

Cost of improving life expectancy

How companies can influence the assumptions

March 2007

Pensioners are living longer – this should be great news. However the adverse consequences have clearly been seen on companies' results. Uncertainty in future mortality trends carries further risks for companies but also presents opportunities to influence the choice of assumptions. This bulletin explores the options that are available.

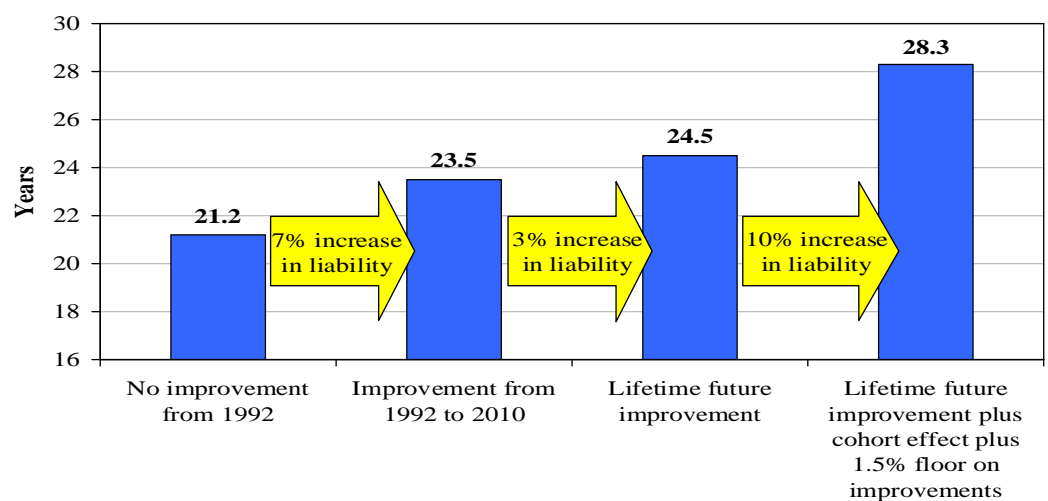
What mortality tables exist?

- 1 Tables based on experience of a well-defined population over a specific period, e.g. "PMA92 tables" reflect life office experience around 1992.
- 2 As (1) plus an allowance for improvements to a given date, e.g. PMA92 calendar year 2010 (which includes improvements to the year 2010).
- 3 As (1) plus an allowance for improvements throughout a member's lifetime, e.g. PMA92 year of birth tables which could go beyond 2010 for most members
- 4 As (3) but with further improvements for the so called 'cohort' effect (see below) and/or with a floor on future improvements (typically up to 1.5% p.a.).

The 'allowance for improvements' is based upon long-term historic trends, together with assumptions as to how these will continue into the future. Often, a basic projection will be overlaid with an adjustment for the 'cohort' effect, ie a further allowance for rapid improvements in longevity for the generation born between 1920 and 1945.

What is the effect?

The chart below shows the impact on the life expectancy of a 60 year old male on working through the various assumptions and allowances under 1 to 4 above:



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What options exist?

Mortality assumptions are very uncertain, thus allowing companies to consider whether any particular set (e.g. as proposed by the trustees' actuary) are appropriate for their workforce. For example:

- Is the underlying experience, often for life office pensioners, appropriate for the work-force - particularly if it is manual and/or low-paid?
- Are there socio-economic considerations – longevity tends to be greatest amongst the most affluent?
- What would be the impact of different future improvements – this is an area of great uncertainty and a range of alternatives could be justified? The trustees' actuary may give particularly prudent advice.
- There are now new tables available published by the actuarial profession based on statistics compiled around 2000, although evidence from our survey is that the use of these tables is currently very limited.

In particular, companies should consider whether the assumptions are for accounting ('best estimate') or funding ('prudent'). One might reasonably expect a difference between the assumptions for these different purposes.

What are companies doing?

Watson Wyatt has conducted surveys on the choice of assumptions for valuations carried out under the new 'Scheme Specific Funding (SSF)' regime. Our survey now covers schemes with combined assets of £67bn with advisers from a range of actuarial firms.

The average assumption for a scheme's first SSF valuation is that a current 60 year old male will live 24.6 years, 1.9 longer than predicted at the previous valuation. This would add just under 6% to the liabilities for a typical scheme.

Increasing numbers of schemes are not just reflecting past improvements in mortality in their assumptions but also allowing for future improvements. Our survey showed that 88% of schemes now allow for future mortality improvements compared with 52% at the last valuation.

It should be noted, however, that there is so far little evidence of schemes building in a floor underpinning future improvements, as life offices are being encouraged to do.

The table below shows a sample of results, broken into different sectors.

Survey results for particular sector	Average male life expectancy from age 60	Increase in liability relative to average
Financial Services	26.0	4%
Manufacturing/Industrial	24.0	-2%
Other	24.5	-0.3%

However, significant variations exist, with a minimum life expectancy as low as 22 years and a maximum of 26.6 years.

How can we help?

Watson Wyatt has a wealth of experience in helping our corporate clients deal with the issues associated with increased longevity. We have developed many practical solutions, from risk sharing measures that enable the company to pass on a share of the cost of increased longevity to members, to advice on selecting appropriate tables and reviewing past experience to prepare the company for negotiations with the trustees prior to a valuation.

If you would like to discuss any of the issues raised in this paper, please call Steven Dicker on 0161 839 1600 or Andrew Reid on 020 7222 8033.