

EP Phone Forum Hybrid Plan Regulations

November 23, 2010

2:00 – 3:00 pm Eastern

Final Regulations

- In general, the final regulations:
 - incorporate the transitional guidance in Notice 2007-6 and the 2007 proposed regulations, and
 - provide guidance on Code §§411(a)(13) and (b)(5)

Definitions

- *Accumulated benefit* - a participant's benefit accrued to date under a plan.
- *Lump sum-based benefit formula* - a benefit formula under which all or some of the accumulated benefit under a defined benefit plan is expressed as the current balance of a hypothetical account or as the current value of the accumulated percentage of the participant's final average compensation.

Definitions – Cont.

- *Statutory hybrid benefit formula* - a benefit formula that is either a lump sum-based benefit formula or a formula that has an effect similar to a lump sum-based benefit formula.
- *Statutory hybrid plan* - a plan that contains a statutory hybrid benefit formula.

Definitions – Cont.

- *Effect similar to* - a benefit formula has an effect similar to a lump sum-based benefit formula if:
 - the formula providing a participant's accumulated benefit at NRA includes adjustments for a future period; and
 - the total dollar amount of the adjustments is reasonably expected to be smaller for the participant, when compared to a similarly situated, younger individual who is or could be a participant in the plan.

Definitions – Cont.

- *Hypothetical account* - a benefit is expressed as a hypothetical account if it is expressed as a current single-sum dollar amount, whether or not the participant has the right to future interest credits.
- These definitions apply to regulations under Code §§411(a)(13) and (b)(5).

Pension Equity Plans

- A PEP formula that provides for interest credits after PEP accruals cease must follow the market rate of return rules to calculate interest credits because a lump sum-based benefit formula that provides interest credits is subject to the market rate of return rules.

After-tax & Employee Contributions

- The benefit properly attributable to after-tax employee contributions, rollover contributions and other similar employee contributions is disregarded in determining if a benefit formula is a lump sum-based benefit formula.

Benefit Indexing

- When determining whether a benefit formula has an effect similar to a lump sum-based benefit formula certain indexing to adjust benefits after the annuity starting date (for example, cost-of-living increases) is disregarded.

Variable Annuity

- Adjustments under a variable annuity do not have an effect similar to a lump sum-based benefit formula if the assumed interest rate used to determine the adjustments is 5% or higher.

Rules under 411(a)(13)(A)

- A statutory hybrid plan will not be treated as failing the requirements of §411(a)(2), §411(a)(11), §411(c), or §417(e) merely because it provides that the present value of benefits determined under a lump sum-based benefit formula is equal to the then-current balance of the hypothetical account maintained or the then-current value of the accumulated percentage of final average compensation under that formula the plan.

Rules under 411(a)(13)(A) – Cont.

- However, it is important to note that Code §411(a)(13) does not alter the definition of the accrued benefit under Code §411(a)(7)(A) or the definition of the normal retirement benefit under Code §411(a)(9).

Present Value Rules of 417(e)

- A statutory hybrid plan that provides benefits under a benefit formula that is a statutory hybrid benefit formula other than a lump sum-based benefit formula must comply with the present value rules of section 417(e) with respect to an optional form of benefit that is subject to the requirements of section 417(e).

Vesting

- A plan fails to satisfy the requirements of Code §411(a)(2) if any part of a participant's DB accrued benefit is determined under a statutory hybrid benefit formula unless the plan provides that:

Vesting – Cont.

- A participant with 3 or more years of service has a non-forfeitable right to 100% of the participant's accrued benefit derived from employer contributions. This requirement applies to the participant's entire benefit derived from employer contributions under a statutory hybrid plan (not just the portion of the participant's benefit that is determined under a statutory hybrid benefit formula); and

Vesting – Cont.

- This requirement applies to the participant's entire accrued benefit under the plan if a participant is entitled to the greater of two (or more) benefit amounts, where each amount is determined under a different formula, and at least one of which is a benefit calculated under a statutory hybrid benefit formula (even if that participant's benefit under the statutory hybrid benefit formula is ultimately smaller than under the other formula.)

Age Discrimination Safe Harbor

- A plan that provides benefits under certain types of benefit formulas may satisfy the requirements of section 411(b)(1)(H)(i) if, as determined as of any date, a participant's accumulated benefit expressed under one of those formulas would not be less than any similarly situated, younger participant's accumulated benefit expressed under the same formula.

Conversion Protection

- A participant whose benefits are affected by a conversion amendment that was both adopted and effective on or after June 29, 2005, must generally be given a benefit after the conversion that is at least equal to the sum of the:
 - benefits accrued before conversion, and
 - benefits accrued after the conversion, with no permitted interaction between these two portions.

Conversion Amendment

- Whether or not an amendment (or multiple amendments) constitutes a conversion amendment is determined on a participant-by-participant basis

Conversion Amendment – Cont.

- Reduces or eliminates the benefits that, except for the amendment, the participant would have accrued after the effective date of the amendment under a benefit formula that is not a statutory hybrid benefit formula and under which the participant was accruing benefits prior to the amendment; **and**

Conversion Amendment – Cont.

- After the effective date of the amendment, all or a portion of the participant's benefit accruals under the plan are determined under a statutory hybrid benefit formula.

Interest Credit

- Generally any increase or decrease for a period to a participant's accumulated benefit, including under a statutory hybrid benefit formula, which under the terms of the plan at the beginning of the period is calculated by applying a rate of interest or rate of return (including a rate of increase or decrease under an index) to any portion of the participant's accumulated benefit as of the beginning of the period, provided that:

Interest Credit – Cont.

- Interest Credits are not conditioned on current service; and
- Interest Credits are not made because of imputed service.

Safe-harbor Interest Credit

- The list of safe-harbor rates has been expanded to include the first and second segment rates as well as the third segment rate.

Market Rate of Return

- An interest crediting rate is not in excess of a market rate of return if:
 - it is always less than a particular interest crediting rate that meets the market rate of return limitation; or
 - it always equals the lesser of two or more rates when at least one of the rates meets the market rate of return limitation.

Indexed Benefits

- For Code §411(b)(5)(E) indexed benefits, an interest crediting rate equal to the actual rate of return on the plan's aggregate assets, both positive and negative, is not in excess of a market rate of return if the plan's assets are diversified to minimize the volatility of returns.

Interest Credits and 411(d)(6)

- The right to future interest credits (which are not conditioned on future service) *is* a protected benefit under section 411(d)(6).

Proposed Regulations

- The 2010 proposed regulations provide additional guidance for hybrid DB plans that compute accrued benefits by reference to a hypothetical account balance or equivalent amounts (under Code §411(a)(13)) and discuss a hybrid DB plan's accrued benefit requirements (under Code §§411(b)(1) and (b)(5)).

Relief under section 411(a)(13)(A)

- Does not apply to benefits determined under a lump sum-based benefit formula unless certain requirements are satisfied. However, if these conditions are met, the relief:
 - extends to all optional forms of benefit, not just single-sum distributions; and
 - applies on a proportionate basis in the event of a partial distribution of a participant's benefit.

133 1/3% Accrual Rule

- A plan that determines any portion of the participant's accrued benefit based on a statutory hybrid benefit formula using a variable interest crediting rate that was less than zero for the prior plan year would not fail the requirements of the 133 $\frac{1}{3}$ % rule for the current plan year merely because it is assumed that the variable rate is zero for the current plan year and all future plan years.

Set and Forget

- Certain plans may satisfy the conversion protection requirements of sections 411(b)(5)(B)(ii), 411(b)(5)(B)(iii), and 411(b)(5)(B)(iv) by establishing an opening hypothetical account balance without a subsequent comparison of benefits at the annuity starting date.

Preservation of Capital

- Only applies at an annuity starting date on which a distribution of the participant's entire benefit as of that date under the plan's statutory hybrid benefit formula commences.

Plan Asset Return as Market Rate

- This is generally allowed if the plan assets are diversified in order minimize the volatility of returns.

Market Rate of Return

- The proposed regulations broaden the list of safe-harbor interest crediting rates.
- An interest crediting rate is not in excess of a market rate of return if it is equal to the rate of return for certain registered investment companies;
- A 3% floor that applies cumulatively may be combined with any permissible rate;

Market Rate of Return

- A plan may use an annual floor of 4% with a permissible bond rate
- A fixed annual interest crediting rate of 5% is a safe harbor rate and is deemed not to be in excess of the rate of interest on long-term investment grade corporate bonds

Market Rate of Return

- Terminating plans must use interest crediting rates and annuity conversion factors (the interest rate and mortality table used) as specified in the regulations; and
- If a plan changes the interest crediting rate for participants currently entitled to receive continuing pay credits, providing the minimum required Code §411(d)(6) protection with respect to the former interest crediting rate and existing accruals does not violate the market rate of return requirements