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## DB to DC Plan Transitions: Thinking Long Term

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When designing an appropriate DB to DC transition strategy, a plan sponsor must address the Internal Revenue Code (IRC) coverage and nondiscrimination requirements with their proposed plan design. Meeting these conditions may be relatively easy at the outset, but turnover in the organization over time may result in compliance issues in future years. In such a case, the plan sponsor may eventually need to seek alternative—and perhaps costly—testing options as well as changes in plan design in order to stay compliant.

One example of how this might happen is with a closed DB plan that allows a grandfathered group of participants to continue accruing benefits until retirement. Over time, the grandfathered group will lose members due to retirement or termination, and for those who remain, pay raises may push some members into HCE status. The combined effects can make compliance a challenge. The DB to DC compliance concerns graphic on the following page illustrates this example.

Over the last few years, the IRS has issued guidance to help certain closed DB plan sponsors facing these issues. On January 6, 2014, the Treasury Department and the IRS published Notice 2014-5, 2014-2 I.R.B. 276, affecting plans closed before December 13, 2013, to provide temporary relief from the minimum aggregate allocation gateway requirement for plan years beginning December 13, 2013 through December 31, 2015 (2014 and 2015 testing years for December 31 plans). Notice 2015-28, 2015-14 I.R.B. 848 extended the same relief through the 2016 plan year. A DB to DC plan can qualify in one of two ways, based on the results of IRC Section 401(a)(4) testing for the 2013 plan year:

- 1) either the aggregated plan passed under the “broadly available” test or was deemed to be “primarily defined benefit,” or
- 2) the DB plan satisfied the requirements as a stand-alone plan.

Earlier this year, the IRS issued proposed regulations REG-125761-14 (Nondiscrimination Relief for Closed Defined Benefit Pension Plans and Additional Changes to the Retirement Plan Nondiscrimination Requirements, RIN 1545-BM58), which, under the current terms, would effectively make the existing relief permanent by modifying the current rules for Defined Benefit Replacement Allocations (DBRAs).<sup>1</sup> DBRAs are considered “transition allocations” by the IRS and may be disregarded when determining whether a DC plan has broadly available rates. By classifying nonelective DC contributions as DBRAs, a plan sponsor may be able to more easily satisfy the 401(a)(4) requirement under the broadly available test, which is needed to qualify for gateway relief.

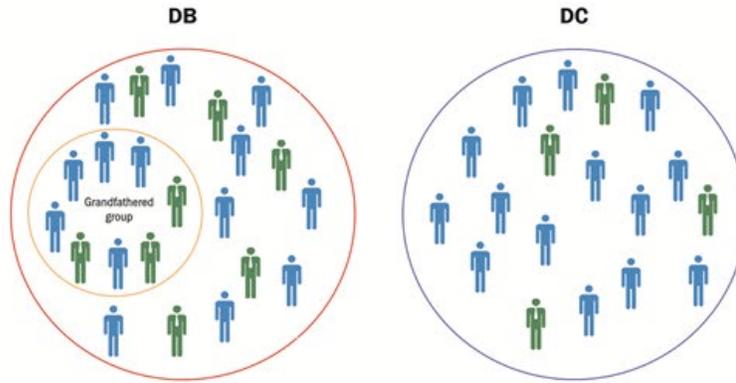
**DB to DC Compliance Concerns**

**1. At freeze**

For the majority of participants, benefits are frozen.

Grandfathered group continues accruing benefits until retirement.

Plan closed to new employees.



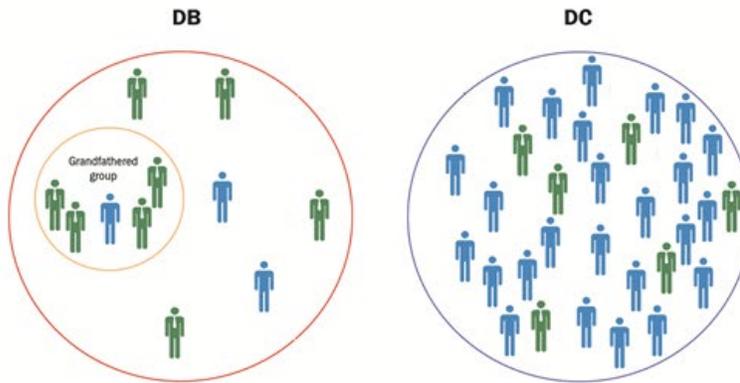
Current participants remain in plan.

Open to new employees, the majority are NHCEs.

**2. Over time**

Grandfathered group contains more highly compensated employees with growing retirement benefits.

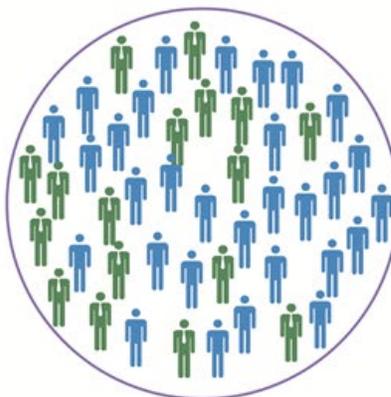
DB plan can no longer satisfy IRC 401(a)(4) nondiscrimination requirement as a standalone plan.



Employer provides nonelective contributions to help offset decreased retirement benefits from closed DB plan.

**3. In the future**

**DB/DC**



DB Plan aggregates with DC plan for testing purposes (cross-tested).

Must first meet special DB/DC gateway requirement before testing on benefits basis:

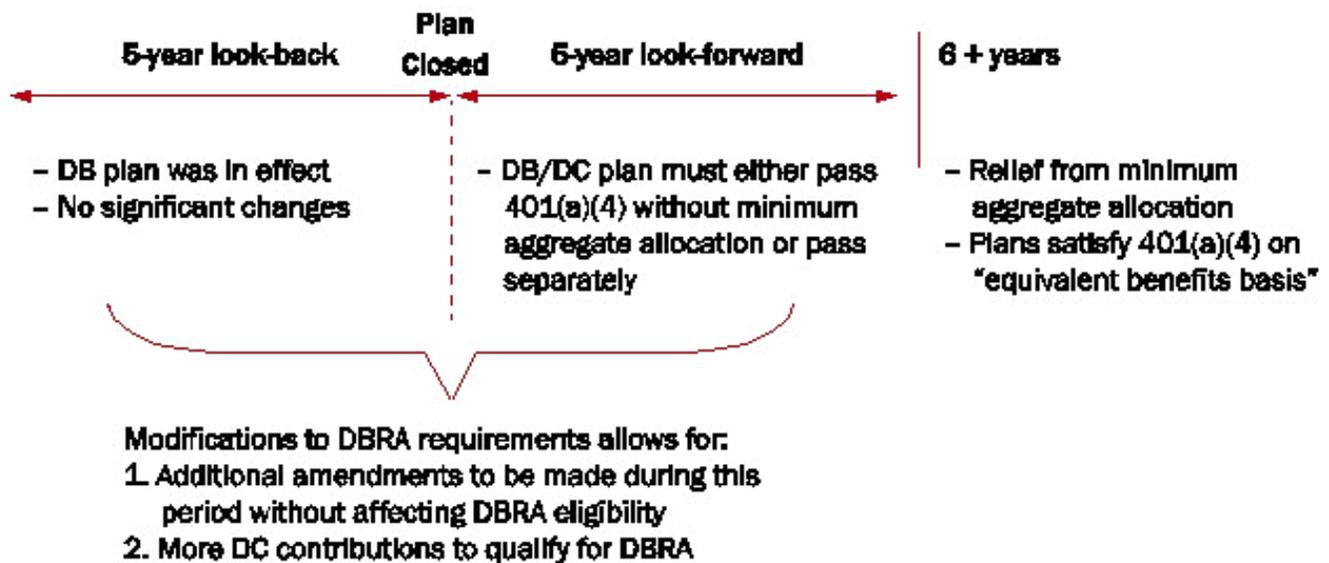
1. Cannot satisfy "primarily defined benefit" test
2. Cannot satisfy "broadly available" test as separate plans
3. Employer must provide minimum aggregate allocation



Presently, employer contributions need to meet strict criteria in order to qualify as a DBRA. A DBRA must totally replace an equivalent age-based DB allocation rate and can only be provided to a group of employees that has a nondiscriminatory composition, among other conditions. Also, the DB plan could not have been modified through amendment in recent years. The proposed regulations would ease these restrictions, allowing a DBRA to replace some or all of the equivalent DB benefit and would permit the use of DB plans that also consider years of service in determining future benefits. Five-year look-back and look-forward provisions, as illustrated below, would also be established to help plans meet the nondiscriminatory and plan amendment requirements:

may over time experience disproportionate coverage of highly and nonhighly compensated employees and future retirement benefits. In such a case, the plan may eventually require alternative testing options in order to remain compliant. These proposed regulations provide needed flexibility in nondiscrimination testing so that the plan sponsor's DB to DC transition is not disrupted, and therefore preserves the retirement benefits promised to those grandfathered participants when the transition began.

<sup>1</sup> <https://www.gpo.gov/fdsys/pkg/FR-2016-01-29/pdf/2016-01675.pdf>



All together, these modifications set the framework for the 'closed plan rule,' providing relief from the minimum aggregate allocation gateway requirement and the 'special testing rule,' which exempts plans from benefits, rights, and features testing for matching contributions allocated to the grandfathered group. The issuance of these proposed regulations indicates that the government is willing to take meaningful steps to help plan sponsors in the path towards DB to DC plan transition.

## In perspective

All qualified plans must satisfy IRC coverage and nondiscrimination requirements. Depending on the plan changes made as part of the DB to DC transition, a plan

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