

How to react to the ageing challenge?

Pierre Wunsch
Governor of the National Bank of Belgium

Chaire d'excellence Ethias sur les pensions complémentaires

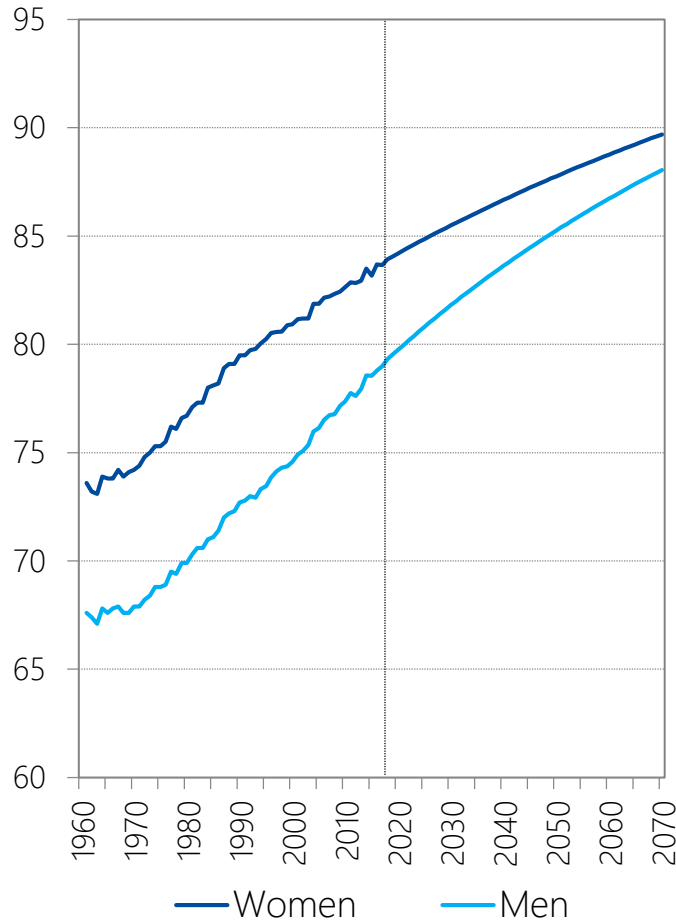
UCLouvain, 21 October 2019

Structure of the presentation

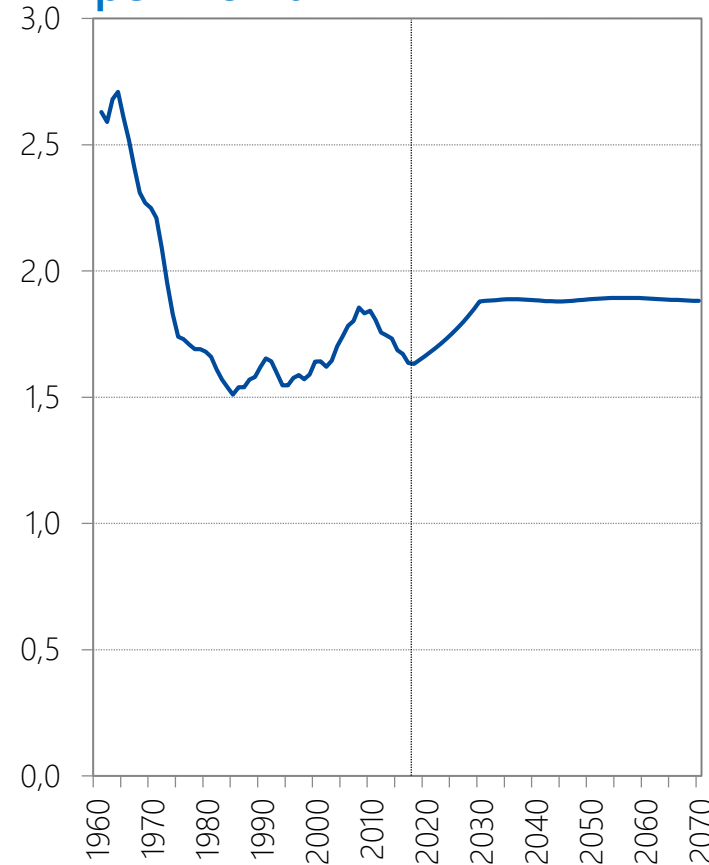
1. Demographics and ageing
2. Important social and economic consequences of ageing
3. Which policy as an answer to the ageing challenge?
4. Impact on savings and the role of insurers and pension funds

Determinants of population patterns and structure in Belgium

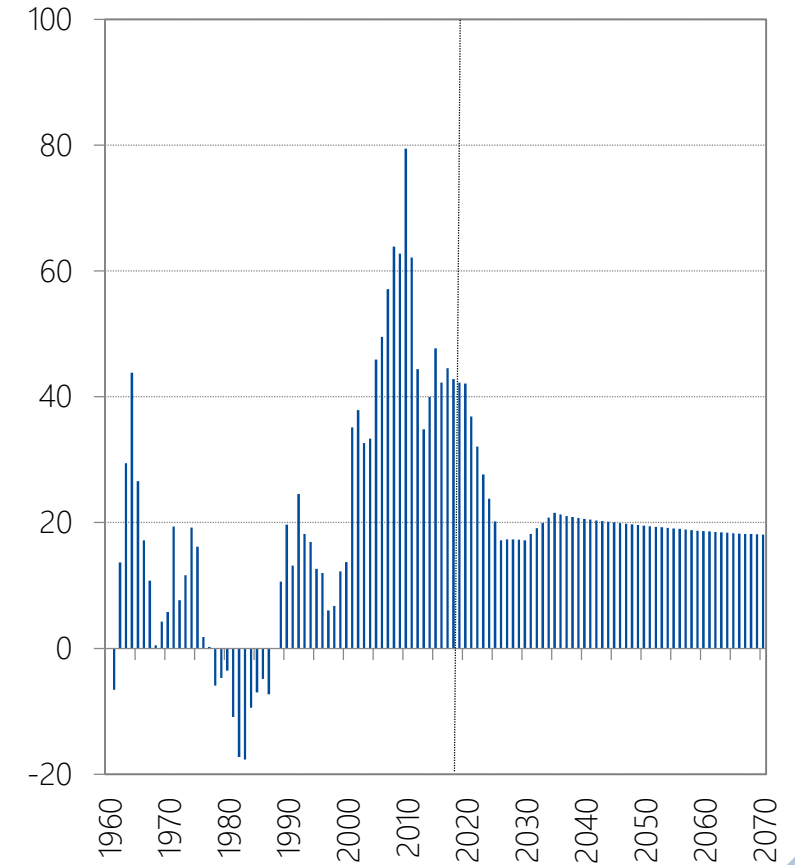
Life expectancy at birth (in years)



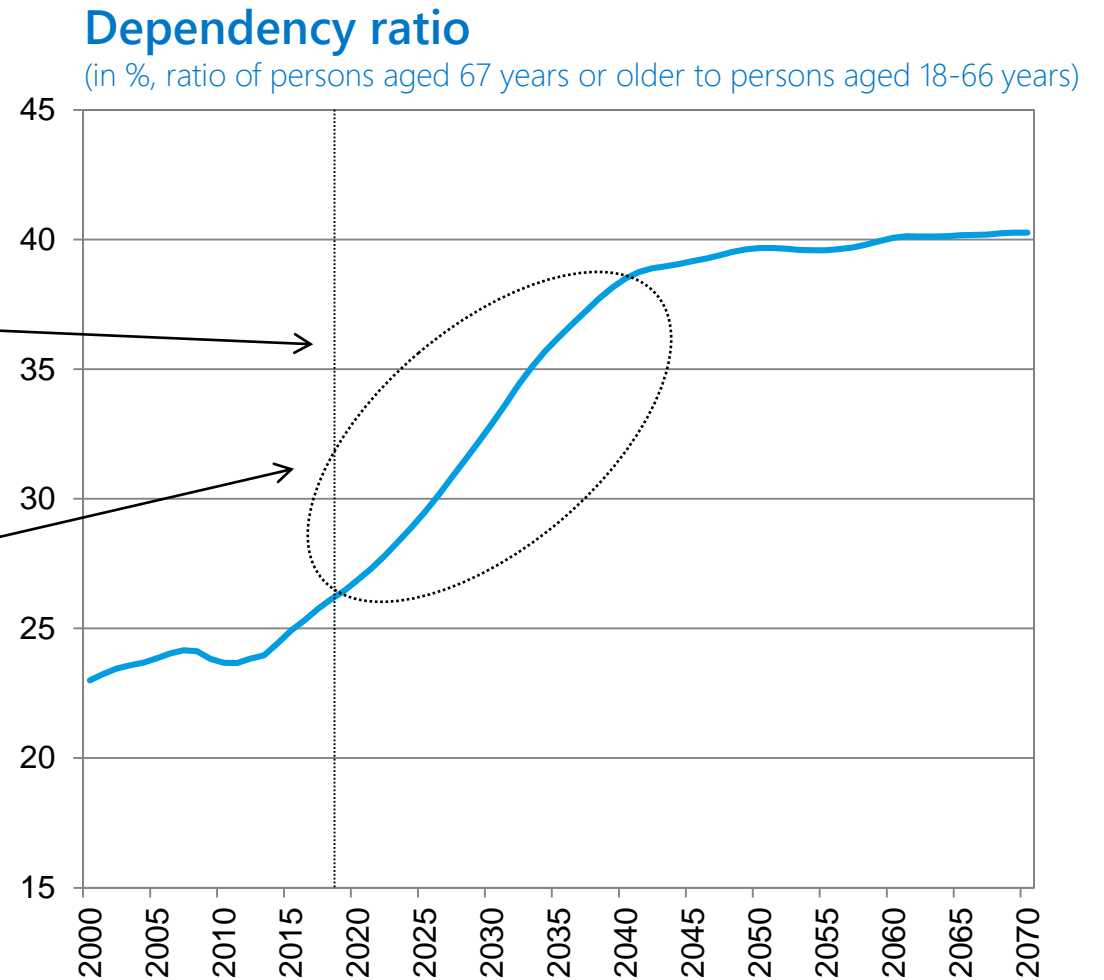
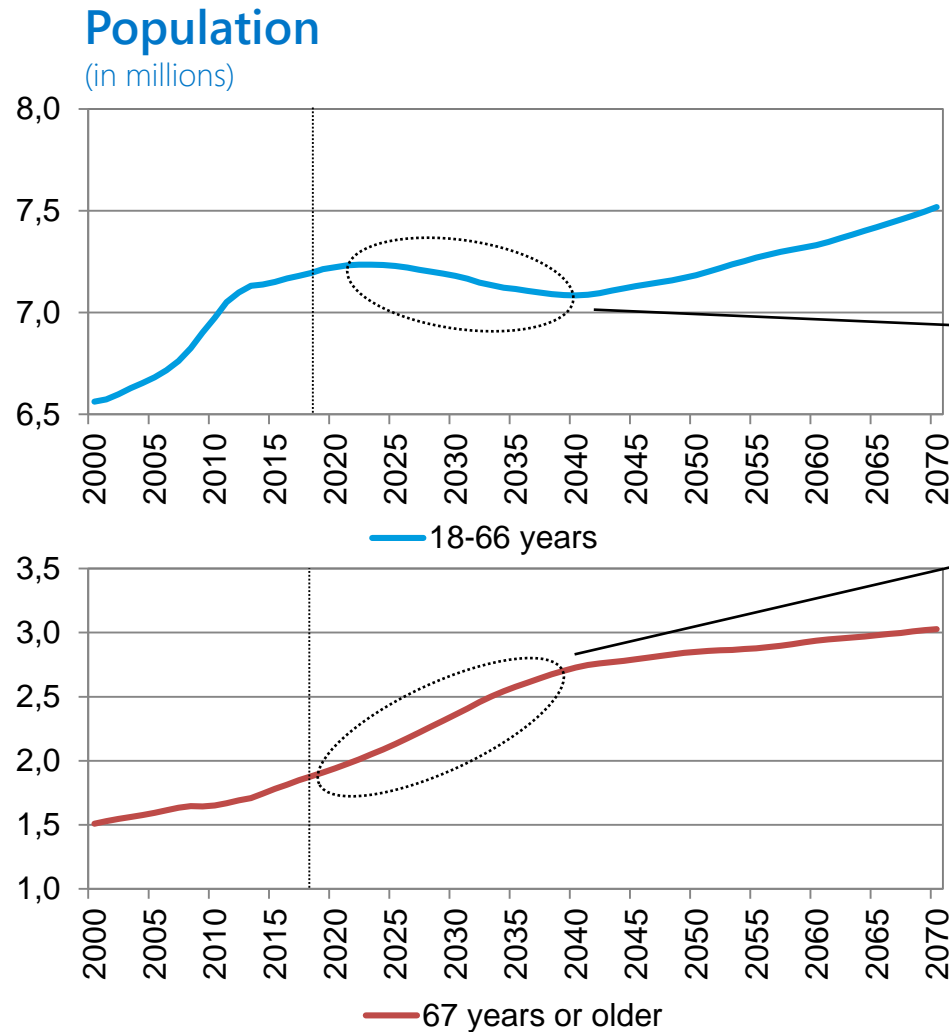
Average number of children per woman



Net migration (in thousands of persons)

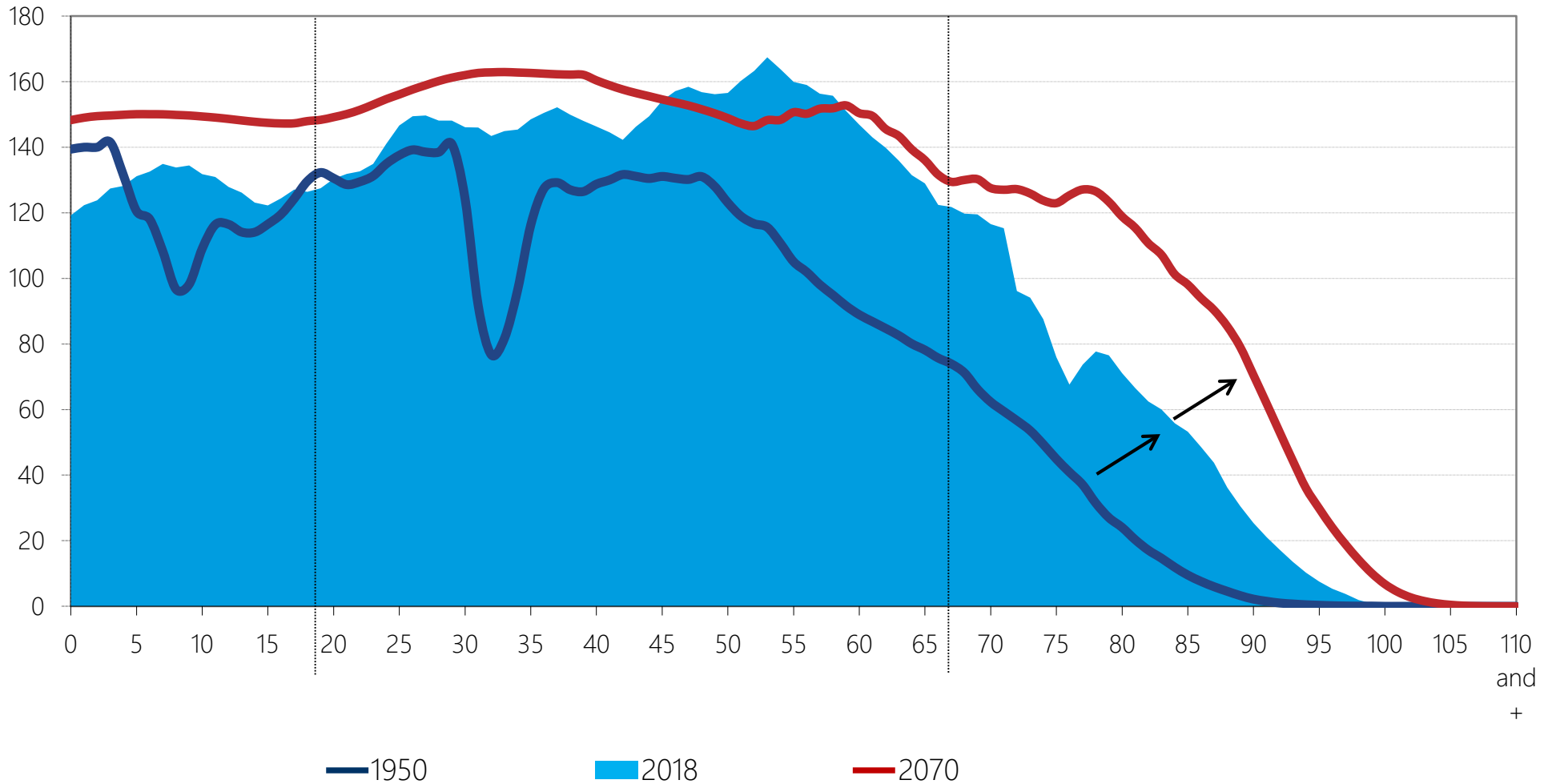


Sharp rise in the dependency ratio, due mainly to an increase in the elderly population



Demographic development: population ageing

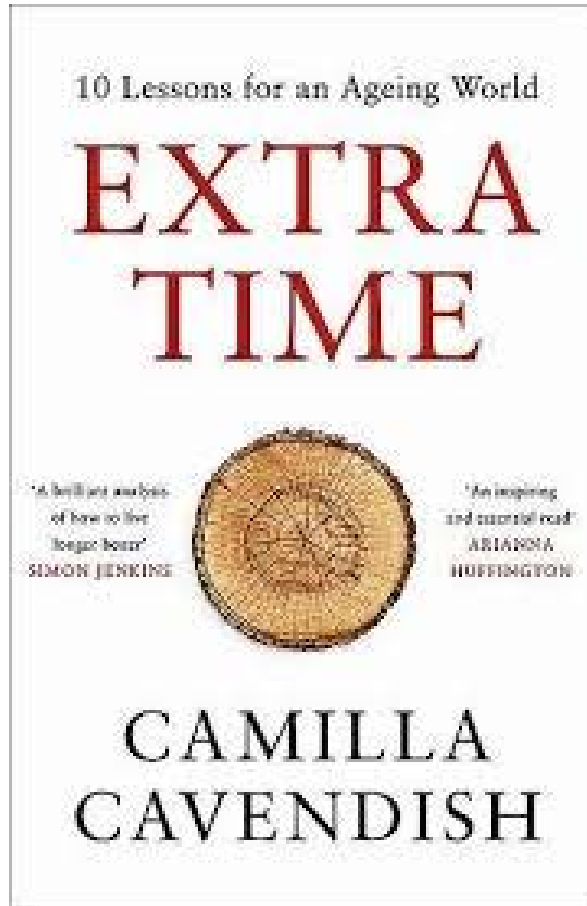
(in thousands of persons, by age)



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Book: 10 Lessons for an ageing world – C. Cavendish (2019)



Ageing poses major challenges to the society ... but public opinion is still stuck in traditional ideas on ageing

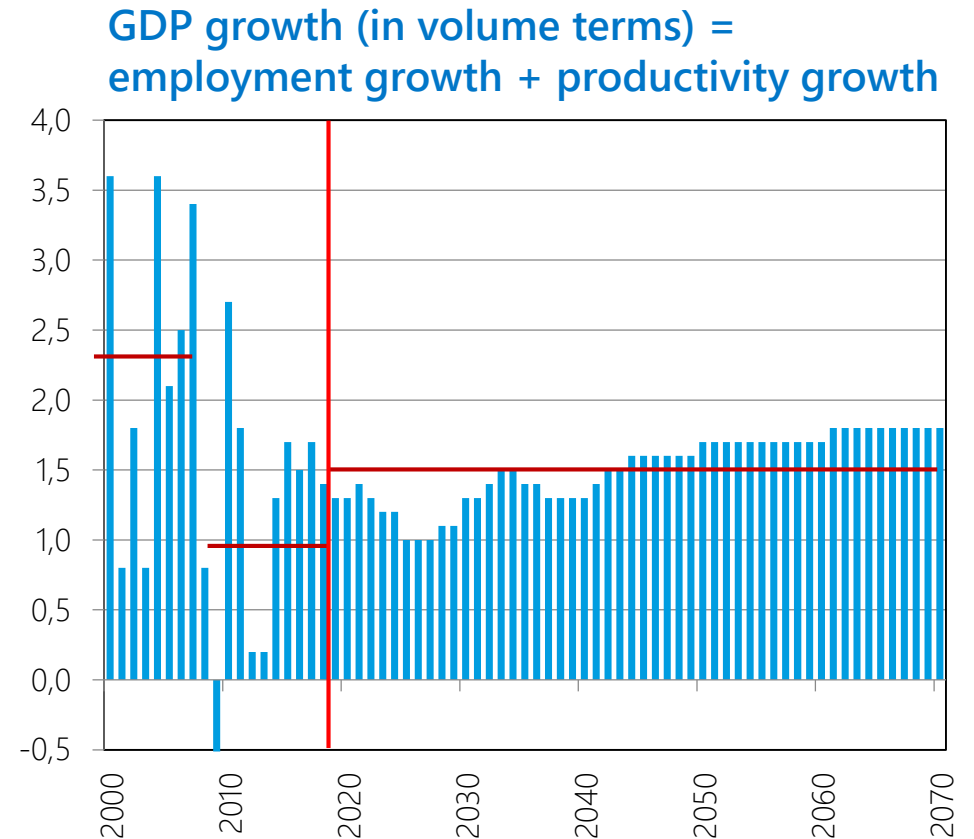
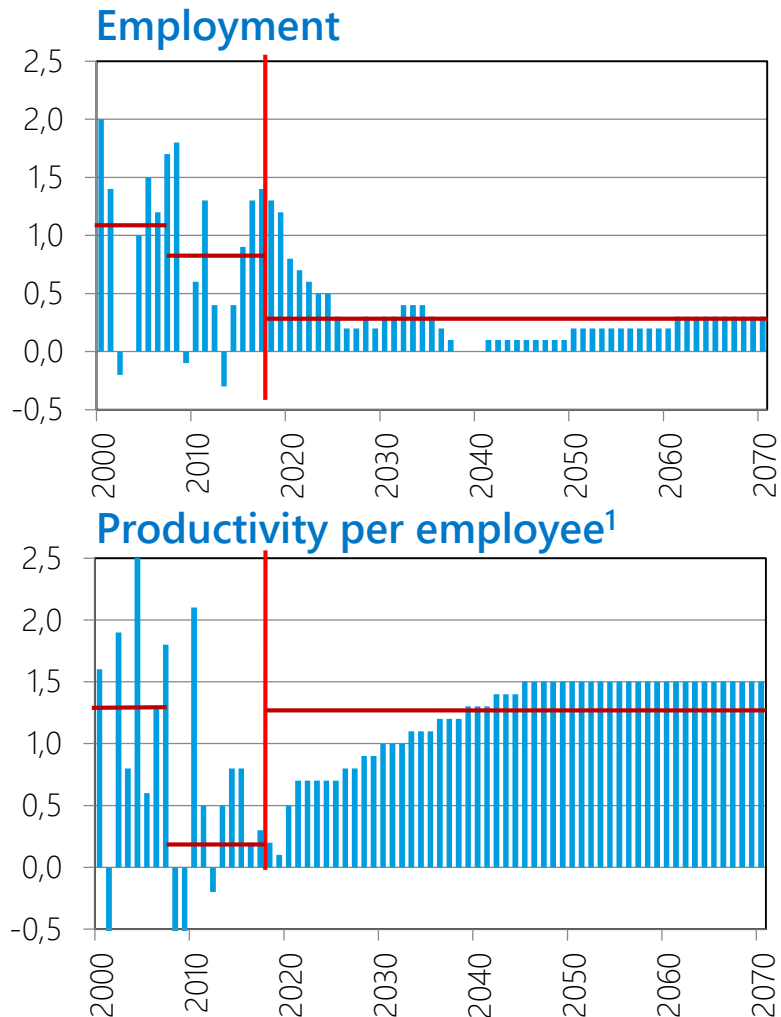
This book gives an optimistic approach to these challenges

Changing our attitudes towards older people and using technology, community, even medicines could bring about a revolution

Government, businesses and the media can help, by changing the signals they send about ageing

Economy: increase in employment will no longer be the engine of GDP growth, but productivity growth should take over

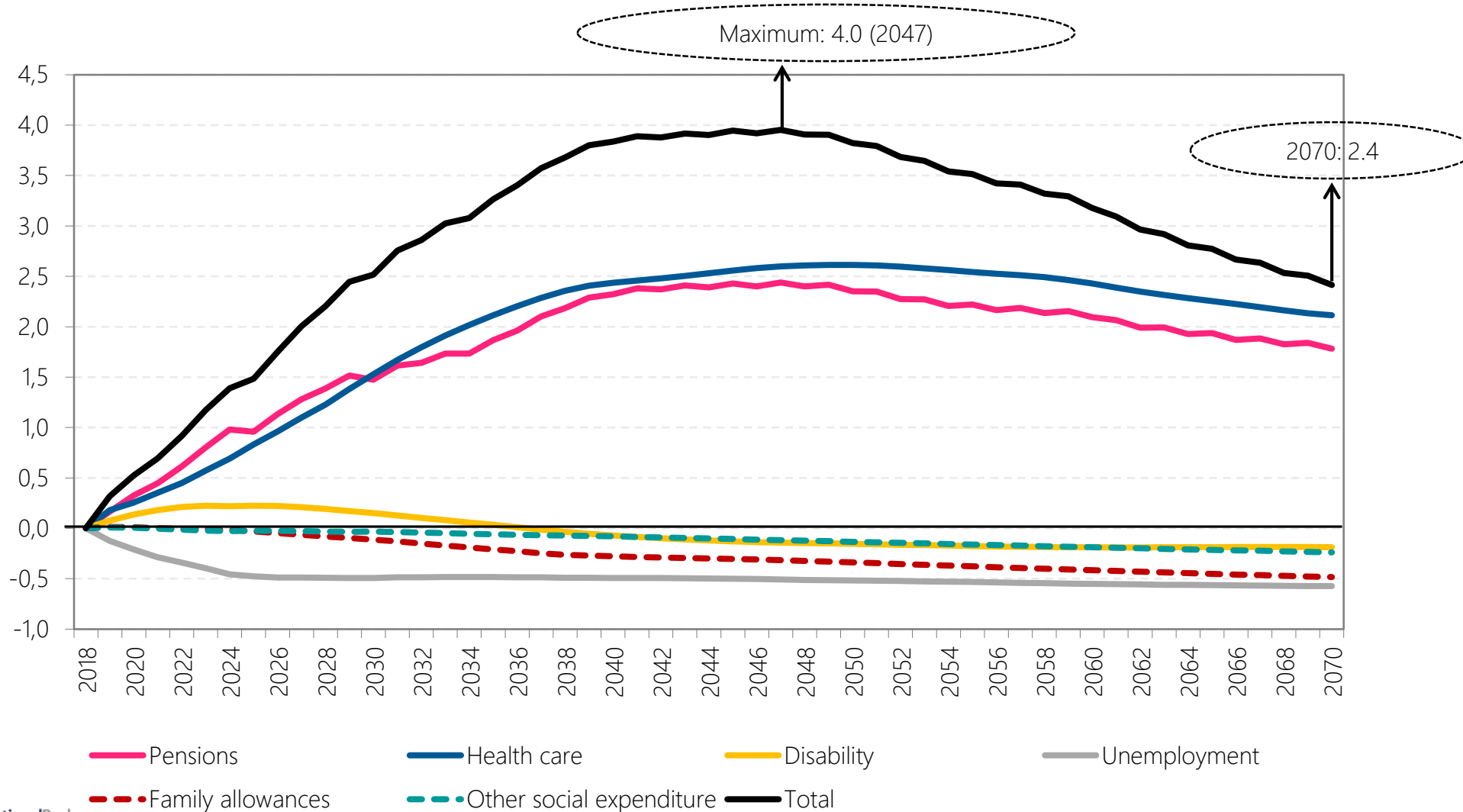
(percentage changes compared to the previous year)



— Averages (2000-2007; 2008-2018; 2019-2070)

Public finances: budgetary costs of ageing increase further and peak in 2047

(change in social benefits in percentage points of GDP compared to 2018)



Structure of the presentation

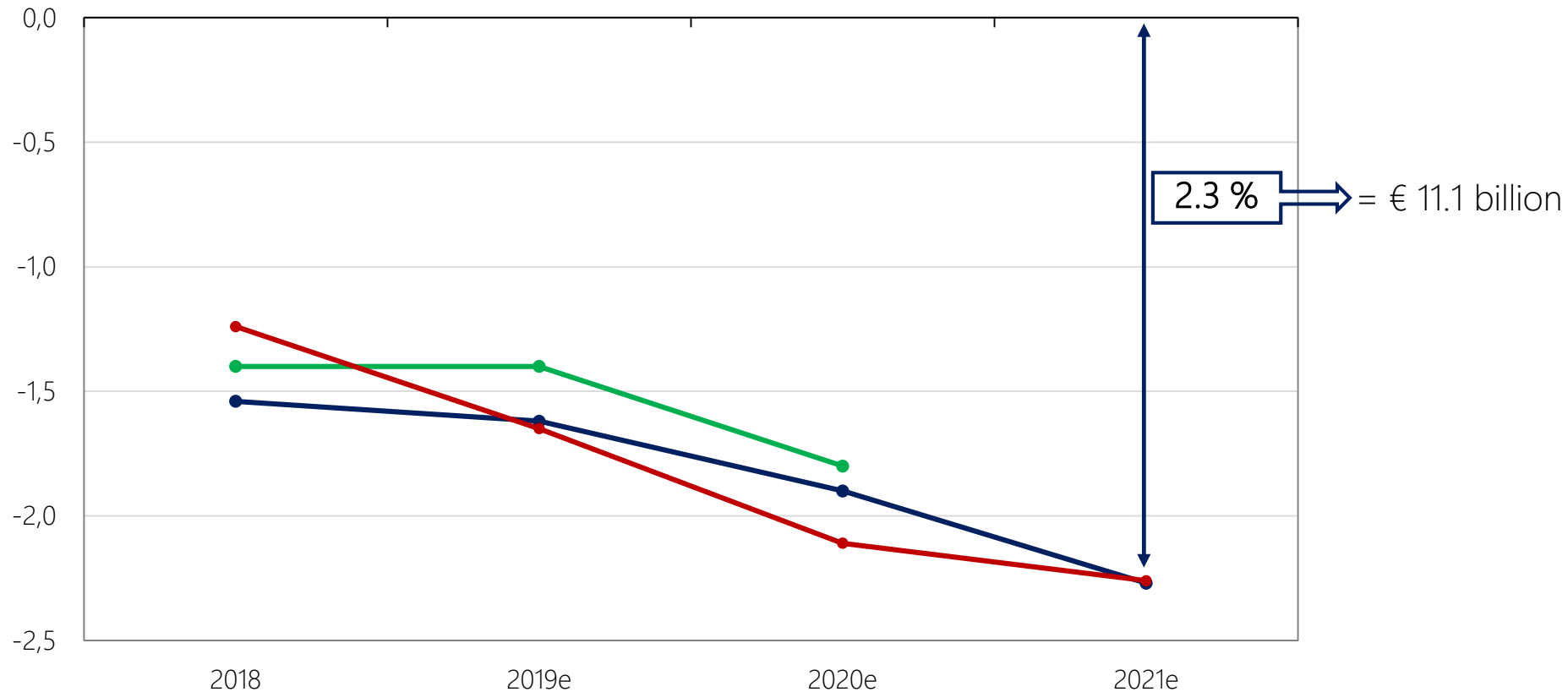
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Three-pronged strategy to tackle the ageing challenge

- ◆ Fiscal strategy:
 - ◇ reach equilibrium in structural balance in the medium term
 - ◇ reduce government debt
- ◆ Pursue an active economic policy to boost potential GDP
 - ◇ mainly by increasing the employment rate ...
 - ◇ ... and also by supporting labor productivity
- ◆ Limit the increase in spending for pensions and health care
 - ◇ pension reform
 - ◇ contain increase in health care costs

Reaching an equilibrium in the structural balance necessitates a substantial fiscal consolidation

(structural balance, in % of GDP, unless otherwise mentioned)



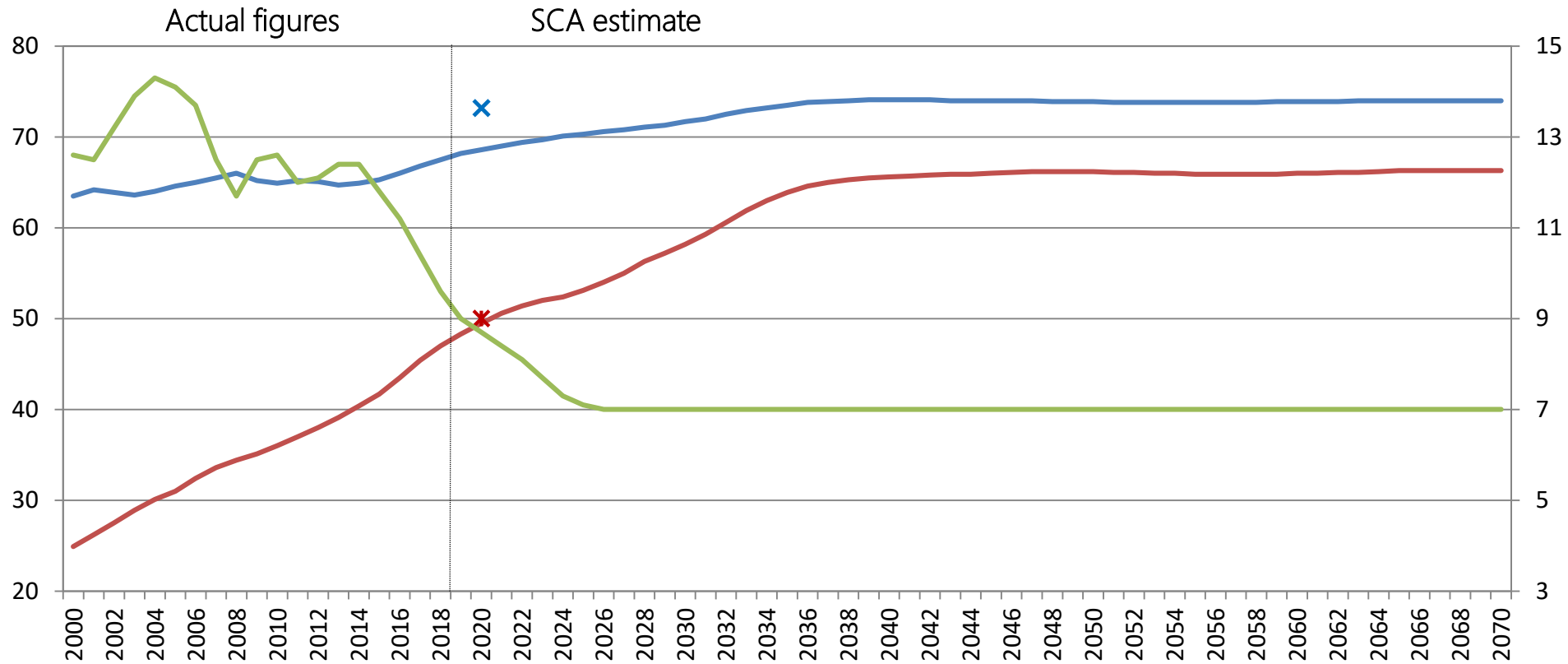
—●— National Bank of Belgium (June 2019)

—●— European Commission (June 2019)

—●— Monitoringcomité (September 2019)

A favourable trend in employment requires an active labour market policy

(in % of the corresponding population)



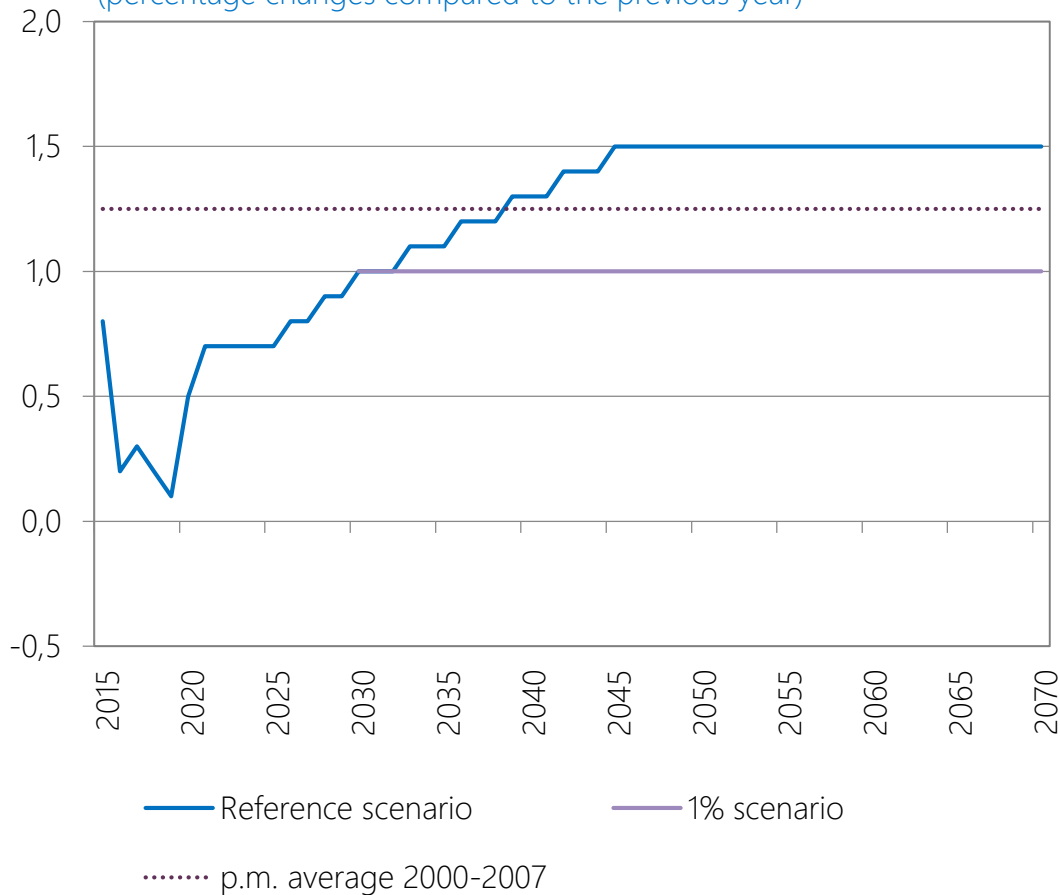
- Total employment 18-66 years
- Employment 55-66 years
- Unemployment¹ (right-hand scale)

- ✕ Total employment 20-64 years target 2020
- ✕ Employment 55-64 years target 2020

Increased labour productivity is vital to contain the costs of ageing

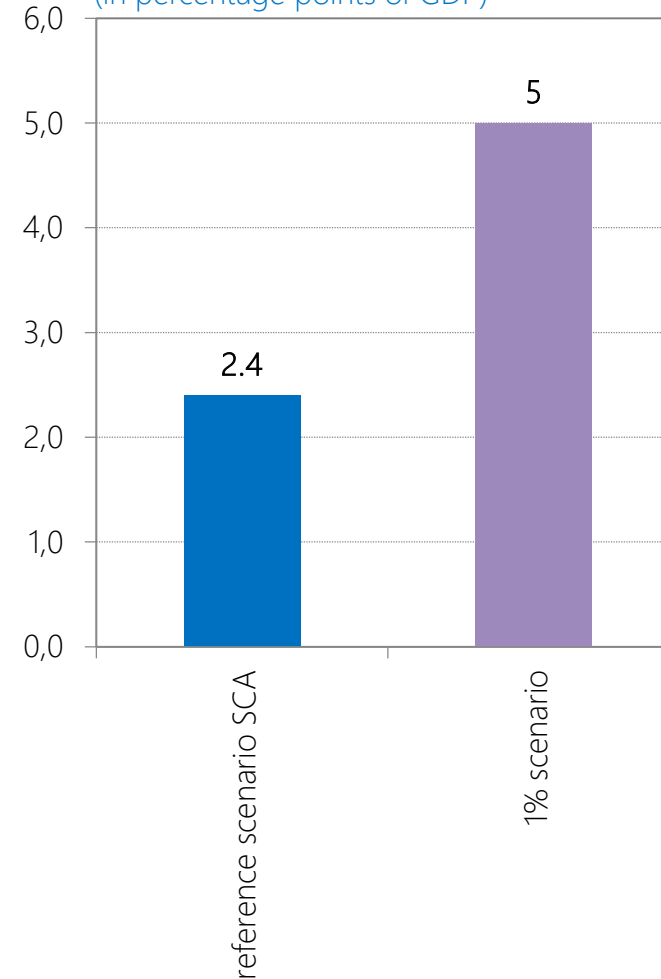
Productivity per person in work

(percentage changes compared to the previous year)



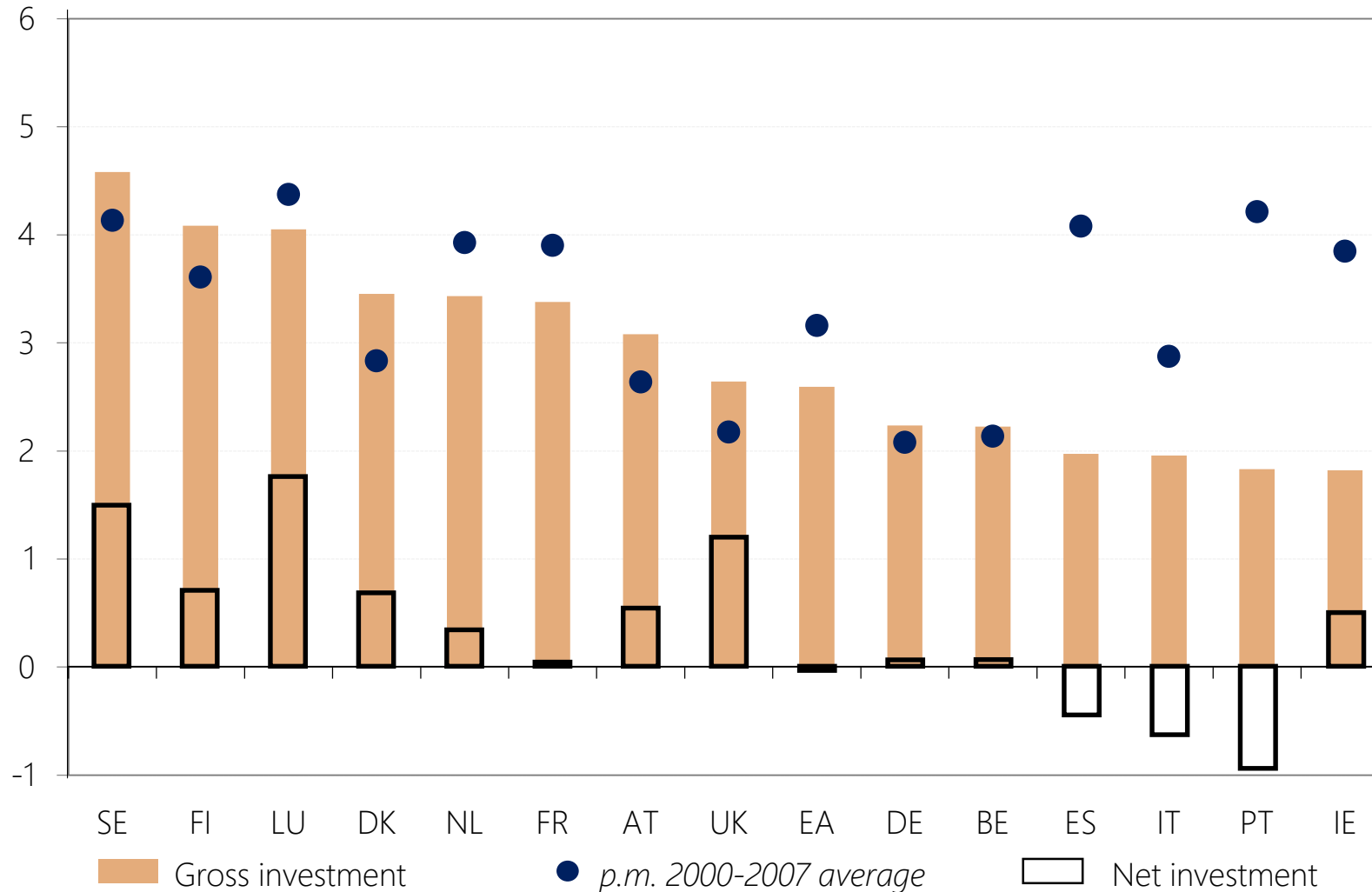
Ageing costs 2018-2070

(in percentage points of GDP)



Public investment is low in Belgium and it should be stimulated in view of enhancing productivity and potential growth

(fixed capital formation, 2017, in % of GDP)



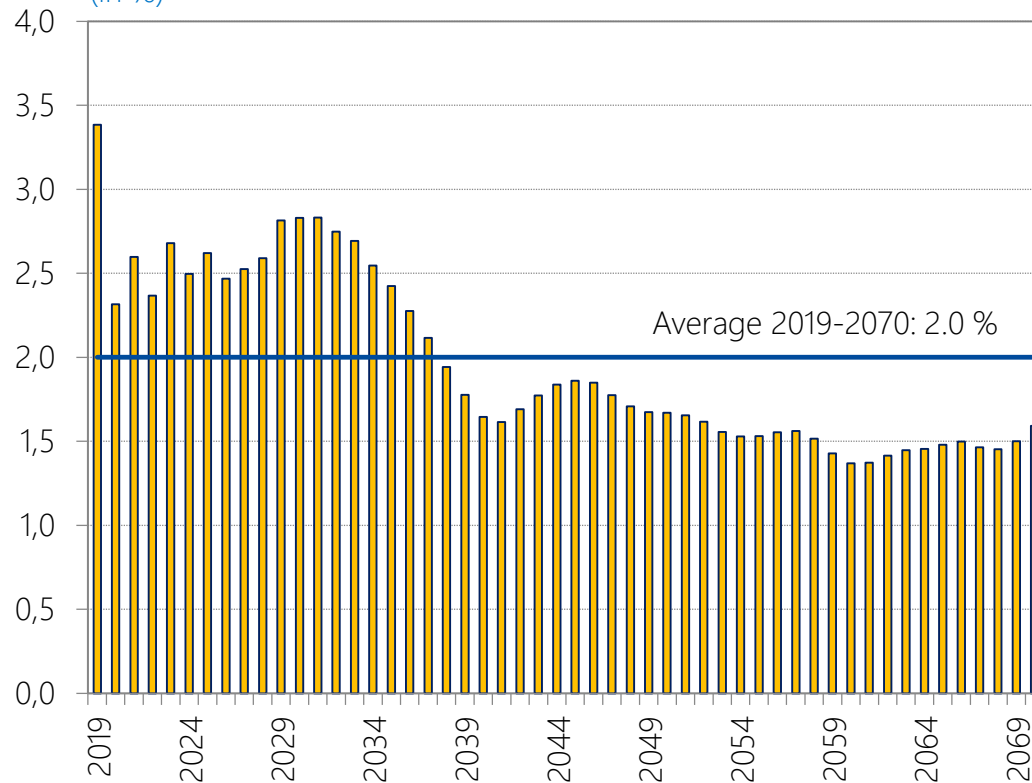
Pension reform – overview of the main measures

- ◆ Legal retirement age raised
- ◆ Stricter conditions for early retirement
- ◆ Pension bonus abolished
- ◆ Conditions for unemployment benefits with employer top-up reinforced
- ◆ Harmonising the incorporation of periods of study in pension calculations in the three main pension systems

The increase in public health care expenditure should be monitored

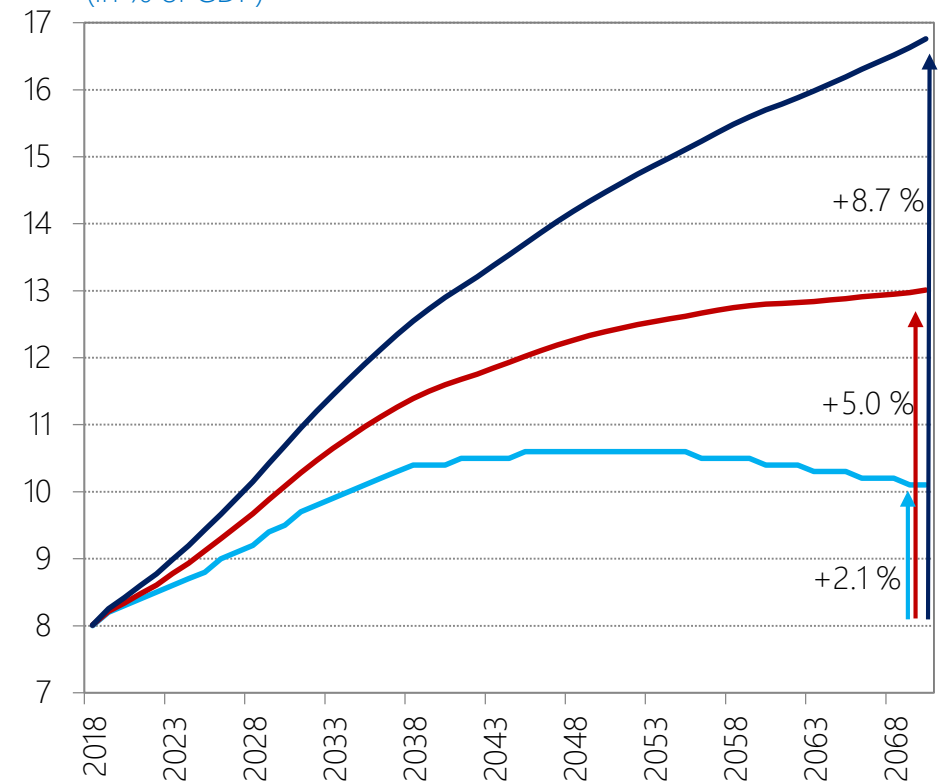
Real growth of health care expenditure according to the SCA projection

(in %)



Health care expenditure: alternative scenarios

(in % of GDP)



- SCA projection
- 0.5% additional real growth
- 1% additional real growth

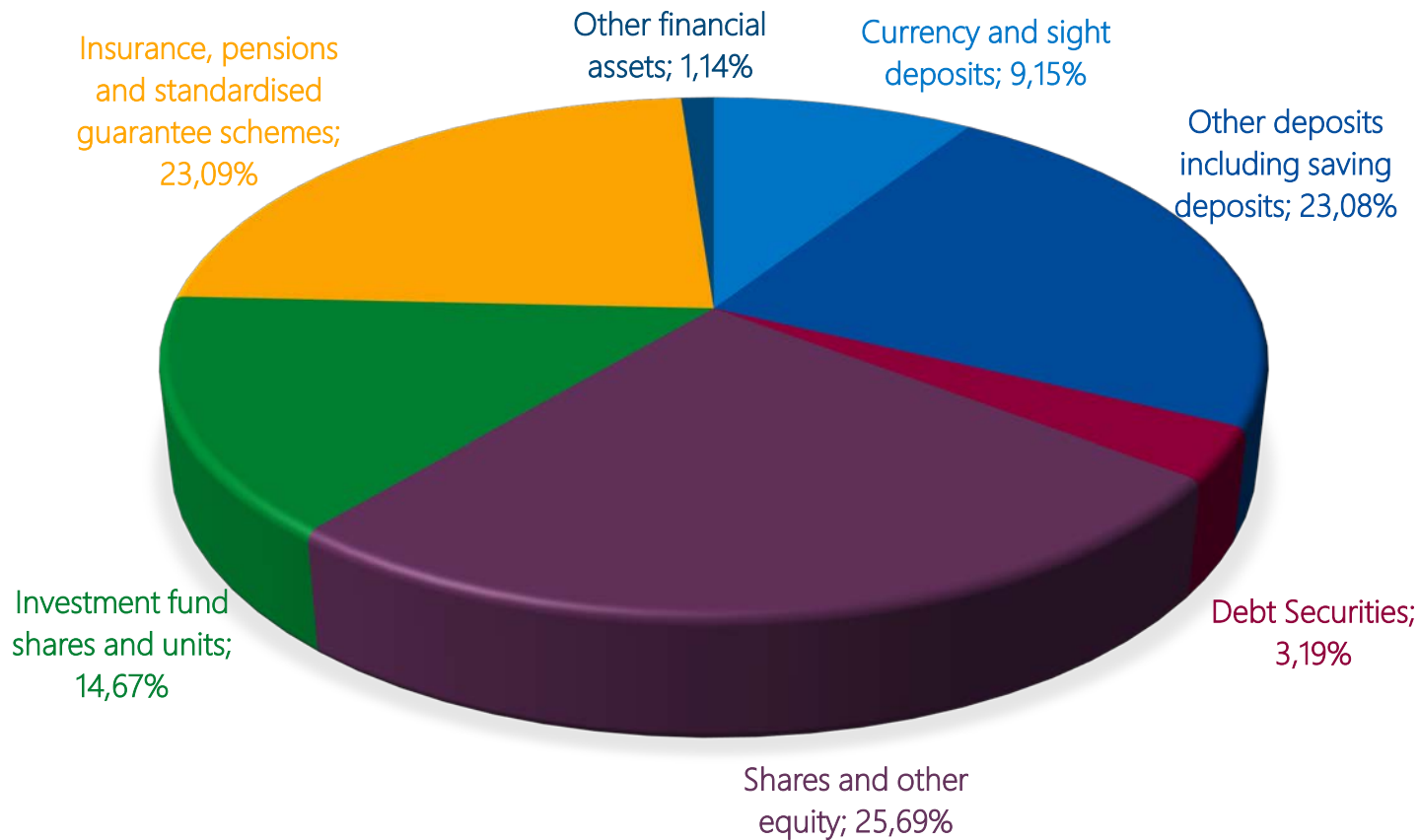
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Landscape of the financial sector in ageing environment

Households savings breakdown

FINANCIAL ASSETS BELGIAN INDIVIDUALS (2018)



A significant amount of the total financial assets of BE individuals (1,308 Bn €) is invested in insurance and pension products: 302 Bn€

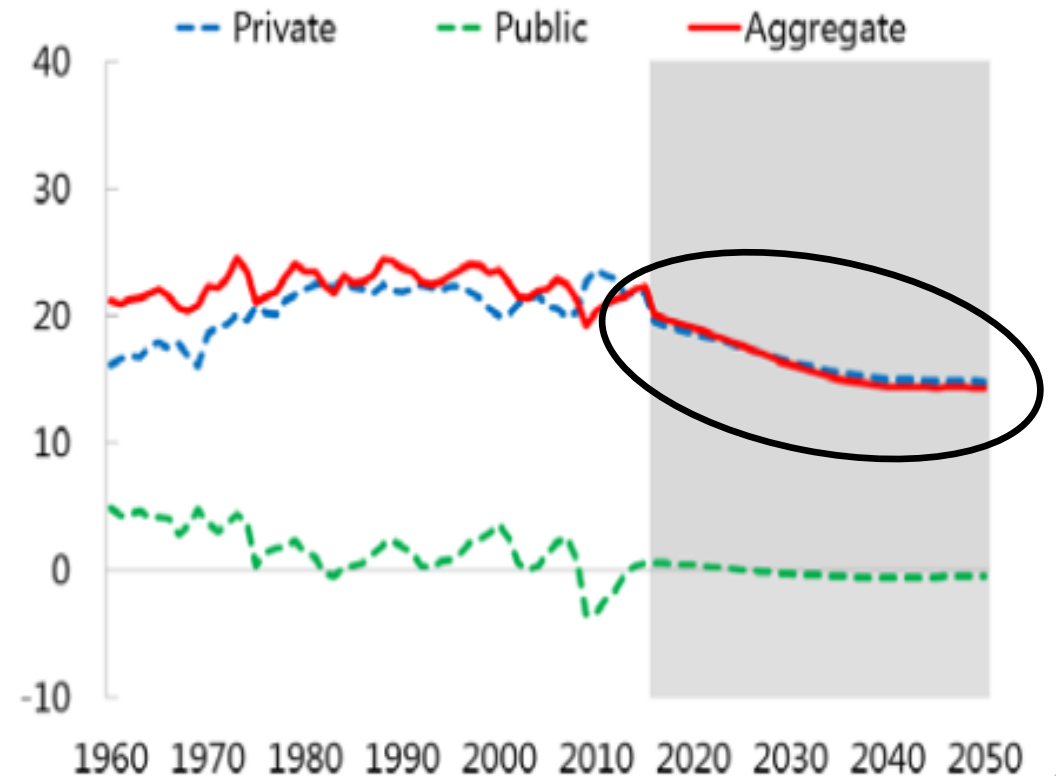
Landscape of the financial sector in ageing environment

The future of savings in a ageing world

Age-saving profile implied by life-cycle hypothesis (Modigliani)



Ageing and saving projections advanced economies



Landscape of the financial sector in ageing environment

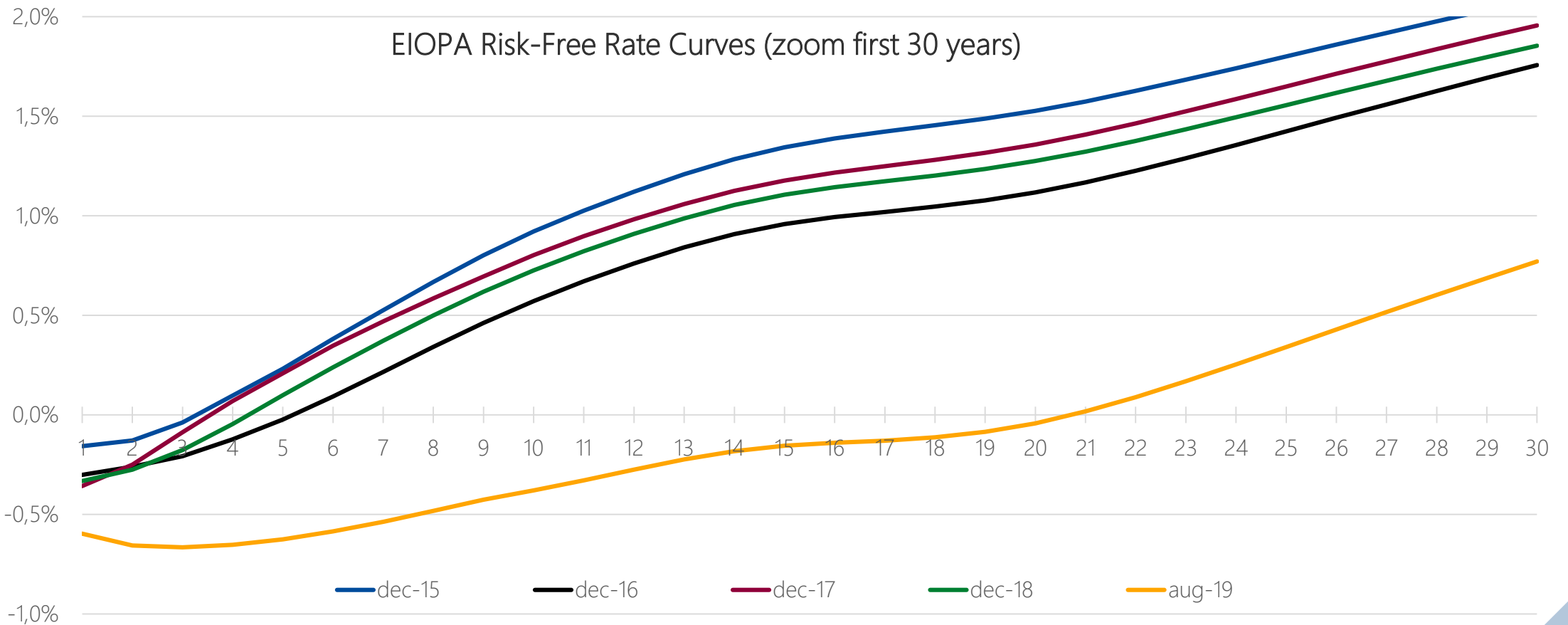
The role of insurers

- ◆ A priori, insurers (and pension funds) could play an **important role** in overcoming the challenges of an ageing society
 - ◇ Long term **saving products** help consumers to save for retirement
 - ◇ **Health and medical insurance** help policyholders to prepare for the increased cost of health services and to provide for a good quality care at an old(er) age
 - ◇ By seeking **long-term investments** to match their liabilities insurers could help to fulfil the long-term financing needs of the real economy
- ◆ The **negative rate environment**, together with other environmental and regulatory evolutions, creates huge challenges in the coming years

The challenges of Life insurers in ageing environment

Low yield environment

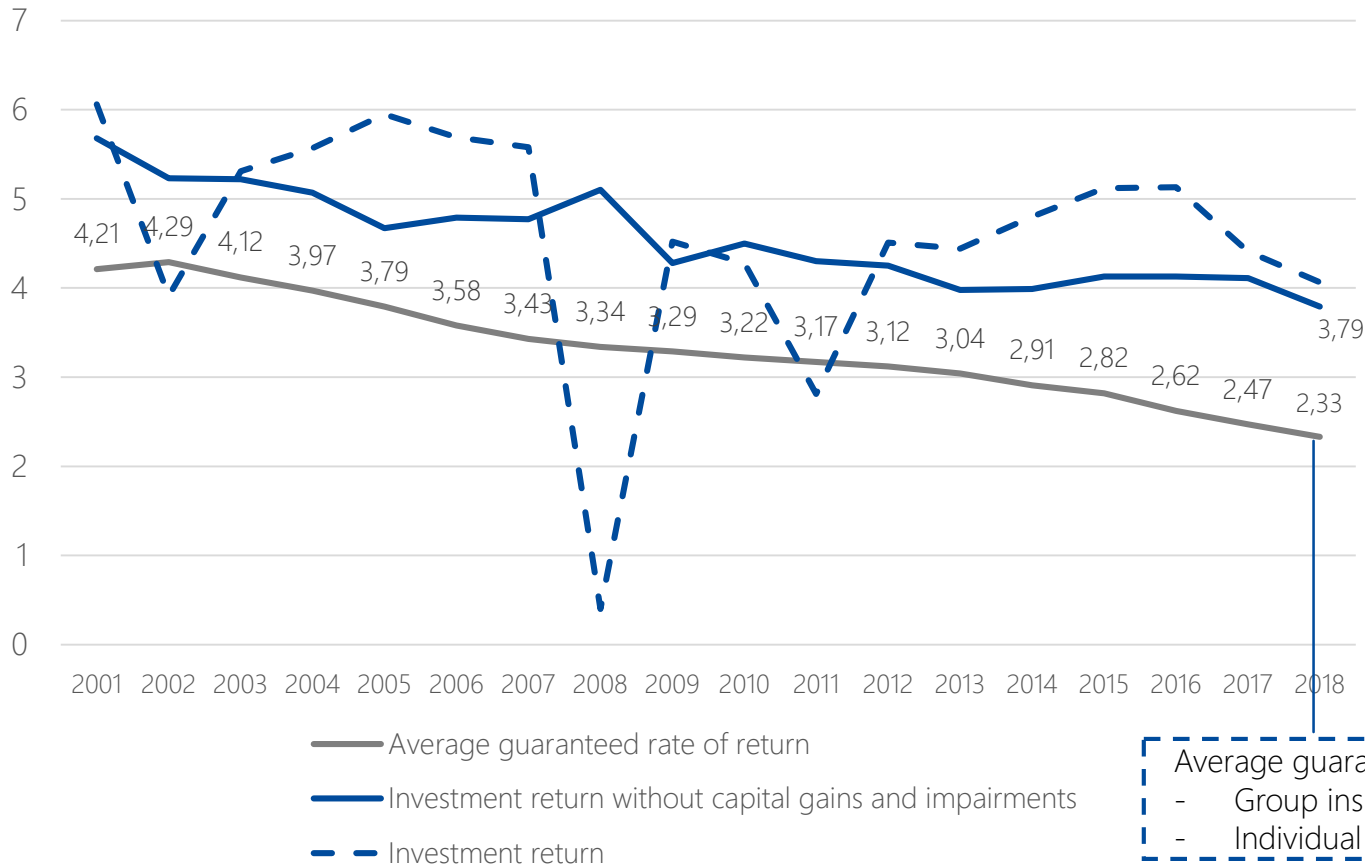
Low yields have turned into negative yields



The challenges of Life insurers in ageing environment

Low yield environment

Guaranteed and investment return on class 21 contracts



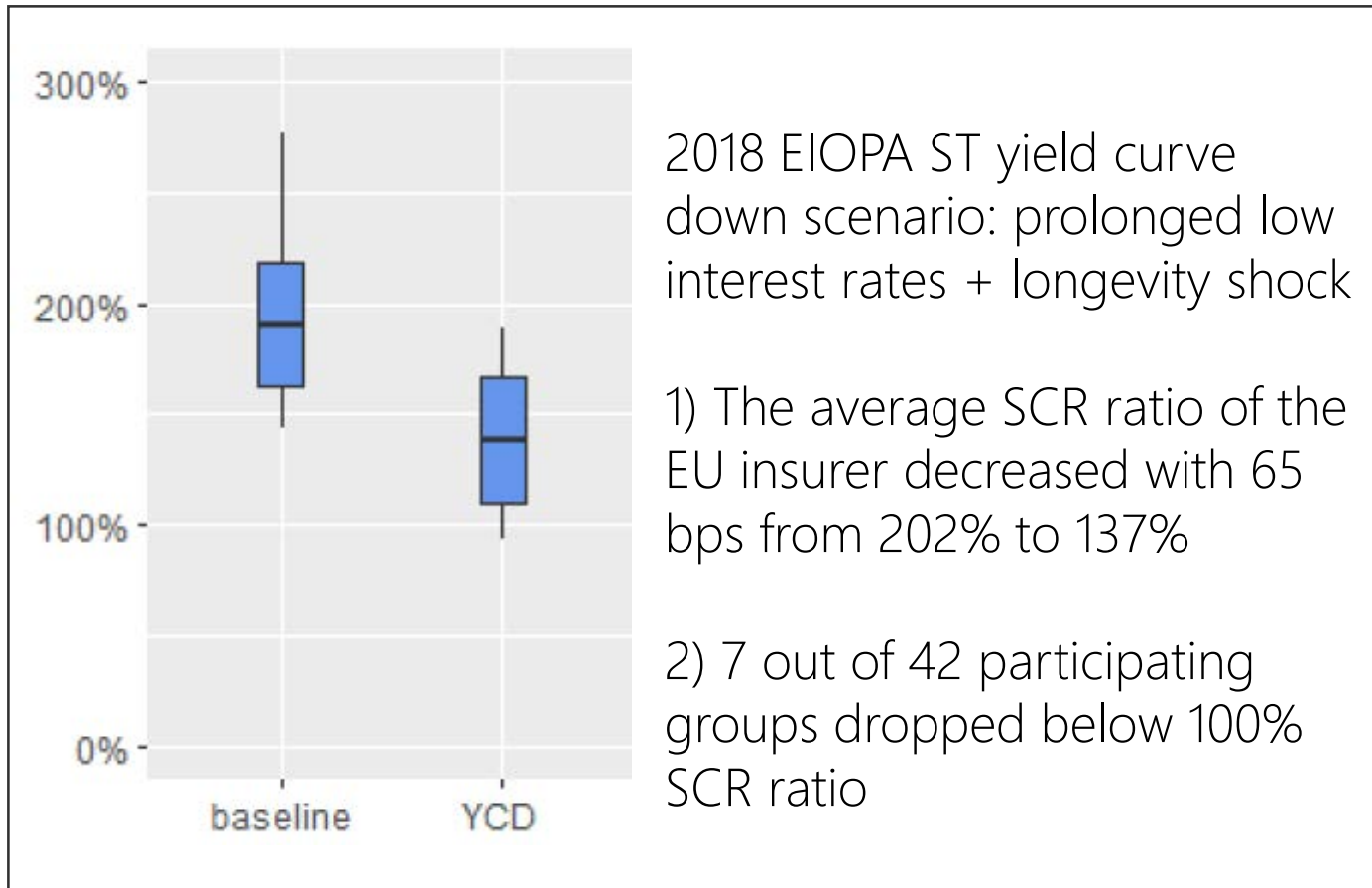
- The low yield environment puts **pressure on the earnings** of long term life and health insurance products
- Additionally, premium increases for long-term health insurance products are heavily regulated (“Loi Verwilghen”)

Average guaranteed rate:
 - Group insurance: 2.63
 - Individual insurance: 2.16

The challenges of Life insurers in ageing environment

Low yield environment

The low yield environment also puts **pressure on the solvency** of insurers

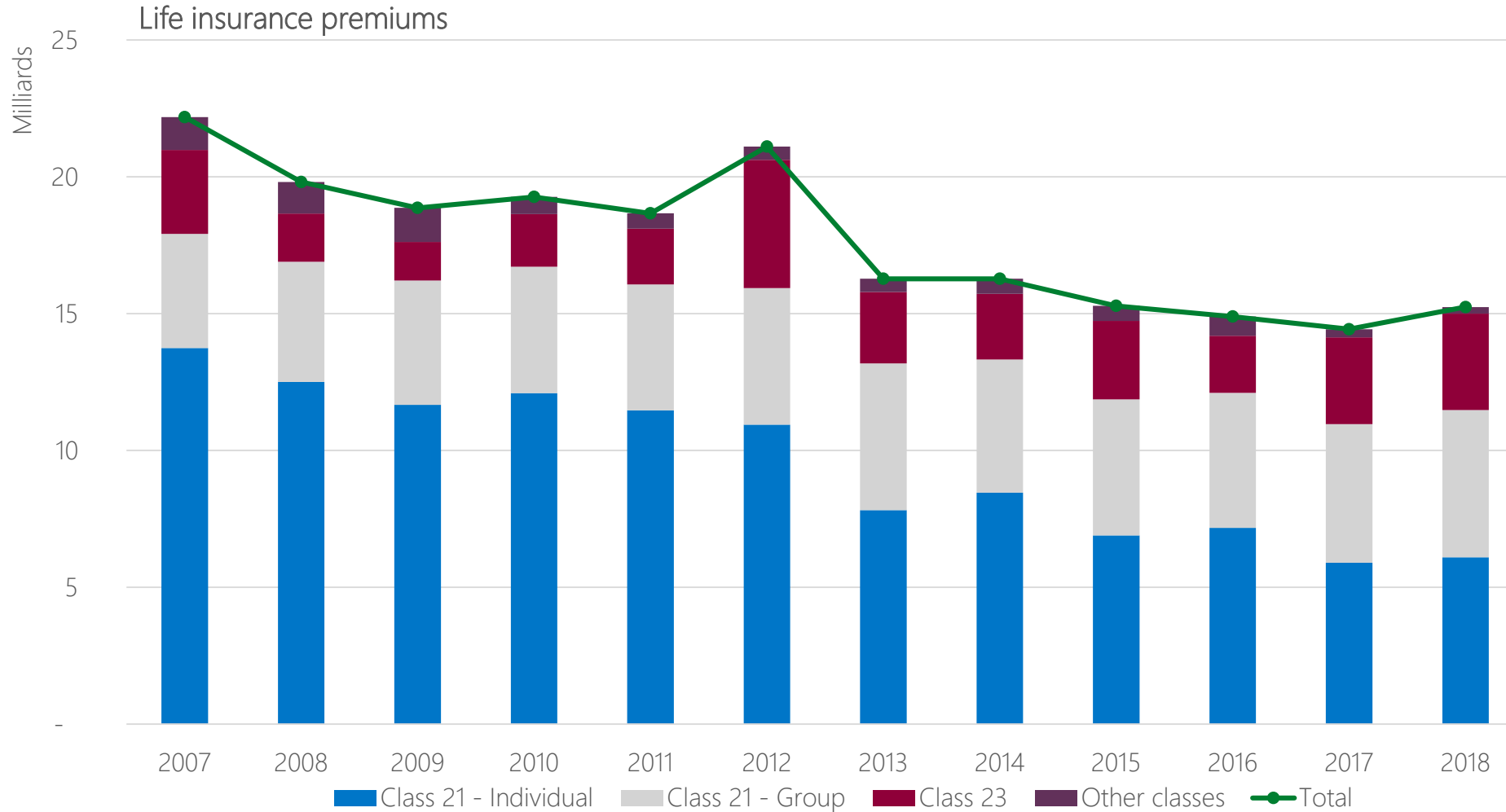


Reactions of insurers to low yield environment:

1. Lowering guaranteed rates → negative impact on retirement income policyholders?
2. Reallocation of assets → supervisors to monitor "Search for yield"-behaviour

The challenges of Life insurers in ageing environment

Struggling premium volumes



Life insurance premium volumes have not recovered to pre-crisis levels

The challenges of Life insurers in ageing environment

Risk-based regulatory framework

- ◆ Solvency II is a **risk-based regulatory framework** based on the principles of market valuation and risk-based capital requirements
 - ◇ **Strengths:** promote sound risk management, give proper risk incentives, trigger governance practices focusing on long-term viability, ...
 - ◇ **Challenges:** pure market value valuation and stringent risk-based capital requirements could induce *artificial balance sheet volatility* which may hamper the provision of long-term saving products and de-incentivise long-term investments
- ◆ To **balance** the framework, safeguard the provision of long-term saving products and avoid de-incentivising long-term investments, regulators have
 - ◇ Introduced measures to reduce volatility by impacting the risk-free discounting rate of technical provisions: Ultimate Forward Rate, Volatility Adjustment, Matching Adjustment
 - ◇ Softened capital requirements for targeted asset classes: infrastructure investments, long-term equity, strategic equity, unrated bonds, ...
- ◆ The **SII review** will continue refining the framework keeping in mind this balance

The challenges of Life insurers in ageing environment

Insurtech & Digitalisation

- ◆ Digitalisation may impact the insurance business throughout the **value chain**
 - ◇ Distribution channels, underwriting & pricing, claim & customer service processes, products
- ◆ Digitalisation creates many **opportunities** for insurers, but **risks** will need to be managed
 - ◇ Big data brings big responsibilities: confidentiality challenges (GDPR)
 - ◇ Anti-selection and reduced mutualisation: 'bad' policyholders risk to be priced out the market
 - ◇ War for talent: IT profiles highly sought after
 - ◇ Cyber security: More digital & analytics leads to higher cyber vulnerability
 - ◇ Model risk: errors made through AI and machine learning with potential reputational damage

Conclusions

- ◆ Population ageing is a vital challenge which needs to be tackled
- ◆ Answering this challenge requires a three-pronged strategy:
 - ◇ A fiscal strategy to obtain sustainable public finances
 - ◇ An active economic policy to boost potential GDP
 - ◇ Limit the increase in spending for pensions and health care
- ◆ Ageing challenge needs also to be part of the long-term strategy of financial institutions, in particular insurance companies and pension funds for which these long-term aspects are a vital part of their business model

◆ Thank you for your attention

◆ Questions?