Summary
- Longevity improvements are beginning to slow, although many argue that this is temporary.
- DB schemes are likely to benefit from improved funding, so should consider escalating de-risking strategies.
- It is also likely that better pricing from insurance firms will occur.
- This extends to the DC market where individual annuities may become better value for money.

The (pensions) problem with old age

Longevity is increasing more slowly than expected. It's bad news for humans – but for now pensions schemes can breathe a collective sigh of relief

For decades longevity rose exponentially, leading philosophers, geneticists and beleaguered pensions scheme managers and trustees to ask – 'are we on the cusp of living forever?'

But since 2011, longevity increase estimates have slowed. We're all living longer, but that's happening less rapidly than we previously thought. And while it's still possible that our great grandchildren will being living into their 1000s it's far less likely that we will be.

Why? Experts are divided. Some put it down to a less effective flu jab, or ineffective social care policies, while others blame everything from austerity and an over-stretched NHS to the fact that improvements in cardiology have slowed down.

Whether the cause is social policy or medical practice, one thing is certain – mortality assumptions are changing the way pension schemes think about longevity.

Scottish Widows' head of demographic assumptions, Stuart McDonald, explains: "Since 2011 the UK has experienced a dramatic slowdown in longevity improvements. This is now reflected in the models used by insurers and pension schemes in their assessments of life expectancy."

Why do schemes care?

For DB schemes – facing down the barrel of huge deficits – people living longer makes it much harder to plug the gap. The collective DB scheme deficit currently stands at £460 billion, and every year longer that someone lives, the worse the problem gets.

By contrast – an unexpected slowing down of longevity increases could improve funding levels for DB schemes. Indeed, many schemes are already seeing the benefit with a gain of around 4 per cent, according to JLT Employee Benefits head of buyout Harry Harper.

So it's good news for funding. And it turns out that plan sponsors are likely to be happy too.

EY global longevity lead Gordon Wood explains: "The slowdown in mortality improvements could see sponsors using this as an opportunity to reduce their deficit-reduction contributions, while leaving the glidepath to full funding the same as their current trajectory."

However, a word of caution for schemes, as not all groups of people are facing the same longevity trends. Research carried out by the Pensions and Lifetime Savings Association alongside Club Vita found that, between 2011 and 2015, affluent men continued to see strong rises in longevity, equivalent to 17 weeks of extra life expectancy. The report pointed out that often half (or more) of a pension scheme's liabilities

will be in this 'comfortable' group. So it is crucial that schemes examine their membership carefully before making any drastic changes. And that any reductions in sponsor contributions are examined in this context.

Another area of concern is that it is not yet clear that this slowdown in longevity increases will be permanent. Prudential Financial's head of longevity reinsurance, Amy Kessler, argues that an increase in the pace of longevity improvements is just around the corner.

She says: "While no class of disease is currently making material progress, there are a number of medical advances in the works that are likely to cause longevity improvements to pick up again and exceed the current 1 per cent improvement rate. Examples of these advances could be genetic treatments of cancer and other diseases, lab-grown organs, the artificial pancreas and a proper flu vaccine that you get once with much greater effectiveness than the annual flu shot. When these medical advances come through, there will likely be an increase in improvements once again."

This uncertainty about long-term mortality rates means schemes are unlikely to be able to adjust their investment strategies. But a huge decrease in longevity might change funding so dramatically that schemes were able to think about changing approach. For instance, some schemes might see it as an opportunity to be more bold in their equity investments – although one would most have learnt lessons on this from past experience.

A more likely outcome is that the pace of de-risking could pick up quite rapidly. As schemes find they reach full funding faster than expected, they can remove risk from the table more quickly too. While the slowdown in longevity estimates may be temporary, schemes close to full funding may find they get the bump they need to de-risk.

Cheaper de-risking for schemes

An increased appetite for de-risking spells good news for insurers, and longevity swaps, buy-ins and buyouts are going from strength to strength. And in return schemes are likely to be benefit from better pricing.

Legal and General head of origination, pension risk transfer, John Towner says: "It is important to recognise that insurer and reinsurer pricing is taking account of the recent slowdown in longevity improvements already and that pension schemes are continuing to look at ways they can transfer their longevity risk. Trustees and sponsoring companies recognise that they will continue to own this risk unless they do something about it. For this reason, demand for longevity protection remains strong and the market has seen almost £6 billion in longevity insurance transacted year-to-date."

Lower pricing might seem like bad news for the insurers themselves, but McDonald points out that any reduction in absolute pricing will be mirrored by a reduction in the liabilities that prices are benchmarked against.

There is a possibility that schemes could adopt a 'wait and see' approach to try and get better pricing on longevity swaps, Harper suggests. He says: "Will pension schemes still buy longevity only protection? This is more of a tricky question. For well-paid members, the mortality risk is genuinely two-sided as their longevity is still improving, but for the rank and file perhaps it is worth waiting another year to see if cheaper longevity pricing arrives next year."

However, this approach is risky, as no one knows for sure when longevity increase rates will pick up again. Trustees who wait too long may find they have missed the boat on attractive pricing.

Indeed, Kessler is expecting schemes to pounce on the opportunity to get better de-risking deals – including in the longevity-only space. She says: "Since pension schemes may be lowering their longevity improvement expectations, they will have a slightly improved funded status… Any kind of de-risking plan, whether it is moving assets into fixed income; adding a longevity hedge; executing a series of buy-ins; or going all the way to a buyout and full plan wind up – all of that becomes more affordable now."

Good news for the DC annuity market

In the DC world longevity is slightly more nuanced. There are social concerns about people running out of money, especially since freedom and choice, but for scheme managers themselves, how long people live is largely irrelevant. If mortality slowed down substantially – we could rethink how much people need to save in an ideal world. But the adjustments at present are minor, and provide scant comfort to everyone who knows that people aren't saving enough.

One upside, however, for the DC market is the possibility that annuity rates might get better, leading to an uptick in sales.

McDonald comments: "In theory a slowdown in longevity improvements improves perception of individual annuity pricing (consumers get a higher annuity amount for a given lump sum). In practice though the impact is small relative to interest rate movements. The combination of interest rate rises and falling longevity should lead to better annuity rates offered to individuals."

And improvements may not happen yet, as individual annuity providers are being cautious on mortality anyway, according to Wood. He says: "The particular subset of the population that is employed or is wealthy enough to have a pension or life insurance generally exhibit greater longevity improvements than the population overall. With this in mind, many firms are awaiting more data and analysis before updating their assumptions.

"As many insurers are not yet reflecting the full extent of the lower population life expectancies in their reserves or pricing, *[annuity]* customers are unlikely to significantly benefit until more data or analysis is produced."

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