



Private & Confidential
Financial Ombudsman Service
South Quay Plaza
183 Marsh Wall
London
E14 9SR

4 July 2013

Dear Sirs

Financial Ombudsman Service pension review cases – Mortality assumptions

You have asked us to recommend new mortality assumptions to apply from 1 July 2013 for pension review loss assessments which fall outside the boundaries of the FSA pension review. Appendix 1 sets out our recommendations.

1. Background

The mortality assumptions we have recommended for loss assessment calculations in the past have been intended to meet two objectives:

- To deliver compensation consistent with that a court might deliver in the event of a successful mis-selling claim. This is our understanding of the objective of FSA's original pension review basis from 1994 (set with advice from the actuarial profession) and of your current objective.
- To fit the existing loss-assessment software used by the firms who carry out the calculations.

The most recent mortality assumption we recommended, for loss calculations from 1 July 2012, was the "PA(90)" mortality table, rated down 11 years.

The PA(90) table is no longer commonly used by UK actuaries for placing a value on occupational pension benefits. Its continuing use for loss assessment has been driven largely by the second objective. We have pointed out that, even with the age rating to reflect improvements in life expectancy, this table is increasingly hard to justify as consistent with the first objective above.

2. Mortality assumptions from 1 July 2013

To meet the first objective above, we suggest adopting mortality assumptions that:

- Are in common used by UK actuaries in 2013 for the purpose of placing a value on benefits payable from UK defined benefit (DB) occupational pension schemes. This would include allowing explicitly for anticipated future improvements in longevity, so that, to give an example, the life expectancy from age 65 for someone reaching that age in 20 years time would be somewhat longer than the life expectancy of someone now aged 65.

*PricewaterhouseCoopers LLP, 31 Great George Street, Bristol, BS1 5QD
T: +44 (0) 117 929 1500, F: +44 (0) 117 929 0519, www.pwc.co.uk*



- Can be expected, overall, to neither overstate nor understate the life expectancy of people who are or have been members of UK DB pension schemes.

The assumptions used by UK companies for reporting DB pension schemes in statutory accounts should broadly meet these criteria. These assumptions are however varied and so we are only using them as a guide in making a recommendation. Some of this variation reflects underlying differences between DB pension scheme populations. We do not propose a methodology that sought out such differences, whatever their cause. This enables us to recommend mortality assumptions that remain relatively straightforward to use.

Alternative, more complex approaches would be possible. An example might be to make some use of postcode in choosing a mortality basis that might be more applicable to an individual. We would be happy to discuss such approaches with you. Their main disadvantage, other than complexity, would be that you would then be using assumptions that would give different results according, to continue the example, to where people live. Communicating this would have its challenges.

Our recommendation does however recognise gender. You should satisfy yourselves that this continues to be appropriate.

In our experience, almost all mortality assumptions for pensions work are now split into two components: Base tables and mortality improvements.

The base table shows rates of mortality in the year to which the base table relates, normally derived by analysing experience. The improvements allow for how the base table mortality rates may already have improved (e.g. up until 2013) and how they are may improve further in future.

Base table

Males: S1NMA; Females: S1NFA

Assumptions in common use in our experience include the “00” series, “92 series” and “S1” series tables. Although not the only option, adopting the S1 tables would be most in line with the first objective.

The S1 tables (also known as the SAPS - Self-administered Pension Schemes - tables) were published by the Continuous Mortality Investigations Bureau (CMIB) in 2008 and derived from an analysis of the mortality experience of UK self-administered pension schemes between 2000 and 2006. They are available in different forms (for lives/amounts, for different pension amounts, for normal/ill-health retirements). There is also information on how mortality may vary by industry sector. In the interest of simplicity, bearing in mind loss calculations could cover ex-members of any UK pension scheme, we recommend adopting the “amounts” version of the S1 tables as they apply for normal retirements.

The “00” and “92 series” tables are possible alternatives but would need some adjustment to reflect the fact that they were based on an analysis of the mortality experience of holders of insurance with UK insurance companies. Some actuaries use bespoke mortality tables that take into account factors such as postcode but we assume that would not be practicable for the purpose of loss assessment. Mortality tables based on the wider mortality experience of England and Wales are another option but again are less directly relevant for members of UK DB pension schemes.



“S2” tables, an update of S1 based on more recent experience of UK self-administered pension schemes (between 2004 and 2011), are expected to be available later this year. It is quite likely we will recommend replacing S1 with S2 for the purpose of loss assessment in due course.

Improvements

CMI_2012, long-term improvements 1.25% p.a. (males)/ 1.0% p.a. (females)

Future improvements

Assumptions about future improvements are necessarily subjective and views differ. From our experience of assumptions adopted for accounting and pension scheme funding, most actuaries are currently recommending improvements in line with the CMI’s projection model. Alternatives, including the “cohort” projections produced by the actuarial profession in 2002, are still used but we expect the CMI projections to become the norm.

The CMI projections require a long-term rate of improvement – the rate at which, ultimately, improvements in mortality are assumed to stabilise. Experience of assumptions adopted by companies for accounting leads us to suggest long-term rates of improvement of 1.25% p.a. for males and 1.0% p.a. for females. The Trustees of pension schemes now typically allow for slightly higher long term rates, for example 1.5% for both males and females. We consider their approach less relevant, since they are usually making an allowance for prudence.

Past improvements

Investigations suggest mortality has improved since the S1 tables were published. For example, the CMIB’s Working Paper 62, published in May 2012, shows that mortality amongst males in self-administered pension schemes in the period to 2003 to 2010 was around 10% lighter than that implied by the S1 table (around 4% lighter for females).

Use of the CMI_2012 projection model in our view makes reasonable allowance for the improvement in mortality that has occurred since the S1 tables were constructed.

3. Benchmarking

Appendix 2 shows the life expectancy assumptions adopted by around 120 PwC clients for their 31 December 2012 statutory accounts. Life expectancies determined using the assumptions recommended for loss assessment from 1 July 2013 are shown for comparison.

Although only a limited sample, and not necessarily representative of all UK pension schemes, the mortality assumptions we recommend from 1 July 2013 result in life expectancies that are around the median level.

Appendix 2 also shows that the majority (over 75%) of this sample are using CMI models of future improvement for their statutory accounting disclosures with long-term rates of improvement of 1.25% p.a. (males) and 1.00% p.a. (females) being common.

4. Software programming

In the interest of ease of change in future years, we suggest sufficient flexibility is incorporated in the software to enable the following to be changed easily:



- Base table (eg S1NMA)
- Scaling factor to apply to base table (eg 90% x S1NMA)
- Age rating to apply to base table (eg 90% x S1NMA -1 year)
- Combinations of CMI projection model and long-term rates of improvement – The CMI models are updated annually, thereby gradually making allowance for recorded improvements in mortality and avoiding larger but less frequent changes (e.g. a CMI_2013 model is likely to follow in late 2013 and it is likely that we would recommend adopting that version from 1 July 2014).

5. Annuity pricing

We do not expect the mortality assumptions we recommend to correspond with those that might be adopted by insurance companies for pricing annuities.

This is to be expected, given our understanding of the objectives of loss assessment as set out at the beginning of this letter.

Yours faithfully

A handwritten signature in black ink that reads 'Mark Packham'.

Mark Packham
mark.packham@uk.pwc.com
T: +44 (0) 117 928 1199



**Recommendation for mortality assumptions for the Financial
Ombudsman Service pension review loss assessments from 1 July 2013**

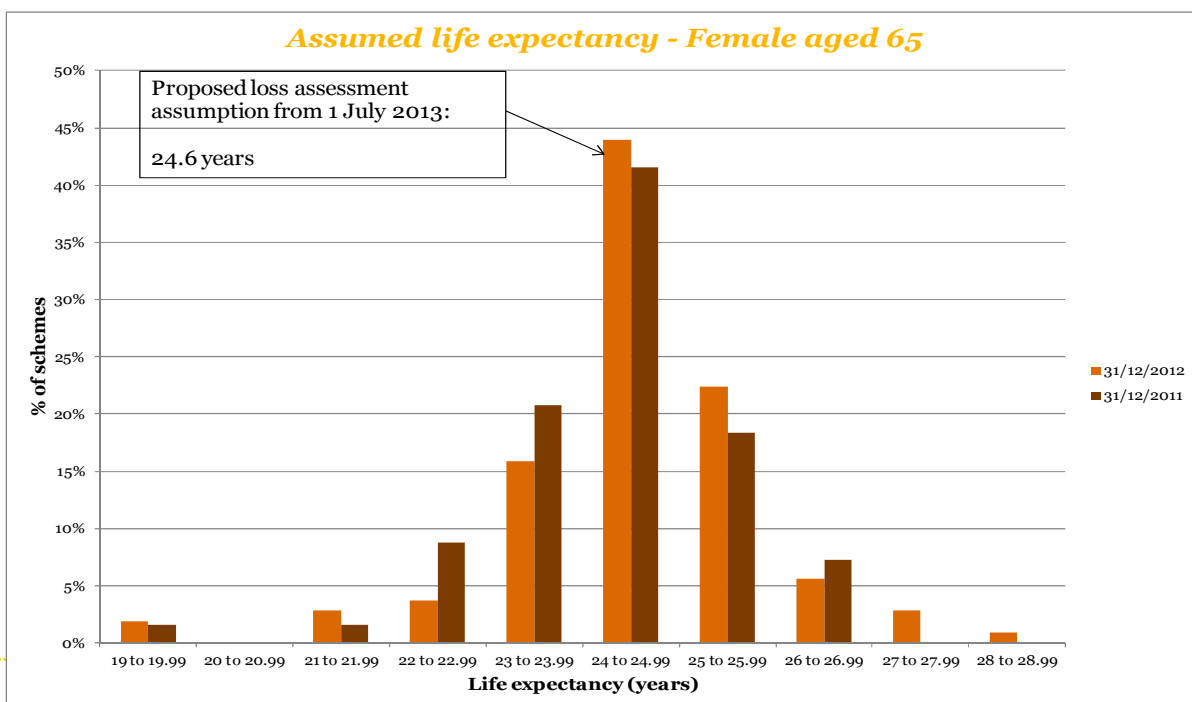
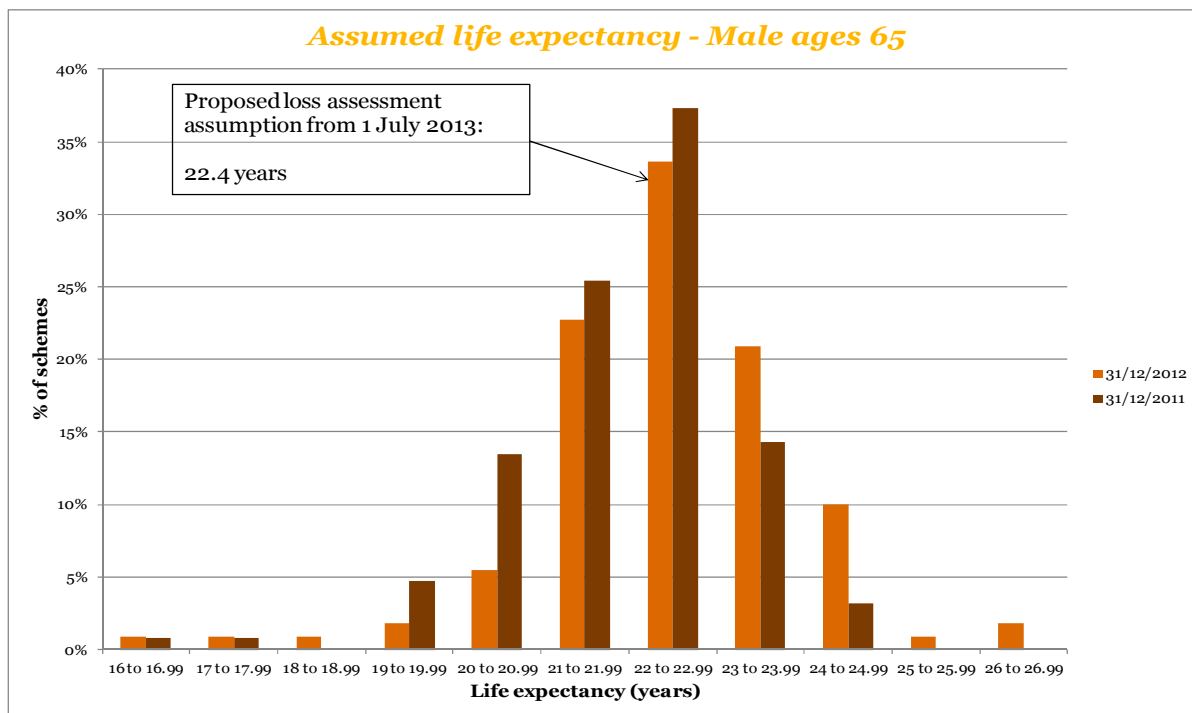
	<i>Base table</i>	<i>Improvements</i>
<i>Males</i>	100% x S1NMA	CMI_2012 1.25% p.a. long-term improvement rate
<i>Females</i>	100% x S1NFA	CMI_2012 1.0% p.a. long-term improvement rate

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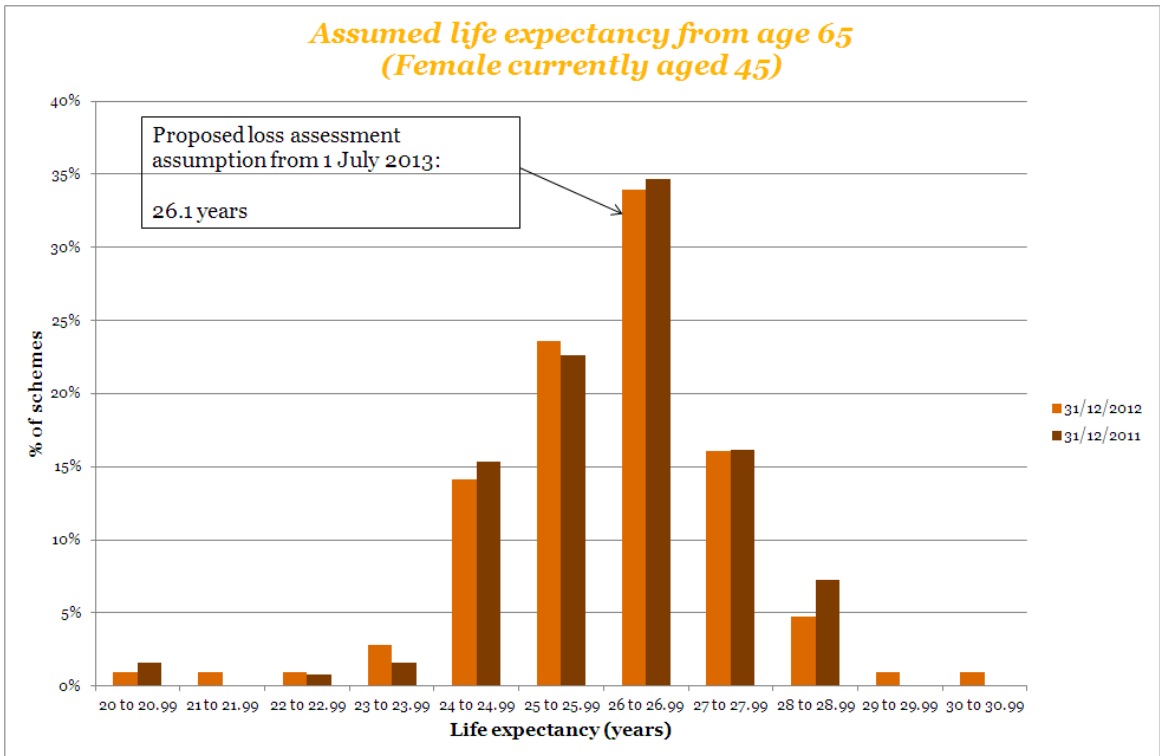
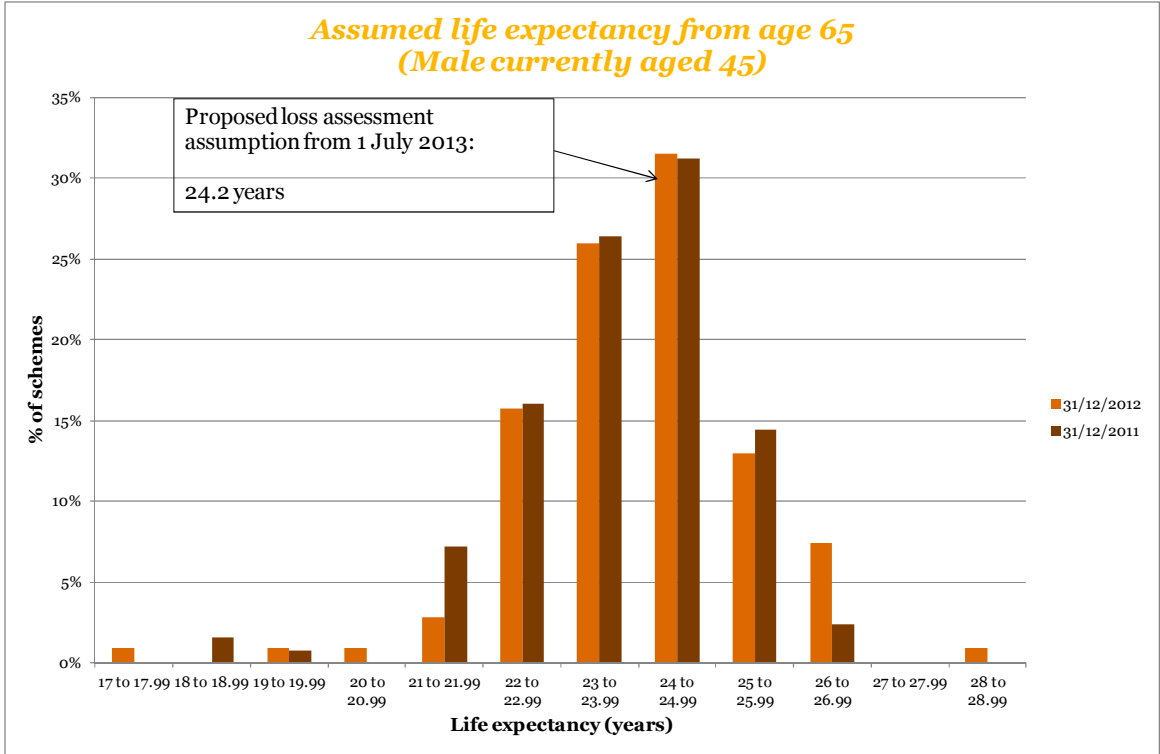
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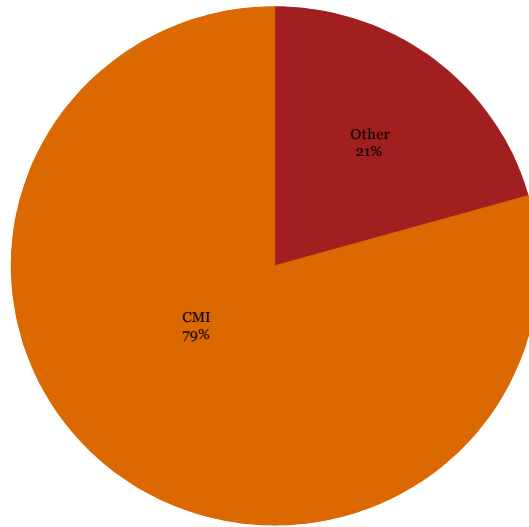
Life expectancy assumptions adopted by companies for purpose of statutory accounts as at 31 December 2012



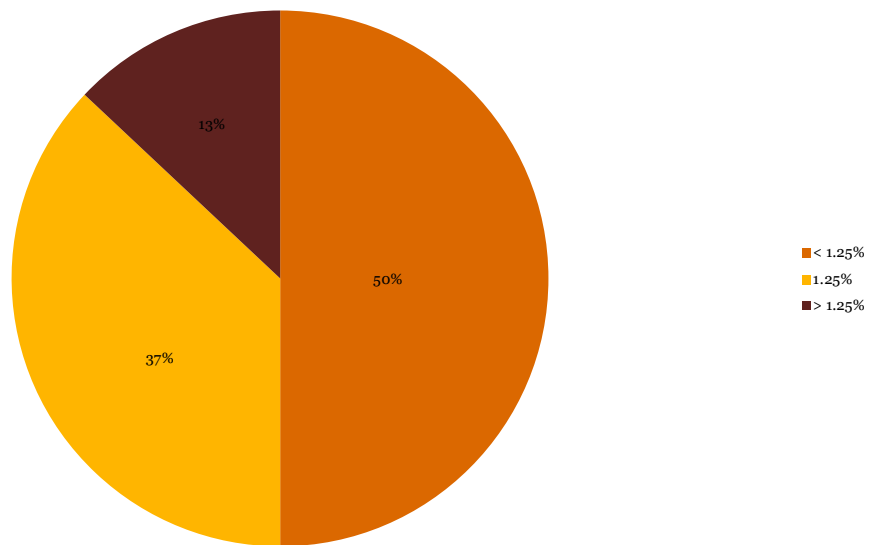
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Companies adopting CMI model of future improvements of mortality



Long term rates of mortality improvement for males assumed by companies adopting CMI model



Long term rates of mortality improvement for females assumed by companies adopting CMI model

