The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

COMMENT LETTER

June 27, 2000

Comment Letter on Proposed Rules Regarding Optional Forms of Benefit Under Qualified Retirement Plans, June 2000

By Hand

June 27, 2000

Internal Revenue Service
Courier’s Desk
1111 Constitution Avenue, NW
Attn: CC:DOM:CORP:R
(REG-109101-98)
Washington, DC 20044

Re: Proposed Special Rules Regarding Optional Forms of Benefit Under Qualified Retirement Plans

Ladies and Gentlemen:

The Investment Company Institute (the "Institute")[1] writes to comment on the proposed special rules providing section 411(d)(6) relief regarding the number and types of optional forms of benefit offered under defined contribution plans. The proposed relief is of great interest to Institute members, many of whom provide a full range of recordkeeping and trust services to plan sponsors. In addition, many members sponsor prototype plans or offer assistance to employers that are merging or consolidating retirement plans in the aftermath of business acquisitions.

The Service’s proposed guidance enabling the elimination of optional forms of benefit would simplify defined contribution plan administration. Just as importantly, this guidance would benefit plan participants who, as a result of the current application of section 411(d)(6), often must select a form of distribution from among an unnecessarily complex and confusing menu of payment options at retirement. We also support the proposed modification of rules regarding elective transfers and in-kind benefits. These proposed regulatory changes would promote benefit portability, make it easier for participants to consolidate and manage their retirement account balances, and significantly reduce administrative burdens for many plan sponsors.

Notwithstanding our general support for the proposed guidance, we set forth below comments that we ask the Service to consider as it finalizes the proposed rules. First, with respect to extended distribution forms, we ask the Service to eliminate the proposed requirement that plan sponsors retain an extended form of distribution option previously offered in the plan, in addition to providing participants with a lump sum distribution. If, however, this requirement is retained in the final regulations, plan sponsors should be provided with significantly greater flexibility in selecting an appropriate extended form of distribution for their employees. At a minimum, the Service should exempt sponsors of plans involved in mergers, plan sponsors using a prototype document and prototype sponsors from the requirement that the retained extended distribution form be one that was previously offered in the plan. Furthermore, plans of small businesses should be wholly exempt from any requirement to retain any extended distribution form.

Second, we believe it is unnecessary for the Service to impose special rules, such as phase-in or age-based rules, for participants near retirement age. Third, with respect to the rules addressing in-kind securities distribution, we recommend that the Service clarify that a plan sponsor need not create a list of participants holding the relevant securities. Finally, we renew the request made in our previous comment letter,[2] that the Service expand this guidance to address the elimination of in-service distribution options.

I. Extended Distribution Forms

A. General

As we stated in our initial comment letter responding to Notice 98-29, the Service should permit the amendment of a defined contribution plan to eliminate all extended forms of distribution so long as the plan preserves or makes available a lump sum distribution option. Because participants can replicate any extended form of benefit payment given a lump sum payment, the elimination of such optional forms of benefit would not result in the loss to participants of a "valuable right."[3] In its preamble to the proposed regulations, the Service recognized the "strong case" made for this analysis.

Nonetheless, the Service proposes requiring the retention of an extended distribution form to advance a policy goal unrelated to the specific purpose of section 411(d)(6) or this regulatory project. Specifically, the Service seeks to assure that unsophisticated participants obtain the benefit of an employer’s continued involvement in selecting and monitoring investment options after retirement distributions have begun.[4] But the requirement that a plan retain the longest extended distribution form previously available does little to advance this goal. Moreover, it undermines the proposed relief by unnecessarily burdening plans with an extended distribution form that may make little sense for current employees.

As a practical matter, many plans offer retiring participants the option of deferring distribution until a later date,[5] and will continue to offer this option, even if the Service’s relief permits plans to eliminate all but a lump sum option. Because options such as this advance the Service’s stated policy goal, the requirements regarding retention of an extended distribution form do little to further advance that goal. Participants, if they choose, can obtain the benefits of employer involvement by deferring distribution until a later date, retaining precisely the same advantages the Service cites as the advantages of requiring the retention of the longest, previously available extended distribution option:

continued employer involvement and oversight.

If the Service determines that an extended distribution form should be retained, it should adopt a more flexible rule. In particular, as we noted in our previous comment letter, the best, simplest and least burdensome approach would be to require the provision of any one extended distribution form—regardless of whether it was the longest extended distribution form previously available in the plan or whether it had been previously offered in the plan at all. In other words, a plan sponsor should not be required to "look back" to distribution forms previously offered and retain one of them. The Service has taken a significant first step in this direction in its proposal by enabling an employer with a plan offering a life annuity or installments over life payment form to choose to retain either one, regardless of which the plan had offered.6

The principal reason why this more flexible approach should be adopted is that current rules have caused plan sponsors to elect or retain benefit options for reasons other than their appropriateness for the workforce. As the Service has recognized in instituting this regulatory project, many optional forms of benefit now available in plans are simply the result of the combined effects of section 411(d)(6), as currently interpreted, plan mergers and prototype plan administration; they are not options that plan sponsors would have chosen, but for the regulatory constraints. A plan sponsor should be permitted to select an extended distribution form of benefit that it believes better fits the needs of its particular workforce and is more appropriate in light of its human resource policies. By comparison, under the rule as proposed, a plan sponsor likely may decide to add more appropriate distribution option(s) to those that the Service would require, adding to the "menu" of options that participants must assess and increasing the difficulty in effectively communicating the options to them—undermining the simplification the guidance aims to achieve.

B. Exemptions

The Institute also believes that, at the very least, the Service should exempt certain types of plans from any requirement to offer an extended form of distribution, as discussed more fully below.

1. Plans Involved In Mergers Should Be Exempt From The Requirement

To Retain Any Specific, Previously Available Extended Distribution Form
The Service has asked whether there should be an exception from the proposed requirement that a specific, previously available extended distribution form be retained when a plan is merged into another plan that does not offer that distribution form (in connection with an asset or stock acquisition, merger or similar transaction involving a change in employer). We believe that such plans should be exempt from this requirement if it is retained in the final rule. First, the less complicated it is to effect a plan merger, the more likely that an employer is to continue to offer a retirement benefit. Second, as discussed above, we believe sponsors of merged plans should be able to select an extended distribution form most suitable for their entire workforce. In the absence of an exemption, an employer would be required to maintain an optional form for only one segment of the workforce or offer the optional form to the entire workforce.7 This is the very problem that the current application of section 411(d)(6) causes, and which the regulations should rectify.

2. Plans Using Prototype Documents And Prototype Sponsors Should Be Exempted From The Requirement To Retain Any Specific, Previously Available Extended Distribution Form

As the Institute discussed in its initial comment letter, many plan sponsors using prototype documents have accumulated a large and complex menu of extended distribution forms of benefit in their plans. Frequently, these options were retained as the plan sponsor added more options when it moved from one prototype plan to another and sought to comply with section 411(d)(6). Similarly, many sponsors of prototype documents historically have offered a broad array of forms of benefit options to assure that potential clients could satisfy section 411(d)(6) when coming onto their prototype. The fact that so many optional forms were available as selections often resulted in increasing the number of benefit forms the employer was likely to adopt.

Plan Sponsors Using Prototype Documents. Because of the manner in which many distribution options may have been selected in the prototype environment, we believe it would be inappropriate to require plan sponsors using prototype documents to retain any of the distribution forms put in place under prior regulatory standards. The Service also should consider the fact that the majority of plan sponsors using prototypes are smaller businesses. Because of their size, these plan sponsors generally have fewer resources available to devote to their human resources function. Thus, to the extent the Service elects to burden them with the continued administrative tasks and costs associated with maintaining an extended distribution option, it should permit them to select the extended distribution form most suitable for their employees – regardless of whether previously offered. (As we discuss below, we recommend that small businesses with under 100 employees should be exempt from any requirement to offer an extended distribution form of benefit.)

Sponsors of Prototype Plan Documents. As noted above, many sponsors of prototype plan documents made available a large number of distribution options only in order to comply with section 411(d)(6). In light of the substantially reduced need to offer so many, often overlapping, distribution options, these plan sponsors should now be able to significantly simplify their plans. In order to be able to do so, however, prototype sponsors need additional guidance from the Service.

First, the Service should clarify that prototype sponsors can reduce or change the number and type of distribution options offered under the prototype for both current and prospective users of the prototype. Specifically, the Service must assure prototype sponsors that they can eliminate extended distribution forms that plan sponsors using the prototype may have previously elected.[8] Second, we request that the Service enable prototype sponsors to take advantage of any extension in filing "GUST" amendments offered to individual filers, so that they, too, are able to take advantage of the final section 411(d)(6) rules.[9]

3. Small Businesses Should Not Be Required To Retain Or Offer Any Extended Distribution Form

The Service has asked whether there should be an exception from an extended form of benefit requirement for small businesses (with fewer than 100 or fewer than 25 employees). If an extended form of benefit requirement remains in the final rule, we recommend that small businesses with fewer than 100 employees be wholly exempt from the requirement.

The Service should eliminate costs imposed on small businesses that have established retirement plans for their employees. Increasing the cost and administrative burdens of plan administration discourages small businesses from establishing and maintaining retirement plans.[10] The requirement that plans retain an extended distribution form imposes such costs and administrative obligations. For instance, the retention of an annuity option may require a plan administrator to implement the requirements of sections 401(a)(11) and 417; furthermore, the plan fiduciary would need to comply with the Department of Labor’s Interpretive Bulletin regarding annuity selection, which imposes significant obligations with respect to the selection of an annuity provider.11 Similarly, the retention of any non-annuitized, installment payment option also would impose on the plan sponsor the ongoing obligation to calculate and process distribution amounts. Regardless of whether a plan sponsor performs these functions itself or hires a third party to do so, it requires additional time and cost.

In brief, we recommend that small businesses be required only to offer a lump sum distribution option and no extended form of benefit option in their defined contribution retirement plans.

II. Individuals Near Retirement

The Service has asked whether special rules are needed to protect individuals near retirement from the elimination of extended distribution forms from their plans. Because all participants – including those near retirement—will be able to replicate any benefit form eliminated if provided with a lump sum, we believe that no special rules are necessary.

More specifically, the Service has asked whether the proposed relief should require that an extended distribution form be required to be retained only for participants who have reached a specified age, or whether there should be additional protections, such as requiring that the amendment not go into effect for a specified period of years. We believe that any age-based standard would require separate recordkeeping for those within the ‘protected class,’ and thus simply impose new administrative burdens in lieu of the ones that the proposed guidance seeks to eliminate. Similarly, any requirement to delay implementation of an amendment for a number of years would undermine the effectiveness of the proposed relief by delaying the opportunity to simplify plans and obtain cost savings beneficial to plan sponsors and participants.

III. In-kind Securities: Clarify "List" Referred To In Examples Is Not Required

In its revisions to the rules applicable to the elimination of provisions relating to the distribution of certain securities in kind, the Service includes several examples demonstrating the application of the rule. The examples suggest that plan amendments eliminating these distribution forms must include a list of participants that hold employer stock and/or non-marketable securities as of the plan amendment date. Prop. Reg. § 1.411(d)-4 Q&A 2(b)(2)(iii)(E)(ii)(B) and (D). We recommend that the Service clarify that the list identified in the examples is not required. The information needed to prepare such a list may not be available at the appropriate date and, therefore, many recordkeepers will be unable to prepare it within the time requirements proposed. The difficulty is compounded by the fact that participants often can trade daily. Moreover, in the instance of a large employer, the list could be very long. Finally, the Service has not imposed any such requirement for identifying protected benefits in the past and should not now begin to do so.12

IV. Expand The Guidance To Address In-Service Distributions

As we did in our initial letter, we ask that the Service consider expanding its guidance to address in-service distributions. Preserving in-service distribution options, such as the right to make withdrawals of employer contributions after a fixed number of years, for example, is particularly difficult when merging one plan into a plan without such features. Although these withdrawal rights were common in profit-sharing and thrift plans established before the 1980s, it is very unusual to find such rights in more recently established plans or in prototype plans.

Maintaining or freezing such rights burdens employers with the same burdens they face in preserving other optional forms of benefit. We note that the Service has already recognized that not all in-service distributions are protected under section 411(d)(6). For instance, the elimination of in-service hardship distribution provisions is permitted under Reg. § 1.411(d)-4 Q&A 2 at 2(b)(2)(x).

* * *

The Institute believes that the Service's proposed relief will be useful to plan sponsors, recordkeepers and other service providers, and will be beneficial to plan participants by delivering to them rational, easy-to-understand benefit payment options and reducing plan administrative complexity and costs. We believe that our recommendations would enhance the effectiveness of the guidance. Most notably, we would urge the Service to reconsider the "strong case" that only a lump sum distribution option should be required to be retained under section 411(d)(6) and the little value to plan participants of retaining an extended distribution form as currently proposed.

If you have any questions regarding these comments, please do not hesitate to contact me at (202) 326-5835.

Sincerely,

Russell G. Galer
Senior Counsel

ENDNOTES

1 The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,036 open-end investment companies ("mutual funds"), 496 closed-end investment companies and 8 sponsors of unit investment trusts. Its mutual fund members have assets of about $7.264 trillion, accounting for approximately 95% of total industry assets, and over 78.7 million individual shareholders. As of year-end 1999, approximately 45% of all 401(k) plan assets were invested in mutual funds. Similarly, about 49% of all IRA assets, many of which are the result of rollovers from qualified plans, were invested in mutual funds. "Mutual Funds and the Retirement Market, " ICI Fundamentals, Vol. 9, No. 2, May, 2000.

2 See Institute comment letter submitted on August 28, 1998.

3 26 C.F.R. 1.411(d)-4 Q & A 2(b).

4 The Service has stated that the advantages to participants of retaining an extended distribution form "include the benefits that participants, especially less sophisticated participants, can derive from employer involvement, which is subject to the fiduciary standards, in selecting and monitoring investment options under the plan after retirement distributions have begun," and made a preliminary assessment that these advantages "may be worth the plan administration costs of retaining this additional option." 65 Fed. Reg. 16548 (March 29, 2000).

5 According to a recent Profit Sharing/401(k) Council of America report, over 66% of profit sharing and 401(k) plans permit participants to retain their balance in the plan (if the balance is more than $5,000) at retirement. Similarly, 58% of profit sharing and 401(k) plans surveyed offer an installments option, which also would allow individuals to retain account balances in the plan. 42nd Annual Survey of Profit Sharing and 401(k) Plans, 1999 at Table 48, p. 31.

6 Prop. Reg. 1.411(d)-4 Q&A-2 (e)(4), Example 1(i). 65 Fed. Reg. 16552. In this regard, we read the proposed regulations to permit the elimination of a "qualified joint and survivor annuity" when offered in a defined contribution plan, such as a profit sharing plan, if that form of benefit was voluntarily adopted, but was not required by statute. We request that the Service clarify that this interpretation of the proposed relief is correct.

On a related point, the Service has asked whether it should permit a plan to satisfy the requirement that it retain an extended distribution form if the plan offers installment payments over a fixed period, such as 20 years. Although, we believe it should not be necessary to retain any extended distribution form, we would support treating an installment payment over a fixed period of years that approximated life expectancy as a substitute for the retention of an annuity or installments over life expectancy option. Some plan sponsors and recordkeepers will find it easier to administer the fixed installment, rather than one paid over life expectancy.

7 The end result of such a rule becomes apparent when one considers the merger of a larger and smaller plan. Forced to retain an extended distribution form of the smaller plan, an employer will either impose that distribution form on the larger plan, whether appropriate for those participants or not, or retain a separate distribution option for the smaller plan population, complicating recordkeeping and plan communications.

8 Because the number of employers using a prototype plan can number into the thousands, it would be impossible for a prototype plan sponsor to assure itself that none of the employers using the prototype had elected a particular distribution option before eliminating it. Employers wanting to retain certain distribution options would still be able to amend their plans to do so.

9 Many prototype sponsors will already have filed plan documents with the Service. The Service should provide a simple mechanism by which these sponsors may readily amend their filings, or to the extent an opinion letter is already obtained, establish an expedited process for amendments resulting from the final regulation.

10 For instance, 20% of small employers (with under 100 employees) that do not sponsor a retirement plan cite a cost and/or administrative-related reason as the most important reason for not offering a plan. Furthermore, of those small employers without a plan, 52%

suggest that lowering the cost of plan sponsorship by reducing administrative requirements would make them think seriously about establishing a plan. "The 2000 Small Employer Retirement Survey," published by the Employee Benefit Research Institute (EBRI) and the American Savings Education Council (ASEC), May, 2000.

11 29 C.F.R. 2509.95-1 (Interpretive Bulletin relating to the fiduciary standard under ERISA when selecting an annuity provider). 60 Fed. Reg. 12328 (March 6, 1995).

12 To the extent that the Service intends there be a "list" requirement, the list should reflect participants holding relevant investments as of the later of the amendment’s effective date or its date of adoption.
