Pensions should fear longevity gains more than low rates: Fitch

By Editorial Staff *Thu, Sep 3, 2015*

The ratings agency said expected increases in interest rates and longevity could offset each other, with its impact on funding depending on the timing of the change, the discount rate and investment returns.

Defined benefit (DB) plan deficits are more vulnerable than to longevity risk than to the low interest rates, Fitch Ratings has warned German and UK financial companies, according to a report in *IPE.com.*

While a fall in the discount rates used by DB plans had recently driven up liabilities, its impact was not a serious as long-term increases in longevity, Fitch said.

According to the ratings agency's analyses, pension deficits rose 38% in 19 UK listed companies and 44% in 14 German listed companies over the course of 2014 as a result of low rates.

For the UK schemes, however, Fitch suggested that an increase in longevity assumptions by two years would immediately add £1.3bn, or 9.2%, to average deficits in its sample, with little chance of a reversal.

By contrast, the agency said, yields for corporate bonds used in International Financial Reporting Standards (IFRS) would eventually rise and reduce liabilities on that front.

"It would take discount rates to move from the current 3.5% to 4.7% to wipe out the current average deficit of £2.7bn based on our sample of UK corporates," Fitch said.

"Low rates have been the main factor behind big increases in corporate pension deficits in the UK and Germany. But interest rates are expected to increase in the medium term, which will eventually at least partially reverse the deteriorating deficits.

"An increase in longevity beyond what has already been factored into expected pension obligations, however, would lead to an increase in deficits and would be highly unlikely to be reversed. Historically, pension schemes have tended to underestimate these improvements, suggesting their longevity assumptions may have to be revised up," Fitch's report added.

Fitch said there were few significant changes in longevity assumptions used in company pension scheme accounting in 2014 compared to 2013.

The ratings agency said expected increases in interest rates and longevity could offset each other, with its impact on funding depending on the timing of the change, the discount rate and investment returns.

“If the longevity assumption improves further in future – the pension deficits will follow suit,” it added.