



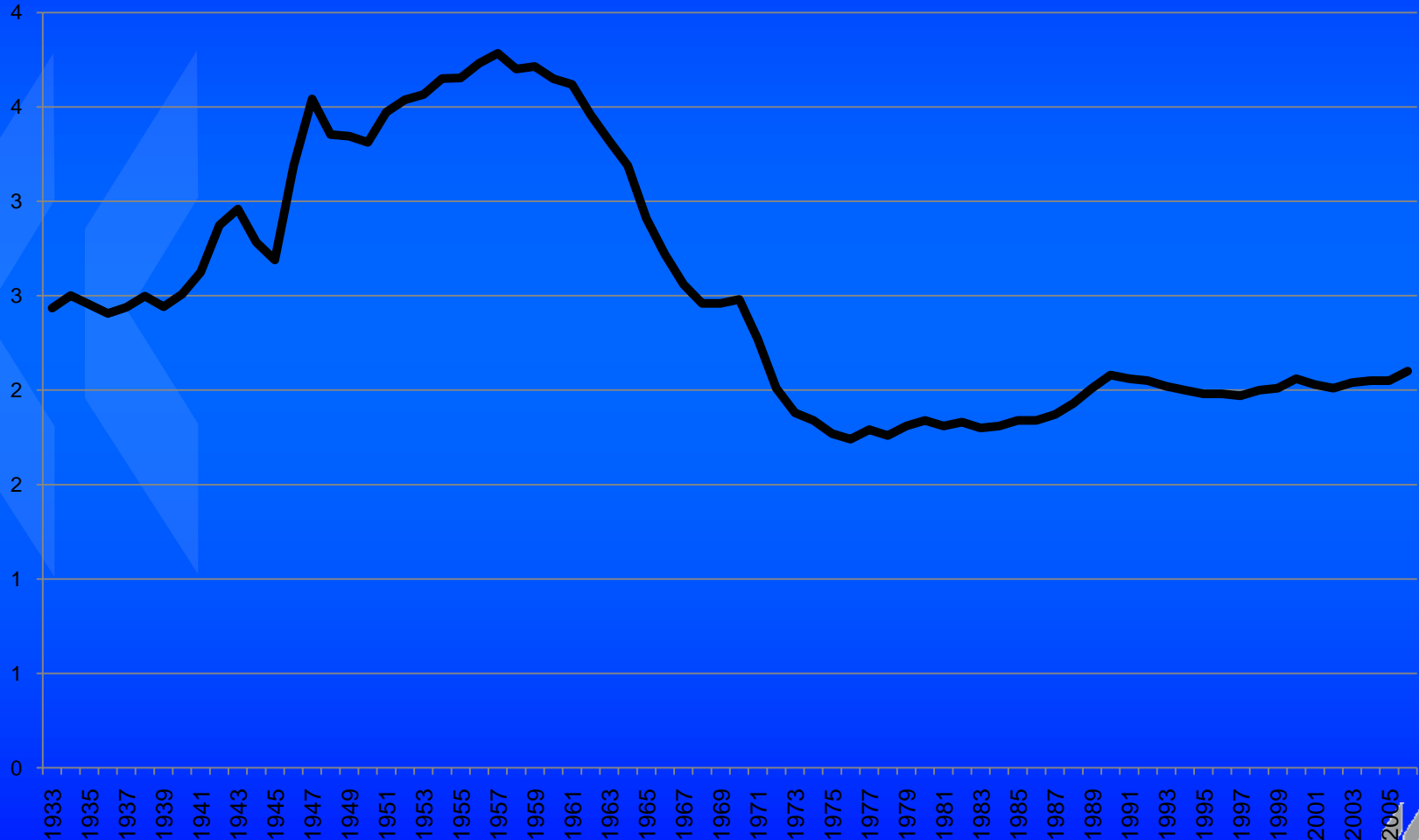
Payout phase of pensions, annuities and financial markets

OECD Seminar on the payout phase, annuities and
financial markets

Paris, 12 November, 2008

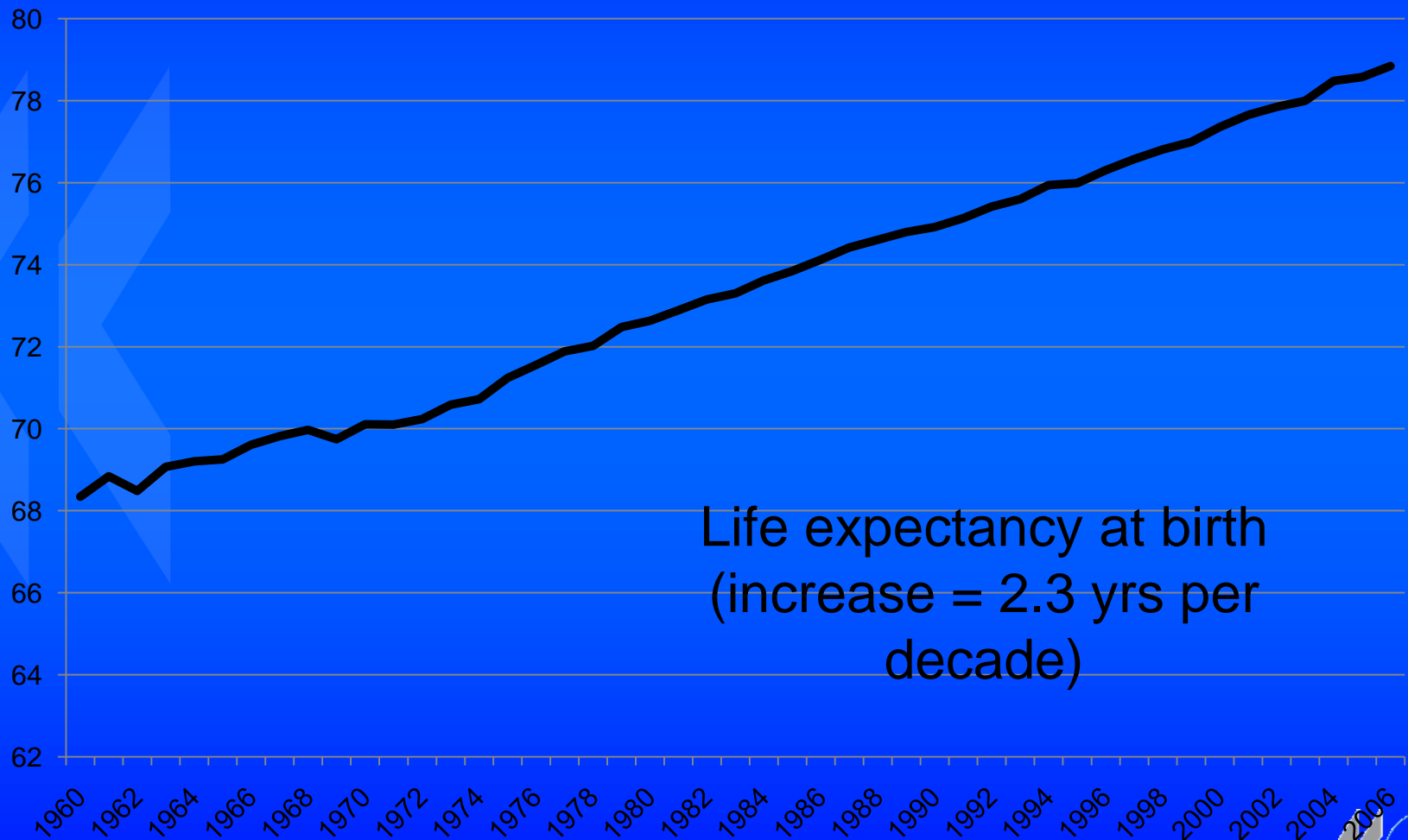
Population Ageing

- Fertility returns to previous lower levels



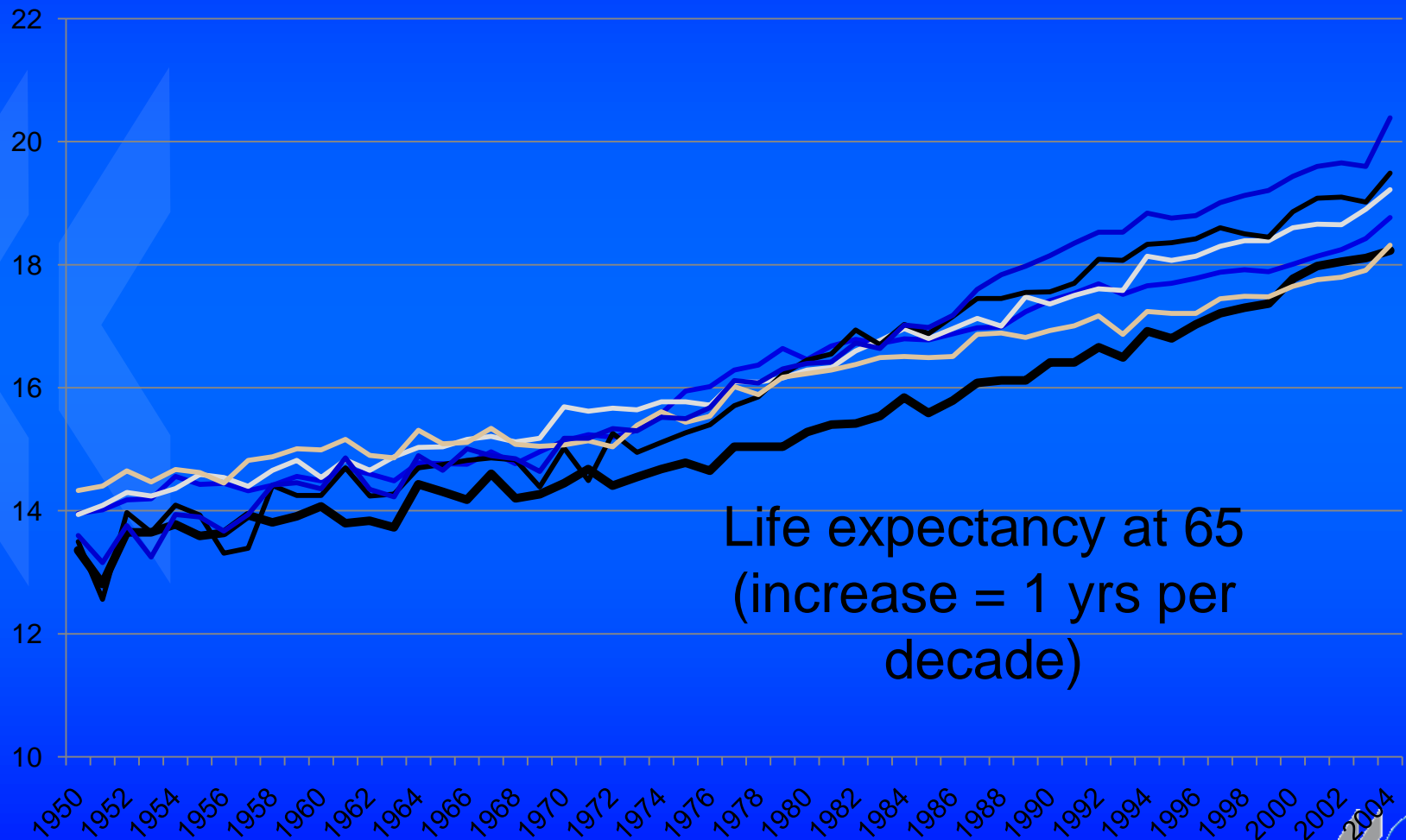
Population Ageing

- Large increases in life expectancy



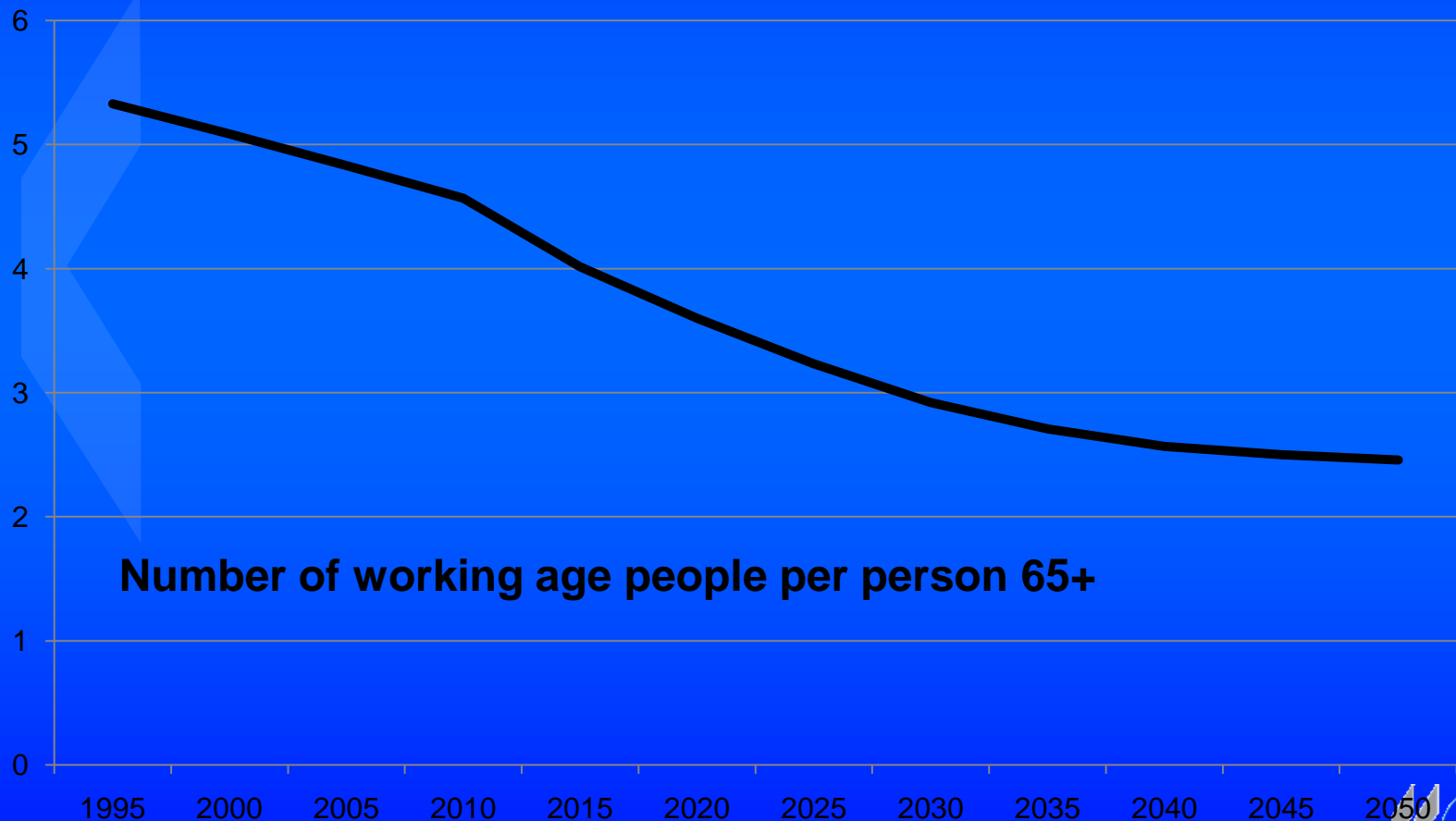
Population Ageing

- Large increases in life expectancy (at age 65)



Population Ageing: Implications

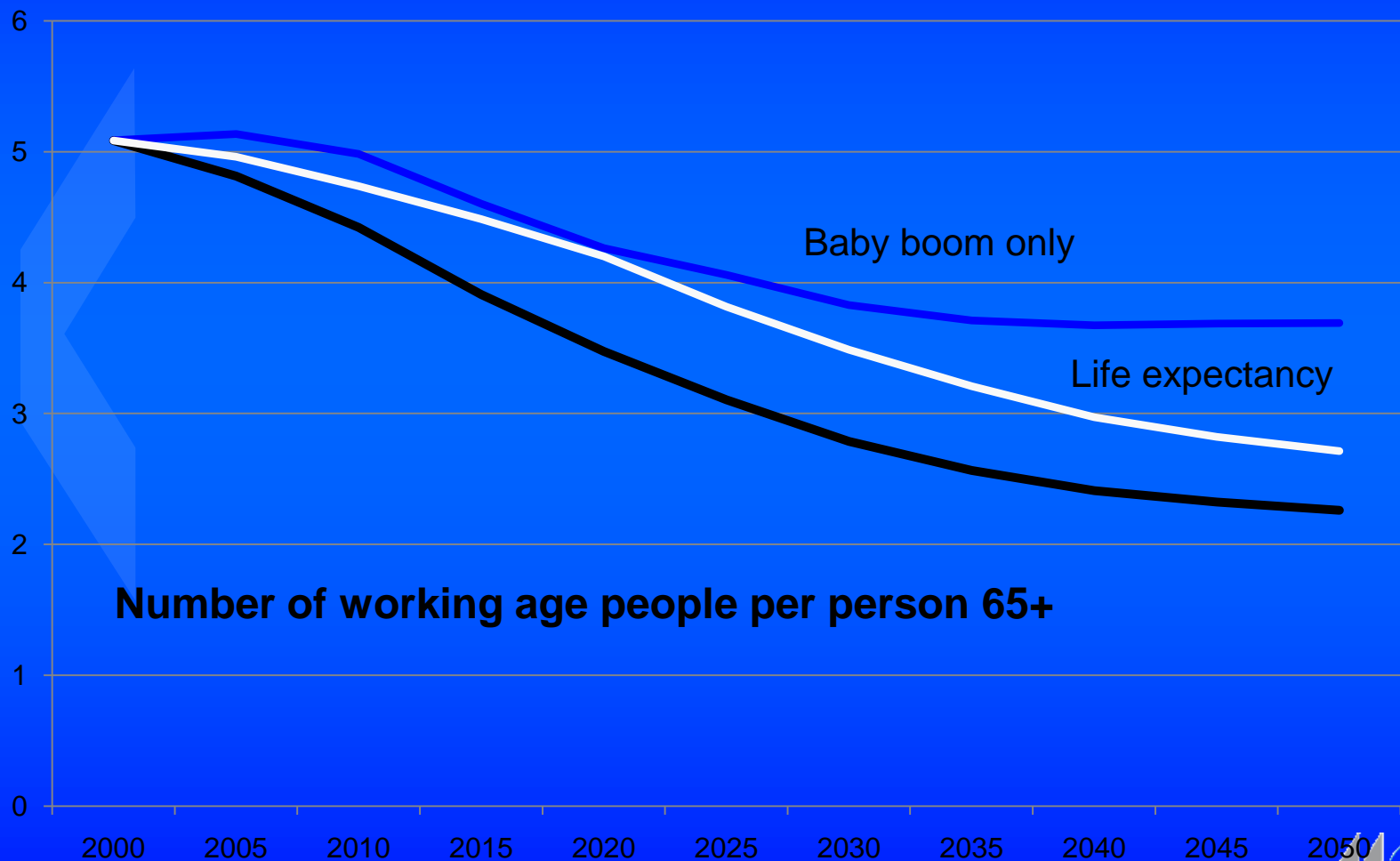
- Increase in average age of the population.
- More people in retirement and for longer.



Number of working age people per person 65+

Population Ageing: Implications

- Major future impact: increases in Lex.



Number of working age people per person 65+

Ageing

- Population ageing several important economic effects (fiscal, labour market).
- This seminar focuses on private pensions and the role of financial markets on retirement income provision.
- Baby boom:
 - impact on asset valuation (meltdown hypothesis, no)
 - Changes in portfolio composition.

Ageing

- Longevity risk (LR): uncertainty surrounding future improvements in mortality and life expectancy
- Lack of financial instruments to hedge against LR.
- Adequacy of retirement savings – save more
- Funding problems (pension funds and annuity providers liabilities uncertain).
- Payout phase of pensions: annuities, but LR compromises the well functioning of annuity markets.

Ageing, Payout Phase and Financial Markets

- What is the impact of ageing on pensions and the role of financial markets: asset meltdown, funding gaps (mainly DB plans), and hedging instruments (interest rate, inflation and longevity)?
- How could financial markets help in addressing some of the problems facing annuity markets?.
- Counter-party risk.
- Lack appropriate instruments

The Payout Phase of Pensions

- Growing importance design payout phase pensions:
 - move from DB to DC
 - some countries only DC (LatAm, CEE)
 - For some is urgent (Hungary, Poland) because no legislation on payout phase.
- Payout phase balance btw flexibility and protection from LR, given
 - country context (share of ret. income already annuitized)
 - main forms of ret. payout options (lump-sums, PW, life annuities)?

The Payout Phase of Pensions

- Proposal: deferred life annuities bought at retirement that start paying at very old ages (age 85) as a default.
 - Balance btw flexibility (PW with balance) and protection from LR
 - Proposal operational if there is supply of adequate financial instruments enabling financial institutions offering annuities to hedge associated risks.

The Payout Phase of Pensions

- Problems with annuity markets.
 - Adverse selection
 - Existence of competing more flexible alternative forms of retirement (PW)
 - Lack of competition among providers
 - Difficulties of dealing with longevity risk
 - Dichotomy between demand for straight forward products (easy to understand) and products that address several needs (e.g. bequest) which are less straightforward and pricier.

The Payout Phase and Retirement Income

- What type of annuity products can or should be allowed?
 - Innovative annuity products (e.g. combining pension payments and long-term care protections)
- Who should provide annuities?
 - Subjected to capital adequacy requirements
- How better address worries adequacy of retirement income in the context of DC pension?
 - Higher contributions, longer contribution periods
 - Investment strategies reducing exposure to risky assets as people ages.

Ultra long-term financial instruments

- The respective roles of the private and public sectors in issuing financial instruments to hedge longevity risk: advantages, approaches and barriers.
- Types of instruments for hedging longevity risk.
- Annuity providers may also need long-term instruments to hedge interest rates on top of longevity risk.