



Important Information

Plan Administration and Operation

March 2004*

IRS Publishes Final Rules on Disclosure of Relative Values Of Optional Forms of Benefit

WHO'S AFFECTED These rules apply to defined benefit plans (including cash balance plans), money purchase plans (including target benefit plans), and other defined contribution plans that are subject to the spousal consent rules. Governmental plans and plans sponsored by churches that elect not to be covered under ERISA ("non-electing church plans") are not subject to these rules.

BACKGROUND AND SUMMARY A qualified joint and survivor annuity (QJSA) is a form of benefit payment that provides a death benefit to a participant's surviving spouse. A qualified pre-retirement survivor annuity (QPSA) is a death benefit payable to a participant's surviving spouse if the participant dies before reaching his or her annuity starting date. Plan sponsors must notify participants and their spouses about these automatic benefits and any alternative benefits available under the plan during specific election periods.

Among other requirements, the QJSA notices must disclose the relative values of all available forms of payment and must describe the financial effect of electing a form of benefit other than the QJSA. Similar information must be provided where the plan provides for a QPSA and either the cost of the benefit is not paid fully by the plan or the plan allows the pre-retirement death benefit to be paid to a non-spouse beneficiary.

On December 17, 2003, the IRS published final rules clarifying these notice and disclosure requirements. The final rules consolidate the content requirements related to QJSA and QPSA notices and provide specific requirements for disclosing information that would help the participant understand the relative value of each available form of benefit as well as the financial effect of selecting a specific form of payment. The intent of the new rules is to provide enough information to the participant so that he or she can make an informed choice when selecting benefits. The notices must be hand delivered or sent using first class mail.

ACTION AND NEXT STEPS These revised disclosure rules apply to both QPSA and QJSA notices provided on and after July 1, 2004. Sponsors of affected plans should review their communications packages and make changes as required by these final regulations.

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Plans that are subject to the spousal consent rules must provide notices to participants and their spouses regarding QPSA and QJSA coverage, as well as any optional forms of benefit provided under the plan. In general, qualified defined benefit plans are subject to these notification and spousal consent rules. For information about the application of these rules to qualified defined contribution plans, you may want to refer to our August 1999 publication titled "[Survivor Benefit Rules for Defined Contribution Plans](#)."

QPSA Notice Content Requirements

If a plan that is subject to the spousal consent rules either:

- Requires participants to pay for QPSA coverage (some defined benefit plans require employees to pay for this coverage through a reduction to their ultimate retirement benefit); or
- Permits participants to name a pre-retirement death benefit beneficiary other than their surviving spouse, it must provide participants and their spouses with QPSA notices.

The QPSA notice must include:

- A general description of the QPSA;
- The conditions under which it will be paid if elected;
- The availability of this benefit; and
- Information on the *financial effect* on the participant's accrued benefit *of electing this benefit*.

QJSA Notice Content Requirements

Plans that are subject to the spousal consent rules must provide QJSA notices to all participants (even if they are not married) and their spouses, before a valid payment election may be made. These notices must describe all optional forms of payment that are available to the participant.

With respect to *each optional form of payment*, these notices must describe:

- The form of payment;
- The eligibility conditions for electing it;
- The *financial effect of electing it*;

- Other material features of the optional form; and
- In the case of a defined benefit plan, *the relative value of that form of payment compared to the value of the QJSA.*

Financial Effect

QPSA Notices

A description of the financial effect on a participant's retirement benefit of electing a QPSA benefit is an estimate of the reduction to the participant's estimated normal retirement benefit that would result from that election. If there is no reduction to the participant's normal retirement benefit for QPSA coverage, as is the case for defined contribution plans, no financial effect disclosure is needed.

QJSA Notices

A description of the financial effect of electing a form of payment other than the QJSA includes a comparison of the amount payable to the participant during his lifetime and the amount payable as a death benefit under the available forms of payment. A plan sponsor may provide reasonable estimates of this financial effect. For example, the description may be based on data as of an earlier date than the participant's actual annuity starting date or based on a reasonable assumption of the participant's spouse's age. A defined contribution plan may provide reasonable estimates of amounts payable under a purchased annuity contract.

For annuity payments made by a defined contribution plan, the QJSA notice must include a statement that the annuity will be provided by purchasing an annuity contract from an insurance company with the participant's account balance. In addition, it must disclose whether estimates are used in providing the annuity information.

Relative Values

To determine the relative values of optional forms of benefit offered by a defined benefit plan as compared to the QJSA, each optional form must be converted to an equivalent value. This conversion must take into account the time value of money and life expectancies so that all forms of benefit can be compared on an "apples-to-apples" basis. As a result, two optional forms that provide different dollar amounts of benefit, may be considered equal in value if the optional form with the lower dollar benefit includes a survivor benefit payable upon the participant's death, and the optional form with the larger dollar benefit provides no survivor death benefit.

The new rules provide several acceptable methods for determining and presenting comparable values of the optional forms of payment.

Determination

The actuarial assumptions used to determine the relative values only need to be "reasonable." The plan's actuarial assumptions do not have to be used in making these determinations except in the case of single sum payments.

Presentation

Acceptable methods for presenting the relative value information include displaying the values:

- As a percentage or factor of the value of the QJSA or normal form of benefit;
- As an annuity that is equivalent to the QJSA and that is payable under the same conditions as the QJSA; or
- In terms of a single sum present value.

The information provided to the participant must include:

- A summary of the each optional form of benefit including their comparable values, or a similar summary based on grouping two or more optional forms that have approximately the same value with disclosure of one representative relative value for each group;
- A general statement that all comparisons provided are based on an estimate of average life expectancies and that the relative value of payments ultimately will depend on actual life expectancy; and
- An explanation of the assumptions used in determining the relative values or a statement that the participant may request information related to the assumptions used.

If all forms of payment are approximately equal in value and the information provided to the participant includes a statement to that effect, the plan sponsor does not have to provide specific relative value information.

Two Options for Providing Information

Under the new rules, there are now two options for providing the financial effect and relative value information. Plans may provide either *participant-specific information* or *generally applicable information*.

If a plan provides *participant-specific information*, only the participant's data (e.g., years of service, beneficiary's date of birth) is used. However, if the data is incomplete, the plan may provide reasonable estimates as long as the participant has the right to a more precise calculation. For defined benefit plans, if the relative value of optional forms of benefit provided with the QJSA notice is materially changed with the use of more precise data, the new values must be disclosed, even if the financial effect of selecting the option has not changed.

Alternatively, a plan may provide *generally applicable information* by providing a chart (or other comparable device) showing the financial effect and relative value of the optional forms of benefit for a hypothetical participant at reasonable representative age ranges. The notice must include a statement explaining that any other ages or variables could produce a different result. The notice must also include the participant's actual benefit amount immediately payable under the plan's normal form of payment, prior to any adjustments, and state that the participant may request participant-specific information related to the other optional forms of benefit.

Effective Date

These new rules apply to:

- QPSA notices provided on or after July 1, 2004; and
- QJSA notices for distributions with annuity starting dates of October 1, 2004, or later

(since QJSA notices may be provided no more than 90 days before the annuity starting date, the new rules apply to QJSA notices provided on or after July 1, 2004).

Until then, plan sponsors should make a good faith effort to provide meaningful information so that a participant can make an informed choice of benefits.

Next Steps

Sponsors of affected plans should review their communications packages and make changes as required by these final rules. Unfortunately, the IRS *did not* include sample language to be used for either QPSA or QJSA notices. However, the IRS did provide examples illustrating how the information may be communicated to participants.

Sponsors of *defined contribution plans* that use Prudential's Distribution Education Center or Direct Service Option (DSO) services need not take any action at this time with respect to QJSA notices. Likewise, sponsors of *defined benefit plans* who have outsourced their administration services to Prudential do not need to take any action at this time with respect to their QJSA notices. We are making appropriate revisions to our procedures, forms and notices. However, plan sponsors still need to review and possibly revise the QPSA notices that they use.

For defined benefit plans that use Prudential's benefit calculation services, but not our outsourcing services, we will be providing sample QJSA notices that follow the requirements of this new rule. However, plan sponsors should discuss modifications to their communication packages and procedures with their ERISA attorneys.

If you have any questions about these new rules, please feel free to contact your Prudential Retirement representative.



COMPLIANCE CLIPS

"Servicemembers Civil Relief Act" Requires Participants to Provide Written Notice

One of the provisions of the Soldiers' and Sailors' Civil Relief Act of 1942 (SSCRA) set a maximum loan interest rate of 6% while a participant serves in the military (see our September 2003 publication titled ["IRS Issues Additional Loan Rules"](#)). In December 2003, President Bush enacted the Servicemembers Civil Relief Act, which updates and clarifies the SSCRA.

The Servicemembers Civil Relief Act (SCRA) retains the provision that prevents a creditor from charging more than 6% interest on any loan outstanding at the time the participant begins military service. However, to qualify for an interest rate reduction, the SCRA now requires the participant to give the plan sponsor written notice and a copy of the military orders calling the participant to military service, including any orders extending military service. If the participant provides this

information within 180 days after military service *ends*, the reduced rate of 6% applies as of the date the participant was called to military service and ends on the date the participant is either released from military service or dies while in military service. Therefore, the reduced rate must be applied retroactively if the participant provides the notice after military service begins. Once the participant provides the proper notice, the plan sponsor must reduce the interest rate unless there is a court order allowing retention of the higher rate. If the original interest rate on the loan was 6% or less, no change in the rate is required.

Only loans taken *before* the participant enters military service are subject to the 6% maximum interest rate under the SCRA. If a participant takes a new loan while on military leave, the new loan accrues interest at the plan's normal rate for that loan type, even if that rate is greater than 6%.

The SCRA also expanded the definition of "military service" to include:

- Active service in the Army, Navy, Air Force, Marine Corps or Coast Guard,
- National Guard service for more than 30 consecutive days for purposes of responding to a national emergency declared by the President and supported by federal funds (new),
- Active service by commissioned officers of the Public Health Service or the National Oceanic and Atmospheric Administration (new), and
- Any lawful absence from duty (e.g., sickness, wounds, leave).

If a participant falls into one of these categories and had an outstanding loan when military service began, the loan is subject to a maximum 6% interest rate for the period of military service if the written notice is supplied as specified above, even if the leave began before the SCRA became law (e.g., in 2002).

Keep in mind that the provisions of the Uniformed Services Employment and Reemployment Act (USERRA) have not changed, and also need to be considered when a participant leaves for military duty. Additional information about USERRA provisions that affect retirement plans can be found in our October 2001 publication titled "[Terrorist Attacks Affect Retirement Plans: Federal Agencies Extend Deadlines and Employers Review USERRA Responsibilities.](#)" General information about USERRA employment and benefit rights can be found at the DOL's Veterans' Employment and Training Services (VETS) web site at <http://www.dol.gov/vets/>.

Please notify your Prudential representative immediately if a participant is called for military duty. You will also need to notify us when a participant returns from military leave to ensure that participant's account, including any outstanding loans, is administered correctly.

Pension Analyst by Prudential Retirement

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