IRS serves up a mortality triple shot

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In this article
Mortality updates | Other items of interest | Likely impact of new tables | Related resources

Three new pieces of IRS guidance address mortality tables for defined benefit (DB) pension plan calculations, starting with the 2023 plan year. Notice 2022-22 provides the mortality tables for minimum funding calculations under Internal Revenue Code Section (IRC) Section 430 and lump sums under IRC Section 417(e), reflecting a new mortality projection scale but making no changes to current methodology. However, a set of proposed regulations would make more substantive changes by updating the base mortality rates, modifying the calculation of the mandated mortality tables, and restricting the use of static mortality tables to plans with 500 or fewer participants. Finally, informal guidance released in the April 28 issue of *Employee Plans News* clarifies the interaction between the notice and the regulations, if finalized. Comments on the proposed regulations are due June 9.

Mortality updates

Mortality tables under Section 430 are used to determine DB plans' minimum funding requirements and for other purposes tied to a plan's funding level, such as variable-rate premiums charged by the Pension Benefit Guaranty Corp. (PBGC) and the application of benefit restrictions under Section 436. Minimum lump sums under Section 417(e) are based on factors derived from the Section 430 tables.

The IRC requires IRS to revise the Section 430 mortality tables at least every 10 years to reflect the actual mortality experience of pension plans and projected mortality trends. The current base mortality rates were published in 2017 final regulations, although IRS has been annually updating the mortality projection scale — a set of factors that adjust the base rates to reflect recent and anticipated mortality experience. Notice 2022-22 provides mortality tables for 2023 plan years, reflecting the current base rates and the latest mortality improvement scale — MP-2021 — from the Society of Actuaries' Retirement Plans Experience Committee (RPEC).

Proposal reflects new mortality table and projection scale, but not COVID-19. The mortality tables in the proposed regulations reflect RPEC's latest report on US private-employer DB plans, which included a comprehensive set of mortality tables (Pri-2012) based on mortality data almost exclusively from 2010–2014. The proposed projection scale — also MP-2021 — reflects data through 2019, without any adjustment for the effect of the COVID-19 pandemic (due to the lack of consensus on whether the pandemic will have a long-term effect on mortality rates).. IRS anticipates that future RPEC studies will reflect any long-term COVID-19 impact, and future agency guidance could specify the use of tables based on those studies.

Use of static tables restricted. Under the current regulations, plan can choose between “static” mortality tables — reflecting a single set of factors for all birth years — and the more computationally complex “generational tables” that have different factors for every birth year. Small plans (plans with no more than 500 participants) can use an even simpler set of “combined” tables that have a single set of rates for nonannuitants and annuitants. In the 2017 regulations, IRS allowed the use of static tables to accommodate actuarial valuation systems that couldn’t properly apply generational mortality.

However, IRS believes generational tables are more accurate and thinks most actuarial firms now have the capability to use generational tables. Accordingly, the proposal would restrict the use of static tables to small plans, multiemployer plans, and cooperative and small-employer charity (CSEC) plans — and would only permit combined tables when static tables are used. IRS intends these changes to guard against anti-selection by plan sponsors for whom static tables produce lower liabilities.

Coordination of proposal and notice. Once IRS publishes mortality rates for a given plan year, those rates generally aren’t subject to change. In this case, however, the proposed regulation would take effect for plan years starting in 2023 — the same plan year as the rates in the notice. To prevent any confusion, IRS issued informal guidance explaining which mortality tables will apply if the proposal is finalized with a 2023 effective date:

- The Section 417(e) tables published in the notice will apply for 2023 calendar-year distributions, regardless of whether the proposed regulations are finalized.
- The static mortality tables in the notice — which use the current base mortality rates — will apply only for plans with plan years starting in 2022 and valuation dates in 2023 (i.e., for small plans with year-end valuation dates). All other plans will have to use the new tables.

Other items of interest

Beyond the base mortality rates and the updated projection scale, DB plan sponsors and other pension professionals should take note of several other items included — or not included — in the proposal.

Plans using substitute mortality tables. Section 430 gives sponsors the option to use a plan-specific mortality table based partly or entirely on the plan’s own experience, subject to IRS approval. A sponsor must use the substitute table for the number of years (up to 10) specified in the application to use the table, subject to a limited list of exceptions permitting early termination. One such exception is for an update to the Section 430 mortality tables, but IRS doesn’t intend to force early termination for most plans when the regulations are finalized. However, the agency intends to require a change for plans that have had a significant change in coverage (a more than 20% change in the average number of individuals covered under the plan relative to the number in the experience study supporting the substitute table). Plans in this situation will not have the option to continue using the substitute mortality table, even if the actuary certifies that the substitute mortality table continues to accurately predict future mortality.

No contingent-annuitant tables. The Pri-2012 report included separate tables for contingent beneficiaries — beneficiaries receiving payments as survivors of deceased participants. Because applying these tables is complex, requires difficult-to-obtain historical data and is unlikely to significantly affect the measurement of a plan's liabilities, IRS decided not to include separate contingent-beneficiary tables in the proposal.

No change for disabled mortality. Section 430(h)(3)(D) requires IRS to establish separate mortality tables that sponsors may use for disabled participants. Notice 2008-29 provided that until IRS issued further guidance, plans could continue to use the tables issued in Rev. Rul. 96-7. IRS has yet to issue updated tables for this purpose, and the proposal makes no change.

Likely impact of new tables

The switch to Pri-2012 and the updated projection scale will likely cause a small increase in liabilities for most plans, which will lead to slightly higher minimum required contributions and PBGC variable-rate premiums. Large plans formerly using static mortality tables will generally see a larger increase in liabilities from the switch to generational mortality, although plans with older retiree populations will be less affected and might even see a reduction in liabilities.

Minimum lump sums under Section 417(e) will get a small boost in 2023 from the new projection scale but won't reflect the new mortality tables until 2024. Although that change will likely increase lump sums relative to those calculated under the current table, the change in the required interest rates will likely have a much bigger effect.

Related resources

Non-Mercer resources

- Proposed regulations (Federal Register, April 28, 2022)
- *Employee Plans News* (IRS, April 28, 2022)
- Notice 2022-22 (IRS, April 27, 2022)

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