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February 5, 2015

CC:PA:LPD:PR (Notice 2013-49)
Room 5203
Internal Revenue Service
POB 7604
Ben Franklin Station
Washington DC 20044
notice.comments@irscounsel.treasury.gov

Joyce Kahn
Technical Guidance and Quality Assurance
Manager, Employee Plans
Internal Revenue Service
United States Department of the Treasury
1111 Constitution Avenue, NW, Room
NCA-621
Washington, DC 20224-0002

Harlan Weller
Government Actuary
United States Department of the Treasury
Suite 4028
1500 Pennsylvania Avenue NW
Washington, DC 20220

Kyle Brown
Special Counsel, Office of Chief Counsel
Tax Exempt and Government Entities
Internal Revenue Service
United States Department of the Treasury
1111 Constitution Avenue, NW
Washington, DC 20224-0002

Carol Zimmerman
Member, Joint Board for the Enrollment of
Actuaries
Internal Revenue Service
United States Department of the Treasury
1111 Constitution Avenue, NW, Floor 4
Washington, DC 20224-0002

Re: Comment for Developing Future Mortality Tables for Use Under §§ 430(h)(3) & 417(e)

Dear Ms. Kahn, Mr. Brown, Mr. Weller and Ms. Zimmerman:

The American Academy of Actuaries¹ Pension Committee (Committee) respectfully asks for your consideration of our comments related to the creation of mortality tables to use under

¹ The American Academy of Actuaries is an 18,000+ member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

§§430(h)(3) and 417(e) of the Internal Revenue Code (Code) for years after 2015, as requested in Notice 2013-49.

In light of the Society of Actuaries' (SOA) publication of the RP-2014 mortality tables and the MP-2014 mortality improvement scale, IRS and Treasury may consider whether to use these tables based on the full dataset (or with adjustments for collar, amount or headcount weighting variants) as published, or with modification, or use alternative tables that reflect other sources of data or underlying assumptions.

We believe that pension plans should be using up-to-date mortality assumptions and best practices where possible. However, we believe that any changes to required tables for pension funding requirements should include alternatives for smaller plans (such as static tables) in order to simplify administration and valuations where the cost of the application of more sophisticated methods may not be justified. For valuation purposes, the sophistication of two-dimensional mortality projection scales may not be warranted for many small plans, or for plans that predominantly pay lump sum benefits. Introducing generational mortality in the calculation of lump sum benefits may increase the administrative complexity and cost of the plan; IRS and Treasury will have to weigh the increased cost to plan sponsors with the value provided to plan participants. In general, we recommend adopting methods that favor simplicity where the value of additional refinements in the resulting liability or lump sum benefit is small.

We also encourage IRS and Treasury to consider the lead time necessary following the release of final regulations to implement these changes in plan administration systems and valuation software.

As this letter will illustrate, many of the questions the IRS and Treasury will consider do not have clear answers. We would be happy to meet with you to discuss these issues and others you may identify, and to share our understanding of the arguments in favor of, and against, the variety of techniques, methodologies and specific assumptions that you may consider.

General Comments Regarding Code §417(e) Mortality

The Committee suggests that the IRS consider whether it is appropriate to apply generational mortality projection to determine minimum lump sums under Code §417(e). Applying generational mortality would be consistent with currently emerging actuarial practice, in which generational projection is becoming increasingly prevalent for determining plan benefit obligations. A generational projection would provide a benefit consistent with some assumed level of sustained long-term mortality improvement. However, the projection of mortality improvement well into the future is clearly very subjective. Reflecting generational mortality improvement in lump sum calculations may result in paying people today for improvements that never come to pass; whereas not reflecting generational improvement may not provide sufficient compensation to reflect the actual level of future improvement that is ultimately realized.

Alternative approaches could be considered to promote simplicity, such as:

- Continue the practice of publishing a single, static mortality table each year (reflecting a combination of the employee and healthy annuitant tables and some appropriate level of

assumed future improvement) and applying that table to all participants. Such an approach would be easier for plan administrators to undertake within their administration systems, minimizing the cost to implement the mortality update.

- Use a single static mortality table, and then apply an adjustment factor that is a simple function of participant age and the deferral period reflected in the lump sum conversion factor. This approach would allow for a close approximation of a generational calculation but would likely be much simpler to incorporate into administrative systems. We have done some analysis of this alternative approach that we would be happy to share if you are interested in considering this option.

For smaller plans, the cost to implement generational mortality in their administration systems may outweigh the benefit of any enhanced accuracy, and we believe some of the simplified alternatives may be more appropriate for these plans.

General Comments Regarding IRC §430 Mortality

Structure of Base Tables

In general, we do not believe there is a need for a combined table, because valuation software used by actuaries can handle distinct employee and annuitant tables. Using separate tables to better capture the relative proportion of active employees and healthy annuitants of each plan provides an improvement in the liability calculation that we believe outweighs the cost to implement separate tables in those valuation systems that do not currently support them.

For similar reasons, we do not think a static table for funding purposes is necessary for larger plans. Most valuation software used by actuaries can already handle generational mortality or can be modified to do so if Code §430 mortality is generational.

However, the Committee feels the use of static projection tables should continue to be allowed in the small plan marketplace where the predominant distribution option is a lump sum, in which case the valuation liability is dependent primarily on the Code §417(e) mortality assumption. In the case of a cash balance plan (a very common plan design in the small plan marketplace), Code §430 mortality may have no impact on valuation liabilities. In these instances, the additional sophistication in the methodology provided by a generational projection will have little or no impact on valuation liabilities, and therefore may not justify the cost of implementation.

We recognize that significant differences in the demographics of small pension plans make it unlikely that a single static approximation could be found that is appropriate for all plans. Consideration might be given to developing a methodology that applies a static projection for a number of years, adjusted with the liability-weighted average participant age or other factors that are highly correlated to the liabilities' duration. Separate approximations might be warranted for the employee table and the annuitant table to account for the differences in the expected duration of benefit liabilities for active, deferred vested and retired participants, and to account for benefits distributed as a lump sum.

Methodology for Projecting Mortality Improvement

The framework used by the RPEC in developing the MP-2014 improvement scale relies on three principles:

- Recently observed experience is the best predictor of future near-term mortality improvement rates;
- Long-term rates of mortality improvement should be based on “expert opinion” and analysis of longer-term mortality patterns; and
- Near-term rates should transition smoothly into the assumed long-term mortality improvement rates over appropriately selected convergence periods.

We believe that this is a reasonable framework for developing a projection of mortality improvement.

Furthermore, it is clear that the historical mortality improvement data presented in the MP-2014 final report demonstrates the existence of both period and cohort effects in the experience of the U.S. Social Security Administration’s mortality data. Consequently, we believe that a current approach for projecting future improvements should take account of both types of effects in the future. To our knowledge, the most recent and simplest attempt to develop such a model is the RPEC_2014 model. We therefore recommend that the IRS adopt some form of the RPEC_2014 methodology in creating the next generation of tables applicable under Code §430.

However, it may be appropriate to consider recent data (discussed below), as well as alternative views on the length of the convergence period (separately for horizontal and diagonal projections), the long-term rate of improvement (also discussed below), and the relative weighting of cohort and period effects.

Recently Observed Experience

It is our understanding that actual mortality improvement in recent years (2007 through 2012, or the first 25% of the MP-2014 convergence period) has been significantly less than that predicted by MP-2014. This conclusion stems from analyzing data from the Human Mortality Database (maintained by the University of California, Berkeley and the Max Planck Institute for Demographic Research, Germany) for 2007-2010, and additional estimated data issued by the Social Security Administration (Age-Sex Adjusted Central Death Rates shown in the 2014 Trustees Report) that indicates that the lower level of actual improvement relative to that projected by MP-2014 is likely to have continued through 2012.²

If the IRS decides to use an alternate projection assumption set in lieu of the MP-2014 table, we recommend that the base mortality tables to which these projections are applied also be modified to reflect the modified projection assumptions for the period from 2006 to the base year of the table.

Rate of Ultimate Improvement

² This recent “cooling” of mortality improvement was recognized in RPEC’s 2013 “Literature Review and Assessment of Mortality Improvement Rates in the U.S. Population: Past Experience and Future Long-Term Trends” (see pages 8-9).

A wide range of experts' views on ultimate future mortality improvement rates exists, which forms a broad assumptions universe from which to select the rate of assumed future improvement.

While RPEC stated that its best estimate of the long-term rate of mortality improvement is 1% (trending from 1% to 0% from ages 85 to 115), the Social Security Administration's best estimate of the average long-term rate of mortality improvement is significantly less at 0.75% from ages 65 to 84 and 0.49% above age 84.³ In contrast, the 2011 Technical Panel of the Social Security Advisory Board recommended life expectancy assumptions consistent with annual improvements of 1.26% and recent Congressional Budget Office work incorporates an annual improvement rate of 1.17%. Given the subjective nature of the long-term improvement rate, we do not believe that RPEC's estimate is necessarily a better estimate than the assumption used by the Social Security Administration or the assumption selected by the Congressional Budget Office, nor do we believe it is consistent with the 2011 Technical Panel recommendation.

Given the disparate opinions on the pattern and level of future mortality improvement, we encourage the IRS to consider all available data in selecting a mortality improvement assumption for Code §430. The selected mortality improvement assumption should reasonably capture anticipated future improvements, so that plans neither become significantly underfunded relative to realized future experience, nor require plan sponsors to fund significantly in excess of that experience.

Disability

We believe the pre-1995 table is no longer necessary. The liability attributable to people who became disabled 20 years ago is small and expected to decline over time as fewer of these participants survive. At the same time, we do not feel it would be appropriate to apply the RP-2014 healthy table to disabled lives, since RPEC did not include disabled lives in the development of that table. Further, the RPEC did not produce a "Social Security disabled" table, so there is no direct replacement in the study for the IRS post-1994 disablement table.

We believe a single table for all disabled lives, based on the RPEC disabled table with some suitable projection, should be used. Such a table would be applied to any participant who retired under a special plan provision for disability retirement, regardless of whether the participant is currently considered to be disabled by Social Security. (It can be difficult for plan sponsors and actuaries to determine whether disabled participants are still considered to be disabled by Social Security after the disability commencement date.)

With respect to mortality improvement, the RPEC concluded that projection of mortality improvement was appropriate based on the Social Security Administration's statements that its observed improvement among disabled lives was similar to that of healthy lives. We recognize that the number of Social Security disabled participants has increased significantly in recent years, which may even suggest that the average Social Security disabled person is now less

³ Mortality improvement rates at older ages are surprisingly significant in terms of their effect on present value calculations, thus the differences between the SSA assumptions and the RPEC assumptions are quite meaningful.

disabled than in the past. While this may also suggest support for the SSA observation that the mortality improvement experience of disabled retirees is similar to that of healthy retirees, we are not aware of any actual studies performed to validate this finding. Rather, the evidence is anecdotal.

In light of the already substantial improvement from the 2006 midpoint of the mortality study period until 2014 built into the RP-2014 disabled retiree table and recent observations that the mortality improvement trend may be slowing, we believe that the IRS and Treasury should consider whether the same mortality improvement assumption should apply for healthy and disabled annuitants.

We appreciate the IRS and Treasury giving consideration to these comments. We recognize there are valid opinions on both sides of many of these issues. We welcome the opportunity to discuss these in further detail with the working group and offer to meet at your convenience.

Please contact Matthew Mulling, the Academy's pension policy analyst (202-785-7868 or mulling@actuary.org) if you have any questions or would like to arrange a convenient time to discuss these items further.

Respectfully submitted,

Ellen L. Kleinstuber, MAAA, FSA, FCA, FSPA, EA
Vice-Chairperson, Pension Committee
American Academy of Actuaries