

## PART II—ASSET REVIEW INFORMATION

### Item 2.01 Findings and Conclusions of a Third Party Engaged by the Issuer To Review Assets

Provide the disclosures required by Rule 15Ga-2 (17 CFR 240.15Ga-2) for any report by a third party engaged by the issuer for the purpose of reviewing assets underlying an asset-backed security.

### Item 2.02 Findings and Conclusions of a Third-Party Engaged by the Underwriter To Review Assets

Provide the disclosures required by Rule 15Ga-2 (17 CFR 240.15Ga-2) for any third-party engaged by the underwriter for the purpose of reviewing assets underlying an asset-backed security.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the reporting entity has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

(Depositor, Securitizer, or Underwriter)  
Date \_\_\_\_\_

(Signature)\*

\*Print name and title of the signing officer under his signature.

By the Commission.

Dated: October 13, 2010.

**Elizabeth M. Murphy,**  
*Secretary.*

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## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

#### 26 CFR Part 1

[REG-132554-08]

RIN 1545-B116

### Additional Rules Regarding Hybrid Retirement Plans

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Notice of proposed rulemaking and notice of public hearing.

**SUMMARY:** This document contains proposed regulations providing guidance relating to certain provisions of the Internal Revenue Code (Code) that apply to hybrid defined benefit pension plans. These regulations would provide guidance on changes made by the Pension Protection Act of 2006, as

amended by the Worker, Retiree, and Employer Recovery Act of 2008. These regulations would affect sponsors, administrators, participants, and beneficiaries of hybrid defined benefit pension plans. This document also provides a notice of a public hearing on these proposed regulations.

**DATES:** Written or electronic comments must be received by Wednesday, January 12, 2011. Outlines of topics to be discussed at the public hearing scheduled for Wednesday, January 26, 2011, at 10 a.m. must be received by Friday, January 14, 2011.

**ADDRESSES:** Send submissions to: CC:PA:LPD:PR (REG-132554-08), Room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-132554-08), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or sent electronically, via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS REG-132554-08). The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

**FOR FURTHER INFORMATION CONTACT:** Concerning the regulations, Neil S. Sandhu, Lauson C. Green, or Linda S.F. Marshall at (202) 622-6090; concerning submissions of comments, the hearing, and/or being placed on the building access list to attend the hearing, Regina Johnson, at (202) 622-7180 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under sections 411(a)(13), 411(b)(1), and 411(b)(5) of the Code. Generally, a defined benefit pension plan must satisfy the minimum vesting standards of section 411(a) and the accrual requirements of section 411(b) in order to be qualified under section 401(a) of the Code. Sections 411(a)(13) and 411(b)(5), which modify the minimum vesting standards of section 411(a) and the accrual requirements of section 411(b), were added to the Code by section 701(b) of the Pension Protection Act of 2006, Public Law 109-280 (120 Stat. 780 (2006)) (PPA '06). Sections 411(a)(13) and 411(b)(5), as well as certain effective date provisions related to these sections, were subsequently amended by the Worker, Retiree, and Employer Recovery Act of 2008, Public

Law 110-458 (122 Stat. 5092 (2008)) (WRERA '08).

Section 411(a)(13)(A) provides that an applicable defined benefit plan (which is defined in section 411(a)(13)(C)) is not treated as failing to meet either (i) the requirements of section 411(a)(2) (subject to a special vesting rule in section 411(a)(13)(B) with respect to benefits derived from employer contributions) or (ii) the requirements of section 411(a)(11), 411(c), or 417(e), with respect to accrued benefits derived from employer contributions, merely because the present value of the accrued benefit (or any portion thereof) of any participant is, under the terms of the plan, equal to the amount expressed as the balance of a hypothetical account or as an accumulated percentage of the participant's final average compensation. Section 411(a)(13)(B) requires an applicable defined benefit plan to provide that an employee who has completed at least 3 years of service has a nonforfeitable right to 100 percent of the employee's accrued benefit derived from employer contributions.

Under section 411(a)(13)(C)(i), an applicable defined benefit plan is defined as a defined benefit plan under which the accrued benefit (or any portion thereof) of a participant is calculated as the balance of a hypothetical account maintained for the participant or as an accumulated percentage of the participant's final average compensation. Under section 411(a)(13)(C)(ii), the Secretary of the Treasury is to issue regulations which include in the definition of an applicable defined benefit plan any defined benefit plan (or portion of such a plan) which has an effect similar to a plan described in section 411(a)(13)(C)(i).

Section 411(a) requires that a defined benefit plan satisfy the requirements of section 411(b)(1). Section 411(b)(1) provides that a defined benefit plan must satisfy one of the three accrual rules of section 411(b)(1)(A), (B), and (C) with respect to benefits accruing under the plan. The three accrual rules are the 3 percent method of section 411(b)(1)(A), the 133 $\frac{1}{3}$  percent rule of section 411(b)(1)(B), and the fractional rule of section 411(b)(1)(C).

Section 411(b)(1)(B) provides that a defined benefit plan satisfies the requirements of the 133 $\frac{1}{3}$  percent rule for a particular plan year if, under the plan, the accrued benefit payable at the normal retirement age is equal to the normal retirement benefit, and the annual rate at which any individual who is or could be a participant can accrue the retirement benefits payable at normal retirement age under the plan

for any later plan year is not more than 133 $\frac{1}{3}$  percent of the annual rate at which the individual can accrue benefits for any plan year beginning on or after such particular plan year and before such later plan year.

For purposes of applying the 133 $\frac{1}{3}$  percent rule, section 411(b)(1)(B)(i) provides that any amendment to the plan which is in effect for the current year is treated as in effect for all other plan years. Section 411(b)(1)(B)(ii) provides that any change in an accrual rate which does not apply to any individual who is or could be a participant in the current plan year is disregarded. Section 411(b)(1)(B)(iii) provides that the fact that benefits under the plan may be payable to certain participants before normal retirement age is disregarded. Section 411(b)(1)(B)(iv) provides that social security benefits and all other relevant factors used to compute benefits are treated as remaining constant as of the current plan year for all years after the current year.

Section 411(b)(1)(H)(i) provides that a defined benefit plan fails to comply with section 411(b) if, under the plan, an employee's benefit accrual is ceased, or the rate of an employee's benefit accrual is reduced, because of the attainment of any age. Section 411(b)(5), which was added to the Code by section 701(b)(1) of PPA '06, provides additional rules related to section 411(b)(1)(H)(i). Section 411(b)(5)(A) generally provides that a plan is not treated as failing to meet the requirements of section 411(b)(1)(H)(i) if a participant's accrued benefit, as determined as of any date under the terms of the plan, would be equal to or greater than that of any similarly situated, younger individual who is or could be a participant. For this purpose, section 411(b)(5)(A)(iv) provides that the accrued benefit may, under the terms of the plan, be expressed as an annuity payable at normal retirement age, the balance of a hypothetical account, or the current value of the accumulated percentage of the employee's final average compensation. Section 411(b)(5)(G) provides that, for purposes of section 411(b)(5), any reference to the accrued benefit of a participant refers to the participant's benefit accrued to date.

Section 411(b)(5)(B) imposes certain requirements on an applicable defined benefit plan in order for the plan to satisfy section 411(b)(1)(H). Section 411(b)(5)(B)(i) provides that such a plan is treated as failing to meet the requirements of section 411(b)(1)(H) if the terms of the plan provide for an interest credit (or an equivalent amount)

for any plan year at a rate that is greater than a market rate of return. Under section 411(b)(5)(B)(i)(I), a plan is not treated as having an above-market rate merely because the plan provides for a reasonable minimum guaranteed rate of return or for a rate of return that is equal to the greater of a fixed or variable rate of return. Section 411(b)(5)(B)(i)(II) provides that an applicable defined benefit plan is treated as failing to meet the requirements of section 411(b)(1)(H) unless the plan provides that an interest credit (or an equivalent amount) of less than zero can in no event result in the account balance or similar amount being less than the aggregate amount of contributions credited to the account. Section 411(b)(5)(B)(i)(III) authorizes the Secretary of the Treasury to provide by regulation for rules governing the calculation of a market rate of return for purposes of section 411(b)(5)(B)(i)(I) and for permissible methods of crediting interest to the account (including fixed or variable interest rates) resulting in effective rates of return meeting the requirements of section 411(b)(5)(B)(i)(I).

Sections 411(b)(5)(B)(ii), 411(b)(5)(B)(iii), and 411(b)(5)(B)(iv) contain additional requirements that apply if, after June 29, 2005, an applicable plan amendment is adopted. Section 411(b)(5)(B)(v)(I) defines an applicable plan amendment as an amendment to a defined benefit plan which has the effect of converting the plan to an applicable defined benefit plan. Under section 411(b)(5)(B)(ii), if, after June 29, 2005, an applicable plan amendment is adopted, the plan is treated as failing to meet the requirements of section 411(b)(1)(H) unless the requirements of section 411(b)(5)(B)(iii) are met with respect to each individual who was a participant in the plan immediately before the adoption of the amendment. Section 411(b)(5)(B)(iii) specifies that, subject to section 411(b)(5)(B)(iv), the requirements of section 411(b)(5)(B)(iii) are met with respect to any participant if the accrued benefit of the participant under the terms of the plan as in effect after the amendment is not less than the sum of: (I) the participant's accrued benefit for years of service before the effective date of the amendment, determined under the terms of the plan as in effect before the amendment; plus (II) the participant's accrued benefit for years of service after the effective date of the amendment, determined under the terms of the plan as in effect after the amendment. Section 411(b)(5)(B)(iv) provides that, for purposes of section 411(b)(5)(B)(iii)(I), the plan must credit

the participant's account or similar amount with the amount of any early retirement benefit or retirement-type subsidy for the plan year in which the participant retires if, as of such time, the participant has met the age, years of service, and other requirements under the plan for entitlement to such benefit or subsidy.

Section 411(b)(5)(B)(v) sets forth certain provisions related to an applicable plan amendment. Section 411(b)(5)(B)(v)(II) provides that if the benefits under two or more defined benefit plans of an employer are coordinated in such a manner as to have the effect of adoption of an applicable plan amendment, the plan sponsor is treated as having adopted an applicable plan amendment as of the date the coordination begins. Section 411(b)(5)(B)(v)(III) directs the Secretary of the Treasury to issue regulations to prevent the avoidance of the purposes of section 411(b)(5)(B) through the use of two or more plan amendments rather than a single amendment.

Section 411(b)(5)(B)(vi) provides special rules for determining benefits upon termination of an applicable defined benefit plan. Under section 411(b)(5)(B)(vi)(I), an applicable defined benefit plan is not treated as satisfying the requirements of section 411(b)(5)(B)(i) (regarding permissible interest crediting rates) unless the plan provides that, upon plan termination, if the interest crediting rate under the plan is a variable rate, the rate of interest used to determine accrued benefits under the plan is equal to the average of the rates of interest used under the plan during the 5-year period ending on the termination date. In addition, under section 411(b)(5)(B)(vi)(II), the plan must provide that, upon plan termination, the interest rate and mortality table used to determine the amount of any benefit under the plan payable in the form of an annuity payable at normal retirement age is the rate and table specified under the plan for this purpose as of the termination date, except that if the interest rate is a variable rate, the rate used is the average of the rates used under the plan during the 5-year period ending on the termination date.

Section 411(b)(5)(C) provides that a plan is not treated as failing to meet the requirements of section 411(b)(1)(H)(i) solely because the plan provides offsets against benefits under the plan to the extent the offsets are otherwise allowable in applying the requirements of section 401(a). Section 411(b)(5)(D) provides that a plan is not treated as failing to meet the requirements of section 411(b)(1)(H) solely because the

plan provides a disparity in contributions or benefits with respect to which the requirements of section 401(l) (relating to permitted disparity for Social Security benefits and related matters) are met.

Section 411(b)(5)(E) provides that a plan is not treated as failing to meet the requirements of section 411(b)(1)(H) solely because the plan provides for indexing of accrued benefits under the plan. Under section 411(b)(5)(E)(iii), indexing means the periodic adjustment of the accrued benefit by means of the application of a recognized investment index or methodology. Section 411(b)(5)(E)(ii) requires that, except in the case of a variable annuity, the indexing not result in a smaller benefit than the accrued benefit determined without regard to the indexing.

Section 701(a) of PPA '06 added provisions to the Employee Retirement Income Security Act of 1974, Public Law 93-406 (88 Stat. 829 (1974)) (ERISA), that are parallel to sections 411(a)(13) and 411(b)(5) of the Code. The guidance provided in these regulations with respect to sections 411(a)(13) and 411(b)(5) of the Code would also apply for purposes of the parallel amendments to ERISA made by section 701(a) of PPA '06, and the guidance provided in these regulations with respect to section 411(b)(1) of the Code would also apply for purposes of section 204(b)(1) of ERISA.<sup>1</sup>

Section 701(c) of PPA '06 added provisions to the Age Discrimination in Employment Act of 1967, Public Law 90-202 (81 Stat. 602 (1967)), that are parallel to section 411(b)(5) of the Code. Executive Order 12067 requires all Federal departments and agencies to advise and offer to consult with the Equal Employment Opportunity Commission (EEOC) during the development of any proposed rules, regulations, policies, procedures, or orders concerning equal employment opportunity. The Treasury Department and the IRS have consulted with the EEOC prior to the issuance of these regulations.

Section 701(d) of PPA '06 provides that nothing in the amendments made by section 701 should be construed to create an inference concerning the treatment of applicable defined benefit plans or conversions of plans into applicable defined benefit plans under section 411(b)(1)(H), or concerning the determination of whether an applicable defined benefit plan fails to meet the

requirements of section 411(a)(2), 411(c), or 417(e), as in effect before such amendments, solely because the present value of the accrued benefit (or any portion thereof) of any participant is, under the terms of the plan, equal to the amount expressed as the balance of a hypothetical account or as an accumulated percentage of the participant's final average compensation.

Section 701(e) of PPA '06 sets forth the effective date provisions with respect to amendments made by section 701 of PPA '06. Section 701(e)(1) specifies that the amendments made by section 701 generally apply to periods beginning on or after June 29, 2005. Thus, the age discrimination safe harbors under section 411(b)(5)(A) and section 411(b)(5)(E) are effective for periods beginning on or after June 29, 2005. Section 701(e)(2) provides that the special present value rules of section 411(a)(13)(A) are effective for distributions made after August 17, 2006 (the date PPA '06 was enacted).

Under section 701(e) of PPA '06, the 3-year vesting rule under section 411(a)(13)(B) is generally effective for years beginning after December 31, 2007, for a plan in existence on June 29, 2005, while, pursuant to the amendments made by section 107(c) of WRETA '08, the rule is generally effective for plan years ending on or after June 29, 2005, for a plan not in existence on June 29, 2005. The market rate of return limitation under section 411(b)(5)(B)(i) is generally effective for years beginning after December 31, 2007, for a plan in existence on June 29, 2005, while the limitation is generally effective for periods beginning on or after June 29, 2005, for a plan not in existence on June 29, 2005. Section 701(e)(4) of PPA '06 contains special effective date provisions for collectively bargained plans that modify these effective dates.

Under section 701(e)(5) of PPA '06, as amended by WRETA '08, sections 411(b)(5)(B)(ii), (iii), and (iv) apply to a conversion amendment that is adopted on or after, and takes effect on or after, June 29, 2005.

Under section 701(e)(6) of PPA '06, as added by WRETA '08, the 3-year vesting rule under section 411(a)(13)(B) does not apply to a participant who does not have an hour of service after the date the 3-year vesting rule would otherwise be effective.

Section 702 of PPA '06 provides for regulations to be prescribed by August 16, 2007, addressing the application of rules set forth in section 701 of PPA '06 where the conversion of a defined benefit pension plan into an applicable

defined benefit plan is made with respect to a group of employees who become employees by reason of a merger, acquisition, or similar transaction.

Under section 1107 of PPA '06, a plan sponsor is permitted to delay adopting a plan amendment pursuant to statutory provisions under PPA '06 (or pursuant to any regulation issued under PPA '06) until the last day of the first plan year beginning on or after January 1, 2009 (January 1, 2011, in the case of governmental plans). As described in Rev. Proc. 2007-44 (2007-28 IRB 54), this amendment deadline applies to both interim and discretionary amendments that are made pursuant to PPA '06 statutory provisions or any regulation issued under PPA '06. See § 601.601(d)(2)(ii)(b).

Section 1107 of PPA '06 also permits certain amendments to reduce or eliminate section 411(d)(6) protected benefits. Except to the extent permitted under section 1107 of PPA '06 (or under another statutory provision, including section 411(d)(6) and §§ 1.411(d)-3 and 1.411(d)-4), section 411(d)(6) prohibits a plan amendment that decreases a participant's accrued benefits or that has the effect of eliminating or reducing an early retirement benefit or retirement-type subsidy, or eliminating an optional form of benefit, with respect to benefits attributable to service before the amendment. However, an amendment that eliminates or decreases benefits that have not yet accrued does not violate section 411(d)(6), provided that the amendment is adopted and effective before the benefits accrue. If section 1107 of PPA '06 applies to an amendment of a plan, section 1107 provides that the plan does not fail to meet the requirements of section 411(d)(6) by reason of such amendment, except as provided by the Secretary of the Treasury.

Section 1.411(b)-1(a)(1) of the Treasury Regulations provides that a defined benefit plan is not a qualified plan unless the method provided by the plan for determining accrued benefits satisfies at least one of the alternative methods in § 1.411(b)-1(b) for determining accrued benefits with respect to all active participants under the plan. Section 1.411(b)-1(b)(2)(i) provides that a defined benefit plan satisfies the 133 $\frac{1}{3}$  percent rule of section 411(b)(1)(B) for a particular plan year if (A) under the plan the accrued benefit payable at the normal retirement age (determined under the plan) is equal to the normal retirement benefit (determined under the plan), and (B) the annual rate at which any individual who is or could be a participant can

<sup>1</sup> Under section 101 of Reorganization Plan No. 4 of 1978 (43 FR 47713), the Secretary of the Treasury has interpretive jurisdiction over the subject matter addressed by these regulations for purposes of ERISA, as well as the Code.

accrue the retirement benefits payable at normal retirement age under the plan for any later plan year cannot be more than 133 $\frac{1}{3}$  percent of the annual rate at which the participant can accrue benefits for any plan year beginning on or after such particular plan year and before such later plan year. Section 1.411(b)-1(b)(2)(ii)(A) through (D) sets forth a series of rules that correspond to the rules of section 411(b)(1)(B)(i) through (iv). Section 1.411(b)-1(b)(2)(ii)(D) provides that, for purposes of the 133 $\frac{1}{3}$  percent rule, for any plan year, social security benefits and all relevant factors used to compute benefits, e.g., consumer price index, are treated as remaining constant as of the beginning of the current plan year for all subsequent plan years.

Proposed regulations (EE-184-86) under sections 411(b)(1)(H) and 411(b)(2) were published by the Treasury Department and the IRS in the **Federal Register** on April 11, 1988 (53 FR 11876), as part of a package of regulations that also included proposed regulations under sections 410(a), 411(a)(2), 411(a)(8), and 411(c) (relating to the maximum age for participation, vesting, normal retirement age, and actuarial adjustments after normal retirement age, respectively).<sup>2</sup>

Notice 96-8 (1996-1 CB 359), see § 601.601(d)(2)(ii)(b), described the application of sections 411 and 417(e)(3) to a single-sum distribution under a cash balance plan where interest credits under the plan are frontloaded (that is, where future interest credits to an employee's hypothetical account balance are not conditioned upon future service and thus accrue at the same time that the benefits attributable to a hypothetical allocation to the account accrue). Under the analysis set forth in Notice 96-8, in order to comply with sections 411(a) and 417(e)(3) in calculating the amount of a single-sum distribution under a cash balance plan, the balance of an employee's hypothetical account must be projected to normal retirement age and converted to an annuity under the terms of the

plan, and then the employee must be paid at least the present value of the projected annuity, determined in accordance with section 417(e). Under that analysis, where a cash balance plan provides frontloaded interest credits using an interest rate that is higher than the section 417(e) applicable interest rate, payment of a single-sum distribution equal to the current hypothetical account balance as a complete distribution of the employee's accrued benefit may result in a violation of the minimum present value requirements of section 417(e) or a forfeiture in violation of section 411(a). In addition, Notice 96-8 proposed a safe harbor which provided that, if frontloaded interest credits are provided under a plan at a rate no greater than the sum of identified standard indices and associated margins, no violation of section 411(a) or 417(e) would result if the employee's entire accrued benefit were to be distributed in the form of a single-sum distribution equal to the employee's hypothetical account balance, provided the plan uses appropriate annuity conversion factors. Since the issuance of Notice 96-8, four Federal appellate courts have followed the analysis set out in the Notice: *Esden v. Bank of Boston*, 229 F.3d 154 (2d Cir. 2000), cert. dismissed, 531 U.S. 1061 (2001); *West v. AK Steel Corp. Ret. Accumulation Pension Plan*, 484 F.3d 395 (6th Cir. 2007), cert. denied, 129 S. Ct. 895 (2009); *Berger v. Xerox Corp. Ret. Income Guarantee Plan*, 338 F.3d 755 (7th Cir. 2003), reh'g and reh'g en banc denied, No. 02-3674, 2003 U.S. App. LEXIS 19374 (7th Cir. Sept. 15, 2003); *Lyons v. Georgia-Pacific Salaried Employees Ret. Plan*, 221 F.3d 1235 (11th Cir. 2000), cert. denied, 532 U.S. 967 (2001).

Notice 2007-6 (2007-1 CB 272), see § 601.601(d)(2)(ii)(b), provides transitional guidance with respect to certain requirements of sections 411(a)(13) and 411(b)(5) and section 701(b) of PPA '06. Notice 2007-6 includes certain special definitions, including: accumulated benefit, which is defined as a participant's benefit accrued to date under a plan; lump sum-based plan, which is defined as a defined benefit plan under the terms of which the accumulated benefit of a participant is expressed as the balance of a hypothetical account maintained for the participant or as the current value of the accumulated percentage of the participant's final average compensation; and statutory hybrid plan, which is defined as a lump sum-based plan or a plan which has an effect similar to a lump sum-based plan.

Notice 2007-6 provides guidance on a number of issues, including a rule under which a plan that provides for indexed benefits described in section 411(b)(5)(E) is a statutory hybrid plan (because it has an effect similar to a lump sum-based plan), unless the plan either solely provides for post-retirement adjustment of the amounts payable to a participant or is a variable annuity plan under which the assumed interest rate used to determine adjustments is at least 5 percent. Notice 2007-6 provides a safe harbor for applying the rules set forth in section 701 of PPA '06 where the conversion of a defined benefit pension plan into an applicable defined benefit plan is made with respect to a group of employees who become employees by reason of a merger, acquisition, or similar transaction. This transitional guidance, along with the other guidance provided in Part III of Notice 2007-6, applies pending the issuance of further guidance and, thus, does not apply for periods to which the 2010 final regulations (as described later in this preamble) apply.

Proposed regulations (REG-104946-07) under sections 411(a)(13) and 411(b)(5) (2007 proposed regulations) were published by the Treasury Department and the IRS in the **Federal Register** on December 28, 2007 (72 FR 73680). The Treasury Department and the IRS received written comments on the 2007 proposed regulations and a public hearing was held on June 6, 2008.

Proposed regulations (REG-100464-08) under section 411(b)(1)(B) (2008 proposed backloading regulations) were published by the Treasury Department and the IRS in the **Federal Register** on June 18, 2008 (73 FR 34665). The 2008 proposed backloading regulations would provide guidance on the application of the accrual rule for defined benefit plans under section 411(b)(1)(B) in cases where plan benefits are determined on the basis of the greatest of two or more separate formulas. The Treasury Department and the IRS received written comments on the 2008 proposed backloading regulations and a public hearing was held on October 15, 2008.

Announcement 2009-82 (2009-48 IRB 720) and Notice 2009-97 (2009-52 IRB 972) announced certain expected relief with respect to the requirements of section 411(b)(5). In particular, Announcement 2009-82 stated that the rules in the regulations specifying permissible market rates of return are not expected to go into effect before the first plan year that begins on or after January 1, 2011. In addition, Notice

<sup>2</sup> On December 11, 2002, the Treasury Department and the IRS issued proposed regulations regarding the age discrimination requirements of section 411(b)(1)(H) that specifically addressed cash balance plans as part of a package of regulations that also addressed section 401(a)(4) nondiscrimination cross-testing rules applicable to cash balance plans (67 FR 76123). The 2002 proposed regulations were intended to replace the 1988 proposed regulations. In Ann. 2003-22 (2003-1 CB 847), see § 601.601(d)(2)(ii)(b), the Treasury Department and the IRS announced the withdrawal of the 2002 proposed regulations under section 401(a)(4), and in Ann. 2004-57 (2004-2 CB 15), see § 601.601(d)(2)(ii)(b), the Treasury Department and the IRS announced the withdrawal of the 2002 proposed regulations relating to age discrimination.

2009–97 stated that, once final regulations under sections 411(a)(13) and 411(b)(5) are issued, it is expected that relief from the requirements of section 411(d)(6) will be granted for a plan amendment that eliminates or reduces a section 411(d)(6) protected benefit, provided that the amendment is adopted by the last day of the first plan year that begins on or after January 1, 2010, and the elimination or reduction is made only to the extent necessary to enable the plan to meet the requirements of section 411(b)(5).<sup>3</sup> Notice 2009–97 also extended the deadline for amending cash balance and other applicable defined benefit plans, within the meaning of section 411(a)(13)(C), to meet the requirements of section 411(a)(13) (other than section 411(a)(13)(A)) and section 411(b)(5), relating to vesting and other special rules applicable to these plans. Under Notice 2009–97, the deadline for these amendments is the last day of the first plan year that begins on or after January 1, 2010.

Final regulations (2010 final regulations) under sections 411(a)(13) and 411(b)(5) are being issued at the same time as these proposed regulations. The 2010 final regulations adopt most of the provisions of the 2007 proposed regulations, with certain modifications, and also reserve a number of sections relating to issues that are not addressed in those final regulations. These reserved issues relate to the scope of relief provided under section 411(a)(13)(A), a potential alternative method of satisfying the conversion protection requirements, additional rules with respect to the market rate of return requirement, and the application of the special plan termination rules. These proposed regulations generally address these issues, as well as an issue under section 411(b)(1).

## Explanation of Provisions

### Overview

In general, these proposed regulations would provide guidance with respect to certain issues under sections 411(a)(13) and 411(b)(5) that are not addressed in the 2010 final regulations, as well as an issue under section 411(b)(1) for hybrid defined benefit plans that adjust benefits using a variable rate.

## I. Section 411(a)(13): Scope of Relief of Section 411(a)(13)(A)

### A. The 2010 Final Regulations

The 2010 final regulations define a lump sum-based benefit formula as a benefit formula used to determine all or any part of a participant's accumulated benefit under which the accumulated benefit provided under the formula is expressed as the current balance of a hypothetical account maintained for the participant or as the current value of an accumulated percentage of the participant's final average compensation. The 2010 final regulations provide that the relief of section 411(a)(13)(A) applies to the benefits determined under a lump sum-based benefit formula.

### B. Limitations on the Relief of Section 411(a)(13)(A)

The proposed regulations would provide that the relief of section 411(a)(13)(A) does not apply with respect to the benefits determined under a lump sum-based benefit formula unless certain requirements are satisfied. In particular, the proposed regulations would provide that the relief does not apply unless, at all times on or before normal retirement age, the then-current hypothetical account balance or the then-current accumulated percentage of the participant's final average compensation is not less than the present value, determined using reasonable actuarial assumptions, of the portion of the participant's accrued benefit that is determined under the lump sum-based benefit formula. However, the plan would be deemed to satisfy this requirement for periods before normal retirement age if, upon attainment of normal retirement age, the then-current balance of the hypothetical account or the then-current value of the accumulated percentage of the participant's final average compensation is actuarially equivalent (using reasonable actuarial assumptions) to the portion of the participant's accrued benefit that is determined under the lump sum-based benefit formula. Thus, for periods before normal retirement age, a statutory hybrid plan with a lump sum-based benefit formula that meets the requirements of the preceding sentence need not project interest credits to normal retirement age and discount the resulting accrued benefit back in order to apply the relief of section 411(a)(13)(A) with respect to the benefit determined under the lump sum-based benefit formula.

In addition, the proposed regulations would provide that the relief of section 411(a)(13)(A) does not apply unless, as

of each annuity starting date after normal retirement age, the then-current balance of the hypothetical account or the then-current value of the accumulated percentage of the participant's final average compensation satisfies the requirements of section 411(a)(2) or would satisfy those requirements but for the fact that the plan suspends benefits in accordance with section 411(a)(3)(B). Thus, for example, a plan that expresses the accumulated benefit as the balance of a hypothetical account and that does not comply with the suspension of benefit rules may have difficulty obtaining the relief of section 411(a)(13)(A) if, after normal retirement age, the plan credits interest at such a low rate that the adjustments provided by the interest credits, together with any principal credits, are insufficient to provide any required actuarial increases.

The proposed regulations would also provide that the relief of section 411(a)(13)(A) does not apply unless the balance of the hypothetical account or the accumulated percentage of the participant's final average compensation may not be reduced except as a result of one of the specified reasons set forth in the regulations. Under the proposed regulations, reductions would only be permissible as a result of: (1) Benefit payments, (2) qualified domestic relations orders under section 414(p), (3) forfeitures that are permitted under section 411(a) (such as charges for providing a qualified preretirement survivor annuity), (4) amendments that are permitted under section 411(d)(6), and (5) adjustments resulting from the application of interest credits (under the rules of § 1.411(b)(5)–1) that are negative for a period, for plans that express the accumulated benefit as the balance of a hypothetical account.

### C. Application of Section 411(A)(13)(A) to Distributions Other Than Single Sums

The proposed regulations would provide that the relief under section 411(a)(13)(A) (with respect to the requirements of sections 411(a)(2), 411(c), and 417(e)) extends to certain other forms of benefit under a lump sum-based benefit formula, in addition to a single-sum payment of the entire benefit. In particular, the proposed regulations would clarify that the relief provided under section 411(a)(13)(A) extends to an optional form of benefit that is currently payable with respect to a lump sum-based benefit formula if, under the terms of the plan, the optional form of benefit is determined as of the annuity starting date as the actuarial equivalent, determined using reasonable actuarial assumptions, of the then-

<sup>3</sup> However, see footnote 6 in Section IV.C of this preamble.

current balance of the hypothetical account or the then-current value of an accumulated percentage of the participant's final average compensation.

In addition, the proposed regulations would create a special rule that provides that the relief under section 411(a)(13)(A) also extends to an optional form of benefit that is not subject to the minimum present value requirements of section 417(e) and that is currently payable with respect to a lump sum-based benefit formula if, under the terms of the plan, this optional form of benefit is determined as of the annuity starting date as the actuarial equivalent (using reasonable actuarial assumptions) of the optional form of benefit that: (1) Commences as of the same annuity starting date; (2) is payable in the same generalized optional form (within the meaning of § 1.411(d)-3(g)(8)) as the accrued benefit; and (3) is the actuarial equivalent (using reasonable actuarial assumptions) of the then-current balance of the hypothetical account maintained for the participant or the then-current value of an accumulated percentage of the participant's final average compensation. This special rule would facilitate the payment of an immediate annuity, such as a joint and survivor annuity or life annuity with period certain, that is calculated as the actuarial equivalent of the form of payment of the accrued benefit under the plan, such as an immediately payable straight life annuity.

Finally, the proposed regulations would provide that the relief under section 411(a)(13)(A) applies on a proportionate basis to a payment of a portion of the benefit under a lump sum-based benefit formula that is not paid in the form of an annuity, such as a payment of a specified dollar amount or percentage of the then-current balance of a hypothetical account maintained for the participant or then-current value of an accumulated percentage of the participant's final average compensation. Thus, for example, if a plan that expresses the participant's entire accumulated benefit as the balance of a hypothetical account distributes 40 percent of the participant's then-current hypothetical account balance, the plan is treated as satisfying the requirements of section 411(a) and the minimum present value rules of section 417(e) with respect to 40 percent of the participant's then-current accrued benefit.

#### *D. Application of Section 411(A)(13)(A) to Plans With Multiple Formulas*

The proposed regulations would clarify that the relief provided under

section 411(a)(13)(A) does not apply to any portion of the participant's benefit that is determined under a formula that is not a lump sum-based benefit formula. Thus, for example, where the participant's accrued benefit equals the greater of the benefit under a hypothetical account formula and the benefit under a traditional defined benefit formula, a single-sum payment of the participant's entire benefit must equal the greater of the then-current balance of the hypothetical account and the present value, determined in accordance with section 417(e), of the benefit under the traditional defined benefit formula. On the other hand, where the plan provides an accrued benefit equal to the sum of the benefit under a hypothetical account formula plus the excess of the benefit under a traditional defined benefit formula over the benefit under the hypothetical account formula, a single-sum payment of the participant's entire benefit must equal the then-current balance of the hypothetical account plus the excess of the present value, determined in accordance with section 417(e), of the benefit under the traditional defined benefit formula over the present value, determined in accordance with section 417(e), of the benefit under the hypothetical account formula. See the request for comments under the heading "Comments and Public Hearing" on the issue of determining the present value of a benefit determined, in part, based on the benefit under a lump sum-based benefit formula.

#### *E. Application of Section 411(A)(13)(A) to Pension Equity Plans*

The preamble to the 2007 proposed regulations asked for comments on plan formulas that calculate benefits as the current value of an accumulated percentage of the participant's final average compensation (often referred to as "pension equity plans" or "PEPs"). Commenters indicated that some of these plans never credit interest, directly or indirectly, some explicitly credit interest after cessation of PEP accruals, and some do not credit interest explicitly but provide for specific amounts to be payable after cessation of PEP accruals (both immediately and at future dates) based on actuarial equivalence using specified actuarial factors applied upon cessation of PEP accruals.

The 2010 final regulations clarify that a formula is expressed as the balance of a hypothetical account maintained for the participant if it is expressed as a current single-sum dollar amount. Thus, a PEP formula that credits interest after cessation of PEP accruals is considered

a formula that is expressed as the balance of a hypothetical account after cessation of PEP accruals. As a result, such a formula is a lump sum-based benefit formula that is subject to the rules of section 411(a)(13)(A) set forth earlier in this preamble, as those rules are applied to PEP formulas during the period of PEP accruals and as those rules are applied to hypothetical account balance formulas after cessation of PEP accruals.

Under these proposed regulations, any other PEP formula (including those that do not credit interest, directly or indirectly, and those that offer actuarially equivalent forms of payment using specified actuarial factors applied after cessation of PEP accruals) would also be subject to the rules of section 411(a)(13)(A), as explained earlier in this preamble. Thus, for example, a PEP that does not explicitly credit interest but, instead, calculates the annuity benefit commencing at future ages as the actuarial equivalent of the PEP value as of cessation of PEP accruals would be eligible for the relief of section 411(a)(13)(A) with respect to the PEP value as of every period before cessation of PEP accruals. In addition, since the accrued benefit is calculated as an annuity commencing at normal retirement age that is actuarially equivalent to the PEP value as of cessation of PEP accruals, the relief described above that applies to annuities that are calculated as the actuarial equivalent of the then-current PEP value would not apply.

#### **II. Section 411(b)(1): Special Rule With Respect to Statutory Hybrid Plans**

Under the regulations with respect to the 133 $\frac{1}{3}$  percent rule of section 411(b)(1)(B), for any plan year, social security benefits and all relevant factors used to compute benefits, e.g., consumer price index, are treated as remaining constant as of the beginning of the current plan year for all subsequent plan years. A number of commenters on both the 2007 proposed regulations and the 2008 proposed backloading regulations expressed concern that this rule might effectively preclude statutory hybrid plans from using an interest crediting rate that is a variable rate that could potentially be negative in a year, such as an equity-based rate. This is because, if a plan treated an interest crediting rate that was negative as remaining constant in all future years for purposes of the backloading test of section 411(b)(1)(B), a principal credit (such as a pay credit) that accrues in a later year would result in a greater benefit accrual than an otherwise identical principal credit that accrues in an earlier year

because the principal credit that accrues later is credited with negative interest credits for fewer years. Thus, these commenters were concerned that a plan that uses a variable rate could fail the backloading rules of section 411(b)(1) even where both the pay crediting and interest crediting formulas do not vary over time.

In response to these comments, the proposed regulations contain a special rule regarding the application of the 133 $\frac{1}{3}$  percent rule of section 411(b)(1)(B) to a statutory hybrid plan that adjusts benefits using a variable interest crediting rate that can potentially be negative in any given year. Under this proposed rule, a plan that determines any portion of the participant's accrued benefit pursuant to a statutory hybrid benefit formula (as defined in § 1.411(a)(13)–1(d)(4)) that utilizes an interest crediting rate described in § 1.411(b)(5)–1(d) that is a variable rate that was less than zero for the prior plan year would not be treated as failing to satisfy the requirements of the 133 $\frac{1}{3}$  percent rule for the current plan year merely because the section 411(b)(1)(B) backloading calculation is performed assuming that the variable rate is zero for the current plan year and all future plan years.

### III. Section 411(b)(5): Special Conversion Protection Rule and Additional Rules With Respect to the Market Rate of Return Limitation

#### A. Comparison at Effective Date of Conversion Amendment

In accordance with the requirements of section 411(b)(5)(B)(ii), the 2010 final regulations provide that a participant whose benefits are affected by a conversion amendment generally must be provided with a benefit after the conversion that is at least equal to the sum of benefits accrued through the date of conversion and benefits earned after the conversion, with no permitted interaction between the two portions. The 2010 final regulations provide for an alternative method of satisfying the conversion protection requirements where an opening hypothetical account balance or opening accumulated percentage of the participant's final average compensation is established at the time of the conversion and the plan provides for separate calculation of (1) the benefit attributable to the opening hypothetical account balance (including interest credits attributable thereto) or attributable to the opening accumulated percentage of the participant's final average compensation and (2) the benefit attributable to post-conversion service under the post-conversion

benefit formula. Under this alternative, the plan must provide that, when a participant commences benefits, the participant's benefit will be increased if the benefit attributable to the opening hypothetical account or opening accumulated percentage that is payable in the particular optional form of benefit selected is less than the benefit accrued under the plan prior to the date of conversion and that was payable in the same generalized optional form of benefit (within the meaning of § 1.411(d)–3(g)(8)) at the same annuity starting date.

The preamble to the 2007 proposed regulations requested comments on another alternative method of satisfying the conversion protection requirements that would not require this comparison at the annuity starting date. In response to favorable comments related to this alternative, these proposed regulations would provide that 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. While testing at the annuity starting date would not be required under this method, a number of requirements like those described in the preamble to the 2007 proposed regulations would need to be satisfied in order to ensure that the hypothetical account balance used to replicate the pre-conversion benefit (the opening hypothetical account balance and interest credits on that account balance) is reasonably expected in most, but not necessarily all, cases to provide a benefit at least as large as the pre-conversion benefit for all periods after the conversion amendment.

This alternative method would be limited to situations where an opening hypothetical account balance is established and would not be available where an opening accumulated percentage of the participant's final average compensation is established because these plans would be unable to reliably replicate the pre-conversion benefit. This is because the value of the opening accumulated percentage would only increase as a result of unpredictable increases in compensation for periods after the conversion amendment until cessation of PEP accruals, rather than by application of an annual interest crediting rate.

This alternative would only be available where the participant elects to receive payment in the form of a single-sum distribution equal to the sum of the then-current balance of the hypothetical

account used to replicate the pre-conversion benefit and the benefit attributable to post-conversion service under the post-conversion benefit formula. Because of the limited availability of this alternative, plans will still need to separately 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 distribution. See the related request for comments in this preamble under the heading "Comments and Public Hearing."

Under this alternative, in order to satisfy the requirements of section 411(d)(6), the participant's benefit after the effective date of the conversion amendment must not be less than the participant's section 411(d)(6) protected benefit (as defined in § 1.411(d)–3(g)(14)) with respect to service before the effective date of the conversion amendment (determined under the terms of the plan as in effect immediately before the effective date of the amendment). Also, the plan, as in effect immediately before the effective date of the conversion amendment, either must not have provided a single-sum payment option (for benefits that cannot be immediately distributed under section 411(a)(11)) or must have provided a single-sum payment option that was based solely on the present value of the benefit payable at normal retirement age (or at date of benefit commencement, if later) and which was not based on the present value of the benefit payable commencing at any date prior to normal retirement age. This condition ensures that the hypothetical account balance used to replicate the pre-conversion benefit does not result in a single-sum distribution that is less than would have been available under an early retirement subsidy under the pre-conversion formula.

Under this alternative method of satisfying the conversion protection requirements, the opening hypothetical account balance must be established in accordance with the rules under which this opening balance is not less than the present value, determined in accordance with section 417(e), of the accrued benefit immediately prior to the effective date of the conversion amendment. In addition, under this alternative, the interest crediting rate under the plan as of the effective date of the conversion amendment must be either the rate of interest on long-term investment grade corporate bonds (the third segment rate) or one of several specified safe harbor rates. Also, as of that date, the value of the index used to determine the interest crediting rate under the plan must be at least as great

for every participant or beneficiary as the interest rate that was used to determine the opening hypothetical account balance. This requirement is satisfied, for example, if each participant's opening hypothetical account balance is determined using the applicable interest rate and applicable mortality table under section 417(e)(3), the interest crediting rate under the plan is the third segment rate, and, at the effective date of the conversion amendment, the third segment rate is the highest of the three segment rates. If, subsequent to the effective date of the conversion amendment, the interest crediting rate changes (whether by plan amendment or otherwise) with respect to a participant who was a participant at the time of the effective date of the conversion amendment from an interest crediting rate that is either the rate of interest on long-term investment grade corporate bonds or one of the specified safe harbor rates to a different interest crediting rate that is not in all cases at least as great as the prior interest crediting rate under the plan, then the new interest crediting rate does not apply to the existing hypothetical account balance as of the effective date of the change in interest crediting rates (or, if the plan created a subaccount consisting of the opening hypothetical account balance and interest credits on that subaccount, then the new interest crediting rate does not apply to the subaccount).

Finally, either the plan must provide a death benefit after the effective date of the conversion amendment which has a present value that is at all times at least equal to the then-current balance of the hypothetical account used to replicate the pre-conversion benefit or the plan must not have applied a pre-retirement mortality decrement in establishing the opening hypothetical account balance.

#### *B. Market Rate of Return*

The 2010 final regulations provide that a plan that credits interest must specify how the plan determines interest credits and must specify how and when interest credits are credited. In addition, the 2010 final regulations contain certain specific rules regarding the method and timing of interest credits, including a requirement that interest be credited at least annually.

The proposed regulations include a rule that would provide that a plan is not treated as failing to meet the interest crediting requirements merely because the plan does not provide for interest credits on amounts distributed prior to the end of the interest crediting period. Thus, if a plan credits interest at periodic intervals, the plan would not

be required to credit interest on amounts that were distributed between the dates on which interest under the plan is credited to the account balance.

Furthermore, the proposed regulations include a rule that would allow plans to credit interest taking into account increases or decreases to the participant's accumulated benefit that occur during the period. In particular, the rule would provide that a plan is not treated as failing to meet the market rate of return limitations merely because the plan calculates increases or decreases to the participant's accumulated benefit by applying a rate of interest or rate of return (including a rate of increase or decrease under an index) to the participant's adjusted accumulated benefit (or portion thereof) for the period. For this purpose, the participant's adjusted accumulated benefit equals the participant's accumulated benefit as of the beginning of the period, adjusted for debits and credits (other than interest credits) made to the accumulated benefit prior to the end of the interest crediting period, with appropriate weighting for those debits and credits based on their timing within the period. For plans that calculate increases or decreases to the participant's accumulated benefit by applying a rate of interest or rate of return to the participant's adjusted accumulated benefit (or portion thereof) for the period, interest credits include these increases and decreases, to the extent provided under the terms of the plan at the beginning of the period and to the extent not conditioned on current service and not made on account of imputed service, and the interest crediting rate with respect to a participant equals the total amount of interest credits for the period divided by the participant's adjusted accumulated benefit for the period.

The proposed regulations would provide that the preservation of capital requirement is applied only 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. The proposed regulations would also provide special rules to ensure that prior distributions are taken into account in determining the guarantee provided by the preservation of capital requirement with respect to a current distribution to which the rule applies.

These proposed regulations would broaden the list of permitted interest crediting rates from those permitted under the 2010 final regulations. A number of commenters on the 2007 proposed regulations requested that the

rate of return on plan assets be treated as a market rate of return for all types of statutory hybrid plans, and not just indexed plans. In response to these comments, the proposed regulations would permit the use of the rate of return on plan assets as a market rate of return for statutory hybrid plans generally if the plan's assets are diversified so as to minimize the volatility of returns. Like the 2010 final regulations, the proposed regulations would provide that this requirement that plan assets be diversified so as to minimize the volatility of returns does not require greater diversification than is required under section 404(a)(1)(C) of Title I of the Employee Retirement Income Security Act of 1974, Public Law 93-406 (88 Stat. 829 (1974)) with respect to defined benefit pension plans.

The preamble to the 2007 proposed regulations asked for comments about the possibility of allowing an interest credit to be determined by reference to a rate of return on a regulated investment company (RIC) described in section 851. The preamble focused on whether such an investment has sufficiently constrained volatility that the existence of the capital preservation rule would not result in an above market rate of return. In response to comments received on the 2007 proposed regulations, these proposed regulations would provide that an interest crediting rate is not in excess of a market rate of return if it is equal to the rate of return on a RIC, as defined in section 851, that is reasonably expected to be not significantly more volatile than the broad United States equities market or a similarly broad international equities market. For example, a RIC that has most of its assets invested in securities of issuers (including other RICs) concentrated in an industry sector or a country other than the United States, that uses leverage, or that has significant investment in derivative financial products, for the purpose of achieving returns that amplify the returns of an unleveraged investment, generally would not meet this requirement. Thus, a RIC that has most of its investments concentrated in the semiconductor industry or that uses leverage in order to provide a rate of return that is twice the rate of return on the Standard & Poor's 500 index (S&P 500) would not meet this requirement. On the other hand, a RIC whose investments track the rate of return on the S&P 500, a broad-based "small-cap" index (such as the Russell 2000 index), or a broad-based international equities index would meet this requirement. The requirement that

the RIC's investments not be concentrated in an industry sector or a specific international country is intended to limit the volatility of the returns, as well as the risk inherent in non-diversified investments. Similarly, the requirement that the RIC not provide leveraged returns is intended both to ensure that rates provided by the RIC do not exceed an unleveraged market rate as well as to limit the volatility of the returns provided. Subject to these requirements, the proposed rule is intended to provide plan sponsors with greater flexibility in choosing an equity-based rate than would be provided if the regulations were to list particular equity-based rates that satisfy the market rate of return requirement.

The preamble to the 2007 proposed regulations requested comments as to how to implement a rule that provides that interest credits are determined under the greater of two or more interest crediting rates without violating the market rate of return limitation. In response to such comments, these proposed regulations would provide that in certain limited circumstances a plan can provide interest credits based on the greater of two or more interest crediting rates without exceeding a market rate of return.

The Treasury Department and the IRS have modeled the historical distribution of rates of interest on long-term investment grade corporate bonds and have determined that those rates have only infrequently been lower than 4 percent and, when lower, were generally lower by small amounts and for limited durations. Therefore, the increase in the effective rate of return resulting from adding an annual 4 percent floor to one of these bond rates has historically been small enough that the effective rate of return is not in excess of a market rate of return. As a result, the proposed rules would provide that it is permissible for a plan to utilize an annual floor of 4 percent in conjunction with a permissible bond rate. Specifically, the proposed regulations would provide that a plan does not provide an interest crediting rate that is in excess of a market rate of return merely because the plan provides that the interest crediting rate for an interest crediting period equals the greater of the rate of interest on long-term investment grade corporate bonds (or one of the safe harbor rates that, under the regulations, are deemed not to be in excess of that rate) and an annual interest rate of 4 percent.

This rule permitting a plan to utilize an annual floor of 4 percent in conjunction with a permissible bond-based rate would also permit plans that

credit interest more frequently than annually using a permissible bond-based rate to also utilize a periodic floor that is a pro rata portion of an annual 4 percent floor. Thus, plans that credit interest more frequently than annually could provide an effective annual floor that is greater than 4 percent, both due to the effect of compounding because the floor would be applied more frequently than annually and because the floor would be applied in any period that the bond-based rate was below the floor, even if the annual rate exceeded 4 percent for the plan year. However, given the nature of bond-based rates, including the serial correlation of rates from one period to the next, as well as the fact that 4 percent is not expected to exceed a permissible bond-based rate except infrequently, by small amounts, and for limited durations, in most instances a periodic floor that is based on a 4 percent annual floor will not provide a floor that is significantly different than an annual floor of 4 percent.

In contrast, because of the volatility of equity-based rates, adding an annual floor to an equity-based rate often provides a cumulative rate of return that far exceeds the rate of return provided by the equity-based rate without such floor. It should also be noted that commenters on the 2007 proposed regulations generally did not request that such an annual floor be permitted (perhaps in recognition that a minimum guaranteed annual return when applied to equity-based rates could have a significant impact on funding). Accordingly, the proposed regulations would not allow the use of an annual floor in conjunction with the rate of return on plan assets or on a permissible RIC.

On the other hand, if, instead of applying a floor on each year's rate of return, a cumulative floor is applied to an equity-based rate, the effective rate of return is not necessarily substantially greater than the rate of return provided without the floor. Specifically, the Treasury Department and the IRS have determined that, based on the modeling of long-term historical returns, a 3 percent floor that applies cumulatively (in the aggregate from the date of each principal credit until the annuity starting date, without a floor on the rate of return provided in any interim period) could be combined with any permissible rate (including a permissible equity-based rate), without increasing the effective rate of return to such an extent that the effective rate of return would be in excess of a market rate of return. As a result, the proposed rule would provide that a plan that

determines interest credits using any particular interest crediting rate that satisfies the market rate of return limitation does not provide an effective interest crediting rate in excess of a market rate of return merely because the plan provides that the participant's benefit, as of the participant's annuity starting date, is equal to the greater of the benefit determined using the interest crediting rate and the benefit determined as if the plan had used a fixed annual interest crediting rate equal to 3 percent (or a rate not in excess of 3 percent) for principal credits in all years. This rule in the proposed regulations that allows for plans to utilize a cumulative floor of up to 3 percent would also allow plans some additional flexibility in design. Thus, for example, a plan that utilizes annual ceilings in conjunction with a permissible rate could also provide a cumulative floor of up to 3 percent.

Similar to the rules with respect to application of the preservation of capital requirement, the proposed regulations would provide that the determination of the guarantee provided by any cumulative floor with respect to the participant's benefit is made only 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. The proposed regulations would also provide special rules to ensure that prior distributions are taken into account in determining whether the guarantee exceeds the benefit otherwise provided under the plan.

In addition to permitting certain fixed floors to be applied to variable rates, the proposed regulations would also permit a standalone fixed rate of interest to be used for interest crediting purposes. While the statutory language at section 411(b)(5)(B)(i)(I) does not explicitly reference a fixed interest crediting rate, the reference to "a reasonable minimum guaranteed rate of return" and the reference to "the greater of a fixed or variable rate of return" necessarily mean that some fixed rate must also be permissible. Further, the statutory language at section 411(b)(5)(B)(i)(III) specifically authorizes the Treasury Department to issue regulations permitting a fixed rate of interest under the rules relating to a market rate of return. However, reconciling a fixed interest crediting rate with the statutory requirement that an interest crediting rate "for any plan year shall be at a rate which is not greater than a market rate of return" [emphasis added] presents unique challenges because, by definition, fixed rates do not adjust with the market. As a result, the use of any

fixed rate will result in an interest crediting rate that is above a then-current market rate of interest during any period in which the current market rate falls below the fixed rate.

In light of this fact, the Treasury Department and the IRS believe that, in order to satisfy the market rate of return requirement, any fixed interest crediting rate allowed under the rules must not be expected to exceed future market rates of interest, except infrequently, by small amounts, and for limited durations. Based on the historical modeling described above, the Treasury Department and the IRS have determined that a 5 percent fixed rate satisfies these criteria and that any higher fixed rate would result in an effective rate of return that is in excess of a market rate of return.

Specifically, the proposed rules would provide that an annual interest crediting rate of a fixed 5 percent is a safe harbor rate deemed to be not in excess of the rate of interest on long-term investment grade corporate bonds. As a result, an interest crediting rate of a fixed 5 percent would satisfy the market rate of return limitation. In addition, the special section 411(d)(6) rule set forth in the 2010 final regulations with respect to certain changes in interest crediting rates would apply to an interest crediting rate of a fixed 5 percent and, as a result, a plan amendment that changes the interest crediting rate under the plan to the third segment rate from a fixed 5 percent is deemed to satisfy the requirements of section 411(d)(6), provided certain requirements are met.

The 2010 final regulations provide that §§ 1.411(b)(5)-1(d)(1)(iii), 1.411(b)(5)-1(d)(1)(vi), and 1.411(b)(5)-1(d)(6), which provide that the regulations set forth the exclusive list of interest crediting rates and combinations of interest crediting rates that satisfy the market rate of return requirement under section 411(b)(5), apply to plan years that begin on or after January 1, 2012. For plan years that begin before January 1, 2012, statutory hybrid plans may utilize a rate that is permissible under the 2010 final regulations or these proposed regulations for purposes of satisfying the statutory market rate of return requirement.

### C. Plan Termination

The proposed regulations would provide guidance with respect to the application of the rules of section 411(b)(5)(B)(vi), which require special plan provisions relating to interest crediting rates and annuity conversion rates that apply when the plan is

terminated. Under the proposed regulations, a statutory hybrid plan is treated as meeting the market rate of return requirements only if the terms of the plan satisfy the rules in the regulations relating to section 411(b)(5)(B)(vi). Title IV of ERISA also imposes special rules that apply when a single employer pension plan is terminated (including special rules relating to plan amendments). See regulations of the Pension Benefit Guaranty Corporation for additional rules that apply when a pension plan is terminated.

These proposed regulations reflect the statutory requirement that a plan provide that, if the interest crediting rate used to determine a participant's accumulated benefit (or a portion thereof) varied (that is, was not a constant fixed rate) during the 5-year period ending on the plan termination date, then the interest crediting rate used to determine the participant's accumulated benefit under the plan after the date of plan termination is equal to the average of the rates used under the plan during the 5-year period ending on the plan termination date. If the interest crediting rate used to determine a participant's accumulated benefit (or a portion thereof) was instead a single fixed rate for all periods during the 5-year period ending on the plan termination date, then the interest crediting rate used to determine the participant's accumulated benefit after the date of plan termination would be equal to that fixed rate.

Under this rule, the interest crediting rate used after plan termination would be based on the average of the rates that applied under the plan during the 5-year period preceding plan termination, without regard to whether this average rate exceeds then-current market rates of return (but, in determining the average rate, a rate would only be taken into account to the extent that the rate did not exceed a market rate of return when the rate actually applied). For purposes of this calculation, the proposed regulations would provide that, subject to certain other rules described in this preamble, the average of the rates used under the plan during the 5-year period ending on the termination date is determined with respect to a participant as the arithmetic average, expressed as an annual rate, of the applicable interest crediting rates that applied in the 5-year period. In determining this average, each interest crediting period for which the interest crediting date is within the 5-year period ending on the plan termination date would be taken into account, with interest crediting rates for periods that are less than a year in

length adjusted and weighted proportionately. However, under this rule, if a period begins on or before the date that is 5 years before the termination date and ends within the 5-year period ending on the plan termination date, the period would be weighted as though the entire period were within the 5-year period ending on the plan termination date.

Section 411(b)(5)(B)(vi) does not explicitly provide rules with respect to plans that determine interest credits based on equity-based rates of return that may involve potential losses. Since the trailing 5-year average of an equity-based rate of return may have little, if any, correlation to the actual future equity-based rate of return, the Treasury Department and the IRS do not believe it is appropriate to provide that the trailing 5-year average of such rate of return be used to determine benefits after plan termination. In such cases, the Treasury Department and the IRS believe that it is appropriate to apply a bond-based rule instead. Thus, the proposed regulations would provide that, with respect to an interest crediting rate used to determine a participant's accumulated benefit for an interest crediting period during the 5-year period ending on the termination date that is not a fixed interest rate or a bond-based rate of interest (or is based on a variable rate that is not permissible under the regulations), the terms of the plan must provide that, for purposes of determining the average upon plan termination, the interest crediting rate for the interest crediting period is deemed to be equal to the third segment rate for the last calendar month ending before the beginning of the interest crediting period, as adjusted for any actual applicable floors and ceilings that applied to the rate of return in the period, but without regard to any reductions that applied to the rate of return in the period. Thus, for example, if the actual interest crediting rate in an interest crediting period was equal to the rate of return on plan assets, but not greater than 5 percent, then for purposes of determining the plan's average interest crediting rate, the interest crediting rate for that interest crediting period would be deemed to equal to the lesser of the applicable third segment rate for the period and 5 percent. However, if the actual interest crediting rate in an interest crediting period was equal to the rate of return on plan assets minus 200 basis points, then for purposes of determining the plan's average interest crediting rate, the interest crediting rate for that interest crediting period would be deemed to

equal the third segment rate (not the third segment rate minus 200 basis points). See the request for comments in this preamble under the heading "Comments and Public Hearing" regarding the application of floors, ceilings, and reductions for purposes of the plan termination provisions when the third segment rate is substituted for an equity-based rate.

As provided in section 411(b)(5)(B)(i), the regulations require that the terms of the plan also provide that the interest rate and mortality table (including tabular adjustment factors) used on and after plan termination for purposes of determining the amount of any benefit under the plan payable in the form of an annuity (commencing at or after normal retirement age) be based on the interest rate and mortality table specified under the plan for that purpose as of the termination date, except that if the interest rate is a variable rate, the interest rate is instead based on the rules described in the preceding paragraphs of this preamble using a 5-year average.

A number of special rules apply for purposes of determining the interest crediting rate that applies after plan termination. In particular, for purposes of determining the average rate during the five-year period ending on plan termination, the interest crediting rate that applied for each interest crediting period is generally the ongoing interest crediting rate that was specified under the plan in that period, without regard to any section 411(d)(6) protected benefit using an old interest crediting rate. However, if, at the end of the last interest crediting period prior to plan termination, the participant's accumulated benefit is based on a section 411(d)(6) protected benefit that results from a prior amendment to change the rate of interest crediting applicable under the plan, then, for purposes of determining the average rate, the pre-amendment interest crediting rate is treated as having applied for each interest crediting period after the date of the interest crediting rate change. In addition, the proposed regulations would provide that if the plan determines a participant's interest credits in any interest crediting period by applying different rates to different predetermined portions of the accumulated benefit as permissible under the regulations, then the participant's interest crediting rate for the interest crediting period is assumed for purposes of the plan termination provisions to be the weighted average of the fixed interest rates, determined under the plan termination rules, that

apply to each portion of the accumulated benefit.

Furthermore, to reduce the administrative burden and to determine the average rate for each participant based on 5 years of interest crediting data, if the plan provided for interest credits for any interest crediting period in which, pursuant to the terms of the plan, the individual was not eligible to receive interest credits (because the individual was not a participant or beneficiary in the relevant interest crediting period or otherwise), then, for purposes of determining the interest crediting rate that applies after plan termination, the individual is treated as though the individual received interest credits in that period using the interest crediting rate that applied in that period under the terms of the plan to determine the benefit of a similarly situated participant or beneficiary who was eligible to receive interest credits. However, if, under the terms of the plan, the individual was not eligible to receive any interest credits during the entire 5-year period ending on the plan termination date, then the rules fixing the interest crediting rate do not apply to determine the individual's benefit after plan termination.

The proposed regulations include examples to illustrate the application of these plan termination rules, including how these rules would apply where a plan bases its interest crediting rate on a weighted average of more than one rate, how these rules would apply where the plan's ongoing interest crediting rate is an equity-based rate of return, and how these rules would apply to a participant whose benefits are determined where the plan had switched interest crediting rates in the past and where the interest credit prior to termination was determined by applying the old rate to the benefit attributable to principal credits before the applicable amendment date.

#### *D. Special Rule With Respect to Changes in Interest Crediting Rates Where Plan Provides Section 411(d)(6) Protection*

An inherent tension exists between the requirement not to reduce a participant's accrued benefit and the requirement that an interest crediting rate not be in excess of a market rate of return that makes changes in interest crediting rates difficult to implement for statutory hybrid plans in many circumstances. This is because, in order to satisfy section 411(d)(6), a participant's benefit can never be less than the pre-amendment benefit increased for periods after the amendment using the pre-amendment

interest crediting rate, thereby effectively requiring a minimum interest crediting rate. In light of this tension, the proposed regulations would create a special market rate of return rule that applies in the case of an amendment to change the plan's interest crediting rate.

In particular, the proposed rule would provide that, in the case of an amendment to change a plan's interest crediting rate for periods after the applicable amendment date from one interest crediting rate (the old rate) that is not in excess of a market rate of return to another interest crediting rate (the new rate) that is not in excess of a market rate of return, the plan's effective interest crediting rate is not in excess of a market rate of return merely because the plan provides for the benefit of any participant who is benefiting under the plan on the applicable amendment date to never be less than what it would be if the old rate had continued but without taking into account any principal credits after the applicable amendment date. A pattern of repeated plan amendments each of which provides for a prospective change in the plan's interest crediting rate with respect to the benefit as of the applicable amendment date will be treated as resulting in the ongoing plan terms providing that the interest crediting rate equals the greater of each of the interest crediting rates, so that the special rule in the preceding sentence would not apply. See § 1.411(d)-4, A-1(c)(1). Thus, in such cases the plan will be treated as providing a rate of return that is in excess of a market rate of return, unless the resulting greater-of rate satisfies the market rate of return rules.

#### *E. Special Rule With Respect to Interest Crediting Rate After Normal Retirement Age*

In coordination with the rules under section 411(a)(13)(A) (as described in section I of this preamble) that apply with respect to the benefit determined as of each annuity starting date after normal retirement age, the proposed regulations would provide that a statutory hybrid plan is not treated as providing an effective interest crediting rate that is in excess of a market rate of return merely because the plan provides that the participant's benefit, as of each annuity starting date after normal retirement age, is equal to the greater of the benefit determined using an interest crediting rate that is not otherwise in excess of a market rate of return and the benefit that satisfies the requirements of section 411(a)(2). Thus, for example, a cash balance plan would not be treated as providing an effective interest

crediting rate in excess of a market rate of return merely because the plan credits interest after normal retirement age at a rate that is sufficient to provide any required actuarial increases.

#### IV. Changes in Interest Crediting Rates and Code Section 411(d)(6)

##### A. Background

An amendment to change a plan's interest crediting rate that only applies with respect to benefits that have not yet accrued (such as where the plan establishes a second hypothetical account balance for future principal credits to which a different interest crediting rate is applied) would not result in a reduction in accrued benefits attributable to service before the applicable amendment date and, therefore, such a change would not violate section 411(d)(6).<sup>4</sup> However, except to the extent permitted under section 1107 of PPA '06 or as otherwise described in section IV of this preamble, an amendment to change a plan's future interest crediting rate with respect to benefits that have already accrued (in other words, with respect to an existing account balance) must satisfy section 411(d)(6) if the change could result in interest credits that are smaller as of any date after the applicable amendment date than the interest credits that would be credited without regard to the amendment.<sup>5</sup>

##### B. Special Section 411(d)(6) Rule With Respect to Changes in Future Interest Crediting Rates

Under the 2010 final regulations, a plan is not treated as providing smaller interest credits after the applicable amendment date merely because the amendment changes the plan's future interest crediting rate with respect to benefits that have already accrued to the rate of interest on long-term investment grade corporate bonds (the third segment rate under section 430(h)(2)(C)(iii)) from one of the other bond-based safe harbor rates permitted under the 2010 final regulations (for example, a rate based on Treasury bonds with any of the margins specified in the

regulations or an eligible cost-of-living index). However, the change is permitted only if: (1) The effective date of the amendment is at least 30 days after adoption, (2) the new interest crediting rate only applies to interest to be credited after the effective date of the amendment, and (3) on the effective date of the amendment, the new interest crediting rate is not lower than the interest crediting rate that would have applied in the absence of the amendment.

##### C. Changes That Would Otherwise Violate Section 411(d)(6) But That Are Made to the Extent Necessary To Satisfy Section 411(b)(5)

After these proposed regulations under sections 411(a)(13) and 411(b)(5) are issued as final regulations, it is expected that relief from the requirements of section 411(d)(6) will be granted for a plan amendment that eliminates or reduces a section 411(d)(6) protected benefit, provided that the amendment is adopted before those final regulations apply to the plan, and the elimination or reduction is made only to the extent necessary to enable the plan to meet the requirements of section 411(b)(5).<sup>6</sup> It is expected that this section 411(d)(6) relief will be available in the case of an amendment that reduces the future interest crediting rate with respect to benefits that have already accrued from a rate that is in excess of a market rate of return under the final market rate of return rules to the extent necessary to constitute a permissible rate under the final market rate of return rules. However, it is expected that this relief would not permit a plan with an interest crediting rate within the list of permitted rates under the final market rate of return rules to change to another permitted rate because the change would not be necessary to enable the plan to satisfy the requirements of section 411(b)(5). Similarly, it is expected that this relief would not permit a plan with an interest crediting rate that is impermissible under the final market rate of return rules to change to a permissible rate using less than the maximum permitted margin for that rate because the reduction would be more than necessary to enable the plan to satisfy the

requirements of section 411(b)(5). For purposes of the preceding sentence, a rate without an associated margin is treated as having a maximum permitted margin of zero. See the request for comments, under the heading "Comments and Public Hearing" in this preamble, regarding limitations on the scope of this anticipated relief under § 1.411(d)-4, A-2(b)(2)(i) because the relief must be limited to amendments that change a plan's interest crediting rate only to the extent necessary to enable the plan to satisfy the requirements of section 411(b)(5).

##### Proposed Effective/Applicability Dates

The specific rules that would be implemented under the proposed regulations generally would apply to plan years that begin on or after January 1, 2012. However, as stated in the preamble to the 2010 final regulations, a plan is permitted to rely on the provisions of these proposed regulations, as well as the 2010 final regulations, the 2007 proposed regulations, and Notice 2007-6, for purposes of satisfying the requirements of sections 411(a)(13) and 411(b)(5) for periods before the regulatory effective date.

##### Special Analyses

It has been determined that these proposed regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

##### Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The Treasury Department and the IRS specifically request comments on the clarity of the proposed regulations and how they may be made easier to understand.

In addition to comments on issues addressed in these proposed regulations, the Treasury Department

<sup>4</sup> However, see section 204(h) of ERISA and section 4980F of the Code for notice requirements relating to amendments that provide for a significant reduction in the rate of future benefit accrual.

<sup>5</sup> Except to the extent permitted under section 411(d)(6) and §§ 1.411(d)-3 and 1.411(d)-4, another Code provision, or another statutory provision such as section 1107 of PPA '06, section 411(d)(6) prohibits a plan amendment that decreases a participant's accrued benefits or that has the effect of eliminating or reducing an early retirement benefit or retirement-type subsidy, or eliminating an optional form of benefit, with respect to benefits attributable to service before the amendment.

<sup>6</sup> Announcement 2009-82 and Notice 2009-97 stated that the IRS and the Treasury Department expected to provide such relief. While Notice 2009-97 indicated the relief would only apply if the amendment is adopted by the last day of the first plan year that begins on or after January 1, 2010, this preamble supersedes that applicability date to provide that it is expected that this relief would apply if the amendment is adopted before final regulations that finalize these proposed regulations apply to the plan.

and the IRS specifically request comments on the following issues:

- Should a defined benefit plan that expresses a participant's accumulated benefit as a current single-sum dollar amount and that does not provide for interest credits be excluded from the definition of a statutory hybrid plan?
- In the case of a statutory hybrid plan that credits interest using an interest crediting rate equal to the rate of return on a RIC, how does section 411(d)(6) apply if the underlying RIC subsequently ceases to exist?
- The proposed regulations permit certain fixed interest crediting rates (a fixed 5 percent rate for any year, the greater of 4 percent or certain bond-based indices for any year, and a cumulative minimum 3 percent annual rate). Comments regarding these specific proposed rules should take into account how any general legal standard for a market rate of return would be applied in different economic circumstances with variable interest rate markets, as well as the related ability that would generally be available under these proposed regulations at § 1.411(b)(5)–1(e)(3)(iii) for the plan sponsor to change the crediting rate on an existing hypothetical account balance for active participants from one interest crediting rate to another, including the risk that whatever fixed rate is permitted might allow a plan's interest credits to exceed market rates of interest either frequently, by an amount that might be large, or for an extended duration. Commenters recommending any additional types of rates of return than those in these proposed regulations should justify how those rates meet a market rate of return, taking into account the minimum guarantee rules.
- Should a statutory hybrid plan be able to offer participants a menu of hypothetical investment options (including a life-cycle investment option, whereby participants are automatically transitioned incrementally at certain ages from a blended rate that is more heavily equity-weighted to a rate that is more heavily bond-weighted) and, if so, what plan qualification issues (*i.e.*, forfeiture, section 411(d)(6), market rate of return, and other section 411(b)(5) issues) arise under such a plan design? In particular, do the following events raise issues: (1) A participant elects to switch from one investment option to another; (2) a bond index or RIC underlying one of the investment options ceases to exist; (3) the plan is amended to eliminate an investment option; (4) a participant elects to switch from an investment option with a cumulative minimum to an investment option without a

cumulative minimum (or vice versa); or (5) the plan is terminated and, pursuant to the special rules that apply upon plan termination, the interest crediting rate that applies to determine a participant's benefit after plan termination must be fixed?

- How does a statutory hybrid plan that provides benefits under a statutory hybrid benefit formula other than a lump sum-based benefit formula (such as a plan that provides for indexing as described in section 411(b)(5)(E))—a plan to which section 411(a)(13)(A) does not apply—ensure compliance with the minimum present value rules of section 417(e)?

- How does a statutory hybrid plan determine the section 417(e) minimum present value of the participant's benefit where a portion of the benefit is determined based partly on the benefit under a lump sum-based benefit formula, although that portion is not determined under a lump sum-based benefit formula? For example, where a portion of the accrued benefit is equal to the excess of the benefit under a traditional defined benefit formula over the benefit under a hypothetical account formula, how is the present value of that portion of the accrued benefit determined?

- Should the proposed alternative method of satisfying the conversion protection requirements that does not require a comparison of benefits at the annuity starting date be broadened to apply to forms of distribution other than a single-sum distribution? If this rule should be broadened, what rules would ensure that the benefit attributable to the opening hypothetical account balance is not less than the benefit available under the same generalized optional form under the pre-conversion formula (which may include subsidized early retirement benefits and other retirement-type subsidies) consistent with the goal of having a simplified alternative?

- How does a statutory hybrid plan that uses a variable interest crediting rate that may potentially be negative satisfy the fractional rule of section 411(b)(1)(C) if the 133 $\frac{1}{3}$  percent rule of section 411(b)(1)(B) is not satisfied?

- For purposes of the plan termination rules, should a floor, ceiling, or reduction that applied to an equity-based rate in an interest crediting period be treated as applying in the same manner to the third segment rate or is it appropriate for such an adjustment to be disregarded or otherwise modified for purposes of such rules?

- Under the relief to be provided pursuant to § 1.411(d)–4, A–2(b)(2)(i),

which authorizes amendments that reduce a section 411(d)(6) protected benefit only to the extent necessary to satisfy the requirements of section 411(b)(5), should a statutory hybrid plan with an interest crediting rate that is impermissible under the final market rate of return rules be permitted to be amended to change the future interest crediting rate with respect to benefits that have already accrued to any permissible rate using the maximum permitted margin for that rate or should that be dependent upon the reasons that the pre-amendment rate exceeded a market rate of return? Thus, for example, should a plan with an impermissible bond-based rate (without a fixed component) be permitted to switch to any permissible rate, bond-based or otherwise, using the maximum permitted margin for that rate? Should a plan with an impermissibly high standalone fixed rate be permitted to switch to the maximum rate of any type, should it be permitted to switch to the maximum permitted bond-based rate with the maximum permitted floor for that rate (the third segment rate with a fixed 4 percent floor), or must it switch to the maximum permitted standalone fixed rate (a fixed rate of 5 percent)? Should a plan with a permissible bond-based rate but with an impermissibly high fixed floor be permitted to switch to the maximum rate of any type, should it be permitted to retain the pre-amendment bond-based rate while reducing the floor to the maximum permitted floor for that rate (a fixed 4 percent floor), should it be permitted to switch to the maximum permitted standalone fixed rate (a fixed rate of 5 percent), or must it switch to the maximum permitted bond-based rate with the maximum permitted floor for that rate (the third segment rate with a fixed 4 percent floor)?

All comments will be available for public inspection and copying. A public hearing has been scheduled for Wednesday, January 26, 2011, beginning at 10 a.m. in the Auditorium, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the **FOR FURTHER INFORMATION CONTACT** section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments by Wednesday, January 12, 2011, and an outline of topics to be discussed and the amount of time to be devoted to each topic (a signed original and eight (8) copies) by Friday, January 14, 2011. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

**Drafting Information**

The principal authors of these regulations are Neil S. Sandhu, Lauson C. Green, and Linda S. F. Marshall, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in the development of these regulations.

**List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

**Proposed Amendments to the Regulations**

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

**PART 1—INCOME TAXES**

**Paragraph 1.** The authority citation for part 1 continues to read in part as follows:

**Authority:** 26 U.S.C. 7805 \* \* \*

**Par. 2.** Section 1.411(a)(13)–1 is amended by revising paragraphs (b)(2), (b)(3), (b)(4), and (e)(2)(ii) to read as follows:

**§ 1.411(a)(13)–1 Statutory hybrid plans.**

\* \* \* \* \*

(b) \* \* \*

(2) *Requirements that lump sum-based benefit formula must satisfy to obtain relief*—(i) *In general.* The relief of paragraph (b)(1) of this section does not apply with respect to benefits determined under a lump sum-based benefit formula unless the requirements of paragraphs (b)(2)(ii) through (iv) of this section are satisfied.

(ii) *Benefit on or before normal retirement age.* A plan satisfies this paragraph (b)(2)(ii) only if, at all times on or before normal retirement age, the then-current balance of the hypothetical account or the then-current value of the accumulated percentage of the participant's final average compensation

is not less than the present value, determined using reasonable actuarial assumptions, of the portion of the participant's accrued benefit that is determined under the lump sum-based benefit formula. However, a plan is deemed to satisfy the requirement in the preceding sentence for periods before normal retirement age if, upon attainment of normal retirement age, the then-current balance of the hypothetical account or the then-current value of the accumulated percentage of the participant's final average compensation is actuarially equivalent (using reasonable actuarial assumptions) to the portion of the participant's accrued benefit that is determined under the lump sum-based benefit formula.

(iii) *Benefit after normal retirement age.* A plan satisfies this paragraph (b)(2)(iii) only if, as of each annuity starting date after normal retirement age, the then-current balance of the hypothetical account or the then-current value of the accumulated percentage of the participant's final average compensation—

(A) Satisfies the requirements of section 411(a)(2); or

(B) Would satisfy the requirements of section 411(a)(2) but for the fact that the plan suspends benefits in accordance with section 411(a)(3)(B).

(iv) *Reductions limited.* A plan satisfies this paragraph (b)(2)(iv) only if the balance of the hypothetical account or accumulated percentage of the participant's final average compensation may not be reduced except as a result of—

(A) Benefit payments under paragraph (b)(3) of this section;

(B) Qualified domestic relations orders under section 414(p);

(C) Forfeitures that are permitted under section 411(a) (such as charges for providing a qualified preretirement survivor annuity);

(D) Amendments that are permitted under section 411(d)(6); or

(E) Adjustments resulting from the application of interest credits (under the rules of § 1.411(b)(5)–1) that are negative for a period, for plans that express the accumulated benefit as the balance of a hypothetical account.

(3) *Alternative forms of distribution under a lump sum-based benefit formula*—(i) *Payment of current account balance or current value.* The relief of paragraph (b)(1) of this section applies with respect to a single-sum payment equal to the then-current balance of a hypothetical account maintained for the participant or the then-current value of an accumulated percentage of the participant's final average compensation.

(ii) *Payment of benefits that are actuarially equivalent to current account balance or current value.* With respect to the benefits under a lump sum-based benefit formula, the relief of paragraph (b)(1) of this section applies to an optional form of benefit that is determined as of the annuity starting date as the actuarial equivalent, using reasonable actuarial assumptions, of the then-current balance of a hypothetical account maintained for the participant or the then-current value of an accumulated percentage of the participant's final average compensation.

(iii) *Payment of benefits based on immediate annuity.* With respect to the benefits under a lump sum-based benefit formula, the relief of paragraph (b)(1) of this section applies to an optional form of benefit that is not subject to the minimum present value requirements of section 417(e) and that is determined under the plan as of the annuity starting date as the actuarial equivalent (using reasonable actuarial assumptions) of the optional form of benefit that—

(A) Commences as of the same annuity starting date;

(B) Is payable in the same generalized optional form (within the meaning of § 1.411(d)–3(g)(8)) as the accrued benefit; and

(C) Is the actuarial equivalent (using reasonable actuarial assumptions) of the then-current balance of a hypothetical account maintained for the participant or the then-current value of an accumulated percentage of the participant's final average compensation.

(iv) *Payment of portion of current account balance or current value.* The relief of paragraph (b)(1) of this section applies on a proportionate basis to a payment of a portion of the benefit under a lump sum-based benefit formula that is not paid in a form otherwise described in this paragraph (b)(3), such as a payment of a specified dollar amount or percentage of the then-current balance of a hypothetical account maintained for the participant or then-current value of an accumulated percentage of the participant's final average compensation. Thus, for example, if a plan that expresses the participant's entire accumulated benefit as the balance of a hypothetical account distributes 40 percent of the participant's then-current hypothetical account balance in a single payment, the plan is treated as satisfying the requirements of section 411(a) and the minimum present value rules of section 417(e) with respect to 40 percent of the participant's then-current accrued

benefit. See paragraph (b)(3)(ii) or (iii) of this section for relief applicable with respect to a distribution with respect to the remainder (60 percent) of the participant's accumulated benefit.

(v) *Conditions for applicability.* This paragraph (b)(3) applies to a payment of benefits under a lump sum-based benefit formula only if the requirements of paragraph (b)(2) of this section are also satisfied.

(4) *Rules of application.* The relief of paragraph (b)(1) of this section applies only to the portion of the participant's benefit that is determined under a lump sum-based benefit formula and does not apply to any portion of the participant's benefit that is determined under a formula that is not a lump sum-based benefit formula. Thus, the following rules apply:

(i) *Greater-of formulas.* Where the participant's accrued benefit equals the greater of the benefit under a lump sum-based benefit formula and the benefit under another formula, a single-sum payment of the participant's entire benefit must equal the greater of the then-current accumulated benefit under the lump sum-based benefit formula and the present value, determined in accordance with section 417(e), of the benefit under the other formula.

Applying this rule where the non-lump sum-based benefit formula provides a benefit equal to a pro rata portion of the benefit determined by projecting a future hypothetical account balance (including future principal credits), a single-sum payment of the participant's entire benefit must equal the greater of the then-current balance of the hypothetical account and the present value, determined in accordance with section 417(e), of the pro-rata benefit determined by projecting the future hypothetical account balance.

(ii) *Sum-of formulas.* Where the accrued benefit equals the sum of the benefit under a lump sum-based benefit formula plus the excess of the benefit under another formula over the benefit under the lump sum-based benefit formula, a single-sum payment of the participant's entire benefit must equal the then-current accumulated benefit under the lump sum-based benefit formula plus the excess of the present value, determined in accordance with section 417(e), of the benefit under the other formula over the present value, determined in accordance with section 417(e), of the benefit under the lump sum-based benefit formula.

(e) \* \* \*  
(2) \* \* \*

(ii) *Special effective date.* Paragraphs (b)(2), (b)(3), and (b)(4) of this section

apply to plan years that begin on or after January 1, 2012.

\* \* \* \* \*

**Par. 3.** Section 1.411(b)–1 is amended by adding paragraph (b)(2)(ii)(G) and (b)(2)(ii)(H) to read as follows:

**§ 1.411(b)–1 Accrued benefit requirements.**

\* \* \* \* \*

(b) \* \* \*  
(2) \* \* \*  
(ii) \* \* \*

(G) Special rule for multiple formulas.

[Reserved]

(H) *Variable interest crediting rate under a statutory hybrid benefit formula.*

For plan years that begin on or after January 1, 2012, a plan that determines any portion of the participant's accrued benefit pursuant to a statutory hybrid benefit formula (as defined in § 1.411(a)(13)–1(d)(4)) that utilizes an interest crediting rate described in § 1.411(b)(5)–1(d) that is a variable rate that was less than zero for the prior plan year is not treated as failing to satisfy the requirements of paragraph (b)(2) of this section for the current plan year merely because the plan assumes for purposes of paragraph (b)(2) of this section that the variable rate is zero for the current plan year and all future plan years.

\* \* \* \* \*

**Par. 4.** Section 1.411(b)(5)–1 is amended by:

1. Revising paragraph (c)(3)(iii).
2. Adding *Example 8* to paragraph (c)(5).

3. Revising paragraphs (d)(1)(iv)(D), (d)(2)(ii), (d)(4)(iv), (d)(5)(ii), (d)(5)(iv), (d)(6)(ii), (d)(6)(iii), (e)(2), (e)(3)(iii), (e)(4), and (f)(2)(i)(B).

The revisions and addition read as follows:

**§ 1.411(b)(5)–1 Reduction in rate of benefit accrual under a defined benefit plan.**

\* \* \* \* \*

(c) \* \* \*  
(3) \* \* \*

(iii) *Comparison of benefits at effective date of conversion amendment—(A) In general.*

A plan satisfies the requirements of this paragraph (c)(3)(iii) with respect to a participant only if an opening hypothetical account balance is established to replicate the pre-conversion benefit and the requirements of paragraphs (c)(3)(iii)(B) through (c)(3)(iii)(G) of this section are each satisfied.

(B) *Single-sum payment.* At the annuity starting date, the participant elects to receive payment in the form of a single-sum distribution equal to the sum of the then-current balance of the

hypothetical account used to replicate the pre-conversion benefit and the benefit attributable to post-conversion service under the post-conversion benefit formula.

(C) *Not less than pre-conversion benefit.* In accordance with section 411(d)(6), the aggregate benefit payable at the annuity starting date after the effective date of the conversion amendment is not less than the benefit described in paragraph (c)(2)(i)(A) of this section.

(D) *Form of pre-conversion benefit.* The plan, as in effect immediately prior to the effective date of the conversion amendment, either did not provide a single-sum payment option (for benefits that cannot be immediately distributed under section 411(a)(11)) or provided a single-sum payment option that was based solely on the present value of the benefit payable at normal retirement age (or at date of benefit commencement, if later), and which was not based on the present value of the benefit payable commencing at any date prior to normal retirement age.

(E) *Minimum opening account balance.* The plan provides for the opening hypothetical account balance under paragraph (c)(3)(i) of this section to be established in accordance with rules under which the amount of this opening balance will not be less than the present value, determined in accordance with section 417(e), of the participant's accrued benefit under the plan immediately prior to the effective date of the conversion amendment.

(F) *Interest credits—(1) Requirement as of effective date of conversion amendment.* As of the effective date of the conversion amendment, the interest crediting rate under the plan is an interest crediting rate described in paragraph (d)(3) or (d)(4) of this section. In addition, as of that date, the value of the index used to determine the interest crediting rate under the plan is at least as great for every participant or beneficiary as the interest rate that was used pursuant to paragraph (c)(3)(iii)(E) of this section to determine the opening hypothetical account balance. This requirement is satisfied, for example, if each participant's opening hypothetical account balance is determined using the applicable interest rate and applicable mortality table under section 417(e)(3), the interest crediting rate under the plan is the third segment rate, and, at the effective date of the conversion amendment, the third segment rate is the highest of the three segment rates.

(2) *Requirement for later interest crediting rate changes.* If, subsequent to the effective date of the conversion amendment, the interest crediting rate

changes (whether by plan amendment or otherwise) with respect to a participant who was a participant at the time of the effective date of the conversion amendment from a particular interest crediting rate described in paragraph (d)(3) or (d)(4) of this section to a different interest crediting rate that is not in all cases at least as great as the prior interest crediting rate under the plan, then the new interest crediting rate does not apply to the existing hypothetical account balance as of the effective date of the change in interest crediting rates (or, if the plan created a subaccount consisting of the opening hypothetical account balance and interest credits on that subaccount, then the new interest crediting rate does not apply to the subaccount).

(G) *Death benefits.* The plan either—  
 (1) Provides a death benefit after the effective date of the conversion amendment which has a present value that is at all times at least equal to the then-current balance of the hypothetical account used to replicate the pre-conversion benefit; or

(2) Applied no pre-retirement mortality decrement in establishing the opening hypothetical account balance under paragraph (c)(3)(iii)(E) of this section.

\* \* \* \* \*  
 (c) \* \* \*  
 (5) \* \* \*

*Example 8.* (i) *Facts where plan establishes opening hypothetical account balance under paragraph (c)(3)(iii) of this section.* Employer O sponsors Plan F, a defined benefit plan that provides an accumulated benefit, payable as a straight life annuity commencing at age 65 (which is Plan F's normal retirement age), based on a percentage of highest average compensation times the participant's years of service. Plan F permits any participant who has had a severance from employment to elect payment in the following optional forms of benefit (with spousal consent if applicable), with any payment not made in a straight life annuity converted to an equivalent form based on reasonable actuarial assumptions: A straight life annuity; and a 50 percent, 75 percent, or 100 percent joint and survivor annuity. The payment of benefits may commence at any time after attainment of age 55, with an actuarial reduction if the commencement is before normal retirement age. In addition, the plan offers a single-sum payment after attainment of age 55 equal to the present value of the normal retirement benefit using the applicable interest rate and mortality table under section 417(e)(3) in effect under the terms of the plan on the annuity starting date. (These facts are the same as those in paragraph (i) of *Example 1*.)

(ii) *Facts relating to the conversion amendment and establishment of opening balance.* On January 1, 2012, Plan F is

amended to eliminate future accruals under the highest average compensation benefit formula and to base future benefit accruals on a hypothetical account balance. As of January 1, 2012, the plan establishes an opening hypothetical account balance for each individual who was a participant in the plan on December 31, 2011, equal to the present value of the participant's accumulated benefits, payable as a straight life annuity commencing at age 65, based on the actuarial assumptions then applicable under section 417(e)(3). New participants begin with a hypothetical account balance of zero on their date of participation. For service on or after January 1, 2012, each participant's hypothetical account balance is credited monthly with a pay credit equal to a specified percentage of the participant's compensation during the month and also with interest based on the third segment rate described in section 430(h)(2)(C)(iii). With respect to benefits under the hypothetical account balance, a participant is permitted to elect (with spousal consent) payment in the same generalized optional forms of benefit (even though different actuarial factors apply) as under the terms of the plan in effect before January 1, 2012, and also as a single-sum distribution. The plan provides that in no event will the benefit payable be less than the benefits attributable to service before January 1, 2012, to be determined under the terms of the plan as in effect immediately before the effective date of the amendment. In the event of death prior to the annuity starting date, the plan provides a death benefit equal to the hypothetical account balance (and allows a surviving spouse to elect payment in the form of an actuarially equivalent life annuity).

(iii) *Conclusion.* Plan F satisfies the requirements of paragraph (c)(3)(iii) of this section for participants who elect to receive payment in the form of a single-sum distribution equal to the hypothetical account balance in accordance with the requirements of paragraph (c)(3)(iii)(B) of this section for the following reasons. First, Plan F satisfies the requirements of paragraph (c)(3)(iii)(C) of this section because the benefit payable can never be less than the pre-conversion benefit, in accordance with the requirements of section 411(d)(6). Second, Plan F satisfies the requirements of paragraph (c)(3)(iii)(D) of this section because prior to conversion it provided for a single-sum payment option that was based solely on the present value of the benefit payable at normal retirement age. Third, Plan F satisfies the requirements of paragraph (c)(3)(iii)(E) of this section because the amount of the opening balance is not less than the present value of the participant's accrued benefit under the plan immediately prior to the effective date of the conversion amendment, as determined in accordance with section 417(e). Fourth, Plan F satisfies the requirements of paragraph (c)(3)(iii)(F) of this section because it provides for interest credits that are described in paragraph (d)(3) of this section on the opening balance and the interest credits are reasonably expected to be no lower than the interest rate used to determine the opening balance. This is the case because interest is credited at least

annually after the effective date of the conversion amendment and the interest rate used to establish the opening balance (which is based on the first, second, and third segment rates described in section 430(h)(2)(C) referenced under section 417(e)(3)) is not greater than the interest rate applicable under the third segment rate described in section 430(h)(2)(C)(iii) which the plan uses to determine interest for all future periods after the effective date of the conversion amendment. Fifth, Plan F satisfies the requirements of paragraph (c)(3)(iii)(G) of this section because it provides a death benefit after the effective date of the conversion amendment which has a present value that is at all times at least equal to the hypothetical account balance at the date of death.

\* \* \* \* \*  
 (d) \* \* \*  
 (1) \* \* \*  
 (iv) \* \* \*

(D) *Debits and credits during the interest crediting period.* A plan is not treated as failing to meet the requirements of this paragraph (d) merely because the plan does not provide for interest credits on amounts distributed prior to the end of the interest crediting period. Furthermore, a plan is not treated as failing to meet the requirements of this paragraph (d) merely because the plan calculates increases or decreases to the participant's accumulated benefit by applying a rate of interest or rate of return (including a rate of increase or decrease under an index) to the participant's adjusted accumulated benefit (or portion thereof) for the period. For this purpose, the participant's adjusted accumulated benefit equals the participant's accumulated benefit as of the beginning of the period, adjusted for debits and credits (other than interest credits) made to the accumulated benefit prior to the end of the interest crediting period, with appropriate weighting for those debits and credits based on their timing within the period. For plans that calculate increases or decreases to the participant's accumulated benefit by applying a rate of interest or rate of return to the participant's adjusted accumulated benefit (or portion thereof) for the period, interest credits include these increases and decreases, to the extent provided under the terms of the plan at the beginning of the period and to the extent not conditioned on current service and not made on account of imputed service (as defined in § 1.401(a)(4)-11(d)(3)(ii)(B)), and the interest crediting rate with respect to a participant equals the total amount of interest credits for the period divided by

the participant's adjusted accumulated benefit for the period.

\* \* \* \* \*

(2) \* \* \*

(ii) *Application to multiple annuity starting dates*—(A) *In general.* Paragraph (d)(2)(i) of this section applies only at an annuity starting date, within the meaning of § 1.401(a)–20, A–10(b), on which a distribution of the participant's entire benefit under the plan's statutory hybrid benefit formula as of that date commences. For a participant who has more than one annuity starting date, paragraph (d)(2)(ii)(B) of this section provides rules for the application of paragraph (d)(2)(i) of this section, taking into account prior distributions. If the comparison under paragraph (d)(2)(ii)(B) of this section results in the sum of principal credits exceeding the sum of the amounts described in paragraphs (d)(2)(ii)(B)(1) through (d)(2)(ii)(B)(3) of this section, then the participant's benefit to be distributed at the current annuity starting date is increased by an amount equal to the excess.

(B) *Comparison to reflect prior distributions.* For a participant who has more than one annuity starting date, the sum of all principal credits credited to the participant under the plan, as of the current annuity starting date, is compared to the sum of—

(1) The participant's benefit as of the current annuity starting date;

(2) The amount of the offset to the participant's benefit under the statutory hybrid benefit formula that is attributable to any prior distribution of the participant's benefit under that formula; and

(3) The amount of any increase to the participant's benefit as a result of the application of paragraph (d)(2)(i) of this section to a prior distribution.

\* \* \* \* \*

(4) \* \* \*

(iv) *Fixed rate of interest.* An annual interest crediting rate equal to a fixed 5 percent is deemed to be not in excess of the interest rate described in paragraph (d)(3) of this section.

\* \* \* \* \*

(5) \* \* \*

(ii) *Actual rate of return on plan assets.* An interest crediting rate equal to the actual rate of return on the aggregate assets of the plan, including both positive returns and negative returns, is not in excess of a market rate of return if the plan's assets are diversified so as to minimize the volatility of returns. This requirement that plan assets be diversified so as to minimize the volatility of returns does not require greater diversification than

is required under section 404(a)(1)(C) of Title I of the Employee Retirement Income Security Act of 1974, Public Law 93–406 (88 Stat. 829 (1974)) with respect to defined benefit pension plans.

\* \* \* \* \*

(iv) *Rate of return on certain RICs.* An interest crediting rate is not in excess of a market rate of return if it is equal to the rate of return on a regulated investment company (RIC), as defined in section 851, that is reasonably expected to be not significantly more volatile than the broad United States equities market or a similarly broad international equities market. For example, a RIC that has most of its assets invested in securities of issuers (including other RICs) concentrated in an industry sector or a country other than the United States, that uses leverage, or that has significant investment in derivative financial products, for the purpose of achieving returns that amplify the returns of an unleveraged investment, generally would not meet this requirement. Thus, a RIC that has most of its investments concentrated in the semiconductor industry or that uses leverage in order to provide a rate of return that is twice the rate of return on the Standard & Poor's 500 index (S&P 500) would not meet this requirement. On the other hand, a RIC whose investments track the rate of return on the S&P 500, a broad-based “small-cap” index (such as the Russell 2000 index), or a broad-based international equities index would meet this requirement.

\* \* \* \* \*

(6) \* \* \*

(ii) *Annual or more frequent floor applied to bond-based rates.* An interest crediting rate under a plan does not fail to be described in paragraph (d)(3) or (d)(4) of this section for an interest crediting period merely because the plan provides that the interest crediting rate for that interest crediting period equals the greater of—

(A) An interest crediting rate described in paragraph (d)(3) or (d)(4) of this section; and

(B) An annual interest rate of 4 percent (or a pro rata portion of an annual interest rate of 4 percent for plans that provide interest credits more frequently than annually).

(iii) *Cumulative floor applied to equity-based or bond-based rates*—(A) *In general.* A plan that determines interest credits under a statutory hybrid benefit formula using a particular interest crediting rate described in paragraph (d)(3), (d)(4), or (d)(5) of this section (or an interest crediting rate that can never be in excess of a particular

interest crediting rate described in paragraph (d)(3), (d)(4), or (d)(5) of this section) does not provide an effective interest crediting rate in excess of a market rate of return merely because the plan provides that the participant's benefit under the statutory hybrid benefit formula determined as of the participant's annuity starting date is equal to the greater of—

(1) The benefit determined using the interest crediting rate; and

(2) The benefit determined as if the plan had used a fixed annual interest crediting rate equal to 3 percent (or a lower rate) for all principal credits that are made during the guarantee period (minimum guarantee amount).

(B) *Guarantee period defined.* The guarantee period is the prospective period which begins on the date on which the cumulative floor described in this paragraph (d)(6)(iii) begins to apply to the participant's benefit and which ends on the date on which that cumulative floor ceases to apply to the participant's benefit.

(C) *Application to multiple annuity starting dates.* The determination under paragraph (d)(6)(iii)(A) of this section is made only at an annuity starting date, within the meaning of § 1.401(a)–20, A–10(b), on which a distribution of the participant's entire benefit under the plan's statutory hybrid benefit formula as of that date commences. For a participant who has more than one annuity starting date, paragraph (d)(6)(iii)(D) of this section provides rules for the application of paragraph (d)(6)(iii)(A) of this section, taking into account any prior distributions. If the comparison under paragraph (d)(6)(iii)(D) of this section results in the minimum guarantee amount exceeding the sum of the amounts described in paragraphs (d)(6)(iii)(D)(1) through (d)(6)(iii)(D)(3) of this section, then the participant's benefit to be distributed at the current annuity starting date is increased by an amount equal to the excess.

(D) *Comparison to reflect prior distributions.* For a participant who has more than one annuity starting date, the minimum guarantee amount (described in paragraph (d)(6)(iii)(A)(2) of this section), as of the current annuity starting date, is compared to the sum of—

(1) The participant's benefit, as of the current annuity starting date, to which a minimum guaranteed rate described in paragraph (d)(6)(iii)(A)(2) of this section applies;

(2) The amount of the offset to the participant's benefit under the statutory hybrid benefit formula that is attributable to any prior distribution of

the participant's benefit under that formula and to which a minimum guaranteed rate described in paragraph (d)(6)(iii)(A)(2) of this section applied, together with interest at that minimum guaranteed rate annually from the prior annuity starting date to the current annuity starting date; and

(3) The amount of any increase to the participant's benefit as a result of the application of paragraph (d)(6)(iii)(A) of this section to any prior distribution, together with interest annually at the minimum guaranteed rate that applied to the prior distribution from the prior annuity starting date to the current annuity starting date.

(E) *Application to portion of participant's benefit.* A cumulative floor described in this paragraph (d)(6)(iii) may be applied to a portion of a participant's benefit, provided the requirements of this paragraph (d)(6)(iii) are satisfied with respect to that portion of the benefit. If a cumulative floor described in this paragraph (d)(6)(iii) applies to a portion of a participant's benefit, only the principal credits that are attributable to that portion of the participant's benefit are taken into account in determining the amount of the guarantee described in paragraph (d)(6)(iii)(A)(2) of this section.

\* \* \* \* \*

(e) \* \* \*

(2) *Plan termination*—(i) *In general*—(A) *Interest crediting rates.* If the interest crediting rate used to determine a participant's accumulated benefit (or a portion thereof) has been a variable rate during the interest crediting periods in the 5-year period ending on the plan termination date (including any case in which the rate was not the same fixed rate during all such periods), then a statutory hybrid plan is treated as meeting the requirements of section 411(b)(5)(B)(i) and paragraph (d)(1) of this section only if the terms of the plan satisfy the requirements of paragraph (e)(2)(ii) of this section. See regulations of the Pension Benefit Guaranty Corporation for additional rules that apply when a pension plan is terminated.

(B) *Annuity conversion factors.* A statutory hybrid plan is treated as meeting the requirements of section 411(b)(5)(B)(i) and paragraph (d)(1) of this section only if the terms of the plan provide that the interest rate and mortality table (including tabular adjustment factors) used on and after plan termination for purposes of determining the amount of any benefit under the plan payable in the form of an annuity commencing at or after normal retirement age are the interest rate and

mortality table specified under the plan for that purpose as of the termination date, except that if the interest rate is a variable rate (as described in paragraph (e)(2)(i) of this section), then the interest rate for that purpose is determined pursuant to the rules of paragraph (e)(2)(ii) of this section.

(ii) *Interest crediting rates that are variable*—(A) *General rule.* Subject to the other rules in this paragraph (e)(2), a plan satisfies this paragraph (e)(2)(ii) only if the terms of the plan provide that, on the plan termination date, if the interest crediting rate used to determine a participant's accumulated benefit has been a variable rate as described in paragraph (e)(2)(i) of this section, then the interest crediting rate used to determine the participant's accumulated benefit under the plan after the date of plan termination is equal to the average of the interest crediting rates used under the plan during the 5-year period ending on the plan termination date. For this purpose, an interest crediting rate is used under the plan if the rate applied under the terms of the plan during an interest crediting period for which the interest crediting date is within the 5-year period ending on the plan termination date and the average is determined as the arithmetic average of the rates used, with each rate adjusted to reflect the length of the interest crediting period and the average rate expressed as an annual rate.

(B) *Variable interest crediting rates that are based on interest rates.* With respect to an interest crediting rate that was a variable interest rate described in paragraph (d)(3) or (d)(4) of this section (taking into account the rules of paragraph (d)(6)(ii) of this section), a variable interest rate that can never be in excess of a rate described in paragraph (d)(3) or (d)(4) of this section, or a fixed interest rate that has not been the same rate during the entire 5-year period ending on the plan termination date, the actual interest rate that applied under the plan for the interest crediting period is used for purposes of determining the average interest crediting rate. For this purpose, the rate that applied for the interest crediting period takes into account minimums, maximums, and other reductions that applied in the period, other than cumulative floors under paragraph (d)(6)(iii) of this section.

(C) *Variable interest crediting rates that are other rates of return.* With respect to any interest crediting rate not described in paragraph (e)(2)(ii)(B) of this section (that is, a variable rate described in paragraph (d)(5) of this section), the interest crediting rate that applied for the interest crediting period

for purposes of determining the average interest crediting rate is deemed to be equal to the third segment rate under section 430(h)(2)(C)(iii) for the last calendar month ending before the beginning of the interest crediting period, as adjusted to account for any minimums or maximums that applied in the period (other than cumulative floors under paragraph (d)(6)(iii) of this section), but without regard to other reductions that applied in the period. Thus, for example, if the actual interest crediting rate in an interest crediting period was equal to the rate of return on plan assets, but not greater than 5 percent, then for purposes of determining the plan's average interest crediting rate, the interest crediting rate for that interest crediting period would be deemed to equal the lesser of the applicable third segment rate for the period and 5 percent. However, if the actual interest crediting rate in an interest crediting period was equal to the rate of return on plan assets minus 200 basis points, then for purposes of determining the plan's average interest crediting rate, the interest crediting rate for that interest crediting period would be deemed to equal the third segment rate.

(iii) *Rules of application*—(A) *Section 411(d)(6) protected benefits.* In general, for purposes of determining the average interest crediting rate under paragraph (e)(2)(ii) of this section, the interest crediting rate that applied for each interest crediting period is the ongoing interest crediting rate that was specified under the plan in that period, without regard to any section 411(d)(6) protected benefit using an interest crediting rate that applied under the plan prior to amendment. However, if, at the end of the last interest crediting period prior to plan termination, the participant's accumulated benefit is based on a section 411(d)(6) protected benefit that results from a prior amendment to change the rate of interest crediting applicable under the plan, then, for purposes of determining the average interest crediting rate under paragraph (e)(2)(ii) of this section, the pre-amendment interest crediting rate is treated as having applied for each interest crediting period after the date of the interest crediting rate change.

(B) *Weighted averages.* If the plan determines the interest credit in any interest crediting period by applying different rates to different predetermined portions of the accumulated benefit under paragraph (d)(1)(vii) of this section, then, for purposes of determining the average interest crediting rate under paragraph (e)(2)(ii) of this section, the interest

crediting rate that applied for the interest crediting period is the weighted average of the relevant interest rates that apply, under the rules of paragraph (e)(2)(ii) of this section, to each portion of the accumulated benefit.

(C) *Participants with less than five years of interest credits upon plan termination.* If the plan provided for interest credits for any interest crediting period in which, pursuant to the terms of the plan, the individual was not eligible to receive interest credits (because the individual was not a participant or beneficiary in the relevant interest crediting period or otherwise), then, for purposes of determining the individual's average interest crediting rate under paragraph (e)(2)(ii) of this section, the individual is treated as though the individual received interest credits in that period using the interest crediting rate that applied in that period under the terms of the plan to a similarly situated participant or beneficiary who was eligible to receive interest credits. However, if, under the terms of the plan, the individual was not eligible to receive any interest credits during the entire 5-year period ending on the plan termination date, then the rules under paragraph (e)(2)(ii) do not apply to determine the individual's benefit after plan termination.

(iv) *Examples.* The following examples illustrate the rules of this paragraph (e)(2). In each case, it is assumed that the plan is terminated in a standard termination.

*Example 1. (i) Facts.* Plan A is a defined benefit plan with a calendar plan year that expresses each participant's accumulated benefit in the form of a hypothetical account balance to which principal credits are made at the end of each calendar quarter and to which interest is credited at the end of each calendar quarter based on the balance at the beginning of the quarter. Interest credits under Plan A are based on a rate of interest fixed at the beginning of each plan year equal to the third segment rate for the preceding December, except that the plan used the rate of interest on 30-year Treasury bonds (instead of the third segment rate) for plan years before 2012. The plan is terminated on March 3, 2016. The third segment rate credited under Plan A from January 1, 2012, through December 31, 2015, is assumed to be: 6 percent annually for each of the four quarters in 2015 (1.5 percent quarterly); 6.5 percent annually for each of the four quarters in 2014 (1.625 percent quarterly); 6 percent annually for each of the four quarters in 2013 (1.5 percent quarterly); and 5.5 percent annually for each of the four quarters in 2012 (1.375 percent quarterly). The rate of interest on 30-year Treasury bonds credited under Plan A for each of the four quarters in 2011 is assumed to be 4.4 percent annually (1.1 percent quarterly).

(ii) *Conclusion.* Pursuant to paragraph (e)(2)(ii)(B) of this section, the interest crediting rate used to determine accrued benefits under the plan on and after the date of plan termination is 5.68 percent. This is determined by calculating the average quarterly rate of 1.42 percent (the sum of 1.5 percent times 4, 1.625 times 4, 1.5 times 4, 1.375 times 4, and 1.1 percent times 4, divided by the 20 quarters that end in the 5-year period from March 4, 2011 to March 3, 2016) and multiplying such rate by 4 to determine the average annual rate.

*Example 2. (i) Facts. The facts are the same as Example 1, except that Participant B commenced participation in Plan A on April 17, 2013.*

(ii) *Conclusion.* Pursuant to paragraph (e)(2)(iii)(C) of this section, the interest crediting rate used to determine Participant B's accrued benefits under Plan A on and after the date of plan termination is 5.68 percent, which is the same rate that would have applied to Participant B if Participant B had participated in the plan during the 5-year period preceding the date of plan termination, as described in *Example 1*.

*Example 3. (i) Facts.* Plan C is a defined benefit plan with a calendar plan year that expresses each participant's accumulated benefit in the form of a hypothetical account balance to which principal credits are made at the end of each calendar year and to which interest is credited at the end of each calendar year based on the balance at the end of the preceding year. The plan is terminated on January 27, 2014. The plan's interest crediting rate for each calendar year during the entire 5-year period ending on the plan termination date is equal to (A) 50 percent of the greater of the rate of interest on 3-month Treasury Bills for the preceding December and an annual rate of 4 percent, plus (B) 50 percent of the rate of return on plan assets. The rate of interest on 3-month Treasury Bills credited under Plan C is assumed to be: 3.4 percent for 2013; 4 percent for 2012; 4.5 percent for 2011; 3.5 percent for 2010; and 4.2 percent for 2009. Each of these rates applied under Plan C for interest credited during this period for purposes of the interest credits described in clause (A) of this paragraph (i), except that the 4 percent minimum rate applied for 2013 and 2010. For purposes of the interest credits described in clause (B) of this paragraph (i), the rate of interest on the third segment rate in the prior years (based on the rate for the preceding December) is assumed to be: 6 percent for 2013; 6.5 percent for 2012; 6 percent for 2011; 5.5 percent for 2010; and 6 percent for 2009.

(ii) *Conclusion.* Pursuant to paragraph (e)(2)(ii) of this section, the interest crediting rate used to determine accrued benefits under the plan on and after the date of plan termination is 5.07 percent. This number is equal to the sum of 50 percent of 4.14 percent (which is the sum of 4 percent, 4 percent, 4.5 percent, 4 percent, and 4.2 percent, divided by 5), and 50 percent of 6 percent (which is the average third segment rate for the 5 interest crediting periods ending within the 5-year period).

*Example 4. (i) Facts.* The facts are the same as in *Example 3*, except that the plan had credited interest before January 1, 2012, using the rate of return on a RIC and was amended effective January 1, 2012, to base interest credits for all plan years after 2011 on the interest rate formula described in *Example 3*(i). In order to comply with section 411(d)(6), the plan provides that, for each participant or beneficiary who was a participant on December 31, 2011, the benefits at any date are based on either the ongoing hypothetical account balance on that date (which is based on the December 31, 2011 balance, with interest credited thereafter at the rate described in the first sentence of *Example 3*(i) and taking principal credits after 2011 into account) or a special hypothetical account balance (the pre-2012 balance) on that date, whichever balance is greater. For each participant, the pre-2012 balance is a hypothetical account balance equal to the participant's December 31, 2011, balance, with interest credited thereafter at the RIC rate of return, but with no principal credits after 2011. There are 10 participants for whom his or her pre-2012 balance exceeded his or her ongoing hypothetical account balance at the end of 2013.

(ii) *Conclusion.* Since Plan C credited interest prior to 2012 using the rate of return on a RIC (a rate not described in paragraph (d)(3) or (d)(4) of this section), for purposes of determining the average interest crediting rate upon plan termination, the interest crediting rate used to determine accrued benefits under Plan C for all participants during those periods (for the calendar years 2009, 2010, and 2011) is deemed to be equal to the third segment rate for the preceding December. In addition, since the pre-2012 balances exceeded the ongoing hypothetical account balance for 10 participants in the last interest crediting period prior to plan termination, for purposes of determining the average interest crediting rate upon plan termination, the interest crediting rate used to determine accrued benefits under Plan C for 2012 and 2013 for those participants is deemed to be equal to the third segment rate for the month of December preceding 2012 and the month of December preceding 2013, respectively. For all other participants, for purposes of determining the average interest crediting rate upon plan termination, the interest crediting rate used to determine accrued benefits under Plan C for 2012 and 2013 is based on the ongoing interest crediting rate (the formula described in *Example 3*).

(3) \* \* \*

(iii) *Coordination of section 411(d)(6) and market rate of return limitation—*  
(A) *In general.* An amendment to a statutory hybrid plan that preserves a section 411(d)(6) protected benefit is subject to the rules under paragraph (d) of this section relating to market rate of return. However, in the case of an amendment to change a plan's interest crediting rate for periods after the applicable amendment date from one interest crediting rate (the old rate) that satisfies the requirements of paragraph

(d) of this section to another interest crediting rate (the new rate) that satisfies the requirements of paragraph (d) of this section, the plan's effective interest crediting rate is not in excess of a market rate of return for purposes of paragraph (d) of this section merely because the plan provides for the benefit of any participant who is benefiting under the plan (within the meaning of § 1.410(b)-3(a)) on the applicable amendment date to never be less than what it would be if the old rate had continued but without taking into account any principal credits (as defined in paragraph (d)(1)(ii)(D) of this section) after the applicable amendment date.

(B) *Multiple amendments.* A pattern of repeated plan amendments each of which provides for a prospective change in the plan's interest crediting rate with respect to the benefit as of the applicable amendment date will be treated as resulting in the ongoing plan terms providing that the interest crediting rate equals the greater of each of the interest crediting rates, so that the rule in paragraph (e)(3)(iii)(A) of this section would not apply. See § 1.411(d)-4, A-1(c)(1).

(4) *Actuarial increases after normal retirement age.* A statutory hybrid plan is not treated as providing an effective interest crediting rate that is in excess of a market rate of return for purposes of paragraph (d) of this section merely because the plan provides that the participant's benefit, as of each annuity starting date after normal retirement age, is equal to the greater of—

(i) The benefit determined using an interest crediting rate that is not in excess of a market rate of return under paragraph (d) of this section; and

(ii) The benefit that satisfies the requirements of section 411(a)(2).

\* \* \* \* \*

(f) \* \* \*

(2) \* \* \*

(i) \* \* \*

(B) *Special effective date.* Paragraphs (c)(3)(iii), (d)(1)(iii), (d)(1)(iv)(D), (d)(1)(vi), (d)(2)(ii), (d)(4)(iv), (d)(5)(iv), (d)(6), (e)(2), (e)(3)(iii), and (e)(4) of this section apply to plan years that begin on or after January 1, 2012.

\* \* \* \* \*

**Steven T. Miller,**  
*Deputy Commissioner for Services and Enforcement.*

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**DEPARTMENT OF LABOR**

**Occupational Safety and Health Administration**

[Docket No. OSHA-2010-0032]

**29 CFR Parts 1910 and 1926**

**Interpretation of OSHA's Provisions for Feasible Administrative or Engineering Controls of Occupational Noise**

**AGENCY:** Occupational Safety and Health Administration (OSHA)

**ACTION:** Proposed interpretation.

**SUMMARY:** This document constitutes OSHA's official interpretation of the term *feasible administrative or engineering controls* as used in the applicable sections of OSHA's General Industry and Construction Occupational Noise Exposure standards. Under the standard, employers must use administrative or engineering controls rather than personal protective equipment (PPE) to reduce noise exposures that are above acceptable levels when such controls are feasible. OSHA proposes to clarify that *feasible* as used in the standard has its ordinary meaning of capable of being done. The Agency intends to revise its current enforcement policy to reflect this interpretation. The Agency solicits comments from interested parties on this interpretation.

**DATES:** Submit comments on or before December 20, 2010.

**ADDRESSES:** You may submit comments by any of the following methods:

*Electronically:* You may submit comments and attachments electronically at <http://www.regulations.gov>, the Federal eRulemaking Portal. Follow the instructions online for making electronic submissions;

*Fax:* You may fax submissions not longer than 10 pages, including attachments, to the OSHA Docket Office at 202-693-1648.

*Mail, hand delivery, express mail, messenger and courier service:* If you use this option, you must submit three copies of your comments and attachments to the OSHA Docket Office, Docket No. OSHA-2010-0032, U.S. Department of Labor, Room N-2625, 200 Constitution Avenue, NW., Washington, DC 20210. Deliveries (hand, express mail, messenger and courier service) are accepted from 8:15 a.m.-4:45 p.m., e.t.

*Instructions:* All submissions must include the agency name and the OSHA docket number for this interpretation (OSHA-2010-0032). Submissions are placed in the public docket without

change and may be accessed online <http://www.regulations.gov>. Be careful about submitting personal information such as social security numbers and birth dates.

*Docket:* To read or download submissions or other material in the docket, go to <http://www.regulations.gov> or the OSHA Docket Office at the address above. All documents in the docket are listed in the <http://www.regulations.gov> index; some information (e.g., copyrighted material), however, can not be read or downloaded at the website. All submissions, including copyrighted material, can be examined or copied at the OSHA Docket Office.

**FOR FURTHER INFORMATION CONTACT:**  
*General information or press inquiries:* MaryAnn Garrahan, Acting Director, Office of Communications, Room N-3647, OSHA, U.S. Department of Labor, 200 Constitution Avenue, NW., Washington, DC 20210; telephone 202-693-1999.

*For Technical Inquiries:* Audrey Proffitt, Senior Industrial Hygienist, Directorate of Enforcement Programs, Room N-3119, OSHA, U.S. Department of Labor, 200 Constitution Avenue, NW., Washington, DC 20210; telephone: 202-693-2190, or fax: 202-693-1681.

**SUPPLEMENTARY INFORMATION:** This **Federal Register** document sets out OSHA's proposed interpretation of *feasible administrative or engineering controls* in 29 CFR 1910.95(b)(1) and 1926.52(b) for the purpose of enforcing compliance with these standards. This document does not address feasibility in any other context. Sections 1910.95(b)(1) and 1926.52(b), which are substantively identical, require that when employees are exposed to sound exceeding the permissible level, feasible administrative or engineering controls must be utilized to reduce the sound to within that level, and if such controls are ineffective, personal protective equipment must be provided and used. *Feasibility* encompasses both economic and technological considerations, but this document addresses only economic feasibility. Under OSHA's current enforcement policy, the agency issues citations for failure to use engineering and administrative controls only when hearing protectors are ineffective or the costs of such controls are *less* than the cost of an effective hearing conservation program.

As discussed below, this policy is contrary to the plain meaning of the standard and thwarts the safety and health purposes of the OSH Act by rarely requiring administrative and engineering controls even though these