Cracking the new DB funding code

Why scheme-specific mortality analysis matters and how we can help

The Pension Regulator's (TPR's) new funding code of practice encourages trustees to use scheme-specific analysis when setting their mortality assumptions – an approach Club Vita have been championing since 2008. But why is it so important?

The new code of practice came into effect last year. It sets out practical guidance for trustees on how to comply with the legislative requirements set out in the statutory funding and investment strategy regulations. The requirements apply to all actuarial valuations with effective dates on and after 22 September 2024. As a result, many trustees will undertake their first valuation under the new code this year. The code covers many aspects of funding investment strategy, but of particular note is its comments on mortality assumptions.

What does the code say about mortality assumption setting?

There are two separate decisions for trustees when determining mortality assumptions – the likelihood of death today (the baseline assumption) and how that likelihood is expected to change over time (the future improvement assumption).

The baseline assumption is a more objective assumption. TPR now states that it generally expects all trustees to have considered completing a scheme-specific mortality analysis, and suggests the following options:

- a 'postcode' analysis and/or experience to adjust standard tables, or
- a bespoke mortality table based on scheme experience.

The improvement assumption is more subjective in nature, but TPR states that trustees should account for the specific socio-economic characteristics of their scheme when setting their future improvements. Recognising that future improvements are inherently more uncertain they also expect schemes to allow for some prudence in this assumption.

Club Vita have been advocates for scheme-specific mortality assumptions for some time now, so we welcome these new additions to the code from TPR.

Why does scheme-specific mortality analysis matter?

The unique characteristics of individual members mean that some are likely to live considerably longer (or shorter) than others. As a result, relying on average mortality statistics is unlikely to be appropriate and could lead to substantial under- (or over-) estimation of liabilities. To put this into context, if a single member lives 2 to 3 years longer than anticipated, the cost of their benefits could increase by as much as 10%. Now, imagine this scenario playing out across hundreds of members – it could quickly escalate into a significant financial challenge. By incorporating the results of scheme-specific mortality analysis into assumptions, much of this risk can be mitigated.

Mortality studies usually involve looking at the characteristics of a membership group, to give the user information about how long that group is expected to live for. For baseline assumption setting, the results of such analysis can be used to create a bespoke mortality table appropriate for that scheme's characteristics. Alternatively, it could be used to select an appropriate scaling factor to apply to a standard mortality table, like the Self-Administered Pension Scheme (SAPS) mortality base tables. For future improvements, the information can be used to support different rates of improvement for different socio-economic groups in the scheme. As a result, scheme-specific mortality analysis can help to reduce the risk of experience being significantly different from expected.

Importantly, any analysis should be refreshed at regular intervals – the longevity world does not stand still and so trustees should keep an eye on the impact of emerging events, particularly in this uncertain phase following the COVID-19 pandemic. This will help to ensure that assumptions reflect up-to-date experience.

Club Vita's approach

Club Vita have been providing schemes with the tools they need to set scheme-specific mortality assumptions for nearly two decades. This can not only help trustees be more confident about their assumptions and meet TPR's requirements, but the analysis provides deeper insights into a scheme's 'demographic DNA', empowering trustees to make more informed and effective decisions overall.

Baseline assumption

Through collecting data on the mortality experience of retirees from over 245 large defined benefit pension schemes, Club Vita have been able to identify a number of characteristics which distinguish people as being longer or shorter lived than others. These include sex, lifestyle (modelled using post-code analysis), affluence, retirement type and occupation. As a result, Club Vita can demonstrate a nine-year difference in current life expectancy between different types of defined benefit retirees. This spread can be captured by trustees in their baseline assumption using our baseline model, VitaCurves. In other words, by using VitaCurves, trustees can set a tailored longevity assumption for every member of a scheme, reflecting their own individual characteristics.

This approach to setting baseline mortality assumptions at the individual level has a number of benefits. For example, trustees can easily calculate the liabilities associated with subsets of members. This avoids inadvertent cross-subsidies between sponsors and ensures more accurate liability splits. And during risk transfer exercises it helps trustees identify where longevity risk is concentrated within the scheme and allows them to make more informed decisions on which subsets of members to insure.

Future improvement assumption

It's not only current longevity that differs between different socio-economic groups. There are now many sources of evidence showing that the rate at which longevity is changing is different for different types of socio-economic groups.

The most widely used improvement assumptions make use of England and Wales population data. Therefore, adjustments are often required to align them with the specific experience of defined benefit pensioners. To help trustees tailor their assumptions to better reflect the unique characteristics of their scheme, we track changes in survival rates within defined benefit pension schemes in three broad socio-economic groups: Comfortable, Making Do and Hard Pressed. Collectively we call these groups VitaSegments. By considering the VitaSegments profile of their scheme and considering recent trends in each of the groups, trustees can set their improvement assumption to reflect the particular socio-economic profile of their scheme.

What do you think?

If you'd like us to carry out scheme-specific analysis for your scheme or would like to know more about how your scheme could benefit from Club Vita, please get in touch. We'd love to hear from you.

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