August 13, 2015

CAB 15-8

Milliman

CLIENT ACTION Bulletin
Employee Benefits

New Developments Affecting Defined Benefit Pension Plans

SUMMARY

Several key developments – in the form of IRS guidance, PBGC proposed regulations, and a new law – have occurred recently for employers that sponsor defined benefit pension plans. This *Client Action Bulletin* provides an overview of these items, which affect: the mortality tables used for a variety of pension plan requirements; the elimination of lump-sum payouts to current annuitants as part of a "de-risking" strategy; the reporting of financial and actuarial information by "underfunded" plans; and transfers of excess plan assets to retiree health and group-term life accounts.

DISCUSSION

IRS Updates Static Mortality Tables for Pension Plans for 2016

IRS *Notice 2015-53* updates the mortality tables that pension plan actuaries will use (unless they construct their own, credible table based on the plan's experience) for 2016 plan year valuations. Without the issuance of these tables, plan sponsors faced the prospect of the IRS adopting and requiring the use of the 2014 Society of Actuaries (SOA) mortality tables; the "RP2014" tables raised significant controversy, as many pension actuaries felt that the tables substantially increased plan liabilities by overstating mortality improvements ("MP2014") due to flawed assumptions.

The notice provides tabular "static" mortality rates, which are used to calculate a plan's funding (and related) requirements for valuation dates occurring during the 2016 calendar year. It also provides a modified unisex version of the mortality tables, which are used to determine the minimum present value of distributions (i.e., lump-sum payments) to participants with annuity starting dates in stability periods that begin in the 2016 calendar year.

Significantly, the IRS notice states that the agency is considering comments it received on RP2014 in developing a forthcoming proposed rule that will revise the base mortality rates and projection factors. The IRS's proposal will not apply until 2017; while there is an implication that RP2014/MP2014 will be the revised IRS mortality assumption, the notice does not guarantee the adoption of either.

For defined benefit plan sponsors (including multiemployer pension plan trustees), the updated tables provide certainty that the RP2014/MP2014 will not be required for 2016. The use of the IRS's updated tables will have a more modest effect than RP2014 on actuarial valuation results, including minimum funding, benefit restrictions, lump-sum calculations, and PBGC premiums. Plan sponsors should be mindful, however, that increases in life expectancy will likely affect the tables that the IRS will apply in the future.

IRS Closes Lump-Sum Windows for Retirees Receiving Benefits

Under IRS *Notice 2015-49,* pension plan sponsors are prohibited, as of July 9, 2015, from replacing annuity payments with lump-sum distributions to retirees and their beneficiaries, unless an exception applies. The notice announces the agency's intent to amend the required minimum distribution regulations so that, in general, a joint-and-survivor, single life, or other annuity that is *currently being paid* must not be replaced with a lump-sum or other accelerated form of distribution.

The IRS's notice comes during a time when many pension plan sponsors are pursuing means to curtail their liabilities and obligations through various "de-risking" strategies. In a few cases, the plan sponsor has offered participants who are receiving an annuity a short-term opportunity to take a lump-sum distribution. (Participants who accept the offer are removed from the plan's participant count, thereby lowering the plan's liabilities and PBGC premiums, and offering other cost savings for the plan.) Although the IRS in 2012 and 2014 issued several Private Letter Rulings (PLRs) approving plan amendments implementing this strategy, the agency is concerned that other plan sponsors are relying on those PLRs without obtaining their own ruling and are taking steps to offer a lump sum to participants who are receiving an annuity payment. Doing so, the IRS states, “undermines the intent” of the minimum required distribution regulations’ prohibition on changes once the payments begin. The notice states that future PLRs or determination letters will include a caveat expressing no opinion on the federal tax consequences of a plan sponsor’s lump-sum risk-transferring program.

The notice states that the forthcoming proposed rule will permit benefit increases (under the current rule’s “plan amendment” exception) only for ongoing annuity payments, and not for those that accelerate the annuity payments. Whether offering lump-sum payments to annuitants in the context of a plan termination will remain permissible is uncertain, but the proposed rule is expected to address this.

Defined benefit plan sponsors that are considering a lump-sum risk-transferring program should review the notice to determine whether they qualify for one of the exceptions. Those that do not might want to consider other de-risking strategies that remain possible, including, for example, liability-driven investing, plan design modifications, or insurance annuity buyouts. In addition, plan sponsors might wish to await the IRS’s forthcoming regulation for more definitive guidance and possible answers to questions not addressed by the notice.

PBGC Proposed Annual Financial and Actuarial Information Reporting Changes

The PBGC released a proposed rule to amend the requirements for the annual financial and actuarial information reporting (under ERISA section 4010) for single-employer defined benefit pension plans, taking into account changes made by recent highway/transportation laws (the 2012 “MAP-21” and the 2014 “HATFA”).

Under the current reporting scheme, a plan sponsor must file a “4010 disclosure” if the pension plan (on a controlled group basis): is considered less than 80% funded; is less than 100% funded and has more than $1 million in missed required contributions; or has an IRS funding waiver of more than $1 million and any amount is outstanding.

The proposed rule would waive 4010 disclosures by plan sponsors with plans that do not meet the 80%-funded threshold if the amount of the underfunding is less than $15 million and the plan had 500 or fewer participants. The addition of the plan size requirement to qualify for the filing waiver will have the effect of increasing reporting requirements for some large plan sponsors. If the plan is subject to the disclosure requirement because of the $1 million in missed contributions or the funding waiver, the 4010 disclosure would be waived if the amounts were timely reported to the PBGC according to the reporting requirements that apply to corporate and plan events (under ERISA section 4043).

The proposed rule, which includes other technical changes, would apply to information years beginning after Dec. 31, 2015 (i.e., the filing of information about the 2016 plan year, generally in 2017, for most plans). The PBGC also seeks public comments by Sept. 25, 2015, on the proposed rule.

Some large pension plans are likely to be affected by the PBGC’s proposed rule; for the relatively few, smaller plans that are, the relief from the 4010 filing requirement could be welcome news. Plans that do not qualify for a reporting exemption might wish to make additional contributions to bring their funded percentage up to 80%, if doing so is feasible.

New Law Extends Overfunded Pension Plan’s Ability to Make Retiree Health Transfers

The newly enacted “Surface Transportation and Veterans Health Care Choice Improvement Act” (P.L.114-41) includes a provision that allows defined benefit plan sponsors to transfer excess plan assets to retiree medical accounts and group-term life insurance accounts for an additional four years. Under current tax code section 420, pension plans with assets that are at least 125% of their funding target may make annual transfers to a retiree medical account and group-term life insurance account for the same group of participants. This provision was set to expire after 2021; the new law extends it through Dec. 31, 2025.

Defined benefit plan sponsors with plans that are more than 125% funded and offer retiree medical and/or group-term life insurance benefits have a longer period to transfer the excess assets.

ACTION For additional information about any of these recent developments as they apply to your defined benefit pension plan, please contact your Milliman consultant.