

Pension Plan Fix-It Handbook

Employee Benefits Series

THOMPSON

October 2014 | Vol. 22, No. 1

Longevity May Give DB Sponsors Gray Hair, If Actuaries Have Their Way

By Mary B. Andersen, CEBS, ERPA, QPA



There is no denying that people are living longer, which is usually viewed as good news. But this development also has a cost for employers that sponsor defined benefit retirement plans.

The ultimate cost of a DB plan is the sum of all benefits paid. Assumptions about participant and beneficiary lifespan help the plan sponsor estimate cost for the benefits it is responsible for paying. Consequently, the accuracy of assumptions is critical to the financial health of the plan as well as corporate finances.

New proposed mortality tables (see ¶131 in the *Handbook*) from the Society of Actuaries now being considered are an attempt to fine-tune these estimates to more accurately reflect the reality of increased longevity for pension plans. However, there is a price for such precision.

The Retirement Plans Experience Committee of the SOA has issued two exposure drafts, RP-2014 Mortality Tables and Mortality Improvement Scale MP-2014, which “establish a new basis for mortality assumptions for retirement programs in the United States.” If adopted in their proposed form, the exposure drafts will increase costs for many DB plans because they assume longer lives for plan participants and beneficiaries (see box below).

The Pension Protection Act of 2006’s minimum funding rules require IRS to consider revisions to mortality tables at least every 10 years. Mortality tables are a component of calculating the cost of a DB plan because they estimate when participants will die. Plans can use published tables (for example, one called RP-2000) that have been supplemented by mortality improvement tables. A plan’s actuary will use the mortality improvement tables (for example, Scale AA or BB) to determine if the mortality rates in the published table should be used to change projected mortality rates. Large plan

sponsors (such as public-sector plans) can develop their own mortality table based on their own experience. The key is that the table in use must be credible.

Lower mortality results in increased longevity, which increases plan liabilities. Increased plan liabilities affect pension costs and, potentially, investment strategies. How much a plan will be affected by the proposed tables depends on the last time the tables being used were updated. The older the table, the greater the impact for plans, if the exposure draft remains as proposed once enacted. The choice of a “static” table versus a “generational” table also will be felt financially.

The exposure draft for RP-2014 Mortality Tables recommends the use of the generational table for calendar years beginning after 2014. A footnote in the draft says that “[m]ost U.S. pension actuaries use IRS-published static tables (based on Scale AA projection) for minimum funding purposes, despite the fact that generational projection of Scale AA is permitted. Some larger plans use plan-specific ‘substitute’ mortality assumptions for minimum funding purposes.” Static tables are constructed at specific points in time, and become outdated as longevity increases. Generational tables are more fluid and tend to more accurately reflect the true longevity of a plan’s participants.

See Andersen, p. 2

The following chart, “Combined Financial Impact of Moving to RP-2014 with Scale MP-2014 from RP-2000 with Scale AA Taken,” illustrates the impact of moving to the revised tables.

Age of Beneficiary	Change in Annuity (%)	
	Male	Female
25	2.5	8.1
35	2.7	7.1
45	2.8	7.1
55	3.0	6.3
65	4.4	5.5
75	10.5	8.1
85	17.4	10.5

Plan sponsors that tie funded status to investment strategy (for example, if the plan is 80-percent funded, x percent of assets will be invested in fixed income) may have to modify their investment strategy as a result of the proposed tables' impact.

The new tables also could change “derisking” strategies, including offering participants lump-sum payments in lieu of lifetime benefits to reduce plan costs and risk exposure.

In Notice 2013-49, IRS issued the static mortality tables to be used for calculating lump-sum distributions for 2014 and 2015. If the SOA's proposed generational tables are adopted by IRS, lump sums will become more expensive, but probably not before 2016. However, employers that purchase group annuities may see a slight decrease in the premium paid for such annuities. Generational tables should reflect the payout stream more accurately than static tables, thereby lowering any premium cushion.

Will SOA Exposure Draft Be Changed?

The exposure draft for the RP-2014 Mortality Tables had a comment period that ended May 31. It garnered a number of comments: Many of the concerns expressed related to the quality of the data used by the SOA's committee and the recommendation of the generational table.

Among the responses were these facts and comments:

- From the 120 plans that submitted data, 38 plans were selected. Two-thirds of the data about retirees came from five plans. The Academy of Actuaries commented, “This is a small base of plans, which could skew the results towards specific industries (it is not known to us what industries these five plans represent....”.
- RP-2014 used approximately 30 percent of the data submitted, while for RP-2000, 78 percent of the data submitted was used.

- The SOA committee eliminated two large public-employer plans because they did not represent private plans. The Academy of Actuaries noted in its comments: “...it appears the REPC used the fact that the public employee plan improvement was similar to [the Social Security Administration's] to conclude that the SSA mortality improvement can be applied to private employer plans, while at the same time saying that the public employee plan data is not representative for private plans.” Human resources consulting firm Mercer made a similar comment supporting use of the SSA assumptions. “The language in the draft makes a very strong recommendation that the MP-2014 table should be used to project mortality improvements for all private plans. Although we believe that the MP-2014 table represents a reasonable view, the rate of future improvements in mortality is highly speculative. We think that the language should make greater allowance for other views, particularly those reflected in the SSA's assumptions.”
- Actual deaths were compared with expected deaths, based on the RP-2000 supplemented with Scale BB, and the resulting ratios were excluded if they were unusually high or low unless the validity was confirmed by the plan submitting the data. Towers Watson noted, “No information is given as to whether the experienced deaths were mostly unexpectedly high or unexpectedly low, or to how rigorous the confirmation process was ... so it is difficult to know what effect these exclusions had. However, the systematic exclusion of these plans lend the appearance of bias in the selection of the final data set.”
- Records from the same participant in different plan years were consolidated. If the records could not be identified as being the same participant, the data was not used. Per Towers Watson, “When unique identifiers could not be provided it appears that the entire plan was excluded. In our experience ... it is clear that a disproportionate share of records that are problematic to track from year to year involves deaths.” This could mean that data reflecting higher mortality was excluded.
- Participants electing lump sums are not included. This could lead to bias because people with lower life expectancies might be likely to take a lump sum rather than a lifetime annuity.
- PBGC data was not used for the RP-2014. Towers Watson notes: “This is a curious omission since the

SPECIAL OFFER

Try a free, 14-day trial to Thompson Information Services' comprehensive digital edition of the *Pension Plan Fix-It Handbook*, where this column originates. It's part of Thompson's digital research library, HR Compliance Expert, which includes the full HR and benefits product line, an advanced, easy-to-use search that will drive you immediately to the content you need, dynamic news content, and insightful commentary from industry experts.

[Click here > www.thompson.com/pensionhandbookoffer](http://www.thompson.com/pensionhandbookoffer)

See Andersen, p. 3

Andersen (continued from p. 2)

PBGC maintains a large relevant data base from the plans it has taken over.”

Plan Sponsor Take-aways

Plan sponsors should begin an ongoing dialogue with their actuary and accountant about these proposed changes to actuarial tables to remain informed of the latest developments from these exposure drafts and their impact on the plan and other financial areas.

The exposure drafts relate to mortality tables but it is possible that IRS will adopt them for lump-sum calculations. It is also possible that accounting standards could be

revised to incorporate the mortality assumptions for financial disclosure purposes. The impact will vary depending on your plan demographics. The coming financial implications should be understood, as much as possible.

Mary B. Andersen is president and founder of ERISA-diagnostics Inc., an employee benefits consulting firm that provides services related to Forms 5500, plan documents, summary plan descriptions and compliance/operational reviews. Andersen has more than 25 years of benefits consulting and administration experience. Andersen is a CEBS fellow and member of the charter class. She also has achieved the enrolled retirement plan agent designation. Andersen is the contributing editor of the Pension Plan Fix-It Handbook. ❖



This article originally appeared in the *Pension Plan Fix-It Handbook*. Go to <http://www.thompson.com/public/offerpage.jsp?prod=mend> for more information. © 2014 Thompson Information Services, Bethesda, MD.