Swiss Re Institute

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Economic Insights:
Global pensions system in crisis: how insurance can help

Key takeaways

- The size of global retirement savings gap will increase by 5% annually to USD 400 trillion by 2050.
- Defined-contribution pension plans now account for over 50% of global pension assets.
- Life insurers can develop customised pension risk transfer solutions for underfunded defined-benefit plans.
- The role of insurance in Pillar 3 can grow with tax incentives, product innovation, digital transformation and easier access to covers.

In a nutshell

The global pension gap is forecast to reach USD 400 trillion by 2050. Life insurers can help close the retirement funding gap by assuming risks facing Pillar 2 defined-benefit pension schemes, and by developing innovative Pillar 3 savings vehicles.

The shortfall in pension funding for the global retired population is forecast to grow by 5% annually, rising from USD 70 trillion in 2015 to USD 400 trillion by 2050.[1] According to *sigma* data, at this level the global pension gap will be 108% of gross domestic product (GDP) in 2050. The US, China and India will have the biggest shortfalls in funding (see Figure 1). We believe insurers can play a key role in narrowing the global pension gap by providing risk transfer solutions for underfunded private Pillar 2 schemes, and with annuity products to encourage more discretionary saving for retirement.

Global life expectancy has increased due to growing wealth and improved standards of living, and advances in healthcare.[2] However, with falling birth rates, populations are aging in many countries. The spectre of shrinking working-age populations and increasing automation of work processes is driving the forecasts for growing pension gaps. The protracted low interest rate environment since the global financial crisis has exacerbated the problem, with low savings rates in advanced economies. And, with latest market volatility, the amount of negative yielding sovereign debt has increased again and now amounts to USD 9.5 trillion globally, about the size of China's economy. In a long-term low(er) growth, low inflation environment, returns achieved on pension funds are mis-aligned with benefit payment projections and individual saving expectations. On the asset side, pension managers have increasingly been allocating funds to non-Treasury investments in search of high yields. They are also investing in corporate credits, foreign assets and private equities, but the risk-return profile of these can face significant downside risks in an environment of flight-to-quality, especially when pension fund management is subject to stringent regulatory and accounting rules. Another contributor to a widening of the global pension gap is lack of eligible and easy access to pension plans among informal/unorganized sectors, particularly in emerging markets.

Sponsors of pension plans can include government, employers and individuals. The World Economic Forum estimates that more that 75% of the global pension gap in 2015 derived from unfunded state-provided Pillar 1 pensions and pensions promised to public-sector employees.[3] In an aggregate lower-growth environment, a large public-sector retirement

About Economic Insights
Analysis of key economic developments and their implications for the global re/insurance industry.

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We welcome your feedback. For any comments or questions, please contact: institute@swissre.com

[1] *We'll Live to 100 – How Can We Afford It?*, World Economic Forum, May 2017.
[2] Note that the latest *sigma* says mortality improvement rates in many advanced market have slowed recently. See *sigma* 6/2018 for investigation of the reasons.
[3] World Economic Forum, May 2017, op. cit.

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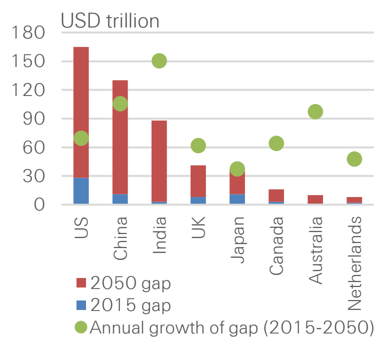
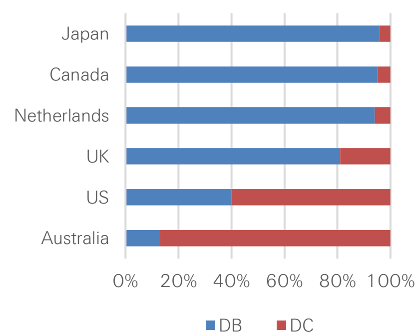
funding gap will remain a major concern as public finances remain under pressure. In a worst case scenario, there could be social unrest given intergenerational inequality as retirement financing requirements impose contingent liability on the already over-burdened younger population. To alleviate the future risk of fiscal imbalance due to pension benefit promises, governments and multinational institutions have advocated more active participation of the private sector in the provision of pension financing. Over the years, Pillar 2 schemes have seen a shift from defined benefit (DB) to defined contribution (DC) pensions, in which individuals take more responsibility for their retirement savings. DC plans now account for over 50% of global pension assets. Countries like Australia, US (see Figure 2) and Chile[4] have built prominent DC structures.

Figure 1 (LHS)
Size of global pension gap (USD trillion)

Figure 2 (RHS)
Defined benefit /contribution plans by country (2017)



Source: World Economic Forum



Source: Willis Towers Watson

We believe the pension gap is a major growth opportunity and also a means for insurers to further build resilience. With expertise in longevity and mortality risk management, life insurers can offer customised pension risk transfer solutions to underfunded DB plans to reduce the earnings volatility of the plans' corporate sponsors.[5] Insurers can also customise annuities to help individuals better manage the longevity risk inherent in Pillar 3 discretionary/ voluntary retirement savings. Lastly, to expand the scope of insurance cover, we encourage actions and innovations to further address the pension gap, including narrowing the gender/income inequality, improving levels of financial literacy, providing tax-incentivised private products and encouraging digital transformation.

[4] *Pension schemes in Latin America: addressing the challenges of longevity*, Swiss Re Institute, February 2018
[5] According to a report by Prudential "*the pension risk transfer market: innovation, globalization and growth* (2015)", more than USD 260 billion in corporate's pension liabilities have been transferred to insurers since 2007, and increasing longevity risk will lead to further adoption of de-risking in the UK, US and Canada markets.