



## THE PCS ALERT

The latest in DB Pensions

# ARE WE ALL GOING TO LIVE TO BE 969?

Dear Sid

It was of course Methuselah who, according to the Old Testament, lived to the great age of 969. To hear some of the doom mongers recently you could be forgiven for thinking that we are all going to live as long as Methuselah and this will cause untold damage to pension funds, insurance companies and, indeed, the whole economy.

Well the good news (or bad news, depending on your perspective) is that we are not all going to live to be 969. In fact most of us are still very unlikely to get to 99. But we are living longer – currently by about 5 hours every day (or about 2 years every decade). But this is not new. Nor is it a UK phenomenon. A study in the May 2002 edition of *Science* magazine “Broken Limits to Life Expectancy” showed increasing longevity at these levels to be a global trend dating back well over 150 years.

So why all the fuss now? Well it probably is the case that with all the increased costs that have been foisted on pension schemes by Government and regulators in recent years, some have been a little slow to continue to update their mortality tables. Many companies and trustees could be forgiven for being confused and overwhelmed by jargon and poor explanations of what is going on. But it is very important that they do attempt to understand what is happening to longevity because the recent scare stories and demands for change will **not** be appropriate for all.

- We are not going to live to 969.
- We are living longer, but this is not new
- Longevity varies hugely by type of workforce, geographic region and size of pension.
- The new tables will not be appropriate for all. Companies need to understand their exposure to increasing longevity and then plan accordingly.
- There are an increasing number of ways to offset longevity risk.

### Jargon Buster

First though we need to break through the log jam of jargon that besets this subject. So here is a quick jargon buster:

PA92 tables	These tables are based on an analysis of insurance company mortality data for the period around 1992
The cohort effect	For those born between about 1925 and 1945 life expectancy started to increase at a faster rate
Short Cohort tables	These mortality tables assume this faster rate of improvement continues until ~2010
Medium Cohort tables	These mortality tables assume this faster rate of improvement continues until ~2020
Long Cohort tables	These mortality tables assume this faster rate of improvement continues until ~2040

The first important point to note is that the current faster rate of improvement in life expectancy shows no sign of going away, so maybe the Short Cohort tables really are no longer appropriate. But it all depends on your starting assumption for life expectancy. Many actuaries are already being prudent about future life expectancy by using the PA92 tables as a starting point.

Because the PA92 tables are based on insurance company data they are not entirely relevant for pension schemes. The work of the Actuarial Profession’s body (the CMI) established to investigate and monitor mortality trends showed in a report published last year that the mortality experience of pension schemes was possibly 30% greater than predicted by the PA92 tables. Moreover, they also showed there is huge variation between pension schemes. Many factors are at work which can mean that it is appropriate to assume much lower (or higher) life expectancy than the “norm”.

To understand your longevity exposure it is therefore necessary to look at some of these factors.

### The key determinants of life expectancy

In our Newsletter last October we published the results of our research into the life expectancies assumed by FTSE100 companies. This research highlighted huge differences between companies, with the highest life expectancy assumed being more than 8 years greater than the lowest life expectancy. There are number of key reasons why this might be justified:

Geographic Region	There is strong evidence and research available which points to life expectancy varying by 3-4 years (or even more) depending on region / local authority
Size of Pension	There is strong evidence and research available which shows how life expectancy can vary by as much as 5 years or even more depending on the size of pension (and hence general level of affluence)
Type of work	Again there is strong evidence and research available showing how life expectancy varies considerably from industry to industry – again differences of 5 years or more can be quite possible.

PCS has access to research carried out on all these factors and can use this to help companies understand their exposure to longevity risk. With the Pensions Regulator (and others) becoming increasingly focused on mortality assumptions it is vitally important for companies firstly to understand where they currently stand and, secondly, to have the evidence to back up any stated assumptions on longevity if challenged by the Regulator.

Of course, if the pension scheme population is comprised largely of very well paid office workers based in the South East of England then maybe the company management has reason to be fearful about the implications of continuing improvements in life expectancy. But for the majority of pension schemes we believe the position will not be as bad as has been predicted by some and may even be better than anticipated.

#### **What about the future?**

The most important part of the analysis on life expectancy is to get the starting point right. The level of future improvement to apply to that starting point is then a little more subjective. It is interesting to note here that different Government bodies seem to have different perspectives. On Monday the Pensions Regulator published its consultation document "*Good practice when choosing assumptions for defined benefit pension schemes with a special focus on mortality*" suggesting that mortality assumptions that appear to be weaker than the long cohort assumptions will attract further scrutiny and could be challenged.

However, last week the Pension Protection Fund (PPF) published its consultation on changes to PPF valuations. It is recommending a change to mortality tables to adopt medium cohort mortality improvement rates with a 1% per annum minimum floor to the level of improvement.

This difference between Government departments does not help matters. With the ever increasing costs of managing pension schemes, it seems inappropriate for regulators to demand pension schemes use different mortality tables for different valuations.

#### **Can anything be done to reduce longevity risk?**

In short, the answer is – yes. PCS has been monitoring the development of products designed to reduce and hedge longevity risk, which have been created by several banks and insurance companies. We can help companies get the best price for cover to reduce or even take away their longevity risks.

#### **In conclusion ...**

It may not be as bad as some have suggested, but companies need to understand what their longevity exposure truly is and, possibly, compile the necessary evidence to present to trustees and regulators. They should then consider the options they have got for mitigating their exposures. Failure to do this risks management neglect of a key area which can have a significant impact on pension scheme and company finances and can lead to erosion of shareholder value.

PCS can help companies gain a proper understanding of their longevity risks and assist in potential solutions. For more information on how we might help please contact Charles Cowling on 0161 242 5388 or Rob Dales on 0113 203 5883.

Yours sincerely




For further information on the services PCS can offer you, please email us at [solutions@pensionstrategies.co.uk](mailto:solutions@pensionstrategies.co.uk) or visit our website at [www.pensionstrategies.co.uk](http://www.pensionstrategies.co.uk) to register your interest. Alternatively call Charles Cowling on 0161 242 5388 or Rob Dales on 0113 203 5883.

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