

Implementing Complex New Pension Disclosure Rules: Part 1

Bill Evans

Part 1 of this two-part article explains that the IRS has issued final regulations that expand disclosure obligations for retirement plans whose distributions are subject to QJSA and QPSA disclosure rules. It explains what plans and distributions are subject to the new disclosure regulations, describes required QPSA disclosures, and begins to describe the financial effect of electing optional distribution forms. Part 2 will discuss how to satisfy new requirements for disclosing the relative value of optional distribution forms. It will also include a sample participant-specific disclosure form.

In late 2003, the IRS published final regulations imposing greatly expanded disclosure obligations on retirement plans whose distributions are subject to qualified joint and survivor annuity (QJSA) and qualified pre-retirement survivor annuity (QPSA) disclosure rules (68 Fed. Reg. 70141, 12/17/2003). The regulations ([Reg. § 1.417\(a\)\(3\)-1](#)) reflect longstanding IRS concerns about the adequacy of the information being provided in this area by plan administrators, such as the ability of participants to compare the value of an unsubsidized lump-sum option with a subsidized annuity payout. These concerns were renewed and heightened by ongoing controversies over cash balance plans.

Comparison to 2002 proposed regulations.

The final regulations largely implement, without change, proposed regulations issued in October 2002. However, the IRS made a few adjustments to the proposed regulations, and also highlighted a number of areas in which it considered and rejected commentators' requested changes. For example, the IRS rejected suggestions that it issue model disclosure language, on the grounds that plan designs and participant sophistication vary too widely to permit a model notice, and that detailed examples in the regulations provide sufficient guidance as to how to disclose relative values. (The author, however, has provided a sample participant-specific QJSA notice. The sample notice will be included with Part 2 of this article.)

The IRS also noted that it is considering how to apply electronic disclosure rules to QJSA and QPSA written notice requirements. Regulations replaced by the new regulations allowed administrators to provide notices using any method reasonably calculated to ensure receipt. An electronic system could be used, as long as it was reasonably designed to provide notice in a manner no less understandable than a written paper document, and the electronic notice advised participants that they could request notice on a written paper document at no charge.

Effective dates.

The new regulations apply to QPSA notices provided after June 2004, and to QJSA notices that relate to distributions with annuity starting dates (ASDs) after September 2004. If a defined benefit (DB) plan administrator provides a QJSA notice for a distribution with an ASD that is retroactive to a date before October 2004, but distributions do not actually commence until after September 2004, the administrator will still need to comply with the new disclosure rules.

Plans and Distributions Subject to New Disclosure Regulations

Application to DB and, potentially, DC plans.

The new regulations apply to any plan distributions that are subject to QJSA or QPSA requirements. Thus, distributions from qualified DB plans and money purchase pension plans (except governmental and church plans) are subject to the regulations. Distributions from 401(k) and other defined contribution (DC) plans are also subject to the regulations, unless they qualify for the "profit-sharing exception" to the QJSA/QPSA rules ([Code Sec. 401\(a\)\(11\)\(B\)\(iii\)](#)). A distribution from a DC plan qualifies for this exception if: (i) the plan provides for payment of a deceased participant's full remaining account to a surviving spouse (or other properly designated beneficiary); (ii) the distribution is not made in the form of an annuity; and (iii) the amounts distributed are not independently subject to the QJSA/QPSA rules (e.g., the amounts were not transferred from a money purchase pension plan).

Relationship to pre-normal retirement age (NRA) distribution disclosures.

IRS regulations require all qualified plans-including 401(k) and other DC plans subject to the profit-sharing exception-to provide notices that "set forth a summary of the distribution options under [the] plan" if a distribution is made prior to the later of a participant's normal retirement age or attainment of age 62, and that advise participants of their right to defer receipt of benefits until the later of normal retirement age or age 62 (Reg. § 1.411(a)-11(c)(2)(iii)(B)(3)). The specific disclosures required by the new regulations do not apply to this kind of early distribution, unless the distribution itself is subject to the QJSA/QPSA rules. Administrators with plans subject to the QJSA/QPSA notice rules generally should structure their notices to satisfy both the early commencement disclosure requirements and the new QJSA notice regulations.

Minimizing impact of regulations by eliminating optional forms.

IRS regulations implementing the ERISA and Code anticutback rule ([Code Sec. 411\(d\)\(6\)](#) and [ERISA § 204\(g\)](#)) currently permit plan sponsors to eliminate certain optional distribution forms. In particular, a DB plan sponsor may eliminate intermediate joint and survivor annuity forms, as long as the largest and smallest available optional survivor payment percentages are maintained. Also, a DC plan sponsor may generally eliminate all non-lump-sum distribution forms (although money purchase pension plans must continue to provide QJSAs). In light of the new regulations, a plan sponsor might now consider eliminating any intermediate joint and survivor annuity forms in a DB plan, and any non-lump-sum distribution forms in a DC plan, in order to reduce the burden of providing enhanced disclosures with respect to these distribution options.

The IRS also may soon issue regulations permitting DB plan sponsors to eliminate certain additional kinds of optional distribution forms without violating the anticutback rule. EGTRRA directs the issuance of these regulations, where application of the anticutback rule to the elimination of optional forms creates significant burdens or complexities for the plan and plan participants, and where eliminating the optional forms would not adversely affect the rights of any participant in more than a de minimis manner. The IRS requested comments on this regulation project in mid-2002. If these anticipated regulations provide significant anticutback relief, the sponsor of a plan that includes numerous distribution options (perhaps due to a series of plan mergers and asset transfers, or a plan's origins as an annuity product) might ultimately be able to avoid some of the complexity and cost of providing enhanced disclosure of optional forms by simply eliminating additional optional forms. Unfortunately, absent timely guidance on the anticutback issue, administrators will generally need to prepare to comply with the new disclosure regulations with respect to distribution forms that are now available.

Required QPSA Disclosures

The regulations do not significantly expand the disclosure requirements for QPSA notices. A QPSA notice must contain a general description of:

- the QPSA;
- the circumstances under which it is paid;
- the availability of the QPSA distribution option; and
- the financial effect, if any, of the election of the QPSA on the participant's benefits (i.e., an estimate of the reduction to the participant's estimated normal retirement benefit that would result from election of the QPSA).

In general, the description of a QPSA's financial effect must provide information about the particular participant's benefits. Alternatively, an administrator may provide a general description of the financial effect of a QPSA election. For example, the description could be in the form of a chart showing reductions to a hypothetical participant's normal retirement benefit at a representative range of participant ages, using reasonable assumptions for the age of the hypothetical participant's spouse. However, the QPSA notice would need to include an offer to provide, upon timely request, an estimate of participant-specific reductions, and a description of how to make that request. The regulations do not set out any specific timing requirements for responding to requests.

Required QJSA Disclosures

The regulations significantly expand the disclosure requirements for QJSA notices. As described below, the administrator must describe (i) a plan's optional forms, (ii) the eligibility requirements for the optional forms, (iii) the financial effect of electing the optional forms, (iv) the relative value of the optional forms as compared to a QJSA, and (v) any other material features of the optional forms.

Description of optional forms.

An administrator must provide a description of each "disclosed" optional form of benefit. Generally, this means that the administrator must describe to a participant each optional form of benefit presently available to the participant (i.e., optional forms with an ASD for which the QJSA explanation applies).

Alternatively, the administrator may limit its initial description to "generally available" optional forms. Presumably, the administrator can omit a description of any distribution form that is not available to most participants with respect to most benefits. For example, the administrator should be able to omit a description of forms available to a small frozen group of participants, or available only with respect to a small piece of a participant's benefit.

Although an administrator may omit initial descriptions of "not generally available" optional forms, it must be prepared to readily provide participant-specific explanations of undisclosed forms on request. The initial QJSA notice must describe where a participant may "readily obtain" participant-specific information described in this discussion of required QJSA disclosures with respect to any presently available form that is not described in the initial QJSA notice. (References in this article to "disclosed" optional forms mean either the optional forms described in the initial QJSA notice, or the optional forms described upon participant request, as applicable.)

Eligibility conditions for optional forms.

The administrator must describe the eligibility conditions for each disclosed optional form of benefit.

Financial effect of electing optional forms.

The administrator must describe the financial effect of electing each disclosed optional form of benefit (i.e., the amount payable under the form of benefit to a participant during the participant's lifetime and the amount payable after the death of the participant). The administrator may satisfy this requirement either by providing participant-specific information, or by providing generally applicable information.

Option to provide participant-specific information or estimates.

If the administrator opts to provide participant-specific information, it can provide either actual numbers, based on the actual age and benefit of the participant, or reasonable estimates.

If a DC plan administrator provides actual numbers for an amount payable under an annuity distribution form, the administrator must assure that an insurer is able to provide the amount disclosed.

If the administrator provides estimates, the QJSA notice must:

- Identify the estimate, e.g., for annuity forms under a DC plan, disclose that the stated amount payable is an estimate rather than an assured amount.
- Explain that the administrator will, upon request, provide a more precise calculation.

The regulations provide examples of permissible estimation techniques:

- Use assumption about spouse's age.
- Use data in effect prior to the ASD.
- Use an estimated interest rate (e.g., estimate an applicable GATT interest rate based on 30-year Treasuries).
- For annuity distribution forms under a DC plan, use a reasonable estimate of the amount payable under a purchased annuity contract.

Option to provide generally applicable information.

If the administrator opts to provide generally applicable information, it can provide a chart or other comparable device showing the generally applicable financial effect of electing each disclosed optional form of benefit. The chart, and accompanying explanation, must:

- Either show, in a series of examples, the amount of each optional form of benefit payable to a hypothetical participant at a representative range of ages, or disclose, using some other method, sufficient information so that a participant can determine the amount of benefits payable in the optional form (e.g., expressing the amount of the optional form as a percentage or a factor of the amount payable under the normal form).
- Use reasonable assumptions for the age of the hypothetical participant's spouse and any other variables affecting the financial effect of the optional form of benefit.
- Include a general statement describing the effect of significant variations between the assumed ages or other variables on the financial effect of electing the optional form of benefit.
- Disclose the amount payable to the participant, either under the normal form of benefit (for this purpose, the form under which payments due to the participant are expressed, prior to adjustments for the form of benefit), or under the normal form of benefit adjusted for immediate commencement. Note that this disclosure is participant-specific. Thus, even if an administrator opts to provide generally applicable information, the administrator must still provide this one piece of participant-specific information.
- Offer to provide, upon request, a statement of financial effects that is specific to the participant (e.g., based on the participant's actual age and benefit).
- Describe how a participant may obtain participant-specific additional information.

DC plan annuities.

Whether the administrator of a DC plan with an annuity option provides participant-specific or generally applicable information, the administrator must state that the annuity will be provided by purchasing an annuity contract from an insurance company with the participant's account balance under the plan.

Bill Evans is an attorney with Groom Law Group.

© Copyright 2004 RIA. All rights reserved.