RP/CP/08/14
Correction 1

December 10, 2008

To: Members of the Pension Committee
(Mr. Portugal, Acting Chairman; Mr. Ge, Mr. Kiekens, Mr. Kotegawa, Ms. Alonso-Gamo, Mr. Ghosh)

From: Padma Gotur, Pension Committee Secretary

Subject: **Amendments to the Supplemental Retirement Benefits Plan to Comply with U.S. Tax Regulations Effective January 1, 2009**

The following minor editorial corrections to the paper on the proposed amendments to the Supplemental Retirement Benefits Plan to comply with U.S. tax regulations effective January 1, 2009 (RP/CP/08/14, 11/25/08) have been provided by the staff:

Page 1: table of contents corrected

Page 6, para. 7, line 11: for "paragraph 8(iii)" read "paragraph 8(iv)"

Page 7, footnote 9, last line: for "four methods" read "five methods"

Page 8, para. (iv), line 7: for "sum" read "sum."

Page 10, para. 12: brackets removed

Page 13, para. b(ii) and page 14, para. b(iii): underlining added

Redlined corrected pages are attached.

Questions may be referred to Ms. Brookbank (ext. 36764) and Ms. Marzouk (ext. 39522) in HRD.

Att: (1)

Other Distribution:
Members of the Executive Board
Members of the Investment Committee
Members of the Administration Committee

Corrected: 12/10/08

INTERNATIONAL MONETARY FUND

Amendments to the Supplemental Retirement Benefits Plan to Comply with U.S. Tax Regulations Effective January 1, 2009

Prepared by the Human Resources Department

In consultation with the Legal Department and the Finance Department

Approved by Markus Rodlauer

November 25, 2008

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EXECUTIVE SUMMARY

The IMF sponsors two defined benefit pension plans: the Staff Retirement Plan (SRP) and the Supplemental Retirement Benefits Plan (SRBP). The SRP is a U.S. "qualified" defined benefit pension plan, meaning that it complies with certain provisions of the U.S. Internal Revenue Code (IRC) in order to allow the deferral of income tax on U.S. taxpayers' pension benefits until those benefits are paid. However, the IRC imposes limitations on the benefits payable from qualified plans, such as the SRP, and the compensation that may be recognized for determining Plan contributions and benefits.[1]

The Executive Board established the SRBP in 1985 to receive pension contributions and pay pension benefits that exceed the pay and benefit limits imposed on U.S. qualified pension plans. As a "nonqualified" plan, the SRBP is not subject to the same limitations as the SRP.

Due to regulations issued under IRC Section 409A, the portion of U.S. participants' benefits under the SRBP accruing after 2004 (the "post-2004 benefits") will be subject to new restrictions on when and how payments may be made, beginning January 1, 2009. The new restrictions will require an amendment to the SRBP, and communications with participants, before the end of this year. In the absence of an amendment, all participants who are subject to U.S. income tax on their Fund compensation would be liable for a 20 percent additional tax on their post-2004 benefits from the SRBP. With the proposed amendment, U.S. SRBP participants would be offered an *initial election*, until December 29, 2008, to choose the timing and/or form of their future payments of post-2004 SRBP benefits. After 2008, U.S. participants in the SRBP will be permitted to make a *subsequent election* to change the timing and/or form of their post-2004 SRBP benefit payments only if they complete a "409A election form" at least 12 months prior to their retirement date (or the date their benefit payment(s) would otherwise begin).

This paper seeks the Pension Committee's approval and recommendation to the Executive Board for adoption of amendments to the SRBP to comply with the regulations issued under IRC Section 409A. These amendments have no financial implications for the Fund.[2] Currently, any benefit provided from the SRBP is payable in the same form (annuity, lump sum, or combination of lump sum and annuity) and at the same time (deferred or immediate commencement) as the SRP benefit. This has allowed for a relatively simple process as participants make one set of pension elections that applies to benefits payable from the SRP and the SRBP.

As a result of the Section 409A regulations, U.S. participants will need to make separate elections with respect to the post-2004 benefits under the SRBP, and their choices will be significantly limited.

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[1] For 2008, the annual pension benefit limit is $185,000 (payable at age 62) and the compensation limit is $230,000 (gross remuneration). The 2009 limits will be $195,000 and $245,000, respectively.

[2] There will be IT implementation costs, however, due to the need to modify FIN's pension and tax systems.

I. INTRODUCTION

1. While the SRBP provides for retirement benefits, there are other types of nonqualified deferred compensation plans that serve merely to defer taxation. Section 409A of the IRC was enacted in 2004 in response to perceived abuses among the latter group of plans. However, the law introduced sweeping new restrictions that apply to all nonqualified deferred compensation, including the SRBP benefits payable to U.S. participants. Pursuant to regulations under Section 409A, which become effective on January 1, 2009, participants who are subject to U.S. income tax on their Fund compensation would be liable for a 20 percent additional tax on the benefits they accrue under the SRBP (and on all SRBP benefits they accrued in prior tax years, plus interest) unless the current arrangements for the SRBP are changed to comply with the new restrictions.

2. The specific modifications to the SRBP that are prompted by Section 409A relate to the form and timing of payments from the SRBP. In particular, in order for the SRBP to comply with Section 409A with respect to U.S. participants, and thus avoid triggering the additional tax for such participants, it is necessary that the SRBP benefits be modified to eliminate the participant's discretion on form and timing of payment, subject to a narrow exception.[6] This requires two changes to the SRBP: first, it is necessary to sever the current linkage between U.S. participants' SRBP payments and their elections under the SRP as to the form (annuity or lump sum) and timing (deferral or immediate commencement) of payment. Second, for U.S. participants who receive an SBF package, it is necessary to sever the current linkage between the commencement of their SRBP payments and their severance payment elections.[7] Elections and payments from the SRP would be unaffected by these changes.

3. Both the World Bank and the Inter-American Development Bank have supplemental pension plans similar to the SRBP. Both organizations are amending their plans to conform to Section 409A.

II. BACKGROUND

4. Currently, any benefit provided under the SRBP is payable in accordance with the terms and conditions that are applicable to the corresponding benefit in the SRP, including all SRP elections as to the form (annuity or lump sum) and timing (deferral or immediate

[6] The only exception to this restriction allows participants to elect to delay receipt of an SRBP pension for not less than five years, but this election must be made at least twelve months prior to the first scheduled benefit payment.

[7] The SBF policy allows staff to choose to take their severance payment as separation leave or as a lump sum (or as a combination of separation leave and a lump sum). Separating staff continue to participate in the pension plans while SBF payments are being made, and may commence their pension benefits after all of their SBF payments have been completed. The new regulations require that the payments from the SRBP be independent of participants' elections to take SBF as a lump sum or as separation leave.

commencement) of payments. For example, if a participant upon retirement elects under the SRP to defer receipt of the pension, or to commute a portion of the pension to a lump sum, the same election applies to the participant's benefit under the SRBP.

5. The contributions by the Fund and participants that exceed the IRC limits for the SRP are held in two trust accounts to fund the benefits payable under the SRBP. For participants who are subject to U.S. income tax on their Fund compensation, those contributions are held in a revocable trust for U.S. tax reasons, whereas for other participants, the contributions are held in an irrevocable trust.

Application of the new rules to the SRBP

6. Provided the SRBP is amended to comply, Section 409A allows for benefits that have vested in U.S. participants by December 31, 2004 to be grandfathered under the old rules, with the new restrictions applying solely to SRBP benefits accruing or vesting after that date.[8] Thus, as U.S. participants in the SRBP separate from the Fund, their SRBP benefits will have two components—the pre-2005 component and the post-2004 component—and only the post-2004 component will be subject to the new rules on the timing and form of payment.

7. In order to comply with Section 409A, it is recommended that the SRBP be amended to provide that post-2004 SRBP benefits for U.S. participants be paid in accordance with one of five methods, specified in paragraph 8 below. In addition, because these methods will restrict the flexibility for current participants in the SRBP who are U.S. nationals, it is recommended that U.S. participants be offered the opportunity, before the amendment becomes effective January 1, 2009, to make an initial election regarding the form of payment (full annuity, or up to one-third commuted lump sum) and the timing of payment after separation (commencing at earliest eligibility for SRP payments, or deferred) with respect to post-2004 benefits under the SRBP. For U.S. participants who choose to make an initial election, their choices will be reflected in Annex II; those elections may be modified by a subsequent election complying with the procedure specified in paragraph 8(i~~ii~~v) below. If no election is made prior to December 29, 2008, staff retiring during 2009 will have to receive their SRBP benefit as an immediate annuity or, if they elect commutation or a deferral of their benefit, they would be subject to the 20 percent penalty tax under the regulations.

[8] The benefits that are subject to the new rules include both the normally accrued SRBP benefits and benefits arising from the purchase of SRP service credits that have been or will be incorporated in the SRBP. However, the benefits attributable to the purchase of SRP service credits that were paid in full by December 31, 2004 are considered vested and not subject to the new rules.

8. Under the proposed amendment, there are five methods for payment of post-2004 SRBP benefits, as applicable:[9]

(i) **U.S. participants who separate after December 31, 2008, and are eligible under the SRP for an immediate pension.[10] For this group**, post-2004 SRBP benefits will be paid in all cases as a monthly pension commencing in the month following separation, unless the participant has made the election specified in subparagraph (iv).[11] These SRBP benefits will be so paid without regard to participants' elections either to defer receipt of their SRP pension or to commute a portion of their SRP pension to a lump sum payment;[12]

(ii) **U.S. participants who separated prior to December 31, 2008, but whose pension commences after December 31, 2008.** The post-2004 SRBP benefits for these separated participants will be paid as a monthly pension commencing as of their earliest eligibility for retirement, unless the separated participant has made the election specified in subparagraph (iv).

(iii) **U.S. participants who separate after December 31, 2008, and are *not* eligible under the SRP for an immediate pension, but who are eligible for a deferred pension.** For this group, the value of the post-2004 SRBP benefits will be paid as a lump sum, unless the participant has made the election specified in subparagraph (iv). The amount of the lump sum payment will be the larger of (a) the withdrawal benefit under Section 4.5 of the SRP or (b) the amount determined using actuarial factors consistent with those provided in the SRP for the commutation of pension payments (Schedule D, paragraph 4 of the SRP).[13]

[9] These new rules will not apply to mandatory withdrawal benefits under the SRBP, which will be paid at the same time as the corresponding mandatory withdrawal benefits under the SRP, as permitted by Section 409A. However, for eligible U.S. participants who elect a withdrawal benefit under the SRP, the amount of their SRBP benefit would be based on their SRP withdrawal benefit, while the form and timing of their SRBP benefit would be determined according to the five~~our~~ methods specified in this paper.

[10] This includes staff on separation leave (under the SBF policy).

[11] This rule would apply to U.S. participants who are eligible for an immediate pension at age 50 under the Rule of Age 50, and to U.S. participants who are eligible for an immediate pension between ages 50 and 61 under the Rule of 75 and the Rule of 85, whether or not such participants elect to defer the commencement of their SRP pension and without regard to any SBF elections of separation leave.

[12] Although an election for a commuted lump sum under the SRP will not be given effect in a participant's post-2004 portion of the SRBP benefit, the U.S. tax regulations do permit changes between different types of actuarially equivalent annuity options, making it possible to give effect, in the payment of SRBP benefits, to a U.S. participant's election of a reduced pension, with an increased pension to survivor, in accordance with Section 4.6 of the SRP.

[13] The Actuary will provide a table of actuarial factors (consistent with those in Schedule D, paragraph 4 of the Plan) to convert deferred pension benefits to lump sum values.

The lump sum will be paid one year after separation, in order to facilitate the elections as described in subparagraph (iv);

(iv) **All U.S. participants whose pensions commence after December 31, 2008.** There will be a limited election available to these participants to modify the form and timing of payment of their post-2004 SRBP benefits. In accordance with current rules, and provided they do not elect a withdrawal benefit under the SRP, U.S. participants will be allowed to elect to defer the commencement of payment. In addition, U.S. participants to whom subparagraph (i) or (ii) applies will be allowed to elect to receive up to one-third of their post-2004 SRBP benefits as a commuted lump sum. Also, U.S. participants to whom subparagraph (iii) applies will be allowed to elect all or a portion of their post-2004 SRBP benefits as a deferred monthly pension instead of the lump sum payment. However, in accordance with the limitations under Section 409A of the IRC, these options must be elected at least 12 months prior to the date that payment under subparagraphs (i), (ii) or (iii) would commence in the absence of any election; an election made by the required date is irrevocable. In addition, the pension must not commence earlier than five years from the date of payment under subparagraphs (i), i.e., five years after separation, (ii), i.e., five years after earliest retirement eligibility date, or (iii), i.e., six years after separation. An explanation of these rules, and the opportunity to make this election using the "409A election form," will be given to U.S. participants in the SRBP and to new U.S. participants going forward;

(v) **U.S. participants who receive an SBF package after December 31, 2008.** The post-2004 SRBP benefits for these participants will be paid as a lump sum or an annuity as determined under (i), (iii), and (iv) above. However, the payment will be deferred until the later of (a) the participant has reached the earliest eligibility for commencement of a pension under the SRP, or (b) 22½ months have elapsed after the participant's last day of active duty.[14] This deferral of the payment of the post-2004 component of SRBP benefits is necessary to sever the link with the participant's election between an SBF lump sum payment and separation leave. Instead, payment of the post-2004 SRBP should be linked to another date that is outside the discretion of the participant or the Fund to determine. Alternative (a) would normally be age 55 for participants who receive an SBF package, or possibly as early as age 50 if the participant is eligible under the Rule of 75. Alternative (b) refers to the latest possible date after which a participant would no longer be on the Fund payroll, taking into account maximum separation leave.[15] This will avoid a situation of participants receiving their post-2004 SRBP benefits before they have formally separated from the Fund.

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[14] This rule would not apply to U.S. participants who have signed an SBF letter with the Fund before January 1, 2009.

[15] In the event the maximum period of separation leave were changed in the future, then the SRBP could be amended to align Alternative (b) with the new SBF policy, without violating Section 409A, provided the change does not apply to U.S. participants who had received an SBF package at the time of such amendment.

New funding rules under Section 409A

9. In addition to the above rules concerning the form and timing of payments, Section 409A also bars the use of "offshore trusts" as a funding vehicle for nonqualified deferred compensation plans such as the SRBP. The meaning of the term "offshore trust" is not entirely clear, but outside tax counsel has advised that, based on the purposes of that prohibition in Section 409A, the revocable trust which the Fund has established for U.S. participants in the SRBP should be deemed compliant. This opinion also was conveyed to the U.S. Treasury Department as formal comments on proposed regulations under Section 409A. However, the new tax regulations do not address this subject, leaving open the possibility that in the future the Fund may need to change its approach to funding the SRBP for U.S. participants.

10. If the IRS should later determine that the SRBP constitutes an "offshore trust" prohibited under Section 409A, it is recommended that management be authorized to establish a separate Fund account that is not a trust to receive and hold the assets currently held in the revocable SRBP trust for U.S. participants. Such an account would also receive and hold all future contributions by participants and the Fund that otherwise would have been paid into the revocable SRBP trust. In the event that such a non-trust account would also be deemed by the IRS to not satisfy Section 409A, then assets and future contributions would be held in the General Resources Account, as was done temporarily after Section 409A was enacted and there was uncertainty about the "offshore trust" requirement. These assets would be held subject to the same terms and conditions as the present revocable trust for U.S. participants, except that they would not be held as a trust.

Financial implications

11. The SRBP amendments would restrict the timing and form of payments to U.S. participants, but would not alter the benefit amounts, other than to pay the larger of a withdrawal benefit or a lump sum equivalent of a deferred pension to those participants described in subparagraph (iii) of paragraph 8. According to the Actuary for the pension plans (see attached letter from Buck Consultants), the present value of benefits for participants who are assumed to take a deferred pension includes the value of assumed future cost-of-living increases. Since the proposed lump sum payments to these U.S. participants would not include the value of future cost-of-living increases, the Plan costs would overstate the actual benefits to be paid out as either a withdrawal benefit or deferred pension lump sum. Therefore, no increase in plan costs is anticipated from the proposed amendments.[16]

[16] There would be IT implementation costs, however, due to the need to modify FIN's pension and tax systems.

III. Conclusion and Recommendation

12. [The SRP Administration Committee has reviewed this paper and recommends the approval of the proposals set out in paragraphs 7, 8, and 10 above, and the adoption of the amendments to the SRBP set out in Annexes I and II. The proposed changes would become effective on January 1, 2009.]

5. **Employer Contributions**. The Employer, in its sole discretion, may at any time, or from time to time, contribute cash or other property to the Trusts to augment the principal to be held, administered and disposed of by the Trustee as provided herein. No participant or beneficiary shall have any right to compel Employer contributions. Employer contributions paid on behalf of Irrevocable Trust Participants shall be paid to the Irrevocable Trust; employer contributions paid on behalf of Revocable Trust Participants shall be paid to the Revocable Trust.

6. **Benefits.**

(a) The Supplemental Plan shall pay to participants and beneficiaries such benefits, if any, as are equal to the additional amounts which would otherwise be payable under the Staff Retirement Plan but for the limitations contained in Sections 1.1(p)-(r), 3.2(d) and 4.12 of the Staff Retirement Plan, as determined by the Administration Committee or its designee. Any benefit provided under the Supplemental Plan is otherwise payable in accordance with all terms and conditions of the Staff Retirement Plan applicable to the corresponding benefit in that plan. An election under the Staff Retirement Plan, including, without limitation, an election regarding the form and timing of distributions, shall be deemed an election under the Supplemental Plan, subject to paragraph (b).

(b) For participants who are citizens of the United States of America, the form and timing of distributions for benefits that are accrued and vested after December 31, 2004 will be subject to the following rules, to the extent necessary to comply with Section 409A of the Internal Revenue Code of the United States of America, and except as otherwise specified in Schedule 1:

(i) If upon separation a participant is eligible under the Staff Retirement Plan for an immediate pension, then Supplemental Plan benefits that accrued and vested after December 31, 2004 shall be paid as a monthly pension commencing in the month following separation, without regard to any elections the participant has made affecting the form and timing of payments under the Staff Retirement Plan, except if the participant has made the election specified in subparagraph (iv).

(ii) For a participant who separated prior to December 31, 2008 but whose pension commences after December 31, 2008, the Supplemental Plan benefits that accrued and vested after December 31, 2004 shall be paid as a monthly pension commencing as of the participant's earliest eligibility for commencement of a pension under the Staff Retirement Plan, without regard to any elections the participant has made affecting the form and timing of payments under the Staff Retirement Plan, except if the participant has made the election specified in subparagraph (iv).

(iii) If upon separation a participant is not eligible under the Staff Retirement Plan for an immediate pension, then the value of the Supplemental Plan benefits that accrued and vested after December 31, 2004 shall be paid as a lump sum, without regard to any elections the participant has made affecting the form and timing of payments under the Staff Retirement Plan, except if the participant has made the election specified in subparagraph (iv). The amount of the lump sum payment will be the larger of (a) the withdrawal benefit under Section 4.5 of the SRP or (b) the amount determined using the same basis for the actuarial factors provided in the Staff Retirement Plan for the commutation of pension payments (Schedule D, paragraph 4 of the Plan), and will be paid in the month following the first anniversary of separation.

(iv) A participant who does not elect a withdrawal benefit from the SRP may elect by a written notice filed with the Administration Committee that payment of the Supplemental Plan benefits that accrued and vested after December 31, 2004 shall be:

(a) deferred until a date of participant's choice not less than five years from the date of payment under subparagraph (i), (ii) or (iii),

(b) paid up to one-third as a commuted lump sum and deferred until a date of participant's choice not less than five years from the date of payment under subparagraph (i) or (ii), or

(c) paid in whole or in part as a monthly pension in lieu of the lump sum specified in subparagraph (iii) and deferred until a date of participant's choice not less than five years from the date of payment under subparagraph (iii).

The election provided for in this subparagraph (iv) will be valid only if received at least twelve months prior to the date that payment otherwise would be made under subparagraphs (i), (ii) or (iii), as applicable, whereupon the election becomes irrevocable, and the election is effective twelve months after it has become irrevocable.

(v) A participant who has become entitled to SBF benefits after December 31, 2008 will have the value of the Supplemental Plan benefits that accrued and vested after December 31, 2004 paid as a monthly pension or a lump sum as determined under (i), (iii) and (iv) above, and payment will be deferred until the later of (A) the participant's earliest eligibility for commencement of a pension under the Staff Retirement Plan disregarding any elections the participant has made affecting the timing of payments under the Staff Retirement Plan, or (B) twenty two and one-half months have elapsed after the participant's last day of active duty (including any applicable job search and notice periods).