

FYI[®] Alert

For Your Information[®]

Volume 37 | Issue 128 | September 19, 2014

IRS Releases Final “Market Rate” Regs for Hybrid Plans

IRS has released final regulations that define the limitations to be observed by a hybrid plan in determining any interest rate credit provided on hypothetical accounts. The final rules increase the permitted fixed interest rate floors, add an option to use actual rate of return based on only a portion of the plan’s trust, and refine the rules for plan terminations. The IRS has deferred making a decision on designs that allow for participant investment choice. Newly proposed rules, released contemporaneously, suggest how IRS will provide anticutback protection for future interest rate credits that must be curtailed to meet the final regulations.

Background

The Pension Protection Act of 2006 ushered in new rules for cash balance and other hybrid plans to address a number of technical issues that had been litigated with uneven results in the courts. In an effort to resolve technical issues and clear the way for these nontraditional designs, PPA excused these plans from the historical minimum present value requirement that had created so-called “whipsaw,” imposed a three-year vesting requirement, and added specific rules aimed at preventing age discrimination.

In 2010, IRS finalized PPA regulations for these plans, with the exception of certain limits on the interest rate credit that these plans can provide, which cannot exceed a “market rate of return.” Proposed rules were provided that explain the IRS’ remaining concerns and potential limitations that would be imposed under final regulations about the permitted market rate of return.

Final Regulations on Market Rates

Yesterday, IRS released these long-awaited [final rules](#), which will generally apply to plan years beginning on or after January 1, 2016. Key points from the regulation include:

- For plans providing a single fixed interest rate, the rate can be as high as 6% instead of the 5% rate allowed by the proposed regulation.
- For plans crediting a government bond or CPI variable rate (with or without additional margins allowed by Notice 96-8) and providing a fixed interest rate floor, the floor rate can now be as high as 5% annually instead of the 4% rate in the proposed regulation.

- All plans are permitted to provide a cumulative floor at benefit commencement, not to exceed providing compound interest at 3% per year.
- Plan designs that include participant choice of investment for determining interest credits are “under further study.” Future anticutback relief for plans using this approach will be limited to those that had already adopted and implemented these provisions by September 18, 2014.
- For plan conversions, the IRS has abandoned the “set it and forget it” approach to creating an opening balance. The accrued benefit at conversion with its associated option and early retirement factors must be considered when benefits are ultimately distributed.
- Plans can obtain the relief from whipsaw provided by PPA even if subsidized early retirement or other optional forms of payment are provided, but not if such benefits are less than the benefit that is actuarially equivalent to the account balance using reasonable actuarial assumptions.

Proposed Anticutback Regulations

Companion [proposed regulations](#) describe the IRS’ thoughts on transitioning to the requirements in the final regulations for situation where the final regulations are more restrictive than what a plan currently has in place. The proposed rules allow reductions in prospective interest crediting rates and address situations where there may be other acceptable approaches to coming into compliance.

In Closing

Additional details will be provided shortly.

Authors

Marjorie Martin, EA, MAAA, MSPA
Douglas K German, FSA, EA, MAAA
Jay P. Rosenberg, EA, FSA, MAAA, FCA

Produced by the Knowledge Resource Center of Buck Consultants at Xerox

The Knowledge Resource Center is responsible for national multi-practice compliance consulting, analysis and publications, government relations, research, surveys, training, and knowledge management. For more information, please contact your account executive or email fyi@xerox.com.

You are welcome to distribute *FYI*® publications in their entirety. To manage your subscriptions, or to sign up to receive our mailings, visit our [Subscription Center](#).

This publication is for information only and does not constitute legal advice; consult with legal, tax and other advisors before applying this information to your specific situation.