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Comment on longevity bonds: Summary

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The discussion on longevity bonds has its roots in the difficulty to handle the risk that the longevity for an insured group (or the whole population) increases more than expected.

Lifelong fixed-value pensions protect the individual against an important life-cycle risk. However, those that make such a commitment run into difficulties if the average longevity increases beyond what is expected.

This is a problem public pension systems in many industrial countries face. In many cases these problems are made worse by the fact that the systems are unfunded.

Public pension systems have been reformed in some countries. Sweden has since 1999 a new system where pension rights are dependent on individual contributions, not as before on income. Moreover, the future pensions are dependent of how aggregate longevity develops. The state has thus shifted aggregate longevity risk to the individuals. The debate is ongoing in other countries and changes are to be expected, possibly in a similar direction, moving away from defined benefit schemes.

Private pension providers have funds, but cannot change agreements made. Can financial markets offer a solution, for example, by allowing longevity risks to be shifted to other sectors of the economy? The present discussion has come to deal with whether longevity bonds may be such a solution.

It is difficult, however, to see what bond issuers that would be tempted to issue longevity bonds. The eyes then turn to governments, which in many countries are big borrowers, but the objectives for most debt offices are to minimise cost while considering risk.

It is difficult to calculate the cost for borrowing through longevity bonds. However, one fundamental fact is that the government already carries other risks related to longevity, for example, related to costs for health care. From the perspective of the government borrower the motivation to issue such bonds therefore should be small.

Ultimately, this discussion is about the government's role as an insurer provider in general. It should be framed in the same way that we discuss why we have public pension systems, public health care etc? In that context, it should be noted that insurance against longevity risk does not need to be combined with a bond, that is, this is not primarily a matter of government debt policy.

If you mix debt policy with social policy the result will be unclear objectives and means. As government borrowers we should try to avoid such a development.