

## Mortality Table Updates Finalized for 2018

The IRS has released final regulations on the applicable mortality tables used by defined benefit plans subject to ERISA to determine minimum funding requirements beginning with 2018 plan years. Although a limited transition rule is available for funding purposes, the updated tables form the basis for the mandatory unisex tables used for minimum lump-sum values and maximum benefits under Code Section 415. Tables reflecting static projections of longevity improvement are still permitted, as are combined annuitant/nonannuitant (small plan) versions of the tables. Updated rules for substitute, plan-specific mortality tables have been released and permit the use of tables reflecting partially credible experience for plans that are too small to have fully credible experience.

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### Background

Defined benefit plan funding rules established in the Pension Protection Act of 2006 (PPA) included the requirement to use mortality tables approved by the IRS to determine minimum funding levels for single-employer plans. In addition to funding, the IRS tables are used in determining a plan's funded position (or AFTAP) under the benefit restriction rules of Code Section 436, and PBGC variable-rate premiums. They are also the basis for unisex mortality tables used to determine minimum lump-sum payments under Code Section 417(e) and maximum benefits under Code Section 415. PPA also required the use of specified mortality tables in determining current liability for multiemployer plans. In lieu of the IRS tables, PPA provided that plan-specific tables could be used for some purposes, if certain conditions were met.

In 2008, the IRS issued final regulations defining the requisite mortality tables based on the RP-2000 Mortality Tables Report released by the Society of Actuaries (SOA) in 2000, and associated rules for plan-specific tables. PPA mandates that the IRS update the tables at least



every 10 years to reflect actual participant mortality experience since the last update, and projected trends in that experience.

In 2014, the SOA issued a new mortality study of participants in private pension plans, releasing both the RP-2014 mortality tables and the MP-2014 mortality improvement scales. The MP-2014 improvement scales were updated in October 2015 (MP-2015) and again in October 2016 (MP-2016). See our [October 20, 2016](#), [October 8, 2015](#) and [October 27, 2014](#) issues of *FYI Alert* for discussion of the report and updates.

For plan years beginning after December 31, 2015, the Bipartisan Budget Act of 2015 changed the rules on the use of substitute mortality tables to allow more plans to reflect adjustments to the generally applicable mortality table based on the actual experience of the pension plan maintained by the sponsor. IRS' proposed regulations for updated tables published on December 29, 2016 were explained in our [January 9, 2017](#) *For Your Information*.

## IRS Finalizes Update with 2018 Effective Date

Plan sponsors and trade organizations raised concerns that the timing of final regulations would significantly increase contribution requirements with insufficient time for thoughtful corporate budgeting and retooling of benefit calculation and distribution systems. IRS was not persuaded that delaying implementation of the update for determining plan benefits could justify inappropriately depressing the amount of single sum distributions in 2018, thus permanently reducing the retirement assets of those participants. IRS [Notice 2017-60](#), issued on the heels of the release of the final regulations, establishes the 2018 Applicable Mortality Table – based on the new mortality regulations – for determining distributions with annuity starting dates that occur during stability periods beginning in the 2018 calendar year. The Applicable Mortality Table is used for calculating distribution options, generally lump sum distributions, that are subject to the minimum present value rules of IRC Section 417(e)(3) and in applying various limitations under IRC Section 415 maximum benefits.

IRS believes that many plan sponsors have had adequate time to set aside funds for additional pension contributions for 2018 and that sufficient time remains before final contributions for 2018 are due on September 15, 2019 (for calendar year plans). So while the final regulations have been made effective for 2018 plan years, IRS included a transition rule that permits a one-year delay in implementing the new tables for funding purposes if the plan sponsor takes both of these steps:

- Concludes that the use of mortality tables determined in accordance with the final regulations for the plan year would be administratively impracticable or would result in an adverse business impact that is greater than *de minimis*
- Informs the actuary of the intent to apply this option

## Making Choices about Timing

Thus far, there has been no guidance or general indication as to how liberally a plan sponsor might interpret the requirements for delaying reflecting the new tables for funding until 2019. For example, there is no mention of a threshold for “*de minimis*,” or insight on what might be viewed as “adverse business impact.” While at first glance this may appear to be a simple criteria to meet, without further information from the IRS as to what is acceptable, the conditioned option to delay may not be clear enough to plan sponsors to be very useful in addressing the budgeting issues created by the delay in issuing the final regulations. Nonetheless, informal indications thus far

have been that the IRS will not likely challenge delays that are based on an “adverse business impact” if the plan sponsor can demonstrate that reflecting the new tables in 2018 would result in an increase in 2018 funding obligations or PBGC variable-rate premiums.

Additionally, funding rules require that lump sums based on Section 417(e)’s Applicable Mortality Table generally must be valued using the updated mortality tables (even if the transition rule for funding is elected), because the transition rule does not apply for Section 417(e). As a result, the benefits of electing the transition rule may be limited for plans where a significant portion of their liabilities are due to expected lump sums that are based on Section 417(e) assumptions.

Finally, a plan sponsor wishing to use substitute mortality tables in lieu of the new standard tables is generally required to submit a request to IRS at least seven months before the beginning of the plan year in which the substitute tables would be used. Because the final regulations were not adopted in time to meet this deadline for 2018 plan years, IRS will accept applications until February 28, 2018 for 2018 plan years, provided the plan sponsor agrees to a 90-day extension of the normal 180-day review period. However, sponsors of calendar year plans that apply at or near the deadline may not receive a determination prior to the September 30, 2018 due date for the final 2018 AFTAP certification. As such, plan sponsors that would like to begin using substitute mortality tables under the new rules might consider electing the transition rule for 2018 (if they meet the criteria), and first apply for a substitute table for the 2019 plan year to allow time for a response from the IRS before the first plan year the table is to apply.

## Deeper Dive on the New Tables

IRS’ [October 5, 2017 final regulation](#) updates the PPA mortality table based on the RP-2014 mortality tables and the improvement rates contained in the Mortality Improvement Scale MP-2016 Report. Recall that the 2016 update lowered anticipated life expectancy improvements, thus moderating the increases in liabilities that would have been produced using earlier improvement scales.

**Comment.** IRS considered, and rejected, using rates that are used by the Office of the Actuary within the Social Security Administration. This decision was partly based on the opinions of an independent advisory board that reviews the Social Security assumptions and methods and that has consistently recommended increasing the rate of mortality improvement used in evaluating Social Security solvency.

The method for developing substitute mortality tables under the final regulations is simpler than the method that applies under the 2008 regulations, and allows the use of substitute mortality tables by plans with smaller populations that have only partially credible mortality experience. As under previous regulations, substitute tables must be submitted to the IRS for approval before use.

## Generally Applicable Mortality Tables

Like the 2008 mortality tables, the tables in these regulations provide mortality rates for males and females, and separately for annuitants (for the period after assumed benefit commencement) and nonannuitants (for the period before assumed benefit commencement).

Like the previous regulation, the new regulations require expected mortality improvements to be reflected in one of two ways – a static projection (one table for all participants updated annually) or a fully generational projection

(projected to all future years from the base table for each participant). The regulations provide static tables for use in 2018 valuations designed to approximate the result determined by the generational tables. The IRS intends to provide updated static tables annually, taking into account the updates the SOA is expected to issue each year to reflect mortality improvement trends for the general population, as well as other sources. They also intend to issue updated improvement rates each year. If the IRS views that a recommended change to mortality improvement would be significant, it may issue proposed guidance to allow time for comments. Otherwise, updated improvement rates are expected to be available at least 12 months prior to the beginning of a calendar year.

Small plans (i.e., those with 500 or fewer active and inactive participants as of the valuation date) are permitted to use a single blended (annuitant and nonannuitant combined) static table for all participants. The regulations use the same male and female weighting factors as the 2008 regulations to create these blended rates.

### **Plan-Specific Mortality Tables**

Plans are still permitted to use plan-specific mortality tables (referred to as substitute tables) instead of the generally applicable mortality tables, if certain conditions are met.

Substitute tables must be generational (based on the IRS-prescribed projection scale) and must reflect the actual “credible” experience of the plan. To be fully credible, the experience must be based on more than 1,082 deaths over the period of the mortality experience study, with the new higher thresholds based on benefit dispersion within the population. New partial credibility rules are included for plans with experience that is not sufficient to be fully credible. If the plan has information on at least 100 deaths in a population, the plan may use a weighted average of the standard table and the table that would be developed if fully credible information were available. In a break from prior rules, substitute tables may be developed based on the combined mortality experience of males and females, an option that must be applied to all plans in the controlled group that have less than fully credible experience for each gender. The new rules also modify substitute mortality rates at advanced ages to converge to the standard table rates.

Like the previous one, the new regulation has restrictions and options for the use of substitute mortality across controlled-group plans, for separate populations such as hourly versus salaried groups, for the aggregation of plans and for handling newly acquired plans. The final regulation retains rules from 2008 on when substitute mortality tables may no longer be used because of changes in credible information, changes in the composition of the controlled group, and similar events. However, if the approved term has not elapsed, there is an option to continue use of substitute mortality rates developed under the prior rules until the end of their approved term. For 2019 plan years and beyond, the updated mortality improvement rates would have to be applied. New rules were also added for multiple employer plans.

[Revenue Procedure 2017-55](#) provides the relevant updated instructions for requesting approval.

### **Anticipated Liability Increases**

The updated IRS mortality tables will tend to increase liabilities, but the specific impact will vary depending on the plan design, demographics, and the versions of the tables (static or generational) used before and after the update. Probably the most common scenario will be plans that use static mortality both before and after the change. Based on sample present value factors, we anticipate liabilities will typically increase 3 to 5% as a result of changing from the 2017 static mortality to the 2018 updated static mortality.

The incremental liability increase between 2018 static and 2018 generational mortality might be on the order of another 1%. However, the structural differences between generational mortality and the IRS methodology for creating static tables make it difficult to predict the impact of such a change.

Going directly from 2017 generational to 2018 generational mortality might increase liabilities 2 to 5%, fairly comparable to the static-to-static update. We emphasize that all these figures are estimates and generalizations; individual plan results could differ significantly from these approximations.

**Comment.** Once the updated tables have been reflected, a new challenge will be to anticipate updates to the mortality improvement rates. While the SOA intends to continue publishing new improvement rates each year, the preamble to the regulations indicates that the IRS may not follow suit if they deem the changes from the prior year to be minimal. The IRS also intends (but does not commit) to publish the new rates at least 12 months in advance of the start of the first calendar year the new rates would apply. Depending on the timing and magnitude, these updates may prove to be difficult to forecast when projecting both funding and benefit calculations.

## Impact on Plan Benefits

Changing how we measure the value of plan benefits doesn't really change the cost of the plan in most cases if benefits are paid in annuity form. For a plan with a non-hybrid, traditional design, actual costs go up only as a result of increases in actual lifetime payouts over time. If a plan allows lump sums or other distribution options subject to Section 417(e), plan benefits will increase once the new funding table is reflected in the Section 417 Applicable Mortality Table. Similarly, larger amounts can be paid when the limits of Section 415 are an issue for a plan.

For hybrid plans such as cash balance plans, much will depend on whether the plan's annuity options incorporate the Section 417(e) table to determine conversions. But to the extent a plan offers lump sums based on the hypothetical account balance or accumulation and participants lean toward taking distributions in that form, the new tables will have minimal impact on the cost of the plan over time.

The ability to pay benefits under certain payment options may be affected by the changes. The benefit restrictions of Section 436 are based on the Section 430 funding target liabilities. An increase triggered by the new mortality table could reduce the plan's AFTAP below one of the thresholds that trigger a benefit payment restriction. Similarly, the new tables may affect the calculations used by a plan to assess whether the "high 25" distribution restrictions for highly compensated employees need to be applied.

As noted earlier, the uncertainty about updates to improvement rates will create new challenges with estimated benefit calculations. This issue might be manageable if the effect of the updates is not significant, and the IRS follows through in publishing new rates at least 12 months in advance of when they would apply.

## Multiemployer Current Liability, PBGC Variable-Rate Premiums and Reporting Requirements

The changes to the Section 430 mortality tables will directly affect certain current liability calculations for multiemployer plans. In addition, PPA liabilities are referenced by various PBGC reporting requirements and are used in determining a plan's variable-rate premium. Higher liabilities due to the expanded longevity reflected in the

updated tables will impact these other determinations accordingly. For example, plan sponsors may encounter higher variable-rate premiums and may be required to report “reportable events” more frequently because they no longer qualify for waivers based on the absence of a variable-rate premium requirement. See our *For Your Information* issues from [March 25, 2016](#) on changes to 4010 Annual Financial Reporting, and from [September 16, 2015](#) on PBGC’s Reportable Event waivers.

## More Than Mortality

The updated mortality tables will increase measured plan liabilities over those that reflected earlier mortality studies. However, appropriate changes in other demographic assumptions may also be considered. For instance, in response to longer life expectancy statistics and the longer period of time retirement savings must stretch, many employees may plan to continue working beyond a plan’s “normal” retirement date instead of retiring in their late 50s or early 60s. Aligning plan retirement assumptions with this new paradigm can potentially offset some of the increase in minimum contribution requirements due to the new mortality assumption. This is particularly true for pension plans with suspension-of-benefits provisions and generous early retirement subsidies.

## In Closing

Plan sponsors should review their budgets and funding forecasts to reflect the final regulations, and should determine whether it is appropriate to notify their actuary of a decision to use the one-year delay option. In addition, plan sponsors should consider whether a plan-specific mortality table would be appropriate. More plans can take advantage of this option now that tables can be based on partially credible data. In particular, plans that primarily cover blue-collar participants may find that the unmodified IRS tables incorporate lower levels of mortality than they realistically expect and thus overstate their liabilities and possibly their PBGC premiums.

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