Proposed 411(d)(6) Regulations for Defined Benefit Plans: What To Do *Right Now*

Proposed Treasury regulations under Code section 411(d)(6) are intended to allow you to streamline your defined benefit plans by eliminating optional forms of benefit. This relief could be especially helpful for plans encumbered by numerous benefit forms as a result of corporate and/or plan mergers.

The IRS maintains that employers cannot amend their plans in reliance on these regulations until the guidance is finalized. Still, there are concrete steps that can – and should – be taken well in advance of the final regulations.

Why? So you can (i) tell the IRS if the proposal doesn't help your plan — **now**, while the comment period is still open; (ii) take advantage of the window for eliminating contingent event benefits — **now**, before the IRS shuts it; and (iii) be poised to start the 4-year clock running on the effective date of any amendments you want to adopt when regulations are final.

1. Look at Your Plans

As proposed, the regulations would provide for a delayed effective date for plan amendments, requiring a lead time as long as 4 years before certain changes take effect. If decision-making is postponed until the regulations are finalized, this delay effectively becomes even longer.

The five steps below will enable you to expedite the amendment process.

- **List each optional form of benefit available**, along with its associated features and actuarial factors.

- **Identify your 4 "core" options**, including the most valuable option for a participant with a short life expectancy. Non-core options can be eliminated for benefits commencing 4 years following adoption of an amendment.

  The IRS has informally confirmed that you might have more than 4 core options, especially if there are different "most valuable" options for different sub-groups.

  You might also have fewer than 4 core options. In this case, options might need to be added to the plan before taking advantage of this rule.

- **Define your various "families" of options**. Redundant options within a family can be eliminated for benefits commencing 90 days following adoption of an amendment. But it is not so clear what "redundant" means.

- **Analyze which options you *could* eliminate**.

  Actuarial calculations will be required to compare the present value of a benefit under each option. Additional demonstrations may also be needed.

- **Decide which options you *want* to eliminate**. For very complex plans, it might be easiest to tackle this step first.

2. Consider Elimination of Contingent Event Benefits Now

The proposed regulations would increase the protection for unpredictable contingent event benefits, making these benefits difficult to eliminate even before the contingent event occurs.

But the proposed regulations specifically provide that the additional protections that will be afforded contingent event benefits will not apply to the years before the regulations are finalized. Accordingly, there is a window of opportunity to eliminate these benefits without fear of reprisal from the IRS. This relief would probably not provide any protection in a participant-initiated lawsuit, however.

3. Tell The IRS What You Think

The regulations' authors have been very receptive to comment from employers. Comments do not need to be formal or lengthy. Even an email to the regulation's author will be considered and treated as part of the official record.

Consider the specific problems described in Exhibit A (attached).

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4. Re-Assess Approach to COLAs

The proposed regulations clarify the IRS position on cost of living increases. Intending to reverse the result of the *Sheet Metal* case in the 5th Circuit, the proposed regulations provide that post-retirement cost of living increases are accrued benefits, protected from reduction.

It is unclear what, if any, effect this provision will have, given the adverse case law. It is unlikely that a court would give these proposed regulations much weight next to the opinion of the Fifth Circuit. At a minimum, all employers should think twice about adding post-retirement COLAs to their plans knowing they may never be able to eliminate them.

Areas for Comment

Below are several areas we have identified as ripe for comment:

1. Add a Utilization Test: The proposed regulations specifically reject a utilization test (*i.e.*, that you cannot eliminate an optional form just because no one uses it). When asked about this, the IRS explained that it was concerned about the impact of a utilization test on small plans. However, the IRS seemed willing to consider that a utilization test might be appropriate for larger plans.

2. Allow Comparisons Across Plans: The proposed regulations define a "family" of optional forms by examining a single plan at a time. But the goal of simplification could not be achieved by most large employers unless optional forms could be examined across *all* of its pension plans. Similarly, an employer should be able to count optional forms across all plans in determining whether the forms are burdensome in the aggregate.

3. Simplify Most Valuable Core Option: The IRS has confirmed informally that a single plan might contain half a dozen different "most valuable" options, each providing the greatest value to a different sub-group of participants. Employers should be allowed to replace these with a single optional form under the spirit of these regulations and the legislative mandate.

4. Ease Changes in Actuarial Factors: Allow employers to change more readily the actuarial factors which are used to calculate benefits.

5. Define Redundancy: Redundant optional forms within the same family can be eliminated, unless a retained form is subject to materially greater restrictions (such as conditions relating to eligibility, or beneficiary designation). But what does this really mean? For example, are two annuities redundant if one offers a pop-up feature and the other does not? The IRS has informally confirmed that the pop-up feature can be eliminated, but further clarification is needed.

6. Separate the Core Option Rule from the Redundancy Rule: The proposed regulation offers two alternative tests – a redundancy rule and a core option rule. Employers should be able to rely on one without the satisfying the terms of the other. Yet in order to utilize the redundancy rule, an employer must ensure that a core option is not being eliminated, subject to certain exceptions. This makes it difficult to satisfy the redundancy rule without, at a minimum, undergoing core option analysis.