Transcript for Hybrid Plans EP Phone Forum

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Moderator: Ladies and gentlemen, thank you for standing by. Welcome to the Hybrid Plans EP Phone Forum. At this time all participants are in a listen-only mode; as a reminder, today's call is being recorded. I would now like to turn the conference over to Mr. Mark O'Donnell; please go ahead, sir.

M. O'Donnell: Hello, everyone. I'm Mark O'Donnell, Director of Customer Education and Outreach for IRS Employee plans. Welcome to our phone forum on the recently issued hybrid plans regulations. Today we'll be hearing from Michael Spade, and IRS employee plans actuary and Linda Marshall from our Chief Counsel's office. They were involved with the drafting of this recent hybrid plan regulations. I'm delighted to have Mike and Linda as our speakers. I'd like to point out a couple of things before we start. Everyone registered for this phone forum will receive a certificate of completion by e-mail approximately one week after the forum. You must attend the entire forum to receive a certificate. Enrolled agents and enrolled retirement plan agents are entitled to continue in professional education credit for this session. Other types of tax professionals should consult their licensing organization to see if this session qualifies for continuing professional or educational credit.

We recently issued an article in our newsletter, *The Employee Plans News* on hybrid plan regulations. You may view it by visiting the IRS employee plans Web site at www.irs.gov/ep. You can also get there by going to the main IRS Web page and clicking on the Retirement Plans Community tab at the top. Look to the left-hand navigation bar and click on Newsletters. While visiting our Web site you may also want to subscribe to one of our free electronic newsletters. We have two newsletters, the *Retirement News for Employers Sponsoring Retirement Plans* and *Employee Plans News* for retirement plans professionals. Without further ado, here are our speakers, Mike Spaid and Linda Marshall.

M. Spaid: Good morning, this is Mike Spaid.

L. Marshal: This is Linda Marshall.

M. Spaid: We're going to break this up into two pieces. I'm going to start by talking about the final regulation and then Linda will follow up talking about the proposed regulations. We're going to have a bit of a dialogue from time to time, back and forth between Linda and me on certain things. We have a handout that I put together; I believe that was posted. For those of you who have it I'm going to try to go through and follow that. I'm going to start on slide two; we're going to talk about the final regulations.

In general, they incorporate the transitional guidance we issued some time ago, in [Notice] 2007-6, and a lot of what you see in the final regulations was contained in the 2007 proposed regulations. Of course, since they're anecdotally known as the hybrid plan regulations or the cash balance plan regulations, they provide guidance on 411 (a)(13) and (b)(5) of the Code looking at whipsaw relief and age discrimination issues. They contain number of definitions and I think it's important to touch on those definitions before w e go really too much farther. I would encourage everyone who's interested in this topic, that would hopefully be everyone on the phone, to not only look at the regulations, final and proposed, but to please look at the preambles. The preambles often carry things, contain things, in much greater detail; sometimes I think they're a lot clearer than maybe what you'd get from reading the promulgation of the regulation. They're just a little more easy to read. Look in there; you'll find we've got the accumulated benefit. Obviously we need to define what we're talking about in a hybrid plan and that's the participant's benefit accrued to date under a plan. Notice that's not the accrued benefit and we'll talk about that in a few minutes.

Of course, we need to talk about what is a lump sum base benefit formula and that's a formula under which the accumulated benefit in a defined benefit plan is expressed as the current balance of a hypothetical account or in what we think of as a pension equity plan, the current value of accumulated percentage of the participant's final average compensation. Statutory hybrid benefit formula is the benefit formula, either lump sum-based benefit formula and that was just defined or a formula that has an effect similar to a lump sum-based benefit formula. That effect similar is important; we'll talk about that in just a minute. Of course, a statutory hybrid plan is a defined benefit plan that contains a statutory hybrid benefit formula.

We're going to take a look at the next slide, The Effect Similar To and this is important. Effect similar to; the benefit formula has an effect similar to a lump sum-based benefit formula if it provides an accumulated benefit at normal retirement age, includes adjustments for a future period and the total dollar amount of adjustments is reasonably expected to be smaller for a younger person when compared to a similarly situated participant who's younger, who is or could be a participant in a plan. I'd like to touch on this a little bit more here. Let's talk about the second term, about how the total amount of adjustment is reasonably expected to be smaller … the participant when compared to a similarly situated younger participant. This is really a very basic definition of the accumulation of interest credit for an older participant compared to a younger participant although it's not necessary that a statutory hybrid plan credit interest.

It's also important to note the comparison includes anyone who could potentially be a plan participant so it doesn't just apply to the demographics of the current plan population. Then looks look a bit at similarly situated. It's like in the 2007 proposed regulations. An individual is similarly situated to someone else if the individual is identical to the other person in every respect that's relative to determining the person's benefit under the plan except for age. That includes things like periods of service compensation, position, date-of-hire, work history; you can find this in the regs as well. If a benefit formula applies to a participant on account of participant's age, an individual to whom the benefit does not apply and is identical to the participant in all respects, is similarly situated. I took this right out of the preamble, which is why it's a good place to look for things, but I think this is a very good description. It says if an individual is not similarly situated to a participant, if not similarly situated, if a different benefit formula applies to an individual and the application of the different formula is based neither directly nor indirectly on age, for example, if the benefit formula in the plan is changed from one type to another for employees hired after the effective date of the change, employees hired after the relevant date would not be similarly situated with employees hired before that date because the benefit formula for new hires is not based directly, nor indirectly, on age; I would encourage everyone to read the regulations and to get the concept of similarly situated very clear in your head.

Then a hypothetical account – benefits expressed as hypothetical account if it's expressed as current single-sum dollar amount and this is what I mentioned before, whether or not the participant has a right to future interest credit. These definitions apply to the regulations und 411 (a)(13) and (b)(5) both so there's not just one set of regulations or definitions with one. Pension equity plans, as I mentioned before, we must think of a pension equity plan as a plan that calculates benefit to the current value … accumulated percentage of a final average compensation. A lot of these do not credit interest while a participant is actively accruing benefits. But if a PEP formula provides for an interest credit after accruals cease, these interest credits must follow the market rate of return rule because a lump sum benefit formula provides interest credit, even in this case, is subject to the market rate of return rules.

Moving on, I believe it's slide eight, benefit properly attributed to after-tax employee contributions, rollovers and other similar employee contributions is disregarded. Just because the plan accepts rollover contributions doesn't mean that's going to make the plan a lump sum-based benefit formula. We say properly attributable to after-tax employee contributions as well. I know there are still some plans out there that have those so keep that in mind.

L. Marshall: A plan like that, they'll have to keep track of the employee contribution and interest that's properly creditable to them for purposes of the minimum benefit attributable to employee contributions under 411 (a), but that won't, the fact that they maintain this kind of account for them or replicate that kind of account at the time of distribution doesn't mean that it turns into a cash balance, lump sum-based plan.

M. Spaid: Right. We didn't want to throw those plans into lump sum-based because they just obviously aren't. When determining whether a benefit formula is in fact similar to, you need to look at indexing, but certain indexing like cost-of-living increases are disregarded. I'm looking here at … that under 411 (b)(5) … indexing means periodic adjustment of the accrued benefit by means of an application of a recognized investment index or methodology. Again, just because you have a standard defined benefit plan that indexes benefits doesn't mean that you have a lump sum-based formula.

Variable annuities, adjustments under variable annuities, we have what we call, we thought of as the hurdle rate, which means the adjustments need to be based on an interest rate of at least 5%. This is something that we proposed; the final regulations retained this rule. It says that adjustments under a variable annuity don't have an effect similar to a lump sum-based formula if the assumed interest rate to determine the adjustment is 5% or higher. We clarified that the variable annuity benefit formulas are exempt also from the no-loss and preservation of capital rule as well.

We're going to look at this, rules under 411 A (13)(a). This is the column we thought of as the whipsaw relief for cash balance plans. It talks about if a plan meets the requirements under 411 A (13)(a), that the plan can pay the present value of the benefits determined under lump sum formula as though it were the present value of accrued benefits without regard to the accrued benefit under the plan. However, it's very, very, very important, keep in mind that this section under 411 A (13) and the regulations do not alter the definition of the group benefit under 411 A (7)(a) or the definition of a normal retirement benefit under 411 A (9). We've seen a large number of recent determination letter submissions that attempt to define the accrued benefit simply as the hypothetical account balance. The claim has been made that the new regulations now allow all distributions regardless of the form to equal the actuarial equivalent of the account balance rather than the actuarial equivalent of the traditional accrued benefit under 411 A (7)(a)(i).

Look at the final regulations. Under the final regulations all optional forms must still be actuarially equivalent to the accrued benefit and a 411 A (7)(a)(i) provides that in case of a defined benefit plan, the accrued benefit must be expressed in the form of annual annuity commencing at … retirement age. Nothing in the final regulations changes this. The accrued benefit is calculated as a function of the hypothetical account balance under the terms of the plan and then optional forms of benefit other than the lump sum because we got relief for that, calculated under the terms of the plan specifically in accordance with the plan's definition of actuarial equivalent. If the plan uses exactly the same factors to project the current hypothetical account balance to normal retirement age and then convert this to an annuity, … accrued benefit, the actuarial equivalents factors then to convert the accrued benefit to an optional form, then this is equivalent to converting the hypothetical account balance directly in … form, but this is usually not the case.

When calculating the accrued benefit, the current hypothetical account balance is projected to NRA using the then-current interest-crediting rate and this is very often not the same interest rate specified in the plan for the purposes of determining actuarial equivalents for optional forms of benefit. But when we get to the proposed regulations I'm just going to talk about something like this that may give us some relief on this. At this point I'd like to also make a comment that anybody who has comments on these, we really encourage you to submit your comments during the comment period because we read them, we take them into account; we really do care. We don't always change things in accordance with comments to questions, but they're definitely taken under consideration.

Let's look at the present … 417(e). If a statutory hybrid plan provides benefits under a benefit formula that's a statutory hybrid benefit formula, but other than a lump sum-based benefit formula, still must comply with 417(e) with respect to an optional form of benefit that is subject to the requirements of 417(e). … vesting. Plans must satisfy certain vesting requirements with respect to a cash balance plan. What it says is a plan fails to satisfy the requirements of 411(a)(2), that's vesting, if any part of the participant's DB accrued benefit is determined under statutory private benefit plan unless basically a participant with three or more years of service has a non-forfeitable right to 100% of the accrued benefit, derived, of course, from employer contribution after three years. It's important to keep in mind that this requirement applies to participant's entire benefit derived from employer contributions under statutory hybrid plans, not just the portion that is determined under the statutory hybrid benefit formula.

Also this requirement applies to a participant's entire accrued benefit plan if the participant is entitled to the greater of two or more benefit amounts where each amount is determined under a different benefit formula and at least one of them is a benefit calculated under statutory hybrid benefit form even if, in the end, when we go to pay the person out, the participant's benefit under the statutory hybrid benefit is ultimately smaller than that determined under the other formula. This brings us up to … offset arrangements and we have some comments about what to do with those. Both the Treasury and the IRS have taken the position of … offset arrangement where the benefit payable under one plan is reduced by the benefit payable under a separate independent plan is only permissible if the arrangement limits the offset to amounts that are vested under the independent plan.

The regulations pertain to the rule we proposed with the three-year vesting as I mentioned before and because the offset isn't done on total benefit basis, it's done on a vested basis.

L. Marshall: So the rule for floor offset plans says that if one is a statutory hybrid plan and if one is not, then the vesting rule still applies, just on a plan-by-plan basis; it doesn't apply to the plan that's not the statutory hybrid plan, but that's because, as Mike pointed out, that you would never be offsetting vested benefits by non-vested benefits anyway.

M. Spaid: That's right, exactly. The age discrimination safe harbor provides benefits under certain types of benefit formulas can satisfy age discrimination if as of any date a participant's accumulated benefit, expressed .. one of the formulas that we've given you, is not less than a similarly situated younger participant's accumulated benefit expressed into the same formula … and again, I've mentioned that before. Please take the time to get straight in your head what similarly situated younger means. Also keep in mind that the accumulated benefit is not necessarily the accrued benefit; they're different things.

Look at conversions because a lot of the plans, of course, this is a lot of the plans were changed from DB to hybrid plans and this is going to apply going forward. Participant's benefits are affected by conversion amendment and they have to be both adopted and effective; that's important, on or after June 29, 2005, must generally be given what we think of typically A+, B benefit where A represents the benefits accrued before conversion and B represents the benefits after conversion. We're not permitted to have any interaction between the two. Of course, the intent here is to prevent wear-away and whether or not the amendment or multiple amendments because there can be several amendments that in conjunction with each other can constitute a conversion amendment. Whether they constitute a conversion amendment is determined on a participant-by-participant basis, not as a whole. I'll explain that a bit more. A conversion amendment is something that reduces or eliminates benefits under the old formula that the participant would have accrued. By … formula, we're thinking of a benefit formula that is not a statutory harbored benefit formula and the participant was actually earning benefits under that formula prior to the amendment and after the effective date of the amendment, all or a portion of the participant's benefit accruals of the plan are now determined under a statutory hybrid benefit rule.

This is a lot like the proposed 2007 reg; these are the final regs adopt … like I said whereby the effective date of the conversion amendment is determined on a participant-by-participant basis … the date of which re reduction occurs that the participant would have accrued under the effective date of the benefit formula, but is not a statutory harbor. In accordance with 411 (d)(6) regulations provide the date future benefit accruals are reduced to … determine the date of adoption conversion amendment. We did this simply to avoid a situation, this appears in the preambles, but it's very clear. Suppose the plan was converted to a cash balance plan, but say the participants were 55 or older, do they continue to get the greater of accruals under the old formula or the new cash balance formula for five years? There were suggestions made in comments to the 2007 regs that once should define the effective date of the conversion amendment for all plan participants to be the date the cash balance formula went into effect rather than applying it on a participant –by-participant rule. If this were allowed, however, five years after the cash balance formula went into effect, the hypothetical balance would result in participants could conceivably provide benefits that are less than the frozen amount under the prior formula and this would produce no additional accruals for some period of time after the five-year period. This approach would allow the type of wear-away that the statute was intended to prevent. That's why we went with participant-by-participant basis from the date which accruals under the old formula cease.

Interest credits, what is an interest credit? Hypothetical plans like this will have a hypothetical account, hypothetical interest credit and hypothetical pay credits. Generally it's going to be any increase or decrease for a period to a participant's accumulated benefit including under a statutory harbored benefit formula, under which the terms of the plan at the beginning of the period, so we look at the term of the period for which the interest is being credited if interest is credited on a quarterly basis, look at the terms at the beginning of each quarter for which interest is credited or annually, of course, at the beginning of the year. Apply rate of interest or rate of return … your rate of increase or decrease under an index to a portion of the participant's accumulated benefit as of the beginning of that period, but provided that interest credits are not conditioned on current service, that interest credits are not made because of imputed service. It isn't on the slide, but it really begs the question; what's a pay credit?

A pay credit or what we prefer to refer to in the regulations as a principal credit means any increase to the participant's accumulated benefit under a statutory harbored formula that's not an interest credit. So if it's not one, we know it's the other. What does that mean? A principal credit includes an increase to a participant's accumulated benefit to the extent the increase is conditioned on current service or is made on account of imputed service. This is important. Even if a plan or an amendment plan would call an increase to the hypothetical account balance an interest credit, say, if it were based on or conditioned on current service or made on account of imputed service, it really isn't. It would be treated as a principal credit. A principal credit includes an increase to the current value of an accumulated percentage of the participant's final average compensation so think of that as being in a PEP plan.

Safe harbor interest credits, the list of safe harbor interest credits in the final regulation has been expanded; there's more proposed expansion, of course, in the proposed regulation, but specifically this is, I think, one of the most important things to point is it's been expanded to include the first and second segment rates as well as the third segment rate.

L. Marshall: Yes and these are the safe harbors that apply for purposes of the market rate of return --.

M. Spaid: Right --.

L. Marshall: That a plan, a statutory hybrid plan can't provide, it's not allowed to provide a rate of return in excess of the market rate of return or it violates the age discrimination requirement 411(d)(1)(H).

M. Spaid: Exactly. What it says about market rate is that a … rate is kind of backhandedly defined it, but it's not in excess. The … rate is not in excess of a market rate if it is always less than the particular interest-crediting rate that we consider to be a market rate of return or always equals the lesser of two or more rates when at least one of the rates meets the market rate of return limitation. I've seen some plans that will have just that; it will be an interest-crediting rate that'll be the lesser of two or more rates. As long as one of the limitations on that is an interest that we think meets the market rate of return limitation then it can never exceed that so that would be all right.

Index benefits, look at Code Section 411(b)(5)(E) to see what we really mean about a defined index benefit, but interest crediting rating equal to the actual rate of return on plan's accrued assets or they could be both positive or negative if not in excess of a market rate. Here's the issue, the plan's assets are diversified to minimize the volatility of returns. The concept being here that the plan, we didn't want to tie this type of indexing to a rate of return that was concentrated in one market sector because of course, that should theoretically be much more volatile than a properly diversified portfolio. There's more about this in terms of tying the interest crediting rates to the plan rate of return for other benefits, but that's in the proposed regulation.

L. Marshall: Right, for plans that are not indexed plans, but rather statutory hybrid plans.

Moderator: Pardon the interruption, this is your 23-minute warning as requested.

M. Spaid: Thank you very much. Excuse me, for those of you who know me, I have a bit of a cold today and I'm kind of a little deeper-voiced than usual. Interest credits, 411(d)(6) right to future interest credits, which are not conditioned upon future service, of course, because interest credits may not be conditioned upon future service, is a 411(d)(6) protective benefit. I like to think of interest credits as being sticky; when a pay credit's made, the interest crediting rate in effect as of the time that pay credit is made is, they stick to that. Of course 411(d)(6) applies to amendments that change accrued benefits, accrued by and changes made by an amendment so plan amendments changing interest crediting rates on future hypothetical pay credits are of course allowed as one would expect. With that, I believe I'm through with the final regulations. I'm going to hand this over to Linda and the proposed regulations.

L. Marshall: The 2010 proposed regulations provide additional guidance for statutory hybrid plans in a number of areas. The areas, in short, include the scope of the anti-whipsaw rule; its application is expanded from the final regulations and we also have some rules clarifying circumstances under which it applies. We have a proposed anti-backloading rule to cover the situation where a cash balance plan provides a rate of return that could be negative for a year. We have a set-and-forget conversion rule that enables a cash balance plan to set a hypothetical opening account balance and not perform further calculations before paying lump sums under certain circumstances. We have a number of additional rules regarding the market rate of return including rules regarding the interest-crediting rate that is required to be used on plan termination. Let me start getting into those now.

On Section 411(a)(13) anti-whipsaw, the proposed regulations provide this does not apply to benefits determined under a lump sum-based benefit formula (that's the cash balance formula or a PEP formula) unless certain requirements are satisfied and however these conditions are met, then it extends to all optional forms, not just single sum; it then applies on a proportionate basis in the event of a partial distribution. The proposed regulations, the way the proposed regulation expands this is, this anti-whipsaw rule applies to many other forms of benefit under a lump sum-based formula and not just to a single sum. This rule under the proposed regulation applies to any optional form of benefit that's currently payable with respect to a lump sum-based benefit formula if under the terms of the plan, that optional form is determined as of the annuity starting date as the actuarial equivalent using reasonable assumptions of the hypothetical account or the accumulated percentage of final average pay.

This rule, under which you don't have to project forward and discount back applies in two cases. Number one, if optional form is the actuarial equivalent using reasonable actuarial assumptions of the hypothetical account or accumulated percentage of final average pay, or number two, if the optional form payable is not subject to 417(e) and is the actuarial equivalent using reasonable actuarial assumptions of the optional forum that commences at the same annuity starting date and is payable in the same generalized optional forum as the accrued benefit. Essentially if the optional form that looks like the accrued benefit if it is payable at a different time, but it's actuarial equivalent and if the actuarial equivalent of the then benefit that looks like the accrued benefit is the actuarial equivalent of the then-current balance of the hypothetical account or then-current value of the accumulated percentage of final average pay.

Essentially, if you have one of these kinds of benefits that's subject to relief then you don't have to do the project forward and discount back that you would normally have to do in the absence of this new rule under the proposed regulations, since the final regulation limited this rule to a lump sum. The proposed regulations also provide rules for the application of the anti-whipsaw rules to partial distribution, under these rules the anti-whipsaw relief generally applies on a proportionate basis when a partial distribution is made whether it's made as a single sum or whether it's made in some other distribution form.

The proposed regulations also impose several conditions on the availability of anti-whipsaw relief including the anti-whipsaw relief that applies to one spouse. The first condition essentially is that before normal retirement age, the hypothetical account balance or accumulated percentage of final average pay has to be equal to not less than the present value of the accrued benefit. Really, if you're, you can have a, this rule is really intended to ensure that the hypothetical account balance is a number that participants are being provided with; it's really the value of their benefit in order for that value to be payable as a, distributions to be payable in that amount.

The second condition is that after normal retirement age either the plan has to satisfy 411(a)(2) by providing a minimum benefit paid based on a reasonable actuarial adjustment to the normal retirement age accrued benefit or the plan has to comply with the suspension of benefits rules in accordance with the requirements of 411(a)(3)(b). It's a defined benefit plan it either has to provide actuarial adjustment as the minimum benefit payable after normal retirement age or it has to suspend benefits in accordance with 411(a)(3)(b). The third condition is that the hypothetical account balance or accumulated percentage of final average pay are only reduced for a list of reasons specified in the regulations, the list of reasons that I think would be logical like distributions or distributions to participant, distribution percentage of the QDRO or negative adjustment on account of a negative interest crediting rate, equity based rate, or things like that.

Going on to the next slide and the next rule in the proposed regulations; the proposed regulations contain an adjustment to the 133.3% accrual rule, under which a plan that determines any portion of the accrued benefit based on the statutory hybrid benefit formula that uses a variable interest crediting rate that's less than zero for the prior plan year, doesn't fail the 133.3% rule merely because it's assumed that that rate is zero for the current and future years when its assumptions are otherwise held constant.

M. Spaid: Things could get really odd of your plan had a, if you're following what we allow in the proposed regs as a market rate of return tied to a variable rate that went negative for a year and all of a sudden projecting to retirement age on a negative rate.

L. Marshall: This issue was really highlighted shortly after we issued the proposed regulations that preceded these final, the accompanying final regulations we also issued a couple items of guidance on the application of the anti-backloading rule to cash balance plans; we issued a revenue ruling on cash balance conversion that illustrated how the 133.3% rule was applied. We also issued proposed regulations that proposed a change for our backloading rule for plans that offer benefits under the greater multiple formulas. In response to these guidance items, we received comments that among other things, you have to have a rule for a cash balance plan that credits interest at a variable rate that can go negative to satisfy anti-backloading. As Mike said, it does result in really weird consequences if you assume that a plan credits interest at a negative rate until normal retirement age so we allow plans to use the zero assumption for that purpose.

The next rule in the proposed regulations is what we call Set and Forget. We had in the conversion rules in addition to providing the basic A+, B rules that Mike explained earlier, a method that we call Set and Test where a plan could establish an opening hypothetical account balance, but then upon distribution, distribute the greater of either the opening hypothetical account balance or the old benefit plus the new cash balance accruals. In addition to that, we asked for comments on this alternative that we call Set and Forget where a plan could establish a hypothetical account balance and then an opening hypothetical account balance on conversion without a need to do further calculations before distributing a lump sum. The proposed regulations take into account the comments we received on what we call Set and Forget, which was a popular alternative with pretty much all commenters, but some commenters asked for conditions that would provide participant protections so we came up with this rule in the proposed regulation. This is a cash balance rule, not a PEP rule; it's not a methodology that lends itself well to establishing appropriate protections for PEP formulas.

The rule in the proposed regulations applies to single sums only. You can only establish an opening hypothetical account balance and not do further calculations if the participant elects a single sum. The plans will separately need to keep track of the pre-conversion benefit in order to satisfy the conversion protection requirements for all forms of distribution other than a single sum. We did ask for comments in the preamble on whether we should apply this rule as well to other forms of benefits; the reason we didn't do this in this round of proposed regulations is because of concerns about subsidies that might be in other optional forms of benefit. We didn't feel we were prepared to come up with rules to take into account subsidies in other forms of benefits and we didn't feel we could permit them to be eliminated.

The conditions for Set and Forget, first of all 411(d)(6) protected benefit must be preserved. The benefit after the effective date of the conversion must be not less than the 411(d)(6) protected benefit with respect to service before the effective date of the amendment and pre-conversion, either no single sum must have been provided under the plan or the single sum must have been based on the present value of the benefit payable at normal retirement age or commenced later so that we don't allow this, if it was possible that the single sum could have reflected an early retirement subsidy, let's say if it were calculated as the actuarial equivalent of an early retirement benefit rather than the normal retirement age benefit.

The opening hypothetical account balance has to be not less than the present value of the accrued benefit at conversion determined using 417(e) actuarial assumptions. The interest crediting rate has to be either the rate of interest on long-term investment-grade corporate bonds or third segment rate or one of several specified safe harbor rates. As of the effective date of the conversion amendment, the value of the index used to determine the interest crediting rate must be at least as great as the rate used to determine the opening hypothetical account balance, and there are also several requirements relating to the plan's death benefit.

The proposed regulations made several proposed changes to the preservation of capital rule. Under the preservation of capital rule, under a statutory hybrid plan, the participant's benefit must be no less than the sum of the pay credits. The original proposed regulations did not address the application of the preservation of capital requirements to multiple annuity starting dates. We recognized that gap and we're providing additional rules in the proposed regulations to cover the gap. Under these multiple annuity starting date rules, the preservation of capital rules only apply at the time the distribution of the entire benefit commences; if the participant takes a partial distribution the preservation of capital rule is not triggered at that time. Of course it could be triggered multiple times if a participant takes the complete distribution and subsequently accrues additional benefits. At that time it would be triggered at the time of the next complete distribution, but it's not triggered except at the commencement of the entire benefit or the entire remaining benefit. At that time the rules apply by comparing a participant's pay credits to the sum of the account balance plus prior offsets to the account balance for distributions plus prior increments that were paid to the participant pursuant to the preservation of capital requirement in earlier days. Those are the changes to the preservation of capital requirement.

The proposed regulations add a number of additional permitted market rates of return and some of these rates are very different from the basic bond-based rates that were permitted under the, that are permitted under the final regulations and weren't permitted under the previous proposed regulations. One of the new proposed market rates is plan assets. The plan assets are added as a permitted market rate of return for a statutory hybrid plan. This means plan assets as a whole, not subsets of plan assets so you can't in effect turn the plan into a defined contribution plan by just defining a subset of plan assets for each participant, but you can use the plan assets as a whole as a permitted interest crediting rate and it will satisfy the market rate of return requirement. This is only permitted if the plan assets are diversified in order to minimize the volatility of returns --.

M. Spaid: … the rule in the final regulations regarding the index benefits.

L. Marshall: Right.

M. Spaid: But it gets expanded to other plans.

L. Marshall: Right and this rule does not require greater diversification than the diversification standard under Title I so if a plan is subject to Title I and is complying with those requirements it will also be permitted to offer, to provide the rate of return on plan assets as a market rate of return, as an interest crediting rate that satisfies the market rate of return requirements.

The proposed regulations also broaden the list of permissible market rates of returns in other ways. An interest crediting rate is not in excess of a market rate of return if it's equal to the rate of return for certain registered investment companies. The RIC rule permits a mutual fund index to be a mutual fund rate of return to be a market rate of return only if it's reasonably expected to be significantly more volatile than the broad US equities market or similarly broad international equities markets. Mutual funds that won't satisfy the market rate of return are sector funds concentrated in one industry or concentrated in a country other than the US and mutual funds that use leverage or significant investment derivative financial product, that uses leverage for the purposes of achieving returns that amplify the returns of un-leveraged investments.

On the other, a mutual fund doesn't have to just be a totally representative of the US market; say a small-cap fund is fine or broad-based international fund is fine. And a plan is permitted to use several different floors in combination with otherwise permissible market rate of return. A plan can use a 3% floor in combination with any permissible rate including equity rate, but this is an accumulative lifetime floor; this is not an annual floor. A plan is allowed to use a 4% annual floor in combination with a bond-based trade. We did a lot of economic modeling to come up with these rates; our goal was to come up with rates that were above market when compared to the rate of return on long-term corporate bonds only infrequently and for short periods based on historical data. Based on this modeling we also came up with a fixed rate that is deemed not to be in excess of the market rate of return.

Under the proposed regulations a rate of 5% is deemed not to be in excess of the rate oaf return on long-term corporate bonds and therefore not in excess of the market rate of return. We came up with that rate also based on the same modeling and the same standard. Also under the proposed regulations the list of market rates of return in the regulations is an exclusive list. A plan that provides a different rate of return than one of these rates of return does not provide a market rate of return once the proposed regulations are finalized. The proposed regulations also provide rules for terminating plans; there's a statutory requirement that a statutory hybrid plan must provide that on plan termination the interest crediting rate or equivalent amount used to determine benefits must be the five-year average of the rate previously used under the plan. The proposed regs address a number of questions that arise in the application of this rule. In particular, equity rates of return aren't really compatible with the five-year average rule. Let's say if it went negative for a year you would get really strange results if you applied that on plan termination. If it were negative for the five-year period, you would get a --.

M. Spaid: … negative for a long time.

L. Marshall: Yes, on the other hand, if --.

M. Spaid: … for a long time.

L. Marshall: It could be really high for --.

M. Spaid: Twenty-seven percent. We'd all love to see those days again.

L. Marshall: Yes we would, but anyway, they provide it if there are either anomalously High or anomalously low for the five-year period they produce results; this five-year rule produced results that really nobody wanted. So for equity rates of return we substitute the third segment rate, applying the caps and floors that apply under the plan, but not other adjustments under the plan. That's how we apply this rule. Okay, 411 (d)(6). Under the final regulation, we issued guidance last year announcing certain expected relief with respect to the requirements of 411 (d)(6) --.

M. Spaid: … announced in [Notice] 2009-82 and Notice 2009- 97.

L. Marshall: Right, the 411(d)(6) relief that applied for plan amendments under Section 1107 of PPA is gone; 1107 of PPA provided 411 (d)(6) relief for all amendments pursuant to PPA. Notice 2009-97 announced that we intend to provide additional 411(d)(6) relief with respect to hybrid plan amendments, but only to the extent necessary to enable the plans to comply with applicable requirements. For interest crediting rates, a change to the plan's interest crediting rate, I think the extent to which it could have been amended during the 1107 period is somewhat broader than the extent to which it will be permitted to be eliminated once we issue final regulations that finalize these proposed regulations.

M. Spaid: Right, … partners that bit about the extent necessary.

L. Marshall: We asked for comments in the preamble to the proposed regulations on exactly how the standard should be applied once we do issue the final regulations. For example I would think that if you had a 6% rate and you reduced it to 5%, if we kept the 5% rate when we finalized the regulations that that would be to the extent necessary --.

M. Spaid: What if I reduced it to zero?

L. Marshall: I don't think that would be to the extent necessary --.

M. Spaid: Do you think that would be more than the extent necessary?

L. Marshall: That reduction would be in excess of the reduction to the extent necessary. The harder issues arise when you change from, say, apples to oranges, when you change from a bond-based rate that might be too high to, say, an equity rate. Is that to the extent necessary? There are just a host of issues that arise when you, when the floors come into play and when you consider changes between different types of rates. We're asking for comments on exactly how that to-the-extent-necessary standard should be provided. The preambles to the proposed and final regulations are unclear about exactly what's being extended regarding plan amendments and we recognize that additional guidance regarding deadlines for amendments would be helpful. We also are sympathetic about the point that it doesn't seem logical to amend for the statute this year and then amend for the regs the immediately following year. We're considering what guidance regarding plan amendment, regarding hybrid plans might be helpful.

I think we have a little bit of time to address a few of the questions that we've gotten. We have a number, I put the questions we got by e-mail into a Word document and it was about ten pages long and I think that was a few days ago. We're not going to address them all, but we will address a few of them now.

M. Spaid: If you were going to read question two that you have on the slide there; I think a lot of people have asked us about timing.

L. Marshall: Sure.

M. Spaid: I'll read it for you and we'll kind of go back and forth. Will there be a 411(d)(6) relief for plans that have to change the timing of a determination of their interest rates in order to comply with the fair market interest rate? For example, a plan uses ten-year securities measured the first day of the plan year; it'll have to change their look-back month. It's possible this could result in a lower interest rate sometime in the future, but it's being forced to be done. The regs seem to say that if it's possible the interest rate could be lower, that would be an impermissible cutback. Will there be 411(d)(6) relief?

L. Marshall: I think we would view a change from our permitted rate with an impermissible measuring date to a permitted rate with the correct look-back month if the change from a rate that's impermissible under the regs to a change that is permissible once the proposed regs are finalized if they keep the same rules. That's where we're likely to grant 411(d)(6) relief or such a change and that sounds exactly like the type of change that would be made to the extent necessary to comply with the regulations; I would expect that we would give relief for that.

M. Spaid: Here's something that I've seen; I get a lot of questions on this … before. How do the market rate requirements apply to frozen cash balance plans, particularly plans that were frozen prior to 2006?

L. Marshall: Yes the requirements for market rate of return apply to a frozen plan just the same as --.

M. Spaid: Just the same --.

L. Marshall: … as an ongoing plan.

M. Spaid: I bet I've got ten questions on this in terms of different things. I think it's something we probably need to address.

L. Marshall: Really. The age discrimination safe harbor isn't going to come into play if there are no ongoing accruals, but the market rate of return requirements apply in an identical manner.

M. Spaid: Are there any other questions that you particularly wanted to get on?

L. Marshall: Let me look.

M. Spaid: I have a quick one while you're looking. Basically about how the 415 limit's determined for a hybrid plan; it's going to be determined like you would for any other plan, actually. You need to, there are two ways to determine your 415 limits that get you to exactly the same way especially if you're paying a lump sum. One thing you can do is you can take the accrued benefit, you can take the lump sum being paid, turn it into an accrued benefit, compare that to the maximum accrued benefit payable or if you've got a lump sum of course you can take the maximum allowable 415 lump sum annuity starting date and convert that into a lump sum and compare that to your lump sum; you can compare the two. Actuaries a lot of times will kind of take a shortcut, do it the second way and that's what you'd do as well here. Keep in mind that your actual 415 limit, the percent of pay limit doesn't change other than being prorated for years of service less ten, but the 415 dollar limit of course is adjusted for annuity commencement dates.

If somebody takes a lump sum at age 45 you don't want to take the present value of his age 65 415 limit; that's not how it's done. It's done just as you always would.

L. Marshall: Let's talk about question one; I think question one is interesting. Question one essentially relates to plans that currently have rates that are in excess of what the market rate of return under the proposed regulation. Do you want me to read this one?

M. Spaid: yes, why don't you.

L. Marshall: If a plan currently uses an above market rate of interest, when will the plan need to begin calculating benefits using a permitted rate? The final regulation indicates that the market rate of return requirements must be satisfied as of January 1, 2008, for calendar year plan and provides for reliance on the various proposed regulations in Notice 2007-6 prior to the regulatory effective date. Thus would a plan with a 6% interest credit need to retroactively calculate benefits back to January 1, 2008, use the permissible rate? If so, does that requirement apply as of January 1, 2012 or a different date? Is the plan required to take any action with respect to participants who have been paid out at the higher rate? And if a plan uses a six percent crediting rate from January 1, 2008, forward, would it take the position that it complied with the market rate of return for 2008 through 2010 because the second bond rate has been higher than 6% for that period?

M. Spaid: It appears the statutory market rate of return withdrawals for a plans in existent on June 29, 2005, went into effect for plan years beginning on or after January 1, 2008; we know that. Well, 6% fixed interest crediting rate is impermissible in the market rate of return in the proposed regulation, those rules are proposed to go into effect for plan years beginning on or after January 1, 2012, although we allow a plan to rely on the rates and regulations for purposes of satisfying statutory rules prior to the regulatory rules going into effect. You could satisfy that now.

L. Marshall: You could use the proposed regs now--.

M. Spaid: You could use the proposed regs, that's right. A reasonable interpretation of the statute rules needs to be used before the regulations are finalized become effective. The rate satisfies the statutory rule before the regulatory rules go into effect, but is in excess of a market rate of return under the regulatory rules when they do go into effect, the rates or regulations, which will constitute exclusive list of rates need to be satisfied, but that's beginning in 1/1/2012. It's like that the reduction of such a rate … permissible rate on a respective basis will be eligible for anticipated 411(d)(6) relief as we've provided in Notice 2009-97 and further clarified in the preamble to the proposed regulation, as stated in the preamble, anticipated 411(d)(6) relief is expected to apply only to future interest credits.

L. Marshall: That's right; none of our guidance anticipates that you will be able to satisfy anything by retroactively reducing peoples' interest credits. If your rate doesn't satisfy the statutory rules pursuant to a reasonable interpretation of the statute, you may have to make other adjustments to satisfy the age discrimination requirements, but --.

M. Spaid: The question is would 6% perhaps be a reasonable interpretation and I think the answer to that may be different to a 42% or a double-digit at least assumed rate of return.

L. Marshall: We haven't really provided any --.

M. Spaid: We haven't really, we have no real guidance on that yet.

Moderator: Pardon the interruption; this is a one-minute warning that we are closing to the end of the conference.

L. Marshall: We don't have time for another question so I think we'll just say please send us your comments; we asked for comments on a number of issues in the preamble to the proposed regulations. We value everyone's input and --.

M. Spaid: We absolutely do, whether it's from a very, very large consulting firm or a single practitioner.

L. Marshall: We have a number of questions that we specifically asked for input on; I've touched on a few of them here and the more input we get, the better the final product.

M. O'Donnell: Absolutely. Thank you all for participating on our phone forum on the hybrid plan regulations. Thanks to our speakers, Mike and Linda, especially. Good day, everyone.

Moderator: That does conclude our phone forum for today. Thank you for your participation and for using AT&T Teleconference Service; you may now disconnect.