WINSTEAD

Spending Quality Time with Your Pension Plan Actuary

10.11.17

The Internal Revenue Service updated its mortality tables under final regulations which are generally applicable on January 1, 2018 and did not delay the implementation of the mortality tables because the update was mandated to occur in 2018. The new mortality tables reflect that people are generally living longer and annuity benefits from pension plans are expected to continue for longer periods than under the previous mortality tables. This means the cost of funding defined benefit pension plans will increase and the value of lump sum distributions from pension plans will increase to reflect the expected longer duration of lifetime annuity benefits.

Employers sponsoring defined benefit pension plans (this alert discussion is limited to single employer pension plans and does not address multiemployer plans) should expect a call from their plan's actuary or may want to initiate the call to learn how the mortality table update will impact their minimum funding requirements under their pension plan, their funding target attainment percentage and adjusted funding target attainment percentage. The mortality changes are likely to increase the minimum funding required contributions for employers. The increase in the longevity in the mortality tables is also likely to impact the funded percentage as the funding target is likely to increase (assuming no other changes to the pension plan) and unless the plan's assets have increased in a similar manner, the increase in the funding target will lower the funded percentage and may cause a plan to fall into a different funded percentage level and trigger the distribution restrictions that come into play under Code section 436 when the adjusted funding target attainment percentage drops below 60% (and in some circumstances 80%), or the restriction on amendments when the same percentage drops below 80%.

Employers sponsoring single employer pension plans will see the new mortality tables go into effect first for the 2018 valuation which will probably increase the annual contribution due to be paid to the plan in 2019. However, a plan sponsor may elect in certain circumstances to continue to use the mortality table in effect on December 31, 2017 for purposes of funding calculations for one additional year as a transition rule. If an employer delays the new mortality tables for this one transition year, it will then spread the increased mortality risk over the remaining 9 years the new table will be in effect (assuming no statutory change occurs) instead of spreading it over the 10 years the new mortality table will potentially be in effect. While we are not actuaries, the implications of spreading the increased cost from the increased life expectancy over 9 years of employer contributions instead of over 10 years may be a question you want to ask your actuary to see if the one year delay will be worth it. If you elect to use this alternative, you must notify your actuary, and it will be documented in the Schedule B to your plan's Form 5500 for the year.

The new mortality tables need to be used for calculating the lump sum distributions from pension plans generally beginning with distributions starting in 2018. There is no delay or extension of the deadline in the case of calculations of lump sum benefits. This will increase the cost to fund a lump sum distribution (or any window benefit programs set up as lump sum cash outs of a pension benefit) which will be paid in 2018 or later years.

Many plans have been drafted to incorporate by reference the statutorily dictated mortality tables and may not require an amendment to adopt these new mortality tables, but any defined benefit pension plan should be reviewed to determine whether it may require updating in one of the various areas impacted by these new mortality tables.

A small group of very large plans with sufficient deaths of participants over a specified period may find it advantageous to develop their own mortality tables for their plan, but use of such a custom table will require preparation of a filing with the IRS and IRS acquiescence. Large pension plans should discuss with their actuary whether their plan might be a candidate for its own custom mortality table.

For anyone who is a party to a multiemployer pension plan under a collective bargaining agreement, the new mortality regulations do not apply to you, but your mortality tables are required to be updated every 5 years (instead of every 10 years for single employer plans) and must use the same standards for calculating their mortality tables.

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