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BENEFITS BRIEF

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IRS Finalizes New Mortality Table Rules for Pension Plans

A. Overview and Action Steps

Last week, the IRS and Treasury issued final regulations and other guidance on the mortality tables that apply to defined benefit plans for the purpose of minimum funding, lump-sum and other accelerated distribution options, and related calculations. 82 Fed. Reg. 46388 (Oct. 5, 2017), Notice 2017-60, Rev. Proc. 2017-55. This guidance brings to a close the contentious process to update the pension plan mortality tables for 2018, which involved a significant amount of back-and-forth between Treasury and the actuarial and plan sponsor community. The update in the tables was dictated by the Pension Protection Act of 2006, which requires Treasury to update these tables at least every ten years to reflect pension plan experience and projected trends in experience. The last update was effective for 2008. As was expected, the new mortality table generally reflects lower mortality rates than the existing table, which will generally increase the present value of plan liabilities and the minimum funding requirements for many plans.

Most significantly, the effective date of the new mortality table rules was not postponed and the rules will generally become effective beginning in 2018. Some in the plan sponsor and actuarial community had argued that the required use of the tables should be delayed to allow plans and plan sponsors more time to adjust. To partially address this concern, the final regulations allow plan sponsors to delay the application of the new tables for one year, but only for funding purposes. This delay option is not available for purposes of calculating the value of lump sum or other distribution options subject to the minimum present value calculations of Code section 417(e) – the new tables must begin to be used for these purposes in 2018.

In light of the final regulations, plan sponsors may want to consider taking the following actions:

- Evaluate the impact, beginning in 2018, of the new mortality table on benefit distribution calculations that the plan determines using the Code section 417(e) mortality table rules:
    - Consider if a plan amendment would be appropriate to reflect the new table (many plans have language that will automatically incorporate the new table), and
    - Consider if the impact of the new table on the value of lump sum distributions warrants changes to participant distribution materials or other participant communications;

- Review and update projections of minimum funding, PBGC premium, and benefit restriction requirements taking into account the new mortality table;

- Consider whether to elect to postpone use of the new mortality tables for funding purposes until 2019;

- Consider whether it may be possible to use a plan-specific substitute mortality table, and whether doing so would result in savings.

B. General Impact of New Mortality Table

The most significant effects of the final regulations in comparison to the current regulations are as follows:

- The final regulations require the use of a new mortality table and mortality improvement scale, which have been anticipated in recent years.

- The new mortality table generally provides for lower mortality rates than the current table, which increases the calculated present value of plan liabilities. This will generally result in increased minimum funding requirements and lower calculated funding levels for single-employer and multiple-employer plans.

- For pension plans with traditional benefit formulas, the new mortality tables will generally increase the value of lump sum and other accelerated distribution options available under the plan.

- For pension plans with cash balance or other hybrid benefit formulas, the new mortality tables may decrease the value of annuity distributions available under the plan where the plan uses the Code section 417(e) mortality table in calculating the annuity values.

- The final regulations relax the requirements for plan sponsors that wish to consider using a plan-specific substitute mortality table, which may allow more plans to avoid using the new IRS-prescribed mortality table for funding purposes. (Plan-specific tables cannot be used for Code section 417(e) purposes.)

The final regulations are largely unchanged from the proposed regulations. Our January 13, 2017 Benefit Brief contains a detailed analysis of the impact of the proposed regulations on plans and plan sponsors.

C. Option to Delay the Use of the New Mortality Table for Funding Purposes Until 2019

The most significant deviation from the proposed regulations concerns the effective date of the new mortality table for minimum funding purposes. Under the proposed regulations, plans would have been required to begin using the new table for 2018 plan years. The final regulations generally maintain this effective date, but they also provide an exception to this requirement that applies when the plan sponsor concludes that using the new table in 2018 is either (a) administratively impractical, or (b) would result in an "adverse business impact that is greater than de minimis". In either of these cases, the use of the new table for minimum funding purposes may be deferred until the 2019 plan year. The regulations do not impose any application or approval process, but require only that the plan sponsor inform the plan's actuary if it intends to use this option. The plan sponsor should, however, document its conclusion that the plan qualifies for the deferral option.

This exception only applies to the use of the new mortality table for minimum funding purposes. For lump sum (and other distribution forms subject to Code section 417(e)) benefit calculations, use of the new table is mandatory beginning in 2018.

D. Applicability of New Mortality Table for Benefit Calculations

For the purposes of applying the minimum present value rules under Code section 417(e), the new mortality table applies to benefits with annuity starting dates that occur in stability periods beginning in the 2018 calendar year. For plans that use the calendar year as the plan year, this will mean that the new table must be used effective with distributions beginning on or after January 1, 2018. For non-calendar year plans the new table could go into effect later in 2018, depending on the stability period that the plan uses. For traditional pension plans that define the accrued benefits as annuities, the new mortality table will generally result in larger lump sum amounts than would have been payable under the prior table.

For cash balance plans, and other similar plans that define accrued benefits in terms of account balances or single-sum amounts, the lump sum benefits will generally be unaffected by the new mortality table. However, the annuity benefits payable from these plans will be affected if the plan uses the 417(e) mortality table to calculate the annuity value of the account, and may tend to be lower than the amounts that would have been payable under the prior mortality table.

Some plans call for the use of the 417(e) assumptions for calculations where these assumptions are not required by law, such as conversions from single-life annuities to joint and survivor annuities. In these cases, the new mortality table may have additional impacts on participant benefit calculations.

Notice 2017-60 sets forth the new mortality table that will apply for these purposes.

E. Technical Changes from the Proposed Regulations for Plan-Specific Tables

The final regulations also contain the following technical changes from the proposed regulations relating to the ability of plans to use substitute mortality tables that reflect their own experience:

- The permissible time range that produces the mortality experience used to develop the substitute mortality table has been increased.
- The final regulations do not permit substitute mortality rates for ages above 109, and only partially permit the use of substitute mortality rates for ages 96 through 109.
- In determining the mortality ratios used to develop substitute mortality tables, the final regulations permit a single ratio to be determined for both genders, as opposed to requiring separate ratios for males and females.
- The final regulations provide guidance on the use of substitute mortality tables for multiple-employer plans.
- The transition period applicable to the controlled group consistency requirement in the case of newly acquired plans has been increased.
- The final regulations provide a transition rule for plans that are currently using a substitute mortality table under the prior regulations.

Revenue Procedure 2017-55 provides procedures a plan sponsor must follow if it wishes to use plan-specific substitute mortality tables.