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Wealth: Retirement

Pension costs are about to balloon. (We have a nice, sharp pin.)

If you sponsor a defined benefit pension plan, you could face a new liability "hit" in 2015. We can help you manage – and possibly lower – that liability (and expense) impact. Here's what's happening.

Updated Mortality Tables

Earlier this year, the Society of Actuaries published a proposed mortality table and a proposed mortality improvement projection scale which are recommended to replace the current assumption. Final tables are anticipated this fall, and accounting firms will expect plan sponsors to adopt the updated mortality tables for year-end reporting. The new tables will increase measured pension plan liabilities at year-end 2014 by more than 10% in many cases.

Fiscal 2015 expense could increase significantly more than that due to cost leveraging inherent in benefits accounting. Updated mortality tables will likely be required for year-end 2014 financial reporting. If you sponsor a defined benefit pension plan you should conduct an assumption review now to help mitigate the impact.

Process of Assumption Selection

Accounting statements require an explicit approach to assumption selection, meaning that each significant assumption must reflect a best estimate solely with respect to that assumption. Actuarial Standards of Practice state that assumptions must be based on a combination of both past experience and future expectations. In order to comply with these standards, an experience review should be completed at least every five years, and the reasonability of each individual assumption should be reviewed every year.

Understanding Pension Assumptions

At its heart, a defined benefit pension valuation anticipates how much the benefits will cost in the future by determining when the benefit will be paid and, in many cases, how much the benefit will be. Of course, the actual cost of the benefits depends on what really happens, whether or not the assumptions used to measure their liabilities correctly predict what will occur.

You want those assumptions to give a reasonable estimate of the costs.

But you don't want to predict higher costs than necessary — effectively deferring real profits that can be reflected now instead of future periods. The new mortality tables increase measured plan costs because retirees receiving those benefits are expected to live much longer. But a number of other assumptions impact the questions of when the benefits will be paid and how much.

We have helped numerous clients carefully evaluate those assumptions. Most often, our review results in a more thoughtful set of assumptions, leading to anticipated reductions in measured liabilities for the plan sponsor.

Assumptions should reflect the best estimate of future expected experience under the plan. Reviewing the actual experience under the plan is an important guide to the selection of assumptions and should be used in conjunction with future expectations of experience considering other factors affecting the plan and participants.

Retirement rates – Retirement trends have changed dramatically. Studies show that current employees do not expect to retire like those of previous generations - many employees are working longer, past age 65. For many plans this means reduced cost in the form of early retirement subsidies that will no longer be paid, or a delay in the receipt of benefits.

Termination rates – Following the financial crisis, employees were not able to change jobs, but as the economy recovered, employee turnover returned – and it is not uncommon for someone to have 10 or more jobs during a full career. For a pension plan, higher turnover results in lower costs through the elimination of assumed future benefit increases (in some cases), early retirement subsidies and fewer participants achieving vested status.

Form of payment – Not all forms of payment are equal. Some forms of payment are subsidized, intentionally or otherwise, and revising this assumption to more accurately reflect actual practice and future expectations may reduce cost.

Mortality – With a new mortality table due to be published in the very near future, which is expected to significantly increase liabilities, many sponsors are thinking about the potential alternatives. Mortality experience typically varies based on geography and socioeconomic status. The plan's mortality assumption can be selected reflecting those factors. Alternatively, plans with 1,000+ retirees may have enough plan mortality experience to justify modifications to the standard tables. Depending on your situation, these considerations may significantly dampen the impact of the new mortality tables.

Why review assumptions now?

An assumption review now may help to mitigate the impact of more conservative mortality tables. Further, to maintain "best estimate" assumptions, experience should be reviewed at least every five years. As part of an experience review, we will:

- Review, assess, and recommend thoughtful assumptions
- Estimate potential cost impact for any recommended changes
- Provide documentation supporting recommendations

Let's get to work.

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