

**THE FINAL AND PROPOSED HYBRID PLAN REGULATIONS  
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**By**

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On October 19, 2010, the IRS issued final and proposed regulations pertaining to hybrid plans. The final regulations, in large part, adopt the proposed hybrid plan regulations issued in 2007 and address the requirements of Code §§ 411(a)(13) and 411(b)(5). The proposed regulations expand upon the final regulations and offer partial relief from some of the provisions of the final regulations. A summary of the guidance provided the final and proposed regulations appears below.

**I. The Final Regulations**

A. Treas. Reg. §1.411(a)(13)-1

Treas. Reg. §1.411(a)(13)-1(c) describes the three-year vesting requirement which a defined benefit plan must satisfy to be entitled to the safe harbor under Code §401(a)(13)(A) if any part of the accrued benefit under the plan is determined under a statutory hybrid benefit formula. This three-year vesting requirement applies as to a participant's entire accrued benefit, even if only a portion of the accrued benefit is determined using a hybrid benefit formula. As was the case with the 2007 proposed regulations, Treas. Reg. §1.411(a)(13)-1(d) provides definitions of several terms used in the regulations, including "accumulated benefit," "lump-sum based formula," "statutory hybrid benefit formula," "statutory hybrid plan," and "variable annuity benefit formula."

The most significant change reflected in the final regulations under Code §411(a)(13) pertains to the application of the three-year vesting rule. Specifically, under Treas. Reg. §1.411(a)(13)-1(e)(2)(E), the three-year vesting requirement does not apply to a participant who does not have an hour of service on or after January 1, 2008.

Treas. Reg. §1.411(a)(13)-1 is generally effective for plan years that begin on or after January 1, 2011.

Treas. Reg. §1.411(b)(5)-1

The final regulations retain the same hybrid plan safe harbor design formulas provided in the proposed regulations that are deemed to satisfy the age discrimination rules of Code §411(b)(1)(H)(i). There is, however, some

variation in the special rules used to compare the accumulated benefits of participants when more than one formula is involved. The general rule described by Treas. Reg. §1.411(b)(5)-1(b)(1)(ii) states that the safe harbor is only available as to an individual if the individual's accumulated benefit under the plan is expressed under only one safe harbor formula and no similarly situated, younger individual who is or could be a participant has an accumulated benefit that is expressed in terms other than the same safe harbor formula. Separate exceptions are provided for sum of benefit formulas, greater of benefit formulas and choice of benefit formulas.

As to a sum of benefits formula, if a participant's accumulated benefit is expressed as the sum of two or more safe harbor formulas, the plan satisfies the Treas. Reg. §1.411(b)(5)-1(b)(1)(i) as to an individual, provided that the plan satisfies Treas. Reg. §1.411(b)(5)-1(b)(1)(i) separately for benefits determined in terms of each safe-harbor formula and no accumulated benefit of a similarly situated, younger individual who is or could be a participant is expressed other than as one of the permitted exceptions (sum of benefits, greater of benefits or choice of benefits). The same test is applied in determining the availability of the greater of benefit formula exception.

A slightly different test is applied in determining whether the choice of benefit formulas exception applies. As to that exception, if the plan provides that a participant's accumulated benefit is determined under a choice by the participant between benefits determined in terms of two or more different safe-harbor formulas, the plan satisfies Treas. Reg. §1.411(b)(5)-1(b)(1)(i) as to an individual, if the plan satisfies Treas. Reg. §1.411(b)(5)-1(b)(1)(i) separately for each safe-harbor formula and no accumulated benefit of a similarly situated, younger individual is expressed other than as either (1) the choice of benefits under two or more safe harbor formulas used for the participant's choice of benefit; or (2) a benefit determined under only one of those safe safe-harbor measures.

Treas. Reg. §1.411(b)(5)-1(c) details the special additional requirements of Code §411(b)(5)(B)(ii) applicable to plan conversions after June 29, 2005. Specifically, as to a participant in the plan before the conversion amendment is adopted, the participant's benefit at any subsequent annuity starting date may not be less than the sum of (1) the participant's Code §411(d)(6) protected benefit as to service before the effective date of the amendment (determined under the pre-amendment plan terms); and (2) the participant's Code §411(d)(6) protected benefit as to service after the effective date of the amendment, determined under the post-amendment plan terms. Each optional form of benefit available to the participant under the pre-amendment plan must continue to be available to the participant after the conversion to the extent of the plan's benefits for service before the effective date of the amendment. The plan must provide that the amount of a benefit payable in an optional form of benefit payable at an annuity starting date based on a lump

sum-based benefit formula that is attributable to the opening hypothetical account balance is not less than the benefit under the comparable optional form of benefit under the pre-amendment plan as to service before the effective date of the amendment.

Whether an amendment is considered a conversion amendment is determined on a participant-by-participant basis. Treas. Reg. §1.411(b)(5)-1(c)(4) provides that an amendment is a conversion amendment if it (1) reduces or eliminates benefits that, but for the amendment, a participant would have accrued after the effective date of the amendment under a non-hybrid benefit formula under which the participant was accruing a benefit; and (2) after the effective date of the amendment, all or a part of the participant's benefit accruals under the plan are determined under a hybrid benefit formula. Only amendments that eliminate or reduce Code §411(a)(7) accrued benefits or a Code §411(d)(6)(B)(i) retirement-type subsidy that would otherwise accrue as a result of future service are covered by this provision. If, under the plan, a change in the conditions of a participant's employment would result in a reduction of the participant's benefits that would have accrued in the future under a non-hybrid benefit formula, the plan is treated as if its terms constitute an amendment that reduces the participant's benefits that would have accrued after the effective date of the change under a benefit formula that is not a hybrid benefit formula. The effective date of a conversion amendment as to a participant, is the date on which the reduction of the participant's benefits occurs.

Treas. Reg. §1.411(b)(5)-1(d) describes the requirement of Code §411(b)(5)(B)(i) that the interest crediting rate as to benefits determined under a hybrid plan may not be greater than a market rate of return. For purposes of the final regulation, an interest credit means any of the following adjustments to a participant's accumulated benefit under a hybrid plan, to the extent not conditioned on current service and not made on account of imputed service: (1) any increase or decrease calculated by applying a rate of interest or rate of return to the participant's accumulated benefit; and (2) any other increase for a period under the terms of the plan at the beginning of the period. A plan amendment that increases a participant's accumulated benefit is not considered an interest credit if the increase is made due to a plan amendment providing for a one-time adjustment to the participant's accumulated benefit. Nonetheless, a pattern of repeated plan amendments providing for one-time adjustments to a participant's accumulated benefit will result in the adjustments being treated as provided on a permanent basis under the plan.

Treas. Reg. §1.411(b)(5)-1(d) provides that an interest rate is not in excess of a market rate of return only if the interest credit is always less than a particular interest crediting rate that meets the market rate of return limitation or always equals the lesser of two or more rates if at least one of the rates satisfies the market rate of return limitation. Different interest crediting rates may be used

for different portions of a participant's hybrid plan account balance. The regulation provides an expanded list of safe harbor interest crediting rates, which includes the three segment rates used to calculate lump sums under Code §417(e) or to determine minimum contributions under Code §430(h).

## **II. The Proposed Regulations**

The proposed regulations under Code §§411(a)(13), 411(b)(1) and 411(b)(5) issued on October 19, 2010 are intended to be effective for plan years beginning on or after January 1, 2012, however, they may be relied upon prior to their effective date. The proposed regulations provide relief from some of the requirements described above.

Prop. Reg. §1.411(a)(13)-1(b)(2) describes the requirements that a lump sum benefit formula must satisfy to obtain the relief available to a hybrid plan that determines benefits under a lump-sum benefit formula from the requirements of Code §§411(a)(2), 411(a)(11), 411(c) and 417(e). As to the participant's benefit on or before normal retirement age, a plan is deemed to satisfy the requirement of the proposed regulations if, upon attainment of normal retirement age, the then-current balance of the hypothetical account is actuarially equivalent to the portion of the participant's accrued benefit that is determined under the lump-sum based benefit formula. As to the participant's benefit after normal retirement age, as to each annuity starting date after normal retirement age, the then current balance of the hypothetical account must satisfy the requirements of Code §411(a)(2) or would satisfy the requirements of that Code section but for the fact that the plan suspends benefits under Code §411(a)(3)(B). Finally, the participant's hypothetical account balance may not be reduced other than for benefit payments, qualified domestic relations orders, forfeitures that are permitted under Code §411(a), amendments that are permitted under Code §411(d)(6) or adjustments resulting from the application of interest credits that are negative for a period, for plans that express the accumulated benefit as the balance of a hypothetical account.

The proposed regulations, at Prop. Reg. §1.411(b)-1(b)(2)(ii)(H), also include a provision under which a hybrid plan that uses a variable interest crediting rate that was less than zero for the prior plan year would not fail to satisfy the 133 1/3% rule for the current plan year because the plan assumed that the variable rate was zero for current and all future plan years.

The proposed regulations also include an extensive discussion of interest crediting rates and expand the list of safe-harbor interest crediting rates.