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## IRS Finalizes Relative Value Disclosure Regulations

On March 24, 2006, the IRS issued final regulations requiring pension plans to disclose the relative value of different forms of pension benefits. As we reported in our July 2004 Management Alert (a copy of which can be found at [www.seyfarth.com/MA072604](http://www.seyfarth.com/MA072604)), the relative value regulations were originally issued in December 2003, and were generally applicable to retirement benefits beginning October 1, 2004. However, the IRS subsequently delayed the effective date on February 1, 2006 (with some exceptions described below), in part in response to criticism of the complexity of the rules and in part to give plan sponsors a chance to amend their plans to eliminate redundant benefit forms.

The extension did not apply to plans that give retirees the choice of a lump sum benefit that is less valuable than the qualified joint and survivor annuity ("QJSA"), and also did not apply to surviving spouses who are given a choice of different forms of benefit for the qualified preretirement survivor annuity ("QPSA").

The final regulations issued on March 24th modified and clarified the 2003 regulations, as discussed below. In general, the final regulations require reasonable good faith compliance with the relative value disclosure regulations for QJSA explanations provided before January 1, 2007. However, the good faith standard does *not* apply to lump sum payments that are less valuable than the QJSA benefit. For these optional forms of payment, the original October 1, 2004 deadline from the 2003 regulations continues to apply.

### Overview of 2006 Final Regulations

In most respects, the 2006 final regulations are consistent with the previous IRS guidance, including the following key points:

- ◆ Prior to the issuance of the relative value regulations, most plans simply described different forms of benefit (*i.e.*, life annuities and joint and survivor annuities) as being equal in value. However, the relative value regulations require the plan to actually calculate, and disclose to retirees, the relative actuarial values of differ-

ent forms of benefit, using reasonable actuarial assumptions that in many cases are different from the actuarial factors used to convert one form of benefit into another.

- ◆ The final regulations continue to allow plans to describe the relative values of different forms of benefit in general terms, including the use of reasonable estimates to determine the amount of a participant's normal form of benefit. However, the plan must provide a more precise calculation for each retiree upon request and must revise previously disclosed information to be consistent with more precise information.
- ◆ The final regulations do *not* change the compliance deadlines for QPSA explanations and QJSA explanations for lump sums and other optional forms of payment subject to Code Section 417(e)(3).

### Changes and Clarifications

The 2006 final regulations also make a number of important changes and clarifications to the prior IRS guidance for relative value disclosure, including the following:

- ◆ The final regulations provide a new standard for determining whether an optional form of payment is approximately equal to a straight life or QJSA benefit. Under the new rule, an optional form of payment that is at least 95% and no greater than 105% of the value of a straight life or QJSA benefit may be described as approximately equal in value to the benefit.
- ◆ The final regulations clarify that the relative value disclosure for an optional form of payment (including any benefits with retroactive annuity starting dates) must describe the amount and timing of benefits during the participant's lifetime, as well as the amount and timing of benefits after the participant's death.
- ◆ The final regulations also permit simplified explanations for plans that offer a significant number of substantially similar optional forms of payment. In the preambles to the final regulations, the IRS provides an

example of a plan that offers a number of J&S annuity options with survivor payments available in all whole number percentages between 50% and 100%. Under the final regulations, such a plan could provide a representative range of examples, which might include disclosing the relative value of the 50% J&S option, the 75% J&S option, and the 100% J&S option.

- ◆ As noted above, the relative value regulations contain special rules that apply to lump sum distributions. Technically, these rules apply not only to lump sums, but to any form of benefit that must be calculated using the 30 year Treasury interest rate and the prescribed actuarial tables under Code Section 417(e)(3). The IRS takes the position that Section 417(e)(3) also applies to certain forms of level income options, under which the amount of the benefit decreases when the retiree becomes eligible for social security, and one example in the 2003 regulations stated that such a benefit was subject to Code Section 417(e)(3). Many commentators objected on the grounds that this is an unresolved issue that would affect the calculation of the benefit and not merely the manner in which it is disclosed, and should be addressed separately. In response, the IRS deleted the example, but stated that it was not changing its position on the applicability of Code Section 417(e)(3) to level income options.

## Effective Dates

As discussed above, with respect to lump sums and other optional forms of benefit subject to Code Section 417(e)(3), the relative value rules continue to apply for QJSA explanations provided for annuity starting dates on or after October 1, 2004. For all other optional forms of benefit, the new rules apply to QJSA explanations for annuity starting dates on or after February 1, 2006. Under the 2006 final regulations, however, plans can satisfy this deadline with reasonable good faith compliance for QJSA explanations provided before January 1, 2007.

Plans that deferred relative value disclosures in reliance on the extension will need to begin providing the disclosures in compliance with the final regulations not later than January 1, 2007. Plans that began providing relative value disclosures in 2004 (typically, cash balance plans that were not eligible for the extension because of the lump sum option) will need to check with their actuaries to make sure the disclosures comply with the final regulations. This will particularly be the case if the disclosures provide that certain benefit forms are “approximately equal”, in light of the new definition contained in the final regulations.

In addition, as noted above one reason the IRS deferred the relative value requirements was to give plan sponsors an opportunity to eliminate redundant benefit forms under the new protected benefit regulations that took effect January 1, 2006. Although the final regulations simplify the disclosures required for multiple forms of benefit, plan sponsors that have not already done so may still wish to review their plans and determine whether some forms of benefit are of relatively little value to retirees and can be simply eliminated prior to the end of 2006.

*If you have any questions concerning this Management Alert, please contact the Seyfarth Shaw LLP Employee Benefits Group attorney with whom you work or any Employee Benefits attorney on the website at [www.seyfarth.com](http://www.seyfarth.com).*

### ATLANTA

One Peachtree Pointe  
1545 Peachtree Street, N.E., Suite 700  
Atlanta, Georgia 30309-2401  
404-885-1500  
404-892-7056 fax

### BOSTON

Two Seaport Lane, Suite 300  
Boston, Massachusetts 02210-2028  
617-946-4800  
617-946-4801 fax

### CHICAGO

55 East Monroe Street, Suite 4200  
Chicago, Illinois 60603-5803  
312-346-8000  
312-269-8869 fax

### HOUSTON

700 Louisiana Street, Suite 3700  
Houston, Texas 77002-2797  
713-225-2300  
713-225-2340 fax

### LOS ANGELES

One Century Plaza  
2029 Century Park East, Suite 3300  
Los Angeles, California 90067-3063  
310-277-7200  
310-201-5219 fax

### NEW YORK

1270 Avenue of the Americas, Suite 2500  
New York, New York 10020-1801  
212-218-5500  
212-218-5526 fax

### SACRAMENTO

400 Capitol Mall, Suite 2350  
Sacramento, California 95814-4428  
916-448-0159  
916-558-4839 fax

### SAN FRANCISCO

560 Mission Street, Suite 3100  
San Francisco, California 94105-2930  
415-397-2823  
415-397-8549 fax

### WASHINGTON, D.C.

815 Connecticut Avenue, N.W., Suite 500  
Washington, D.C. 20006-4004  
202-463-2400  
202-828-5393 fax

### BRUSSELS

Boulevard du Souverain 280  
1160 Brussels, Belgium  
(32)(2)647.60.25  
(32)(2)640.70.71 fax

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