COMMENTS REGARDING THE INTERNAL REVENUE SERVICE AND TREASURY DEPARTMENT PROPOSAL ON WAIVER OF SECTION 411(D)(6) PROTECTION FOR CERTAIN FEATURES OF DEFINED BENEFIT PLANS

The following 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 Employee Benefits Committee of the Section of Taxation. Substantive contributions were made by Joni Andrioff, Eleanor Banister, Carol Buckmann, Steven Friedman, Thomas A. Jorgensen, Judy Mazo, Robert Miller, Marc Sandberg, and George Whitfield. These comments were reviewed by Thomas R. Hoecker and Taina E. Edlund of the Section’s Employee Benefits Committee, Richard Gilbert of the Section’s Committee on Government Submissions, Stuart Lewis the Council Director for the Employee Benefits Committee, 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 many of the members of the Section of Taxation who participated in preparing these comments have clients who would be affected by the federal tax 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 to influence the development or outcome of, the specific subject matter of these comments.

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EXECUTIVE SUMMARY

The current regulations under section 411(d)(6) of the Internal Revenue Code of 1986, as amended (the “Code”) prohibit any reduction or elimination of an early retirement benefit or a benefit involving a retirement type subsidy under a plan that is intended to meet the qualification requirements of Code section 401(a). They also prohibit almost all changes in optional forms of benefits under a qualified defined benefit plan. In addition, the regulations establish a very expansive definition of “optional form of benefit” to encompass small details as to the commencement, time of payments and the medium of the payment. Under Treasury Regulations and a statutory amendment, defined contribution plans can now eliminate all payment options except for lump sums and, in the case of money purchase plans, the qualified joint and survivor annuity (“QJSA”).

At many meetings of the Employee Benefits Committee of the Section of Taxation of the American Bar Association, members repeatedly single out Code section 411(d)(6) and the regulations thereunder as perhaps the most burdensome set of rules applicable to qualified retirement plans. Optional forms of benefits which are rarely, if ever, elected by participants cannot be eliminated as to accrued benefits. A decision to phase out an optional form of benefit will take from 40 to 70 years before finally eliminating the optional form. During that period the plan administrator and the participants will have the complexity of dealing with an optional form of benefit which only applies to a portion of the participant’s accrued benefit. Such a phase-out of an optional form of benefit subjects plan sponsors and plan participants to decades of burdensome and confusing plan communications about optional forms of benefits.

The problem is exacerbated in the case of mergers of defined benefit plans with different optional forms of benefits. Frequently, the two plans have dissimilar optional forms of benefits and a decision must be made with respect to which options will be made available to all participants and which will be limited to the original group of employees who had the options available. In addition, the decision must be made whether to preserve the option for the participant’s full accrued benefit or just the benefit accrued at the time of the plan merger. Either way it will take decades for the unwanted optional form of benefit to be completely eliminated from the plan. In the meantime, both the plan administrator and the plan participants must put up with the burdens of administering optional forms of benefits which the plan sponsor does not want in its plan. Finally, some plans are prevented from terminating because it is not possible to purchase an annuity contract which provides for certain unusual optional forms of benefits.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”) amended Code section 411(d)(6) to require the Internal Revenue Service (“IRS”) and Department of the Treasury to issue regulations that waive those restrictions for plan amendments that reduce or eliminate early retirement benefits or retirement-type subsidies that create significant burdens or complexities for the plan and plan participants, unless such amendments adversely affect the rights of any participant in a more than de minimis manner. The Secretary of the Treasury is further directed by EGTRRA to promulgate applicable regulations no later than December 31, 2003. In Notice 2002-46 and Notice 2003-10, the agencies invited comments and suggestions on how to proceed with respect to early retirement benefits, retirement-type subsidies and optional forms of benefit.
In this comment, individual members of the Employee Benefits Committee of the Section of Taxation of the American Bar Association respond to that request. This paper analyzes various issues related to the new statutory mandate. This paper also analyzes additional alternatives for improving the regulations under Code section 411(d)(6), including:

1. defining an “early retirement benefit” to mean any benefit that commences before normal retirement age, without regard to whether the benefit is subsidized and without regard to what optional forms are available before normal retirement age;

2. defining a “retirement-type subsidy” as any benefit that is more valuable than the actuarial equivalent of the benefit payable at normal retirement age;

3. redefining “optional form of benefit” to eliminate features such as the commencement date and medium of the distributions, preserving only the form of payment;

4. recommending that two or more amendments affecting early retirement benefits, retirement-type subsidies and optional forms of benefits within a single three-year period be aggregated to determine if their effect is more than de minimis;

5. recommending that, when two amendments affecting early retirement benefits, retirement-type subsidies and optional forms of benefits have more than a de minimis effect when aggregated but not when standing alone, the plan only be treated as being disqualified from the date of the second amendment;

6. recommending that, in valuing early retirement benefits and retirement-type subsidies, the actuary be required to consider all relevant factors including the probability or likelihood of a participant continuing to work in order to be eligible for the early retirement benefit or subsidy, the likelihood of the participant retiring at any specific age to take advantage of the early retirement benefit or subsidy, and the likelihood that the participant would elect to receive his benefit at the early retirement age rather than deferring commencement until a later date;

7. recommending that, even if an early retirement benefit does not have any associated subsidy, it still be treated as having value based upon the amount of benefits payable before normal retirement age discounted by the actuarial factors described in the preceding paragraph;

8. recommending that a plan sponsor be permitted to amend a plan to reduce or eliminate an early retirement benefit or retirement-type subsidy for any participant who will not be eligible for such early retirement benefit or retirement-type subsidy for at least 15 years;

9. recommending that, where the value of an early retirement benefit or subsidy is no more than 5% of the annualized compensation of the participant, it would be conclusively presumed to be de minimis;
10. recommending that, where such value is greater than 5% of annualized compensation, the plan be permitted to reduce the subsidy by an amount not in excess of the lesser of one-half the subsidy or 5% of annualized compensation;

11. recommending that, where an amendment is adopted in advance of the effective date of the proposed reduction or elimination and participants are given notice of the amendment in accordance with Code section 4980F:
   a. redundant unsubsidized optional forms of benefits may be modified or eliminated by plan amendment adopted at least one year prior to the date the amendment becomes effective;
   b. unsubsidized early retirement benefits may be modified or eliminated by plan amendment adopted at least five years prior to the date the amendment becomes effective;
   c. non-redundant unsubsidized optional forms of benefits, other than lump sums, may be modified or eliminated by plan amendment adopted at least ten years prior to the date the amendment becomes effective;
   d. subsidized optional forms of benefits may be modified or eliminated by plan amendment adopted at least ten years prior to the date the amendment becomes effective;
   e. subsidized early retirement benefits may be modified or eliminated by plan amendment adopted at least 15 years prior to the date the amendment becomes effective; and
   f. lump sum payments may be modified or eliminated by plan amendment adopted at least 15 years prior to the date the amendment becomes effective;

12. permitting elimination of optional forms where the present value of the participant’s affected benefit is immaterial in comparison to the participant’s annualized compensation;

13. permitting elimination of optional forms where the difference in the amount of the participant’s periodic benefit is relatively immaterial;

14. permitting elimination of optional forms at least a specified number of years before retirement age;

15. permitting the elimination of optional forms of benefit other than a set of “core” options consisting, for example, of a straight life annuity, 50% and 100% joint and survivor annuity, 10-year certain and life annuity (if the plan currently offers certain and life annuities), and a lump sum (if the plan currently offers a lump sum);
16. permitting a change in actuarial assumptions for calculating early retirement benefits and optional forms of benefits for participants where the change does not have an impact of 5% or more;

17. allowing the elimination of multiple versions of the same form of payment; and

18. allowing the elimination of an optional form of benefit where all participants consent to the elimination.

Each of the foregoing suggestions has merit, but no single suggestion will solve all the difficulties presented by the rules under Code section 411(d)(6). We encourage the Treasury and the Internal Revenue Service to consider and adopt each of the suggestions in total, so that plan sponsors will have a number of alternatives to utilize where appropriate.
Comments

II. Introduction

   Code section 411(d)(6) provides that the accrued benefit of a participant may not be decreased by plan amendment (with certain limited exceptions) and that “a plan amendment that has the effect of (i) eliminating or reducing an early retirement benefit or retirement-type subsidy or (ii) eliminating an optional form of benefit with respect to benefits attributable to service before the amendment will be treated as reducing accrued benefits.”\(^1\) In addition, prior to its amendment by EGTRRA, Code section 411(d)(6) provided Treasury with discretion to allow plan sponsors to amend plans to eliminate optional forms of benefits but not early retirement benefits or retirement-type subsidies.

   Regulations under Code section 411(d)(6) describe what constitutes an “optional form of benefit,” but they fail to define either an “early retirement benefit” or a “retirement-type subsidy.” The regulations prohibit almost all changes in optional forms of benefits under a defined benefit plan that is designed to meet the qualification requirements of Code section 401(a). In addition, the regulations establish a very expansive definition of “optional form of benefit.” In contrast, under Treasury Regulations and a statutory amendment, defined contribution plans can now eliminate all payment options except for lump sums and, in the case of money purchase plans, the qualified joint and survivor annuity ("QJSA").

   As explained at greater length in this paper, EGTRRA amended Code section 411(d)(6) to provide:

   The Secretary shall by regulations provide that [Code section 411(d)(6)] shall not apply to any plan amendment which reduces or eliminates benefits or subsidies which create significant burdens or complexities for the plan and plan participants, unless such amendment adversely affects the rights of any participant in a more than de minimis manner.\(^2\)

   It is our experience that the existing regulations under Code section 411(d)(6), as applied to defined benefit plans, impose significant administrative burdens on plan administrators and increase the complexity of plan administration and communications with plan participants. Further, the complexity of these regulations results in increased incidence of noncompliance and actually frustrates the policy of accumulating income for retirement.

III. Description of Problems Arising Under Current Regulations Under Code Section 411(d)(6).

   Before discussing the change in the regulations mandated by EGTRRA, it is appropriate to provide some background on why defined benefit plans have accumulated optional benefit forms, early retirement benefits and other retirement-type subsidies and discuss the significant

\(^1\) Code §411(d)(6)(A) and (B).
burdens and complexities resulting from the application of the current provisions of the Treasury regulations under Code section 411(d)(6).

A. Origin of Problems.

1. Defined Benefit Plans Have Reluctantly Accumulated Early Retirement Benefits and Optional Forms in Connection With Plan Mergers Resulting From Various Corporate Transactions or From Consolidation of Plans to Satisfy Various Nondiscrimination Rules.

Employers experienced a period of intense plan merger activity over the last two decades. This merger activity was a result of either corporate transactions or the need to satisfy various nondiscrimination requirements arising out of changes made by the Tax Reform Act of 1986 and various regulations promulgated thereunder, such as, for example, Code sections 401(a)(4), 401(a)(26) and 410(b). As a result of Code section 411(d)(6) and the regulations promulgated under that section, the surviving plans were required to preserve optional forms of benefit, early retirement benefits and other retirement-type subsidies of the pre-merger plans.

As discussed in other sections, the term “optional form of benefit” as currently defined in the regulations encompasses virtually all aspects of a distribution to a participant including, but not limited to, the time of commencement, the payment method and medium, and the actuarial assumptions used to compute the payment. Elsewhere we suggest that it would be appropriate to simplify the definition, at least in the context of applying it to defined benefit plans under the 411(d)(6) regulations, so that it focuses on the payment method. While that is the approach we recommend, in order to avoid confusion in the following discussion, we use the term “optional form of benefit” as it is currently defined and the term “payment method” to mean the distribution form (that is, the type of annuity, installment or single sum payment) and medium (cash or in-kind) in which the benefit is paid.

Simply protecting the payment methods in plan mergers can be complex. For example, one such plan was the result of the merger of four plans in 1988. The four plans each had different optional forms of benefits:

Plan A had six core payment methods (plus an unlimited number of other methods, subject to administrative discretion);

Plan B had five payment methods;

Plan C had eight payment methods; and

Plan D had six core payment methods (plus an unlimited number of other methods, subject to administrative discretion).

Of the payment forms in the plans, only four were common to all of the plans. In addition, all of the plans had different early or deferred vested retirement provisions:
Plan A provided for early retirement at age 55 with 10 years of service, with unreduced benefits at age 65, age 60 (in the event of job elimination), or as early as age 57 (for some grandfathered groups). It provided for deferred vested retirement payable at age 65 or, with 10 years of service, at age 55.

Plan B provided for early retirement at age 55 with 10 years of service, with unreduced benefits payable at age 65. It provided for deferred vested retirement payable at age 40 with 10 years of service.

Plan C provided for early retirement at age 55 with 10 years of service, with unreduced benefits payable at age 65. It provided for deferred vested retirement payable at age 55 with 10 years of service, but for some payment forms, benefits could commence at termination of employment.

Plan D provided for early retirement at age 55 regardless of years of service, with unreduced benefits at age 65. It provided for deferred vested retirement payable at age 55.

The early retirement reduction factors for each of the plans were different.

The consolidated plan provided for seven payment methods for all participants. In addition, it provided for one special payment method for the former participants in Plan B based upon such participants’ total accrued benefits. Supplements were attached to the Plan providing for special payment methods applicable to the participants in each of the predecessor plans for their benefit accrued as of the date of Plan merger as follows:

Plan A: one grandfathered payment method based upon the frozen accrued benefit;

Plan B: one special payment method based upon the entire accrued benefit;

Plan C: two grandfathered payment methods based upon the frozen accrued benefit; and

Plan D: no grandfathered payment methods.

With respect to early retirement benefits, the consolidated plan provided for early retirement at age 55 with 10 years of service. Unreduced benefits were made payable at age 62 with 10 years of service. In addition, the consolidated plan had to provide for special early retirement benefits and deferred vested retirement benefits for the former participants in each of the four plans.

The Plan was then merged with Plan E in 1992. At the time of the merger, Plan E had four payment methods, all of which were already included in the Plan. However, Plan E allowed for early retirement at age 55, regardless of length of service. Plan E also provided for commencement of the employee-funded portion of the benefit at any time after termination of employment prior to age 55. These features were preserved for the former participants in Plan E but not extended to the other Plan participants.
Finally, the Plan was merged with Plan F in 2002. Plan F had a total of five annuity payment methods available to all participants, plus a lump sum for some participants. Four of the annuity payment methods were identical to core options in the pre-merger Plan. However, each of the five annuity payment methods could also be elected on a Social Security adjustment basis and/or on the basis of converting into a full cash refund form if the beneficiary died prior the receipt of the original present value of the payment method. This means that any participant in Plan F who has even one month of accrued benefit will have to have 21 payment methods preserved until he or she retires. If a 21 year old participant works until age 65, all 21 options will have to be preserved for 44 years. Then, if the participant chooses the joint and survivor form of payment with the full cash refund feature, the final payment of benefits will not occur until the death of both the participant and his contingent annuitant – perhaps 30 or more years after the participant’s retirement – perhaps even longer if the contingent annuitant is a child or grandchild. Thus, even if the plan sponsor decided in 2002 to get rid of these unwanted options, it will take until 2076 or later for them to actually be eliminated from the plan.

As a result of all the plan mergers, the plan in 2002 contains seven core payment methods and in excess of 16 additional payment methods (plus, in many cases, special sets of conversion factors) which the plan administrator must administer for different groups of grandfathered participants. The plan has one set of early retirement and deferred vested retirement provisions that apply to all participants for their total accrued benefit but must also maintain in excess of six additional sets of special early retirement provisions for different groups of grandfathered participants. This requires that the plan have multiple sets of forms communicating early retirement elections and payment methods to different groups of participants, including multiple sets of forms explaining the economic effect of the payment methods. It also requires that there be multiple sets of election forms for the participant to elect the form of benefit payable and for the participant’s spouse to consent to the election.

2. Defined Benefit Plans Contain Many Optional Forms as a Result of The Insurance Contracts That Originally Funded Those Plans.

Many defined benefit plans originally were funded through group annuity contracts. Insurance companies had no reason to limit the number of optional forms of benefit that were available under the group annuity contracts and, perhaps, had incentives to “showcase” the various forms of annuity available from the particular company. These optional forms too often include a “cash refund” feature at termination of employment or death, numerous term certain options, and various combinations of single and joint life annuities and term certain options. While Treas. Reg. § 1.411(d)-4, Q&A 2(b)(2)(ii) permits sponsors to reduce the number of joint and survivor annuity options offered, there is no analogous authority for reducing the number of term-certain or joint and survivor/term-certain options. Similarly, there is no existing authority for completely eliminating the cash refund feature in a formerly contributory plan.

Many of these optional forms were simply incorporated without much thought to whether they were or eventually would become burdensome. Further, as long as the defined benefit plans were funded by the group annuity contracts, the insurance company generally would administer the plan distributions. Accordingly, the optional forms offered did not place any additional burden on the employer. Once the employer moves away from group annuity funding to other types of investments, however, the insurance company may no longer provide administrative
services to the plan. Finally, disclosure obligations were less onerous when many defined
benefit plans were implemented, so there was little need to limit optional forms on that basis.

For example, one such plan had been funded by an insurance company’s group annuity
contract which included 50% and 100% joint and survivor annuities. In addition, the contract
provided for 50% and 100% joint and survivor annuities with five, ten, 15 or 20 year certain
guaranteed terms. The funding of the plan has subsequently changed from a traditional group
annuity contract to a diversified portfolio of stocks, bonds and other investments held in trust.
However, the insurance company has left its mark on the plan for the next 70 years until the
death of both the last participant to elect the term - certain joint and survivor optional form of
benefit and his or her contingent annuitant.

Tax-exempt organizations, in particular, frequently used group annuity contracts to fund
their defined benefit plans. Those organizations typically have small staffs and operational
budgets. The multiplicity of optional forms complicates plan drafting, administration and
employee communications in organizations least able to bear the time and expense burdens
caused by these optional forms.

3. Plan Drafters Added Optional Forms and Early Retirement Subsidies
to Defined Benefit Plans in Response to Particular Business or
Participant Situations That May No Longer Be Relevant.

It may have made good business sense, for example, to offer a lump sum under a defined
benefit plan at a time prior to the adoption of Code section 417(e) (adding required interest rate
and, later, mortality factors for lump sums). Once offered, however, that lump sum would
remain a part of the defined plan into the future simply as a result of the enactment of §
411(d)(6), without any regard to business considerations.

4. Plan Sponsors Did Not Expect Code Section 411(d)(6) to be
Interpreted to Require Optional Forms and Early Retirement and
Retirement Type Subsidies to be Preserved Indefinitely, and They
Had Little or No Opportunity to Eliminate Undesirable Subsidies and
Optional Forms.

Regulations under Code section 411(d)(6) were originally proposed on January 30, 1986
(51 F.R. 3798), and finalized July 11, 1988 (53 F.R. 26050). Once the regulations were
finalized, existing plans were generally given until the 1989 plan year to conform to the
regulations. There was no opportunity to eliminate an optional form of benefit unless the
existing plan provision provided for employer discretion. Treas. Reg. § 1.411(d)-4, Q&A 9.
Moreover, the regulations prohibited the addition of employer discretion on or after January 30,
1986, except for a very limited window from January 30 to August 1, 1986. Accordingly, there
was no opportunity for employers to “clean up” their plans once the Code section 411(d)(6)
regulations were proposed.

Thus, plan sponsors which had added optional forms of benefits to their plans in the pre-
411(d)(6) environment under the understanding that they could be changed or eliminated were
locked into whatever optional forms of benefits existed at the time the 411(d)(6) regulations were proposed.

B. Increased Administrative Burden for Plan Sponsors and Plan Administrators.

1. Plan Sponsors Do Not Have Any Good Options to Get Rid of Unwanted Early Retirement Benefits and Optional Forms of Benefits.

If a plan sponsor has unwanted early retirement benefits and optional forms of benefits in its qualified defined benefit plan, it does not have any good options for eliminating them. Under the regulations, except for a limited right to eliminate certain joint and survivor annuity forms of payment, the plan sponsor must, at a minimum, preserve the plan feature for all participants for the benefits which have been accrued prior to the amendment to the plan to freeze the feature. Freezing a plan feature based upon benefits accrued to the date of the amendment has a different effect depending upon whether the feature is a retirement-type subsidy or whether it is an early retirement benefit or optional form of benefit. If the feature is a retirement-type subsidy and the portion of the accrued benefit to which it applies is frozen, future accruals under the plan will “wear away” against the retirement-type subsidy and in a relatively few years the retirement-type subsidy may have been fully worn away by subsequent accruals. For example, suppose Plan A has an unreduced benefit payable at age 62 and it is merged into Plan B which has an unreduced benefit payable at age 65. The unreduced benefit at age 62 can be frozen with respect to the accrued benefits of the participants in Plan A on the date of merger. Over a few years, as the former participants in Plan A accrue additional benefits under the merged Plan, reduced benefits at age 62 will eventually exceed the value of the unreduced frozen accrued benefit. Thus, in relatively short order (four or five years), the retirement-type subsidy will be worn away and no longer affect plan administration and communications.

In contrast, a frozen early retirement benefit continues until the last participant who has a right to the frozen early retirement benefit satisfies the generally applicable early retirement conditions. For example, suppose Plan A which allows participants to retire at age 50 with 15 years of service is merged into Plan B which allows participants to retire at age 55 with ten years of service. Suppose further that the former participants in Plan A are given the right to receive their benefits at age 50 with 15 years of service. For a 21 year old with only one year of service, this right must be preserved until he reaches age 55 or, if the participant dies with a surviving spouse, the date the participant would have reached age 55. Thus, it may take 34 years for the early retirement benefit to be erased.

The ultimate problem occurs with respect to optional forms of benefits. Optional forms must be preserved until the participant elects a different form of payment or until the end of the payment period under the optional form of benefits. Thus, it may take 70 to 80 years to eliminate a full cash refund contingent annuitant option form. Earlier elimination may be possible if the plan sponsor freezes the portion of the accrued benefit to which the option will apply rather than freezing the group of participants who will receive the option. By freezing the accrued benefit, the plan sponsor decreases the chance that a participant will actually select the option because payment of the participant’s benefits will be made in two different forms. However, assuming that no participant ever selects the option, the plan sponsor still has to
provide information about the optional form of payment and payment amounts for 40 to 50 years until the last person in the frozen group of participants commences benefits and rejects the grandfathered option. Thus, neither freezing the group of participants to which the option applies nor freezing the portion of the accrued benefit to which it applies is a good option for the plan sponsor.

2. **Plan Sponsors and Administrators Expend Substantial Additional Time and Money to Explain and Calculate Amounts Payable Under Multiple Early Retirement Benefits, Subsidies and Optional Forms.**

Many “grandfathered” early retirement benefits, subsidies or optional forms of benefit are often available only to a limited group of participants or for a limited portion of the accrued benefit. The combination of the nonstandard early retirement benefits, subsidies or optional forms and restricted availability makes it burdensome to process the early retirement benefit, subsidy or optional form under the plan sponsor’s normal administrative regime. Depending on the history of the plan, the number of plan mergers and the frozen early retirement benefits, subsidies and optional forms, there may be a large number of different groups of participants who have to receive special forms, extra calculations and special treatment. Each request must often be separately processed by the administrator and screened to see if a grandfathered feature applies to the participant, thereby increasing the cost of administering the plan and the incidence of error.

The regulations under Code section 411(d)(6) increase the time required to administer a defined benefit plan. For example, preserving early retirement benefits, retirement-type subsidies and optional benefits forms requires the plan administrator to spend more time creating forms and other participant communications, calculating benefits, and explaining options to participants. A separate summary plan description or supplement to the summary plan description must be provided to each group of participants who has a different set of early retirement benefits, retirement-type subsidies or optional forms of benefit payments. The additional time is particularly noticeable in the case of plans where very few participants elect the grandfathered optional form of benefit.

Administering a defined benefit plan, which is a complex process in any event, is made even more complicated by the preservation of unwanted and rarely utilized optional forms of benefits. For every possible subsidy and additional optional form of benefit, a different calculation or set of calculations must be made in order to process a participant’s request for benefits. Much attention has been paid in the press to the sharp decline in the rate of adoption of new defined benefit plans. Surveys by the Bureau of Labor Statistics of the U.S. Department of Labor indicate that only about five to eight percent of small employers (with no more than 100 employees) maintain defined benefit plans. Therefore, almost all defined benefit plans are maintained by medium or large sized employers and have been in existence for a number of years. The complexity of maintaining defined benefit plan contributes to the reluctance of employers to adopt them.

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We are not aware of any studies that record the burden imposed upon a sponsor of a
defined benefit plan to process a termination of employment or retirement. However, anecdotal
information that we receive from plan administrators indicates that the process is far too
burdensome. One plan administrator estimated that it takes about four hours to prepare the
paperwork and calculations for each terminated employee or retiree. This process is then
followed by meetings with the participant in order to try to explain the calculations and the
available distribution options. In an extreme situation, where a plan sponsor had been through
several acquisitions and the mergers of several plans, the plan administrator spent 40 hours
preparing the distribution forms for a single participant. Much of that time was spent trying to
document the information as to the formulas for prior plan benefits, including early retirement
subsidies, and the optional forms of benefits under the grandfathered plans rather than merely
calculating the amounts payable.

For example, one large plan sponsor has recently combined all of the defined benefit
plans for one of its divisions into a single plan (for ease of administration). The new single plan
is a combination of at least 15 different plans acquired over the years in various mergers and
acquisitions. The supplement to the summary plan description describing the various
grandfathered accrued benefits, early retirement benefits, retirement-type subsidies and optional
forms of benefit is 22 pages long, each single spaced with two columns per page. The plan has
at least four different grandfathered early retirement subsidies, each applying to a portion of the
benefit, and at least three different early retirement ages. The plan offers six optional forms to
all participants and has at least 40 grandfathered optional forms for at least nine different
populations of participants.

3. Plan Sponsors Need Additional Systems to Track Early Retirement
   Benefits, Subsidies and Optional Forms.

   One approach to minimizing the administrative burden of tracking early retirement
   benefits, retirement-type subsidies and optional forms of benefits is for the plan sponsor or
   administrator to develop computer or other administrative systems that will identify the
   participants covered by each type of early retirement benefit, retirement-type subsidy and
   optional form of benefits and automatically calculate the amounts of each subsidy or optional
   form when the participant terminates employment or retires. This approach has an extremely
   large up-front cost and, typically, only the largest employers (or largest plans) can justify the cost
   of automating all calculations. A small or medium-sized employer’s plan could have just as
   many early retirement benefits, retirement-type subsidies and optional forms of benefits as a
   large employer plan, but the smaller employer is less likely to be able to justify the cost of such a
   system.

   Another approach is to subscribe through vendors to highly automated systems or to
   outsource plan administration. A plan sponsor desiring to utilize the administrative services of a
   particular vendor must carefully review the vendor’s system to be certain that all early retirement
   benefits, retirement-type subsidies and optional forms of benefits available under the sponsor’s
   plan also can be administered under the vendor’s system. The vendors of such administrative
   systems are generally reluctant to handle special early retirement benefits, retirement-type
   subsidies and optional forms of benefits (even for large employers) since to do so will require
much more individualized administration or manual administration than is contemplated by, or cost-effective for, the vendor.

The cost of customizing an administrative system to accommodate the availability of nonstandard early retirement benefits, retirement-type subsidies and optional forms of benefits that are utilized infrequently may often exceed the perceived or actual legal risks in ignoring such features, thus encouraging noncompliance.

4. **Many Optional Benefit Forms Are Never Selected by Participants.**

When the number of optional forms of benefits increases beyond four or five, it becomes more difficult to communicate the options to the participant and more difficult for the participant to understand. There is a great tendency on the part of participants to focus on the most common forms of payment, the life annuity, the joint and survivor annuity and the ten-year certain life annuity form of payment. Very few participants ever elect the more exotic forms of payment, such as the joint and survivor annuity with a full cash refund or a term certain feature. In addition, relatively few participants elect the Social Security adjustment option form of payment because the plan’s payment frequently is reduced to zero when the participant reaches age 65. We are in the process of trying to locate statistics on the utilization of various types of optional forms of benefits because it will be very helpful in developing the core options as proposed below. Up to now, we have not been successful in finding any such statistics.

The non-utilization of optional forms of benefits becomes exacerbated when the defined benefit plan contains a single lump sum payment option. In such a plan, it is our experience that most participants take the lump sum option, and only a minority take annuity forms of payment. We are trying to develop more concrete numbers on this but have not been successful in getting useful information in the period of time available. We did obtain information from the sponsor of one cash balance plan that, out of 11,000 retirees and terminated participants over the last 12 years, no participant elected an annuity form of benefit. While this might be true for cash balance plans, we expect that traditional defined benefit pension plans have some participants electing an annuity form of payment, albeit a minority of the retiring participants.

C. **Increased Complexity for Participants.**

The communication of plan benefits to participants is a fiduciary duty that plan administrators take very seriously. The interplay between this fiduciary duty and Code section 411(d)(6) presents difficult communication issues for the plan administrator of a defined benefit plan. In preparing the forms to process a benefit election by a retired or terminated plan participant in a plan which has grandfathered subsidies or benefit options for certain plan participants, the plan administrator must make several decisions on how it will structure the forms. The first decision is whether to have a single form containing all the information, alternatives and options that might be applicable to any participant in the plan or to tailor the forms to describe only the information, alternatives and options applicable to the particular participant. If the plan administrator chooses to have multiple forms, it will have the added expense of creating the multiple forms as well as the administrative burden of making sure that each participant receives the correct form. If, instead, the plan administrator opts to use a single distribution form, participants who are not eligible for a particular early retirement benefit,
retirement-type subsidy or optional form of benefit will have to disregard the information that relates to that early retirement benefit, retirement-type subsidy and optional forms of benefit and likely will be confused about why those early retirement benefit, retirement-type subsidy and optional forms of benefit are available to others.

For example, suppose that an employer has two divisions – Divisions A and B. Only employees of Division A are entitled to a ten-year certain and life annuity form of payment. Under the single form approach, the distribution form given to employees of Division B would contain a description of the ten-year certain and life annuity form of payment but would contain text stating that the form is available only to employees of Division A. The difficulty with this single form approach is that employees of Division B are given a lot of confusing information that is not applicable to them.

The multiple form approach is not much better. In this example, there would be two different forms - one for Division A and one for Division B. The advantage of this approach is that the employee of Division B gets only the information that is relevant to him or her. The difficulty with this approach is that the plan administrator must create and maintain multiple forms. In addition, it becomes a challenge for the plan administrator to provide the correct form to a terminated or retired participant. Not only is the preparation of these documents burdensome on the plan administrator, but a participant can be genuinely confused by the complexities contained in the content and instructions on the forms, as well as the number of documents that need to be completed. The problem is exacerbated if employees regularly transfer between Divisions A and B.

For example, one plan administrator who utilizes the multiple form approach provides each retiring or terminating participant with forms that describe only those options appropriate for the participant. There are 25 groups of participants entitled to receive different optional forms of benefits, resulting in 25 distribution forms ranging from five to 16 pages in length. The administrative manual contains over 195 pages of distribution forms.

The complexity for plan participants becomes even more acute when, because of the non-discrimination rules contained in Treas. Reg. § 1.401(a)(4)-4, an early retirement benefit, retirement-type subsidy and optional form of benefits is preserved for a portion of the participant’s benefit - that is, the portion of the benefit which was accrued prior to the date that the early retirement benefit, retirement-type subsidy and optional form of benefits were frozen. When this occurs, the participant will have different early retirement benefits, retirement-type subsidies and optional forms of benefits applicable to different portions of his or her benefit. This becomes a communication nightmare. The plan administrator must choose between having different forms for each portion of the participant’s accrued benefit and having a single form with different early retirement benefits, retirement-type subsidies and optional forms of benefits for different portions of the accrued benefit. There are no simple ways to handle the forms for a participant who has different options for different portions of his or her accrued benefit.

Finally, more and more plan sponsors are attempting to provide benefit calculation opportunities to participants via the internet or the plan sponsor’s intranet to permit retirement modeling. The existence of non-standardized early retirement benefits, retirement-type subsidies and optional forms of benefits makes it difficult, if not impossible, to provide complete
information to a participant electronically and requires additional non-electronic communications for those individuals who are eligible for the non-standardized early retirement benefits, retirement-type subsidies and optional forms of benefits.

D. Increased Incidence of Noncompliance.

1. Subsidies and Optional Forms are Difficult to Identify and Create a Trap for the Unwary.

There is no definition of “early retirement benefit” or “retirement type subsidy” under the Code or ERISA. Further, the breadth of the definition of “optional form of benefit” in the current regulations is counterintuitive. When asked about optional forms, most employers think of the basic distribution forms - lump sums, installments and annuities. Few employers would further break down an optional form of benefit with respect to other features, such as timing and election rights with respect to optional forms. Thus, many employers and plan administrators simply fail to identify subsidies or optional forms of benefit and therefore fail to preserve them.

Anecdotal evidence confirms that large employers with individually designed plans have problems identifying subsidies and optional forms. We assume that small employers experience even greater difficulty in identifying subsidies and optional forms and therefore complying with these rules since they are less likely to have experienced ERISA counsel to assist them.

2. Subsidies and Optional Forms Often are Lost in Plan Amendments.

Subsidies and optional forms tend to be “lost” when plans are amended. This is particularly true when the amendment is made by adopting a “form” plan (e.g., a prototype, volume submitter or specimen plan) because such plans do not always provide specific language for each of the optional forms of benefits available under the prior plan document. Form plans are attractive because they reduce retirement plan complexity through uniformity and provide broader access to retirement plans by providing cost and administrative efficiencies through economies of scale. However, form plans are unable to provide for every conceivable optional form of benefit.

When an employer amends its plan by adopting a prototype plan, the primary motivating factor is typically to obtain access to the prototype sponsor’s investment and administrative services. The adoption of the new prototype plan document often is a secondary by-product of the transaction, and scant attention is paid to it. Since such amendments may be sold to the client by a sales person and adopted without advice of counsel, the employer may not be aware that optional forms of benefit have to be preserved. Often the employer is not even provided with a complete set of plan documents until after the adoption agreement has been completed and may not even know that the benefit options have been changed.

Although prototypes usually contain boilerplate language that preserves the optional forms of benefit made available under the previous document, the terms of the optional forms required to be preserved may be lost in operation or in future restatements if they are not specifically stated in the employer’s adoption agreement. Typically, the prototype sponsor’s election forms and descriptions of optional forms contemplate only the optional forms specifically provided in that sponsor’s prototype and do not require or provide adequate space to
describe prior plan options. Unless the prior optional forms are described in the amended plan or adoption agreement, they may get overlooked, and any record of the prior optional forms may be lost over time as prior plan documents are lost or discarded. Therefore, the preservation of an optional form not specifically described in the current prototype plan generally requires that the employer understand that the optional form must be preserved, and that the employer develop its own administrative practices, forms and notices incorporating such optional forms.

Another typical method of “grandfathering” in individually designed plans is to attach the prior plan documents or portions of those documents as appendices to the restated plan. Over time, appendices may be lost or misplaced, eliminating documentation of the grandfathered subsidies or options.

E. Plan Mergers.

1. Interplay Between Code Sections 411(d)(6) and 401(a)(4).

The prohibition against the elimination of early retirement benefits, retirement-type subsidies and optional forms of benefits contained in Code section 411(d)(6) always adversely impacts the ability of an employer to remove early retirement benefits, retirement-type subsidies and optional forms of benefits that the employer does not wish to retain. The adverse impact of Code section 411(d)(6) is particularly significant in the context of plan mergers resulting from business acquisitions followed by the combination of the target company’s plan with that of the acquiring entity.

In the context of a plan merger, Code section 401(a)(4) and Treas. Reg. § 1.401(a)(4)-4 require that any early retirement benefits, retirement-type subsidies and optional forms of benefits made available to any participants in a merged plan must be tested for nondiscriminatory availability. Essentially, this means that any early retirement benefit, retirement-type subsidy and optional form of benefits must be made currently available to a group that satisfies Code section 410(b), without regard to the average benefits test of Treas. Reg. § 1.410(b)-5, and must also be effectively available on a basis that does not substantially favor highly compensated employees. This nondiscrimination rule, coupled with § 411(d)(6)’s prohibition on the elimination of any early retirement benefit, retirement-type subsidy and optional form of benefits creates enormous problems. The interplay between Code section 411(d)(6) and Code section 401(a)(4) generally requires the plan sponsor in a plan merger situation to take one of three basic courses of action.

One approach is to offer all previously existing early retirement benefits, retirement-type subsidies and optional forms of benefits to all participants in the merged plan. This alternative does not require individual nondiscrimination testing with respect to any particular benefit, but does require the plan sponsor to continue all previously existing early retirement benefits, retirement-type subsidies and optional forms of benefits, resulting in a proliferation of subsidies and optional forms of benefits under the plan, additional complexity in the administration of the plan, and confusion for participants.

A second approach is to limit the previously available early retirement benefits, retirement-type subsidies and optional forms of benefits under the pre-merger plan to the portion
of each pre-merger plan participant’s benefit accrued as of the date of the plan merger or amendment. Under the Code section 401(a)(4) nondiscrimination rules, if a plan is amended to eliminate an early retirement benefit, retirement-type subsidy or optional form of benefit with respect to benefits accrued after the amendment is adopted, the early retirement benefit, retirement-type subsidy or optional form of benefit will be deemed to satisfy Code section 401(a)(4) for all subsequent periods if it satisfied the current and effective availability requirements of Treas. Reg. § 1.401(a)(4)-4 as of the date it is curtailed. See Treas. Reg. § 1.401(a)(4)-4(b)(3). Thus, continued nondiscrimination testing could be avoided under this alternative. This alternative also has the possible advantage of allowing a retirement-type subsidy to eventually “wear away” as the pre-merger plan participant group accrues additional benefits or gradually retires or terminates employment. However, it can be quite difficult to administer a program that offers participants one set of optional forms for a portion of their accrued benefit and another set of optional forms for the remainder of their accrued benefit. Not only does this make communication with participants difficult, but it also carries with it a considerable risk of confusion on the part of plan participants and administrative personnel. Indeed, as noted earlier, the use of the split benefit alternative will also tend to discourage the use of the preserved subsidies and optional forms that Code section 411(d)(6) is designed to protect because a participant is unlikely to elect to receive his or her accrued benefit in two or more different forms. Finally, from a business perspective, this approach tends to perpetuate distinctions in the workforce, which is counterproductive to the acquiring entity’s efforts at workforce integration following a business merger or acquisition.

A third approach is to preserve the previously existing subsidies and optional forms only for the group of pre-merger plan participants to whom they were available as of the date of the plan amendment, but make the subsidies and optional forms applicable to each such participant’s entire accrued benefit. This alternative is easier to administer and communicate to participants because it does not involve splitting the participant’s benefit. If the change is made in connection with a business merger or acquisition and is preserved only with respect to a closed group of participants whose benefits are transferred to the acquiring entity’s plan, then the nondiscrimination rules of Code section 401(a)(4) will be deemed satisfied with respect to the employee group if they are satisfied as of the time the group is closed. In all other circumstances, however, the plan would be required to test the current and effective availability of the benefit on a continuing basis if it is made available to a select group of employees. Over time there is a substantial danger, if not a virtual certainty, that such a group would become more highly compensated and thus less likely to satisfy the nondiscrimination rules on a continuing basis. Additionally, like the second approach, this approach perpetuates distinctions in the workforce.

2. Impact of Code Sections 401(a)(4), 401(a)(26) and 410(b).

The coverage and nondiscrimination rules sometimes make it difficult to maintain a separate plan for an isolated group of employees. For example, suppose that Division A and Division B both maintain defined benefit plans with different benefits, rights and features and optional forms of payments. Suppose that Division A has 65 employees who are all covered by one of the defined benefit plans. Suppose further that Division A’s 40 hourly paid employees become unionized and become covered by a multiemployer plan. Division A’s plan will now cover the remaining 25 salaried employees. Suppose that Division B’s hourly workforce is non-
union and Division B’s plan covers 25 salaried and 40 hourly employees. Suppose further that Division A and Division B each has five highly compensated employees. That is, the workforces of Division A and Division B are identical except that Division A is now unionized and Division B is not.

In this scenario, Division A’s plan will no longer comply with Code section 401(a)(26) because it covers only 25 out of 90 nonunion employees (28%). In addition, Division A’s plan will not meet the ratio percentage test of Code section 410(b)(1) since it only covers 28% of the nonunion employees. Finally, Division A’s plan will meet the nondiscrimination rules only if the two plans together satisfy the average benefit percentage test of Code section 410(b)(2).

Because Division A’s plan fails to satisfy Code section 401(a)(26), subsequent to the transfer of coverage of the union employees to the multiemployer plan, it will have to be terminated or merged into Division B’s plan. Assuming that Division A’s plan is, in fact, merged into Division B’s plan, then the benefits, rights and features of the two plans will have to be integrated in a manner that meets the requirements of Treas. Reg. §1.401(a)(4)-4. This process is not limited to methods of payment of benefits, but also includes the provisions of the two plans relating to subsidies and the time for payment of benefits.

The integration of the benefits, rights and features of the two plans becomes very complicated. For example, if Division A’s plan has a 20-year certain and life annuity option and Division B’s plan does not, and if Division B’s management does not want to add a 20-year certain and life annuity option for its employees, then it will be necessary to grandfather the 20-year certain and life annuity option for the participants who were covered by Division A’s plan for benefits accrued prior to the merger. Treas. Reg. § 1.401(a)(4)-4(b)(3) would not allow the former participants in Division A’s plan to continue to accrue benefits under the 20-year certain and life annuity option, as it is only a matter of time until the grandfathered group of Division A’s Plan participants becomes discriminatory. (In any frozen group of participants, the persons who do not terminate employment become older and higher paid so that the group tends to become discriminatory over time.) As a result, sooner or later, the 20-year certain and life annuity option will have to be curtailed with respect to benefits accruing after a certain date or expanded to Division B in order to satisfy Code section 401(a)(4).

Once the optional form is grandfathered on a split basis, the administrator will need to (1) establish a special procedure to determine what portion of the benefit may be paid in the 20-year certain and life option, (2) design, produce and maintain separate forms for processing those participants’ retirement benefits, (3) screen applicants for benefits to determine if they are eligible for the 20-year certain and life benefit, and (4) compute the amount of the benefit payable as a 20-year certain and life annuity.

3. **Timing of Distributions.**

The timing rules set forth in Treas. Reg. 1.411(d)-4, can create problems when combining plans or making design changes to existing plans. The regulations provide an exception for a *de minimis* change in the timing of benefit payments as long as the change in the date of payment does not exceed two months (six months if the payment is made prior to termination of employment or retirement). Treas. Reg. § 1.411(d)-4, Q&A 2(b)(2)(ix). This timing rule makes
it cumbersome to integrate plans that have different early retirement dates where the earliest
early retirement dates are more than two months apart. For example, if Plan A has an early
retirement provision that allows participants to retire at age 50 with 15 years of service and Plan
B has an early retirement provision that allows participants to retire at age 55 with ten years of
service, it will not be possible to apply one early retirement age to all participants in the merged
plan. For example, if the merged plan will allow early retirement at age 55 with ten years of
service, the age 50 and 15 years of service requirements of Plan A will have to be grandfathered
for the participants in Plan A for the benefits which accrued prior to the merger date. If Plan A
and Plan B are being merged because of a corporate acquisition or merger, then pursuant to
Treas. Reg. § 1.401(a)(4)-4(d)(1) the grandfathering can relate to benefits accrued after the
merger date. For one client who has engaged in a number of acquisitions and mergers, the vast
majority of the grandfathering provisions in its defined benefit plan relate to preserving prior
plan provisions relating to eligibility for payment of benefits and early retirement reduction
factors that do not mesh with the acquiring company’s existing plan provisions. This is also true
for the merger of plans with different normal retirement ages – there is no way to consolidate
them, or wear them away.

F. Plan Terminations

Special considerations arise when a defined benefit plan is terminated in a standard
termination in which all accrued benefits are paid out to employees, either as lump sums or in the
form of non-transferable individual annuity contracts purchased from third-party insurers. In a
plan termination situation, the current rules under Code section 411(d)(6) may prevent the
efficient liquidation of the plan or result in acceptance of a less attractive insurance company’s
bid to annuitize benefits. In the standard termination situation, the sponsor of a single employer
plan solicits bids from third-party insurers to annuitize all of the preserved early retirement
benefits, retirement-type subsidies and optional forms of benefits under the plan. The bid must
require the insurer to provide all of the elections available under the ongoing plan as part of the
annuity contracts distributed to participants. For example, if the plan provides for a life annuity
with a term certain of five, ten, 15 or 20 years available commencing in any year following
termination of employment or retirement until the “required beginning date,” the bid must
require that the insurer make each of these options available. In a plan which is itself the product
of prior plan mergers, there may be a large number of annuity options with differences hardly
noted by or insignificant to employees which must all be preserved on termination under the
current Code section 411(d)(6) rules. Some insurers with the best financial ratings may not
provide or wish to provide all of these preserved options, and so may not provide a bid, limiting
the available choices to insurers with lower financial ratings. Indeed, some optional forms may
be so old that no insurer in the current market will want to make a commitment to provide them.
For example, we are aware of a plan that provided grandfathered annuities with fixed cost-of-
living increases not tied to a formula based on a current cost-of-living index. The plan sponsor
had been self-funding this annuity in part. In evaluating whether the plan could be terminated in
a standard termination, the sponsor discovered that there appeared to be no insurer willing to
annuitize this benefit. It was not clear how the sponsor could have terminated this plan under the
current rules if it had decided to go ahead.
IV. Scope of EGTRRA.

A. Relevant EGTRRA Provisions

For 16 years prior to the enactment of EGTRRA, Code section 411(d)(6)(B) provided that a plan amendment which has the effect of (i) “eliminating or reducing an early retirement benefit or a retirement-type subsidy . . . or (ii) eliminating an optional form of benefit” shall fall within the protections afforded by Code section 411(d)(6). Further, the Code provided that “[t]he Secretary may by regulations provide that this subparagraph shall not apply to a plan amendment described in clause (ii) an optional form of benefit (other than a plan amendment having an effect described in clause (i) eliminating or reducing an early retirement benefit or retirement-type subsidy,” (emphasis added). Therefore Treasury was given the authority to eliminate “optional forms of benefit” provided any such optional form of benefit did not constitute an early retirement benefit or retirement-type subsidy.

EGTRRA amended Code section 411(d)(6)(B) to provide that “[t]he Secretary shall by regulations provide that this subparagraph shall not apply to any amendment which reduces or eliminates benefits or subsidies which create significant burdens or complexities for the plan and plan participants, unless such amendment adversely affects the rights of any participant in a more than a de minimis manner,” (emphasis added).

The Code section 411(d)(6) provisions contained in EGTRRA are significant because they (i) contain a mandate for Treasury to promulgate regulations changing the Code section 411(d)(6) rules (as opposed to the permissible nature of the prior provisions), (ii) now specify that both benefits and subsidies (which presumably include early retirement benefits and retirement-type subsidies) are to be included in the relief granted by Treasury, and (iii) provide some clarity as to the standard by which Treasury will change the treatment for benefits and subsidies.

In Notice 2002-46, the IRS acknowledged that the scope of its regulatory guidance includes the permissible elimination of defined benefit plan “optional forms of benefit (including early retirement benefits and retirement-type subsidies).” However, the IRS suggested in Notice 2002-46 that the standard provided under EGTRRA for relief (i.e., a feature which creates significant burdens or complexities for the plan and plan participants, the elimination of which does not adversely affect the rights of any participant in a more than a de minimis manner) is the appropriate standard when considering whether any optional form of benefit may be eliminated. The plain language of the Code, however, clearly states that “benefits and subsidies” alone are subject to the enumerated standard, not all optional forms of benefit. Pre-EGTRRA law already provides that optional forms of benefit (which do not constitute early retirement benefits or retirement-type subsidies) can be eliminated through regulatory guidance without meeting the standard enumerated in EGTRRA.

B. Proposed Definition of Terms.

1. Early Retirement Benefit.

The Retirement Equity Act of 1984 amended Code section 411(d)(6) to provide that an amendment that has the effect of eliminating or reducing an “early retirement benefit” is treated
as an amendment that decreases the accrued benefit. Neither Code section 411(d)(6) nor Treasury Regulations define “early retirement benefit.” The absence of a definition creates uncertainty for employers, plan participants and practitioners. EGTRRA mandates the issuance of regulations providing an exception for those amendments that reduce or eliminate early retirement benefits that create significant burdens or complexities and do not adversely affect the rights of participants in more than a de minimis manner. The EGTRRA regulations should define “early retirement benefit.” There are at least three alternative definitions that come to mind.

a. **An “Early Retirement Benefit” is the Right to Receive Any Benefit Identified as an Early Retirement Benefit in the Plan Document.**

Most defined benefit plans do label certain benefits as “early retirement benefits.” One alternative is to define “early retirement benefit” for purposes of Code section 411(d)(6) as the right to receive a benefit identified as an early retirement benefit under the terms of the plan. Such a definition would be simple and easily understood. If the plan calls a benefit an early retirement benefit, it is one and has the full protection of Code section 411(d)(6). A simple definition promotes certainty and facilitates compliance and enforcement.

On the other hand, such a definition would be subjective, depending on plan terms, and its meaning would be different for each plan. There is no requirement that a plan define “early retirement benefit,” and employers could by-pass the protections of Code section 411(d)(6) by simply failing to designate a benefit as an “early retirement benefit.” This would be a glaring loophole which would allow abuses.

b. **An “Early Retirement Benefit” is the Right to Receive a Benefit That Commences Before Normal Retirement Age.**

Another alternative is to focus solely on the timing of the benefit payment. Any benefit that is payable before normal retirement age (as defined in Code section 411(a)(8)) could be defined as an early retirement benefit. Such a definition would be broad enough to pick up benefits traditionally defined in the plan as “early retirement benefits” as well as vested termination benefits that may commence before normal retirement age.

Such a definition also is simple and easily understood. It is intuitive and would be the same for every plan. It incorporates the concept of “normal retirement age,” which is defined in Code section 411(a)(8). An employer could not bypass the protections of Code section 411(d)(6) with clever drafting. This definition protects both subsidized and unsubsidized benefits.

Another advantage of focusing the definition on just the timing of the benefit payment is that the definition will apply equally to subsidized and non-subsidized benefits alike. There would be, for this purpose, no distinction between the vested termination benefit that may be paid early, but is the actuarial equivalent of the normal retirement benefit, and the true subsidized early retirement benefit.

The early retirement benefits described in many defined benefit plans contain a subsidy to reward long service with the employer. In using the term “early retirement benefit,” Congress
may have been referring to the more valuable subsidized early retirement benefit and might not have intended to include vested termination benefits. However, such benefits are best handled definitionally by including them as a “retirement-type subsidy.” Thus, under this option, the timing of the payment will determine if the benefit is an “early retirement benefit” and, if there is a subsidy, it will also be treated as involving a “retirement-type subsidy.”

c. **An “Early Retirement Benefit” is the Right to Receive Any Benefit That Commences Before Normal Retirement Age and the Normal Form of Which is More Valuable (Determined at the Early Retirement Benefit Commencement Date) Than the Actuarial Equivalent of the Normal Form of the Benefit Commencing as of the Same Date.**

A third option is to define “early retirement benefit” as any subsidized benefit commencing before normal retirement age. The basis for determining whether a benefit is subsidized should be the factors for actuarial equivalence as set forth in the plan document, as long as those factors are reasonable. Thus, where all benefits are reduced for early commencement by the same factors, there is no subsidy. But where some benefits are reduced by a more favorable set of factors (for example, early retirement versus vested terminated benefits), the early retirement benefit would be “subsidized.”

Such a definition would be the same for every plan. It incorporates the general concept of early retirement benefits as subsidized benefits taking in the possibility that Congress was intending to refer to just subsidized early retirement benefits. Most importantly, it singles out a benefit which is worthy of being protected since it involves a subsidy.

On the negative side, this definition is not as simple as alternative b. because it requires an analysis of whether the benefit is subsidized. A definition that protects only subsidized benefits is too narrow and leaves early commencement of vested termination benefits unprotected. Additionally, such a definition is somewhat redundant as any subsidy is separately protected as a “retirement-type subsidy.” (See part IV.B.3. below. If Congress had meant to limit protection to subsidized early retirement benefits, it could have easily done so. In fact, since retirement-type subsidies are also protected, it is clear that an “early retirement benefit” need not be subsidized.

d. **Recommendation: Alternative b.**

“Early retirement benefit” should be defined in a manner that does not overlap with a “retirement-type subsidy.” We recommend that Treasury define “early retirement benefit” to mean any benefit that commences before normal retirement age (as defined in Code section 411(a)(8)) without regard to whether the benefit is subsidized.

2. **Scope of “Early Retirement Benefit”**

There is a further question as to the scope of a protected “early retirement benefit.” There are two distinct possibilities.
a. “Early Retirement Benefit” is Each and Every Type of Benefit Payable Prior to Normal Retirement Age.

One possibility is that the term “early retirement benefit” refers to each and every type of benefit payable prior to normal retirement age. Under this approach, every variation in the amount payable under every optional form of benefit would be a separate “early retirement benefit.” In addition, every subsidy in the amount payable would also constitute a separate “early retirement benefit.” The advantage of this approach is that it most closely reflects the natural meaning of the term. If the participant can get a life annuity at age 55, that is an “early retirement benefit.” Similarly, if the participant can get a lump sum at age 55, common parlance would also call the lump sum an “early retirement benefit.” However, such an interpretation would subsume into the definition of “early retirement benefit” every optional form of benefit payable prior to normal retirement age and every retirement-type subsidy which is payable prior to normal retirement age, and would be inconsistent with actions already taken by Treasury under the current regulations which allow plans to eliminate certain joint and survivor forms without regard to when those forms commence. Under such an interpretation, the Treasury regulations could only have allowed plan sponsors to eliminate the specified joint and survivor forms for participants at or beyond their normal retirement ages but not for participants who commence benefits prior to their normal retirement ages.

b. “Early Retirement Benefit” is Simply the Right to Receive a Benefit at a Specified Age Which is Prior to the Normal Retirement Age Under the Plan.

The other possibility is to define “early retirement benefit” simply as the right to receive a benefit at a specified age which is prior to the normal retirement age under the Plan. As long as the participant can still receive a benefit at the specified age even though the certain joint and survivor benefits and perhaps other optional forms of benefits have been eliminated, the “early retirement benefit” has not been reduced or eliminated. Thus, under this approach, an “early retirement benefit” is defined solely with respect to the timing of benefits and without regard to subsidies and optional forms of benefits, both of which are separately protected by Code section 411(d)(6).


We think the better approach is to define “early retirement benefit” solely with reference to the timing of the commencement of the benefit payment, which is our alternative b.

3. Retirement-Type Subsidy.

The definition of a “retirement-type subsidy,” within the meaning of Code section 411(d)(6)(B), is necessary to determine what, if any, retirement-type subsidies could be eliminated under the new authority in Code section 411(d)(6), as amended by EGTRRA.
a. **Any Benefit That is More Valuable Than the Actuarial Equivalent of the Benefit Payable At Normal Retirement Age Would be a “Retirement-Type Subsidy.”**

Revenue Ruling 85-6 provides a simple example: The right of a participant under the plan to immediate payment without actuarial reduction is a retirement-type subsidy under Code section 411(d)(6)(B). A number of rulings simply state that the retirement-type subsidy is part of the accrued benefit. Notice 98-29; Rev. Rul. 92-66; GCM 39869. The definition of “accrued benefit” is found in Treas. Reg. §1.411(a)-7(a):

> “[T]he term “accrued benefit” means—

1. **Defined benefit plan.** In the case of a defined benefit plan—
   
   i. If the plan provides an accrued benefit in the form of an annual benefit commencing at normal retirement age, such accrued benefit, or

   ii. If the plan does not provide an accrued benefit in the form described in subdivision (i) of this subparagraph, an annual benefit commencing at normal retirement age which is the actuarial equivalent (determined under section 411(c)(3) and §1.411(c)-5) of the accrued benefit determined under the plan.”

The use of the word “subsidy” suggests that any benefit that is more valuable than the actuarial equivalent of the benefit payable at normal retirement age would be a subsidy. The difference between the actuarial value of the benefit that is currently payable and the value of the actuarial equivalent (determined at the particular retirement age) of the benefit payable at normal retirement age would be a retirement-type subsidy. In the case of *Jan C. Harms, v. Cavenham Forest Industries, Inc., et al.*, 984 F.2d 686, (5th Cir.), cert. denied., 510 U.S. 944 (1993), the court determined that a benefit involved a retirement-type subsidy when the benefits were in lieu of normal retirement benefits, were payable for life, and were computed in a similar way to retirement benefits in general.

The term retirement-type subsidy implies that the subsidy is payable throughout the retirement period. Thus, a special benefit which is a short-term benefit would not be a retirement-type subsidy. For example, many pension plans in the steel industry provide for a special 90-day benefit upon the retirement of a participant, similar to severance pay, computed under a formula which is different from the formula used to compute the normal retirement benefit. While this 90-day benefit is a subsidized benefit, because it is more valuable than the actuarial equivalent of the benefit payable at normal retirement age, it is only payable for 90 days, and thus should not be considered a “retirement-type subsidy.”

The base amount for comparison for purposes of determining the existence of a subsidy should be the accrued benefit payable at normal retirement age. Benefits paid at any other age could then be compared to the accrued benefit at normal retirement age to determine if there is a retirement type subsidy.
b. Determination of Value

In order to determine whether a retirement-type subsidy exists, a comparison of actuarial equivalent must be made. This requires the use of actuarial assumptions including an interest rate or rates and a mortality table. We see at least three alternatives to determine whether a benefit payable prior to normal retirement age includes a “retirement-type subsidy”:

i. The Actuarial Factors Set Forth and Used Consistently Under the Plan Could Be Used to Determine the Existence of a Retirement-Type Subsidy.

Every defined benefit plan has actuarial equivalent standards, either explicitly spelled out in the plan or implicitly contained in factors or tables. The use of the plan’s assumptions are both simple and plan-based. In addition, the use of the plan’s assumptions ensures that the only benefits which will be deemed to be retirement-type subsidies are those which the plan sponsor intended to be subsidized. It does not make sense to deem a benefit to be a retirement-type subsidy when the plan sponsor intended that the benefit not be subsidized.

Early retirement benefits which provide an unreduced benefit relative to the benefit at normal retirement age would be deemed to be subsidized even if there are no explicit early retirement reduction factors. In plans where there are two or more sets of reduction factors, the set of factors that produces the greatest reduction to the benefit relative to the normal retirement benefit will not be deemed to be subsidized, but any set of factors that produces a lesser reduction (as compared to the set of factors that produces the greatest reduction) will be treated as subsidized.

A major negative of this approach is that the actuarial factors used in a plan document frequently do not reflect the current economic conditions - they represent long term assumptions and not current reality or they may have been picked during different economic conditions and are now substantially out of date. Thus, compared to actuarial factors which are more reflective of current economic conditions, the plan’s actuarial assumptions may produce a subsidized benefit.

ii. The Actuarial Factors Used for Determining the Most Valuable Accrued Benefit for Purposes of the Nondiscrimination Rules under Treas. Reg. § 1.401(a)(4)-3 Could be Used to Determine the Existence of a Retirement-Type Subsidy.

The nondiscrimination rules under Treas. Reg. §1.401(a)(4)-3 include any retirement-type subsidies in the determination of the most valuable accrued benefit. Those regulations provide for the valuation of the most valuable accrued benefit by specifying a range of interest rates and an approved list of mortality tables. These assumptions could be used in determining the existence of a retirement-type subsidy for purposes of Code section 411(d)(6).

One advantage of this approach is that the Code section 401(a)(4) assumptions are generally understood by actuaries, and actuaries are used to working with them. Plans that
utilize an interest rate from the specified range and use a mortality table from the approved list would be considered as not having subsidized benefits except where the plan sponsor intended that a subsidized benefit be paid. One aspect of this approach is that, for plans which utilize actuarial assumptions and factors which are outside acceptable standards, some of the methods of payment will be deemed to be retirement-type subsidies and subject to a stricter standard.

There are several negatives to this approach. The range of interest rate and mortality table factors set forth in the nondiscrimination regulations may afford too much discretion to the plan sponsor in determining what is a retirement-type subsidy and some truly subsidized benefits may “slip through the cracks.” On the other hand, for a mature plan under which the actuarial equivalent factors were established many years before the issuance of the Treasury Regulations, some optional forms of payment may be considered to be retirement-type subsidies even though the plan sponsor did not intend the benefit to be subsidized and the participants do not perceive the benefit to be subsidized.

### iii. GATT Interest Rates and Mortality Table Could be Used to Determine Whether a Benefit is a Retirement-Type Subsidy.

It is possible to determine whether a benefit involves a retirement-type subsidy based upon the GATT interest rates and mortality table. The GATT interest rate and mortality table will provide a reasonably current measure of the economic conditions. Thus, any benefit which has extra economic value in the current year would be considered to be a retirement-type subsidy.

Basing the determination of whether a benefit is a retirement-type subsidy on volatile assumptions will have a number of deleterious effects. Benefits which were not intended to be subsidized will be deemed to be subsidies - perhaps because of slight differences in interest rates. As the GATT interest rates fluctuate, an optional form of benefit may be considered to be a retirement-type subsidy one year and may not be considered to be a subsidy in the following year. It would be confusing and difficult to understand if optional forms of benefits slipped in and out of retirement-type subsidy status from year to year, and thus had different standards for their elimination in different years. In addition, such an approach would penalize the many defined benefit plans which have deemed it important to have stable conversion table factors between optional forms of benefits. Finally, the GATT interest rates and mortality table were adopted for the purpose of valuing lump sum payments. It is unfair to apply them to all other forms of payment where they were not intended to be applied.

### iv. Recommendation - Alternative i.

While there are pros and cons for any method of determining the value of a benefit for the purpose of defining a “retirement-type subsidy,” we believe, on balance, that it is best to determine whether a benefit is a retirement-type subsidy on a basis which conforms to the intent of the plan drafter. That is, the only benefits that should be deemed to be retirement-type subsidies are those which are subsidized based upon the terms of the plan. Thus, an unadjusted 100% spousal annuity form of payment would be a retirement-type subsidy. Similarly, an unreduced benefit (relative to the normal retirement benefit) payable at any age would be a
retirement-type subsidy, as would a partially reduced early retirement benefit where the reduction is less than the reduction applicable to vested deferred participants.

4. Optional Form of Benefit.

The introductory language of current Treas. Reg. §1.411(d)-4, Q&A1 (b) begins by stating that “[a]n optional form of benefit is a distribution form with respect to an employee’s benefit ...” (emphasis added). In defining an “optional form of benefit” for purposes of EGTRRA, at least three alternative definitions come to mind:

a. An Optional Form of Payment Could be Defined as a Distinct Form of Payment Available Under the Terms of the Plan Which is or Remains Payable at and After Normal Retirement Age.

An optional form of benefit could be defined by reference to the major differences that distinguish forms of payment - that is, whether there is a survivor benefit payable after the participant’s death, whether a survivor benefit is payable only to the participant’s spouse or to joint annuitants other than the participant’s spouse, whether there is a guaranteed payout period in the event that the participant and/or the joint annuitant dies following benefit commencement, whether payments are level or may increase or decrease over the payout period, whether there is a refund feature, and whether a full or partial cashout of the accrued benefit is available.

Under this definition, a benefit such as a Social Security adjustment option would be considered to be an optional form of benefit because it has separate features (i.e., an adjustment of the monthly payout downward when Social Security benefits may commence) and because payments will continue on and after normal retirement age.

For this purpose, minor differences in the form of payment would not create separate options. For example, if a plan sponsor wishes to change a life annuity with a maximum 30-year term certain option to a life annuity with a maximum 25-year term certain, these would not be viewed as two separate options, and the maximum term certain of 30 years would not be viewed as protected by Code section 411(d)(6). This is consistent with the definition of “option” in Treas. Reg. §1.401(a)(4)-4(e), which defines distributions available on “substantially the same terms” as one option.

Optional forms of payment would be defined without regard to timing of commencement, which would be separately protected, to the extent that protection is warranted under the definition of “early retirement benefit.” Any subsidy payable in connection with an optional form would also be separately protected as a “retirement-type subsidy.” Consistent with the existing regulations under Code section 411(d)(6), the right to be paid in the same form through a fully paid up, nontransferable individual annuity contract or directly from the trust should be treated as one optional form.

The advantages of defining optional forms of benefits as described above is that it will simplify the definition of optional form of payment and will thereby assist in the avoidance of inadvertent violations of Code section 411(d)(6). Such a definition would extend the statutory protection only to those differences in the manner of payment which would be significant to
participants and beneficiaries. This definition clearly separates “optional form of benefit” from “retirement-type subsidies” and from “early retirement benefits,” eliminating redundancy and making the different rules applicable to each easier to communicate and easier to understand.

On the other hand, timing differences and small differences in form of payment may not be \textit{de minimis} to all participants in all cases. It may be better to include such small differences in the definition of optional forms of benefit and then to establish reasonable rules for their amendment or elimination in the regulations, rather than to provide no standards for their amendment or elimination.

In addition, the proposed definition is inconsistent with Treas. Reg. § 1.401(a)(4)-4(e)(1)(i), which contains the current definition of “optional form of benefit,” and the portions of Treas. Reg. § 1.411(d)-4, Q&A 1(b) reflecting the prior definition of that term (the definition for pre-1994 plans years, under the last sentence of Treas. Reg. § 1.411(d)-4, Q&A 1(b)(i)). In addition, the proposed definition is arguably contrary to the language of Code section 411(d)(6) which describes the authority of the Treasury to prescribe regulations allowing for amendments that eliminate optional forms of benefits, other than amendments having “the effect of eliminating or reducing” an early retirement benefit or a retirement-type subsidy. Such statutory language would arguably not have been necessary if Congress had intended that optional forms of benefits be defined narrowly so as not to overlap with the definition of “retirement-type subsidies” or “early retirement benefits.” However, a better reading of Code section 411(d)(6) would be to recognize that some optional forms of benefits also involve retirement-type subsidies or early retirement benefits. For example, under a plan the 75% spousal joint and survivor annuity may be unreduced. If so, the optional form of benefit is subsidized. To eliminate the optional form of payment would also eliminate a retirement-type subsidy. The better interpretation is to view such a subsidized optional form of benefit as both an optional form and a retirement-type subsidy.

b. Optional Forms of Benefit Could be Defined to Include Not Only the Form of Payment But the Timing of the Payments.

It is possible to define optional forms of benefits to include not only the form of payment but the timing of the payments. This would then mean that all early retirement benefits would also be optional forms of benefits even if they were payable under the normal form of benefits provided by the plan. One advantage of this approach is that it preserves timing differences for participants for whom they are not \textit{de minimis}. This approach is also more consistent with the existing Treasury Regulations. See Treas. Reg. § 1.411(d)-4, Q 1(b).

On the negative side, depending on the definition of “early retirement benefit,” timing differences with respect to optional forms of benefit will certainly overlap with timing differences with respect to early retirement benefit (or retirement-type subsidy). Overlaps of this type lead to confusion as to what part of the statute applies to which part of the benefit. This is particularly important since Congress applied different standards to the elimination of “early retirement benefits” and “retirement-type subsidies” than it did to “optional forms of benefit,” giving the Treasury broader authority for the elimination of pure optional forms of benefits which do not involve early retirement benefits or retirement-type subsidies.
c. **Optional Forms of Benefit Could be Defined to Include Small Differences in Form of Payment (Such as 25-Year vs. 30-Year Maximum Term Certain).**

Instead of treating forms of payment which are similar as a single form of payment as described in alternative a. above, the regulations could treat them as separate forms of payment. This approach would recognize such small differences so that standards can apply to their elimination or amendment. This is more consistent with the existing regulations under Treas. Regs. §§ 1.401(a)(4)-4(e)(1)(i) and 1.411(d)-4, Q&A 1(b).

This approach may, depending on the definition of “early retirement benefit,” cause small differences with respect to optional forms of benefit to be considered both “optional forms of benefits” as well as “early retirement benefits” and will result in confusion in applying the different standards for elimination or amendment of the feature. For instance, is a 75% joint and survivor annuity payable before the plan’s normal retirement date an “early retirement benefit” as well as an “optional form of benefit”? If so, then Treasury, which prior to EGTRRA had no authority to allow plan sponsors to eliminate an “early retirement benefit,” exceeded its statutory authority when it allowed plan sponsors to eliminate 75% joint and survivor annuity benefits for persons of less than the normal retirement age.

**Recommendation:** Alternative c.

While we recognize that the recommended approach will create a conflict between the regulations under Code section 411(d)(6) and the regulations under Code section 401(a)(4) (to the extent that they define optional forms of benefit as including all early retirement benefits and retirement-type subsidies), the recommendation is, on balance, the better approach. It eliminates the confusion which comes from overlapping definitions. It is also consistent with the earlier regulations which allowed the elimination of certain joint and survivor annuity forms of payments even though they might be payable prior to the participant’s normal retirement age. The best way to correct the conflict with the regulations under Code section 401(a)(4) would be to insert a sentence in the preamble to the Code section 411(d)(6) regulations indicating that the definitions are different because of the different purposes of the regulations. We recommend alternative cover alternative a. on the basis that it is better to deal explicitly with the amendment or elimination of small variations between options rather than engaging in a fiction that they are not different and allowing them to be eliminated without any standards.

5. **De minimis Standard.**

a. **Background.**

Treasury is required to promulgate regulations by December 31, 2003, that provide an exception from the general Code section 411(d)(6) rules for amendments that reduce or eliminate burdensome and complex early retirement benefits or retirement-type subsidies unless the amendment “adversely affects the rights of any participant in more than a de minimis manner.”

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The House Committee Report\textsuperscript{5} includes a nonexclusive list of five factors that should be considered in determining whether an amendment has more than a \textit{de minimis} adverse effect on a participant:

\begin{itemize}
  \item[i.] All of the participant’s early retirement benefits, retirement-type subsidies and optional forms of benefits that are eliminated or reduced by the amendment;
  \item[ii.] The extent to which early retirement benefits, retirement-type subsidies and optional forms of benefit in effect with respect to a participant after the amendment’s effective date provide rights that are comparable to the rights that are reduced or eliminated by the amendment;
  \item[iii.] The number of years before the participant attains normal retirement age under the plan (or early retirement age if applicable);
  \item[iv.] The size of the participant’s benefit that is affected by the plan amendment, in relation to the amount of the participant’s compensation; and
  \item[v.] The number of years before the plan amendment is effective.
\end{itemize}

The example in the House Report, based on the elimination of an early retirement subsidy following a plan merger, is instructive. It describes the effect of the merger on two different participants – one age 25 and one age 50. Each participant had compensation (presumably, annual) of $40,000. The present value of the older participant’s early retirement subsidy is $10,000 while the value of the younger participant’s early retirement subsidy is $75.

The surviving plan in the example also had an early retirement subsidy, but it is different from and less valuable than the subsidy in the merged plan (compare $10,000, which is the present value of the older participant’s benefit in the merged plan, with $9,500, the present value of the surviving plan). The House Report would permit the surviving plan to eliminate the subsidy entirely for the younger participant. Taking into account all relevant factors, including the value of the benefit, the participant’s compensation and the number of years until the participant would be eligible to receive the subsidy, the House Report concludes the subsidy is \textit{de minimis} and, therefore, may be eliminated.

With respect to the older participant, the House Report concludes that the more valuable subsidy could also be eliminated as long as the participant had the less valuable early retirement subsidy in the surviving plan because the difference between the value of the subsidies is \textit{de minimis}. However, the subsidy could not be eliminated entirely as with the younger participant.

\textsuperscript{5} H.R. Rep. No. 107-51.
b. Defining the Standard.
   
i. Individual Basis.

   Regulations should require that the inquiry be made on a participant-by-participant basis since both the statute and the House Report suggest that the inquiry be made on a participant-by-participant basis.

   ii. Totality of Benefits.

   In considering what “rights” of participants are protected, the regulations should emphasize that it is the totality of the participant’s benefit, rather than each aspect of that benefit.

   iii. De minimis Value.

   Assuming satisfaction of the significant burden and complexity standard, a particular early retirement benefit or retirement-type subsidy may be eliminated if, considering all of the relevant factors, the economic value to the participant of the “right” affected by the cutback is de minimis. The House Report suggests the use of present value comparisons to determine whether the impact to a participant is more than de minimis. However the Report does not indicate how the benefit is to be valued. There are at least two alternatives:

   (I) Look to Plan Terms.

   The regulations could incorporate concepts of actuarial equivalence as defined in the underlying plan. This method is simple and will be easily administered. It is also consistent with the recommended approach in defining a retirement-type subsidy. By using the same valuation approach, there will be consistency between the determination of whether there is a subsidy and the amount of the subsidy.

   Determining value based upon the plan’s own actuarial factors and assumptions has the negative aspect that the value of a right or benefit would be different from plan to plan. However, the concept of a subsidy is different from plan to plan.

   (II) Standardized Assumptions to Determine Value.

   An alternative would be to measure value to the participant by use of standardized interest and mortality assumptions. Using standardized assumptions has the effect that the value of the subsidy will not vary from plan to plan. However, getting consensus on which assumptions should be used will be a lengthy process. All employers do not use the same factors for determining actuarial equivalence. Frequently, the assumptions may be different within multiple plans for a single employer. The value of a uniform set of assumptions does not outweigh the need for quick, clear guidance. Further, as noted earlier in our discussion of “retirement-type subsidy” (see Part IV.B.3. above), using standardized assumptions has the unintended consequence of creating a subsidy in circumstances in which neither the plan sponsor nor the participant perceived a subsidy to exist. Finally, using standardized factors like the GATT interest and mortality factors would be disadvantageous since values could fluctuate from year to year or month to month.
iv. **The Regulations Should Incorporate Safe Harbors.**

In order to offer simplicity and ease the compliance burden, the regulations should incorporate certain safe harbors that generally will be considered to satisfy the *de minimis* standard. (See parts V.A and B below.)

c. **“Significant Burden” Standard.**

There has been some suggestion that early retirement benefits, retirement type subsidies and optional forms of benefit should not be amended or eliminated to the extent they were included in the plan voluntarily by the plan sponsor and were therefore “self-inflicted.” While the idea that sponsors and plan administrators should live with the consequences of the sponsor’s actions may have appeal to some, it is not a standard that does or should apply to EGTRRA relief under Code section 411(d)(6). Nothing in the statute or history suggests that significant burdens or complexities are in any way a function of the past actions of the sponsor or the plan. Moreover, as explained at length in part I.A-F of this paper, plan features protected by Code section 411(d)(6) are often thrust upon a plan sponsor. In short, there is no real basis or logic to attempting to impose a self-infliction exception to the plain and clear language of the statute. To do so would unduly restrict the intent of the proposed relief.

V. **Possible Regulatory Approaches.**

A. **Early Retirement Benefits and Retirement-Type Subsidies.**

1. **Regulations Should Allow for the Elimination of *De minimis* Early Retirement Benefits and Retirement-Type Subsidies.**

   a. **Considerations in Applying the *De minimis* Standard.**

   Based on the House Report, it is clear that Congress intended to provide some relief to plan sponsors and participants. It is also clear that a *de minimis* adverse impact to a participant is not sufficient to require a plan to continue to offer a particular early retirement benefit, retirement-type subsidy or optional form of benefit. The regulations should provide this much needed relief.

   As described above, the House Report sets forth five factors to be considered in connection with the reduction or elimination of an early retirement benefit or a retirement-type subsidy but does not provide an indication of how the five factors work together. In addition, the House Report does not indicate whether all five factors should be subjective factors or whether some or all of them can be made the subject of bright line tests. The following is our suggested analysis of these questions:

   i. **Consideration of All Changes Made in a Single Amendment.**

   The first factor listed in the House Report requires consideration of
all of the participant’s early retirement benefits, retirement-type subsidies and optional forms of benefits that are eliminated or reduced by the amendment.

Thus, if a single amendment reduces an early retirement benefit by two percent of the participant’s annual compensation and reduces a retirement-type subsidy by three percent of the participant’s annual compensation, the plan sponsor must use five percent of compensation as the measurement of the impact of the amendment on that participant.

The House Report indicates that all the changes made in a single amendment must be taken together. It does not indicate whether reductions and eliminations made in two separate amendments must be taken together. Thus, there is the implication that if the plan sponsor makes two separate amendments, the reductions and eliminations made in each of them are not considered together. We believe that such a rule is prone to abuse since it would enable a plan sponsor to do in two amendments what it cannot do in one amendment. Thus, we recommend that more than one plan amendment made within a specified period be aggregated.

If amendments are aggregated, Treasury would need to develop a rule which is reasonable in the context of changes to pension benefit plans. In addition, the rule would need to be simple to administer and should avoid retroactive disqualification where the violation is the result of a subsequent aggregated amendment. For example, suppose that the rule is that amendments adopted within a five-year period will be aggregated. The adoption of a second amendment four and one-half years after the first amendment should not disqualify the plan retroactively four and one-half years earlier. The disqualifying event occurs with the adoption of the second amendment. This would allow the plan sponsor to correct the amendment within the remedial amendment period for the second amendment. This is important because the remedial amendment period for the first amendment would have most certainly expired.

The other alternative is to aggregate amendments only if they are made during the same plan year or by the due date of the plan sponsor’s tax return for the year of the first amendment. Such a rule is dependent upon whether the plan sponsor files for an extension on its tax return and is consequently not as desirable as a fixed time period.

Where the reduction of an early retirement benefit or retirement-type subsidy is permitted because the reduction amount is less than a percentage of the benefit or is less than a percentage of the participant’s annual compensation, then it would seem that amendments made within a period of years should be aggregated, but after some particular time period, for example, from two to five years, after which aggregation should not apply. In our view, any amendments that are more than five years apart would seem to be too remotely connected to be aggregated. Out of these possibilities three years seems to be a reasonable compromise. Thus, we recommend that any plan amendments within three years of each other be aggregated. This will prevent an abusive use of multiple amendments by plan sponsors.

A related question is whether if a subsequent amendment exceeds the de minimis threshold, the prior amendment would be prohibited or whether the prohibition should only apply to the subsequent amendment. We recommend that, if a subsequent amendment, when aggregated with earlier amendments, will cause a plan to be disqualified, the period of
disqualification will commence on the later of the date of adoption of the second amendment or its effective date. The plan will not be disqualified back to the date of the first amendment.

ii. Consideration of Post-Amendment Early Retirement Benefits, Retirement-Type Subsidies and Optional Forms of Benefit.

The second consideration listed in the House Report is:

The extent to which early retirement benefits, retirement-type subsidies and optional forms of benefit in effect with respect to a participant after the amendment’s effective date provide rights that are comparable to the rights that are reduced or eliminated by the amendment.

Thus under this consideration, the plan sponsor would determine the value of the reductions to the participant’s early retirement benefits and retirement-type subsidies by netting the value of the early retirement benefits, retirement-type subsidies and optional benefit forms remaining for the participant after the amendment against the early retirement benefits and retirement-type subsidies which he or she has lost. This is illustrated in the House Report by the example of the older participant who lost an early retirement benefit valued at $10,000 but after the amendment retained a comparable early retirement benefit worth $9,500. Thus, in the example the net loss to the participant was $500.

The issue with respect to this consideration is the determination of which benefits are “comparable” to the early retirement benefits or retirement-type subsidies lost. In this regard we recommend that all early retirement benefits, retirement-type subsidies, and optional forms of benefits after the amendment be compared to all early retirement benefits, retirement-type subsidies and optional forms of benefits available to the participant after the amendment. This will allow consideration of the total benefits, subsidies and optional forms lost by the participant.

There is an additional issue which relates to how plan sponsors will be able to value an early retirement benefit which does not involve a subsidy. That is, suppose two plans merge. One allows for early retirement at age 50 with 15 years of service while the other plan allows for early retirement at age 55 with ten years of service. Suppose further that both early retirement benefits are pure actuarial equivalents of the normal retirement benefit - neither benefit involves a subsidy. If the age 50 early retirement benefit is eliminated, what is the value of the right to retire at age 50 and begin receiving actuarially reduced retirement benefits?

One way to value the actuarially reduced benefit payable at age 50 is to say that it has zero value since all value which would have been paid between ages 50 and 55 will be made up by greater benefits payable after age 55. This would then lead to the conclusion that the early retirement right has no value and can be eliminated with impunity. This, however, would seem to ignore the fact that Congress sought to protect early retirement benefits that did not involve retirement-type subsidies.

Another approach to valuing the right to retire and receive pension benefits at age 50 with 15 years service would be to look at the total benefits which would be payable to a participant
between ages 50 and 55. Since such payments are not payable under the age 55 early retirement provision which remained in the plan, those are the benefits which are being eliminated. However, this seems to overstate the value of the benefit because it assumes that the participant will terminate precisely at age 50 and will decide to commence to receive his pension then rather than deferring the pension to his retirement years.

The most precise way to value the age 50 early retirement benefit would be to have an actuary compute the total amount payable between ages 50 and 55 but discount it by the probability that the participant will not terminate employment at age 50 but will continue to work and also to discount the value by the probability that the participant, even if he or she terminates employment at age 50 will decide not to receive the pension at that age. Perhaps actuaries have statistics on the number of participants who terminate or retire at age 50 but defer their pension benefits until a later date. Having computed this value for age 50, the actuary would need to compute the similar values for ages 51, 52, 53 and 54 and add them together.

We do not have the actuarial experience or expertise to determine if the foregoing calculation is an easy or difficult calculation. However, it appears to some of us that, unless the calculation is unusually difficult or impossible, the precise way of valuing the unsubsidized early retirement benefit is the one that the Treasury regulations should endorse. This was not a universal conclusion, however. Some of us believe that a simpler standard which employers and participants could understand would be a better approach. All agree that, if the precise value is difficult or impossible for an actuary to calculate, a less precise alternative should be adopted.

A similar calculation could be done with respect to subsidized early retirement benefits and retirement-type subsidies. Just because a plan has a subsidized early retirement benefit, not all participants retire or terminate employment in order to receive the subsidized benefit. Thus, the amount of the subsidy which is eliminated should be calculated but should be discounted to reflect the fact that not all participants retire to receive the subsidy. In addition, unless the subsidy is large, it may also be appropriate to discount the value of the subsidy by a factor representing the participants that elect to defer their retirement benefits to a later date.

While these calculations are more complex, they provide a better picture of the true value of the early retirement benefit or retirement-type subsidy which is being reduced or eliminated. However, some of us believe that it would be better to have a rough measure of the value of an early retirement benefit or a retirement-type subsidy so that it would be more understandable by employers and participants.

### iii. Consideration Must be Given to the Number of Years Before the Participant Reaches Normal Retirement Age or Early Retirement Age, as Applicable.

The House Report specifies that consideration must be given to the number of years before the participant reaches normal or early retirement age. It is not clear from the House Report whether the number of years before retirement age is determinative or whether it is just one factor to be considered. For example, if it will be 30 years before a participant will reach retirement age, we believe that all changes in early retirement benefits and retirement-type subsidies will be *de minimis* for that participant. We do not believe it is necessary to do complex
calculations of the value of the benefit being reduced or eliminated. On the other hand, if the participant is two years away from early or normal retirement age, as applicable, then calculation of the value of the reduction or elimination will be necessary and factors in addition to years to retirement should be considered.

Since it is clear that, for participants who are some number of years away from retirement age (for example, 30), an early retirement benefit or retirement-type subsidy will have *de minimis* value without further calculation, the question then becomes whether Treasury should define a bright line test. The advantage of such a test is that plan sponsors will know that, for participants who have more than a specified number of years until they reach retirement age, they can reduce or eliminate early retirement benefits or retirement-type subsidies without further calculations.

The problem with a bright line test is that it is likely to be set too conservatively in order to prevent any risk that some participants might be hurt by the elimination of an early retirement benefit or retirement-type subsidy. Despite this risk, we recommend that a bright line test be included in Treasury regulations allowing plan sponsors the option of eliminating an early retirement benefit or retirement-type subsidy for persons who are a stated number of years from the earliest retirement age or the earliest date that a retirement-type subsidy could be paid.

Having recommended that there be a bright line test based upon the number of years remaining to the earliest retirement age or earliest eligibility for a retirement-type subsidy, there remains the question of what the bright line should be. In this regard, there are at least three factors which contribute to diminishing the value of the early retirement benefit or retirement-type subsidy over time:

1. The chances of remaining employed with the plan sponsor until the date that the benefit is payable, which generally decrease under standard actuarial turnover tables the further one is from retirement eligibility;

2. The ratio of benefit service prior to the elimination or reduction of the early retirement benefit to the total benefit service when the participant retires diminishes the further the participant is from retirement when the amendment is adopted; and

3. The impact of compensation on the value of the benefit - under typical compensation patterns as reflected in actuarial salary scale assumptions, the pre-elimination compensation will be substantially less than the post-elimination compensation as the number of years to retirement increase.

Assume that the value of a subsidized early retirement benefit is frozen. Assume also that the participant continues to accrue benefits at the same normal accrual rate after the date that the subsidy was frozen. Assume further that the participant is of the age and has the number of years of service that make the subsidy most valuable (for example, a 30-and-out benefit would be most valuable for a participant if he was hired at age 18 so that he or she could retire with unreduced benefits at age 48). If compensation increases at four percent per year, the frozen subsidy will be completely “worn away” by new accruals over a period of time. The length of
time it takes to “wear away” a frozen subsidy will depend upon the size of the subsidy, as shown by the following table:

<table>
<thead>
<tr>
<th>Value of the Subsidized Benefit as a Percentage of the Accrued Benefit</th>
<th>Number of Years to “Wear” Subsidy Away</th>
</tr>
</thead>
<tbody>
<tr>
<td>125%</td>
<td>4 years</td>
</tr>
<tr>
<td>150%</td>
<td>6 years</td>
</tr>
<tr>
<td>200%</td>
<td>10 years</td>
</tr>
<tr>
<td>250%</td>
<td>12 years</td>
</tr>
<tr>
<td>300%</td>
<td>14 years</td>
</tr>
</tbody>
</table>

Based upon the foregoing, it is apparent that the value of modest subsidies are worn away in four to six years while the value of huge subsidies, such as some 30-and-out benefits, are worn away in 14 years. This does not take into account the fact that normal turnover as a result of termination of employment, disability or death might disqualify the participant from being eligible for the subsidized benefit. If one assumes combined turnover for all such causes at three percent per year, there is a 42% chance the participant illustrated in the last line of the foregoing table would not complete the 14 years of service necessary to qualify for the subsidy. Based upon the foregoing, it is apparent that even the most extremely subsidized benefits are de minimis 15 years before the earliest retirement age when the subsidy is largest.

(iv) Consideration Should be Given to the Size of the Participant’s Benefit That is Affected by the Plan Amendment, in Relation to the Amount of the Participant’s Compensation.

Another factor mentioned in the House Report is the amount of the participant’s benefit that is affected by the amendment. The House Report example allows the elimination of an early retirement subsidy where the value of the benefit is less than 0.20% of the participant’s compensation. However, where the value of the benefit is at least 25% of the participant’s compensation, the example indicates that the full subsidy cannot be eliminated but can be reduced to 23-3/4% of the participant’s compensation – a reduction of 1.25% of compensation.

Since the House Report only provided an example with a large subsidy (25% of compensation) which could not be eliminated and with a small subsidy (1.25% of compensation) which could be eliminated, it will be necessary for Treasury to determine whether to establish a bright line test for the size of a subsidy which can be eliminated and, if so, to determine the percentage of the bright line test.

First, we believe it is appropriate for the Treasury to establish a reasonable bright line test. Such a bright line test will make it easier for both employers and the Service to administer the provision. While a subjective standard would provide employers with an opportunity to argue their case for a higher limit, we believe that having a reasonable bright line test will make the administration of the law easier for the government and the private sector alike.
One difficulty in trying to establish a bright line test is to pick a reasonable percentage. One alternative would be to take the example in the House Report as defining 1.25% as the upper limit of subsidies which can be eliminated. This would certainly be the safest way to avoid criticism from Congress. However, this would impose a very strict standard and would limit the utility of the safe harbor.

At the other extreme, it would be possible to determine that any percentage, as long as it was less than 25%, would be allowed. We believe that such a standard would be unreasonably large. Many employers target replacement ratios at normal retirement date at 70% - 80% of pre-retirement compensation with Social Security providing 20 to 35% of the retirement income. Assuming that the amount being provided by employer plans will be in the range of 35% to 50% of compensation, allowing a reduction of 24% of compensation might involve cutting the plan benefit to less than half of what it would otherwise be.

Based upon the foregoing, we believe that the bright line test should be higher than 1.25% of compensation and less than 25% of compensation but should be closer to 1.25% of compensation than to 25% - perhaps five percent of compensation.

Thus, we propose that, where the value of the benefit is no more than five percent of the annualized compensation of the participant, it would be presumed to be *de minimis*. However where that value is greater than five percent of annualized compensation, the plan could reduce the subsidy by an amount not in excess of the lesser of one-half the subsidy or five percent of annualized compensation. Thus, where there are two similar subsidies, the plan sponsor could eliminate a duplicative early retirement benefit or retirement-type subsidy as long as the differences between the two are not significant. The plan sponsor could not, however, eliminate the benefit or subsidy entirely. Value would be determined based on the actuarial factors in the plan and the methodology described above.

The advantages of this option are that it is a simple rule and could be uniformly administered in all plans. Additionally, it would permit the reduction of some complexity in plan administration. The principle disadvantage is that the eliminated benefits and subsidies may have some value to a participant even though small. However, on balance, we recommend the incorporation of a bright line rule as a safe harbor, defining a maximum percentage of annual compensation that will be considered *de minimis*.

(v) **Consideration Should Be Given to the Number of Years Before the Plan Amendment is Effective.**

The House Report specifies that one of the five factors to be considered is the number of years before the plan amendment is to become effective. Such a consideration is important in that it allows participants who are close to retirement age, and who are expecting to receive an early retirement benefit, retirement-type subsidy or optional form of benefits, the right to receive such early retirement benefit, retirement-type subsidy or optional form of benefits without having it taken away at the last moment.

In evaluating the appropriate length of time before an amendment becomes effective will be the criteria for the elimination of an early retirement benefit, retirement-type subsidy or
optional form of benefits, the Treasury should first consider whether the length of time before an amendment becomes effective should be different for early retirement benefits, retirement-type subsidies and optional forms of benefits. For example, it is possible to adopt a rule that an optional form of benefit which does not involve a retirement-type subsidy can be eliminated two years after the plan amendment, an early retirement benefit can be eliminated five years after the plan amendment, and a retirement-type subsidy can be eliminated ten years after the plan amendment.

A rule that has different lead times based upon what is being taken away would take into account the fact that an optional form of benefit which does not involve a retirement-type subsidy does not involve actuarial value in excess of other forms of retirement benefit. Since it does not involve value, the law should allow for elimination with less advance notice than where there is actuarial value. In contrast, an early retirement benefit is more likely to be counted upon by a participant than an unsubsidized optional form of benefit. That is, a participant who can retire at age 50 with 15 years of service and receive an unsubsidized benefit is somewhat more likely to be relying on the right to retire than on whether he can receive benefits for life on a 20 years certain basis. If the benefit at age 50 is subsidized, especially if it is unreduced, then the participant is even more likely to be relying upon receiving the benefit.

Of course, having different times that an amendment needs to be in place before it can be effective will make the rule more complicated. Such additional complication will make the rule more difficult to administer for both the Service and employers.

Despite the added complexity, we recommend that separate rules be applicable to early retirement benefits, retirement-type subsidies and optional forms of benefits. We further recommend that the regulations establish a relatively short standard applying to optional forms of benefits which do not involve retirement-type subsidies, a somewhat longer standard applying to early retirement benefits which do not involve retirement-type subsidies, and a relatively long standard applying to retirement-type subsidies.

As to the length of time a plan amendment needs to be adopted before it can be effective, some guidance can be taken from the regulations which were adopted subsequent to the passage of the Small Business Job Protection Act of 1996 (“SBJPA”). SBJPA changed the rules under Code section 401(a)(9) so that plans did not need to commence a participant’s benefits at age 70½ if the participant was still employed. Treasury recognized that employees attaining age 70½ near the passage of SBJPA “may have had an expectation of receiving preretirement distributions in the near future and may have made plans that took into account these expected distributions.”6 Faced with these concerns, Treasury adopted a rule which required that the plan amendment be adopted in the year before it becomes effective.

The regulations under SBJPA are instructive as to the length of time certain amendments need to be adopted prior to becoming effective but not controlling as to early retirement benefits, retirement-type subsidies and optional forms of benefits. First, the right to receive in-service distributions at age 70½ would have limited impact on most participants who generally retire

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prior to age 70½. Even for participants who worked beyond age 70½, the right to commence receiving benefits may not have been exercised by some of them - especially if they were working full-time and receiving full-time pay. Nonetheless, being able to commence benefits while working would have been viewed by many participants as a valuable right since it would allow them to reduce their hours of work and maintain their standard of living while working part-time.

Second, the right to commence benefits at age 70½ was by its nature an unsubsidized right. That is, to the extent that benefits were deferred until actual retirement, they are actuarially increased so that the deferred benefits have the same actuarial value as the benefits which would have commenced at age 70½. Thus, the SBJPA’s one-year rule is more appropriate for unsubsidized optional forms of benefits and unsubsidized early retirement benefits. We believe that retirement-type subsidies require a much longer lead time before the plan amendment becomes effective.

Such an approach is borne out by anecdotal evidence of the behavior of participants who are entitled to receive unsubsidized early retirement benefits at relatively young ages compared to similar aged participants who are entitled to receive heavily subsidized early retirement benefits. We are told by our clients that very few participants who have the right to receive annuity benefits at relatively young ages - 45 or 50 - take an immediate annuity. That is because the benefits are so reduced that they become inconsequential. Certainly the participant cannot live on the reduced benefits without taking another full-time job.

The behavior of participants is different if the plan contains a lump sum payment option available at an early age. Participants almost always take the immediate lump sum payment rather than an annuity either immediately or on a deferred basis. Some, but not all, such participants roll the lump sum payment over into an individual retirement account so that the money will be available at a more typical retirement age. Because of this difference in behavior of participants, Treasury may want to have separate rules depending upon whether the plan contains a lump sum payment option. In fact, we recommended that the “lump sum trumps all” rule be incorporated in the regulations under Code section 411(d)(6) relating to defined contribution plans. We do not recommend that the regulations relating to defined benefit plans contain a similar rule.

On the contrary, despite the original legislative history of Code section 411(d)(6) which seemed to indicate that lump sum distributions are to be sacrosanct, we propose to allow plan sponsors to reduce or eliminate lump sum payments with at least 15 years advance notice. Such a provision would allow plan sponsors that had added lump sum payments to their plans in the 1980’s and discovered they were problematical in the 1990’s and downright dangerous in the 2000’s, to get out of the 411(d)(6) trap.

Based upon the foregoing discussion and recognizing that any specified advance notice period will appear somewhat arbitrary, we propose the following where an amendment is adopted in advance of the effective date of the proposed reduction or elimination and participants are given notice of the amendment in accordance with Code section 4980F:
1. Redundant unsubsidized optional forms of benefits may be modified or eliminated by plan amendment adopted at least one year before it becomes effective;

2. Unsubsidized early retirement benefits may be modified or eliminated by plan amendment adopted at least five years before it becomes effective.

3. Non-redundant unsubsidized optional forms of benefits, other than lump sums, may be modified or eliminated by plan amendment adopted at least ten years before it becomes effective.

4. Subsidized optional forms of benefits may be modified or eliminated by plan amendment adopted at least ten years before it becomes effective.

5. Subsidized early retirement benefits may be modified or eliminated by plan amendment adopted at least 15 years prior to when the amendment becomes effective.

6. Lump sum payments may be modified or eliminated by plan amendment adopted at least 15 years before it becomes effective.

2. Recommendations Based Upon the De minimis Standard Set Forth in the House Report

Based upon the foregoing discussion of the considerations set forth in the House Report, we recommend that:

   a. Two or more amendments affecting early retirement benefits, retirement-type subsidies and optional forms of benefits within a single three-year period be aggregated to determine if their effect is more than de minimis;

   b. When two amendments affecting early retirement benefits, retirement-type subsidies and optional forms of benefits have more than a de minimis effect when aggregated but not when standing alone, the plan only be treated as being disqualified from the date of the second amendment;

   c. In valuing early retirement benefits and subsidies, the actuary be required to consider all relevant factors, including the likelihood of a participant continuing to work in order to be eligible for the early retirement benefit or subsidy, the likelihood of the participant retiring at any specific age to take advantage of the early retirement benefit or subsidy, and the likelihood that the participant would elect to receive his or her benefit at the early retirement age rather than deferring commencement until a later date or apply a safe harbor standard which will be easier for participants and plan sponsors to understand;
d. Even if an early retirement benefit does not have any associated subsidy, it must still be treated as having value based upon the amount of the benefits payable early, discounted by the actuarial factors described in the preceding paragraph or based upon a safe harbor standard which will be easier for participants and plan sponsors to understand;

e. A plan sponsor be permitted to amend a plan to reduce or eliminate an early retirement benefit or retirement-type subsidy for any participant who will not be eligible for the early retirement benefit or retirement-type subsidy for at least 15 years;

f. Where the value of an early retirement benefit or subsidy is no more than five percent of the annualized compensation of the participant, it would be presumed to be de minimis;

g. Where the value is greater than five percent of annualized compensation, the plan could reduce the subsidy by an amount not in excess of the lesser of one-half of the value or five percent of annualized compensation; and

h. Where an amendment is adopted in advance of the effective date of the proposed reduction or elimination and participants are given notice of the amendment in accordance with Code section 4980F:

i. Redundant unsubsidized optional forms of benefits may be modified or eliminated by plan amendment adopted at least one year before it becomes effective;

ii. Unsubsidized early retirement benefits may be modified or eliminated by plan amendment adopted at least five years before it becomes effective.

iii. Non-redundant unsubsidized optional forms of benefits, other than lump sums, may be modified or eliminated by plan amendment adopted at least ten years before it becomes effective

iv. Subsidized optional forms of benefits may be modified or eliminated by plan amendment adopted at least ten years before it becomes effective.

v. Subsidized early retirement benefits may be modified or eliminated by plan amendment adopted at least 15 years before it becomes effective.
vi. Lump sum payments may be modified or eliminated by plan amendment adopted at least 15 years before it becomes effective.

3. If Different Actuarial Factors Specified in the Plan Document, The Regulations Should Permit a Change in Actuarial Assumptions for Calculating Early Retirement Benefits and Optional Forms of Benefits Where the Change Does Not Have an Impact of Five Percent or More

As indicated above, we recommend that actuarial values and actuarial subsidies be determined based upon the actuarial assumptions and methods either explicitly spelled out or implicitly contained in factors or tables in the plan. This presents a problem when the plan document contains more than one set of actuarial factors and assumptions. This can happen in either of two ways:

(1) When defined benefit plans merge. Currently, when defined benefit plans merge and those plans have differing actuarial equivalent assumptions, the merged plan often is required to continue to use the actuarial equivalent assumptions for optional forms of benefit or for early retirement benefits as to frozen accrued benefits or frozen participants populations; or

(2) When a defined benefit plan changes its actuarial equivalent assumptions. A plan may occasionally update its actuarial equivalent assumptions, either because it is required by law (e.g., Rev. Rul. 2001-62) or to update the plan to better reflect plan experience. Currently, in those cases, the benefit accrued prior to the change may have to be protected, although the protection may only last for a few years as the participant grows out of the protected benefit. For instance, Rev. Rul. 2001-62 provides °411(d)(6) relief in the case of plan distributions, but does not provide relief if a plan sponsor chooses to use the GAR 94 mortality table for other purposes under its plan.

Multiple sets of actuarial assumptions create two problems. First, in applying the standard set forth above for valuing an early retirement benefit or retirement-type subsidy, it may not be clear which set of options should be used to determine the value of the benefit or the subsidy. We propose that, if it is clear which set of assumptions or factors apply to the benefit or subsidy, it be valued using the applicable set of assumptions. If it is not clear which set of assumptions or factors apply, we propose that the set of assumption or factors be used which results in the greatest actuarial value for the benefit or subsidy.

The second problem is determining when one of the sets of assumptions or factors can be eliminated rather than being preserved for a frozen benefit or a frozen group of participants. We take it as a given that the plan can eliminate one set of assumptions or factors if it results in a lesser benefit than another set of assumptions or factors. However, under the current regulations, one cannot eliminate one set of assumptions or factors if, for any benefit or any participant, it results in a higher benefit than the set of assumptions and factors replacing it.
Following the principles set forth above, we suggest that a plan sponsor be permitted change the actuarial assumptions for calculating early retirement benefits and optional forms of benefits for a participant where the change does not impact the participant by more than five percent. This would solve many of the problems that plans have with grandfathered sets of actuarial assumptions and factors. This suggestion would require a participant-by-participant calculation which is burdensome and complex. However, despite its burdens and complexities, it is better than the current situation where plans need to preserve all earlier sets of actuarial assumptions for all participants. Thus, the proposal is actually less burdensome and less complex than the current regulations under Code section 411(d)(6).

B. Optional Forms


   a. Considerations in Applying Significant Burden/De minimis Standard.

   Unlike early retirement and retirement-type subsidies, optional forms of benefit generally do not affect the value of the benefit received. Optional forms of benefit generally are actuarially equivalent to the normal or early retirement benefit payable in the normal form and to each other. Thus, the standards should be applied less rigorously with respect to optional forms than early retirement benefits and retirement-type subsidies. Further, optional forms are more numerous than early retirement benefits or retirement-type subsidies, and generally present a greater burden to the plan. In particular, it is extremely burdensome for a plan to be required to communicate all the different forms to participants and to calculate benefits payable on partial benefits. In addition, grandfathered optional forms of benefits take much longer than early retirement benefits and retirement-type subsidies to work themselves out of a plan. As noted above an optional form of benefit could take 70 to 80 years after it is frozen before it no longer applies to benefits payable under the plan.

   Treasury should also recognize that its statutory authority to allow elimination of optional forms of benefit is substantially more liberal than its authority to allow elimination of early retirement benefits and retirement-type subsidies. That is, under the statute, the significant burden/de minimis standard does not apply to optional forms of benefits that do not involve separate early retirement benefits or retirement-type subsidies. Thus, by developing definitions of early retirement benefits and retirement-type subsidies, Treasury would make it possible to determine which optional forms of benefits do not involve early retirement benefits or subsidies.

   We propose that, in such cases where optional forms of benefits do not involve separate early retirement benefits or retirement-type subsidies, Treasury utilize its greater regulatory authority to provide relief to plans that are becoming more and more burdened with grandfathered and frozen optional forms of benefits.
b. **Redundant Unsubsidized Optional Forms of Benefits May be Modified or Eliminated by Plan Amendment Adopted at Least One Year Before it Becomes Effective.**

Treasury should adopt rules that would afford plan sponsors the ability to eliminate redundant optional forms of benefit that do not involve subsidies one year after the adoption of an amendment and one year after providing the plan participants plan with notice that the optional form of benefits is being eliminated. Such a safe harbor would allow plan sponsors to “clean up” their optional forms of benefits and eliminate extraneous ones that do not involve retirement-type subsidies. A participant who will be eligible to retire within the one-year advance notice period would be able, if he or she considers the optional form of benefit important to his or her family circumstances, to retire and take the benefit. This rule is consistent with the regulations relating to the age 70½ commencement rules under SBIPA where only those participants who were close to age 70½ were considered to have an expectancy of receiving benefit payments while they continued to work.

We recognize that an arbitrary line creates arbitrary distinctions. There is little difference between a participant who is six months from retirement and one who is 13 months away. In addition, we also recognize that optional forms of benefits have values beyond their actuarial value. For example, a term-certain period option which is actuarially equivalent to a life annuity option may protect a dependent better than a joint and survivor option would. This would occur if an unmarried participant has a healthy dependent child who is age 15. The participant may prefer to elect a ten-year certain and life option with the child as a beneficiary rather than a joint and survivor option with the child as a beneficiary. The certain period option protects the child until he or she will reasonably complete his or her education. A joint and survivor option would protect the child for beyond the period necessary and result in a very large and probably unacceptable reduction in the benefit payable to the participant. Because of the inherent differences in optional forms of benefits, we propose that the one-year rule be limited to “redundant” options.

For a plan which has a large number of grandfathered optional forms of benefits, it is inherent that many of the options are redundant in that they provide benefits which are close to each other. For example, a 20-year certain benefit for a spousal beneficiary is very close in amount and expectancies to a 100% joint and survivor benefit. The main difference is that the benefit continues if both die within 20 years rather than ending at the second death. In contrast, if only the spouse lives beyond 20 years, the benefits stop rather than continuing, which could be a financial disaster to the spouse. Thus, in addition to being redundant, the 20-year certain option can be dangerous.

For a plan with multiple options, the task is to define the options that are deemed to be redundant. This is not an easy task. It requires that an analysis be made of the various options available under the plan and the legitimate reasons a participant might elect the optional form of benefits. Where payments are similar, preference should be given to the optional form of payment which best fulfills a logical need to provide both life-time income to the participant and income to a dependent during the period of dependency. The following is our attempt at such an analysis:
1. A lump sum payment is not redundant because it is unlike any other form of payment under a defined benefit pension plan. It permits a participant to take his or her entire benefit in a lump sum rather than an annuity, invest it, and live off of whatever portion of the principal and interest the participant deems appropriate. The participant is able therefore to structure his or her stream of payments to fit his or her living needs.

2. A life annuity form of payment is not redundant since it allows a single participant without any dependents to receive an annuity payment that maximizes the amount of his or her annuity benefit.

3. A 50% joint and survivor annuity and a 100% joint and survivor annuity with the spouse of the participant as the beneficiary are not redundant since they are the primary forms of retirement benefits which allow a participant to make sure that his or her spouse will have a stream of income payments for the rest of the spouse’s life. Percentages other than 50% and 100% will be redundant since they do not add a significantly different form of payment to the choice of forms.

4. A 50% joint and survivor annuity and a 100% joint and survivor annuity with someone other than the spouse of the participant as the beneficiary are not redundant since they are the primary forms of retirement benefits which allow a participant to make sure that a dependent or life partner will have an income stream for the balance of the beneficiary’s life. Percentages other than 50% and 100% will be redundant since they do not add a significantly different form of payment to the choice of forms.

5. Installment forms of payment without a life annuity component are redundant forms of payment. That is, payment for a fixed period of years provides a stream of income which is similar to a life annuity or a 100% joint and survivor annuity depending on the ages of the participant and his or her beneficiary but without the guarantee of payments for life. The payments are also redundant with life annuities with a certain period. Such a form of payment lacks the assurance that accompanies the other forms of payment that the benefits will not run out during the participant’s life. Thus, the form of payment does not fulfill a reasonable desire on the part of the participant to provide life-time benefits for himself and/or a beneficiary. We consider this to be a redundant form of payment.

6. Social Security adjustment options provide a participant with higher payments until a participant reaches the age to receive Social Security payments and with payments for life thereafter. We propose that the Social Security adjustment option not be deemed redundant in that it offers a unique form of distribution to a participant even if the plan offers a lump sum form of payment. All other Social Security adjustment options such as any joint and survivor annuity with a Social Security adjustment would be considered redundant.
It should be noted that a Social Security adjustment option in a plan which does not include a lump sum form of payment takes on a higher degree of “value” to a participant who is terminally ill or has been diagnosed with a disease and who does not have a logical beneficiary. That is because the Social Security adjustment option provides for the fastest payout of benefits. This enables such a terminally ill participant, to maximize his or her payments from the plan prior to death. If the plan has a lump sum option, such a participant would not choose the Social Security adjustment option because the lump sum form of payment pays the participant the greatest amount in his or her fore-shortened life.

7. Ten- or 15-year certain and life annuity options are not redundant in that the term-certain period allows a participant to protect a healthy young dependent until the dependent reaches majority or a later time, such as the completion of the dependent’s education. A five-year certain and life annuity option is redundant because it is so close to a straight life annuity. On the other hand 20-year certain and life annuity options also seem to be redundant because they are so close to the joint and survivor annuity options. If a plan has both ten-year and a 15-year certain option, one of them can be treated as redundant since the two are so close to each other. Thus, if a plan has five-, ten-, 15- and 20-year certain options, we propose that the plan must keep either the ten-year certain option or the 15-year certain option but be permitted to eliminate the other three options.

8. Single life or joint and survivor annuities with full cash refunds at the end of the payment period are redundant. They are similar to the same annuity form of payment without the full cash refund feature. The full cash refund portion of the option does not provide either a lifetime or period certain protection to the beneficiary of the participant. As a consequence, we do not see any public policy reason to preserve these options when faced with the complexity of administering them.

9. Joint and survivor annuities with term-certain periods guaranteed are redundant with either joint and survivor annuities or certain period annuities.

Based upon the foregoing, we propose that the following options be treated as not being redundant:

a. lump sum;
b. life annuity;
c. 50% joint and survivor annuity and a 100% joint and survivor annuity;
d. Social Security adjustment option; and
e. either a ten- or 15-year certain and life annuity option.
It should be noted that the life annuity, 50% joint and survivor annuity and a 100% joint and survivor annuity, and the ten-year certain period and life annuity option are the primary options in most defined benefit pension plans and are included in the “core options” set forth below in our core options proposal. Lump sum and the Social Security adjustment option are rarer but are treated as not redundant because of their uniqueness when compared to the other options.

In contrast, the following optional forms of payment would be considered to be redundant:

i. installment forms of payment without a life annuity component;

ii. term-certain and life annuity options other than either a ten-year or 15-year certain option;

iii. single life or joint and survivor annuities with full cash refunds at the end of the payment period;

iv. any Social Security adjustment option other than payments for the life of the participant; and

v. joint and survivor annuities with term-certain periods guaranteed.

C. Non-Redundant Unsubsidized Optional Forms of Benefits, Other Than Lump Sums, May be Modified or Eliminated by Plan Amendment Adopted at Least Ten Years Before it Becomes Effective

As noted above, Treasury has greater authority to permit the modification or elimination of optional forms of benefit than for early retirement benefits or retirement-type subsidies. We believe that Treasury should exercise this authority to permit the modification or elimination of non-redundant unsubsidized optional forms of benefits where the amendment is adopted far in advance of its effective date.

One example of such a non-redundant unsubsidized optional form of payment is a Social Security adjustment option. Should a plan sponsor be able to eliminate a Social Security adjustment option even if it is not subsidized? Does it make a difference if the plan contains a lump sum option? There are arguments both ways.

The argument against allowing elimination of the option is that it provides a unique method of payment which might be attractive to some participants. It may be particularly attractive to participants who are primarily dependent on the plan and Social Security for retirement income and who are forced to take early retirement because of a reduction in force or other downsizing event. Without the Social Security adjustment option, such a participant might not be able to have an adequate retirement income during the years prior to the start of Social Security benefits. This is especially true if the participant does not have retiree medical coverage and must therefore provide his or her own medical benefits until he or she becomes eligible for Medicare.
As noted above, the argument becomes stronger if the plan does not contain a lump sum option. This is because the Social Security adjustment option is the one that allows the participant to be paid his or her benefits the fastest. This should be attractive to a participant who has been diagnosed with a life-shortening or terminal illness.

The arguments in favor of allowing the option to be eliminated include, first, the argument that the only form of payment mandated for a qualified defined benefit pension plan is the qualified joint and survivor annuity form of payment. No other forms of payment are required to be provided by a plan - the ones that are provided are a matter of the plan’s history, not government requirements. It does not make sense for the law not to require a plan, to have a Social Security adjustment option, however useful it might be to certain participants but, if it ever had it, to treat the option is too “valuable” for it to be taken away from a participant no matter how much advance notice is provided.

The approach that Treasury took with respect to the SBJPA changes to 401(a)(9) and the right to commence benefits at age 70½ was to take into account the reasonable expectations of the participants and the degree to which the participants will have made retirement plans in reliance on the right contained in the plan. In that case, Treasury took the position that the right to receive in-service benefit payments could be taken away as long as the effective date of the amendment occurs in the year following its adoption and in a year which is more than two years after passage of SBJPA. For participants who were less than age 68½ when SBJPA passed, Treasury and the Service determined that they had not developed the expectancy of working past age 70½ and receiving retirement benefits. Thus, the regulations under SBJPA indicate that Code section 411(d)(6) must take into account the expectations of the participants, especially where they would have made plans based upon the availability of the benefit.

We suggest that a participant who does not retire for ten years would not have made substantive plans to receive a Social Security adjustment option. In addition, forced early retirement situations, such as reductions in force or diagnosis of a life-shortening or terminal illness, would not have occurred ten years in advance of actual retirement. Thus, ten years seems to be more than enough years in advance for the amendment eliminating the non-redundant non-subsidized optional form of benefit to be adopted.

d. Subsidized Optional Forms of Benefits May be Modified or Eliminated by Plan Amendment Adopted at Least Ten Years Before it Becomes Effective.

As noted above, it should take longer to eliminate optional forms of benefits involving retirement-type subsidies than those that are actuarially equivalent. How long is a matter to be decided by Treasury and the Service. We recommend that the time it takes to eliminate a subsidized optional form of benefit be longer than the time it would take to eliminate a redundant unsubsidized optional form of benefit (one year - see above) and equal to or shorter than the time it would take to eliminate a retirement-type subsidy or an early retirement benefit (15 years - see above).
We recommend that ten years be specified as the advance adoption period for an amendment which will eliminate a subsidized optional form of benefit. Ten years is recommended rather than 15 years because we perceive that, among our clients’ plans, the subsidies for certain optional forms of benefits are not as large as some of the retirement-type subsidies and early retirement benefits. For example, where the plan fully subsidizes the 100% joint and survivor annuity with the participant’s spouse, the subsidy may range in value from ten percent to 70% of the accrued benefit. In contrast, an unreduced benefit payable at age 48 may have a value which is 300% or more of the accrued benefit.

e. Lump Sum Payments May be Modified or Eliminated by Plan Amendment Adopted at Least 15 Years Before it Becomes Effective.

Perhaps the most controversial optional form of benefit is the lump sum payment option. It is extremely popular with participants, especially those who are less than age 60 when the lump sum is payable. In addition, the legislative history of the Retirement Equity Act of 1984 (“REA”), which enacted Code section 411(d)(6), singled out lump sum payments as being specially protected. Specifically, the legislative history stated that “the committee expects that the regulations will not permit the elimination of a ‘lump sum distribution’ option because, for a participant or beneficiary with substandard mortality, the elimination of that option could eliminate a valuable right even if a benefit of equal actuarial value (based on standard mortality) is available under the plan.”

This legislative history of REA raises the initial question of whether lump sum payment options are still sacrosanct such that Treasury should not allow for them to be eliminated under any circumstances or whether EGTRRA was intended to permit the elimination of lump sum payments when the EGTRRA standards are met. Neither the provisions of Code section 411(d)(6) as amended by EGTRRA nor the legislative history of EGTRRA mentions lump sum distributions or the REA legislative history. Since EGTRRA is silent, one interpretation would be that Congress intended that lump sum payment options would remain sacrosanct. If Congress had intended to revoke its previous statements about lump sum payment options, it could have done so explicitly.

There are a number of powerful arguments that a plan sponsor should not be allowed to eliminate lump sum payments under the new EGTRRA authority. First, EGTRRA is intended to allow for the elimination of optional forms of benefits, early retirement benefits and subsidies where they create significant burdens and complexities for the plan and plan participants. Lump sum payments do not involve substantial administrative burdens or complexities. The calculation of a lump sum payment is a fairly simple actuarial calculation, and the payment of a lump sum is less burdensome for the plan than paying any annuity form of distribution. Thus, on its face, a lump sum payment does not create the significant burdens and complexities required by the EGTRRA provision. Even if a plan sponsor freezes a lump sum option as to current accrued benefits, offering a lump sum on a frozen accrued benefit is less complex and less burdensome than offering an unusual form of annuity payment on the frozen accrued benefit. That is, when the participant makes his election, if he or she chooses a lump sum on a frozen accrued benefit, the calculation is performed, the lump sum is paid, and the residual benefit is
payable in accordance with a single form of annuity payment. This is not as burdensome as paying two parts of an accrued benefit under two different annuity forms of payment.

While there are financial reasons and design reasons that a plan sponsor may want to eliminate a lump sum option, these reasons do not fit within the EGTRRA standards for elimination of an option. To be eliminated under EGTRRA, the optional form of benefit must be complex and burdensome for the plan and plan participants, and its elimination should not adversely affect any participant in more than a *de minimis* manner.

Lump sum payments have a special role under the regulations as well as in the minds of participants. Recent regulations under Code section 411(d)(6) relating to defined contribution plans provide that, if such a plan contains a lump sum payment option, the plan sponsor can eliminate all other forms of payment except for the statutory joint and survivor provisions applicable to certain defined contribution plans. This indicates a strong recognition that participants favor lump sum payments when they are offered by plans and elect to receive them almost to the exclusion of other optional forms of payment.

Finally, the EGTRRA standard states that the elimination of an optional form of benefit, early retirement benefit or subsidy must not adversely affect the right of any participant in more than a *de minimis* manner. Since lump sums are so popular with participants, it is argued that adverse impact on a participant of the elimination of a lump sum option can never be *de minimis*. This is particularly true with respect to participants who recognize that they have shorter than normal life expectancies as was pointed out in the REA legislative history. Even though the lump sum form is actuarially equivalent to other forms of payment, once a participant has been diagnosed with a life shortening or terminal illness, normal life expectancy tables are no longer applicable and the lump sum optional form becomes, for that participant, more valuable than any other form of payment.

Based upon the foregoing it is clear that there are strong arguments for not including lump sums in the ambit of the EGTRRA provision. However, there are also arguments the other way. First, the EGTRRA provisions create a standard for the elimination of early retirement benefits and retirement-type subsidies and gives Treasury discretion whether to apply this standard to optional forms of benefits. It is unlikely that Congress would intend that lump sum payment options which meet the EGTRRA standards for elimination could still not be eliminated. That is, if lump sum payments create significant burdens or complexities and are *de minimis*, Congress must have intended that they could be eliminated. If Congress did not intend for the new standard to apply to lump sum payment options, it could have explicitly so stated.

While a lump sum option which is payable on the full accrued benefit of a participant does not create significant burdens or complexities for the plan or participants, the only method available to a plan sponsor to eliminate lump sum payments is complex and burdensome. That is, freezing a lump sum form of payment for a portion of the accrued benefits of a portion of the plan participants will require calculation and storage of the frozen portion of the accrued benefit and the use of special explanation forms and special election forms for the frozen group of participants until the last of the frozen group retires, dies or terminates employment - perhaps for 40 years. At some point in the 40-year period, for many if not all participants, the frozen lump
sum payment will become *de minimis* in accordance with the standards set forth above but with a lot of complexity and burden in the interim.

The issue becomes whether a plan sponsor which would like to eliminate lump sum payments from its defined benefit plan can do so in a manner simpler than the complex and burdensome freeze methodology. That is, can the lump sum option be frozen for a period of time with the proviso that, after a period of years, it will be totally eliminated. If so, a balance would be struck between the rights of participants to receive the lump sum on the frozen accrued benefit for a period when it is a significant part of the total benefit and the desire of the plan sponsor not to have to continue the lump sum option on the frozen accrued benefit for 40 or more years. Any such period of years will seem arbitrary, but this comment suggests 15 years should be sufficient.

The burdens of lump sum payments in defined benefit pension plans are not just the burdens of administration but also include financial burdens. First, lump sum payments present a hazard to the viability of a defined benefit plan which was not fully appreciated when most employers added the lump sum form of payment to their plans. This is because lump sum payments can deplete the assets of a defined benefit plan faster than any other feature of a plan. During periods of low interest rates, lump sum values increase substantially - thereby increasing the potential adverse effect on plan funding of a series of lump sum payments. Second, lump sum payments from defined benefit plans (other than cash balance pension plans) are sufficiently contrary to the basic purpose of such plans that Code section 411(d)(6) should not favor them over all other optional forms of payment. At most, Code section 411(d)(6) should be neutral with respect to lump sum payments from defined benefit plans. Finally, unsubsidized lump sum payments take on extreme extra value only when a participant is diagnosed with a life shortening or terminal illness or condition. If there is sufficient time between when the amendment is adopted and when it becomes effective, people who have been diagnosed with such an illness or condition at the time of the amendment will have had an opportunity to retire or terminate employment. For people with such an illness or condition on the date of the amendment, 15 years should be sufficient for them to retire or terminate employment.

Under this approach, people who become diagnosed with a life shortening or terminal illness 14 years after the amendment will not have the lump sum option available, even on the portion of their benefit which was accrued prior to the date of the amendment. The 15 year period is designed to meet the needs of the participants who were diagnosed at the time of the amendment. They were the ones who, at the date of the amendment, were likely to have made plans to retire and receive the lump sum optional form of benefits. The person who is diagnosed in the 14th year after the amendment was not planning 14 years earlier on taking a lump sum payment because it was significantly more valuable due to his or her health status.

Based upon the foregoing discussion, there are strong arguments against applying the EGTRRA standard to lump sum payments under defined benefit pension plans and strong arguments for allowing the elimination of lump sum payments over a period which is less than 40 years. After considering the arguments, a majority of the persons involved with this comment recommend that plan sponsors should be allowed to eliminate lump sum payments effective at least 15 years after the adoption and communication of the necessary amendment. A strong
minority feel that the case cannot be made for their elimination based upon the EGTRRA standards and dissent from this recommendation.

It should be noted that there is an argument that a lump sum form of payment is always subsidized under the current provisions of the Code. Specifically, Code section 417(e)(3) specifies that lump sum payments must be computed using an interest rate not greater than the 30-year Treasury rate. Because 30-year Treasury securities are not being issued currently, the 30-year Treasury rate is currently understated. The effect of the rate being understated is to make lump sum payments larger than would be the case if 30-year securities were being issued by Treasury. We suggest, however, that, as indicated earlier, the determination of whether an optional form of benefit is subsidized should be made by looking at the terms of the plan. Applying the recommended test, we believe that, based upon the terms of the plan and the Code, the lump sum form of payment should not be considered to be subsidized. Congress, in adopting Code section 417(e)(3) and the plan sponsor in complying with Code section 417(e)(3) both expected that the lump sum payment would be an unsubsidized actuarial equivalent of the normal form of benefit payment. Thus, as set forth above, lump sums calculated in accordance with Code section 417(e)(3) should be treated as an unsubsidized non-redundant optional form of benefit payment.

f. The Regulations Should Permit Elimination of Optional Forms Where the Present Value of the Participant’s Affected Benefit is Immaterial in Comparison to the Participant’s Annualized Compensation.

As noted above, a factor mentioned in the House Report is the amount of the participant’s benefit that is affected by the amendment. The House Report example allows the elimination of an early retirement subsidy where the value of the benefit is less than two-tenths of one percent of the participant’s compensation. However, where the value of the benefit is not de minimis as a percentage of the participant’s compensation, the subsidy can be reduced by 1.25% of the participant’s compensation. We have recommended that bright line safe harbor of five percent of compensation be applied in dealing with early retirement benefits and retirement-type subsidies. There is no reason this concept should be limited to early retirement benefits or retirement-type subsidies. Where the value of the benefit payable under the optional form is no more than five percent of the annualized compensation of the participant, it would be conclusively presumed to be de minimis.

g. The Regulations Should Permit Elimination of Optional Forms Where the Difference in the Amount of the Participant’s Benefit is Relatively Immaterial.

Where two options are actuarially equivalent using plan factors and the difference in annual benefit payable to the participant under the two options is less than a specified safe harbor percentage - perhaps ten percent - of the benefit, one of the two options can be eliminated. That is, suppose under a ten-year certain form of benefit the participant would receive $1,000 per month. Suppose further that the participant would receive $975 per month under a 15-year certain method of payment and $925 under a 20-year certain and life annuity. In such an instance, the 15-year and 20-year certain and life annuity forms can be eliminated because the
differences between the three options are *de minimis* utilizing the same rule as applies to retirement-type subsidies and early retirement benefits.

This is a simple rule and could be uniformly administered in all plans. It would permit the reduction of some complexity in plan administration. However, the eliminated optional forms may have some value to a participant in certain circumstances. For example, a participant whose primary beneficiary is a healthy minor child who is age five could protect the child until age 25 using the 20-year certain and life option while the ten-year certain and life benefit would not protect the child beyond age 15. We believe, however, that such a situation is quite rare because participants who have five year-old children do not usually retire unless they have other sources of wealth to provide for the child.

On balance, we recommend the incorporation of this rule as a safe harbor.

**h. The Regulations Should Permit Elimination of Optional Forms at Least a Specified Number of Years Before Retirement Age.**

The House Report also mentions the number of years before retirement as a factor to consider in eliminating optional forms and subsidies. This is, no doubt, because a benefit that cannot be realized for a number of years is less valuable to the participant and the benefits to that participant do not outweigh the administrative burdens to the plan. Further, unlike the participant who is close to retirement age, the younger participant does not have the expectation of receiving a particular optional form.

In the example in the House Report, the older participant was only five years away from early retirement age (55), while the younger participant was at least 20 years away. Even though the surviving plan had a lower early retirement age (50 as compared to 55), the House Report said the early retirement benefit could be eliminated completely for the younger participant.

Following this example, a plan should be able to eliminate optional forms for participants who are at least a specified number of years from the earliest retirement age with the number of years being dependent upon whether the optional form of benefit is redundant, is subsidized, or is a lump sum form of payment, as follows:

1. If the optional form of benefit is a redundant unsubsidized form of payment, the optional form of payment can be eliminated for participants who are more than one year away from the earliest retirement age;

2. If the optional form of benefit is a non-redundant unsubsidized form of payment, other than a lump sum payment, the optional form of payment can be eliminated for participants who are more than ten years away from the earliest retirement age;

3. If the optional form of benefit is a subsidized form of payment, the optional form of payment can be eliminated for participants who are more than 15 years away from the earliest retirement age; and
4. If the optional form of benefit is a lump sum payment, the optional form of payment can be eliminated for participants who are more than 15 years away from the earliest retirement age.

The foregoing rule is very similar to the rules set forth above on the length of time for an amendment eliminating optional forms of benefits to become effective. Having the same rules for both will make the rules easier to understand and apply in various situations. We recommend that there be four different time frames as set forth above because the same rule would not work well for the elimination of a lump sum payment as for the elimination of a redundant unsubsidized optional form of payment. While, for certain options it would take 15 years to eliminate them, that is a substantial improvement over the current situation when it might take 40 to 70 years to eliminate an option.

2. **The Core Option Approach: Regulations Should Provide That Plan Sponsor May Eliminate, After Notice, All Options That Are Not “Core Options.”**

Another approach is to determine which options are most commonly selected by the majority of plan participants without regard to the individual plan or the personal circumstances of individual participants and to define these as “core options.” A plan sponsor could eliminate, after notice, all options which are not part of this core package. This approach is consistent with important policy goals of avoiding unnecessary administrative burdens on defined benefit plan sponsors, and promoting uniformity in the application of the new rules and plan operations.

a. **Defining Core Options.**

Core options would clearly include joint and survivor (50%, 100%) (not limited to the statutory QJSA) and straight life annuities for both married and single participants. The defined QJSA and straight life annuities are statutorily required under Code section 401(a)(11). We suggest that as the lump sum is becoming increasingly popular with participants, a full lump sum payment should also be part of the core package at least if the plan already offers a lump sum benefit.  

The other optional form of benefit which is typically offered is the term certain and life annuity, with a ten-year term certain being typical. This would suggest a package of core options defined as follows:

1. straight life annuity
2. 50% and 100% joint and survivor annuity (limited to spouses only if the plan currently so limits it)
3. 10-year certain and life annuity (if plan currently offers certain and life annuities)

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The core option proposal provides uniformity for plans and participants and preserves a range of typical options. However, the core option proposal may result in the elimination of options which are not *de minimis* to particular individuals who have special circumstances. However, it should be noted that many of the largest retirement plans in the world, governmental plans, do not provide for such special circumstances.

b. **Special Considerations for Mergers; Transitional Rule**

We suggest that the core options approach be adopted generally for all plans in all situations. However, if it is not generally adopted, we recommend that there be a rule that plan sponsors will have a defined period such as three years following a plan merger to eliminate non-core options resulting from the plan merger. Existing plans should have a one-time transition period following the issuance or effective date of new regulations to eliminate any options grandfathered by plan merger or otherwise, other than core options. We suggest a three-year retrospective look-back for all mergers effective prior to the new regulations to eliminate inherited options and the accumulated past complexity.

3. **The Regulations Should Allow for the Elimination of Multiple Versions of the Same Form of Payment Option.**

As a supplement or alternative to the *de minimis* approach, the regulations should allow for the elimination of multiple versions of the same form of payment option (e.g., five-, ten-, 15, or 20-year certain and life form of payment) or overlapping benefit options (e.g., such as a plan which provides not only joint and survivor annuities and life and term certain annuities, but also joint and survivor annuities with a term certain features). Where such options are actuarially equivalent (using the plan’s assumptions) and are substantially the same except for one aspect with respect to which the distribution options involved form a series, then the sponsor should be permitted to eliminate one or more of those annuity forms, provided that the plan retains at least one of the forms and either one or more of the retained forms are intermediate forms in the series or the periodic payment under one or more of the retained forms would not be significantly different than under the form or forms eliminated. Under this proposal, a plan which maintained five-, ten-, 15n and 20-year certain and life annuity forms of payments could be simplified to retain the ten-year certain and life form and eliminate the others.

Under the current Treasury regulations, a plan with 50%, 75% and 100% joint and survivor annuity forms of payment can eliminate the 75% joint and survivor annuity. We propose that joint and survivor annuities with term certain features should be treated as being substantially similar to joint and survivor annuities without term certain features so that one of them can be eliminated. For example, suppose a plan has a 50% and 100% joint and survivor annuity form of payment without any term certain guarantee and also has a 50% and 100% joint and survivor with term certain guaranteed annuity forms of payment. Under this proposal, the plan sponsor could eliminate two of the optional forms of payment - either those without the term certain feature or those with the term certain feature.
The relief requested in this section, as well as others, builds on provisions in the existing regulations under Code section 411(d)(6). For example, Treasury already utilized a bookends type of approach in the case of elimination of intermediate joint and survivor annuities. Thus, if a plan provides 50%, 75% and 100% joint and survivor annuities, the regulations under Code section 411(d)(6) allow the plan sponsor to eliminate the 75% joint and survivor annuity as long as the 50% annuity and the highest percentage annuity remain. While EGTRRA mandates that Treasury grant relief in accordance with the significant burden and *de minimis* standards (and with respect to early retirement benefits and retirement type subsidies, as well as optional forms of benefit), EGTRRA by no means precludes Treasury from granting relief with respect to optional forms of benefit on a broader basis than that. Indeed, EGTRRA did not impact the final sentence of Code section 411(d)(6), which gives broad discretion to Treasury to provide that the requirements do not apply to amendments eliminating an optional form of benefit.

Moreover, the definition of optional form of benefit as set forth in Treas. Reg. §1.401(a)(4)-4(e) itself allows for some room for changes which are not substantial. The definition indicates that different optional forms of benefit only exist “if a distribution alternative is not payable on substantially the same terms as another distribution alternative.” Consequently, the very definition of optional form already uses a standard which is softer than the “no more than a *de minimis* impact on any participant” standard.

The proposal would allow for the elimination of similar optional forms of benefits and treat all life with certain period annuities as similar to each other. While they are similar, the extremes of a five-year certain life annuity and a 20-year certain life annuity are not similar enough so that a plan should be able to eliminate all period certain annuities except one of the extremes. A plan sponsor should be allowed to eliminate the extremes but should be required to keep one of the middle term certain options - either the ten-year certain or 15-year certain options.

The proposal also deems joint and survivor annuity options as being substantially similar to joint and survivor annuity options which have term certain features, and would allow the elimination of either, but not both of them. While it is rare, the term certain joint and survivor annuity serves the needs of a few situations where a participant is responsible for both a spouse and an underage child or grandchild. The term certain joint and survivor annuity allows the participant to provide for guaranteed income through the lives of the participant and his spouse and until the underage child or grandchild reaches an appropriate age. That way, if the both the participant and his or her spouse die prematurely, the child or grandchild continues to receive annuity payments for the balance of the certain period. This proposal allows for that option to be eliminated.

4. **The Regulations Should Allow for the Elimination of an Optional Form of Payment Where All the Participants Consent to the Elimination.**

It is possible for the regulations to allow for the elimination of an optional form of payment where all participants consent to the elimination of the option. This would be particularly useful for smaller plans where consents would be easier to obtain. If all the participants consent to the elimination of the optional form, it is a strong indication that the
optional form of benefit is of *de minimis* value to the participants. In such a situation, it would not be worthwhile to go through the complexity and burdens of continuing the option for a frozen accrued benefit for any period of years.

5. **Summary of Recommendations Relating to Optional Forms of Benefits.**

Based upon the foregoing, we recommend that:

a. Redundant unsubsidized optional forms of benefits may be modified or eliminated by plan amendment adopted at least one year prior to when the amendment becomes effective.

b. Non-redundant unsubsidized optional forms of benefits, other than lump sums, may be modified or eliminated by plan amendment adopted at least ten years prior to when the amendment becomes effective.

c. Subsidized optional forms of benefits may be modified or eliminated by plan amendment adopted at least ten years prior to when the amendment becomes effective.

d. Lump sum payments may be modified or eliminated by plan amendment adopted at least 15 years prior to when the amendment becomes effective.

e. The regulations should permit elimination of optional forms where the present value of the participant’s affected benefit is small in comparison to the participant’s annualized compensation.

f. The regulations should permit elimination of optional forms where the difference in the amount of the participant’s benefit is relatively immaterial.

g. The regulations should permit elimination of optional forms at least a specified number of years before retirement age.

h. The regulations should provide that a plan sponsor may eliminate, after notice, all options which are not “core options.”

i. The regulations should allow for the elimination of multiple versions of the same form of payment option.

j. The regulations should allow for the elimination of an optional form of benefit where all participants consent to the elimination.

VI. **Conclusion.**

We applaud the efforts of the Service and Treasury in proposing to deal with the difficult issues presented by the current regulations under Code section 411(d)(6) and encourage both Treasury and the Service to address the myriad problems that face plans resulting from Code
section 411(d)(6). Because of Code section 411(d)(6), plans are burdened with a multiplicity of early retirement benefits, retirement-type subsidies and optional forms of benefits with no viable method of eliminating them. Optional forms of benefits provide the biggest challenge because it sometimes takes 40 to 70 years to eliminate them - 40 to 70 years of administrative complexity and confusing communication materials.

In particular we encourage Treasury and the Service to utilize the authority provided by EGTRRA to define early retirement benefits, retirement-type subsidies and optional forms of benefits in a manner so that an “early retirement benefit” identifies the timing of the commencement of a benefit prior to a participant’s normal retirement date, a “retirement-type subsidy” identifies benefits that have actuarial value in excess of the normal retirement benefit, and “optional form of benefit” refers to the method of payment without regard to the commencement date or the amount of the benefit. The foregoing definitions will allow for clarity as to the three different features in a defined benefit plan.

We further recommend that Treasury and Service follow the provisions of EGTRRA and the legislative history to allow for the elimination of burdensome early retirement benefits, retirement-type subsidies and optional forms of benefits which have de minimis value to a participant. In addition, we encourage Treasury and the Internal Revenue Service to utilize their greater authority with respect to optional forms of benefits to more liberally allow for the elimination of optional forms of benefits which do not involve retirement-type subsidies.