# Could Underwritten Annuities work for Japan?

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Longer lives, asset needs and medical advances are three of the main ingredients currently generating an unprecedented demand, in Asia as well as around the world, for insurance products that can provide lifetime asset and income protection. **Mr Greg M Goodfliesh** of **RGA Reinsurance Company Japan Branch** and **Mr Peter Banthorpe** of **RGA UK Services Limited**, explore the concept of Underwritten Annuity, a popular hit in the UK, and its applicability as a useful and appropriate product for ageing Japan.

Several Asian nations are experiencing the fastest-rising average ages in the world, due to longer lifespans as well as several years of below-replacement-level fertility as well as other factors. State pension programmes, both in developed nations such as Japan and in developing economies such as China, are already encountering underfunding difficulties.

At the same time, many elders do not have sufficient assets to support their needs as they age, and the traditional Asian value of caring for elders in developed as well as developing countries is ebbing at an alarming rate.

This confluence of trends points to the growing need to build new layers of protection into social safety nets to handle the rising tide of ageing citizens and their rising income, asset and health protection needs.

## Enhancing annuities by incorporating underwriting

The underwritten annuity is a product that can meet the income and asset portions. The product, which first was introduced in the United Kingdom in 1995, has gained tremendous traction there and stirred interest elsewhere as well.

In the UK, a portion of each individual's retirement pension, until 2011, was required to be invested in instruments that will provide a lifetime income. Although the legal requirement was removed, the majority of people do annuitize at retirement.

This type of annuity, which takes an individual's current health into account, is proving an increasingly popular choice, as adding underwriting to annuities provides additional monthly annuity income to individuals with compromised longevity due to health or lifestyle factors.

Enhancing annuities by incorporating underwriting, especially for older individuals with health impairments, could be worth consideration in Asia.

## The UK's underwritten annuity market

The requirement for retirees to annuitize their pension funds has long been a feature of the UK market. However, it was not until the mid-1990s that annuities were first developed for this market that incorporated underwriting enhancements that took into account the impairments that can come with ageing, lifestyle and occupations.

The UK's first underwritten annuity products focused primarily on two pre-retiree market segments: first, those with medical conditions such as cancer, cardiovascular disease; and second, those with lifestyle-generated impairments

from, for example, smoking or drinking habits, or obesity, or metrics such as blood pressure or cholesterol levels.

As these individuals would, as a rule, have actuarially below-average life expectancies due to these impairments, they could be prime candidates for underwritten annuities, which actuarially leverage shorter life expectancies to enable higher annuity payments. The more serious the impairment, the higher the potential annuity payout.

The product clearly has proven attractive to UK annuity buyers. Currently, 10 UK insurers offer the product, and the Association of British Insurers (ABI) found that as of 2011, underwritten annuities comprised 19% of total annuity sales and 27% of premiums.


According to an annual Towers Watson survey that tracks UK enhanced annuity sales trends, totals have grown with remarkable and increasing rapidity since the product's introduction. In 2005, just 10 years after the product was first introduced, enhanced annuity sales reached GBP638.7 million (US$1,026.3 million). By 2010 – just five years later – sales had nearly quadrupled, to GBP2,468.1 million, and in the two years since, sales grew 30% each year, with a 2012 total of GBP4,484.8 million.

## Longevity is growing fast too

As the UK's baby boom cohort – itself sizable – continues to age into retirement, sales in the UK are most likely to continue to increase. Baby boomers are retiring in increasing numbers each year, and by 2050, British government research is projecting that 25% of the nation's population will be age 65 or older. Longevity in the nation is growing fast as well: the research also is projecting that a boy born in 2013 might expect to live to 92, and a girl born in 2030 could expect to live to 95.

Morbidity and mortality information on these products is continuing to accrue, which is increasing the strength and precision of their risk profile in the UK.

A third type of underwritten annuity is emerging in the UK, specifically targeted to the 75 and older market. These Care Annuities (also known as immediate needs annuities) are for impaired individuals between the ages of 75 and 90, or for persons who have already begun to incur long-term care costs. These annuities assume a much shortened life span, and are underwritten using elements such as frailty, cognitive skills or impaired mobility, measured in terms of Activities of Daily Living (ADLs).

## Japan's annuity market

Several global market trends, from ageing and contracting populations, low interest rates and greater older-age protection needs, are impacting Japan right now.

Japan's average age is rising fast, due to population contraction, which began in 2006, when deaths first outnumbered births, and an extremely low fertility rate – 1.41 births per woman in 2012. More than 20% of Japan's population is currently over age 65, and by 2050, more than 40% will likely be over age 65. Already in 2010, Japan's average age was 44 and average life expectancy, 83. By 2040, Japan's average age could rise to 55, if fertility and longevity trends do not change.

Clearly, elder protection needs are going to rise quickly, and it is not clear that the nation's current pension system will be able to handle the coming burden. Japan's two-tier pension system, which replaces approximately 60% of lifetime salary, consists of a defined benefit, for which every citizen is eligible, and an earnings-related pension benefits available only to full-time employees who work 30 or more hours a week, which covers dependent spouses. Normal pension age is 65, and the full pension is payable after 40 years of contributions.

## Could Underwritten Annuities succeed in Japan?

Japan's annuity market has been in existence for more than 30 years. Until 2000, the market was primarily fixed annuities, and that year, variable annuities were introduced, with products that provided guaranteed minimum death benefits as well as an annuity streams.

Japan quickly grew into the world's second largest variable annuity market, but the global financial crisis of 2008 precipitated the exit of many foreign players, as well as a broad effort to de-risk the products. Banks have backed off on variable annuity sales as well, and now primarily sell fixed annuity products.

Today, economic conditions in Japan require solutions that can let life insurers mitigate both direct and contingent long-term risk exposure. Lifetime annuities are not currently a huge market in Japan, but as lifespans continue to increase, annuities that can be underwritten are one solution that can mitigate risk for providers and buyers.

Underwritten annuities can provide consumers with the most beneficial rating based on their underwritten life expectancy and give carriers more flexibility in accepting risk. Provider risk can be mitigated with thorough, detailed research to assess mortality, and by reinsurance and hedging strategies.

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