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Relief for Amending Hybrid Plan Interest Crediting Rates

Final IRS regulations have been released on permitted amendments to hybrid plans to reduce interest crediting rates to acceptable market rates of returns under the Pension Protection Act of 2006 without violating the qualified plan anti-cutback rule. The regulations permit plan sponsors to amend plans up to the beginning of the 2017 plan year — as late as the beginning of the 2019 plan year for collectively bargained plans.

Background

Proposed regulations on the transition rules for the final market rate of return regulations were issued back in 2014 along with the second set of final regulations on the Pension Protection Act of 2006 (PPA) changes to the hybrid plan rules. These were needed to allow sponsors to amend their plans to meet restrictions in the final rules without violating the usual anti-cutback rule that would have required the plans to continue crediting interest at a higher rate than permitted. See our October 2, 2014 *For Your Information* for highlights of the final and proposed regulations.

Under the proposed hybrid plan regulations, it was anticipated that plan sponsors would get any necessary amendments to comply with the market rate of return requirement in place before the January 1, 2016 effective date (for calendar year plans). But plan sponsors were told to wait until final anti-cutback rules were in place if a change in the plan's interest crediting rate was needed. As the deadline drew near, it became clear that adopting amendments by the end of the 2015 plan year would be difficult.

More Time

The final transition rules substitute an effective date of the plan year beginning on or after January 1, 2017 for the sections in the 2014 regulation that would have been effective for the plan year beginning on or after January 1, 2016. For collectively bargained plans, even more time is allowed. Such plans have until the earlier of the plan year beginning on or after (1) January 1, 2019, or (2) the date collective bargaining agreements in effect on November 13, 2015 expire, if that date is later than the general January 1, 2017 deadline.

To be clear, the additional year applies to requirements that would have gone into effect for 2016. These are generally requirements related to the market rate of return maximum. Among the other extended items are the mandate that a lump sum-based benefit formula set any lump sum distribution of that formula equal to the

accumulated benefit under the formula, and that other options be at least equal to the then current balance using reasonable assumptions.

> **Key Point.** The additional time to comply with these sections of the final regulations does not allow for more time to adopt other required amendments such as an amendment implementing the PPA vesting requirement or to eliminate whipsaw without providing a grandfathered benefit value. Earlier deadlines applied for those requirements.

More Options for Correcting Noncompliant Interest Crediting Rates

The final regulation adds some flexibility, but generally retains the “silo” approach to aligning the plan’s rate to an effective rate of return that does not exceed a market rate. Amendments to bring the plan into compliance will need to revise the specific feature that is noncompliant without changing other existing features. If the plan provides for multiple interest crediting rate groups or investment options, the rules apply separately to each of these. The regulations also state that a plan can substitute a higher compliant rate if it can never be less than the rate determined after applying these adjustments. Here’s the basic outline of the required changes.

Noncompliant Feature	Acceptable Change
Timing and similar rules:	
Bond-based rate uses impermissible basis for determining applicable rate, such as rate on the last day of a month rather than for a lookback month, average of months, and stability period under the 417(e) regulation	For a bond-based rate, adopt a compliant lookback and stability period, ***or*** cap the rate at a third segment rate (long-term lump sum or funding rate – with or without stability adjustments) that satisfies the lookback and stability rules
Investment-based rate credits interest based on a period other than the allocation period	For an investment-based rate, align the current effective rate period with the interest crediting period
Fixed rate too high:	
Interest crediting rate is a fixed rate in excess of 6%	Reduce rate to 6%
Bond-based rate adds excessive margin:	
Bond-based rate adds margin in excess of the margin specifically permitted in regulation	Reduce to the maximum margin permitted for the underlying rate, ***or*** cap the rate at a third segment rate (and retain any fixed minimum, adjusted as necessary to meet the rules for floor rates)
Bond-based rate with excessive floor	
Bond-based rate with an annual or more frequent fixed floor in excess of the permitted rates (4% for a segment rate or 5% for other rates)	Reduce the fixed minimum to the highest permitted rate, ***or*** change the rate to a fixed rate of 6%, ***or*** cap the rate at a third segment rate (with fixed 4% minimum)

Noncompliant Feature	Acceptable Change
Multiple bond-based rates Rate is set at greatest of two or more bond-based rates	Cap the rate at a third segment rate
Impermissible bond-based rate Rate is bond-based, but not one of the specific rates permitted in the regulation	Substitute one of the permitted rates that has similar duration and quality characteristics ***or*** cap at a third segment rate
Impermissible investment-based rate Rate is investment-based (actual investments or an index) that is not based on plan assets, an annuity contract, or a RIC (regulated investment company/mutual fund) that complies with any applicable diversification or volatility requirements	Substitute one of the permitted rates based on actual plan assets or a RIC that has similar duration and quality characteristics
Investment-based rate with excessive floor Investment-based rate with an annual or more frequent fixed floor in excess of the permitted rates (3% cumulative floor)	Remove any minimum or adjustment to the investment-based rate ***or*** substitute the third segment rate (with a fixed annual minimum up to 4%)
Other impermissible investment-based rates Even after adjustments specified above for investment-based rates, the rate is not compliant	Substitute an acceptable investment-based rate similar to the impermissible rate but without the characteristics that cause it to be impermissible ***or*** substitute the third segment rate (with a fixed minimum of 4%)

Unanswered Questions

The IRS noted that, in addition to comments on the transition rules, they received comments asking for further information on the regulations that already had been finalized. For example, comments asked how a cash balance plan that had not eliminated whipsaw could now be changed to fit into the final definition of a lump sum-based plan. Others asked for guidance on how balances should be projected to reflect future investment returns for purposes of nondiscrimination testing, IRC 415, and accrual rule testing. None of these various questions were addressed in the transition regulation, nor was there a hint of whether there might be additional guidance to respond to these questions any time soon. In addition, the question of whether a cash balance plan providing for individual investment direction is permitted remains unanswered.

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In Closing

Although there are still open questions that may keep some sponsors from deciding on all amendments needed to bring their plans into compliance with the PPA requirements, this last piece of the puzzle should set the stage for a final review, adjustment to administrative procedures, and formal amendments to memorialize decisions to the extent possible.

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