

Unit-linked annuities

Increasing need for flexible retirement solutions

When it comes to financial retirement planning, it seems that you can choose either security or flexibility. On the one hand, lifetime annuities provide financial security during the pensioner's lifetime. On the other hand, once a lifetime annuity is purchased, the annuitant is locked into the insurer's investment decisions and return assumption. As the insurer guarantees the investment return, this is usually a rather conservative assumption, which in turn makes the annuity rate unattractive, especially in a low interest environment.

However, as seniors are increasingly prepared to take on investment risks, they choose products such as drawdown solutions that allow for a higher investment return but leave them at risk of financial instability very late in their lifetime. Consequently, lifetime annuity providers are at risk of losing market share, as their product does not meet the needs of their customers.

Product concept

The idea behind unit-linked annuities is simple yet efficient. Just as for standard lifetime annuities, a single premium is paid at retirement. Here however, the policyholder chooses where to invest the single premium, which is transferred into investment units. The policyholder has a guaranteed corresponding number of units paid out regularly for life – the unit-linked annuity. The value of the units fluctuates with the investment performance.

The policyholder thus assumes the investment up- and downside, as the actual pay-out is dependent on the unit value. Potentially a significantly higher investment return for the policyholder compared to standard lifetime annuities is possible. At the same time, the longevity risk stays with the insurer, as the number of units paid out regularly are guaranteed for life. Figure 1 shows two possible outcomes of the unit-linked annuity based on different simulations for the unit value.

Figure 1: Unit and actual income



Just like standard lifetime annuities, a variety of options can be offered in combination with unit-linked annuities, such as joint lives, escalations, guarantee periods, or death benefits.

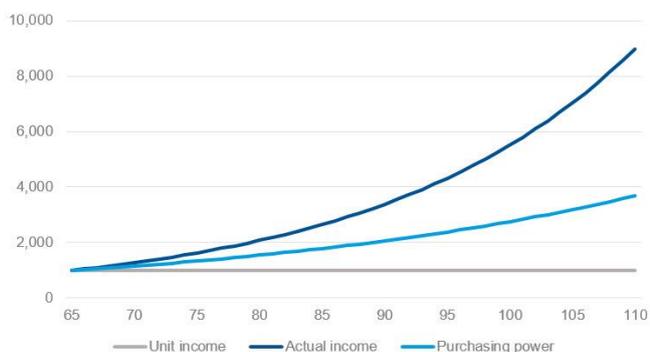
Furthermore, the investment component is customisable according to the policyholders' needs, for example by offering pre-defined investment profiles or guaranteeing a minimum unit value. Of course, such a guarantee would come at a price.

Spotlight on purchasing power

Usually, the regular income from an annuity should have a constant purchasing power over time and thus increase with inflation.

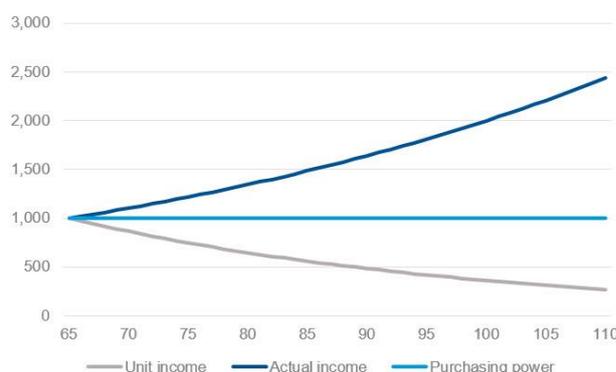
If a constant number of units is guaranteed by the insurer and the expected return of the chosen investment profile is higher than expected inflation, the actual annuity income is likely to be high in old ages, cf. figure 2. The actual expenses of the elderly often decrease the older they get.

Figure 2: Unit income, 2% inflation, 5% actual return



By decreasing the number of units paid out over time with a constant factor that matches the difference between the expected inflation and expected investment return, an expected annuity pay-out with constant purchasing power can be achieved, cf. figure 3.

Figure 3: Unit income decreasing by 3%, 2% inflation, 5% actual return



Benefits for providers

- Access to target groups that are looking for more attractive annuity rates and are willing to take on investment risk.
- Increased product range, and improved image as an innovative insurer with the ability to tailor-make retirement solutions.
- Clear distinction between investment and insurance products.

Joining forces with Hannover Re

Hannover Re's partners benefit from a cooperation in several ways:

- Biometrical risk sharing and cash flow stabilisation through a reinsurance treaty.
- Risk adequate setting of longevity assumptions continuously updated by our data analytics team.
- Support in product development, taking into account current behavioural economics research.

Regardless whether you are a first mover in your market or aiming to enhance your product offering in an already developed market: As worldwide leaders in longevity reinsurance, we at Hannover Re are the ideal partner for your annuity business. We look forward to teaming up with you to make your retirement solution offering a success story.