HYMANS ROBERTSON

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2024 valuations – why the mortality assumption matters

Current views on future improvements in life expectancy could save corporates millions.

Summary

For schemes with a three-yearly funding valuation in 2024, life expectancy, and in particular how this might change in the future, will be a key assumption. A lot has changed in the last three years and reflecting current views on future life expectancy could save corporates millions.

Introduction

With the DWP having released its draft funding regulations, and the revised funding code being expected soon, the focus of many trustees will be on whether their schemes comply with the new requirements (although of course the new code does not apply to March or April 2024 valuations).

However, for many schemes approaching three-yearly funding valuations in 2024, the last review of their longevity assumptions will have been 3 years ago. The long-term impact of the Covid-19 pandemic on longevity is not yet clear, and so longevity assumptions are highly subjective and need particular attention.

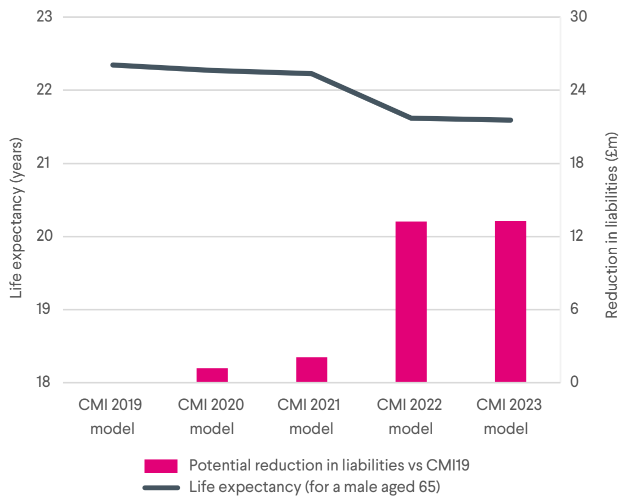
ONS data over the past few years shows significant excess deaths, relative to pre-pandemic levels. There is a body of opinion that the pandemic will negatively affect mortality experience for many years to come, resulting in lower projections of future life expectancy than would otherwise have been the case. The next CMI model is being consulted on with the final outcome being published in April 2024. It brings another year of data and a particularly complex calibration decision. Longevity data towards the end of 2023 and in early 2024 showed possible signs of a return to pre-pandemic levels, although it is still early days.

For those schemes who last reviewed their longevity assumptions for funding 3 years ago, the importance of reflecting current views has never been more critical.

CMI projection models

The CMI 2022 model, released during the summer of 2023, had a core parametrisation with a 25% weighting applied to data from 2022 and no weighting applied to 2020 and 2021 data. The value of this weighting parameter had a material impact on the final result of life expectancy and is also highly subjective.

Looking to 2023, the current consultation suggests that adopting the core parameterisation will result in broadly similar levels of life expectancy to that assumed in the CMI 2022 model. This supports the position that longevity data may be starting to return to levels seen before the pandemic.



The CMI's proposal for CMI 2023 is to apply a core weighting of 10% to population data for 2022 and 2023. This compares to their initial proposal from a year ago to increase the core weight for each upcoming year of data by 25% (which would have led to a further material reduction in life expectancy in CMI 2023) and to enable a gradual return to the typical assumption-setting approach used in the past. This change in approach relative to what was anticipated less than a year ago illustrates how much uncertainty there is. At the moment the CMI's plans for future core weights are not set in stone.

It is important for sponsoring companies and trustees of pension schemes to carry out their own analysis to determine a suitable model calibration. In any situation though there will always remain a risk of herding in the industry around the default core parameters, particularly as these may not appropriately reflect your scheme's membership profile.

We have assessed the impact on life expectancy of a variety of different CMI models at 1 January 2024, and how this may affect upcoming three-yearly valuations when using the core parameterisation.

The above scenario applies to a scheme with £500m liabilities and members with an average age of 65. It assumes the core parameterisation is adopted with improvements projected from 2013, with a long term rate of improvement of 1.5% pa and base tables set as 100% of the S3 tables. The CMI 2023 model figures are based on the provisional core parameters as set out in the consultation.

The chart shows clearly that updating the longevity assumptions to one of the more recent CMI models could see a significant improvement in the funding position of the scheme, in the order of nearly 3% of liabilities when using the core parameters.

Key considerations for the CMI model

The choice of weighting for 2022 and 2023 population data will have a material impact on the model output and adopting a greater weighting than the current core parameters could significantly change the position. However, demonstrating how the approach taken reflects real-world drivers of future improvements will be a key consideration for users of the CMI 2023 model.

There are also other elements to think about. For example, there are many different views of the A parameter and the long term rate of improvement, which could change the position significantly.

CMI 2023 will reflect updated population estimates for 2012-2020, following the 2021 census. These updates will impact the overall level of improvements implied by the CMI model and are another factor to consider in the assumption setting process.

Setting a trend assumption using the CMI model isn't getting any easier and the default projection now involves a lot more judgement than it has in the past.

Conclusion

In all, it's clear that current views of longevity will be a significant part of discussion at 2024 funding valuations and, from a corporate perspective, this will require careful consideration.

Understanding the profile of your membership, particularly with detailed analysis, and comparing the scheme to the broader UK and other real-world considerations is a helpful starting place in informing what an appropriate assumption could be.

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