IRS Proposes New Mortality Rates

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A Defined Benefit Feature Article

The IRS recently issued long awaited proposed regulations regarding required mortality rates for defined benefit pension plans. The proposed regulations would increase funding requirements and PBGC premiums beginning in 2018 for single-employer plans. In addition, the regulations would likely result in higher single sum distributions which primarily impact plans with lump sum distribution options. The direct impact on multiemployer and governmental pension plans is minimal, however, the new mortality rates will put additional pressure on these plan sponsors to ensure the mortality rates used for funding and accounting purposes are best estimate assumptions.

Background

Single-employer defined benefit plans are required to use IRS mandated mortality assumptions for the determination of annual minimum funding requirements, maximum tax deductible amounts, PBGC premiums, and lump sum payouts. The existing law is based on mortality studies that are 20+ years old, although the IRS has annually updated these tables in order to approximate mortality improvement since that time. The law has also allowed the use of substitute mortality tables based on specific plan experience for very large plans, subject to IRS approval.

In 2014, the Society of Actuaries released a new study of mortality experience and expected mortality improvement in the future, based on single pension plan experience through 2006 and mortality improvement through 2014 (i.e. RP-2014 tables). Each year thereafter, the Society publishes updated expected mortality improvement factors based on the inclusion of additional years' data. The mortality improvement factors for future years are "two dimensional". That is, they are based on both the age of an individual and the future year the individual reaches that age. The most recent mortality improvement scale was published in 2016 (MP-2016).

Impact of Proposed Regulations on Funding Requirements and PBGC Premiums

The proposed regulations retain many of the features of the current law, but adopt the more recent RP-2014 tables developed from the Society of Actuaries study and the MP-2016 improvement factors. The regulations allow some variations of these tables for funding purposes, such as "generational" tables or "static" tables, and simplified tables for plans with no more than 500 participants. The net result, regardless of which variation is used, will be higher funding requirements and PBGC variable premiums. While the impact on each plan will depend on its demographic makeup, it is anticipated that on average actuarial liabilities may increase up to 5%. How this translates to higher funding requirements and PBGC premiums will depend on the relationship of plan assets to plan liabilities.

Substitute Mortality Tables

The current law allows plans to use substitute tables, based on individual plan experience, if the plan experienced at least 1,000 deaths during the experience review period. The use of substitute tables is only allowed upon specific approval by the IRS. This rule only has been used by some very large plans.

The proposed regulations retain the use of substitute mortality tables, subject to IRS approval, although the 1,000 death criterion has been modified. In addition, the proposed regulations now allow the use of substitute tables for plans that have "partially credible mortality experience" (i.e., at least 100 deaths).

Larger Lump Sum Distributions

Under current regulations, the mortality tables that are used for funding purposes are adjusted on a unisex basis for the determination of lump sum payouts to participants. The proposed regulations do not specifically address mortality tables for lump sum distributions. However, it would be reasonable to conclude that adjustments for lump sums would occur in a similar manner as under current regulations, resulting in larger lump sum distributions beginning with the 2018 Plan Year.

Next Steps

The IRS has asked for comments on these proposed regulations by March 29, 2017 with a public hearing scheduled for April 13, 2017. Given that new regulations have been expected for some time, it is likely that final regulations will be issued soon, including guidance on lump sum distributions. Full implementation can be expected to occur for 2018 Plan Years. In the meantime, single-employer plan sponsors may wish to assess the impact of the proposed regulations on their funding requirements and PBGC premiums, as well as consider "lump sum windows" before the implementation of the new rates, as described in our article *"Strategies to Reduce Single-Employer Defined Benefit Plan Costs".*

Sponsors of governmental and multiemployer plans should work with their actuaries to ensure that the mortality tables used to calculate actuarial liabilities are up to date and consistent with recent mortality studies.