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Publications

Final Regulations Update Pension Plan Mortality Tables and Proposed Regulations Address COVID Impact on Substitute Tables

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PUBLISHED
10/26/2023

SOURCE
Groom Publication

SERVICES
Employers & Sponsors
Retirement Programs

The IRS recently published final regulations regarding new mortality tables to be used for most qualified defined benefit plans. 88 Fed. Reg. 72,357 (Oct. 20, 2023). The new tables are effective for plan years starting in 2024. On the same day, the IRS also issued proposed regulations regarding the calculation of substitute mortality tables for plans that have sufficiently credible mortality experience. 88 Fed Reg. 72409.

Below, we provide a high-level summary of these developments.

Final Regulations Updating Mortality Tables

For background, actuaries generally use mortality assumptions when determining the value of pension liabilities. Under the Code, specific rules must be followed with regard to the mortality assumptions, with most qualified single-employer plans needing to use IRS-provided mortality tables to calculate funding requirements and the minimum value of lump sum distributions. The final regulations update the method used to determine those IRS-provided mortality tables.

Back in 2017, the regulations updated how the mortality rates were determined. Those regulations provided that mortality rates would be calculated by using a base table, and then applying mortality improvement factors to project future mortality rates. The base tables were the tables from the RP-2014 Mortality Tables Report, and the improvement factors were Scale MP-2016.

The final regulations update both the base tables and improvement factors. The new base tables, from the Pri-2012 Report, reflect more current data. Specifically, the old RP-2014 tables were based upon data through 2009, while the new tables reflect updates through 2014. The new improvement factors, a modified version of Scale MP-2021, similarly are based on more recent data updated through 2019. In addition to including adjustments for COVID experience, the modified Scale MP-2021 in the final regulations reflects the requirement in the SECURE 2.0 Act that future rates of mortality improvement be capped at 0.78%.

In general, a mortality table may consist of a single set of life expectancies that apply in all future years, or a table may consist of life expectancies that change over time. The first approach is referred to as a static mortality table, and the second approach is called a generational mortality table. Neither approach necessarily produces higher or lower liabilities, but a generational approach is viewed as a more precise methodology and the inclusion of an explicit allowance for future mortality improvements provides greater transparency. In recent years, as computers have become more powerful and valuation software has become more sophisticated, the use of generational mortality tables has increased significantly.

Prior to the final regulations, pension plans were permitted to calculate their minimum funding requirements using either a static approach or a generational approach. The final regulations require that plans with more than 500 participants use a generational approach, while smaller plans may continue to use static mortality tables.

Proposed Regulations Regarding Substitute Mortality Tables

The proposed regulations regarding substitute mortality tables are intended to address the impact of COVID on the development of substitute mortality tables. Briefly, plans with substantial mortality experience are permitted to blend their recent mortality experience with the standard IRS tables. However, due to the unusually high levels of mortality that many plans experienced during the COVID years, this process could produce a substitute mortality table that is not a good predictor of future experience. The proposed regulations modify how plans' mortality experience from the years 2020 to 2023 is incorporated into substitute mortality tables, to ensure that COVID does not unreasonably influence future expectations.

Comments on the proposed rules are due by December 19.

Key Takeaways

- **Effective Date**: Plans are required to use the new tables and methodology for valuation dates on or after January 1, 2024.
- **Use of Generational Tables for Large Plans**: While the regulations now require plans with more than 500 participants to use the more complex generational mortality tables, most actuarial firms are able to use these tables. Therefore, we do not expect this will be an issue for almost all affected plans. However, a sponsor of a defined benefit plan with more than 500 participants may want to confirm with their actuary that the generational tables can and will be used for these valuations after January 1, 2024.
- **Impact on Liabilities**: Due to the change in methodology and the complexity of generational mortality calculations, it is not immediately clear whether plan sponsors are likely to see an increase or decrease in their liabilities due to the new mortality tables. However, in many cases, the increases to interest rates in recent years may result in liability reductions regardless of the impact of the new mortality tables.
- **Application to Lump Sums**: These mortality tables are inputs to develop the mortality table used calculate lump sum payments (and other accelerated forms of benefit)—which was published in IRS Notice 2023-73 for the 2024 calendar year. Unlike the tables used for funding, the mortality tables for calculating lump sums are still simpler static tables. However, the lump sum mortality tables will apply the same baseline mortality data and mortality improvement scales, so these trends may impact the value of lump sums in the future (although again, recent interest rate increases are likely to have a much more substantial impact than these mortality updates).
- **Plan Provisions**: To the extent a defined benefit plan contains provisions relating to the new tables (for example, describing how lump sum amounts are calculated), it is unlikely that a plan amendment is needed, because nearly all defined benefit plan documents incorporate the IRS-required table by reference. Accordingly, no action should be necessary in most cases. However, a plan may want to confirm that the appropriate language either (1) incorporates the IRS table by reference or (2) is updated to ensure it refers to the latest tables.