AMERICAN ACADEMY *of* ACTUARIES

February 8, 2005

Ms. Cathy A. Vohs
CC:PA:LPD:PR (REG-114726-04)
Room 5203
Internal Revenue Service
PO Box 7604 Ben Franklin Station
Washington, DC 20044

Dear Ms. Vohs:

The American Academy of Actuaries'[1] Pension Practice Council appreciates the opportunity to respond to your request for comments regarding proposed regulations on distributions from pension plans under a phased-retirement program. Facilitating phased retirement is now more important than ever.

The council appreciates the IRS's efforts to make phased retirement an option for employers and employees: such a program allows companies to address issues such as shrinking labor supplies and an aging workforce and allows employees to address issues such as increased life expectancy and the desire to remain active. Furthermore, we are pleased that the IRS recognized and incorporated some of the comments we provided in our letter dated Dec. 31, 2002. While we discuss below areas in which the proposed regulations need to be clarified or revised, they offer movement in the right direction for those employees who want to phase out of employment gradually.

Although the proposed regulations deal with one important aspect, that of phased retirement, they do not address the related issue of large numbers of employees who retire from their current employment solely to access their pensions in full, even though they plan to continue working. Many of these employees retire from their current employers, claim retirement benefits and then seek other employment or reemployment as a consultant. We believe that, due to the minimum age requirement of 59½ and administrative complexity associated with implementing formal phased retirement, you will still see that movement under these proposed regulations.

Normal Retirement Age
The proposed regulations permit a pension plan to pay benefits when an employee reaches "normal retirement age," with the stipulation that such age cannot be set so low as to avoid the requirements of section 401(a). Furthermore, they state that the normal retirement age "cannot be earlier than the earliest age that is reasonably representative of a typical retirement age for the covered workforce."

[1] The American Academy of Actuaries is the public policy organization for actuaries of all specialties within the United States. In addition to setting qualification standards and standards of actuarial practice, a major purpose of the Academy is to act as the public information organization for the profession. The Academy is nonpartisan and assists the public policy process through the presentation of clear actuarial analysis. The Academy regularly prepares testimony for Congress, provides information to federal and state elected officials, regulators and congressional staff, comments on proposed federal and state regulations and legislation, and works closely with state officials on issues related to insurance. The Academy also develops and upholds actuarial standards of conduct, qualifications and practice, and the Code of Professional Conduct for all actuaries practicing in the United States.

We believe that this description is unclear about what age is "reasonably representative." We would like to see guidance on how such an age can be determined within small companies with a limited number of employees, new companies with no history of a representative retirement age, and organizations with a diverse workforce in which retirement ages vary depending on job classification and the physical demands of the job.

Phased Retirement Distributions
Currently, many individuals are opting to leave the labor force in steps, in effect, creating their own personal phased-retirement programs. This can be accomplished several ways: (1) retire from one company and get a job at another, often part-time; (2) retire and then get rehired, usually on a limited basis by the same company (e.g., as an independent contractor doing essentially the same job at the same desk); or (3) phase-out gradually before leaving the labor force completely.

Definition of phased retirement: Payment of benefits is permitted in a phased-retirement program only if participation is voluntary and the employee is expected to reduce hours worked by at least 20 percent or more. First, such a definition would require employers to count hours in order to ensure that employees under this program are not exceeding their individual limits. While we suggested this alternative in our December 2002 letter, we do recognize that it could be administratively burdensome for employers and may discourage them from implementing such a program. The compensation-test approach may be similarly ineffective whenever compensation has a large performance-based component that could jeopardize the part-time status. Perhaps these thresholds can be based on scheduled hours or base compensation.

If the concept of "hour-counting" proves to be too burdensome, other simplified approaches could be used. For example, base receipt of pension on percentage of time worked. In other words, participants working more than 75 percent of a full-time schedule would not qualify for a benefit distribution; participants working between 25 and 75 percent could receive one-half of their pension; and participants working less than 25 percent could opt to receive a full benefit payment. While other methods could be devised, it is important to ensure that the chosen method is not so burdensome as to negate its use.

Second, the proposed regulations require that distributions must be proportionate to the designated reduction in hours. Some believe that payments should not be restricted; partial or full payments should be allowed from such phased-retirement programs. In essence, not allowing employees to opt to receive partial or full benefit payments means it will still be more beneficial for them to opt to retire in full and go to work for another organization (or be reemployed as a consultant). However, a consequence of allowing partial and/or full payments from a phased-retirement program is the issue of adequacy. Employees who are allowed to access their pensions earlier will receive less per month when they ultimately retire. While they can make up for this reduction by continuing to work, that option may not be feasible at truly advanced ages, when the monthly benefit may be inadequate to meet their needs. Even more fundamental to retirement security, allowing full retirement benefits while an individual is still working is inconsistent with the notion of pensions being reserved for retirement.

Minimum age/service: Under the proposed regulations, phased retirement benefits cannot be paid before an employee reaches age 59½. Consistent with the Academy's previous letter to the IRS regarding phased retirement, we believe that the eligible retirement age for a phased-retirement program should be consistent with an individual plan's designated earliest retirement age. These ages vary by plan and are often based on: a minimum age (e.g., age 55); a minimum age and years of service; a total age and years of service; minimum years of service; or some combination of these. If an employee is required to wait until age 59½ to phase into retirement, despite being eligible for early retirement at age 55 under the plan, an employee may once again opt to retire at age 55 and go to work for another organization (either full-time or part-time). Alternatively, the minimum age should be lowered to age 55, which is a common early retirement age in plans that have a normal retirement age of 65.

Lump sums: The proposed regulations require that all optional forms of benefit and early retirement benefits available upon full retirement also be made available under the phased-retirement program, with the exception of lump sums. While the council recognizes annuitization as a key component of a secure retirement policy and therefore agrees with the general prohibition against paying lump sums in phased retirement, we would like to suggest that de minimis benefits be allowed in the form of a lump sum in order to maintain a level playing field between 401(k)-type plans (which do have this flexibility) and defined-benefit plans.

Section 415 maximum: For the regulations to be complete, they should address the conditions under which a participant's benefits may initially be limited under IRC Sec. 415 and what happens during a phased-retirement period as the limits increase. In addition, we believe that under phased retirement, companies should be allowed to restrict the total of the pension benefits paid and the partial salary earned to the amount of the participant's full-time annualized salary.

Age discrimination in employment: As noted in our previous letter, ADEA is beyond the specific professional expertise of actuaries. There is, however, a great deal of uncertainty with regard to ADEA whenever any type of program for older employees is implemented. Some well-defined safe harbors would be helpful.

Safe harbors on rehires: There are currently legal uncertainties surrounding the practice of rehiring retirees. A termination must be a bona-fide termination, or there is legal risk to the plan and the employer upon rehire. Discussions with a number of attorneys indicate that no clear tests exist for when rehire is acceptable, and different companies have different views. The proposed regulations should clarify/provide guidance on safe harbors that need to be met when an employee retires and is then rehired.

Conclusion

The current qualified-plan rules do not facilitate, and in some cases impede, phased retirement. Therefore, we do appreciate the efforts the IRS has made to simplify the administration of a phased retirement program. For example, the proposed regulations: require only periodic checking of the work schedule, allow a compensation alternative (although this may result in employees working without compensation for hours over their regularly scheduled time), and do not require an adjustment in the benefit unless the work schedule is one-third more than expected.

On balance, the proposed regulations, as written, also add a layer of administrative complexity that may discourage employers from implementing phased-retirement programs. For those employees who are not interested in phasing down their working hours but are interested in taking a portion of their pension, their primary recourse is to retire and go to work for another organization. For employers, this is a loss of knowledge and talent that may be unnecessary if regulations for a phased-retirement program were written to address this practice. At the same time, we realize that allowing employees to take their pensions prior to actually retiring raises adequacy issues. However, the IRS should recognize that the proposed regulations, as written, do not address this specific need of employers and employees.

We appreciate this opportunity to share our thoughts on the proposed regulations regarding distributions from pension plans in a phased retirement program. We would be interested to meet with you to answer any questions or discuss any of the concerns expressed in this letter. Please contact Heather Jerbi, the Academy's senior pension policy analyst (202.785.7869; Jerbi@actuary.org), if you have any questions or would like additional information.

Sincerely,

Donald J. Segal, MAAA, EA, FCA, FSA
Vice Chairperson, Pension Practice Council
American Academy of Actuaries