing one, failing the test in the 2002 Proposed Regulations.

This result seems likely to occur with respect to many, and perhaps all, participant funded plans. Thus, the 2002 Proposed Regulations may effectively outlaw a longstanding plan design. This result would be all the more objectionable because it would be directly due to compliance with other statutory requirements (in this case, another subsection of section 411 of the Code). It seems unreasonable to suppose that Congress intended compliance with one subsection of section 411 of the Code to trigger a violation of another, but that is the apparent result of using a rigid, mathematical test as the measuring stick for an age discrimination analysis.

9. **Pension Equity Plans.**

Over the years, a variety of plan designs have been used which combine elements of both defined contribution plans and defined benefit plans. In a very real sense, floor-offset plans and participant funded plans are hybrid arrangements. More recently, cash balance plans have become popular, and the 2002 Proposed Regulations provide a special rule for them. However, pension equity plans constitute another important hybrid plan design, one which has apparently been overlooked in the 2002 Proposed Regulations.

In a pension equity plan, participants typically receive annual credits which represent a percentage of their final average pay. A participant’s benefit is generally stated as a lump sum payable at termination of employment equal to the aggregate percentage of the participant’s final average pay. The participant could, of course, receive his benefit as an annuity commencing at normal retirement age, in which case, the immediate lump sum amount would be projected to normal retirement date and converted into an actuarially equivalent annuity.

Like defined contribution plans and cash balance plans, pension equity plans are easy for participants to understand because they provide a benefit which is stated in the form of an immediate lump sum amount. On the other hand, like many traditional defined benefit plans, pension equity plans provide benefits which increase in line with a participant’s final average compensation.

On their face, there is nothing discriminatory in the design of a pension equity plan. Unfortunately, the 2002 Proposed Regulations would mandate that they be tested for age
discrimination not based on the lump sum amount stated in their formula, but rather on the normal retirement annuity derived from that lump sum amount. If a younger employee and older employee have the same compensation and lump sum amount under the plan’s formula, then the younger employee’s accrual rate (as measured under the 2002 Proposed Regulations) will be higher than the older employee’s accrual rate, simply due to the time value of money and the fact that younger employees have more years until normal retirement age for the lump sum amount to grow.

(c) The Phrase “Rate of Benefit Accrual” Is Flexible -- It Does Not Require The Use Of A Rigid And Complex Mathematical Test. Section 411(b)(1)(H) of the Code treats a plan as violating the vesting provisions if “under the plan, an employee’s benefit accrual is ceased, or the rate of an employee’s benefit accrual is reduced, because of the attainment of any age.” This flexible language does not mandate the wholesale reengineering of traditional defined benefit plan designs seemingly required by the mathematical test called for by the 2002 Proposed Regulations.

As further explained below, the legislative history indicates that the main concern of Congress was to prohibit the practice of halting accruals at normal retirement age. A fair reading of the conference report even suggests that section 411(b)(1)(H) of the Code was not intended to apply prior to normal retirement age. Regardless of whether section 411(b)(1)(H) of the Code is intended to address pre-normal retirement age accruals, nothing in the legislative history or language of section 411(b)(1)(H) of the Code seems to suggest that Congress intended to require the use of complex mathematical tests before or after normal retirement age.

Unlike the 2002 Proposed Regulations, the 1988 Proposed Regulations did not attempt to rigorously delineate a single, quantifiable standard for age discrimination. Instead, the 1988 Proposed Regulations simply restated the basic statutory rule and then gave guidance on certain types of plan terms which would or would not result in a violation. Thus, they left the core concept of “rate of benefit accrual” largely flexible.

Since the publication of the 1988 Proposed Regulations, the major issues which have arisen in the area have involved new hybrid designs, including cash balance plans (and, to a lesser extent, pension equity plans). In contrast to the controversy surrounding cash balance plans and cash balance conversions, there has been relatively little litigation regarding the application of the age discrimination rules to non-hybrid defined benefit plans with traditional designs. Therefore, it is ironic that the 2002 Proposed Regulations seem to impose the most extensive new burdens on those very types of plans.

(d) Section 411(b)(1)(H) of the Code and Section 4(i)(1)(A) of the ADEA Clearly Contemplate a Design-Based Standard, Not a Numerical Test. The text of section 411(b)(1)(H) of the Code and section 4(i)(1)(A) of the ADEA seem to support the use of a design-based standard. Section 411(b)(1)(H)(i) of the Code (with emphasis added) reads as follows:

(H) Continued accrual beyond normal retirement age.
In general. Notwithstanding the preceding subparagraphs, a defined benefit plan shall be treated as not satisfying the requirements of this paragraph if, under the plan, an employee’s benefit accrual is ceased, or the rate of benefit accrual is reduced, because of the attainment of any age.

Section 4(i)(1)(A) of ADEA (with emphasis added) reads as follows:

(1) Except as otherwise provided in this subsection, it shall be unlawful for an employer, an employment agency, a labor organization, or any combination thereof to establish or maintain an employee pension benefit plan which requires or permits—

(A) in the case of a defined benefit plan, the cessation of an employee’s benefit accrual, or the reduction of the rate of an employee's benefit accrual, because of age...²

Both the Code and the ADEA seem to provide that the plan, by its terms, cannot reduce the rate of benefit accruals on account of age. The location of the underlined “plan” text, appearing before benefit accrual, supports this reading, together of course with the use of the words “the rate of” benefit accrual under the statutes. The foregoing statutory interpretation supports a “design-based” standard under which an accrued benefit formula cannot reduce the rate of benefit accrual on account of age.

Had Congress intended a numerical test as the exclusive method of testing age discrimination, section 411(b)(1)(H) of the Code and section 4(i)(1) of ADEA would not contain the underlined text, and the statutes simply would have read “benefit accruals under the plan shall not decrease because of age,” i.e., with the plan reference appearing after the words benefit accrual. Moreover, Congress could have written the statutes to read “benefit accruals under the plan, either directly or indirectly, shall not decrease on account of age.” But Congress did not write the statutes that way. Accordingly, a plain reading of the statutes supports a “design-based” standard under which the terms of the plan cannot provide for declining accrual rates, factors, or computation methods.

Finally, neither the Code, ERISA nor the ADEA, which contain corollary provisions, provide a definition of “rate of benefit accrual.” Congress chose not to use other similar terms with more precisely defined meanings, such as “accrued benefit” or “normal retirement benefit,” which are subject to specific Treasury regulations and have specific meanings regarding the “accrual” of such defined term amounts. This “generalistic” approach, with merely the “rate of benefit accrual” terminology, supports the more general, non-numeric approach for compliance with the statutes. It certainly is consistent with the significant OBRA legislative history under which Congress intended the provision to continue benefit accruals beyond normal retirement age, as a basic matter of pension and tax policy.

² The foregoing ADEA reference to “permits” still refers to a plan provision, consistent with the ADEA remaining statutory provision and section 411(b)(1)(H).
OBRA 1986 Congressional Purpose Was to Remove Disincentives to Working Beyond Normal Retirement Age. The OBRA 1986 law changes, including section 4(i)(1)(A) of the ADEA and section 411(b)(1)(H) of the Code, merely were intended to remove disincentives of older workers from working past normal retirement age. Congress did not intend to impose a strict numerical test for measuring accruals prior to the attainment of retirement age.

Congress in OBRA 1986 adopted the following three ADEA law changes impacting retirement plans, all of which were intended to remove disincentives of older workers from working past normal retirement age:

1. A plan no longer may impose mandatory retirement at any age (with certain limited exceptions). Congress effected this law change by removing the age 70 upper limit under the ADEA, thereby extending protection from age discrimination to all employees age 40 and over regardless of age and eliminating an employer’s ability to impose a mandatory retirement age and “forced retirements.” ADEA section 12(a), (c).

   Congress amended the ADEA to provide that “no such employee benefit plan or voluntary early retirement incentive plan shall excuse the failure to hire any individual, and no such employee benefit plan shall require or permit the involuntary retirement of any individual specified by section 12(a) [age 40 up to any age], because of the age of such individual.” ADEA section 4(f)(2).

2. A defined benefit plan no longer may exclude from participation an employee hired within five years of normal retirement age under the plan. (A plan may, however, delay normal retirement age to the fifth anniversary of employment, thereby delaying in certain cases vesting and benefit entitlement for five years.) Code section 410(a).

3. A defined benefit may not cease benefit accruals, or reduce the rate of benefit accrual, because of the attainment of any age. ADEA section 4(i)(1)(A); Code Section 411(b)(1)(H). To support its meaning, section 411(b)(1)(H) of the Code is entitled “Continued accrual beyond normal retirement age.”

The following OBRA 1986 legislative history indicates Congress adopted the prohibition on declining benefit accruals to remove uncertainty which existed within the DOL and EEOC (which assumed regulatory responsibility effective July 1, 1979) regarding whether a plan could suspend benefit accruals upon attainment of normal retirement age (normally age 65):

Summary of Senate-House Conference Agreement.—Reasons for change:

When both ADEA and ERISA were enacted, authority for the administration and enforcement of both laws was the responsibility of the Secretary of Labor. Presidential Reorganization Plan No. 1 of 1978 transferred the authority for ADEA from the Secretary of Labor to the Equal Employment Opportunity Commission (EEOC), effective July 1, 1979.

Prior to that date, the Secretary of Labor issued an amendment to the Interpretative Bulletin on Employee Benefit Plans, 29 C.F.R.
860.120(f)(2)(ii) (relating to the application of sec. 4(f)(2) of ADEA to employee benefit plans covered under ERISA), which allowed employers to cease benefit accruals and allocations to an employee's account with respect to employees working beyond the normal retirement age under the plan.

Disagreement exists as to whether and to what extent benefit accruals and allocations are required under ADEA, as currently in effect. 132 Cong. Rec. H11437 (daily ed. Oct. 17, 1986) (emphasis added).

Summary of Senate-House Conference Agreement.—In general: Under the conference agreement, benefit accruals or continued allocations to an employee’s account under either a defined benefit plan or a defined contribution plan may not be reduced or discontinued on account of the attainment of a specified age. 132 Cong. Rec. H11437 (daily ed. Oct. 17, 1986).

To elaborate, uncertainty did exist in the law at the time concerning whether post-normal retirement age accruals were required. The EEOC, having received authority under ADEA, announced on June 24, 1984 that it intended to rescind the DOL’s previous interpretation that a plan could suspend benefit accruals without violating the ADEA. But the EEOC never formally issued this interpretation.

The following OBRA 1986 legislative history indicates Congress adopted the prohibition on declining benefit accruals specifically, and with no other expressed purpose than, to allow continued benefit accruals after normal retirement age (age 65):


Rep. Jeffords (speaking in support of the bill).—It is important for this body to understand what this “Older Americans Pension Benefits” provision does and does not do. What it does is prevent a covered employee pension benefit plan from eliminating or reducing an employee’s pension benefit accruals, because of the attainment of any age, for the period of employment after the employee attains the normal retirement age under his or her plan. 132 Cong. Rec. H11437 (daily ed. Oct. 17, 1986) (emphasis added).

Rep. Roukema.—Mr. Speaker, I rise in support of the Older Americans Pension benefit provisions included in this omnibus budget reconciliation bill (H.R. 5300). These provisions included in the conference report which amend ERISA, ADEA, and the Internal Revenue Code, remove a significant disincentive for our older citizens to continue working beyond the point when they reach age 65 or an earlier normal retirement age as
defined under the pension plans in which they participate. The legislation amends current law to preclude the “attainment of any age” as a reason for eliminating or reducing pension benefits accruals after normal retirement age. Therefore, employees who want or need to continue working beyond normal retirement age will no longer be able to be treated adversely under their pension plans because of their age. 132 Cong. Rec. H11437 (daily ed. Oct. 17, 1986) (emphasis added). Moreover, the following OBRA 1986 legislative history further supports the conclusion that Congress did not intend for the section 4(i)(1)(A) of the ADEA and section 411(b)(1)(H) of the Code to change the method of benefit accrual prior to normal retirement age:

Summary of Senate-House Conference Agreement. – Under the conference agreement, the rules preventing the reduction or cessation of benefit accruals on account of the attainment of age are not intended to apply in cases in which a plan satisfies the normal benefit accrual requirements for employees who have not attained normal retirement age. Under the benefit accrual rules, the rate of benefit accrual for an employee may vary depending on the number of years of service an employee may complete between the date of hire and the attainment of normal retirement age. H.R. Conf. Rep. No. 99-1012, at 379 (1986) (emphasis added).


To summarize, the OBRA 1986 legislative history indicates that the main concern of Congress was to prohibit the practice of suspending benefit accruals at normal retirement age. As shown above, some portions of conference report also suggest that section 411(b)(1)(H) of the Code was not even intended to apply prior to normal retirement age. (See H.R. Conf. Rep. No. 1012, , 99th Cong., 2d Sess. 378 (1986), at 379.) The legislative history makes it abundantly clear that Congress did not intend to impose new, numerical testing requirements on plan sponsors.

(f) Design-Based Standard Consistent with Other ADEA Employee Benefit Plan Provisions and OBRA 1986 Regulatory Guidance and 1988 Proposed Regulations. A design-based standard also is consistent with the various other ADEA employee benefit plan provisions.

The other ADEA employee benefit plan provisions, including the various safe harbors for employee benefit plans enacted in OWBPA and the 1988 Proposed Regulations, do not provide for numerical tests to determine age discrimination, except for the equal cost provision of section 4(f)(2)(B)(i) of ADEA (which is uniformly not considered to apply to, or otherwise used to decrease benefit accruals under, a defined benefit pension plan). These provisions also allow some disparity of benefits based on age. And of course none of these ADEA provisions call for
numerical tests to determine compliance with section 411(b)(1)(H) of the Code for accruals before normal retirement age.

Section 4(f)(1) of ADEA also provides that no violation occurs where “differentiation is based on reasonable factors other than age.” The legislative history of ADEA and Department of Labor regulations support the proposition that higher labor costs associated with employment of older employees constitute “reasonable factors other than age” which an employer can consider. *Mastie v Great Lakes Steel Corp.*, 424 F Supp 1299, 1318 (E.D. Mich. 1976).

The Older Workers Benefit Protection Act (OWBPA) contains various “design-based” safe harbors for employee benefit plans. See ADEA section 4(l), including voluntary early retirement incentives, severance pay, retiree medical and other benefits. A design-based standard for ADEA section 4(i)(1)(A) and section 411(b)(1)(H) of the Code would be consistent with the OWBPA safe harbors for employee benefit plans.

The 1988 Proposed Regulations under section 411(b)(1)(H) of the Code in fact followed a design-based standard, providing that a defined benefit plan will fail section 411 of the Code “if, either directly or indirectly, because of the attainment of any age— [a] participant’s accrual of benefits is discontinued or the rate of a participant’s accrual of benefits is decreased . . . .” 1988 Proposed Regulations section 1.411(b)-2(b)(1)(i)(A). While the preceding regulation refers to “indirectly”, the regulation does not contain a numerical test to determine compliance with Section 411(b)(1)(H) of the Code for certain pre-normal retirement age accruals. In fact, the 1988 regulations use the term “indirectly” to refer to design-based techniques, e.g., finding that a combination of age and service as a cut-off of benefit accruals is age discriminatory. *See 1988 Proposed Regulations section 1.411(b)-2(b)(2)(ii).*

Unlike the 2002 Proposed Regulations, the 1988 Proposed Regulations did not attempt to rigorously delineate a single, quantifiable standard for age discrimination. Instead, the 1988 Proposed Regulations simply restated the basic statutory rule and then gave guidance on certain types of plan terms which would or would not result in a violation, thereby utilizing a “design-based” standard to determine compliance with section 411(b)(1)(H) of the Code. Thus, the 1988 Regulations left the core concept of “rate of benefit accrual” for pre-normal retirement age accruals as a “design-based” compliance matter.

(g) **Design-Based Standard is Consistent with Case Law Involving Employee Benefit Plans and Age-Based Disparate Impact Claims.** A design-based standard also is consistent with ADEA case law involving retirement plans and other employee benefit plans and age-based disparate impact claims.

Case law under the ADEA generally requires a showing of ‘disparate treatment’ (and not merely ‘disparate impact’) in order to make out a claim of age discrimination. *See, e.g., Campbell v. BankBoston, N.A.*, 206 F. Supp. 2d 70, 78 (D. Mass. 2002), which held that a cash balance plan which contained a formula which was not facially discriminatory was not age discriminatory, and rejected a ‘disparate impact’ claim. *See also Adams v. Florida Power Corp.*, 255 F.3d 1322, 1324-26 (11th Cir. 2001); *Mullin v. Raytheon Co.*, 164 F.3d 696, 699-704 (1st Cir. 1999); *Salvato v. Illinois Dep’t of Human Rights*, 155 F.3d 922, 926 (7th Cir. 1998); *Ellis v. United Airlines, Inc.*, 73 F.3d 999, 1009 (10th Cir. 1996).
Since the courts have rejected a “disparate impact” analysis, in order for a reduction in the rate of benefit accrual due to the attainment of any age to occur, it should be necessary (1) to show that the plan provision involved is facially discriminatory based on age or (2) to combine a non-facially based distinction based on age with a showing of an actual intent by the employer to design the plan in a manner which is detrimental to older employees in some significant manner (i.e., a disparate treatment).

A mathematical test, such as the one included in the 2002 Proposed Regulation, is, at the very least, effectively a disparate impact analysis, and thus not in accord with the prevailing case law. Indeed, the mathematical test included in the 2002 Proposed Regulation constitutes a particularly onerous version of a disparate impact analysis. Under such a test, in the event a plan’s benefit formula would produce an incremental, accrual rate for any actual or hypothetical participant which is, even to a de minimis degree, less than might have been produced if the individual were any younger age, then the plan will violate the age discrimination requirements. We submit that such a test represents a significant misreading of the law and imposes unnecessary burdens on defined benefit plans and their sponsors.

(h) Use of a More Flexible Mathematical Test. As discussed in detail above, a facial analysis of a plan’s benefit formula should be the core method for demonstrating compliance with age discrimination requirements. In our view, a mathematical approach should only be used as an alternative method to demonstrate compliance with the age discrimination requirements if a plan for some reason has difficulty satisfying a design-based standard. If a mathematical approach is retained in the regulations, either as the sole test or as a fallback test, the mathematical test should be much more flexible than the test prescribed by the 2002 Proposed Regulations.

The nondiscrimination rules under section 401(a)(4) of the Code illustrate some methods by which this added flexibility could be accomplished. Although those regulations also attempt to define the concept of discrimination in mathematical terms, they do so in a manner which retains flexibility in several important ways:

- First, the regulations permit defined benefit and defined contribution plans to demonstrate nondiscrimination based either on an allocations or benefits basis.
- Second, they permit plans to be aggregated for testing purposes.
- Third, they permit a range of methods, including plan year, accrued to date and projected, for determining the accrual rates to be tested.
- Fourth, they permit accrual rates to be grouped in a way in which minor differences are disregarded.
- Fifth, the core test (namely, that each “rate group” needs to satisfy coverage testing) is focused on the overall pattern of how the participants are treated, so that minor differences in treatment between the two groups (highly and nonhighly compensated employees) tested would not typically be sufficient to trigger failure of the test.
Sixth, in cases in which the mathematical test might be failed due to the rates of a few outlying individuals, the regulations provide for a facts and circumstances determination as a backstop.

Seventh, the regulations allow prior formulas (and accruals for the periods during which they applied) to be disregarded for some testing purposes, if certain transition approaches are utilized.

Unfortunately, the mathematical tests contained in the 2002 Proposed Regulations contain none of these features. Although we acknowledge that there are differences in the statutory provisions, we believe that the age discrimination provision in section 411(b)(1)(H) of the Code is flexible enough to include all of them.

The treatment of eligible cash balance plans under the 2002 Proposed Regulations suggests that Treasury recognizes that the statute is susceptible of a flexible construction. There would seem to be no particular reason that this flexibility should not be applied to all plan designs, including floor-offset plans and pension equity plans. To this end, we urge that any mathematical age discrimination test permit some form of general cross-testing, as was done in the regulations precluding discrimination in favor of highly compensated employees.

We also believe that there is no particular reason that “rate of benefit accrual” would have to be computed, for the purposes of an age discrimination analysis, based solely on each year’s incremental accrual. The phrase could justifiably be read to permit the determination to be done with reference to a participant’s total benefit accrued to date or his projected benefit.

In addition, to the extent a mathematical, discriminatory impact analysis is to be undertaken, then it would be appropriate for the test to be failed only if the degree of discriminatory impact were significant. At a minimum, any such rule should be designed so that minor differences in accrual rates would be disregarded and only an overall pattern of decreasing accruals on account of increased age would result in a violation. In addition, the existence of a facts-and-circumstances failsafe determination would also seem appropriate, if a mathematical approach is retained in the final regulations.

Finally, where a plan’s formula has been changed from one which is not age discriminatory to another which would also not be age discriminatory if evaluated on its own, then the mere transition between the two should not give rise to an age discrimination issue. Thus, it would be appropriate for the final regulations to treat such a plan as satisfying the testing requirements, at least if any reasonable transition approach is used (including those set forth in Regulation Section 1.401(a)(4)-13). To this end, the regulations could be revised to allow any applicable mathematical test to be applied only taking into account the new formula, and disregarding the prior formula and any accruals thereunder or any “wear-aways” resulting as part of the transition from the prior formula to the new formula.
(3) **Recommendation.**

We urge that final regulations return to the flexible approach used in the 1988 Proposed Regulations with respect to traditional plans. This could be accomplished by reverting to most of the provisions of the 1988 Proposed Regulations and adding to them the guidance provided with respect to cash balance plans in the 2002 Proposed Regulations. It also would be appropriate for the regulations to specifically indicate that age discrimination for a defined benefit plan is tested based on whether the plan’s benefit formula, on its face and in terms of the normal form in which the benefit is stated, actually refers to age as a factor and reduces accruals due to increasing age.

The core test for age discrimination under the regulations should not be a rigid mathematical test which generates difficulties for many defined benefit plan designs. If a mathematical test is utilized at all, it should be as an alternative to a facial test and it should be more flexible. As noted above, the revised test should incorporate features similar to those used with respect to the general nondiscrimination tests under the section 401(a)(4) regulations, include elements of flexibility to accommodate previously accepted design techniques, allow career based as opposed to annual testing, permit insignificant and unintended disparities, and accommodate reasonable transition approaches.

**B. Post-Retirement Issues.**

(1) **Incremental Annual Testing.**

(a) **Issue.**

Should the regulations require that the impact of actuarial increases on post-normal retirement date accruals be done incrementally and annually, rather than only at the point the benefit is ultimately payable?

(b) **Comment.**

The statute provides that in the case of any employee who has, as of the end of any plan year, attained normal retirement age, and for whom distribution of benefits has not commenced, then any requirement under section 411(b)(1)(H) of the Code for continued accrual of benefits under the plan with respect to such employee during such plan year shall be treated as satisfied to the extent of any adjustment in the benefit payable under the plan during such plan year attributable to the delay in distribution of benefits after the attainment of normal retirement age.

The 2002 Proposed Regulations reformulate this rule entirely, casting the test in terms of the incremental increase in the plan’s benefit (whether due to actuarial increase or regular accrual under the plan’s formula) which must be tested in terms of an incremental, annual accrual for age discrimination purposes. Further, as indicated in the preamble to the 2002 Proposed Regulations, one of the impacts of restating the test in the form set forth in the 2002 Proposed Regulations was to preclude a plan from reducing a participant’s rate of benefit accrual in one plan year to take into account the fact that, in a preceding plan year, the actuarial increase was greater than the accrual under the plan formula. This approach appears to have two flaws.
First, as explained in our comments to Regulation Section 1.411(b)-2(b)(3)(iii), Example 13, below, the test as formulated by the 2002 Proposed Regulations would not even be satisfied by providing, each year, the better of the incremental accrual under the plan’s formula and the incremental actuarial increase on the prior year’s benefit. Thus, the formulation goes beyond what even the preamble indicates was the intended result.

Second, the statutory language does not mandate the approach described in the preamble. The statute allows any adjustment in the benefit that would otherwise be payable during a plan year which is attributable to any delay in the distribution of benefits after the attainment of normal retirement age to reduce any accruals that would otherwise need to be provided under the plan’s formula. Thus, the statute would appear to allow actuarial increases occurring any year after normal retirement age to reduce any accruals otherwise required during that year or any later year. For example, it would appear that a plan could satisfy the statutory requirement by comparing the benefit accrued through normal retirement age, as adjusted by any actuarial increase provided by the plan for the delay in payment to a later age, against the total benefit accrued under the plan’s stated formula taking into account compensation and service through that later age. Such an approach would be far simpler for plans to administer than the year-by-year comparisons required under either the rule stated in the 2002 Proposed Regulations or the approach suggested by the preamble to them. It also would better reflect the statutory provision.

(c) **Recommendation.**

The regulations should be revised so that any actuarial increase provided by a plan for delay in payment after normal retirement age may offset any requirement for further accrual of benefits in any period after normal retirement age. The regulations should not require a plan to compare the net impact of actuarial increases and accruals under the plan’s formula each year or penalize a plan in later years for providing actuarial increases in former years which are more generous than additional accruals under the plan’s benefit formula.

(2) **Examples 12 and 13.**

(a) **Issue.**

Can the mathematical test for post-normal retirement date accruals in the 2002 Proposed Regulations be satisfied by a plan which utilizes the approach in Example 13 to Regulation Section 1.411(b)-2(b)(3)(iii) to provide the better of the incremental actuarial increase on the prior year’s benefit and the incremental accrual under the plan’s formula? If not, should the proposed mathematical test be abandoned in favor of a simpler approach?

(b) **Comment.**

Examples 12 and 13 attempt to illustrate how post-normal retirement date accruals under traditional defined benefit plans would be tested under the principles set forth in the 2002 Proposed Regulations. Both plans have formulas which provide a benefit equal to two percent of final average pay per year of service. After normal retirement age, both plans provide participants the greater of the formula accrual or an actuarially increased benefit. The plan in Example 12 calculates the benefit each year by comparing the total benefit under the plan’s formula with the actuarial equivalent of the prior year’s benefit. The plan in Example 13
provides that any incremental benefit resulting from the actuarial increase in any year is preserved; that is, for each year the plan provides an incremental accrual which is the greater of the increase in benefit resulting from applying the 2 percent formula or the increase in benefit resulting from adjusting the prior year’s benefit for actuarial equivalency. According to the 2002 Proposed Regulations, the approach in Example 12 is not able to meet the mathematical test, but the approach in Example 13 does. As explained below, the approach in Example 13 also seems to fail the mathematical test, which indicates that the test is quite difficult and onerous, indeed.

In both Example 12 and 13, Participant G has 13 years of service at age 67. Thus, his end-of-the-year benefit would be 26% of final average pay under the basic formula. In that year, however, the actuarial increase of his prior year’s benefit is greater than 26% of final average pay. Under the formulas of both plans, therefore, Participant G’s benefit is increased to $15,697, which is 26.16% of his final average compensation of $60,000.

At age 68, the two approaches begin to diverge because Participant G earns enough to see his final average pay increase from $60,000 to $66,000. In Example 12, the plan formula provides that he receives the greater of 28% of final average pay, which is $18,480, or his prior year’s benefit actuarially increased. The $18,480 is higher than the actuarial equivalent of his prior year’s benefit ($17,762), so his benefit is $18,480. This results in an increase of 1.86% from the prior year’s benefit expressed as a percentage of prior year’s final average pay. Because this percentage is less than 2%, which is the increase that a younger participant would receive, the plan fails the mathematical test of the 2002 Proposed Regulations.

In Example 13, for the year in which Participant G is 68, the plan provides that he receives the greater of the actuarial increase in the prior year’s benefit ($17,762 minus $15,697, or $1,777) or the increase under the 2% formula ($18,480 minus $15,600, or $2,880). Thus, his benefit is increased to $18,577, which (according to the example) is 28.1% of final average pay. This (according to the example) is an increase of 2%, which is the same as that given to younger participants with the same pay and service, so the plan qualifies.

If the percentages in Example 13 had been rounded to two decimal places, the age 68 percentage would be 28.15% and the rate of benefit accrual (as defined in the regulation) would have been 1.99%. Because 1.99% is less than the rate of benefit accrual applicable to a younger person with the same age, service and pay history the plan in Example 13 should fail. This is not an accident of rounding, but represents the actual mathematics of the transaction.

Let us illustrate by using actual numbers taken to 7 decimal places.

The age 67 annual benefit as a percentage of pay is $15,697 divided by $60,000. This is 26.1616667%.

The age 68 annual benefit as a percentage of pay is $18,577 divided by $66,000. This is 28.1469697%.

The difference between these percentages is 1.98530330%, not 2%. There is a shortfall, when compared to a 2% accrual of .0146970%. When expressed as a percentage of final average compensation ($66,000) this shortfall is $9.70.
It is useful to explain where this $9.70 shortfall comes from. For a younger participant with the same service and pay history, the increase in his or her benefit is $2,880. This is the sum of two amounts: The amount of $1,320, which represents a 2% accrual on final average pay of $66,000, and an amount of $1,560, which is the past service benefit of 26% applied to the increase in final average pay of $6,000. (26% times $6,000 = $1,560).

There is another way to look at this, however. The second amount is also the same as saying that the prior year’s accrued benefit ($15,600) has been increased proportionate to the increase in pay. Pay has increased by 10% (from $60,000 to $66,000) so the accrued benefit for past service increases proportionately (10% of $15,600, which is the prior year’s accrued benefit, is $1,560).

But Participant G does not have a prior year’s accrued benefit of $15,600. His age 67 accrued benefit is $97 higher, or $15,697. In order for him to have an accrual rate of 2% of pay, defined in the manner of the regulation, he would have to have an increase of 10% on this amount as well. (10% of $97 is $9.70, which is exactly the amount of shortfall in Example 13.)

While the shortfall in Example 13 resulted from an increase in benefit due to a post retirement age actuarial adjustment, we point out that this problem is not inherently due to the fact that Participant G is past normal retirement age. It arises whenever an older participant has a prior year’s benefit that includes an amount that is not indexed for final pay.

One way to solve the problem might be to add an additional factor to the test: the assumption that all younger participants, in addition to the same age and service, also have the same benefits that are not related to age and service. Thus in the example an assumption that all younger participants also had an extra prior year’s accrued benefit of $97 would solve the mathematics. But this might not solve the policy issues. Furthermore, persons attempting to test plans would constantly be faced with judging what assumptions to make as to what characteristics can be assumed to be attributed to all actual or hypothetical younger participants.

(c) **Recommendation.**

The problem illustrated by Example 13 is inherent in the fact that the 2002 Proposed Regulations require a method of determining the rate of benefit accrual that can produce anomalous results in countless numbers of cases. A better approach would be to return to a facial analysis (design-based) standard for the core age discrimination test.

C. **Rules For Optional Forms Of Benefit, Ancillary Benefits, And Other Rights Or Features.**

(1) **Issue.**

Under the statutory provisions is it appropriate for the regulations to impose age discrimination requirements with respect to optional forms of benefit, ancillary benefits, and other rights or features?
Sections 411(b)(2) and 411(b)(1)(H) of the Code (and the corresponding ERISA provisions) each appear to relate solely to the amount of a participant’s retirement benefit. The former section specifically refers to the “rate of allocations” and the latter to “rate of benefit accrual.” Other features of a plan, such as the availability of optional forms of distribution, ancillary benefits or other rights and features, are not mentioned by the statute. Moreover, section 411(b)(1)(H) of the Code clearly indicates that the age discrimination tests will not be failed because the subsidized portion of any early retirement benefit is disregarded in determining benefit accruals. Thus, early retirement subsidies also appear to fall outside of the scope of the Code and ERISA statutory prohibitions on age discrimination.

Based on the above provisions, it would appear that the age discrimination analysis required by the Code and ERISA only relates to plan provisions which impact the value of a participant’s accrued benefit. That is, although the phrase “rate of benefit accrual” is sufficiently flexible to allow the determination of age discrimination to be based on the actual formula in which a plan states a participant’s benefit and the normal form in which such benefit is stated, only those provisions which impact a participant’s “accrued benefit” under Code section 411 are relevant to the analysis.

The 2002 Proposed Regulations also take the position that for purposes of determining a participant’s rate of benefit accrual, only benefits that are included in a participant’s accrued benefit are taken into account. Thus, for example, the 2002 Proposed Regulations indicate that a participant’s rate of benefit accrual does not take into account disability benefits, social security supplements, and early retirement benefits.

Despite these provisions, Regulation Section 1.411(b)-2(d) provides that the age discrimination provisions will be violated if “optional forms of benefits, ancillary benefits, or other rights or features under a plan provided with respect to benefits or allocations attributable to credited service prior to the attainment of the participant’s age are not provided on at least as favorable a basis with respect to benefits or allocations attributable to credited service after attainment of the participant’s age.” While we have no objection to the policy encompassed by this provision of the 2002 Proposed Regulations, the phrases “rate of benefit accrual” and “rate of allocations” are simply not broad enough to be stretched to address the availability of optional forms, ancillary benefits or other rights and features. As a result, Regulation Section 1.411(b)-2(d) goes well beyond the scope of the Code and ERISA statutory provisions. Whether a plan’s provisions regarding the availability of optional forms, ancillary benefits or other rights and features may be subject to an age discrimination analysis under the more general provisions of the ADEA is a different question. In any event, it would not appear appropriate to attempt to address those issues in regulations promulgated under sections 411(b)(1)(H) and 411(b)(2) of the Code and the corresponding ERISA provisions.

We recommend that Regulation Section 1.411(b)-2(d) be deleted from the final regulations.
IV. Defined Contribution Plans

A. General

(1) Issue.

Code section 411(b) bears the heading “Accrued Benefit Requirements”, and paragraph 411(b)(2) provides: “A defined contribution plan satisfies the requirements of this paragraph …” The 2002 Proposed Regulations, at Regulation Section 1.411(b)-2(a), quote that same provision as: “… a defined contribution plan does not satisfy the minimum vesting standards of Section 411(a) …” (emphasis added) Thus, the 2002 Proposed Regulations make it clear that plan disqualification is the intended consequence of age discrimination by a plan as defined in the 2002 Proposed Regulations. While we agree that disqualification is an appropriate consequence, we believe the regulations should be crafted to provide that plan sponsors as well as the Internal Revenue Service can determine from the plan’s language whether there is such impermissible age discrimination. The 2002 Proposed Regulation, as drafted, does not rely on objective rules to determine if there is a violation of the provisions of section 411(b)(2)(A) of the Code; rather, it requires a subjective test. This would require both plan sponsors and the Internal Revenue Service to continually analyze whether a plan satisfies the age discrimination provisions. Accordingly, we believe there is a need for a clarification and simplification of the rules defining age discrimination, under Regulation Section 1.411(b)-2(c).

The 1988 Proposed Regulations contained a clear and reasonable guideline as a general rule in Regulation Section 1.411(b)-2(a). It provided that age discrimination cannot be demonstrated “solely because of a positive correlation between increased age and a reduction or discontinuance in benefit accruals or account allocations under a plan.” This general rule eliminated the possibility of an assertion of age discrimination on the basis of statistical or other such analyses and is supported by the legislative history and case law. In the 2002 Proposed Regulations, this general rule has been relegated to a sub-rule under Regulation Section 1.411(b)-2(c)(3)(ii)(B).

The 2002 Proposed Regulations provide that reductions may be “directly” or “indirectly” because of a participant’s attainment of any age. (See Regulation Section 1.411(b)-2(c)(3)(i) and (ii)). We see no basis in the statute (Code section 411(b)(2)(A)) for the adoption of an “indirectly” test as set out in the regulations. These rules are vague, may be inconsistent with those of the EEOC or DOL, may permit “disparate impact” testing, and expose plans to disqualification on a purely subjective basis.

(2) Comment.

Defined contribution plans should not be permitted to contain any provisions which, on their face, would eliminate or reduce benefit accruals as a result of age. This approach is consistent with the language of Code section 411(b)(2)(A), which specifically references “under the plan.” However, parties should not be required to divine the extent to which age was a determining factor with respect to a plan design feature which implicates a participant’s allocation, when such allocation on the face of the plan is based on factors other than age, such
as inclusion in a group or classification not facially based on age. This is inconsistent with the statute. This provision needs to be moved back into Regulation Section 1.411(b)-2(a)(1).

(3) **Recommendation.**

The 2002 Proposed Regulations should be modified to make it clear that a plan violates the provisions of section 411(b)(2) only if, under the written provisions of the plan, a participant’s rate of allocation is reduced or eliminated because of the participant’s growing older. The 2002 Proposed Regulations also should be modified to make it clear that the provisions of section 411(b)(2) are not violated “solely because of a positive correlation between increased age and a reduction or discontinuance in benefit accruals or count allocations under a plan.”

**B. Other Comments Relating to Age Discrimination in Defined Contribution Plans.**

Regulation Section 1.411(b)-2(c)(2) defines aggregate allocations by cross-reference to Treasury Regulations section 1.401(a)(4)-2(c)(2). The cross-referenced provision would, *inter alia*, count all “employer contributions”. In various pronouncements, the IRS has indicated that elective deferrals by participants are considered to be “employer contributions”. Regulation Section 1.411(b)-2 should be clarified to state that “employer contributions” do not include elective contributions by participants as defined in Treasury Regulations section 1.401(k)-1(g)(3).

Regulation Section 1.411(b)-2(c)(2)(ii) provides a general rule for the determination of a “rate of allocation” which is the “dollar amount” of allocation. The regulation then provides “alternatively, if a plan’s formula bases a participant’s allocations solely on compensation for the plan year and compensation is determined without regard to attainment of any age, then a participant’s rate of allocation can be determined as a percentage of the participant’s compensation for the plan year.” This percentage of compensation alternative is far more practical and will likely be the testing alternative available to most plans. However, clarification should be provided to insure that profit sharing plans with multiple contribution classes (or categories or tiers) based on factors other than age are not precluded from taking advantage of the alternative rule. That is, in the case of a profit sharing plan with multiple contribution classes, a participant’s allocation will depend both on the participant’s compensation and on the identity of the classification to which the employee belongs.

**V. Other Comments on Effective Dates**

**A. Issue 1.**

In the preamble, under “Proposed Effective Date,” appears the following:

“The Regulations are proposed to be applicable to plan years beginning after the date Final Regulations are published in the Federal Register.”

Should this refer only to the regulations proposed at Sections 1.411(b)-2(a) through (e)?
B. **Issue 2.**

In the preamble, under “proposed effective date,” appears the following:

“In addition, the proposed regulations at Sections 1.410(a)-4A, 1.411(a)-3, 1.411(b)-3 and 1.411(c)-1(f)(2) (relating to maximum age for participation, vesting, normal retirement age and actuarial adjustments after normal retirement age), which were published in the same notice of proposed rule making as the 1988 proposed regulation and which are not republished here, are also expected to be finalized for future plan years.”

Are these regulations expected to be finalized “as is?” When finalized, are these to be effective prospectively only? See recommendation for a delayed effective date in previous comments.

C. **Issue 3.**

The 2002 Proposed Regulations also propose changes to Treasury Regulations sections 1.401(a)(4)-3 and 1.401(a)(4)-9. No effective date information is provided for the changes to these sections.

These changes to the final regulations should expressly provide the same effective date used for final regulations under Regulation Section 1.411(b)-2.

D. **Issue 4.**

The use of the term “applicability date” rather than the more common “effective date” in Regulation Section 1.411(b)-2(f)(1) and Regulation Section 1.411(b)-2(f)(2) is unnecessarily confusing. The final regulation should change “applicability date” to “effective date”.