

CLIENT ACTION Bulletin

Employee Benefits

IRS Issues Final Rule on Mortality Tables for Defined Benefit Plans

SUMMARY The Treasury Department and the IRS released a final rule updating the mortality assumptions that single-employer defined benefit (DB) pension plans must use to calculate the actuarial liabilities for minimum funding requirements, benefit restrictions, and the Pension Benefit Guaranty Corporation (PBGC) variable-rate premiums. The updated mortality tables are also used to calculate lump-sum distributions to plan participants in DB plans that offer such one-time payments. The final rule generally is applicable for plan years beginning on or after Jan. 1, 2018, but also provides a limited one-year transition period (to Jan. 1, 2019), in certain circumstances.

The IRS concurrently released *Notice 2017-60*, with two mortality tables. The first is a sex-distinct table for the above-mentioned one-year 2018 transition period. The second is a unisex table (blended as 50% female mortality rates and 50% male mortality rates) that must be used for the calculation of certain optional forms of payments, such as lump-sum distributions, beginning with the 2018 plan years. Also released was *Revenue Procedure 2017-55*, providing instructions to obtain IRS approval of plan-specific mortality tables.

Although the final rule is aimed at single-employer DB plans, its mortality assumptions are also used to determine “current liability” for multiemployer pension plans and cooperative and small employer charity (CSEC) plans.

DISCUSSION **Background**

The 2006 Pension Protection Act (PPA) requires that plan sponsors use IRS-approved mortality tables to determine a DB plan’s minimum funding levels, adjusted funding target attainment percentage (AFTAP), and PBGC variable-rate premiums, as well as to determine minimum lump-sum payments and maximum benefits for participants. The PPA stated that Treasury/IRS should review these mortality tables and consider them for updates at least every 10 years to reflect the actual mortality experience (and projected trends) of pension plan participants.

Final regulations published in 2008 required the use of mortality tables based on the RP-2000 Mortality Tables Report released by the Society of Actuaries (SOA), and also provided rules allowing for plan-specific tables.

The 2015 Bipartisan Budget Act (BBA) changed the rules on the use of substitute mortality tables, allowing for the use of tables based on a DB plan’s actual participants’ mortality experience. In December 2016, the IRS issued a proposed rule that both described the agency’s intent to update the 2008 mortality basis and revised the technical rules for implementing the changes made by the BBA to develop substitute mortality tables.

In 2014, the SOA released a mortality study of participants in private pension plans, based on mortality experience from 2004 to 2008, referred to as the RP-2014 Mortality Tables report. The SOA also issued a companion study of “mortality improvement,” referred to as the Mortality Improvement Scale MP-2014 report. In 2015 and 2016, the SOA released updated mortality improvement scales MP-2015 and MP-2016, utilizing more recent data.

Generally Applicable Mortality Tables under the Final Rule

Under the final rule, the generally applicable mortality tables are derived from the base tables contained in the RP-2014 Mortality Tables report and the MP-2016 mortality improvement scale. The mortality

tables under the final rule are gender-distinct to reflect significant differences between expected male and female mortality. The final rule also provides separate mortality rates for annuitants and nonannuitants.

Use of the following options remains available under the final rule:

- generational tables or static tables;
- a combined static table for small plans (under 500 participants); and
- special mortality rates for certain disabled participants.

Limited Transition Period

The final rule provides a limited transition period for plan years beginning in 2018. Where plan-specific mortality tables (see below) are not used for funding purposes, a plan sponsor may use mortality tables determined in accordance with former regulations for valuations in 2018 if the plan sponsor:

- concludes that the use of the new mortality tables would be administratively impracticable or would result in more than a de minimis adverse impact, and
- informs the actuary of the intent to use the previous mortality tables (RP-2000, updated for 2018).

While this option offers flexibility for 2018 funding purposes, it does not affect the mortality table used to determine minimum present value for lump-sum distributions beginning with the 2018 plan year. Therefore, the lump-sum distributions received by such participants must reflect the final rule's base mortality assumptions.

Plan-Specific Substitute Mortality Tables

The final rule also provides guidance on constructing a substitute mortality table, including consideration of appropriate mathematical formulas, means to increase the credibility of a plan's mortality experience, and options for plans that do not have sufficient deaths to have fully credible mortality data. Transition relief for obtaining approval to use substitute mortality tables is available if a plan sponsor submits an application on or before Feb. 28, 2018, to the IRS.

Estimated Effect on DB Plan Calculations

How the final rule's increase in life expectancy will affect the actuarial liabilities for single-employer DB pension plans will depend on several factors. If all variables other than mortality are held constant, actuarial liabilities for most plans can be expected to increase between 2% and 5%. However, the actual impact will depend on a plan's demographics, assumptions regarding future terminations and retirements, its "open or frozen" status, its benefit formula (traditional versus cash balance), and availability of lump sums. A similar 2% to 5% increase in lump-sum values may be observed for plans that provide such optional forms of payment to plan participants.

Plan sponsors that are required to pay PBGC variable-rate premiums may see significant premium increases in future years, due to the highly leveraged nature of the PBGC variable-rate premium calculation.

ACTION Plan sponsors should review with their actuaries the final rule for its specific effects on their plan's minimum funding projections, PBGC variable-rate premiums, and benefit distribution calculations, including lump-sum distributions. For some plans, the use of substitute, plan-specific tables may be appropriate, even if doing so in the past was not. In addition, plan sponsors should work closely with their third-party plan administrators, as new calculations will be necessary to address retirements or lump-sum settlements occurring in 2018. Because the rule applies to plan years beginning in 2018, plan sponsors and plan administrators have only about two months to update their plans and/or communicate necessary changes to participants, particularly – but not exclusively – if lump sums are involved. Plan sponsors should also bear in mind that the new final rule contemplates annual updates to the mortality assumptions, unless the changes from one year to the next are minimal.

For more information about the new mortality tables, please contact your Milliman consultant.