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Employee Benefits Corner

Pension Plans Come Under Fire for Outdated Mortality Tables

By Elizabeth Thomas Dold and David N. Levine

Many defined benefit plans have a long history of complex plan formulas and long-standing actuarial assumptions used to determine early retirement benefits and actuarial equivalence of various forms of periodic plan distributions. And with the only requirement that those actuarial assumptions be "reasonable,"—compounded with the fact that prior actuarial assumptions are protected under ERISA's anticutback rule—there has been a tendency for some plan sponsors to not update interest and mortality tables used for determining early retirement factors and annuity payments under the plan. That approach has many plan sponsors eagerly awaiting the outcome of four class action cases that were filed recently, claiming plan participants are due additional plan benefits under ERISA as a result of the use of outdated mortality tables (and other "unreasonable" actuarial assumptions) set forth in the plan. Below is a brief summary of the law, the cases filed, and what plan sponsors should consider doing in light of these cases.

The Law

ERISA and the Internal Revenue Code of 1986, as amended (the "Code"), require that annuities must be "the actuarial equivalent of a single annuity for the life of the participant," and that failure to comply can result in rights being improperly forfeitable.[1] U.S. Treasury Department regulations provide that actuarial equivalence for this purpose must be based on "consistently applied reasonable actuarial factors."[2] More specifically, in accordance with Rev. Rul. 81-9, the regulations require that a qualified joint and survivor annuity be *at least* the actuarial equivalent of the normal form of life annuity or, if greater, any optional form of life annuity offered under the plan. This rule applies whether or not the benefits provided under the life annuity are at the maximum level under section 415 of the Code. Importantly, the term "reasonable" is not defined, and there appears to be little caselaw or other IRS authority interpreting this requirement.

This is in stark contrast to the requirement to use IRS approved interest and mortality assumptions under Code Sec. 417(e) for lump sum (and certain other) distributions and under Code Sec. 430 for funding purposes, for which the IRS regularly issues updated mortality tables and interest rates. But the IRS has never

required updates in actuarial assumptions in the context of joint and survivor annuity calculations or early retirement adjustment factors.

It is also notable that actuarial assumptions must be set forth in the Plan in order for the plan to meet the requirement that benefits be definitely determinable. Moreover, changes to actuarial assumptions raise anti-cutback considerations under ERISA and Code Sec. 411(d)(6), and, in some cases, advance participant notice requirements under ERISA §204(h). So along with the consistency requirement noted above, plan sponsors have tended to make few changes over the years to the plan's actuarial assumptions used for determining annuity plan distributions and early retirement factors.

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Lastly, we note that because these actuarial assumptions are set forth in the plan document, they are generally reviewed as part of the determination letter process, and therefore a favorable determination letter should provide some weight to this discussion. However, we note that in a similar case in 2007 (that only addressed inappropriate interest rate assumption, as the court did not allow the case to be expanded to add the updated mortality argument), the court stated that a determination letter would not be afforded great weight.[3] Specifically, the court incorrectly focused on references to nondiscrimination and assumptions for funding and deduction purposes to justify its decision:

> Defendants-appellees argue that the 1995 determination letter that Dun & Bradstreet received from the IRS demonstrates implicit approval by the IRS that the discount rate and other actuarial assumptions in the Master Retirement Plan were reasonable. The determination letter refers to only two sections of the Treasury regulations, sections 1.401(a)(4)-1(b)(2) and 1.401(a)(4)-4(b), both of which require that benefits be provided in a nondiscriminatory manner, and does not refer to the regulation addressing reasonable actuarial assumptions, section 1.401(a)-14(c)(2). See 26 C.F.R. §§1.401(a)(4)-1(b)(2), (a)(4)-4(b), (a)-14(c)(2). In addition, I.R.S. Publication 794, which discusses the significance and limitations of a favorable determination letter, states that "[a] determination letter does not consider whether actuarial assumptions are reasonable for funding or deduction purposes or whether a specific contribution is deductible." I.R.S. Publ. 794, Favorable Determination Letter at 2 (Rev. Sept. 2006). The court therefore declines to accord great weight to the determination letter. See *Esden v. Bank of Boston*, 229 F.3d 154, 175-76 (2d Cir. 2000).

The Cases

The cases to date largely mirror one another and focus on the use of older mortality tables (or conversion factors based on such tables) to make a number of ERISA violations and seek to provide for additional Plan benefits during the "class period." The class period is not defined but appears to be a six-year statute of limitation period. As the class includes all participants in pay status during such period who elected a benefit that used the allegedly outdated actuarial factors, the potential damages are likely to add up quickly.

The complaints include claims that the plan fiduciaries breached their ERISA fiduciary duties by relying on those allegedly outdated mortality tables because they represent "unreasonable conversion factors that do not provide for actuarially equivalent options," resulting "in participants and beneficiaries illegally forfeiting and losing vested benefits." The lawsuits also include two additional counts for declaratory and equitable relief, and for reformation of the plans and recovery of benefits pursuant to ERISA §502(a). Plaintiffs' counsel in all three lawsuits are Izard, Kindall & Raabe LLP and Bailey & Glasser LLP.

Metropolitan Life Retirement Plan[4]

- *Plan Terms*: The Plan specifies the interest and mortality assumptions for calculating the conversion factor and thus the value of alternative annuity benefits:
  - Interest rate: 6%
  - Mortality table: 1971 Group Mortality Table for Males (the "1971 GAM" table), set back one year for participants and five years for beneficiaries
- Noting that it appears as though the mortality table has not been updated since the plan's implementation

in 1976. The complaint also notes that the plan sponsor should have known that the mortality tables were outdated and produced a lower monthly benefit because very different assumptions (*i.e.,* Code Sec. 417(e) assumptions) are used to convert a cash balance account to a life annuity.

- *Assertion*: By not offering actuarial equivalent pension benefits, the employer caused retirees to lose part of their vested retirement benefits in violation of Section 203(a) of ERISA. The 6% interest rate is not, standing alone, necessarily unreasonable; however, the Plan's use of the 1971 GAM is unreasonable when combined with a 6% interest rate.
- *The Class*: Participants who are receiving a joint and survivor annuity for the class period (which may include beneficiaries receiving a qualified preretirement survivor annuity).
- *Losses*: The complaint says that the benefits payable under the optional forms of benefit are much lower than they should be, but does not indicate the scope involved.

Retirement Benefit Plan of American Airlines, Inc. for Employees Represented by the Transport Workers Union of America, AFL-CIO; the Retirement Benefit Plan of American Airlines, Inc. for Agent, Management, Specialist, Support Personnel and Officers; the Retirement Benefit Plan of American Airlines, Inc. for Flight Attendants; and the American Airlines, Inc. Pilot Retirement Benefit Program Fixed Income Plan[5]

- *Plan Terms*: The Plan provides for a 5% interest rate and the 1984 Unisex Pension ("UP 1984") mortality table to calculate the joint and survivor, qualified pre-retirement survivor annuity and other optional annuity forms of benefit.
- *Assertion*: By not offering actuarial equivalent pension benefit, the employer caused retirees to lose part of their vested retirement benefits in violation of Section 203(a) of ERISA. Specifically, even though the 5% interest rate is reasonable for the Class Period, the use of the UP 1984 to calculate actuarially equivalent benefits is unreasonable, especially when combined with the 5% interest rate.
- *The Class*: Beneficiaries who are receiving a qualified pre-retirement survivor annuity during the Class Period and participants who elected an optional form of annuity benefit (including a joint and survivor annuity) during such period.

Given the lack of guidance in this area, the unsettled nature of the "reasonableness" standard, and the interplay of fluctuating interest rates with gradual changes in mortality rates, it is difficult to predict how the courts will view these issues.

- *Losses*: Using the UP 1984 table instead of a current mortality table reduced the monthly benefit by over 6% for a 50% joint and survivor annuity and by over 11% for a 100% joint and survivor annuity. Also, the value of the 120 month certain and life option was reduced by over 7% because of outdated actuarial assumptions.

PepsiCo Salaried Employees Retirement Plan[6]

- *Plan Terms*: Notably, the plan did not describe how the J & S conversion factors were determined—which the complaint uses to argue that participants could not exercise reasonable diligence to discover that the form of benefit was not the actuarial equivalent to a single life annuity.
- *Assertion*: By not offering actuarial equivalent pension benefit, the employer caused retirees to lose part of their vested retirement benefits in violation of Section 203(a) of ERISA. Specifically, the use of 0.90 conversion factor to the single life annuity for a 50% joint and survivor annuity (J & S annuity), a 0.85 conversion factor for a 75% J & S annuity, and a 0.80 conversion factor for a 100% J & S annuity were unreasonably low conversion factors.
- *The Class*: Participants who are receiving a joint and survivor annuity for the class period (which may

include beneficiaries receiving a qualified preretirement survivor annuity).

- *Losses*: As a result of the unreasonable joint and survivor annuity conversion factors, the complaint asserts that the monthly benefit for a 50% J & S annuity was reduced by nearly 3% and by nearly 8% for a 100% J & S annuity, determined based on current interest and mortality assumptions.

U.S. Bank Pension Plan[7]

- *Plan Terms*: The Plan provided the following table for early commencement factors (ECF) to be applied to participant normal retirement benefit under the final average pay formula (*see* Table 1):

The complaint indicates that the fixed ECF have not changed since at least 2002 despite dramatic increases in longevity.

- *Assertion*: Unreasonable, excessive reductions to pension benefits earned under the Plan's final average pay formula when participants retired before age 65.
- *The Class*: Participants with an early retirement benefit for the class period.
- *Losses*: The ECF improperly reduce participants' retirement benefits by as much as 22% compared to the current actuarial assumptions used to calculate actuarial equivalent of other benefits and by as much as 32% compared to the ECF that apply to the Plan's other benefit accrual formula.

TABLE 1.

Age	Final Average Pay ECF	Age	Final Average Pay ECF
64	0.90	59	0.55
63	0.81	58	0.50
62	0.73	57	0.46
61	0.66	56	0.42
60	0.60	55	0.38

Next Steps

Given the lack of guidance in this area, the unsettled nature of the "reasonableness" standard, and the interplay of fluctuating interest rates with gradual changes in mortality rates, it is difficult to predict how the courts will view these issues. But for plan sponsors of these older pension plans, these cases may present a new area of potential legal exposure, and steps should be considered to understand the legal exposure and any steps to address the concerns going forward. Therefore, while we await the court decisions, plan sponsors of defined benefit plans (even frozen plans) should review their actuarial assumptions and related participant communications (*e.g.,* distribution packages and relative value notice), being mindful of preserving attorney-client privilege. Areas of consideration include:

- Conversion of the plan's benefit formula amount to other forms of distribution:
  - For a cash balance benefit, this would include the assumptions used to convert the account balance to the annuity form of distributions,
  - For a traditional benefit stated as a life annuity, this would include the assumptions used to convert the single life annuity to all optional annuity forms of distribution (including a joint and survivor annuity);
- Adjustment of a participant's accrued benefit to be payable to a surviving spouse or other beneficiary following a pre-retirement death; and
- Adjustment of normal retirement benefits to benefits to commence at early retirement ages and late retirement ages.

And stay tuned as these cases develop.

ENDNOTES

1 ERISA §205(d)(2)(A)(ii); Code Sec. 417(b)(2); Reg. §1.411(a)-4(a).

2 Reg. §1.401(a)-11(b)(2); *see also* Reg. §1.401(a)-14(c)(2).

3 *McCarthy v. Dun & Bradstreet*, CA-2, 482 F3d 184 (2007).

4 *Masten, et al. v. Metropolitan Life Insurance Company, et al.*, 1:18-cv-11229 (S.D.N.Y Dec. 3, 2018).

5 *Martinez Torres, et al. v. American Airlines, Inc., et al.*, 4:18-cv-00983 (N.D. Tex. Dec. 11, 2018).

6 *DuBuske, et al. v. PepsiCo, Inc., et al.*, 7:18-cv-11618 (S.D.N.Y. Dec. 12, 2018).

7 *Janet Smith, et al. v. U.S. Bancorp, et al.*, 0:18-cv-03405 (D. Minn. Dec. 14, 2018).