

**MEMO# 19907**

March 31, 2006

# **IRS Issues Final Regulations on Relative Value Disclosures**

©2006 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [19907] March 31, 2006 TO: PENSION MEMBERS No. 22-06 PENSION OPERATIONS ADVISORY COMMITTEE No. 9-06 RE: IRS ISSUES FINAL REGULATIONS ON RELATIVE VALUE DISCLOSURES The IRS released revised final regulations under section 417(a)(3) of the Internal Revenue Code regarding disclosure of the relative value and financial effect of optional forms of benefit.<sup>1</sup> The regulations generally require defined benefit plans to disclose the relative value of each optional form of benefit as compared to the value of the QJSA and the financial effect of electing each optional form of benefit. Defined contribution plans subject to the QJSA rules<sup>2</sup> generally are required to describe the financial effect of electing each optional form of benefit, including a statement that an annuity form of benefit will be provided by purchasing an annuity from an insurance company using the participant's account balance. As described below, for certain QJSA explanations provided before January 1, 2007, a reasonable good faith effort to comply with the final regulations will satisfy the requirements. Effective Dates Final regulations on relative value disclosures originally were issued in 2003, effective for QJSA explanations provided with respect to annuity starting dates beginning on or after October 1, 2004. In response to comments from the Institute<sup>3</sup> and others regarding the significant system modifications and extensive review of optional forms of benefit necessary to comply with the regulations, the IRS postponed the generally applicable effective date until February 1, 2006 (i.e., for QJSA explanations 1 A copy of the final regulations is attached. These disclosures are part of the written qualified joint and survivor annuity (QJSA) explanation that must be provided to a participant 30 to 90 days before his or her annuity starting date. 2 The QJSA rules apply to money purchase plans and other defined contribution plans that offer participants an annuity option. 3 See Memorandum to Pension Members No. 35-04 and Memorandum to Pension Operations Advisory Committee No. 45-04 [17698], dated June 22, 2004. 2 provided with respect to annuity starting dates beginning on or after February 1, 2006).<sup>4</sup> The October 1, 2004 effective date continued to apply to optional forms of benefit that are subject to the assumptions under Code section 417(e)(3) (such as lump sum payments, partial lump sum payments, and installment payments) if the actuarial present value of the optional form is less than the actuarial present value of the QJSA. The 2006 final regulations provide that the 2003 regulations (as amended by the 2006 final regulations) are effective generally for QJSA explanations provided with respect to annuity starting dates beginning on or after February 1, 2006, except for those optional forms of benefit subject to Code section 417(e)(3) for which the original effective date continues to apply.<sup>5</sup> However, with respect to QJSA explanations provided before January 1, 2007 for which the postponed effective date applies, a

reasonable good faith effort to comply with the final regulations will satisfy the requirements.<sup>6</sup> Changes to the Final Regulations The 2006 final regulations make a number of clarifications and modifications to the 2003 regulations, including the following:

- The disclosure of the financial effect of an optional form of benefit (including a benefit available with a retroactive annuity starting date) must describe the amounts and timing of payments to the participant under the form of benefit during the participant's lifetime, and the amounts and timing of payments after the participant's death.
- If a plan offers a significant number of substantially similar optional forms of benefit and disclosing the financial effect and relative value of each such optional form would provide a level of detail that could be overwhelming rather than helpful to participants, then the financial effect and relative value of those optional forms of benefit can be disclosed by explaining the relative value and financial effect of a representative range of examples of those optional forms of benefit.
- If a plan permits a participant to make separate benefit elections with respect to two or more portions of the participant's benefit, the description of the financial effect and relative

<sup>4</sup> See Memorandum to Pension Members No. 39-04 and Memorandum to Pension Operations Advisory Committee No. 48-04 [17738], dated July 1, 2004. In January 2005, the IRS issued new proposed regulations confirming the postponed effective date of the 2003 final regulations and proposing certain changes to the 2003 final regulations.

<sup>5</sup> The IRS eliminated from the 2006 final regulations a list of examples of optional forms of benefit subject to Code section 417(e)(3), in response to comments that these regulations are not an appropriate place for guidance on the minimum present value requirements of section 417(e)(3) and, specifically, whether social security level income options are subject to section 417(e)(3).

<sup>6</sup> The 2006 final regulations provide that a reasonable, good faith effort includes substantial compliance with the 2003 final regulations.

<sup>3</sup> values of optional forms of benefit can be made separately for each portion, rather than for each optional form of benefit.

- The relative value of all optional forms of benefit that have an actuarial present value that is at least 95 percent of the actuarial present value of the QJSA and no greater than 105 percent of the actuarial present value of the QJSA is permitted to be described by stating that these optional forms of benefit are approximately equal in value to the QJSA, or that all of these forms of benefit and the QJSA are approximately equal in value. This rule is effective only for explanations provided on or after January 1, 2007.

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