



Institute of Actuaries of Australia

Super Policy Forum

Next generation pensions – making longevity protection popular

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Longevity risk is a huge, global issue... and opportunity

The scale of longevity risk issues

“By providing financial protection against the major 18th and 19th-century risk of early death, life insurance became the biggest financial industry of that century.

Providing **financial protection against the new risk of not dying soon enough** may well become the **next century's major and most profitable financial industry”**

Peter Drucker – “Innovate or Die”
The Economist, September 1999

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“By providing financial protection against the major 18th and 19th-century risk of early death, life

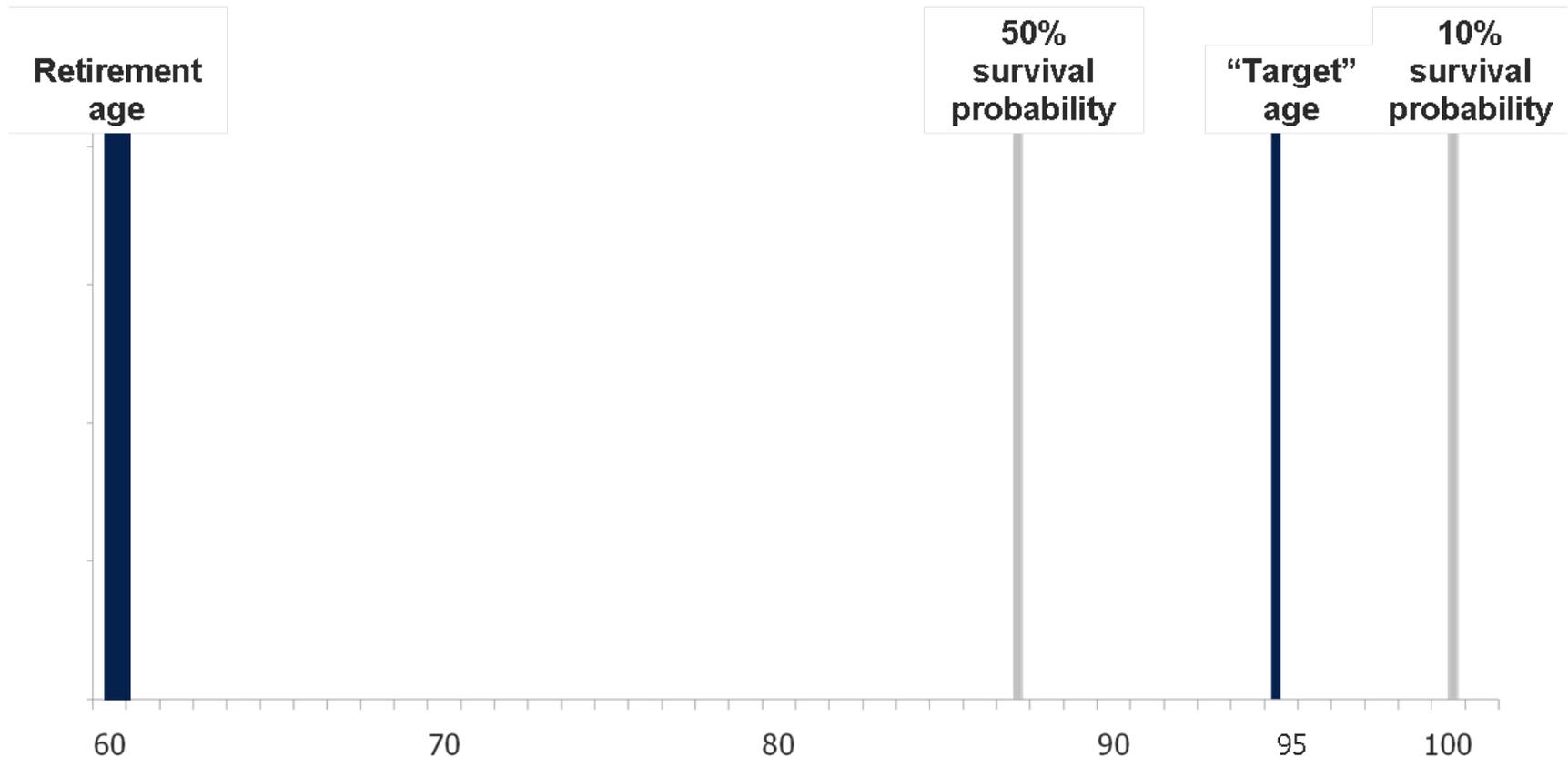
Australia was a global leader in retirement saving, but we are a long way behind in retirement incomes... that's about to change!

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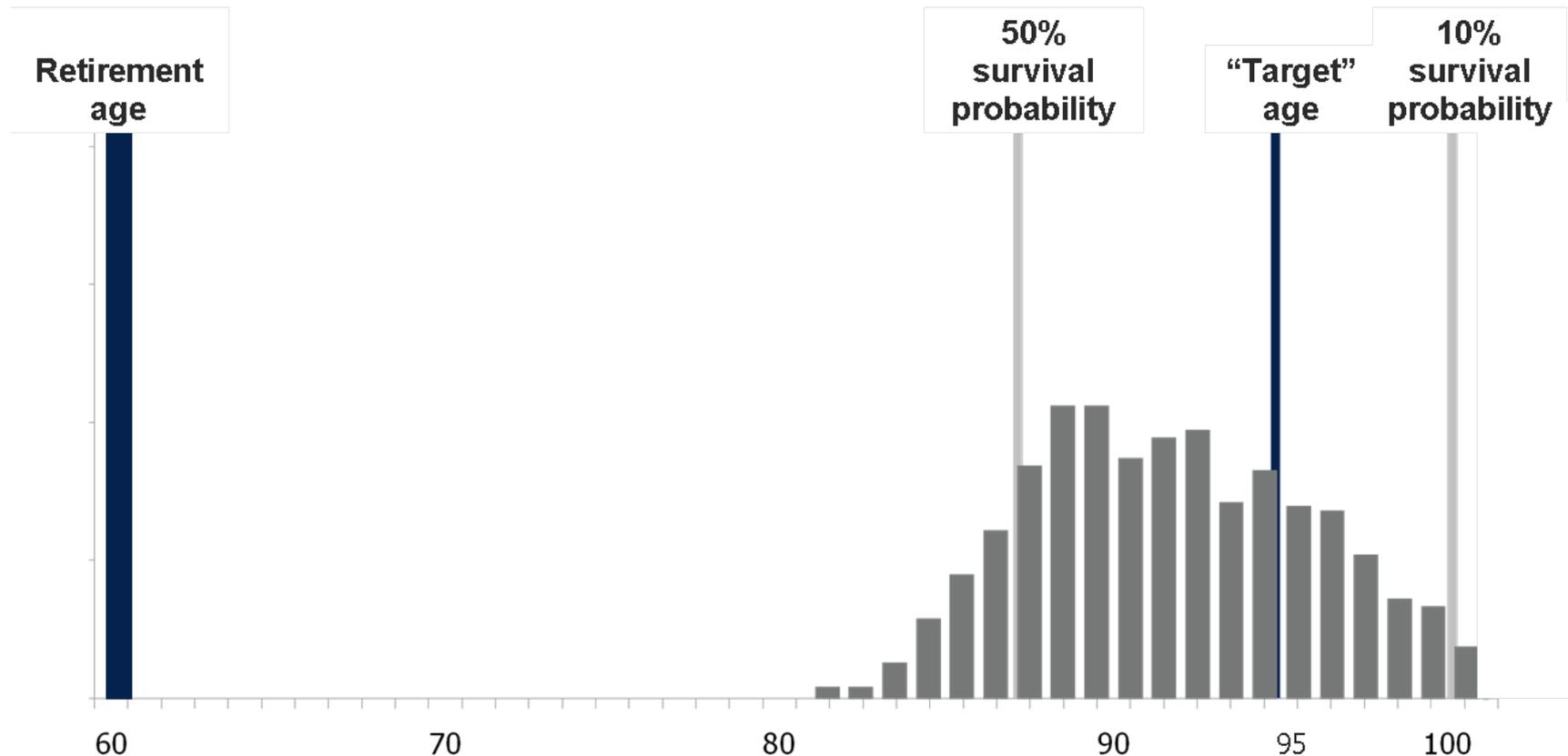
Understanding the issue – we're setting retirees up for a risky retirement

Case study – a “typical” Account Based Pension strategy



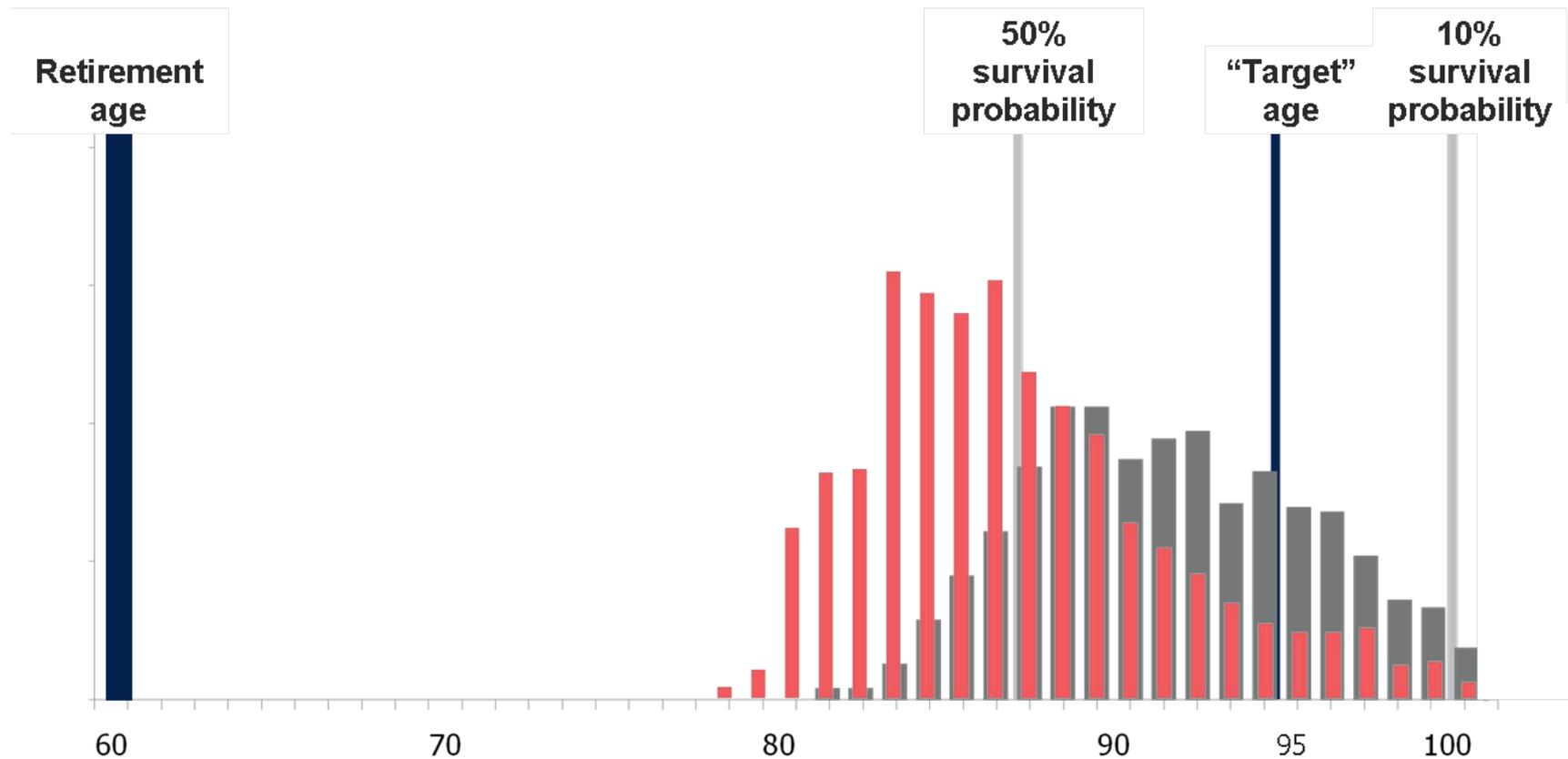
Understanding the issue – we're setting retirees up for a risky retirement

Historical back-testing highlights the risks of running out...



Understanding the issue – we're setting retirees up for a risky retirement

... the impact of a 15% balance fund fall early in retirement



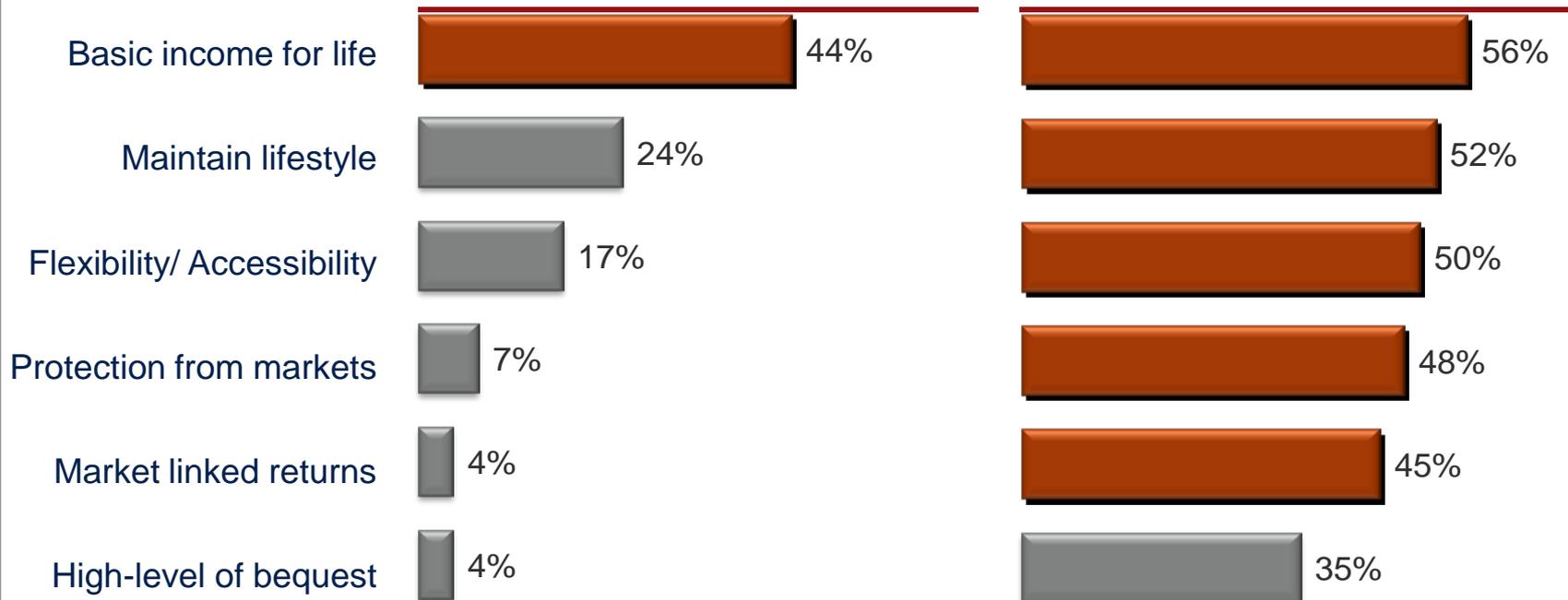
Lifetime annuities are an unpopular solution... why?

For retirees, longevity risk is an important issue...

... but they really want a “little bit of everything”!

MOST important pension feature?

ALSO important pension features



The rest of the world is doing better...

International innovations

- > Variable Annuities with lifetime income guarantees (North America and Europe)
- > Diverse annuity markets (UK)
- > Hybrid annuity “friendly” principles based regulation (Ireland)
- > Longevity indices (US, UK, Netherlands)
- > Longevity derivatives, swaps and buy-outs (UK)
- > Public lifetime income guarantees (Singapore)
- > “Monte Carlo” analysis in retail advice (US, Canada)
- > Lifestage and target-date strategies



**Why is Australia
so far behind?**

Barriers have slowed innovation...

Market issues

- > In 2005 there was still “only” \$50b in Retirement Incomes
- > “Latent” – at best – recognition of the risk:
 - Strong equity market performance
 - Low (but growing awareness of longevity)

Commercial issues

- > “Comfortable” shift of risks away from product providers to customers – “conspiracy of silence”?
- > Missing capital markets “building blocks” (eg long/inflation/ longevity-linked bonds, equity derivatives depth)

Regulatory issues

- > Distorting government involvement (tax & welfare incentives) – products must “conform to the rules”
- > “Rules” not principles based (SIS, Tax, Life, Social Security)
- > Conflicting regulators

Barriers have slowed innovation... but they are being broken down

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**Baby Boomers &
Global Financial
Crisis**

**International
Competition**

**Henry Review
proposals**

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**The conditions are right for once in 25 year changes...
next year will be a big year for the super system**

**Baby Boomers &
Global Financial
Crisis**

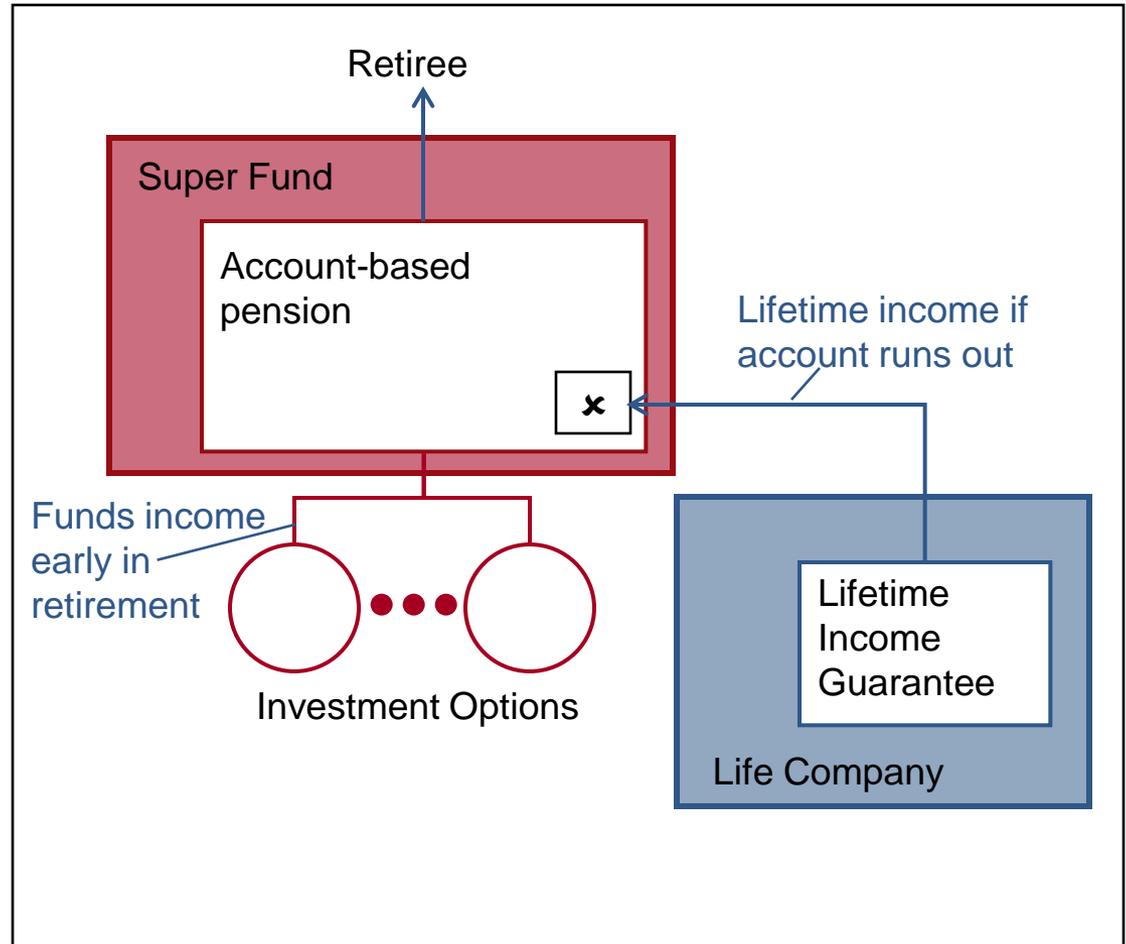
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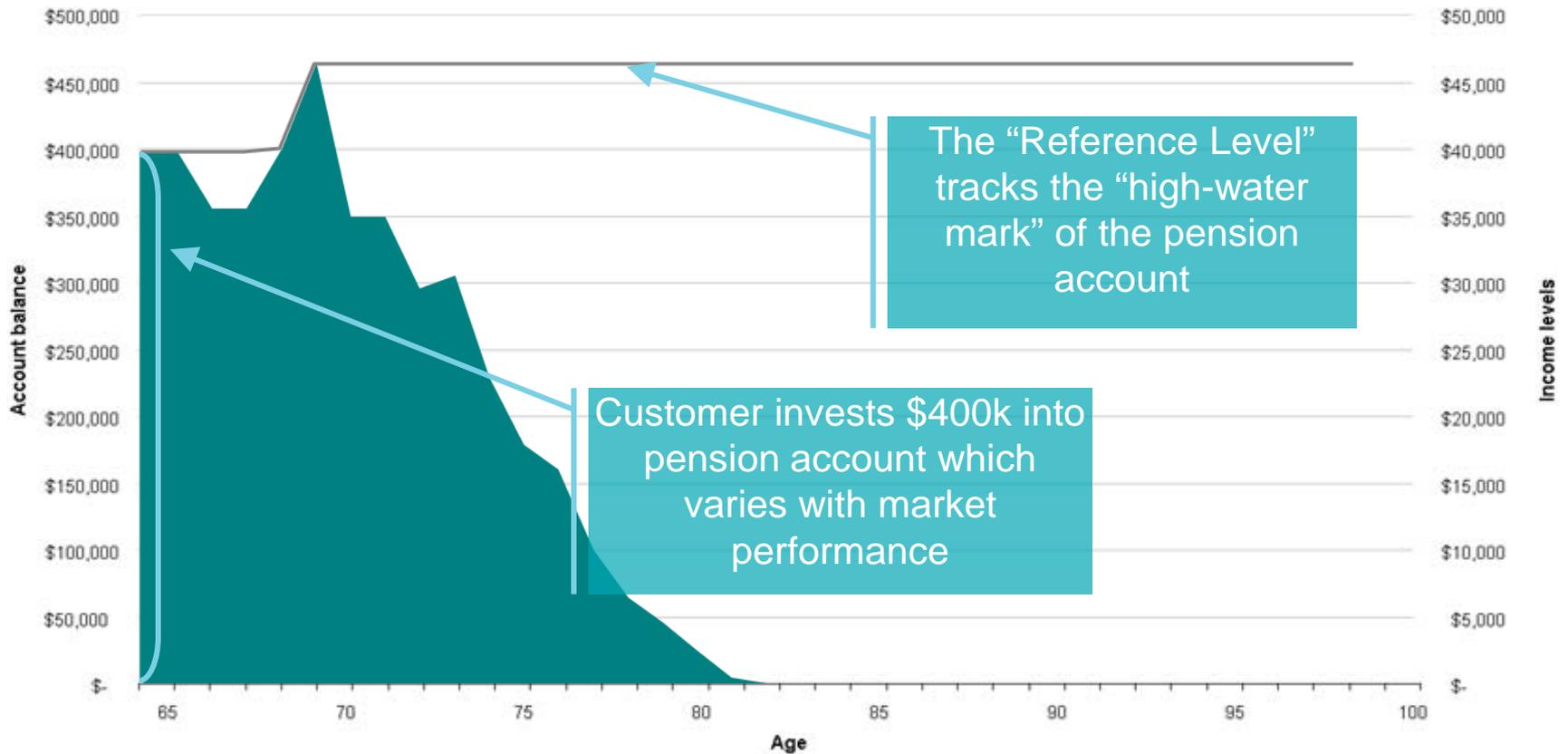
What will longevity protection look like in Australia?

Basic terms

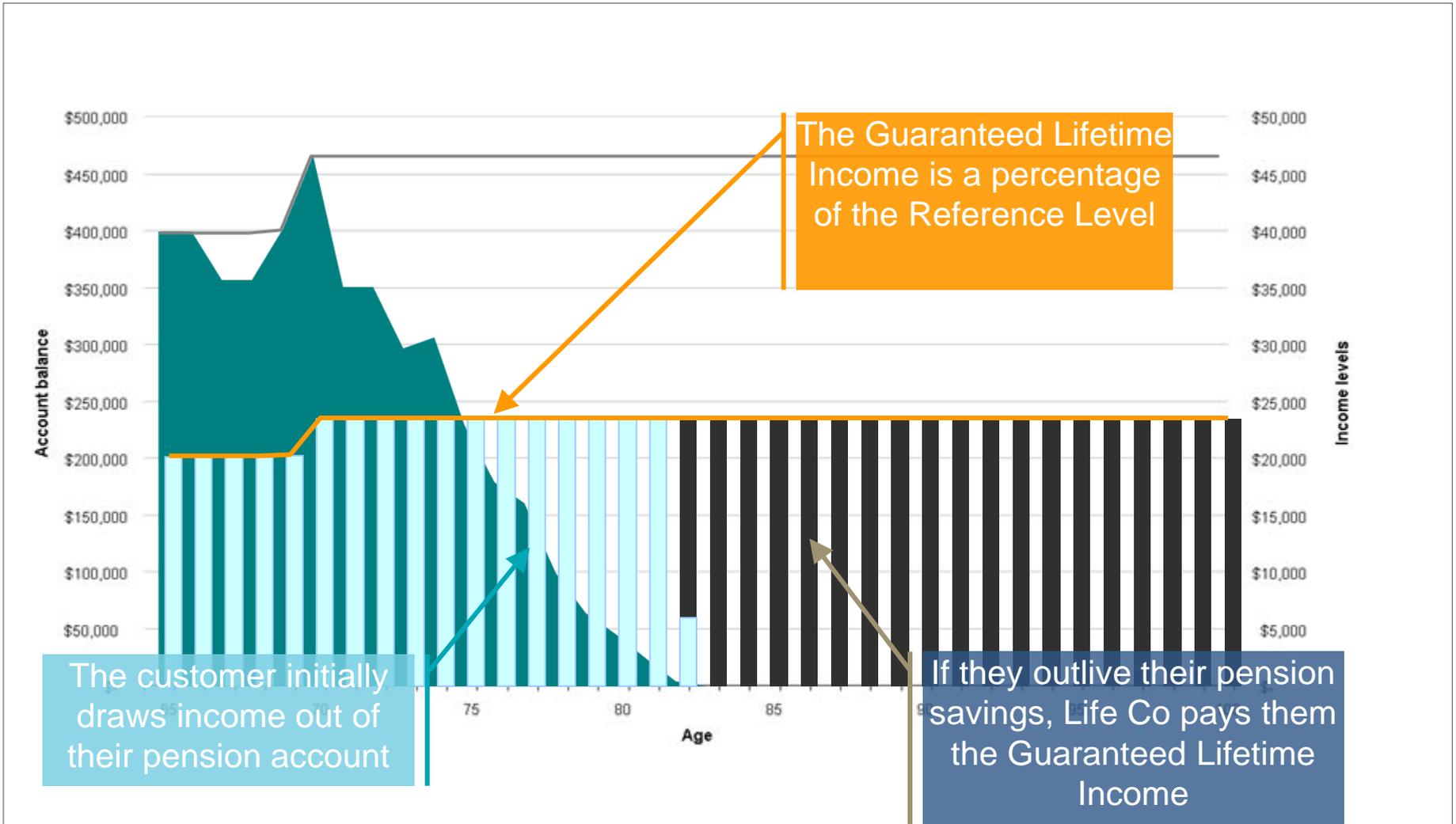
- > Investor owns an Account Based Pension
- > Draws income from account early in retirement
- > Pays annual protection premium
- > If account runs out, Life Company pays income for as long as the investor lives



How it works – an example



How it works – the Guaranteed Lifetime Income



* The level of the Guaranteed Lifetime Income as a percentage of the Reference Level is set for a year of new business based on market conditions at launch.

Real challenges in manufacturing and managing these guarantees

Life licence

The Lifetime Income Guarantee is a contract “*contingent on the continuance of human life*” – therefore only life companies may issue it

Financial market risk

The contract is akin to a long-term exotic basket option, valuation and management of these risks requires sophisticated capital markets pricing, trading and risk management systems, people and processes

Product structuring

Product design and structuring impacts the riskiness of the liability and the tax treatment of the product

Admin systems

Enhancing legacy administration systems to administrate these new “non-unit-priced” products entails significant development risk

Few Australian super funds are well positioned to manufacture this product

Product has the potential to create significant disruption in the industry...

Interesting issues

Demand

Will this product family enjoy similar exponential growth trends as seen overseas?

Product evolution

What product features will be most attractive for Australian retirees?

Pricing

Will we see “rational” competition or an “arms race”?

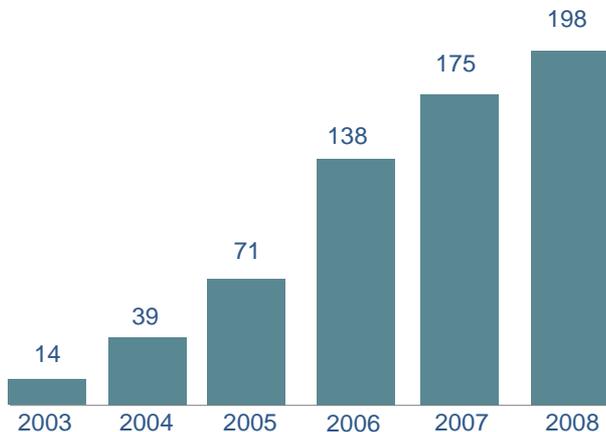
Strategy

What relevance does this have for industry funds? Will an outsourcing market spring up?

Public Policy

Will government foster the development of this market or “compete” with it?

Assets under Flexible Guarantee Japan,
\$US “billion”



“They have stumbled onto a ‘Killer App’ for the financial needs of today’s boomers – it’s called a GMWB”

Washington Post, 2004

...whatever the answer to these questions, we can expect an exciting few years!

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