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NONDISCRIMINATION RULES

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- 401(a)(4)
- 401(l)
- 401(a)(26)
- 410(b)

MS. JANICE P. BRICKER: I'm a consulting actuary with Milliman & Robertson. Joe Macaulay is a consulting actuary with George Beram and Company. Adrien LaBombarde is a research actuary with Milliman & Robertson.

MR. JOSEPH P. MACAULAY: One of the reasons we ended up doing this session is because it is desirable to give people a little more of an overview of general nondiscrimination. I'm saying an overview only because we're not going to get into specific subsections of the code. If it gets to that, I have the regulations here, and we can do it. But I really don't think that was the intention of this session.

As consultants, in general, our clients hate this right now. They would love to get rid of a defined benefit plan, and still provide a good benefit for themselves. They really find this to be a pain in the neck; except the very large client basically just considers the testing cost a side effect. And they just have to keep paying it. But any company with less than 4,000 or 5,000 people, if it sees another bill for doing the general test again, is going to be really unhappy. And it's really getting hard. It's basically a business problem in the consulting industry. And this has been brought on by abuse, and this desire expressed by Congress in the 1986 Tax Act, to replace facts and circumstance tests with bright lines. Well none of us walked in here carrying a bright line; we'll do the best we can to try to help you find a way of building bright lines as we go along.

There have been enough complaints about these regulations that they've basically been given a one-year hold. A complete reissue is anticipated, probably adding one or two safe harbors, and maybe fuzzying the bright lines, or the things that are near bright lines. So that may be part of what is going on. The Treasury has changed; there's a new benefits counsel at the Treasury. And so it is heading in a slightly different direction, due to congressional pressure, to make changes.

Having said that, let's see if we can work our way through nondiscrimination. I'm going to discuss the testing universe, the background that we're looking at, and basically the coverage and participation portion of 410(b). Then Adrien is going to start to discuss 401(a)(4), which is nondiscrimination. Then I'm going to try to go through the general test. And at that time, we'll do the average benefits percentage test from 410(b), because it seems silly to define how to do testing twice. And then Adrien's going to discuss the rest of 401(a)(4).

Generally, in nondiscrimination, the thing you have to look at is what you are testing. How are you testing? And the first place you start testing is at the employer. And basically the employer is the parent company in general. So if there are many small subsidiaries, you may only be working on one company's plan. But that company may be owned by a succession of companies. And for the purposes of the testing, if it's in a controlled group, you have to use denominators that are at the controlled group level for all of your testing. And many things have to be tested against the whole controlled group. And I think we have to continue to remember that.

When I have to test a plan, the problem is that, for certain purposes, the denominators I need to use are not the denominators taking into account people in the plan. They're the denominators that take into account people of the employer. Or if I get lucky, and can make use of the separate line of business (SLOB) regulations and define a qualified separate line of business (QSLOB) for many purposes, then the denominators move down one notch. And I'm looking at the required denominators for the qualified separate line of business. The problem really is that the methods of handling this are very difficult. You have to get straight exactly where you're doing the test. And this is the most important thing to remember when starting. Who is the employer that you're doing the tests on? The employer is very frequently the parent company.

The concept of controlled groups is the thing that causes this whole problem. I'm not intending to go into how to define a controlled group in all of its glorious varieties that are available. In general, if a company is owned to some extent, and if the ownership is 80%, it's a controlled group. If it's less than 80%, unless there are special options for purchase or things like that, it is not a controlled group.

There are special rules, and there are publications that we can all look at for some of the things we're doing. Commerce Clearing House (CCH) has a guide by Adrien. Adrien does build, I think, a nice logical foundation of what is to be done. And if you're going to be doing much, this is a very good starting point. My major complaint with it, and I gave it to him earlier, is that he decided to redefine some of the IRS defined terms. And for those of us who understand them, it's very confusing.

If you can't use a separate line of business, you have to use all of the people covered by the controlled group, and all of the highly compensated. And that's the first thing to think about. There are separate-line-of-business rules that came out in December, and there has been a six-month allowance of not having to follow them. Basically, in order to have a separate line of business, you have to have a separate organizational unit, and be able to tell what it is and break it down. There has to be separate financial accountability, which basically means profit-line requirements or something like that. You have to be able to define that your workforce and management are separate. And there are tests for this. Now in the final regulations the test for separate management was made easier. Previously people were required to spend a very high proportion of their time working in a unit. Now there is an optional rule for vertical integration that allows you to satisfy the separateness conditions.

Having a separate line of business isn't enough; it then has to be a qualified separate line of business. There has to be at least 50 employees, and here you can count some union employees, which you can't otherwise. The IRS has to be given notice.

Nobody has yet done that, because nobody has yet had to, because the IRS has said, for the time being, don't.

Administrative scrutiny has to be passed. Previously everything we've done has to be passed. There's an old statutory requirement called the 50/200% test. The proportion of highly compensated cannot be less than 50%, or more than 200%, in any unit of the ratios for the employer as a whole. An industry category safe harbor exists. A separate line of business satisfies this safe harbor if it is in a different industry than every other separate line of the employer.

An industry segment in a company can qualify as a separate line of business. The industry segment must meet Financial Accounting Standards Board (FASB) rules and be required to report under Securities and Exchange Commission (SEC) requirements.

There's a safe harbor test based on either a maximum or minimum benefit. And then there's a safe harbor for companies that have been through mergers. Basically four years are given to straighten things out. Prior to that, the purchased company and its lines can be kept separate. There's an average benefits safe harbor for comparability. And then there's always individual determination. Throw it to the IRS and pray, is another way of thinking about that one.

I have a couple of comments on SLOB in our practice. We have a fair number of U.K. parent companies. And they don't necessarily have a good understanding of what they're doing with regard to their units here. So getting some of the data (when you count the employees for the unit you're supposed to count worldwide employees) is rather difficult. So there are a lot of problems if you have a foreign parent. The major problem with the separate line of business is getting your hands on the data to test it out. Allocating employees is another problem. Many companies have centralized service entities, such as accounting, data processing, etc. That causes some real problems with the separate management tests.

This isn't necessarily a problem with the separate line of business, but it's a statement of what the separate line of business doesn't do for you. You still have to test plans for a nondiscriminatory classification on the basis of the whole employer, not just the separate line. And, as I said earlier, the problem with the foreign parent is you have to count nonresident aliens in all of these counts. And just getting that data, if the parent is foreign, or if there are significant foreign subsidiaries, could be quite difficult.

Okay, now we will discuss testing. The first thing you have to look at is the definition of the highly compensated. Effectively you use gross pay with the deferrals cranked back in. In other words, if somebody has a 401(k) plan, you have to put that money back in there. If somebody has a 125 plan, a flexible spending account, that has to be cranked back in.

Then there are three approaches of looking at highly compensated. The easiest one is $75,000 indexed first. That's $93,518 this year. Even though right now, if you're looking at testing, you're not looking at testing somebody in 1992. You're looking at testing for calendar 1991. That's $90,803.

Another choice is the top 20%. And with the top 20%, there's the $50,000 indexed scale, which is $62,345 and was $60,535 last year. If companies don't pay very high, you may have to count officers who make less than either of these thresholds. And then there is a threshold that is $45,000 indexed. And I didn't make a note of what that is. I don't have any companies as clients that have officers that make less than the $50,000 indexed threshold.

There's a concept called the "look-back-year." Highly compensated employees are identified on the basis of two years: the current year and the look-back-year. If this is confusing for you, try to tell somebody with 12 subsidiaries to give you data on this basis. So you can go for a simplified definition, and avoid the look-back-year as long as there are entities in more than two geographical areas. You can basically use the $50,000 indexed definition with 20%. By the way, all of these dollar numeric definitions, even if there are SLOBs, are tested against the whole employer for finding the percentages and the counts.

So you can use a simplified definition which would use the $50,000 indexed, the $62,345 today, and you avoid the look-back-year. And if you don't do that and you're testing a large number of companies, you are insane and your clients will probably tell you so. If you really can't get the data, and it isn't worth doing.

By the way, there's a requirement that says that even if no officer earns over $45,000 indexed, there would be one officer counted. So if nobody earns over $45,000, the highest paid employee gets counted. Again, this is on an employerwide basis.

The reason this all comes up in controlled groups is that there are a lot of people who buy companies and let them run on, on their own. And, unfortunately, you can let them do that, but somebody has to collect the data so that it can be tested and reported. And this is basically all reported on line 22 of the form 5500. And it gets somewhat messy.

I'll talk now about coverage and participation, which is 410(b). One of three sets of tests has to be passed. Cover 70% of the nonhighly compensated employees of the employer you're testing. Again, if a QSLOB is allowed, that can be 70% of the nonhighly compensated in the QSLOB. Technically, Adrien would say it's the nonexcludable, nonhighly compensateds. People who've had too little service, or who are too young, or both, are allowed to be taken out of the counts. But basically once that is cleaned up, you have to count everybody who can't be excluded.

The easiest example of excludable is 21 and 1. If the plan has an eligibility requirement of age 21 and 1 year of service, all the people who don't satisfy that requirement can be excluded. If the plan has an eligibility requirement that is lower than that, everybody with less than 21 and 1 can still be excluded from one set of tests. You then have to test those who pass the lower eligibility requirement as a separate group. And from a data collection standpoint, that becomes a real mess. It would be glorious if everybody's plan would have the same definition for a controlled group.

One of the problems that comes up is frequently 401(k) plans have an easier eligibility requirement than defined benefit plans. And so you end up having to collect a lot of data to be able to do the tests in various ways. So if you can cover 70% of the nonhighly compensateds, you're home free for that plan.

The second one is the 70% ratio test. And basically the 70% ratio test is really a ratio of ratios. For the development of that ratio, see the table. The first ratio is the percent of the nonhighly compensated in the plan (the number of the nonhighly compensated in the plan divided by the number of nonhighly compensated in the employer). Now that is then divided by the number of highly compensated in the plan, divided by the highly compensated in the employer. If that is greater than 70%, you're done for that test for this plan.

Coverage Test Limits

Concentration Percentage	Safe Harbor	General Test	Unsafe Harbor
10%	50%	45%	40%
15%	50%	45%	40%
20%	50%	45%	40%
25%	50%	45%	40%
30%	50%	45%	40%
35%	50%	45%	40%
40%	50%	45%	40%
45%	50%	45%	40%
50%	50%	45%	40%
55%	50%	45%	40%
60%	50%	45%	40%
65%	46%	41%	36%
70%	42%	37%	32%
75%	39%	34%	29%
80%	35%	30%	25%
85%	31%	26%	21%
90%	27%	24%	20%
95%	24%	22%	20%

Concentration Rate R
R = #NHCEs/(#NHCEs + #HCEs) where NHCEs is the number of nonhighly compensated employees and HCEs is the number of highly compensated employees.

Section 410(b) is totally linked with the rest of general nondiscrimination. And basically when you look at the general tests for nondiscrimination, it qualifies as long as it can pass 410(b). Well, this is one way of passing 410(b). Because the 70% ratio can be passed. The problem that comes up is that when you get into the general test, when you start trying to get groups that can pass, usually you can't get them to pass 70%. So you need a way to get better than that. And we'll get to that a little later. Another problem is if there is a company with a number of subsidiaries, let's say with an engineering company subsidiary that doesn't have enough nonhighly compensated employees, forget whether it is in the plan or not, to make this ratio work. It would need another 40, 50, 100, 200, or 500 people to pass the 70% ratio. So you have to find some other test.

In the past, we've tried to make things qualify as separate lines of business. And then maybe the test could be passed that way. Otherwise you're going to have to do what the last line says, which is nondiscriminatory classification and average benefits test.

I have decided not to talk about the performance of the average benefits test here, simply because the calculation is very similar to the general test. And it would be easier to only go through calculations like that once. And so we're going to hold off until then.

The nondiscriminatory classification part of it basically says two things. The classification must be reasonable for business reasons. Hourly and salary sometimes works. Different location works. A lot of allowed methods work for that. The other thing then is the numerical test based on proportion of highly compensated, possibly subjective, which has facts and circumstances. Basically what we're saying here is if you pass the average benefits percentage test, the percentages for your tests drop. The concentration is the percentage of nonhighly compensateds in the employer. If you have to do the nondiscriminatory classification, it's in the complete controlled group, because that has to be done on a controlled group basis. And if the concentration is 0-60%, then the safe harbor is 50%. If the plan passes the safe harbor, you don't have to do facts and circumstances. Adrien, by the way, at the moment calls that the intermediate threshold.

Then there's another item called the unsafe harbor, which is 40%. If the plan fails 40%, you've got to find something else, because it has failed completely. When you're in between them, that's where facts and circumstances come in. In calculating this, you can get rid of the excludables. But basically, if the employer has 90% nonhighly compensated, the thresholds are a lot lower. So this helps a lot. But this is why passing the average benefits test makes life a lot easier for companies that have a lot of subsidiaries, or when trying to pass the general test. Try to get a rate group in the general test that has a 70% ratio; that doesn't happen with most of my clients, and I don't think it happens with most of yours.

There's a center column on the table that I just call the general test. When they did the final regulations under 401(a)(4) for rate groups, they wanted to continue the bright-line thing. So it's basically the average of the safe and unsafe harbors. And basically, if you're above that, you win. If you're below that, you fail. And no facts and circumstances are available.

Let's go on to at least the general concepts of the average benefits percentage test. Again, you're not doing that for a plan. If you start saying you're doing an average benefits percentage test for a plan, you're going to confuse your client, and you may confuse yourself enough so you start thinking that's what you're doing. The calculation of the average benefits percentage test is done at the level of the employer: separate line of business if you're there, or the whole controlled group if you're not. You have to calculate it for all nonexcludable employees. You calculate the benefit as a percent of testing compensation, and this is not a hard test to pass. It's just a hard test to do. Because the test is not a severe test to pass. The problem is, if it's a large employer, you have to gather an awful lot of data to do it.

And basically what it says is, add up the average benefits percentage for all of the highly compensated and average that. Add up the average benefits percentage for all of the nonhighly compensated, and average that. And if the nonhighly percentage is at least 70% of the highly percentage, the plan passes. We're going to talk about the calculation itself when we get to the 401(a)(4) general test. If there are nonexcludable employees who have no benefit, they go in as zeros in calculating the averages.

Now theoretically it was originally proposed that the average benefits test be done on all plans of the employer. There is an exception in that you can test only all the defined contribution plans and only all the defined benefit plans. You can test them separately as long as you pass a few requirements.

The biggest no-no here is you couldn't have used any cross-testing in doing your nondiscrimination test. So if one of the companies has one of these new popular age-weighted, profit-sharing plans, you test everything together, because that uses cross-testing. There are other restrictions. Basically you can test them separately as long as nothing has been cross-tested, and as long as you do average benefits on both sides separately. Or frequently there is an employerwide 401(k) plan and a whole load of defined benefit plans. Then if the 401(k) plans passes the 70% ratio, you're home free. But the big thing is, the average benefits percentage test is performed on the whole employer, with one exception. I make a lot of use of the exception. You have to test all plans together either on a contributions or a benefits basis.

MR. ADRIEN R. LABOMBARDE: It's so hard talking about nondiscrimination and everything else in so short a time. And with that in mind I'm going to waste a few minutes right at the beginning, since Joe mentioned the book. If anyone is using the book, regarding the formula on page 270, the publisher really screwed up the parentheses on it. If you bother to use page 270, fix them; I'll leave it to you to figure out how to fix them. Page 70 has a subtle little error someplace that I'll leave you to find. Chapter two on timing is obsolete, because there is now a one-year delay, and there are a lot of other things that come in terms of reasonable, good faith interpretations. Chapter eight is now obsolete. The material on QSLOBs was written before the final QSLOB regulations came out, although much of the structure remains. Chapter 10 is obsolete, because participation regulations came out after the book, although much of the structure remains the same.

And last but not least, bringing me to the threshold of the topic here, is the nondiscrimination portion. All the chapters from 12 and beyond are kind of open game right now. Although from what we expect from Treasury at this point in time, I think most of the structure will remain in place. Some of you might charitably remember the days of Section 89, when everything kept being delayed, and delayed, and delayed; and it was finally repealed and then was no longer. Don't expect the same thing here. It's just not going to be like Section 89. This is not going to be repealed. When the changes are made, they are going to be another layer. For some employers, that will make it simpler. Many complained about 600 pages of regulations; I think you're going to wind up seeing maybe another 200 pages that will make it so that if you satisfy those rules, it will be simpler for you to apply year by year. But they're not going to repeal some of what was there and go back. So if you've already gone done the pike with a lot of these rules, preparing for application of this, much of the structure is going to remain the same.

Now what is that structure on nondiscrimination? I think you really have to bear in mind that there are some special rules, which a lot of times tend to get overlooked when people talk about nondiscrimination structure. And then you have to remember that there are separate rules for former employees versus active employees. Most of the discussion that we do concentrates on active employees, and that's where most of our concentration will be on here. But you cannot forget the former employees as well. A plan can be discriminatory. If it's nondiscriminatory with respect to active, but discriminatory with respect to former, that will damn the whole plan.

The first special rules that I really want to talk about is this anti-abuse rule. Now again, this gets ignored a lot. The IRS pulls it out of its pocket any time it hears one of us gamesters find some special way through the rules; such as with the age-weighted profit sharing plans. The anti-abuse rule is in Section (1)(c)(2) of the regulations. And it really had me scratching my head at first as to exactly how far this is going to go. All it says is that you have to interpret the regulations in a way that is consistent with the enterprise of protecting against nondiscrimination, in favor of the highly compensated employees. So what? They've set up these 600 pages worth of rules, and does it still come back to facts and circumstances? Can the IRS still come back and subjectively say, well you've satisfied all of these rules, but the way you've satisfied them still doesn't please us, so you're still discriminatory.

Well, essentially that's what Section (1)(c)(2) says. And that's what's implied whenever you see the Treasury or the IRS basically pulling it out of its hip pocket. I don't want to be giving advice here, but I think a lot of us really feel that that's really pushing it. The IRS is really going to be hard pushed to pull Section (1)(c)(2) out of the blue if it ever comes to tax court, if you have satisfied all of the other rules.

Now let me go to one quick example that the IRS itself points out. When we get to the general test, you'll see that there's a single-rate version and there's a dual-rate version. The single-rate version, in theory, is simpler. People like me always use the dual-rate version. But if you want to use the single-rate version, there's a list of conditions that you have to satisfy. But the IRS gives an example where every single one of those conditions is satisfied, yet it still judges the plan to be discriminatory because of Section (1)(c)(2). All of the highly compensated employees were past the age where the most valuable benefit was the highest. The plan used that fact to basically get a little bit of extra edge for the highly compensated employees. All the nonhighly compensated employees were under the age, where the most valuable benefit was the highest. And they basically transferred that value across to the highly compensated employees. Now, some of us might shrug and say, that does smack of being abuse to some. To others, no. The real problem with that is, if you really take that to heart, it says there's an additional condition for use of the single general test. You have to have been able to satisfy the dual-rate general test to begin with; which to a lot of us, I think, is taking it one step too far.

There are a lot of ambiguous situations; for example, subsidized lump sums in integrated plans. There's been a problem with that if you're trying to go into 401(l). If you use the general test, for those plans, nine times out of ten, in fact, more frequently than that, you'll go through the general test with flying colors, if it would have failed in the safe harbor. And there've been some questions raised about Section (1)(c)(2) in that. Again, I think if you apply the rules exactly as they are in the book, it's really difficult to condemn.

Exemptions are going to seem rather trite until you actually see one come up. I've seen a number of plans where the consultants stretch and crimp and crawl over a primary insurance amount (PIA)-offset plan until they realize that it's a collectively bargained plan. And you can do any PIA-offset that you want with that. You can do anything that you want if the plan is restricted to just all nonhighly compensated employee. If the plan isn't restricted to nonhighly compensated employees, sometimes it's good to consider going out there and restricting it to nonhighly compensated employees, and letting the highly compensated employees handle it with the nonqualified benefit, instead of going through what it might take to otherwise qualify the plan.

401(k) plans, of course, are the Actual Deferred Percentage (ADP) test. 401(m)s under the Actual Contribution Percentage (ACP). 401(h) is separated out of the 401(a) for analysis, but it's not ignored. If you've got 401(h), remember that you've got separate nondiscrimination requirements there.

For the active employees, as you all no doubt are probably quite aware of right now, plans have to be nondiscriminatory with respect to amounts, nondiscriminatory with respect to availability of rights and features, and nondiscriminatory with respect to the effect of certain events, such as amendments and planned terminations.

Regarding nondiscrimination with respect to amount of contributions or benefits, again, there are some special rules that you need to pick up at the front end. I won't go through those right now. The basic question that comes up in nondiscrimination of amounts is really the heart of the question of all of the analysis. Coverage, participation, nondiscrimination, and the whole ball usually come back to -- is your plan going to be a safe harbor plan, or are you going to go with the general nondiscrimination test?

Now I was at a meeting, where at one point someone complained about all of these rules and said, why doesn't the IRS just leave us all alone? Why can't we just set up a plan that gives 5% to every single employee and be done with it? Then I said, "Well the point is, you can." If you set up a plan that is very simple, uses the 414(s) definition of compensation, doesn't have integration in it, and has universal coverage, the IRS isn't going to bother you. All of the complexity here comes about by virtue of different plan designs, nonuniversal coverage, and different features that the employers want because of purposes on their own. Now, I'm not trying to shift the blame back onto the employer. But to some extent, I think you can understand a little of what's going on in the safe harbor and the general test, if you realize that to some extent what the IRS is doing is coming back to that home base, of where you would be if you had uniformity universally. Because they will now break up the plans into units of uniformity. If the unit of uniformity is the entire plan, you may be able to satisfy safe harbor; if not, you're going to be walking through the general test. And essentially you're breaking out the units of uniformity, based on the rates that are provided by the plan itself. Each one of those units of uniformity incidentally then has to satisfy coverage, which gets into this little circular passage between coverage and nondiscrimination. But I think if you bear in mind the basic uniformity requirements, and the units of uniformity within the plan, a lot of this is a little bit easier to break apart and understand.

Under the safe harbors, probably the biggest problem that we're coming up with is the definition of compensation under 414(s). If you're going to use the safe harbor you must satisfy 414(s). That does not have to be a safe harbor 414(s) definition of compensation. When I wrote the book, I was tired of trying to explain to people that safe harbor 410(b) is not the same as safe harbor 414(s), is not the same as safe harbor 401(a)(4). And so I used some alternative words; you don't have to satisfy the safe harbor under 414(s), but you must have a 414(s) definition of compensation.

Probably the most important permissible nonuniformity that we see is the multiple formula rule; that is, if you have the sum of two formulas or the greater of two formulas. Prior plan offsets are also seeing a fair amount of activity right now. The present rules don't want you to update those prior plan offsets with compensation. The IRS is looking at that.

As you all know, the IRS has not given a safe harbor exemption with respect to 401(l) PIA-offset plans. It has given something called a mock offset plan. I haven't seen anyone yet who has found an employer willing to try to use that. If anyone's got any alternative note on that, I'd appreciate hearing it.

The actual safe harbors themselves can be broken out into design-based safe harbors, calculation-based safe harbors and special safe harbors. I think that's pretty well self-explanatory.

The general nondiscrimination test is the alternative you need if you do not satisfy the safe harbor. But that's not where my outline ends, before I go into my part two, because as I said, the basic structure of nondiscrimination for active employees had two other parts. So I'll just mention them in passing. Nondiscriminatory availability is where you measure current availability on a 410(b)-type concept, without the average deferred percentage (ADP) test, and effective availability is facts and circumstances.

Nondiscriminatory effective plan amendments is generally a facts and circumstances type of determination. There is a safe harbor for certain grants of past service.

Regarding former employees, you only have to test the nondiscriminatory amount of the accruals, and the nondiscriminatory availability. You're not looking at the non-discriminatory effect of plan amendments there. However, suffice it to say that as the rules stand right now, you better hope to get into a safe harbor on former employees, because it's a real bloody mess to try and test it under the general test, if you're not under a safe harbor. The IRS is looking to try to dress those rules up and make them a little bit cleaner for them. Right now, if you're testing your former employees, you better fly towards a safe harbor as quickly as possible with respect to them.

Having touched on the other areas of the structure, we now come back to the general nondiscrimination test, which is principally composed of three steps.

Essentially, you have to determine your rates. You have to form your rate groups, and you satisfy 410(b) with those rate groups. And again, as I said, each of those rate groups is essentially the structure of uniformity that you're dealing with.

MR. MACAULAY: I actually have a couple of quick points before we get too deeply into doing the general test. I'm going to talk about the general test for convenience using defined benefit plans, and test it as for benefits. Actually that's the hardest of the two types of tests. So I don't think that's a major problem. The other thing is, if you're going to do any of this, there are really two things, both for this task and for the other general tasks, that you really need to do in the background to make it work.

And the first thing that you should do is get some reading matter that gives you a logical way of following the regulations. Which are not written by actuaries. There may have been actuarial input into the formulation of calculation methods, etc., but these are not written by actuaries, and they can trap the actuary who's working on them who is not very, very familiar with them. They are somewhat complex and convoluted in the way you have to apply them.

Sometimes you have to see that you're allowed to do this. There are allowances for imputing disparity, for example. And for those of us who are older like me, it's called integration. But somebody built a new term, and they love it, so they're using it.

But the thing is, there are a lot of requirements. And I saw one case recently where a fairly experienced actuary missed one of the requirements, where the plan he had designed would have had to have passed a demographic test to be allowed to be considered a safe harbor. And that was not the desire of that plan's sponsor.

I have a minor comment also on the general test. I have seen safe harbor formulas that wouldn't have a chance in blazes of passing the general test. Some different types of formulas and different features – specifically subsidized early retirement – get a different treatment between the two approaches. And I really feel that the subsidized early retirement on a 401(l) safe harbor is treated nicer there than it's treated in the general test. And the real reason is, there's a limit to how much disparity you're allowed to impute in doing the general test. And when testing on the most valuable basis you're really limited on premitted disparity.

You have to have enough data to do a general test and it has to be fairly clean. Let's hope you won't have to collect additional data to do this. If it's done at the right time and in a quick enough manner, you can probably do it after a valuation, and that may work. But on an audit, this could get messy on the data requirement.

There are two requirements for doing the general test. First, this two-way versus one-way test. And let's start with the way that's got to be done, no matter what, which is called the most valuable. You have to test most valuable at all times. And if you're lucky, and you don't have any of the other uniformness problems, you may not have to also test with regard to the normal. But basically, the most valuable test asks at what age are the benefits the most valuable available?

In most instances that comes down to doing a calculation to determine which age is best. And there are good examples in the regulations and in the book. Basically what happens is, if you have a plan with a 30-and-out provision, most of the time the most valuable is the earliest unreduced age, unless the reductions themselves from there are more generous than actuarial.

Basically, if the reductions are more generous than actuarial, you have to do a calculation. But you can fairly easily define by formula which age is the most valuable age. For many plans it's the earliest, early retirement age.

The next thing you have to do is calculate normalization factors for this purpose. I'm going to just mention that you have to do it. You have to use any one of an allowed set of mortality tables: Unisex Pension Table (UP)-1984, Group Annuity Mortality (GAM) Table 1971 or 1983, Individual Annuity Mortality (IAM) 1983. The table has to be sex-neutral. Nowhere have they mentioned setbacks. I've taken the position, reasonable setbacks can be used, if for no other reason than the fact that the unisex versions used by the different regulatory agencies frequently have setbacks. You can use any interest rate between 7.5% and 8.5%. Apparently the people who wrote these regulations didn't take into account the political pressure to drop interest rates in this county. They may be outside the range of rates that are reasonable in the near future. By the way, the 7.5-8.5% is also used for cross-testing.

Let's say the rate is at age 55. You have to convert that into a deferred annuity payable at 65. That is the basic process. If it's a significantly subsidized benefit, you can get a normalization factor above three. Many times you'll get a normalization factor over two. And so you have the normalization factor, and now you calculate the accrual rate.

There are three ways of calculating the accrual rate: the annual rate, the accrued-to-date method, and the projected method. The accrual rate, as calculated for the annual and the accrued-to-date method, can also be used as the accrual rate for the average benefits percentage test, which is why we didn't spend time developing it earlier.

To get the accrual, let's take the annual first. For each person, take the amount of his or her accrued benefit at the end of the plan year, and subtract the amount of his or her accrued benefit at the end of the prior plan year. This makes the annual method not necessarily the most favorable method on a final salary plan, when you could end up with a few highly compensated people having some significant benefit increases, because of their pay increases coming through.

Now this is then divided by testing compensation. Testing compensation in general should be a three-plus-year average, ending in the year that you're testing. Now, if the person only has two years or one year, then it's, of course, a one- or a two-year average. For the annual method, if you do not want to use permitted disparity, you can use a one year average. But that's quite a high price to do one-year averaging, because you may well need permitted disparity to pass your tests.

Now we go to the accrued-to-date method. I'm skipping, by the way, any of the fresh-start methods, or anything like that. There are enough restrictions on those. It's not saying you can't do that. It's saying if you're going to do that, you'd better get well into the code, or find some very thorough write-up on how to do it. There are so many little pieces that you have to go through and that isn't appropriate for a session of this length.

For the accrued-to-date method, you basically take the benefit accrued to date. You divide it by the service to date, and that produces an annual accrual. That one-year accrual is then divided by the testing compensation, which is usually a three- or a five-year average. It's convenient to take a number you have to calculate for other reasons anyway. For all these purposes, by the way, the testing compensation is limited to the $200,000 limit, as projected, and so are the benefits that are accrued. At the present time, there can sometimes be problems with people who had accrued benefits with much higher compensation before 12/31/88.

Okay, so now you have an amount of accrual for the year, and you've divided, and you have a rate. You're partway there. Now, you then have to normalize it if it's the most valuable. And there are sometimes requirements to normalize, if it's not the most valuable, or if it's at an unusual age; but most times that doesn't happen. So you now have a most valuable rate that is normalized, multiplied by the most valuable factor. You also have a normal rate which you may need to test as well.

The other testing method is projected. In doing the projected benefit method, you assume the current compensation level continues, and you basically divide by all service. A frequently projected benefit method is not very helpful because the level compensation sometimes has a significant problem with making it not so useful. Also, you can't use the projected benefit method's numbers for doing the average benefits percentage test.

Okay, now we have an adjusted accrual rate for most valuable, and an adjusted accrual rate for normal. Let's assume you want to use permitted disparity. Want is usually defined as you need it to pass. But let's assume you want to use a break for permitted disparity. Back when you looked at the safe harbors, you saw a rate that was allowed, .75%. That was at the Social Security normal retirement age. And basically you can use the same rate for everybody, if you use a rate that is allowed for everybody. You can also, if you need it, use the .75% for people with a Social Security retirement age of 65, .70% for those at age 66, and .65% for those at age 67.

Now, that has to be adjusted further if you are using an accrued-to-date method. If the person has more than 35 years of service, it's appropriate to use that. But that has to be adjusted by a factor to take into account that there are more than 35 years used.

Now that's the starting point for adjusting for permitted disparity. The next thing you do is ask if the person is above or below covered compensation. If their testing compensation is below covered compensation, then you take the lesser of twice their accrual rate, or their accrual rate plus the allowed disparity. There's a different formula for those who are above, and it's easier to just look it up.

A problem comes up by using this lesser of the amount accrued, or the allowable disparity. Usually when you're looking at a highly compensated individual, he or she has an accrual rate in excess of one. And by the time you use the 2-3 normalization factor, the permitted disparity just doesn't bring that up enough. And that's why it causes a problem there. But okay, you've now got a most valuable accrual rate, and a normal accrual rate with permitted disparity. You then have to define highly compensated groups.

I'm going to skip the one-way testing. One-way testing is fairly easy. You just define the highly compensated groups on the most valuable test. Each highly compensated person has a most valuable accrual rate, and a normal accrual rate. Now in this highly compensated group, every other person's two rates are above the previous person's two rates.

This is fine for a small company to look at it that way. There are 10 highly compensated groups, or something. That works fairly well. Because you can just look at the results and see if it passes or not. The highly compensated groups all have to pass 410(b). And they use that test line. If the ratio of participants in that highly compensated group will pass, depending on the concentration, then the highly compensated group has passed. And if all of the highly compensated groups pass that test, the plan has passed the general test.

If there are a fair number of people, just being able to see if it's passed, unless you've added to your software a method for counting them, is going to be a bit messy. And so you can use another feature that is allowed. And that is grouping. You can basically define a group as something that is plus 5% of the midpoint of a group or lower. Now the regulation allows you to define any number of groups you want, as long as they pass the requirement for a group.

A friend of mine's in a very large company; there are 16,000 highly compensated groups. To determine if it passes, a software approach is needed. I've had one that's had 110 groups, and it doesn't look that good doing it that way. So you basically have to define groups.

You can take the easy way out, if you're able to pass with the easy way out, of defining groups with differentials of 0.1 of 1% of accrual rate apart. There is another allowance, so that everybody with an accrual rate between 1 and 1.1 is in a group. And let's say that it's a nice, neat normalization factor. And so then their most valuable is 2, and 2.1 would be another group.

You're allowed to use wider bands than that, once the accrual rate is above 1%. The groups basically have to be plus or minus 5% of the midpoint of the group. And as long as the groups are no wider than that, you're allowed to do that. And you can define as many groups as you want doing that. Now that makes it a little easier; with my plan with 110, it compressed the highly compensated groups to five, which was nice and convenient. And that made it a lot easier to determine that it passed. When first looking at the plan with 110 highly compensated groups sorted out, it really looked like they didn't pass. But once grouped, they did look like they passed. So that is an advantage to you.

Actually I only defined two or three large groups, and that worked out well. You can make one wide group and a whole load of nonwide groups. The IRS has a technical requirement. If the group had all the highly compensated at the high end of the group, and all the nonhighly compensated were at the bottom end of the group, you could be challenged. But as long as there's a reasonable distribution, there doesn't seem to be a line for challenge on this. Again, as I say, if you're going to do this, you really have to work your way through something that'll give you pretty good guidance in this, if you don't do it all of the time.

Okay. When you satisfy them, you have that test threshold. This is supposed to be bright line; you can have it or not. The one other topic I was going to go into was average benefits percentage test.

In most instances, the normal accrual rate is the one to use. The only instance it's not true is if there are special early retirement provisions that may have a discriminatory availability. I guess that may be the best way of putting it; if they have very significant early retirement provisions, and the highly compensated people get them in a disproportionate way. Basically if they're under the safe harbor, and even maybe under the unsafe harbor, you'd have to use the test on most valuable. But basically otherwise you use the normal accrual rate that you've done for the general test. And then you do a much simpler test for that purpose. You just sum up all the highly compensated, and average out theirs. And you sum up the nonhighly compensated, and average out theirs. If their rate is more than 70% of the highly compensated, you've passed. As I say, it's a simple test to pass, it's just a difficult test to perform.

Now we've got a number of other features that Adrien is going to cover.

MR. LABOMBARDE: I just want to talk about some miscellaneous rules that you should be aware of when you're doing this. Again, in the shortness of time, there's no way we can go through all of the rules. As Joe mentioned, you really have to be careful when you're applying any of this stuff. I would simply second that notion by saying you have to be careful, whether you're doing the general test or are in the safe harbor. I know a lot of people who run like crazy from the general test, because they find it very, very complex, only to find out that satisfying the safe harbor can be a complex enterprise as well.

So, if you're green on this material, if this is the first time you've seen it, I highly recommend going to the book that I did. It's not the only one that's out there. There are other books out there. I highly recommend going to one of those, along with the regulations, because there are just too many rules and too much complexity to this for you to be playing around with it.

But to touch on a couple of miscellaneous rules, the first one is fresh-start rules. Of all of the additional rules, I would recommend this as one of the first. If you've not rolled up your sleeves and gotten down and dirty with this stuff, there may be a little bit of awareness of the structure, and so on and so forth. But you really want to start getting down to brass tacks. I would highly recommend the fresh-start rules as being one of the first places to start. When you go to apply the rules, frequently plans are going to be wanting to head toward a safe harbor. And almost every plan out there has some features somewhere, be it the compensation definition, or the integration, or something, where it was not safe harbor before. Or it's not safe harbor at this point now. If you're moving from nonsafe harbor to safe harbor, you must go through these fresh-start rules. Now even if you're going to go through the general test, it's useful to have these fresh-start rules in your hip pocket. That's in case you want to use any of the fresh-start methods that Joe just touched on lightly.

If you're using the fresh-start rules, you must have consistency. Now that makes sense. There should be consistency throughout in all these rules. But I'll just point one real big area where you could trip up on this. And that's if you're doing planned aggregation, aggregating plan A with plan B, and if there are two defined benefit plans, and this happens frequently, if you've got different units within the employer. Then if they're both defined benefit plans, you have to have the same fresh-start date. Okay? And there's no problem with that; if there are different fresh-start dates, you can simply set up a new fresh-start date. Because you are permitted to do multiple fresh starts. You fresh start the formula at the point that you comply with tax reform. You fresh start it again a couple years from now or a couple years after that. You can fresh start as often as you want, either because of plan aggregation or to move to a safe harbor. Say you're running general tests for a couple of years now, and you want to move to a safe harbor five years from now. You can fresh start at that time. The biggest danger of multiple fresh starts, or of this consistency rule, is if any of your plans are using the permitted adjustment, the general compensation adjustments.

Some employers are interested in taking the pre-tax-reform formula, particularly if it was a PIA-offset plan. They want to take the basis that they had before tax reform and upgrade with future salary increases, so that they get the final average earnings against the past service. You are permitted to do that only if you're using a fresh-start date that's before the end of this transition period, which has now been extended through the end of 1992. But if you've got a calendar year plan, 12/31/92 is the latest fresh-start date that you can have and still have those compensation upticks in your benefit formula. If you then subsequently set up a new fresh-start date somewhere down the road, the compensation upticks stop on the accrued benefit that you're using with a fresh start.

Now what's fresh start really all about? There are some fancy names here, and I will use the terminology that's in the regulations. But it's fancy terminology for some basic concepts here. Formula without wearaway is simply the frozen accrued benefit that you have from your past benefit formula, plus a new formula applied to future service. Formula with wearaway is simply a grandfathering-type concept that has the greater of the frozen accrued benefit, or the new formula applied to all service. The formula with extended wearaway is simply the greater of those two.

This general compensation adjustment is essentially different ways of grandfathering. A lot of us toy around with terminology that you'll never find in the regulations; that is, whether it's a comatose grandfather, or a live grandfather, or a dead grandfather, or various different forms.

The compensation adjustments can be very, very useful. I've touched on probably the most critical requirement, and that is the timing. The second most critical requirement is the minimum benefit adjustment. Essentially you have to make sure that, before you give the compensation upticks, you've satisfied the two-for-one rule that's in the integration requirements. In other words, if you've got a PIA-offset plan, you can't have any frozen benefits that are the starting basis of your compensation adjustments, where the initial starting basis is zero. This is common with a PIA-offset plan that doesn't have a floor in it. You've got to have at least that 50% floor in there.

You can also adjust for top-heavy minimum benefits, increases and 415 limits, and certain adjustments permitted for former employees. When you are applying these transition rules, you do have to continue to give service for eligibility in vesting. There are special fresh-start rules that are for any of the plans that use a special safe harbor for target benefit plans or cash-balance plans.

Does anyone out there still have contributory plans? Very few. The essence of the IRS rules here is to almost drop them. I heard one speaker from the Treasury Department who was surprised to be fielding questions about some of these different methods. He said that it was their understanding, their hope, I think, that most plans would use what's called the frozen contributions rule. The frozen contributions rule says to stop those employee contributions before the end of this transition period, before the end of 1992, and then the IRS will permit you to treat all of the benefits as employer provided. And everything's fine.

You could get the same thing if you have a governmental plan. A lot of governmental plans are contributory. They're permitted to be all employer provided on their treatment. But all of the other rules are an absolute mess. You can basically use any acceptable methodology with the special grandfather rule. But there are some twists and turns in getting into that. Composition of work force and minimum benefit rules permit a uniform rate. Some demographic test must be satisfied. But that's not the biggest problem. The biggest problem is essentially when you apply the uniform rate to it, the typical formulas I've looked at wind up squeezing the integration below what the plan really wants to use. Of course the general rule on 411(c) involves a fair amount of complex computations for which the IRS still hasn't given us final guidance anyway.

When you're all set and done with a contributory plan, you do have to test on the basis of both the employer-provided amounts, as well as nondiscrimination of the employee contributions there.

Cross-testing is probably one of the most fun places of the regulations, other than permitted disparity. I have a lot of fun in permitted disparity. But in cross-testing, there are three principal places where you get some practical applications. And one is when you cross-type plan aggregation. And we do see a lot of this. Defined contribution (DC) plans aggregate with defined benefit (DB) plans. When you aggregate them to test for nondiscrimination or for coverage, you've got to use cross-testing, because you test on the basis of either the benefits or the contributions. And one or the other of the plans is going to have to come across to the other type.

Where we've been seeing a lot of really heavy-duty activity, in terms of creative thinking under the regulations, is under cross-type plan design. Cross-testing may have been created by the IRS for purposes of the first type, that is cross-type plan aggregation, but there's no restriction in the regulations that says you can only use cross-testing when you're aggregating plans of different types. You have heard of the age-weighted profit-sharing plan. Essentially, the contributions to the profit-sharing plan are weighted by the age in such a way, that when you cross-test it and look at it on the basis of the benefits that would have been provided by those contributions, everything works through clean on the benefit side. And it looks like you're giving really, really discriminatory contributions. That's not so when you cross-test it.

A cash balance plan is similar. Cash balance plans are designed on a DC basis, but they're DB plans. Well, frequently it's good to cross-test those, and go back to the DC basis. Although we're testing the largest cash balance plan that I work with on the DB basis and we're not bothering to cross-test it. And it still works just fine. And we're not going safe harbor with it either.

Now there are also situations where I've used cross-testing that have involved special demographic characteristics. For instance, I've had some DB PIA-offset plans where all of the older employees are nonhighly compensated employees (NHCEs), and it's useful to test that as a DC-type plan. Test it on the basis of the equivalent allocations that are attributable to the benefits. I will say that anytime I see one of those plans, I caution the employer that those plans are highly unstable, because you're really depending on specific demographic circumstances that are here today gone tomorrow. When that set of older NHCEs passes along, and the highly compensated employees (HCEs) get up to the higher age, you're going to have to bring it back to the DB basis, or else resolve the plan design in some other way.

Joe already mentioned that the effect on the average benefit percentage test is that you can't use a segregated testing. You would then have to aggregate both the DB and the DC. The actuarial assumptions here are set in stone. For normalization you could use other assumptions, other than those specified, as long you can show they're reasonable. Here you've got to use a 7.5-8.5% interest rate and certain specified mortality tables.

With the exception of the very, very specific safe harbors laid out for cash-balance plans and target benefit plans, if you go through cross-testing, you must then satisfy nondiscrimination on the basis of the general nondiscrimination test. Like age-weighted profit sharing plans, you can design it in such a way that once you pass it through the cross-testing process, everything looks like it's on a uniform basis. Well, if that's so, then it will pass the general tests with flying colors. But you are still passing the general test. And probably the critical thing there, if you really are passing it with flying colors, is you're not going to be able to submit for a determination letter at this point. You have no questions. You have no problems with it. It passes with flying colors. But there is a distinction between general test versus safe harbor at this point. And suffice it to say there are other distinctions in terms of some of the data that you're going to need to demonstrate the general tests and the like.

I don't think we need to go through the determination of rates. This is general actuarial-type material. You're basically finding the equivalent allocations that are attributable to the accruals or vice versa. And the IRS did have, in my estimation, some pretty good actuarial advice going into this. I don't see any real huge twists or curves there.

For retroactive corrective amendments, I want to point out that there is a 9.5-month period, and there are no reductions in accruals or allocations. This is a nice little thing that the IRS gave us, because we were complaining that the proposed regs had this "gotcha" attitude to it. Or you didn't really know where you stood until after the end of the year and you had the data in hand. Well, now it is a little easier to go ahead and do the general test, if that's the way you want to go. Because if you get to the end of the year and you find out that in fact you failed, you do have 9.5 months after the close of the year, where you can maybe put in a minimum benefit, or in some other way satisfy the test.

Regarding compliance, Announcement 92-29 gave us an extension of one year. There's some good news buried in there, that may not be immediately evident. There was an extension of good faith here for things that weren't given to us previously. One good example is on 401(a)(17), the compensation limit. The reasonable good faith compliance guidelines that were sent around to the IRS offices late last year indicated that you could give the upticks each year. Each year when $200,000 is lifted up to the next higher level as the cost-of-living increase comes, you can give those to the previous years, for purposes of applying the rules, but only during the transition period. Well now the transition period has been extended. So that gives us a little bit more slack there.

So take a closer look at the good-faith, reasonable compliance materials, with respect to the dates. The bad news that we do have some verbal word from the IRS, that for governmental employers, the notice was anticipated or expected to be applied beyond the regulations that were cited in the notice. So governmental employers apparently will still have sections 401(a)(26) and 401(k) extended up to the plan year beginning in 1995. That's not the case with the private tax-exempt and the private nontax-exempt; 401(k) and 401(a)(26) were not on the list. That means, for example, that they cannot use the restructuring for 401(k) for years beyond 1991.

Out of 100 different situations, there are 100 different answers. No two employers and no two situations are the same. A lot of times what I see coming down has less to do with the rules than it has to do with the employer's objectives. And that's why I've listed some of these objectives here. And each of these objectives gets played out in different ways. I've seen situations where employers would go through the general tests with flying colors. But they want their determination letter now. So they have to go with the safe harbor. And, you know, other things have come into play in other ways, where it doesn't always have anything to do specifically with the rules, but it has more to do with where the employer is and where the employer wants to be going.

MR. JAMES F. OBERNESSER: I have a question for Adrien on the particularly aggravating situation under the final regulations as they're written. We have a number of clients who, as sort of a tax reform compliance strategy, have merged hourly and salaried plans. Let's say for the moment that the hourly plans are flat dollar, of the dollar-type service plan. And the salaried plan is an integrated plan that would satisfy the permitted disparity rules. And maybe by itself it would satisfy the safe harbors. But there are a number of problems. In addition to 401(l) problems, cumulative disparity, because one plan did not have disparity prior to the fresh-start date, there's also a very big problem with the fresh-start rules, if you wanted to have a safe harbor. Many of these employers felt, at least under the proposed regulations, that they could bring in these hourly plans on a future-service-only basis. In other words, they would only be tested going forward, not for what they had done in the past. But, similarly, under the final regulations, it's as if you have to retroactively bring these people in, because you're really applying different fresh-start approaches to your salaried and hourly employees, if you do this future-service-only kind of approach.

I just wondered if you had any comments or any predictions on whether you thought there might be any relief on that.

MR. LABOMBARDE: Are you continuing to maintain different formulas going forward?

MR. OBERNESSER: No, the same formula is going forward. The issue is though, for the hourly people, it's a future-service-only added to the fresh-start accrued benefit. But salaried employees are treated differently, which literally looks like two different fresh-start approaches. And I may not be able to pass the coverage test.

MR. LABOMBARDE: It may be the same formula looking forward, but if it's treated differently with respect to the past, yes the IRS will look at that as being different formulas. I would point out there were a lot of employers that did merge plans. And I've seen this a lot with all firms, including my own, where actions were taken to merge plans that may not have really been necessary. The biggest distinction that I see in merging plans is 401(a)(26) versus 410(b). If you've got a 401(a)(26) problem, probably the only way you can cure it in a lot of instances is to merge the plan. And plan merger is a valid option there. If you merge in order to cure a 401(a)(26) problem, you do not have to do the kind of thing that we're talking about here, that is, bring the plan structure to a uniform basis. You can merge plans, secure 401(a)(26), and not face that problem.

But for 410(b) and 401(a)(4), which are tied together, you really have to come back to this uniformity-type concept that I was looking at. Are they treating them the same with respect to the future, with respect to everything, including fresh start? Because if not, then the IRS is going to be looking at them separately. And at that point, merger or no merger, you're right back in the same situation as they were before the merger. In other words, you merged the plan, but as long as you continue to treat the two groups separately, as far as the IRS is concerned, it is as though you still had an hourly plan and still had a salaried plan. At this point that's the way it is. From the direction that the IRS is going at this point, with respect to the changes in the regulations, I don't anticipate any relief on that.

MR. OBERNESSER: Would you answer the same way in terms of the related issue of the service accreditation? With the requirement of uniform service crediting, there are going to be a lot of problems with the prior years' service for many plans that . . .

MR. LABOMBARDE: They are addressing that. And I think there's going to be a fair amount of cleaning up there. When I say cleaning up, I think most people will be very happy with what comes out on the service crediting end. If that really came down to being your only problem, I think you'd be pretty far down the road. I think your bigger problem is that it is typical in these situations for the salaried to want to give the upgrades: either the different fresh-start formula or the upticks for the previous compensation and the like. And there's just no way out of that with the typical plan if you don't have the coverage.

Now in many situations there, you may have the coverage; it's just you may have to go through the average benefit percentage just to prove it. And then at that point you just want to find the cleanest way through. If you can't even satisfy it with the average benefit percentage test, then you've got to start talking about putting minimum benefits in or something like that and sliding through the general tests in order to make it fly. It's a big mess.

I just want to make a couple of comments about the general test. You know the biggest problem with the general test is the amount of data that needs to be collected for it. I think I could probably claim to have run as many general tests as just about anybody. And yet to this point I don't think I've run but maybe one, where I really have had all of the data that's required within the regulations.

MR. MACAULAY: That's better than the rest of us.

MR. LABOMBARDE: I ran one where I had every single piece of data, every single stitch, and I dotted all the "I"s and crossed all the "T"s. For all of the remaining ones, I would still claim that every single one that I gave a green light to would have passed the general test if, in fact, all the data had been there. And every one that I've given a red light to, I would claim has, in fact, failed. Every one that's in my yellow light district should probably be changing their plan anyway. I, and a number of other people, are going back to the IRS and Treasury and saying, look "Let's be reasonable; we want the general test to become something like what Statement of Financial Accounting Standards (SFAS) 87 is now." A lot of us hate SFAS 87. But what's it become to a lot of you? It's an appendage on the valuation. You run the valuation through and there's a little button you push and out pops SFAS 87. We want to get it to a point where you use the valuation data. You push a button, out pops a general test. And that is the direction the IRS is considering. I won's say it is going to actually give it to us, but it is seriously giving consideration to going in that direction.

Now if we get that, if we can get the data cleaned up, I would maintain that the general test is not the mess that a lot of people have been viewing it as. It's a lot simpler than a lot of people see. And a lot of people were running toward safe harbors, I think, unfairly. I think that they would find a lot more flexibility and a lot more simplicity in the general test than appears at first glance.

MS. JANICE P. BRICKER: Are there any more questions?

FROM THE FLOOR: I have a question regarding the average benefits test. If a plan doesn't meet the mandatory use of the most valuable accrual rate, can you use the most valuable accrual rate? Or do you have to use the normal accrual rate?

MR. LABOMBARDE: I have to confess I was always using the most valuable accrual rate there. And if I recall the way that it's worded, you're supposed to be using the normal accrual rate. That's the way it's defined. And then you go to the most valuable accrual rate if you don't satisfy. There's a specific test in there that says if the early retirement reduction factors don't satisfy a certain standard, then you have to use most the valuable accrual rate. Like I say, I had always been using the most valuable accrual rate anyway. I think you could probably go on the contention that if it does satisfy with the most valuable accrual rate, it should satisfy it with the normal accrual rate. Of course, the problem there might be that the IRS forms tell the actual percentage. And it would be nice for me to say, "Well, I know that the percentage is greater than or equal to the following amount." I don't know whether the IRS will buy that.

But yes, if you want to dot all the "I"s and cross all the "T"s, you must use the normal accrual rate for the average benefit percentage test. Unless you do not satisfy the early retirement reduction factors standard.

MS. BARBARA J. EVERSBERG: Would one or both of you comment on the following situation? We're aggregating a DC plan with a DB plan. And we don't need the average benefits percentage test. But the DB plan doesn't qualify for most valuable only testing. Is it correct or incorrect that we only need to calculate one rate under the DC plan?

MR. LABOMBARDE: If you were doing the DB plan alone, you're saying it would not qualify, you would have to do both rates. If that's the case and you aggregate it with the DC plan, then you still have to calculate both rates. You've got to have a most valuable accrual if you test on a DB basis, and a normal accrual if you test on a contributions basis. You basically have to have a most valuable equivalent allocation and a normal equivalent allocation.

For every general test I've run for the last six months, I've always run the dual-rate general test, the normal accrual rate and the most valuable accrual rate.