



**COALITION TO PRESERVE
THE DEFINED BENEFIT SYSTEM**

February 21, 2017

CC:PA:LPD:PR (Notice 2016-67)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20004

RE: Notice 2016-67

Dear Sir or Madam:

This letter is being submitted on behalf of the American Benefits Council (the “Council”) and the Coalition to Preserve the Defined Benefit System (the “Coalition”) with respect to the request for comments in IRS Notice 2016-67. The issue is whether the hybrid plan regulations should be amended to subject implicit pre-retirement interest in an “implicit interest pension equity plan” (“implicit interest PEP”) to the market rate of return limitation rules.

The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council’s members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

The Coalition is an employer organization with 75 member companies ranging from modest-sized enterprises to some of the largest corporations in the country, all of which sponsor hybrid pension plans. Together the Coalition members provide retirement benefits for more than 1.5 million American workers.

First, we would like to thank you for your ongoing openness to considering and addressing issues confronting hybrid plans, their sponsors, and their participants. We very much appreciated the guidance issued in Notice 2016-67 and your commitment to seeking input on possible changes to the current rules.

Background.

IRS Notice 2016-67 describes implicit interest PEPs as follows:

[Some] PEPs provide for increases in annuity benefits for annuity starting dates after principal credits cease by applying a deferred annuity factor to the participant's accumulated benefit as of the date principal credits cease. Such a PEP is often referred to as an "implicit interest PEP" because preretirement interest is implicitly reflected in the deferred annuity factor. One example of an implicit interest PEP is a PEP that defines the accrued benefit (that is, the annual benefit payable at a participant's normal retirement age) as the actuarial equivalent of the accumulated benefit determined as of the date principal credits cease (or the current date, if principal credits have not yet ceased), and determines actuarial equivalence using a deferred annuity factor that reflects preretirement interest.

Notice 2016-67 concludes that implicit interest PEPs are not currently subject to the market rate of return rules, but asks for comments on whether the regulations should be modified to subject such plans to the market rate rules.

Discussion

With respect to whether pre-retirement interest in an implicit interest PEP should be subject to the market rate rules, the Notice requests that comments take into account the statutory intent of Code section 411(b)(5) to subject interest credits and equivalent amounts to a market rate of return limitation. From this perspective, we understand why Treasury and the IRS are considering modifying the regulations to subject implicit interest to the market rate rules. Unless that is done, there would be an opportunity to circumvent the market rate rules and thus achieve the age discriminatory effect that Congress intended to prevent by imposing the market rate rules.

We thus would understand if Treasury and the IRS were to modify the regulations to reach this result and provide corresponding anti-cutback relief to comply with this rule. In this context, we would like to make a number of related points set forth below.

Treatment of pre-retirement mortality. Under the Notice, the implicit assumption for pre-retirement mortality is aggregated with a PEP's implicit interest, and the issue posed is whether both together should be subject to the market rate of return rules. We see no basis under the law for treating the assumption for pre-retirement mortality as part of the interest crediting rate subject to the market rate rules. In fact, this could raise questions about, for example, cash balance plans that have explicit pre-retirement interest, but also have annuity conversion factors. If Treasury and the IRS are proposing to change the treatment of all hybrid plans with respect to annuity conversion factors, the community is not on notice, since Notice 2016-67 does not raise this issue.

Confirmation of lump sum calculation. As noted above, if a participant does not elect the initial lump sum offering, implicit interest PEPs generally pay a lump sum

equal to the 417(e) present value of the annuity offered under the plan; in some cases, plans provide a floor lump sum benefit equal to the current value, on termination of employment, of an accumulated percentage of the participant's average compensation. Without regard to whether implicit interest is subject to the market rate rules, these approaches seem perfectly permissible, and we would ask that this be confirmed in any guidance that is issued. This is not to say that these are the only permissible approaches, however.

Effective date of regulation subjecting implicit interest to market rate rules.

Any such regulation should not be effective until the first plan year beginning at least 12 months after the regulation is finalized.

Guidance needed if implicit interest not subject to market rate rules. Some employers have treated implicit interest as subject to the market rate rules and have reduced the implicit interest to comply with the market rate rules. If implicit interest is not made subject to the market rate rules:

- We urge the IRS to issue prospective guidance confirming this, so that the uncertainty is resolved.
- In this guidance, we ask the IRS to approve any reduction based on the contrary interpretation for all purposes (including qualification, funding, and benefit restrictions), provided that the reduction is voided prospectively within a reasonable specified period after the issuance of the guidance (such as six months). With respect to benefits paid prior to the end of such specified period, we see no rationale for challenging the reasonable interpretation of the statute and regulations under which the reduction was based or for requiring "correction" of payments made under such a reasonable interpretation.
- There would need to be anti-cutback relief to permit any prior reduction to be voided. Because a market rate can in many instances be lower than a non-market rate, we would need this anti-cutback relief.
- The guidance should state that the voiding of the prior reduction would not require a 204(h) notice.

Thank you for your consideration of the issues discussed above.

Sincerely,

American Benefits Council

The Coalition to Preserve the Defined Benefit System

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