Intersector Group Meeting With

the U.S. Department of Treasury and Internal Revenue Service—Notes

May 18, 2022 (Virtual Meeting)

Periodically the "Intersector Group" ("the Group") meets with representatives of the Internal Revenue Service (IRS) and the Department of the Treasury ("Treasury") to discuss regulatory and other issues affecting pension actuarial practice. The Intersector Group is composed of two delegates from each of the following actuarial organizations: American Academy of Actuaries (Academy), Conference of Consulting Actuaries (CCA), Society of Actuaries (SOA), and American Society of Enrolled Actuaries (ASEA). Attending from the Intersector Group at this meeting were Bruce Cadenhead (Academy), Kelsey Mayo (ASEA), Eric Keener (SOA), Tonya Manning (CCA), David Pazamickas (Academy), and Maria Sarli (SOA). Linda K. Stone, Academy senior pension fellow, and Philip Maguire, Academy staff member supporting the Intersector Group, also attended.

These meeting notes are not official statements of the IRS or Treasury and have not been reviewed by its representatives who attended the meetings. The notes are a reflection of the Intersector Group's understanding of the current views of IRS and Treasury representatives and do not represent the positions of the IRS, Treasury, or of any other governmental agency and cannot be relied upon by any person for any purpose. Moreover, the IRS and Treasury have not in any way approved these notes or reviewed them to determine whether the statements herein are accurate or complete.

Discussion topics were submitted by the Intersector Group to the IRS and Treasury in advance of the meeting and are shown in regular typeface below; a summary of the discussion is shown in italics.

Discussion Topics

- **Guidance on new closed plan rules and clarification on what plans are eligible for relief**
  The SECURE Act included nondiscrimination testing relief for certain closed defined benefit plans. There are questions regarding which plans qualify for the relief, including which plans are considered closed for purposes of sections 410, 401(a)(4), and 401(a)(26) relief—in particular whether the entire plan must be closed to qualify for relief and what is considered a discriminatory amendment modifying the closed participant group. Plan sponsors and their advisors would benefit from IRS guidance in this area to ensure plan sponsors have appropriate guidance to continue their defined benefit plans.

IRS/Treasury has been working on closed plan guidance. They intend to address the questions identified in that guidance. They also expect that guidance would take the position that a plan must be entirely closed to qualify for relief—simply closing one group within the plan would not be enough if there are still new entrants into the plan.

Significantly discriminatory amendments will be harder to define. IRS issued proposed closed plan rules saying all amendments would make a plan ineligible for relief, with some exceptions. In the SECURE Act, Congress took the opposite approach—amendments are acceptable unless significantly discriminatory.

IRS/Treasury asked what specific types of amendments were being implemented or considered. Specific guidance on whether early retirement windows, lump sum windows, guarantees of minimum lump sums to address the workforce implications of rising interest rates, distribution enhancements (e.g., allowing commencement at age 59½ or later), etc. are significantly discriminatory was requested.

As there are different relief provisions for different situations, IRS/Treasury guidance might provide that whether an amendment is discriminatory is determined separately for various relief provisions—for example, an amendment only affecting benefits, rights, and features (BRFs) would only affect relief for BRF testing. However, the group discussed that, if a change in a BRF would not satisfy BRF testing if the SECURE Act relief was invalidated by the amendment, it would be likely that the relief on the cross-testing gateway would still be needed. This is because if the enhanced BRF could not satisfy BRF testing, that suggests that the closed group would likely need to continue to be aggregated with the DC plan in order to satisfy §410(b) coverage testing, and if a plan is aggregated with another plan for §410(b), it must also be aggregated for §401(a)(4), and so the relief would still be needed.

- **It would be helpful if a status update on the issuance of Section 404 guidance could be provided.**

  IRS/Treasury acknowledged the desire for guidance, but it is not on the imminent release list. While time has been spent on this project, they must balance the priority of this project with other large guidance projects. The Intersector Group informed IRS/Treasury that this is not as high a priority as some other requests for guidance, so it will not be forthcoming in the short term.

- **Statutory and substitute mortality tables**
  - 417(e) tables for 2023 – An update on the expected timing for release of the 2023 tables would be helpful. Any information you can share on whether Pri-2012 will be reflected would be appreciated.
  - Plans using substitute mortality tables (SMTs) – Many plans now need to refile every year so that the actuary can attest that the tables remain "accurately predictive." This could happen for any number of reasons related to demographic changes in the participant data, including frequent changes due to lump sum distributions or other pension risk transfer activity. The IRS also wants comments about the effect of COVID in the supporting analysis. In our experience, most plans have not seen a spike in mortality due to COVID or have seen an increase that is not clearly greater than what might be expected by normal year to year fluctuations. In addition, there are varying opinions of the effect of COVID on future mortality patterns. As a result, in our experience, the discussion of COVID that is provided is nearly always "no effect but will continue to monitor." It would be helpful to plan sponsors and the actuarial community to learn more about this process such as:
    - The acceptability to the IRS of that type of response regarding COVID
    - Any insights that can be shared regarding how the IRS is handling these attestations that a substitute mortality table remains accurately predictive that would enable actuaries to prepare better submissions
    - Clarification about whether the Enrolled Actuary should expect a confirmation that the determination submitted that a table remains accurately predictive is acceptable to the IRS
    - Possibility that the IRS could disagree with the determination that a table remains accurately predictive on audit several years down the road

Because of the issuance of the 2023 §417(e) applicable mortality table and the proposed regulations updating §430 mortality tables since the summary above was written, the group discussed some additional issues related to the proposed regulations, assuming they are finalized later in 2022 and effective in 2023. For plans that must discontinue the use of an SMT because there has been a change of more than 20% in the covered population since the SMT was approved (even though the actuary has certified that the table remains accurately predictive), IRS/Treasury expect that the required discontinuance of use of the SMT would be effective for the 2024 plan year for the plan using the SMT, assuming the regulations are finalized and effective in 2023 as proposed. The discontinuance would apply to any other plans in the controlled group with credible mortality experience due to the consistency rule, assuming that the plan discontinuing the use of the SMT does not receive approval for a new SMT based on the Pri-2012 tables.

IRS/Treasury noted that for filings that are due by May 31, 2022 (i.e., for SMTs intended to be adopted for 2023 calendar year plan years), they should be filed under the current rules (i.e., using the RP-2014 tables) and that they would likely be treated like other plans with an existing SMT that did not have a more than 20% change in plan population (i.e., the use of the SMT based on RP-2014 tables would not be terminated once the regulations are finalized). If, however, there was a more than 20% change in coverage during the experience study period, it would seem more consistent to treat that like other SMTs with a more than 20% change in coverage, so that the SMT would become invalid in 2024. The Intersector Group noted that coverage changes are prevalent due to attrition as well as risk transfers. IRS/Treasury noted that if participants were removed from coverage due to an event, such as a risk transfer, the applicant might carve those employees out of the mortality study entirely. For example, if there was a small benefit annuity purchase during the experience study period, it may be acceptable to submit for an SMT removing from the population for the entire experience study period (a) those for whom annuities were purchased and (b) those for whom annuities would have been purchased had they not died before the purchase. By removing them from the population in the study, IRS may treat the plan as not having a more than 20% change in headcount.

IRS/Treasury has not yet seen filings with experience study periods that include the COVID-19 pandemic period, and does not have any specific recommendations, other than indicating they would require a discussion in the filing of the effect of the COVID years on both the mortality observed and the demographics more generally (e.g., termination of employment, retirement patterns).

IRS/Treasury also indicated that one way of dealing with transition issues—COVID-19 or the changes in §430 mortality tables—may be to approve new SMTs for a shorter period of time. This is an approach IRS/Treasury has used in the past when there were significant changes in population during the experience study period.

IRS/Treasury officials indicated that when an actuary sends in a certification that an SMT remains accurately predictive they may or may not receive any kind of response. One reviewer indicated that he makes it a practice to make a phone call indicating that he sees no issues with it (assuming that is the case) but there is nothing in writing and, with other reviewers, there may be no communication. IRS/Treasury are looking at them and will reach out if there is an issue but the message seems to be that if actuaries do not hear otherwise, they can continue to use the SMT (despite the language in the regulations indicating that the actuary must certify to the satisfaction of the secretary that the SMT remains accurately predictive).

- **Funding balance usage and rules**

  This topic was raised at the November 13, 2019, Intersector meeting. The Intersector Group noted some of the inadvertent errors relating to elections that can result in significant penalties for missing funding balances deadlines. The Intersector Group referred to a letter sent to the IRS and Treasury in 2012 that addressed some, but not all of these issues:
  https://www.actuary.org/sites/default/files/files/publications/Academy-Letter-on-Funding-Balance-Elections.pdf.
  In response to the letter, IRS and Treasury representatives invited further comments on areas relating to Code sections 430 and 436 that are not working well. The Academy then issued another letter with additional ideas, including solutions that should not be disruptive to the necessary sequence of events for funding and benefit restriction calculations. This letter can be found at:
  https://www.actuary.org/sites/default/files/2021-06/Comments_Maintenance_and_Application_of_Funding_Balances_Academy_Pension_Committee.pdf. The single most helpful change would be a one-month extension in the deadline for creating and applying funding balances. We ask that the IRS/Treasury consider the ideas discussed in this letter.

  With respect to IRC 430/436, good progress is being made on guidance for mergers and spinoffs.

  With respect to difficulties encountered with funding balance election deadlines, there was significant discussion of why this happens—for example, why are there simply not standing elections in place to avoid these issues? The Intersector Group described some examples—simply overlooking the standing election because there was no funding balance previously, a change in actuary or other event that makes the standing election invalid, etc. IRS has not provided guidance on when the plan's enrolled actuary actually changes, so a mistaken assumption about the timing of such a change could leave a plan without a valid election for a period of time. We also discussed that the punishment does not seem to fit the crime—being a day late on an election to apply funding balance to the contribution due 9/15 means (a) a 10% excise tax and (b) inability to actually use funding balance to satisfy the missed contribution. We suggested that simply requiring the funding balance election to be made by 10/15, rather than 9/15 (for calendar year plans), would help a lot given that these issues are often discovered shortly after 9/15 and before the Schedule SB is filed. We also suggested that in the absence of guidance formally modifying the timing rules, it would be helpful to have a procedure to apply for relief in specific situations.

  This is a tricky issue—IRS/Treasury will consider potential options.

- **Retroactive annuity start dates for small plans as well as larger plans**
  - Many plan sponsors are encountering issues with lower-paid individuals working to advanced ages and, because of actuarial increases, hitting the Section 415 compensation limit.
  - The regulations provide that, in order not to violate either Section 415 or Section 411, a participant's benefit must begin when the benefit in the normal form reaches the Section 415 limit. If benefits begin at such date, and the participant chooses a lump sum form of payment, the benefit will be cut back because of the 5.5% interest rate used for lump sums under Section 415 vs. the lower required interest rates under IRC Section 417(e).
  - This situation could be avoided if the plan sponsor allowed a retroactive annuity starting date (RASD) to be chosen in such a situation (i.e., the date the lump sum form of payment would first be limited); however, the regulations require that Section 415 limits be satisfied at both the RASD and at a current annuity starting date, forcing the participant to take a cutback.
  - Could consideration be given to revising the regulations to permit a RASD payment of the full lump sum in limited circumstances to avoid the reduction of participant benefits?

The Intersector Group pointed out that while the 5.5% §415 lump sum interest rate, and the applicability of the compensation limit, are statutory, the requirement that when a RASD is offered §415 must be satisfied both at the RASD and at the current ASD that must also be offered (not simply at whichever date is elected) is regulatory.

IRS/Treasury noted that lump sums are an optional form of payment subject to §411(d)(6), but are not part of the accrued benefit, which is why a forfeiture of lump sum value to satisfy §415 can occur, while a forfeiture of the accrued normal form of benefit cannot occur to satisfy the §415 limit.

IRS/Treasury noted that the RASD rules were intended to ensure you can't use RASD rules to get a better §415 result. Therefore, this request does not seem consistent with the policy intent of the regulations.

The group suggested that the policy intent might not have considered the effect on lower-paid individuals (NHCEs and/or those earning well below the 401(a)(17) compensation limit). For example, a participant with average earnings of $50,000 a year who intended to elect a lump sum, but was not aware of this issue, might have had an opportunity under the terms of the plan to elect payment before the plan lump sum exceeds the present value of $50,000 calculated at a 5.5% discount rate. By missing this opportunity, not only does the lump sum not grow with interest in the intervening period *before the annuity limit is reached, it, in fact, decreases due to the participant's increasing age. In this situation, application of the RASD rule (without the need to apply the 415 limit based on current age) would allow this individual to be on similar footing to a better-informed participant.*

- **Issues with plans terminating in surplus position**
  As an increasing number of plans have surplus at termination, this situation raises a number of issues that would benefit from additional guidance, such as:
  - If the plan has a 401(h) account, the account cannot exist beyond the life of pension plan. There are a number of areas relating to the potential reversion that would benefit from further guidance, such as:
    - Whether the excise tax applies at the 20% level or at the 50% level due to the absence of a qualified replacement plan (QRP).
    - Whether the remaining assets could be used to fund a qualified replacement plan, either through transfer to a VEBA or to provide other types of benefits, such as a defined contribution QRP.
  - Some terminating plans are created as a spinoff from an existing plan. Where the original plan has a surplus on a termination basis, and one of the plans is being terminated in connection with the spinoff, the rules for allocating surplus under Section 414(l)(2) do not apply. This would appear to give sponsors significant discretion to allocate surplus among the plans involved. It would be helpful to know if there are any limits to this discretion.
  - When a qualified replacement plan is established, it must benefit 95% of the active participants in the terminating plan.
    - In some situations, the terminating plan has no active participants. In this situation, it seems like there are no participants from the terminating plan who would have to receive benefits from the replacement plan.
    - For terminating plans that are created from a spinoff, it would be helpful to have clarification whether the 95% rule should apply only to the active participants in the spun off plan, or should it also apply to participants in the ongoing plan as well.

The Intersector Group indicated that it is not clear whether the 20% or 50% excise tax applies to an overfunded §401(h) account on termination and this uncertainty is delaying plan terminations. Most plan sponsors would prefer an option to avoid a reversion entirely and instead apply these assets to other employee benefits (e.g., continued retiree medical benefits after the termination of the DB plan and/or medical benefits for active participants.)

Plan sponsors can't get a ruling on these topics and some sponsors think they are stuck and can't terminate the plan if they can't resolve these issues.

Some plans are terminated pursuant to a spinoff termination. If the original plan had a surplus on a termination basis, there is no requirement to allocate surplus in a reasonable manner. Because there are no clear rules, some plan sponsors will take a more aggressive view than others of how surplus might be allocated—perhaps allocating a disproportionate share of the surplus to the terminating plan. The Intersector Group identified this as an area where some guidance could be useful.

IRS/Treasury is aware of these issues, but they are difficult to address without a comprehensive regulation project on §4980, which is a very big project and not as high a priority as other big projects. The Intersector Group indicated that overfunded §401(h) accounts is not a widely applicable issue, but where it applies it is a very large issue.

- **Status update on determination letter window**
  The recent determination letter (DL) window for statutory hybrid plans and merged plans was a helpful opportunity for plan sponsors to request a determination for individually designed plans that would not otherwise have been eligible to file for such a determination. The DL window application period ended August 31, 2020. Absent such a window, sponsors of individually designed plans cannot currently request a DL to document that a plan meets the applicable qualification requirements, except on plan inception or termination. As a result, it would be instructive for sponsors and practitioners to hear about the IRS' experience with the DL window, including use by plan sponsors, progress on submitted applications, particular issues that may have been identified in DL reviews, and whether similar windows may be offered in the future for similar or different fact patterns.

  About 750 plans were submitted in the cash balance DL window. IRS has completed its review for almost 99% of those applications. Generally, there were no surprises, only a few unusual situations and plan designs, including variable annuity plans. Letters have been issued for most of the submissions received.

  With regard to future windows—IRS/Treasury is always looking for additional circumstances for windows that will benefit both the IRS and the industry. IRS is currently working on a permanent §403(b) determination letter program. This will be a significant undertaking with potentially a lot of plans eligible for submission. Likely, the §403(b) program will need to be phased in over several years to avoid overwhelming the IRS. Therefore, additional windows for other plans are likely to wait until that program is underway, although specific suggestions on new windows are welcomed.

- **Cash balance plans that use actual investment return**
  - There are a number of issues relating to statutory hybrid plans that have not yet been addressed in regulations and on which further IRS guidance would be helpful. In particular, further guidance is needed for plans that credit interest based on actual investment returns, including guidance on projection of future interest credits for purposes such as nondiscrimination testing, application of Section 415 limits, and accrual rule testing.
  - Participant choice among investment options: It is unlikely that a single asset mix will be ideal for all plan participants and at all stages of their careers. Permitting choice among different investment options or different sub-funds within the plan could address these concerns. Offering choice more frequently (e.g., annually or monthly) would allow individuals to adjust more quickly to changes in life circumstances. Similar considerations might apply to variable annuity plans.

  IRS/Treasury is aware of the issues on this topic. They asked how common participant investment direction models are. The Intersector Group indicated that there are a few existing plans that allow participant investment direction. Other sponsors are interested but don't want to implement this option absent guidance. There are also plan sponsors that would be interested in a target date fund approach, where the risk and expected return would vary by individual participant. The Intersector Group indicated that, with greater regulatory clarity, these plans would be more common than they currently are. Plan sponsors are often dissuaded by regulatory uncertainty.

  IRS/Treasury asked whether certain provisions that have been proposed as part of a "SECURE 2.0" legislative package could help plans with market-based interest crediting rates. The Intersector Group responded that it could help with accrual rules, nondiscrimination testing, and §415 but not participant choice.

  There was discussion regarding the need to prioritize guidance on the SECURE Act nondiscrimination testing relief and merger/spinoff issues under §430 and §436 above these particular cash balance plan issues.

- **Valuation of variable annuity plans under 430**
  There are two primary views on how to value variable annuity plans under the PPA funding rules. These are described in detail in an Academy practice note: https://www.actuary.org/sites/default/files/2019-11/PensionCommittee_VariableAnnuityPlans_PracticeNote.pdf. These can be roughly summarized as:

1) The assumed earnings rate used to project benefits is not a prescribed assumption and should be set independent of the discount rate.
2) The assumed earnings rate should be set to the discount rate under the theory that it is not an independent assumption. Mathematically this gives a result similar to valuing the plan at the hurdle rate.

Variable annuity plans are generally designed to ensure that assets and liabilities of a plan remain closely aligned, by making benefit adjustments that match the plan's asset performance. The first of the approaches described above can result in a liability that is very different from the underlying plan assets, while the second approach preserves the alignment between assets and liabilities. If the IRS has a clear view on the correct approach, it would be helpful to have guidance to this effect. Ideally it would be helpful to have guidance supporting an approach that allows for the alignment of assets and liabilities.

Similar theoretical issues apply to the valuation of a cash balance plan where the interest credit is based on the return on plan assets.

IRS/Treasury is aware of the issue. Discussion was had on the merits and theoretical efficacy of the different approaches—with the Intersector Group noting that although most actuaries would likely agree that the second approach is more theoretically sound, there is less comfort about whether the regulations permit this interpretation. It was noted that this is a current issue for existing plans, but also is stunting potential adoption of these plans and is therefore having an overall negative effect on DB plan adoption/continuation. These designs are increasingly attractive (because they permit lifetime-guaranteed DB benefits to be provided to participants with less risk to the plan sponsor) particularly in the large plan market. Similar issues apply to rate of return CBs that are popular in the small plan market.

When discussing how important this guidance is, the Intersector Group indicated that If the IRS/Treasury view is that there is only one acceptable approach, and that IRS/Treasury intend to apply related guidance or enforcement actions retroactively, that could be problematic and so it would be important to know that sooner rather than later.

- **Affiliated service groups**
    - As IRS/Treasury knows, correct determinations of affiliated service groups are important for retirement plan compliance. The proposed regulations, published in 1983, are not binding and do not reflect or address how the rules should apply to current industries or practices, nor does it address situations that commonly arise, such as how an overlapping controlled group and affiliated service group should be treated. Issuance of guidance on this topic will significantly reduce

issues relevant to many retirement plan sponsors and practitioners, and it will promote sound tax administration in both the retirement plan and health plan contexts.

  - This item was included in the 2019-2020 Priority Guidance Plan but was dropped from the 2020-2021 Plan.
  - Considering the importance of this matter to the industry, an update on the issuance of guidance on this topic would be helpful.

  IRS/Treasury is very aware of the need and desire for guidance on this topic and have been reviewing the prior comments and other issues on this topic. IRS/Treasury noted that this is a significant undertaking, particularly due to the far-reaching effect of any guidance issued, since these rules apply well beyond pension and other employee benefits and will require coordination of different areas within IRS/Treasury. However, it is being reviewed. IRS/Treasury suggested commenting on their Priority Guidance Plan to suggest inclusion.

- **Applicability of excise taxes on multiemployer plans remaining in critical status after their rehabilitation period ends**
  Some multiemployer plans have not emerged from critical status by the end of their rehabilitation period and could fear excise taxes based on a lack of guidance from IRS. Any new thinking on the applicability or enforcement of excise taxes would be appreciated by those plans and others with a delayed emergence from critical status—including those plans receiving special financial assistance (SFA) that will be deemed in critical status through the plan year ending in 2051.

  IRS/Treasury acknowledged the issues. The temporary five-year rehabilitation period extension under the American Rescue Plan Act of 2021 was discussed. Plan sponsors of multiemployer plans in critical status with delayed emergence that took advantage of this extension have additional time before they face potential excise taxes. However, this temporary extension is not a long-term solution to this issue.

- **Annual certification under IRC Section 432 for plans receiving SFA**
  - Plans receiving SFA are subject to a variety of conditions/restrictions, including the following:
    - a plan receiving SFA shall be deemed to be in critical status for plan years beginning with the plan year in which the effective date for SFA occurs and ending with the last plan year ending in 2051, and
    - any SFA received by a plan is not taken into account for determining contributions required under IRC Section 431.
  - It would be helpful for plan actuaries and plan sponsors to understand how these new conditions/restrictions may impact the annual certification under IRC Section 432.

IRS/Treasury noted that any guidance on specific questions for plans receiving SFA must be coordinated with the Pension Benefit Guaranty Corporation (PBGC) and Department of Labor (DOL). Guidance is likely to be part of larger package. IRS/Treasury noted they are working on a standard form for plan actuaries to use when certifying a plan's zone status under IRC Section 432, which will potentially provide more clarity on this and other issues.

- **Mortality table for nonbinary**
    - Questions are arising regarding employees who report as nonbinary to the employer and therefore would not be listed as male or female for purposes of the prescribed mortality assumption. Current regulations do not make any provision for this situation.

IRS/Treasury suggested including this as a comment on the proposed mortality table regulation.