Proskauer

IRS Postpones Effective Date for Cash Balance Plan Interest Crediting Rules

October 18, 2011

On October 12, 2011, the Internal Revenue Service ("IRS") and Treasury Department released Notice 2011-85 which postpones the effective date for the interest crediting rules for hybrid retirement plans (such as cash balance plans) as well as the timing for the adoption of plan amendments reflecting those rules. Notice 2011-85 also formalizes previous IRS guidance that afforded certain plan sponsors with a special timing deadline for providing "Section 204(h) notices."

Hybrid retirement plans include cash balance and other defined benefit pension plans that contain features of both defined benefit plans and defined contribution plans. A hybrid retirement plan generally calculates a participant's accumulated benefit using a lump sum-based benefit formula (or similar formula). Under a hybrid retirement plan, a hypothetical account is established in each participant's name. Generally, each participant is credited with the employer's hypothetical contributions that are based on a participant's eligible compensation (referred to as compensation credits) and hypothetical earnings (referred to as interest credits).

The Pension Protection Act of 2006 (the "PPA") clarified the rules applicable to hybrid retirement plans, including specific rules for hybrid retirement plan conversions as well as certain other participant protections. In December 2007, the IRS first issued proposed regulations to implement certain of the PPA rules (the "2007 Proposed Regulations"). In October 2010, the IRS issued both final and new proposed regulations for hybrid retirement plans (the "Final Regulations" and the "Proposed Regulations," respectively). The Final Regulations, which were based upon the 2007 Proposed Regulations, addressed issues such as age discrimination, special vesting rules, conversions from traditional defined benefit plans, and safe harbor interest crediting rates. The Proposed Regulations addressed issues not fully covered by the Final Regulations, with particular attention to alternative interest crediting rates that could satisfy the PPA requirement for hybrid retirement plans to credit interest at a rate no greater than a "market rate of return."

In short, Notice 2011-85 postpones the effective date of certain provisions of the Final Regulations and Proposed Regulations as well as the requirement that plans be amended to reflect final rules in this area. This alert provides a summary of Notice 2011-85.

Interest Crediting Rate Effective Dates Postponed

Code Section 411(b)(5) generally requires that a hybrid retirement plan's interest crediting rate cannot exceed a "market rate of return." Current guidance limits the available "safe harbor" interest crediting rates to rates that are much lower than many plan sponsors desire as part of the benefit they would like the plan to deliver. In some cases, plans may already be crediting rates in excess of these "safe harbor" rates and may need to consider permissibly lowering those rates to a "market rate of return." In the absence of guidance, these decisions are difficult ones to make.

The Final Regulations and Proposed Regulations provided limited guidance on the interest crediting and market rate of return requirements. Although the Final Regulations were generally effective for plan years beginning on or after January 1, 2011, provisions of the Final Regulations establishing the exclusive list of interest crediting rates and combinations of rates that satisfy Code Section 411(b)(5), were to be effective for plan years beginning on or after January 1, 2012. The Proposed Regulations which describe additional interest crediting rates that satisfy Code Section 411(b)(5) were also proposed to be effective on January 1, 2012.

The IRS has received and considered numerous comments on the market rate of return issue as reflected in the Final and Proposed Regulations and is trying to balance the various interests at stake. The IRS recognizes that when the Proposed Regulations are finalized plan sponsors will require time to interpret the guidance and implement the new rules. Therefore, Notice 2011-85 provides that the Proposed Regulations, when finalized (which is likely to be in 2012), will apply to plan years beginning on or after a date to be specified in those new final regulations, which will not be earlier than January 1, 2013. Notice 2011-85 also provides that the IRS will postpone the effective date of the Final Regulations governing the list of interest crediting rates and combinations.

Separately, Notice 2011-85 extends the deadline for adopting certain interim or discretionary amendments to hybrid retirement plans. Specifically, Notice 2011-85 extends the deadline to amend a hybrid retirement plan to comply with the key hybrid retirement plan regulations and guidance (including rules concerning special 3-year vesting requirements under Code Section 411(a)(13) and age discrimination rules under Code Section 411(b)(5)) until the last day of the plan year *before* the plan year for which the Proposed Regulations, once finalized, apply to the hybrid retirement plan. For example, if the new regulations become effective January 1, 2013, amendments to a calendar year hybrid retirement plan would be required by December 31, 2012. For more information on these special rules related to vesting and age discrimination for hybrid retirement plans, please see our previous alert "IRS Issues Cash Balance Plan Guidance."

Anti-Cutback Relief Expected

In amending plans to comply with the hybrid retirement plan regulations, and in particular the market rate of interest crediting rules, hybrid retirement plan sponsors need to consider the interplay with the anti-cutback restrictions under Code Section 411(d)(6). For example, hybrid retirement plan sponsors whose plans include an interest crediting rate higher than that permitted under IRS guidance may find themselves in a difficult position because amending their plans to reduce the interest crediting rate to an IRS-approved rate may cause these plans to violate the anti-cutback restrictions. In Notice 2011-85, the IRS indicated that it expects to grant relief from the anti-cutback restrictions for a plan amendment that eliminates or reduces a protected benefit if (i) the amendment is adopted by the last day of the plan year *before* the plan year for which the final regulations apply to the plan and (ii) the amendment eliminates or reduces the protected benefit only to the extent necessary to enable the plan to meet the special rules related to age discrimination under Code Section 411(b)(5).

Section 204(h) Notice Deadline for Certain Hybrid Retirement Plan Amendments

When an amendment to a defined benefit plan, including a hybrid retirement plan, significantly reduces the rate of future benefit accruals, ERISA Section 204(h) generally requires that advance notice be sent to all affected parties at least 45 days before the amendment's effective date (a "Section 204(h) Notice"). If a Section 204(h) Notice is not timely provided, the IRS will assess an excise tax against the plan administrator.

In IRS Announcement 2009-82, the IRS announced that hybrid retirement plan administrators who had previously amended their plans to comply with the PPA rules on interest crediting rates could provide a Section 204(h) Notice up to 30 days after the date the amendment is effective as long as the amendment: (i) changes an interest crediting rate under a hybrid retirement plan; (ii) is adopted after November 10, 2009, and on or before the last day of the first plan year beginning on or after January 1, 2009; and (iii) is effective no later than the first day of the first plan year beginning on or after January 1, 2010. Notice 2011-85 formalizes that prior announcement and is helpful to those plan sponsors who took advantage of that earlier relief.

This relief was intended to assist administrators of hybrid retirement plans to comply with the Section 204(h) Notice timing requirements for plan amendments that modified the interest crediting rate pursuant to the PPA. For more information on this limited relief for with respect to Section 204(h) Notices, please see our previous alert "IRS Grants Limited Relief for Cash Balance Plans."

For more information on the Final Regulations and Proposed Regulations, please see our previous alert "IRS Issues Cash Balance Plan Guidance."

If you would like to discuss the application of Notice 2011-85 to your particular situation, or have questions about employee benefit matters generally, please contact one of the Proskauer lawyers listed on this Alert, or the Proskauer lawyer with whom you normally consult on these matters.

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