PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
Plumtree Court
London EC4A 4HT
Telephone +44 (0) 20 7583 5000
Facsimile +44 (0) 20 7822 4652
pwc.com/uk

Peppi Knott
The Pensions Regulator
Napier House
Trafalgar Place
Brighton
BN1 4DW

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Dear Peppi

Good practice when choosing assumptions for defined benefit pension schemes with a special focus on mortality

I am writing with the views of PricewaterhouseCoopers on your consultation paper. In summary, we are of the view that:

- Current mortality rates can be assessed through analysis and evidence. It is therefore reasonable for the Regulator to expect suitable evidence to be collected and used in determining current mortality rates
- However, the provision for future changes in mortality rates is the subject of wide uncertainty. We do not consider the Regulator should establish a trigger point for this aspect, though it is right that trustees be encouraged to consider the issue.

Current mortality rates

The assessment of current mortality rates is effectively a question of establishing the facts (for a large scheme) or suitable rating factors (for a small scheme). For larger schemes, this can be done by assessing the scheme's death rates against the wide range of mortality tables which are now (or very shortly will be, in the case of the CMI's current SAPS investigation) available. For smaller schemes, various tools are now becoming available to enable actuaries to use appropriate rating factors where the volumes of data are insufficient for scheme-specific assessment of death rates. PwC agrees with the Regulator that there is scope for evidence-based judgements in this respect.

Future changes in mortality rates

It is very clear that there is a wide range of views as to the pattern of future changes in mortality rates; the long-term assumption in this respect cannot be formed on the basis of "evidence" in the same way as the current levels of mortality can be reviewed. Generally we believe there is a risk to tPR of being seen to "endorse" any particular level of projection given the wide range of views and high degree of uncertainty.

To date the Regulator has taken the view that it will provide guidance on the process and the framework for setting assumptions rather than provide specific guidance on any particular assumptions. We believe that the current approach is the right approach. In our view the Regulator

should provide guidance on the relevant factors trustees and actuaries should consider but should not provide guidance (or a trigger point) on a specific longevity projection method.

We believe that the Regulator should view the overall prudence of the actuarial assumptions in the light of the strength of the employer covenant (rather than reviewing the longevity assumption on its own and without reference to the employer covenant).

We do not believe there is sufficient evidence to conclusively support the use of the long cohort projection table. A number of organisations and individuals are carrying out research in this area some of which challenges the suitability of adopting long cohort projections.

We are sympathetic to the inclusion of a floor to the rate of improvements where the floor reflects the trend over the long term (say 50 to100 years), rather than changes from the more recent past (say 20-30 years). However, contrary views are possible and we believe that trustees' main expectation should be that they clearly address the issue and the conclusion they have reached.

Responses to specific questions – summary points for discussion.

Question 1: Do you agree that we should issue guidance on this subject?

Yes, but we do not think this should extend to endorsing or prescribing specific assumptions. We believe the Regulator should be concerned with the process followed and its documentation. Care should also be taken to ensure that any obligations resulting on Scheme Actuaries and corporate actuarial advisers are not at odds with Standards that may be issued by the BAS (currently under consultation).

Question 2: Have we identified the appropriate principles to apply when choosing prudent funding assumptions?

Yes. However, we would argue that a broadly best estimate basis (erring on the side of caution) with prudence concentrated in a small number of transparent, unconnected elements of the basis reduces the complexity of scheme funding negotiations relative to a scenario where all (but minor) assumptions have been set with appreciable margins for prudence. Our experience is that this is the approach taken in practice by many schemes. For example, in a scheme where the liabilities are driven by the real discount rate, although inflation is a key assumption, there should be no issue with setting a best estimate inflation assumption and a prudent nominal discount rate to reduce the areas of contention in negotiations. We would caution against the Regulator making a statement which is open to the interpretation that "all assumptions must be chosen prudently".

Question 3: Have we identified the appropriate matters for trustees to consider with their actuary?

Yes. It has been our experience that a number of actuaries have argued that particular schemes are too small to carry out a pensioner mortality experience. It may be appropriate for the Regulator to comment on the types of investigation that can be carried out. For example

- Modest number of deaths in the experience – rely on general background information and rating factors e.g. postcodes, pension size
- Sufficient numbers of deaths to justify conclusions – an experience analysis e.g. measure the overall comparison between actual and expected deaths, adjustments to the slope of the mortality curve chosen at particular ages.

Question 4: Have you any other suggestions for the effective illustration of the impact of mortality choices?

In our view a good understanding is obtained by communicating the two features that make up the assumption i.e.

- Current life expectancy without allowance for future improvements and

- The rate of future improvements in life expectancy

However this approach can suffer from complexity as the rate of improvement may be a function of age today and time. A simpler approach is to communicate the expectation of life at NRA both now and in 20 years time.

We also believe actuaries should communicate the sensitivity of the valuation results to alternative assumptions.

Annuity values are unhelpful because they are liable to change between valuations as interest rates/inflation change.

Particular attention should be paid to the views of BAS on this matter.

Question 5: Are we right to discourage allowance for the effect of a factor by way of adjustment to another assumption?

Yes. It fails to meet the transparency test.

Question 6: Are we right to encourage adoption of the CMI's recommended notation for describing mortality assumptions?

Yes. However, the descriptions of the more complex versions (especially P-spline) will mean little to anyone other than a highly sophisticated reader of the report.

Question 7: Is this background material helpful? Have you anything further you would like to see included?

Yes it is helpful. However, as commented above care is needed so that tPR avoids being seen to endorse any particular level of projection given the wide range of views and high degree of uncertainty. Acknowledgement of the fact that heterogeneity within a population and the nature of the population itself (for example a group of ex-miners on incapacity benefits) can affect future mortality improvements would also be a welcome addition.

Question 8: Do you agree that a focus on mortality improvement assumptions is appropriate?

Yes. We would however discourage the Regulator from being too dogmatic about the precise form of improvements. The cohort projections were, after all, only ever meant as an interim ad hoc adjustment to the projections underlying the 92 series. The use of underpins is also arguably only an interim ad hoc approach to addressing a perceived short-coming in the cohort projections (although there is some evidence of an underpin-like time trend in past data).

Question 9: Do you agree that our proposal offers the best way for the regulator to identify mortality improvement assumption risks?

Some form of effective disclosure of the chosen mortality assumptions is clearly appropriate. However, the assumption of the long cohort table of improvements with a minimum rate of improvement could be subject to substantial criticism. We would draw the Regulator's attention to three specific projects.

1. The BAS has recently issued a consultation where it finds itself unable to provide the kind of guidance the Regulator is seeking to give to Trustees with regard to future mortality improvements.
2. The recent paper by Humble and Wilson discussed at the Staple Inn Actuarial Society questions the extent to which future improvements can be assumed to continue at the rate recently observed and argues that the shape of the cohort improvements may be inappropriate, because of the reducing impact of changes in smoking behaviour.

3. A sub-committee of the CMI is taking a further step by discussing projections of mortality improvements on a "cause of death" approach. The results of the study are unknown but likely to provide more relevant information in considering future longevity trends. This is one example (of which there will be many) of future research projects that potentially will lead to revisions in best practice thinking for future longevity trends

So, we do not agree that the Regulator should introduce a trigger point relating to the allowance for longevity improvements.

Question 10: If your answer to question 9 is no, what other approach would you prefer and why?

We believe the Regulator should provide guidance on the factors and information that trustees and actuaries should take into account. We believe that the Regulator should encourage transparent disclosure and the provision of comparative information by all schemes.

Yours sincerely

Peter Tompkins
Partner