AMERICAN ACADEMY of ACTUARIES

Objective. Independent. Effective.™

April 28, 2016

CC:PA:LPD:PR (REG-125761-14)
Room 5203
Internal Revenue Service
PO Box 7604
Ben Franklin Station
Washington, DC 20044

RE: Nondiscrimination Relief for Closed Defined Benefit Pension Plans

To Whom It May Concern:

The American Academy of Actuaries'[1] Pension Committee respectfully requests your consideration of our comments and recommendations regarding the proposed regulations for Nondiscrimination Relief for Closed Defined Benefit Plans (REG-125761-14). The committee commends the Department of the Treasury and the Internal Revenue Service (IRS) for taking on this difficult, but much-needed, process of updating the application of well-established rules to closed plans. The proposed regulations move forward the intent that plans that were in compliance with the applicable nondiscrimination rules at the time they were closed should be allowed to continue to provide benefit accruals to the participants in those plans for as long as possible.

The proposed regulations will provide relief for some employers and will help to stem the trend toward fully freezing pension plans; however, many plan sponsors will not be able to use the closed plan rules for a variety of reasons. We respectfully submit that the regulations need to go further in order be effective. In addition, we believe that certain aspects of these regulations, if implemented as proposed, could have unintended consequences that will likely lead to more plan freezes and terminations, further eroding the retirement security of the workforce.

We recognize the recent publication of Announcement 2016-16 withdraws the provisions of the proposed regulations that would modify §1.401(a)(4)-2(c) and §1.401(a)(4)-3(c). In our experience with plans, we found these provisions to be troubling and appreciate the IRS removing these aspects of the proposed regulation. Our comments were originally prepared prior to this announcement; to assist the IRS if you intend to revisit these concepts in the future, we have included those originally drafted comments as an Appendix to this letter.

[1] The American Academy of Actuaries is an 18,500+ member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

1850 M Street NW Suite 300 Washington, DC 20036 Telephone 202 223 8196 Facsimile 202 872 1948 www.actuary.org

Relief for Closed Plans

Relief From Cross-Testing Gateway for Aggregated DB/DC Plans

We appreciate the common-sense approach taken that a closed plan that initially grandfathered a reasonably broad group of participants (demonstrated by being able to satisfy the usual nondiscrimination rules for a five-year period thereafter) be permitted to be aggregated with a defined contribution (DC) plan and tested on a benefits basis thereafter without satisfying a gateway test. We believe that this approach reasonably balances the desirability of avoiding plan freezes with the need to ensure that the grandfathered group is reasonably nondiscriminatory and that the remaining employees are provided reasonable DC allocations. However, the conditions imposed on use of the relief will greatly limit the number of closed plans that would be able to use it, and we believe that a balance can be reasonably struck in a different manner that would allow more plan sponsors to use the revised testing rules.

Post-closure Requirements

Requirement to Satisfy Testing for Five Years

We ask that exceptions be added to prevent plan sponsors from losing relief because of corporate events (e.g., mergers, acquisitions, divestitures, facility closings) that occur during the five-year period after plan closure. Such business transactions can change the composition of the workforce in a way that causes a closed plan to fail testing, resulting in a loss of the testing relief under the proposal. Possible alternatives include:

1) Providing an alternative rule that if the plan, immediately after closure, passed testing using a 20 percent increased testing threshold (e.g., 70 percent becomes 84 percent, a nondiscriminatory classification test percentage of 30 percent becomes 36 percent), then the five-year requirement would not apply. An anti-abuse rule could be included such that if a divestiture or facility closing occurs within a short period—say one year—and results in the termination of employment of a significantly higher percentage of the grandfathered Non Highly Compensated Employees (NHCEs) than Highly Compensated Employees (HCEs), the alternative rule would cease to apply.
2) Allowing acquired employees to be ignored, or divested employees to continue to be counted, for purposes of meeting the testing requirements during the five-year period.

Plans That Took Advantage of Temporary Relief

We ask that deemed passage of the testing requirements for closed plans that resulted from using the temporary relief provided by Notice 2014-5 and Notice 2015-28 for 2014–2016 be included in the acceptable ways to satisfy the testing requirements for the five-year period beginning on the closing date. Without the temporary relief, some plan sponsors would have made the changes necessary to satisfy testing for a temporary period while IRS was considering more permanent changes to the rules, and thus would have been able to satisfy the five-year requirement. It appears that some of these plans that closed within the past five years may not be able to satisfy the five-year post-closure testing requirement using one of the enumerated methodologies in the proposed regulations (which do not include using the temporary relief).

Amendments in the Five-Year Period Preceding Plan Closure

We believe that the requirement that no plan amendments occurred that increased the accrued benefit or future accruals of any participant or increased plan coverage during the five-year period pre-closure will bar many otherwise deserving plans from having access to this relief. We believe that most plans have some sort of amendment in any given five-year period and that any such amendments that are "nondiscriminatory" (see "Definition of Nondiscriminatory Amendments" later in our comments) should not preclude relief, particularly because plan sponsors had no warning that the amendment they were making—which even may have been very beneficial to plan participants—would have that result. Our concern about the restrictions on amendments in the five-year period extends to all the relief that is contingent on it, including the ability to use Defined Benefit Replacement Allocations (DBRAs) and to avoid Benefits, Rights and Features (BRF) testing on a match.

We believe that the following types of amendments should be permissible during the five-year period:

1) Early Retirement Windows: The window would already need to have been proven to be nondiscriminatory for both BRF and amounts testing under the current regulations.
2) Recent Cash Balance Conversions: Many plan sponsors changed from a final-average-pay (FAP) formula to a cash balance formula, before eventually closing the plan. Because cash balance plans accrue benefits in a different pattern than FAP plans, it seems unlikely that such a conversion would satisfy the condition to not increase *any* future accrual of *any* employee.
3) Small (but not clearly *de minimis*) Changes to Other Plan Provisions: Common examples of these changes include improvements to early retirement or optional form factors to replace outdated ones that may overcharge for the option, allowing part-time employees to participate, and including bonuses and overtime in compensation.
4) Amendments Affecting Only Inactive Participants: Amendments that do not affect active participants (e.g., retiree cost-of-living increases, or bulk lump sum offers for terminated vested employees) should not eliminate relief from testing with respect to which those participants are not included.
5) Collectively Bargained Benefit Improvements: Some plans cover both collectively bargained and non-bargained plan participants and have historically extended changes made pursuant to a new collective bargaining agreement to non-bargained participants (sometimes referred to as the "me too" approach). Given that these benefit improvements would not need to be tested for nondiscrimination if applied only to bargained employees in a stand-alone plan, they should not cause a plan covering bargained and non-bargained participants to lose relief.

Acquired Groups

We ask that the same rule that applies for DBRAs when replacing a DB plan of a prior employer apply for relief both from the gateway and BRF testing—namely that the requirement that the DB plan have been in effect, and neither the benefit formula nor the coverage of the plan have been significantly amended for five years before the closure date, be replaced with a one-year requirement that takes the prior employer's plan into account.

Definition of Nondiscriminatory Amendments

Certain amendments can be ignored under the proposed regulations for purposes of the prohibition on amendments provided that they are nondiscriminatory. While we agree that it is reasonable to require such amendments to be nondiscriminatory, the definition of "nondiscriminatory" in the proposed regulations as currently described is difficult to implement and will flag many common amendments as discriminatory.

The proposed regulations define a nondiscriminatory amendment as one that does not reduce the coverage ratio for either the plan as a whole or for the rate group defined by any HCE. There are a number of practical problems with how this requirement interacts with rate group testing under §401(a)(4) (also referred to as the "general test"). For large plans, rather than having potentially thousands of rate groups (one for each HCE), the general test has typically been performed by grouping accrual rates. It is unclear whether the prohibition against reducing any ratio percentage applies with respect to the rate group defined by each HCE, or with respect to these "banded" rate groups. If the requirement applies with respect to each HCE (rather than the banded groups), an amendment that occurred many years ago (but within five years after plan closure) could then require the general test run in the year of amendment to be redone twice, once ignoring the amendment, but also without the grouping of accrual rates, and then a second time reflecting the amendment (again without grouping). Even if banded groups are permitted to be used, the files, data, and systems needed to perform such testing may no longer exist, or may reside with an actuarial firm no longer providing services to the plan sponsor. Redoing these tests to establish that an amendment was nondiscriminatory would be burdensome and costly (if even possible).

Benefit improvements are permitted post-closure (e.g., to expand the formula to additional NHCEs or improve NHCE benefits to enable the plan to continue to satisfy coverage or the general test as the group becomes more heavily HCE), and it makes sense that those amendments should be required to be designed in a nondiscriminatory manner. However, an improvement that on its face seems nondiscriminatory will not necessarily satisfy a "no rate group coverage ratio may go down" rule as included in the proposed regulations. Any test that can be failed if even one rate group result declines is heavily dependent on random demographic changes outside the control of the plan sponsor—in fact, in many cases the only way to ensure compliance is to exclude HCEs from the improvement.

For example, the following changes may cause a plan to fail this test:

1) An across-the-board improvement in qualified joint and survivor annuity or early commencement factors in an integrated plan.[2] Integrated plans by necessity use imputed disparity in testing. When a plan benefit is improved (e.g., by replacing an outdated and therefore overly steep early commencement reduction with an actuarial equivalent reduction based on the current interest rate environment and updated mortality tables), the most valuable accrual rate (MVAR) for NHCEs will increase by proportionately less than for HCEs, because the portion of the total MVAR that comes from the (unimproved)

[2] Many plans have improved their early commencement or joint and survivor optional form factors out of concern that changes in mortality and the interest rate environment may have raised questions about whether conversions included in the plan many years ago continue to satisfy IRC §411.

permitted disparity will be higher for NHCEs than for HCEs. Any integrated plan that made such a change would be almost certain to fail this rate group requirement.

2) A change in the rate of accrual in a career average pay plan that is tested using the accrued-to-date method.

3) A level, across-the-board improvement or an improvement where the percentage increase is lower for HCEs, in either the accrued benefit or the current year's accrual, in any integrated plan that has early retirement subsidies (as the MVARs for HCEs are likely to increase more than for NHCEs because the imputed disparity includes no early retirement subsidy and represents a higher percentage of the total benefit for NHCEs).

4) An early retirement window where additional years of age or service are granted to all eligible participants. Because the effect on MVARs is likely heavily dependent on the ages of individual participants in the group, it seems unlikely that no rate group would decline.

We believe that the concern about allowing plans that make discriminatory amendments to take advantage of special closed plan rules can be addressed by simply requiring that, beginning with the period five years before closure:

1) No permanent improvements in benefits can have been made, unless those improvements were applied uniformly to either (a) the entire plan population or (b) a group that satisfied a 70 percent coverage ratio at the date of amendment (with the requirement to satisfy testing for five years after closure ensuring that the grandfathered group does not consist disproportionately of HCEs who benefitted from an increase in future accruals).

2) Any temporary improvements in benefits (e.g., window programs or benefits granted on facility closing) that were made for any HCE were made available on the same basis to all similarly situated NHCEs. The "effective availability" requirements for BRFs currently in the regulations would apply, and could be extended to temporary changes in benefit formulas as well, to ensure that age and service requirements for a window program are not set to only benefit a targeted group of HCEs.

3) Other changes in benefits (e.g., a reduction in the benefit formula, or a change to a cash balance formula from a final average pay formula) that applied to any NHCE could be required to have applied to all similarly situated HCEs, again with an "effective availability" requirement to prevent abuse.

BRFs in Closed DB Plans

The proposed regulations provide relief from BRF testing beginning five years after plan closure for grandfathered BRFs in a DB plan to which a significant change in the plan formula has been made (e.g., from final average pay to cash balance) with a grandfathered group remaining under the prior formula. We believe this is a sensible rule and we welcome its inclusion in the regulations. However, we do have a couple of concerns.

1) <u>Requirement That DB Formula Was Changed:</u> The special rule for a benefit, right, or feature provided to a grandfathered group of employees requires that the closure amendment be "a significant change in the type of benefit formula under the plan (such

as a change from a benefit formula that is not a statutory hybrid benefit formula to a lump sum-based benefit formula).” It would be helpful to have additional examples of what is or is not a significant change. For example, we ask that the regulations clarify that a change to no future accruals for new hires or non-grandfathered participants (e.g., because they are receiving only DC benefits, prospectively) is a significant change. While there are special BRF testing rules for aggregated DB/DC plans that may allow certain BRFs to be deemed to satisfy testing when non-grandfathered employees receive only DC benefits, there are a number of situations and BRFs for which this will not be true.

2) Testing of Grandfathered BRFs in Isolation: Example 1 of §1.401(a)(4)-4(d)(8)(v)) suggests that if a traditional DB plan is amended to be a cash balance plan, with a grandfathered group receiving the better of the cash balance and traditional formula benefit, the early retirement factor BRF (and any other BRFs that apply only to the traditional formula benefit) is a separate BRF for the grandfathered group, and must therefore be tested separately. This appears to be a different result from the response received in 2015 Gray Book Q&A 23, 2014 Gray Book Q&A 41, and 2012 Gray Book Q&A 21. We believe the Gray Book responses provide the more workable and useful approach, and ask that the regulations be revised accordingly.

Closure Date

We suggest that the definitions of closure date and closed plan be clarified as follows:

1) For plans that were closed to new hires after a specified date, the closure date be defined as the hire date cutoff (because as of that date, the population that will be eligible for the plan is closed), even if some of those participants will enter the plan later as they meet the age and service requirements.
2) We ask that a salaried plan that allows plan entry for bargained plan participants who are promoted to a salaried position not be precluded from being treated as a closed plan, as long as the promoted participants must meet any age, service, or date-of-hire conditions as of the closure date that applied to other grandfathered participants in the closed plan.

In addition, in response to a question that was posed in the proposed regulations’ preamble, we believe that guidance is needed for plans that have had more than one closure. For example:

1) Many plans were closed to new entrants and then, due to nondiscrimination testing problems or other issues, subsequently frozen. Those plans should be treated as closed plans for various purposes (e.g., for the DBRA rules or BRF testing for enhanced DC matches) for both the group originally excluded from the plan when it was closed and the additional group affected by the freeze.
2) A plan may be changed from final average pay to a hybrid design, with grandfathered participants remaining in the FAP formula, with the FAP formula subsequently curtailed in favor of the hybrid formula for the grandfathered participants, or the plan subsequently frozen.

3) There are often multiple closed DB plans that were closed at different times and that are aggregated for nondiscrimination testing purposes. Based on our reading of the proposed regulations, it appears such an aggregated plan would be viewed as having more than one closure amendment.

Proposed Changes in Cross-Testing Gateways for Closed Plans

We appreciate the rule that would permit an aggregated DB/DC plan to test on a benefits basis without having to satisfy a cross-testing gateway, if a 6 percent normalization rate is used. We suggest that this option be available retroactively for 2014 and later plan years as well, instead of only applying after the regulations have been finalized.

However, in our opinion, the most significant problem with the minimum aggregate allocation gateway remains unaddressed. We continue to believe it is inappropriate for the allocation rates for all NHCEs to be driven by the present value of the DB accruals currently received by older, long-service HCEs. These older, long-service HCEs were covered during their career under a plan design that very disproportionately provides the highest value accruals in the latest years of service.

For example, consider that a 65-year-old, long-service HCE covered by a 1.2 percent or greater final average pay per year of service benefit formula, earning modest compensation increases, would require that all NHCEs receive an average equivalent allocation of 7.5 percent of compensation. In addition, relatively small fluctuations in compensation, especially in the later years of employment, can result in significant changes in a particular HCE's equivalent allocation rate and result in significant increases or decreases in the NHCE benefits required to satisfy the gateway.

Many of these long-service employees received significantly lower DC allocations in the early years of their career when the primary benefit delivery was via the DB plan. By forcing employers to increase the amount they contribute to NHCEs in order to satisfy the gateway requirements, employers may be forced to freeze the benefits in the closed plan to keep their overall benefit costs neutral. This result penalizes those employees who were not given the opportunity to receive DC allocations early in their career, and now will have their DB plan accruals frozen later in their career.

A rule whereby the allocation rate for HCEs could be averaged would also avoid targeting the contribution required for **all** NHCEs to the equivalent allocation rate of one or a handful of otherwise unremarkable HCEs who simply have long service and moderate increases in FAP caused by higher inflation, bonus fluctuations, or other factors. To eliminate any concern about the highest-paid HCEs receiving special benefit formulas, averaging could be unavailable if any of the HCEs is covered under a formula that did not cover a reasonable classification. Alternatively, a lower gateway requirement (e.g., the 5 percent maximum that applies to DC plans that are cross-tested), either for all plans or specifically for closed plans, may also be appropriate.

Additionally, we ask that the IRS remove the requirement that an average match rate that is taken into account for NHCEs in the minimum aggregate allocation gateway be provided under a DC plan that is part of the DB/DC plan being tested (as opposed to being provided under any §401(k) plan in the controlled group). We do not understand the purpose of this restriction, and believe that, if implemented, you should consider the following situations:

1) Could the match be used if the plan that includes the match has a different plan year than the aggregated DB/DC plan?
2) If participants receiving §401(a) contributions in the aggregated DB/DC plan receive their matching contributions under different §401(k) plans, those plans would need to be aggregated with each other and with the plan that provides the §401(a) contributions. How would this aggregation be achieved if some of the §401(k) plans are safe harbors and some are not, or if their safe harbor provisions are different?
3) Would relief be available to employers who previously performed Actual Deferral Percentage and Actual Contribution Percentage (ADP/ACP) testing on each plan individually who are now being required to perform ADP/ACP testing by aggregating §401(k) plans, with unpredictable results?

Relief for Standalone Defined Contribution Plans

We welcome changes that make the DBRA rules more useful. Historically, these rules have generally not been used because the regulations implied that the DBRAs needed to be designed individually and required the full replacement of DB accruals. We appreciate that the proposed regulations relax the DBRA rules to allow partial replacement of lost DB accruals. However, we do have similar concerns to those expressed previously with respect to certain other changes in the proposed regulations.

The requirement to have satisfied IRC §410(b) and §401(a)(4) for the year before closure without aggregation and without the mergers and acquisitions transition rule precludes some sponsors who previously made good-faith business decisions in compliance with regulations in effect at that time from obtaining relief.

Suppose a plan sponsor is acquired by a company with proportionately more NHCEs and no DB plan. Because of the year-to-year change in the plan's coverage as a result of the change in the controlled group, the DB plan does not meet the nondiscrimination tests and thus would need to be frozen at the time the controlled group changed so the prior plan year would still have been passing. If, instead, the sponsor enhances the DC plan for the affected participants, either through an increased nonelective contribution or a matching contribution, this sponsor would not be eligible for the liberalized DBRA rules.

The purpose of the transition rule is to afford the plan sponsor some time to determine the effect of the change in the controlled group on the nondiscrimination tests and to analyze the available options. The requirement to have satisfied IRC §410(b) and §401(a)(4) for the year before closure without the mergers and acquisitions transition rule may eliminate an otherwise appealing path forward.

Also, the proposed rules requiring no changes in the BRFs associated with the matching contributions after the plan closure should be clarified. They are unclear as to whether the BRF that could not be changed consists of only the enhancement to the underlying match rate available to other employees (so that an improvement to the underlying match rate would not cause loss of the closed plan BRF testing rule) or whether the BRF is the total match rate. We believe it should be clarified that an improvement in the underlying match rate (which increases the available match equally for grandfathered and non-grandfathered §401(k) participants) should not cause a loss of this testing relief.

In addition, we believe that the proposed requirement that the testing relief would be prospectively lost if the additional match rate for grandfathered participants is reduced would be counterproductive. Consider an employer that is deciding the level of additional match to provide to employees whose DB plan is being frozen. The employer would be less likely to provide a higher rate if it knew it would permanently lose the testing relief if it encountered financial difficulty and had to reduce the rate of enhanced match in the future. This prohibition on reductions in the additional match rate does not seem to be in the best interests of the grandfathered participants.

As discussed in the BRF section, the requirement that the DBRA not change is counterproductive. We believe that a plan sponsor must have the ability to reduce the DBRA, in a facially nondiscriminatory manner (i.e., not defined as "the coverage ratio must not decline for any rate group in the general test," a test that clearly could not be passed even if an across-the-board 5 percent DBRA were changed to an across-the-board 3 percent DBRA, just because NHCEs are younger than HCEs). Otherwise, it may simply be less generous upfront when determining the level of DBRA.

In addition, we believe the rules requiring no significant changes in the previous five years will needlessly block many sponsors from using this rule for the same reasons we have cited above.

IRC §401(a)(26) Minimum Participation Relief Still Needed

The proposed regulations do not provide any relief for closed plans in meeting the minimum participation rules of IRC §401(a)(26). This significantly limits the effectiveness of the nondiscrimination testing relief provided.

Absent relief, all closed plans will eventually have to be frozen, and possibly terminated, prior to participants earning the total benefits they would have otherwise earned under the plan's formula. Plans of smaller employers will generally need to freeze/terminate much more quickly than larger employers, resulting in far fewer participants of smaller employers having the ability to continue earning benefits under closed benefit formulas.

We ask IRS to consider providing relief from the minimum participation rules for closed plans. Should no relief be provided, we request that IRS address this topic in the preamble to the final regulations in order to provide certainty to affected plan sponsors.

Other Concerns

Sponsors that close their plans to new hires and, in order to encourage retirement savings among employees, provide most or all of the employer-provided benefit through higher matching contributions under the company's §401(k) plan, rather than through DC nonelective contributions, will not be helped by the proposed changes because matching contributions cannot be taken into account for DB plan testing under IRC §401(a)(4). This represents a large group of DB plans that are in danger of being frozen. We strongly believe that providing employer retirement contributions in the form of match is good public policy that encourages saving, increases participant engagement in retirement planning, and improves financial security in retirement. Plan sponsors, and their grandfathered DB participants, should not be penalized for taking this approach. Allowing *actual* matching contributions to be reflected in amounts testing for the DB plan would have the further benefit of incenting plan sponsors to proactively encourage NHCEs to take full advantage of the match available to them.

In addition, plan sponsors that provide certain contributions in the form of IRC §403(b) contributions, Employee Stock Ownership Plans (ESOPs), or under plans that have different plan years, cannot take credit for those contributions to satisfy the nondiscrimination testing requirements for other plans. We see no policy reasons for these distinctions.

****

The Pension Committee appreciates the opportunity to provide input to IRS on these important proposed regulations. We would be happy to discuss any of these items with you at your convenience. Please contact Matthew Mulling, the Academy's pension policy analyst (202-223-8196, mulling@actuary.org) if you have any questions or would like to discuss these items further.

Sincerely,

Ellen L. Kleinstuber, MAAA, FSA, FCA, FSPA, EA
Chairperson, Pension Committee
American Academy of Actuaries

Appendix—Qualified Supplemental Executive Retirement Plans (QSERPs) and Other Non-Uniform Benefit Formulas

The following comments regarding §§ 1.401(a)(4)-2(c) and 1.401(a)(4)-3(c), withdrawn by Announcement 2016-16, are offered to assist the IRS if the concepts introduced in those originally proposed regulations are revisited in the future.

The proposed changes to the rules for plans that provide benefit formulas to HCEs that don't cover a classification of employees that is reasonable and established under objective business criteria will likely result in fewer plans adopting special benefit formulas that apply to a select group of HCEs i.e., Qualified Supplemental Executive Retirement Plans (QSERPs). However, we believe the rules may inadvertently affect a far wider range of plans and have the unintended consequence of causing more sponsors to freeze and terminate plans.

There are reasons outside of QSERPs that plans provide particular formulas to different groups of employees, and these groups may not be considered reasonable classifications (a fact that a plan sponsor may not discover until a plan undergoes an IRS audit, as "reasonable classification" is not defined). For instance, some formulas that do not apply widely may simply be protecting certain benefit formulas of an acquired group after an acquisition. We appreciate that it may not be advisable to offer a clear definition of what constitutes a "reasonable classification" of employees. However, introducing this subjective determination into what is otherwise a purely objective, mathematical test would likely cause many plan sponsors concern that they will not know for certain whether they have met the nondiscrimination requirements.

Also, it is common for smaller plans to provide different benefit formulas to different groups of HCEs, resulting in the potential for the proposed rule to disproportionately affect smaller plan sponsors. The vast majority of the small plan sponsors potentially affected by the proposed change are already meeting the "gateway" requirements to perform nondiscrimination testing on the basis of benefits or equivalent benefits. Consequently, these sponsors are generally providing higher benefits to NHCEs than would be required to pass the general test absent the gateway test. A change that further increases the cost of maintaining current plan designs could result in the freezing and termination of many of those plans.

In addition, plans with QSERP benefits that need to rely on the accrued-to-date basis to pass the general test (which would be the case for most final average pay plans, for example) may also be vulnerable to being frozen. If a portion of HCE accrued benefits are based on QSERP benefits, the plan would have rate groups for HCEs where the "benefit formula" for the HCEs fails to satisfy a reasonable classification, even if the QSERP benefit does not provide ongoing accruals and was simply an increase in accrued benefits added in a prior year. Even though current and future accruals may be under a uniform formula for HCEs and NHCEs, such plan sponsors would have two choices: (i) incur significant and unanticipated costs to increase NHCE accrued benefits, or (ii) freeze the plan. We believe the choice will often be to freeze the plan, and at the same time eliminate any gateway contributions being provided to NHCEs.

Any rules that incentivize additional plan freezes are contrary to the primary purpose of the proposed regulations. This result would be avoided by making these new rules effective only for plan designs adopted after the proposed regulations were issued. Absent such grandfathering, the following considerations would help affected plan sponsors transition to the new rules:

1) Providing sufficient time after the regulations are finalized to determine and implement any needed design changes;

2) Modifying the fresh-start rules to permit such plans to use a fresh-start method and to be able to ignore the effect of final average pay increases on the accrued benefit as of the date of the change; and/or

3) Providing that the rule is inapplicable in cases where the formula not covering a reasonable classification of employees is eliminated prospectively.