Causes of Insurance Companies' Longevity Risk and Its Management

Our life expectancy has increased by remarkable 28 years between 1960 and 2009, which is the largest gains among OECD countries. Even the life expectancy in Korea is still on the rise and it will enlarge a fiscal crunch of the public pension and burden for the next generations. Therefore, it is essential that the government and financial institutions induce people to prepare for their old ages with self support efforts and annuitize their retirement savings for hedge their longevity risk.

Individuals can hedge their longevity risk with annuitization that guarantees lifetime benefits, but even a very small change in life expectancies and the individuals’ adverse selection and moral hazards can create severe solvency issues for insurance companies. Therefore, it is important to have an elaborate system for managing the insurer’s longevity risk which is defined as payout levels that are higher than what a company originally accounts for.

Nevertheless, the longevity risk has been little studied in Korea and even it is little known what the longevities risk is, what creates the longevity risk for a insurance company, and why the management of the insurer’s longevity risk is important for managing individuals’ and the government’s longevity risk.

With this study, we hope that insurance companies realize not only the potential blue chip market of annuitization, but also how important managing their longevity risk is. We also hope people to realize that managing the longevity risk faced by insurance companies is essential for managing longevity risk faced by individuals and government.