

Delivering Annuities in Developing Markets: the role of private providers

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A decorative graphic consisting of five horizontal stripes of varying shades of blue, ranging from a dark navy blue at the top to a light sky blue at the bottom, positioned below the text.

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Section 1

From 1994 to 2014: What has been done in Annuity Markets?

Section 2

2014 and beyond: What should be done to improve the current situation?

Developing Annuity Markets in Latin America

- When pension reforms in Latam were implemented, the market for retirement products **practically did not exist.**
- Private insurance companies** provide mandatory annuities from **2nd pillar** and voluntary products from **3rd pillar.**
- There is a **potential growth for annuity markets** (mandatory & voluntary). Most of the assets managed by pension funds will eventually convert into retirement flows.

Country	Annuity Provider		Mandatory schemes	
	Life insurance Co.	Specialized insurance Co.	Pension fund assets (% GDP)	Life annuity assets (% GDP)
Chile	✓		60%	13%
Colombia	✓		20%	0.7%
Peru	✓		18%	0.4%
Mexico	✓ Voluntary	✓ Mandatory	12%	1.1%

Source: SSV, SP, SBS, CNSF, CONSAR, SF

The Regulatory Framework

- **Product design and price** of annuities is influenced by the regulatory framework and the fiscal treatment of these products.
- In Latam, there is a **Solvency-oriented** regulatory framework for Insurance Companies:
 - **Capital regulations** penalizing mismatches in Asset-Liability Management (ALM) were introduced in Chile and Mexico, to strengthen the capital buffer and promote the adoption of appropriate ALM strategies in the early stages of market development.
 - **Mexico:** A new insurance regulation compliant with **Solvency II**, will be in force from 2015 onwards.
 - **Chile:** **Risk-based** supervision focused on solvency and market behavior, following Solvency II principles.
 - **Colombia and Peru:** Adoption of best practices on reserves, investment regime and capital requirements.

Adequate Pricing

- **More accurate parameters** for annuity pricing (dynamic mortality tables) are essential. Each additional year of life expectancy not provisioned for, can add 3-4% to current liabilities of annuity providers.*
- Despite the lack of a legal requirement to provision **improvements in mortality** in some countries, **annuity providers do so in practice**.

Annuity Providers: Mortality Tables and Improvements in mortality*

Country	Minimum Mortality Tables required by regulation	Mortality Improvements	
		Required by regulation	Used in Practice
Chile	✓	✓	✓
Mexico	✓	✓	✓
Colombia	✓	x	Some
Peru	✓	x	Some

*Source: OECD

Market Transparency

Mandatory annuities

- **Electronic quotation systems** eliminate the participation of brokers and sales agents: Chile (SCOMP) and Mexico (SAOR). Pensioners can **choose among different payout options** (programmed withdrawals vs. annuities) **and providers**.

Voluntary annuities

- **Scarce information** to compare between options and providers
- Detailed **quantitative data** on the voluntary annuity market is often **not available**, even at the most aggregate level. It is difficult to assess the role of private annuities.

Strengthening of 3rd Pillar

- Efforts have been done to **promote voluntary and complementary private pension arrangements**. Governments have established **fiscal incentives**.
- Voluntary savings can be made through **different channels and providers** (Afores/AFPs, Insurance Companies, Asset Management Companies).

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Challenges ahead

Strengthen Voluntary Savings

- The challenge of balancing sustainability and adequacy of pension systems will become more pronounced over the next years.
- Pensions from 1st and 2nd pillars **will not be able** to provide an **adequate** and sustainable **retirement income**
- Strong need to **encourage Voluntary Savings** through insurance contracts and private pension funds.
- **Voluntary Annuity Markets** should be encouraged.

Financial education

- Informed decisions enhance the personal financial situation of consumers, encouraging **voluntary savings** and their **preponderant role on retirement income**.

Challenges ahead

Risk management

- In a context of persistent low interest rates and more restrictive capital requirements, insurance companies managing annuities should focus on:
 - **Increase risk transfer:** to reinsurance companies or through securitization
 - Management of **Longevity Risk** and **Reinvestment Risk**
 - **Asset-Liability Management:** Minimize the duration gap between assets & liabilities, since the risk associated must be covered with capital.
 - **A greater use of derivatives for hedging purposes:** Interest rates and inflation swaps, equity options
 - **Need to find higher-yield assets:** Infrastructure projects

Challenges ahead

Adequate Pricing

- Realistic assumptions (more accurate pricing parameters) are necessary to sufficiently provision for future payment obligations: **long-term dynamic mortality tables** and adequate discount rates
- Assumptions must be **kept up-to-date**, recognizing the risks to which annuity providers are exposed. Countries where the industry experts actively participate in assumption setting, regardless of regulation, seem to be the less exposed to longevity risk. (OECD WPPP)
- **Intelligent pricing**: including more specific variables (health, life-style, etc.) to better assess risks and **diminish the risk of adverse selection** in voluntary annuities.

Evolving Customer Needs on Insurance & Savings

Past / Now

Protection in case of death & serious illness



Support to spouse and young children



Savings are “nice to have”

Future

Protection in case of long survival



Retirement Income + Housing + Health + Long-term care



Failure of pension systems in providing an adequate retirement income



Savings are a “must have”

BBVA's commitment

- Being part of a global financial group, BBVA makes **synergies** with the banking sector and asset management companies, to improve the investment returns of our clients.
- **A wide offer of voluntary savings products**, designed to benefit from fiscal incentives in each country
- **Active participation of our clients**: Election of the pension fund portfolio's risk profile
- **Different payout options**: programmed withdrawal, term annuity, life annuity, guaranteed annuity
- **Financial education** is a **strategic priority** in corporate responsibility for the BBVA Group:
 - **Mexico**: «*Adelante con tu futuro*» (Forward With Your Future) offers free on-line workshops for the general public, focused on personal finances and voluntary savings
 - **Chile**: «*Educación Financiera para Jóvenes*» (Financial Literacy for Young People) and «*Adelante con tu Futuro para Colegios*» (Forward With Your Future for Schools)

Spain: BBVA Pension Institute

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- **Our project:** To share information and knowledge on Pensions with the society, so everyone can understand and take decisions now and in the future
- **Pension simulator** (mobile app): Planning contributions needed to obtain a desired replacement rate at retirement, and calculate associated tax savings.



Simulador de Pensiones BBVA

Para todos los que quieren una jubilación diferente

[Calcula tu pensión](#)