



Swiss Re's new *sigma* study highlights innovative ways of financing retirement

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Zurich, 21 October 2008 – Swiss Re's new *sigma* study draws on the experience of several countries to highlight innovative solutions that help individuals and companies manage the risks of retirement.

The study discusses solutions including annuities, long-term care insurance and reverse mortgages. It also addresses the outsourcing of pension plan risks and the transfer of existing pension liabilities to (re-)insurers. The study notes how reinsurance and capital market capabilities help companies and insurers provide these solutions. Innovative solutions can benefit individuals, businesses and governments, whose citizens will be better prepared to cope with the uncertain costs of retirement.

Annuities as retirement solutions

Life annuities are contracts that guarantee a regular series of fixed payments over a person's lifetime, thereby eliminating the risk of individuals outliving their wealth. Variable annuities are more flexible products that offer retirees various guarantees. Their payouts are tied to the performance of an investment portfolio.

According to Mike Barnshaw, one of the study's co-authors, "Variable annuities have grown in popularity in the US and Japan, mainly because they offer upside market potential and flexibility, which are important considerations for retirees. They are now catching on in Europe and the rest of Asia." Gross sales of variable annuities in the US are set to grow 7–9% per year over the next decade, and could reach USD 400–500 billion by 2018. In Japan, variable annuity assets have skyrocketed – from JPY 1.1 trillion in 2003 to JPY 15.8 trillion in 2008.

Long-term care insurance and reverse mortgages as solutions

A typical 65-year old person has about a 1-in-3 chance of needing nursing home care during his or her lifetime.

Long-term care insurance helps people to cope with the costs of nursing homes and other types of long-term care. The government, which often has to step in when elderly people need assistance, has a strong incentive to support private market solutions. Given the large protection gap, it is surprising how underdeveloped the long-term care insurance market currently is. The largest markets for long-term care insurance today are the US, France and Germany.

Reverse mortgages, which are prominent in the US and the UK and growing in other markets, have also become increasingly attractive as solutions. Co-author Lukas Steinmann notes, "They allow retirees to monetise the equity in their homes – often the most valuable asset they own – without selling or moving out of the house." The homeowner receives a lump sum payment, periodic payments for life, access to a line of credit or any combination of these options. Steinmann adds, "Heirs may keep the house by repaying the loan. Otherwise, the lender assumes ownership of the house." If the loan and the accrued interest exceed the value of the home, insurers step in to cover this gap.

Insurers can also help companies manage employee pension obligations

Providing pension benefits has become increasingly expensive and risky for employers. The *sigma* study notes that employers who wish to eliminate their exposure to pension risks purchase bulk annuities from insurers. More and more companies are opting to transfer pension plan risks to insurers, who are often better equipped to manage their complex range of difficult-to-hedge risks related to longevity, asset prices and employee behaviour. There is increasing interest in new tools that make it possible to reproduce the characteristics of a bulk annuity within the framework of a pension plan. According to the study, only 1% of the potential UK market of over GBP 1.1 trillion for private sector defined benefit pension plans has been tapped.

Reinsurance as a solution

According to the *sigma* study, insurers offering variable annuity products or long-term care insurance might team up with reinsurers who can guide them on product design, share the risk, and help to finance the product launch. Reinsurers also assure industry analysts, rating firms and regulators that the products are appropriately priced and hedged.

Regarding pension liabilities, insurers can also team up with reinsurers to transfer the liabilities of an existing book of business to the reinsurer, outsource administration of policies to reinsurers, and engage in a pure longevity risk deal to reinsure risks while retaining the investment risk.

Capital market solutions

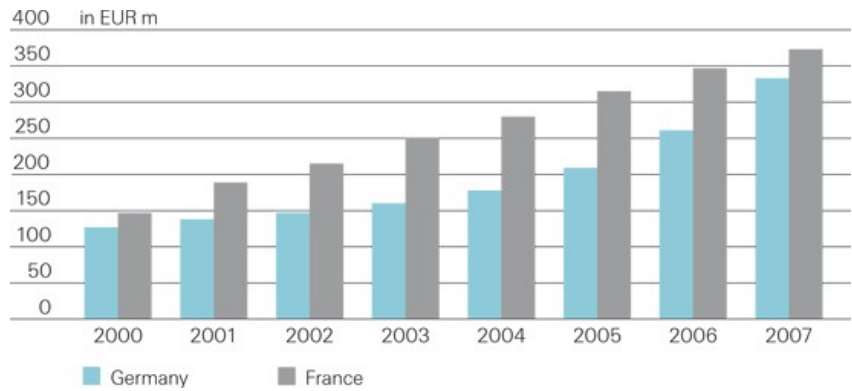
According to David Laster, another co-author, capital markets have the potential to facilitate more efficient ways of managing longevity risk, enabling insurers, pension sponsors and governments to hedge their longevity exposures more effectively.

What governments can do

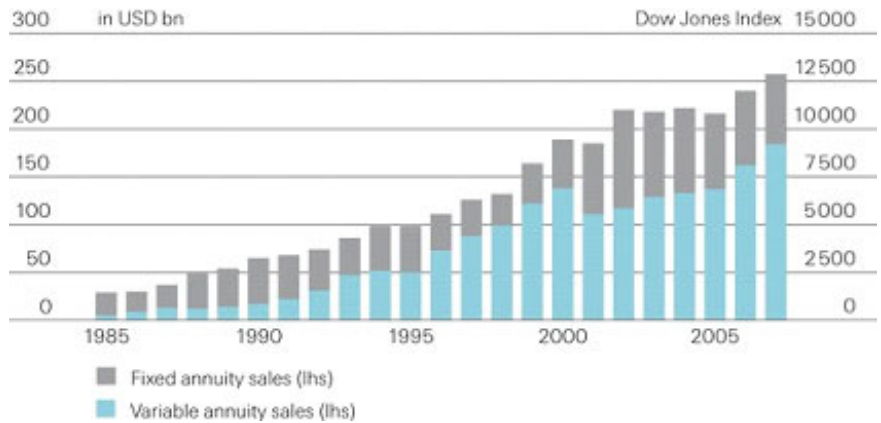
Governments have a clear interest in supporting old age solutions to reduce their need to finance retirement for the elderly. The authors suggest a number of successfully tested solutions that should be considered. For example, governments could ask employers to automatically enrol employees into retirement savings plans (but allow employees to opt out) instead of asking them to opt in. Governments should also clearly communicate their limited ability to finance state-run retirement plans and long-term care while promoting the need to save adequately. Moreover, governments should educate the general public about long-term care insurance.

Other options that governments might pursue include offering tax incentives on pension savings and limiting the use of pension savings for non-retirement purposes. Finally, governments could require that a minimum level of pension assets is annuitised to cover basic living expenses.

Supplementary Private Long-Term Care insurance in France & Germany



US Fixed and Variable Annuity Sales



Notes for editors

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How to order this *sigma* study:

The English, German, French, Italian and Spanish versions of the *sigma* study No 4/2008, "Innovative ways of financing retirement" are available electronically on Swiss Re's website: www.swissre.com/sigma. The versions in Chinese and Japanese will appear in the near future.

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