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Pension Plan Sponsor Alert

USI CONSULTING GROUP

2024 Pension plan outlook: What you need to know

2023 has been a big year for defined benefit (DB) pension plans – continued improvement in funded status, record-setting activity in de-risking and legislative changes from the SECURE 2.0 Act of 2022 ("SECURE 2.0"). One key regulation impacting pension plan sponsors and administrators in 2024 is the **final regulations prescribing mortality tables**, released by the Internal Revenue Service ("IRS") on October 20, 2023, that must be used for DB Plan funding and certain other purposes, including lump sum benefit calculations under such plans beginning in 2024 and thereafter. The revised mortality tables consider recent changes in life expectancy, including those due to the expected impact of COVID-19, and will generally (slightly) reduce expected plan costs over time on a permanent basis.

BACKGROUND

In accordance with the relevant provisions of the Internal Revenue Code ("Code"), the IRS has the power to determine the mortality tables that must be used for a variety of plan purposes, including determining minimum funding requirements under ERISA, potential "at-risk" status and benefit restrictions under Code Section 436, Pension Benefit Guaranty Corporation ("PBGC") variable rate premiums, PBGC 4010 filings and minimum lump sum calculations for plan participants.

The Code generally requires that the IRS update these (Code Section 430) tables at least every 10 years to reflect the emerging mortality experience of pension plans and projected mortality trends. In 2014, before the most recent regulations, the IRS adopted prior regulations requiring that DB pension plans use a consistent mortality table based on the Society of Actuaries RP-2014 mortality table, with (generally) annual projected improvements in mortality experience. Beginning in 2018, the IRS issued updated regulations regarding the mortality tables that must be used for DB Plan purposes, culminating in the issuance of the most recent final regulations that were issued on October 20th.

Mortality tables essentially reflect the percentage of the overall population (including DB Plan participants) who are expected to die each year and a change in the mortality tables (or the rate of expected mortality) thus directly affects the amount of money that must be accumulated in a DB Plan in order to fund expected future benefit liabilities, including both lump sum payments as well as annuities payable to DB Plan participants and their beneficiaries.

NEW 2023 MORTALITY REGULATIONS

The new regulations issued by the IRS are the first update to the Code Section 430 mortality tables since 2018. The new regulations provide that the Code Section 430 mortality tables that must be used for valuation dates for Plan Years beginning on and after January 1st, 2024, will be based on the Pri-2012 Private Retirement Plans ("Pri-2012") Mortality Tables. In addition, the mortality rates reflected in the Pri-2012 base table must be adjusted each year to reflect expected mortality improvements that are contained in a modified version of the "MP-2021" Mortality Improvement Scale. The adjusted MP-21 scale eliminates mortality improvements that were previously required from 2020 to 2023 and, under the SECURE 2.0 Act of 2022, incorporates a .78 percent annual cap on mortality improvement rates for Plan Years beginning after 2024.

The resulting updated mortality table has higher mortality rates (shorter life expectancies) than using the base Pri-2012 table alone without any adjustment to the MP-2021 improvement scale. The Treasury Department views this as a way to incorporate the impact of COVID-19, which the Society of Actuaries Research Institute decided not to incorporate within their base improvement scale.

DB PLAN IMPACT

Plan Liability Measurements. DB Plan sponsors can expect liabilities to be slightly lower under the new mortality basis. Compared to the 2023 Section 430 mortality, the new mortality (expected death) rates will generally be higher, particularly for older participants. The changes vary based on age and gender, so there may be decreases in mortality rates for certain younger participants. Plans using annuity-based benefit formulas should expect an overall net decrease in liabilities of about 1%.

The updated mortality table will also provide slight relief to minimum contribution requirements, although the longer shortfall amortization periods that are currently in place due to the enactment of the American Rescue Plan Act of 2021 will limit the impact on plan contribution requirements. In addition, other factors, such as rising interest rates and market volatility will also impact plan contribution requirements and could significantly exceed the effect of the new mortality tables on plan costs.

Lump Sum Determinations for Participants. Lump sums calculated for participants will also be slightly lower due to the mortality table changes. A version of the new mortality table will be applied to lump sum distributions under Code Section 417(e). For example, for a 65-year-old, the lump sum benefit calculated using 417(e) rates will decrease approximately 1% since the new mortality rates are higher between ages 62 and 102.

This decrease will be in addition to the recent large decreases in lump sum benefits due to the rise in interest rates. The sharp rise in interest rates and new mortality basis will thus result in plans paying smaller lump sums than they have at any time in the last decade. This may cause more terminated participants with smaller vested benefits to be eligible for lump sum cash-outs of their DB Plan benefits. In addition, Secure 2.0 allows cash-out limit for smaller plan benefits to increase to $7,000 for distributions after December 31, 2023, which could further increase the number of participants who receive lump sum cash-out payments.

EXAMPLES

A DB Plan offers a lump sum distribution option upon termination of employment. Benefits are generally payable under the plan commencing at age 65, the plan's normal retirement age.

Below are two examples of the effects of how lump sum benefits would be calculated for two different participants who are eligible to receive a $200 monthly benefit commencing at age 65, assuming that the new mortality table were in effect and the (IRS required) interest rates used to calculate lump sum benefits changed from (4.48%/5.26%/5.07%) to (5.58%/5.66%/5.56%), the rate that was in effect in September, 2023:

1. **For a 30-year-old participant with an accrued benefit of $200/month, the lump sum changed from $5,070 to $4,080** (decrease of 1.2% from mortality, decrease of 18.6% due to higher interest rates)

2. **For a 65-year-old participant with an accrued benefit of $200/month, the lump sum changed from $30,000 to $28,500** (decrease of 1.1% from mortality, decrease of 4.1% due to higher interest rates)

How USI Consulting Group (USICG) can help

The USICG team is happy to assist employers with all retirement plan matters, including those discussed here. Please contact your USICG Actuary or email information@usicg.com to discuss the new mortality tables and/or to learn more about how we can help better predict and manage pension plan costs and expenses, while optimizing plan design, financial impact and employee appreciation.