Living Longer Raises Costs of Public Plans

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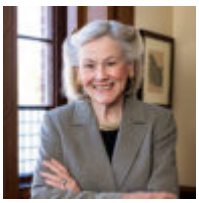
MarketWatch Blog by Alicia H. Munnell



Alicia H. Munnell is a columnist for ***MarketWatch*** and director of the Center for Retirement Research at Boston College.

But state and local plans do a pretty good job of updating their life expectancy assumptions.

The fact that people are living longer is good news from a human perspective. But longer lifespans also make defined benefit pension plans more expensive because sponsors must pay benefits to retirees for a longer period of time.

In 2014, CalPERS – one of the nation's largest plans – revised its longevity assumptions, significantly increasing its liabilities and reducing its funded ratio by 5 percentage points. This event led us to wonder whether other shoes were about to drop that would seriously worsen the funded status of state and local plans.

To answer this question, **we explored** what public plan liabilities and funded ratios would look like under two alternative scenarios: 1) if public plans were required to use the new mortality table designed for private sector plans; and 2) if public plans were required to go one step further and fully incorporate expected future mortality improvements.

At the risk of providing too much information, a little background. The Internal Revenue Service (IRS) publishes mortality tables for private sector plans to use for funding calculations. Currently, these IRS tables are based on the RP-2000 mortality table, which has been updated for mortality improvements. In an effort to approximate future mortality improvements, the 2014 IRS table actually uses estimated mortality rates for 2021.

The Society of Actuaries has just produced **a new mortality table** – RP-2014 – based on more recent data, which shows people living longer than the current IRS table. They also produced a "generational" version of the new table, which fully incorporates expected future mortality improvements. Although it is unclear when these tables will be adopted for private sector plans, our exercise assumed that they were required for state and local plans. State and local plans are currently not required to use any specific mortality table.

The analysis proceeded in two steps. First, we estimated a simple model that relates the impact of improved longevity to liabilities. The results showed that, if beneficiaries live an additional year, liabilities increase by 3.5 percent.

Second, the results from the equation were used to calculate what pension liabilities and funded ratios of state/local plans would have looked like if liabilities had been calculated based on the new RP-2014 mortality table and then on the generational version of RP-2014.

The results suggest that, under the first standard, public plans underestimate life expectancy by only 0.5 years and adopting it would have virtually no impact on funding. Adopting the second standard would increase life expectancy by 2.3 years and reduce the funded ratio of public

plans from 73 percent to 67 percent, but even the private sector is not considering using such low mortality rates. Of course, public plans vary significantly, so the impacts would be much larger for some and smaller for others.

Overall, though, the answer to the question of whether outdated mortality assumptions are a serious problem among state and local plans appears to be “no.” But that conclusion still leaves us with lots of other stuff to worry about.