



March 26, 2002

MEMORANDUM FOR: ELLIOTT P. LEWIS
Acting Deputy Inspector General for Audit
Office of the Inspector General

FROM: ANN L. COMBS
Assistant Secretary 

SUBJECT: OIG Draft Audit Report entitled "PWBA Needs to Improve Oversight of Cash Balance Plan Lump Sum Distributions," Report No. 09-02-001-12-121

Thank you for the opportunity to comment on the findings and recommendations in your above-referenced draft audit report. The mission of the Pension and Welfare Benefits Administration (PWBA) includes protecting the integrity of private pension, health, and other employee benefit plans covering more than 200 million people. Your draft report analyzes whether PWBA's oversight of cash balance plan conversions adequately protects participants' benefits.

Your draft report states that you "identified PWBA's level of oversight and reviewed a judgmental sample of 60 converted plans to determine if there was a need to improve oversight." You concluded that the conversions from traditional defined benefit plans to cash balance plans "adequately protected benefits from earlier plans" and that "all sponsors ensured that benefits paid after the conversion exceeded accrued benefits from earlier plans as required by ERISA." Your draft report concludes, however, that 13 of the cash balance plans "were underpaying participants their accrued benefits when workers left the cash balance plans before normal retirement age." You assert that these underpayments violated the benefit forfeiture and lump sum distribution rules in sections 411 and 417 of the Internal Revenue Code (Code), and the parallel provisions in sections 203 and 205 of Title I of ERISA. Your draft audit report includes the following three recommendations:

- PWBA should direct more enforcement resources to protecting cash balance plans' participant benefits.
- PWBA should initiate specific action on the 13 plans identified in your draft audit report as having underpaid accrued benefits to participants.
- PWBA should work with IRS to develop improved guidance for plan sponsors in calculating participant accrued benefits.

Before addressing each of your recommendations, we wish to point out important restrictions on our regulatory and enforcement authority in this area that are not noted in your draft report. Under Reorganization Plan No. 4 of 1978, (codified in the notes to 29 U.S.C. 1001), the authority of the Department of Labor to issue regulations, rulings, opinions, variances and waivers with respect to the benefit accrual, forfeiture, and related provisions in Part 2 of ERISA were transferred to the Secretary of the Treasury. While the Reorganization Plan provides that the Secretary of Labor may continue to enforce compliance with the provisions in Part 2, including sections 203 and 205 of ERISA, the Department is bound by regulations and interpretations issued by the Secretary of the Treasury in bringing such actions.

ERISA section 502 (b)(1) further restricts the Department's ability to initiate enforcement actions with respect to alleged violations of Part 2. Section 502(b)(1) provides:

In the case of a plan which is qualified under section 401(a), 403(a), or 405(a) of the Internal Revenue Code of 1986 (or with respect to which an application to so qualify has been filed and has not been finally determined) the Secretary may exercise his authority under subsection (a)(5) with respect to a violation of or the enforcement of, parts 2 and 3 of this subtitle (relating to participation, vesting, and funding), only if ---

- (A) requested by the Secretary of the Treasury, or
- (B) one or more participants, beneficiaries, or fiduciaries, of such plan request in writing (in such manner as the Secretary shall prescribe by regulation) that he exercise such authority on their behalf. In the case of such a request under this paragraph he may exercise such authority only if he determines that such violation affects, or such enforcement is necessary to protect, claims of participants and beneficiaries to benefits under the plan.

In light of these restrictions on PWBA's interpretive authority and enforcement oversight with regard to the issues you raised, we concluded, after discussing the issue with your audit team, that we needed the official view of the Department of Treasury regarding the alleged violations identified in your report in order to properly evaluate your recommendations and provide you with comments. Accordingly, and again after discussing the issue with your audit team, we forwarded a copy of your draft report and supporting work papers to the Treasury/IRS for its review and comments. Treasury/IRS has agreed to provide us with comments in writing on your findings. We have asked for Treasury/IRS to expedite their review and we anticipate receiving their response in the near future.

Nonetheless, we would like to offer the following interim comments and observations regarding your draft report and recommendations.

Recommendation No. 1 -- Directing More Enforcement Resources to Cash Balance Plans Benefit Calculations

As part of our review of the recommendation to direct additional enforcement resources to protect cash balance plan participants' benefit accruals, we examined the methodology used in

this study. A number of questions came to mind as to whether the sampling methodology employed by the audit team was appropriate for reaching such a broad conclusion and whether the assumptions used to extrapolate the error from the sample to the overall population were correct.

Because of these potential issues with the methodology employed in determining your sample size and extrapolating the error, we question the conclusion that “workers may be losing between \$85 million and \$199 million annually.” Consequently, unless you were able to undertake a broader survey of the problem to provide us with more detailed information, we cannot commit to redirecting our enforcement resources to cash balance plan benefit calculations at this time. However, we will continue to coordinate with the IRS on these issues and will take appropriate enforcement action in this area whenever it arises in one of our investigations.

Recommendation No. 2 -- Initiating Enforcement Actions On the 13 Plans Identified in the Audit Draft Report

As described in your draft report, IRS Notice 96-8, issued in 1996, addresses certain requirements of Code sections 411 and 417 (and the parallel provisions in sections 203 and 205 of Title I of ERISA) as applied to present value calculations of lump sum distributions from cash balance plans. Your audit team relied on IRS Notice 96-8 in determining whether a plan was in violation of the applicable statutory and regulatory requirements.

As noted above, PWBA’s enforcement oversight with regard to these issues is restricted due to the Reorganization Plan and ERISA section 502(b)(1), and we are awaiting comments from Treasury/IRS regarding the alleged violations identified in your report. Once these comments are received and discussed with the IRS, an appropriate course of enforcement action will be determined in connection with the 13 plans identified in your report. In that regard, there may be issues involving statute of limitations that may limit what enforcement actions can be taken. We, of course, will provide you with a copy of what we receive from Treasury/IRS.

Recommendation No. 3 -- Working with IRS to develop improved guidance for plan sponsors in calculating participant benefit accruals

It is the policy of PWBA to provide the highest quality of service to its customers--over 200 million pension, health and other employee benefit plan participants and beneficiaries and more than 3 million plan sponsors and members of the employee benefit community. PWBA promotes voluntary compliance by plan fiduciaries and works diligently to provide quality assistance to plan participants and beneficiaries. The Secretary has set the protection of pension assets as a top priority and we welcome suggestions on ways in which we can improve our efforts to strengthen the nation’s pension system and to protect the pensions of Americans workers. After receiving the Treasury/IRS comments regarding the alleged violations identified in your report, we intend to work with Treasury/IRS on determining what additional guidance should be developed for plan sponsors and others in the regulated community on calculating lump sum distributions of accrued benefits in cash balance plans.

If there are questions, my staff would be pleased to discuss these comments with you.