PERSPECTIVES

LIVE (LESS) LONG AND PROSPER?

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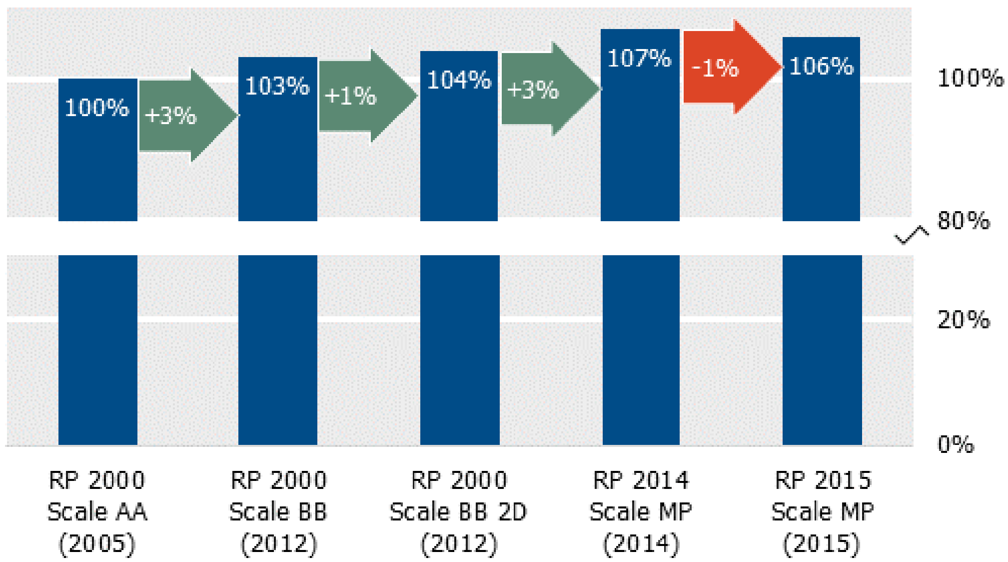
Topics: [Pension Risk Management] / Contributors: [David G. Eichhorn, CFA]

Working in the pension industry, it can be confusing to know which side to root for when new longevity projections come out. And when the Society of Actuaries released new mortality projections in October[1] that predicted lower life expectancies than previously indicated, our reaction was decidedly mixed. While as human beings hoping to live to a ripe old age this update was less than welcome, as people concerned about pension longevity risk it was a positive—and not altogether unexpected—surprise.

Others in the industry have observed for some years that the Society of Actuaries' projections seemed to consistently undershoot actual participant outcomes. As a result, plan sponsors could be forgiven for thinking that longevity risk—not the risk that participants may live longer, but that their life expectancies could differ than expected—only ran in one direction. Last month's downward revisions offer a useful reminder that longevity risk cuts both ways.

Check out the chart below for a look at how the different mortality tables and projections in the last few years have affected the value of an illustrative liability.

Exhibit I: Value of an Illustrative Liability in 2015 Under Selected Projections and Tables from the Society of Actuaries



Source: Society of Actuaries and NISA calculations. The liability present value and duration were estimated by discounting illustrative cash flows using the Citigroup Pension Discount Curve as of 10/31/2015.

What should plan sponsors conclude from the updated mortality projections? We would suggest two key takeaways. The obvious one is that pension liabilities will decrease. The Society of Actuaries estimates that the changes, known as MP-2015, will cause liabilities to shrink anywhere from 0% to 2% depending upon the plan. Our own calculations for a typical large defined benefit pension liability agree with that estimate.

The second takeaway ties back to our point about longevity risk: it's not a one-way street. Some plan sponsors may have been under the impression that longevity risk could only hurt them and seen longevity risk as a big reason to offload the plan to an insurer. While we've previously argued that longevity risk is a small concern in the grand scheme of things (see our white paper "Putting Longevity Risk in its Place" from April 2013), this news reminds us that longevity risk can sometimes actually work in favor of plan sponsors.

[1] *The "Mortality Improvement Scale MP-2015" from the Society of Actuaries, released on October 8, 2015.*