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CC:PA:LPD:PR (REG-110980-10)
Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Dear Sir or Madam,

Subject: Aon Hewitt Comments on Proposed Modifications to Minimum Present Value Requirements for Partial Annuity Distribution Options Under Defined Benefit Plans (RIN 1545-BJ55)

Aon Hewitt appreciates the opportunity to submit comments on the proposed rule intended to clarify the application of Internal Revenue Code (IRC) Section 417(e) to partial annuity distribution options in defined benefit pension plans. The proposed regulation was published in the Federal Register on February 3, 2012.

In this letter, Aon Hewitt provides comments regarding the proposed clarification of the minimum present value requirements under IRC Section 417(e); requests retroactive application of this clarification; requests interim guidance in advance of final regulations being issued; and requests that final regulations include expanded examples of partial annuity distribution options, such as for plans with employee contributions.

Who We Are
Aon Hewitt is the global leader in human resource consulting and outsourcing solutions. The company partners with organizations to solve their most complex benefits, talent, and related financial challenges, and improve business performance. Aon Hewitt designs, implements, communicates, and administers a wide range of human capital, retirement, investment management, health care, compensation, and talent management strategies. With more than 29,000 professionals in 90 countries, Aon Hewitt makes the world a better place to work for clients and their employees.

Proposed Clarification of Present Value Requirement Is Necessary
Aon Hewitt supports the proposed clarification of how IRC Section 417(e) present value requirements apply to "split" payment options (i.e., optional forms of benefit that are paid partly in the form of an annuity and partly in a more accelerated form) in defined benefit pension plans. Many plans currently offer these split payment options, which combine the retirement income security of a life annuity with the benefit portability of an accelerated form of payment such as a lump sum.

Currently, neither IRC Section 417(e) nor corresponding regulations explicitly address requirements for benefits paid partly as a life annuity and partly as a more accelerated form. Aon Hewitt understands that, at least informally, some at Treasury and the Internal Revenue Service (Service) have expressed the view in the past that in the case of such split payment options, the minimum present value requirements of IRC Section 417(e) must be applied to both the accelerated portion of the benefit and the annuity portion of the benefit. This informal view has created a potential obstacle for plan sponsors that might otherwise be interested in offering split payment options in their plans. The proposed clarification of the regulations to
allow the application of IRC Section 417(e) present value requirements to the accelerated payment form but not the residual annuity would reduce the administrative burden on such plan sponsors, and potentially make them more likely to offer such options.

It is important to note that, in addition to creating an obstacle for plan sponsors that do not currently offer split payment options, the informal Service view discussed above has also created regulatory uncertainty for plan sponsors that already offer such benefits.

While the regulations under IRC Section 417(e) provide specific requirements for calculating the present value of a participant’s accrued benefit, Treasury Regulation Section 1.417(e)-1(d)(6) states that these present value calculation requirements do “not apply to the amount of a distribution paid in the form of an annual benefit that… does not decrease during the life of the participant…” The regulations do not clearly define what constitutes a “distribution” for this purpose. Many plan sponsors who currently offer split payment options have historically applied this requirement to each separate distribution payable from the plan (and have included this separate application in the plan document). Aon Hewitt believes this is a reasonable reading of the regulations. It is also consistent with Treasury Regulation Section 1.436-1(d)(3)(ii)(B), which states that for purposes of the partial limitation on accelerated benefit distributions under IRC Section 436, “[t]he rules of §1.417(e)-1 are applied separately to the separate optional forms for the unrestricted portion of the benefit and the remainder of the benefit (the restricted portion).”

A split payment option may consist of two or more distributions that begin at multiple Annuity Starting Dates (ASDs). For example, a participant might elect a partial lump sum distribution at termination of employment, and then commence their residual annuity benefit at a later date (e.g., normal retirement age). A split payment option may also consist of two or more distributions that begin on the same ASD, as when a participant elects a partial lump sum distribution together with an immediate annuity benefit. Many plans with such split payment options have historically applied the minimum present value requirements under IRC Section 417(e) to the accelerated portion of the distribution, while applying the plan’s general actuarial equivalence basis to the residual annuity benefit. Such plans have paid distributions in this manner for many years—in many cases, since before the informal view of the Service was expressed—and have relied on determination letters received for plan documents that explicitly state the approach being used.

As noted in the following section, Aon Hewitt believes that retroactive application of the proposed clarification is appropriate to relieve the administrative and compliance burden on plan sponsors that already offer split payment options.

Provide for Retroactive Application Without Anti-Cutback Concerns

Aon Hewitt is concerned by the language in the preamble to the proposed regulations regarding anti-cutback protection and plan amendment requirements related to the proposed clarification of IRC Section 417(e) present value requirements. The preamble states that:

“To provide for such bifurcated treatment, a plan sponsor would be required to amend its plan to provide for use of the plan factors that generally apply to annuity distributions instead of the section 417(e)(3) assumptions in these circumstances. Any plan amendment must comply with the requirements of section 411(d)(6).”

This statement implies that any plan that already provides for a split payment option must be amended to specifically state how IRC Section 417(e)(3) applies to that payment option. However, plans that currently
provide split payment options may already have plan language that adequately describes the calculation of a split payment option.

For example, many plans provide for a split payment option as a result of a past plan merger (e.g., from an acquisition) where a prior plan provided a lump sum of the accrued benefit but the current plan does not. A participant is provided an option of the past service benefit as a lump sum payment along with a future service benefit that is not payable as a lump sum. The future service annuity benefit has not historically been calculated using assumptions under IRC Section 417(e)(3) since the plan sponsor viewed each payment as a separate distribution payable to a participant. The preamble to the proposed regulations implies this plan must be amended when the proposed regulations are finalized in order to apply IRC Section 417(e)(3) assumptions to the future service annuity benefit. This amendment is completely unnecessary and should not be required. Indeed, it would not be required if the prior plan had remained as a separate plan rather than being merged with the acquiring company’s plan.

Moreover, the preamble provides a significant consequence if the plan were to be amended simply to recognize the clarification from these proposed regulations. The preamble provides that:

“If the regulations are finalized as proposed and a plan that previously provided for a partial single-sum distribution together with a specified annuity distribution is amended to treat that distribution form as a bifurcated accrued benefit (and applies less favorable actuarial factors to the portion of the benefit that is not subject to section 417(e)(3)), then the plan must comply with the requirements of section 411(d)(6).”

The requirement to amend the plan coupled with the requirement to protect accrued benefits under an IRC Section 417(e)(3) basis—benefits which were never historically calculated under such a basis—is contrary to the goal of simplifying the administration of split payment options. It also unnecessarily punishes plans that provided such options prior to the clarification of the present value requirements.

This application of the final regulations would require any plan that currently provides a split payment option to retroactively calculate a protected benefit which was never provided for under the plan. In fact, it would significantly complicate the administration and payment of benefits as well as increase costs for these plans. However, plans which adopt a provision after the clarifying regulations are finalized would have no such complicated administration. This would be inconsistent with the goal of the proposed regulations, in that the proposed regulations allow precisely the bifurcation approach that many plans have historically used, and the fact that the final IRC Section 436 regulations permit the same bifurcation approach without any special requirement for IRC Section 411(d)(6) protection.

The final regulations should clarify that any plan that historically provided a split payment option would not need to retroactively apply the informal Service view of the application of IRC Section 417(e)(3) to the entire benefit provided to a participant who elects a split payment option in order to protect a benefit that was never offered. In addition, the final regulations should specifically provide that such plans that have historically calculated benefits in a manner that would meet the final regulations would only need to be amended in cases where the application and calculation needs additional clarification, but such amendment would not require the application of IRC Section 411(d)(6) to accrued benefits if the administration of the plan matches the updated clarification of plan language.
On the other hand, certain plans have specifically applied IRC Section 417(e)(3) assumptions to both the accelerated payment form and the annuity payment form in a split payment option. Any retroactive changes to such plans to use plan factors for the calculation of annuity payments would be subject to anti-cutback requirements. Also, any plans that specifically change an application of optional form factors on a prior accrued benefit would be subject to anti-cutback requirements.

Thus, the “relief” requested from the anti-cutback rules is only for plans that would already meet the proposed regulations and that do not change the calculation of accrued benefits from the plan’s methodology when the regulations are finalized.

**Issue Interim Guidance Prior to Final Regulations**

Aon Hewitt hopes these proposed regulations will be finalized quickly. However, there may be an extended period of time during which these proposed regulations provide the only guidance on the Service’s view on the application of IRC Section 417(e)(3) to split payment options. This may cause concern for plan sponsors that already provide split payment options in a manner consistent with the guidance in the proposed regulations. While the provisions of the proposed regulations may provide some comfort regarding the methodology employed for split payment options, the statements in the preamble regarding the plan amendment and anti-cutback requirements may be concerning.

Aon Hewitt would encourage the Service to provide interim guidance or a statement indicating that, for periods prior to the effective date of the final regulations, it will not challenge a reasonable interpretation of IRC Section 417(e)(3) requirements for split payment options. Even informal statements in this context might be helpful to such plan sponsors.

**Clarify and Add Examples to Final Regulations**

Aon Hewitt welcomes the examples provided in the proposed regulations. These examples accurately reflect many of the split payment options currently provided and illuminate the opportunities for defined benefit plans to provide split payment options in the future.

Aon Hewitt believes the examples should be expanded to include the following:

- Certain plans provide for a return of employee contributions as an “add on” to the accrued benefit. These employee contributions are typically either mandatory employee contributions made to the plan decades ago or voluntary employee contributions. A participant can elect to receive these contributions (including interest) as a lump sum. The final regulations should specify that this provision of a lump sum as a split payment is subject to the same calculation rules as provided for in the proposed regulations. That is, the annuity payments from the plan are not subject to the assumptions required under IRC Section 417(e)(3).

- Plans that have mandatory employee contributions are required to split the benefit between employer and employee contributions using the assumptions under IRC Section 417(e)(3). However, after the payment is split, the annuity options are determined using the plan’s general basis for actuarial equivalence. These contributory plans should be included in the example provided to illustrate proposed Treasury Regulation Section 1.417(e)-1(d)(7)(v).
Closing
Aon Hewitt appreciates the opportunity to submit these comments regarding the proposed regulations. If you have any questions regarding these comments, please contact the undersigned at the telephone number or electronic mail address provided below.

Sincerely,

Aon Hewitt

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