Toulouse School of Economics

'The Future of Savings' Conference

Business models and regulatory changes in the new environment

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Real returns during the XXth century

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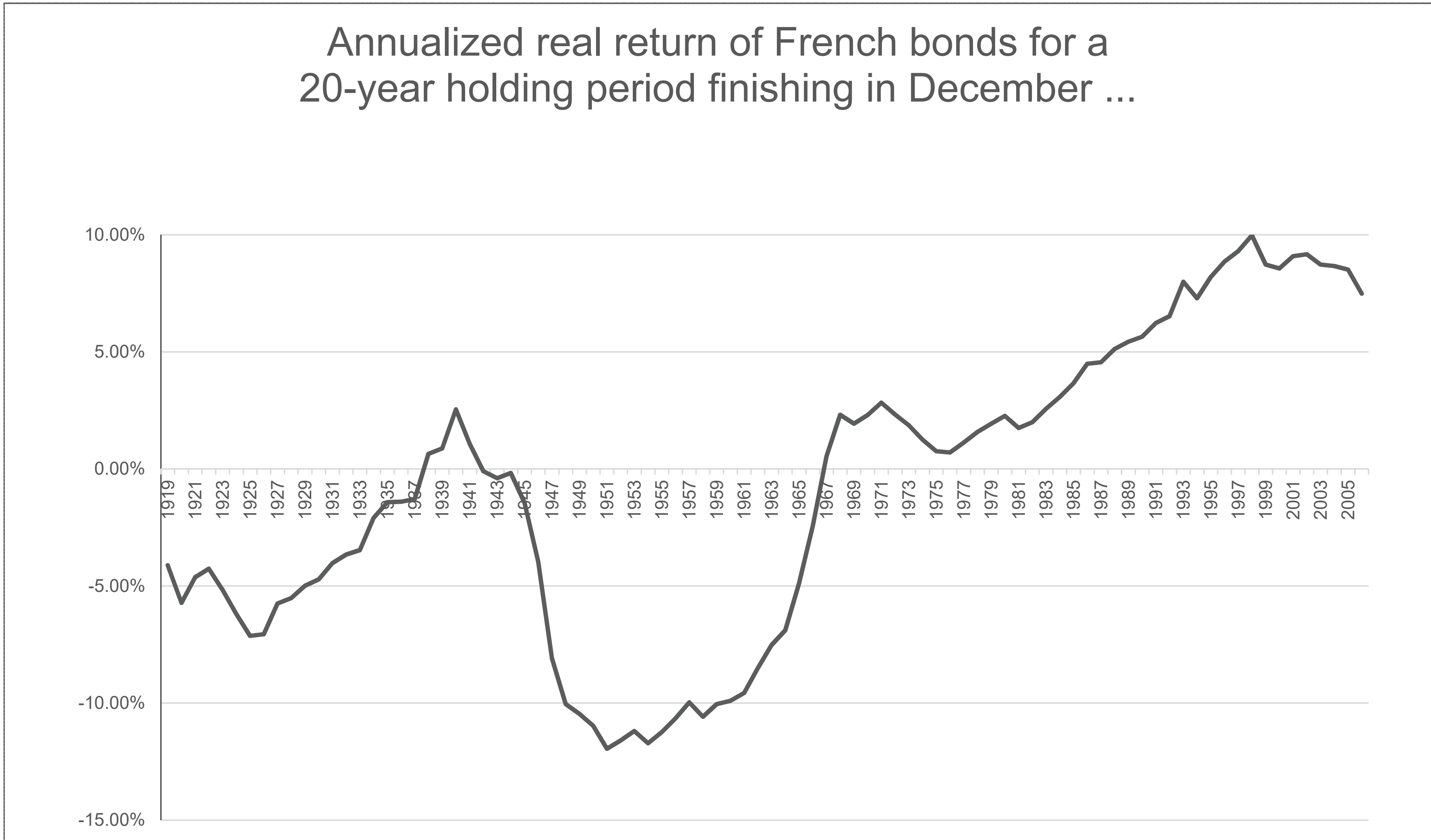
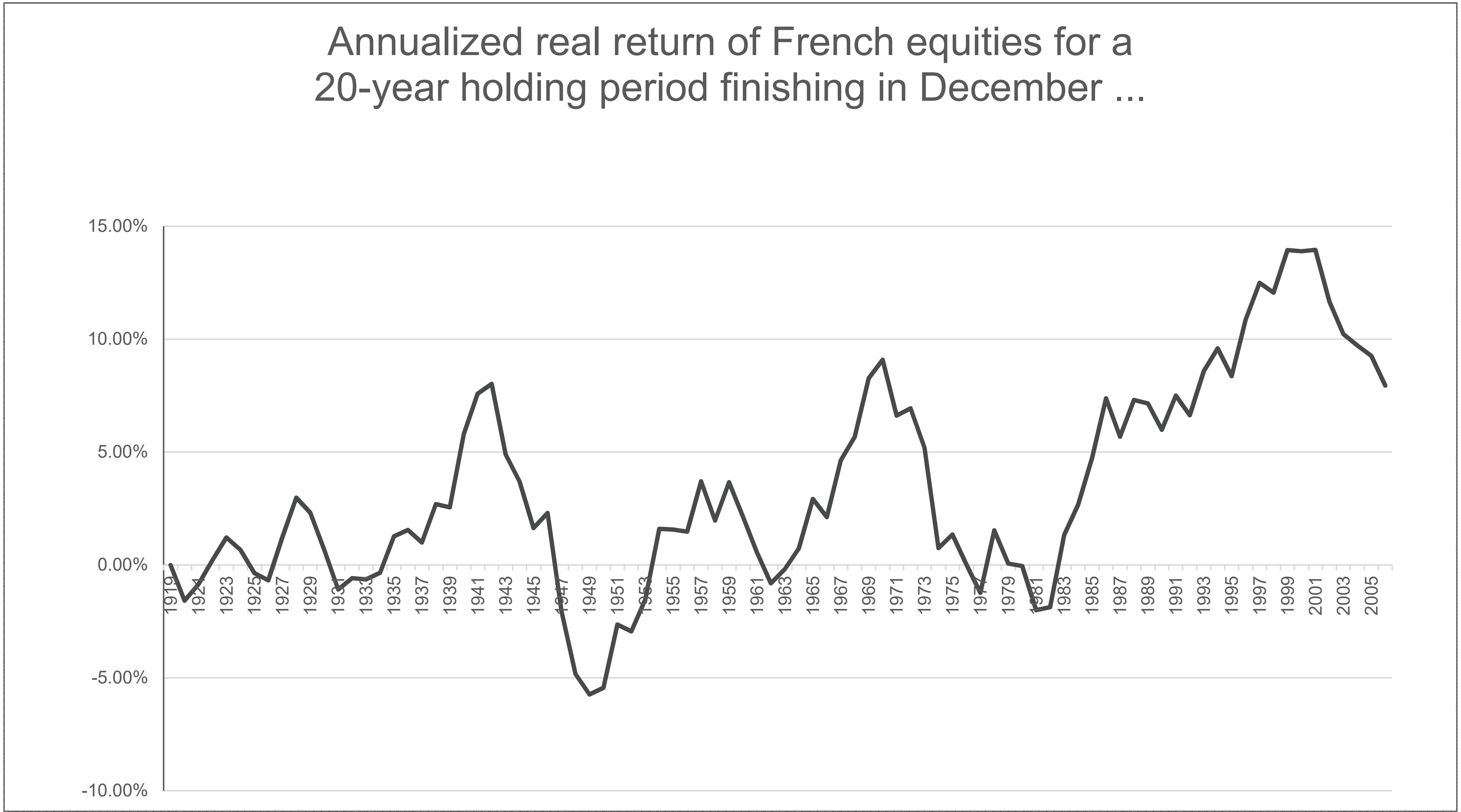
	Monétaire		Obligations 10 ans		Actions	
	1900-2006	1971-2006	1900-2006	1971-2006	1900-2006	1971-2006
Australie	0,6%	2,5%	1,3%	2,8%	7,8%	6,3%
Canada	1,6%	2,7%	2,0%	4,5%	6,3%	5,8%
Danemark	2,3%	3,5%	3,0%	7,0%	5,4%	9,0%
France	-2,9%	1,2%	-0,3%	6,6%	3,7%	7,8%
Italie	-3,8%	-0,3%	-1,8%	2,8%	2,6%	3,0%
Japon	-2,0%	0,4%	-1,3%	3,9%	4,5%	5,0%
Pays-Bas	0,7%	1,8%	1,3%	3,9%	5,4%	8,5%
Royaume-Uni	1,0%	1,9%	1,3%	3,9%	5,6%	7,1%
Suède	1,9%	2,4%	2,4%	4,2%	7,9%	11,0%
Suisse	0,8%	0,4%	2,1%	2,8%	5,3%	6,1%
USA	1,0%	1,3%	1,9%	4,0%	6,6%	6,6%

Destiny of French bondholders in the XXth century



Destiny of French stockholders in the XXth century



Summary

- Financial reserves of French life-insurers: 1 500 billion euros.
- Most households with life insurance have a long-term objective. But insurers have invested their savings mostly in short-lived, safe and liquid assets.
- This is inefficient, both for savers and for the economy.
- This market failure originates from an inefficient product design (initially constructed under a very inefficient solvency regulation), and from an inappropriate incentive mechanism for long-term saving.

The golden age of assurance-vie in France

- Characteristics of the « euro contract »:
  - partial intergenerational mutualization;
  - a minimum guaranteed return (now 0%);
  - maximum liquidity;
  - tax incentive for contracts older than 8 years.
- In a context of diminishing returns, insurers have served the large return of the past investments to new customers. ☺
- In the future, insurers will serve the low return of the current investment to new customers. ☹ There will be the real test…

The golden age of life insurance in France

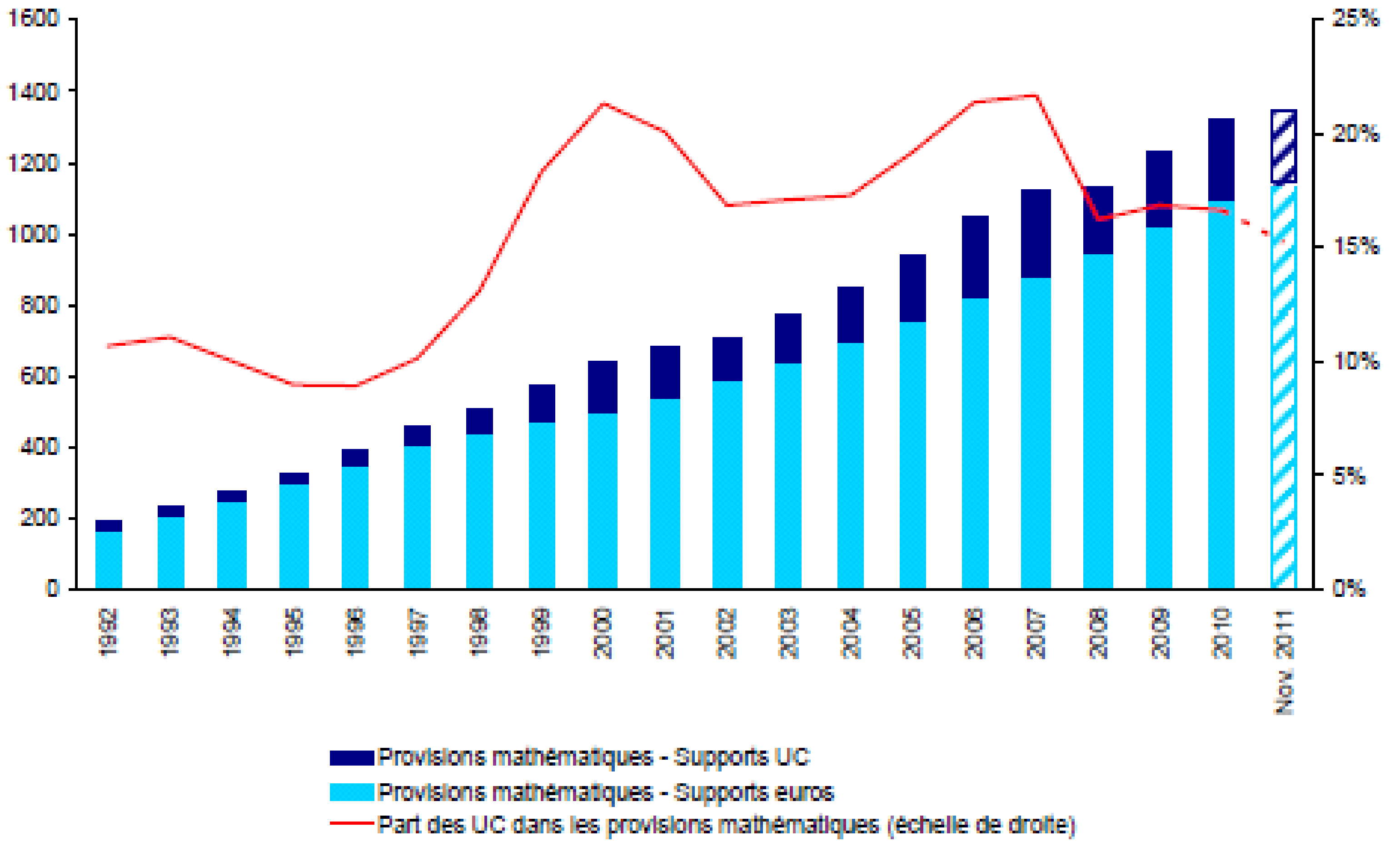
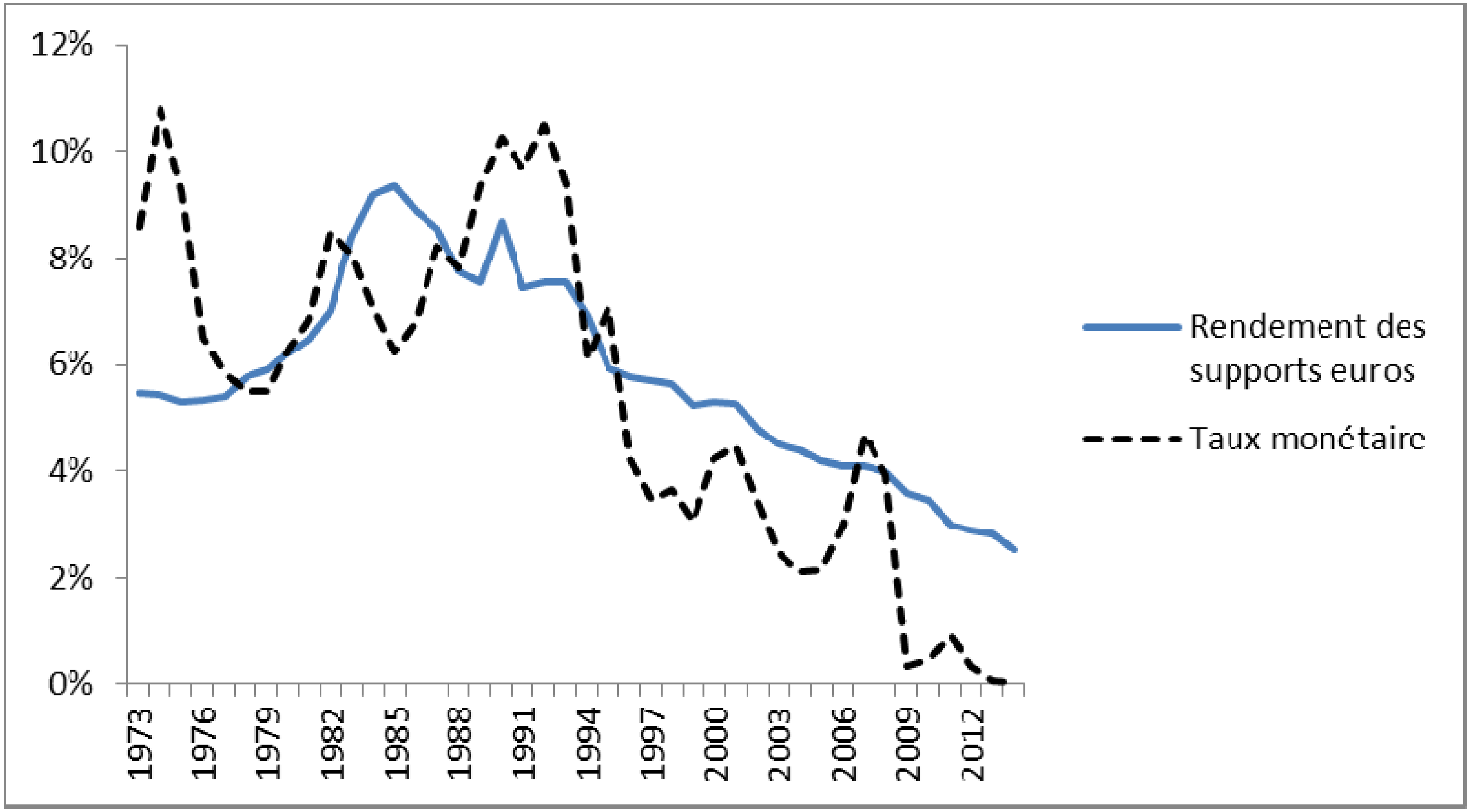


Figure 1: Evolution of reserve. Source: Cours des Comptes (2012)

Interest rate and the return of assurance-vie in France



Source : FFSA.

Intergenerational risk-sharing (IRS)

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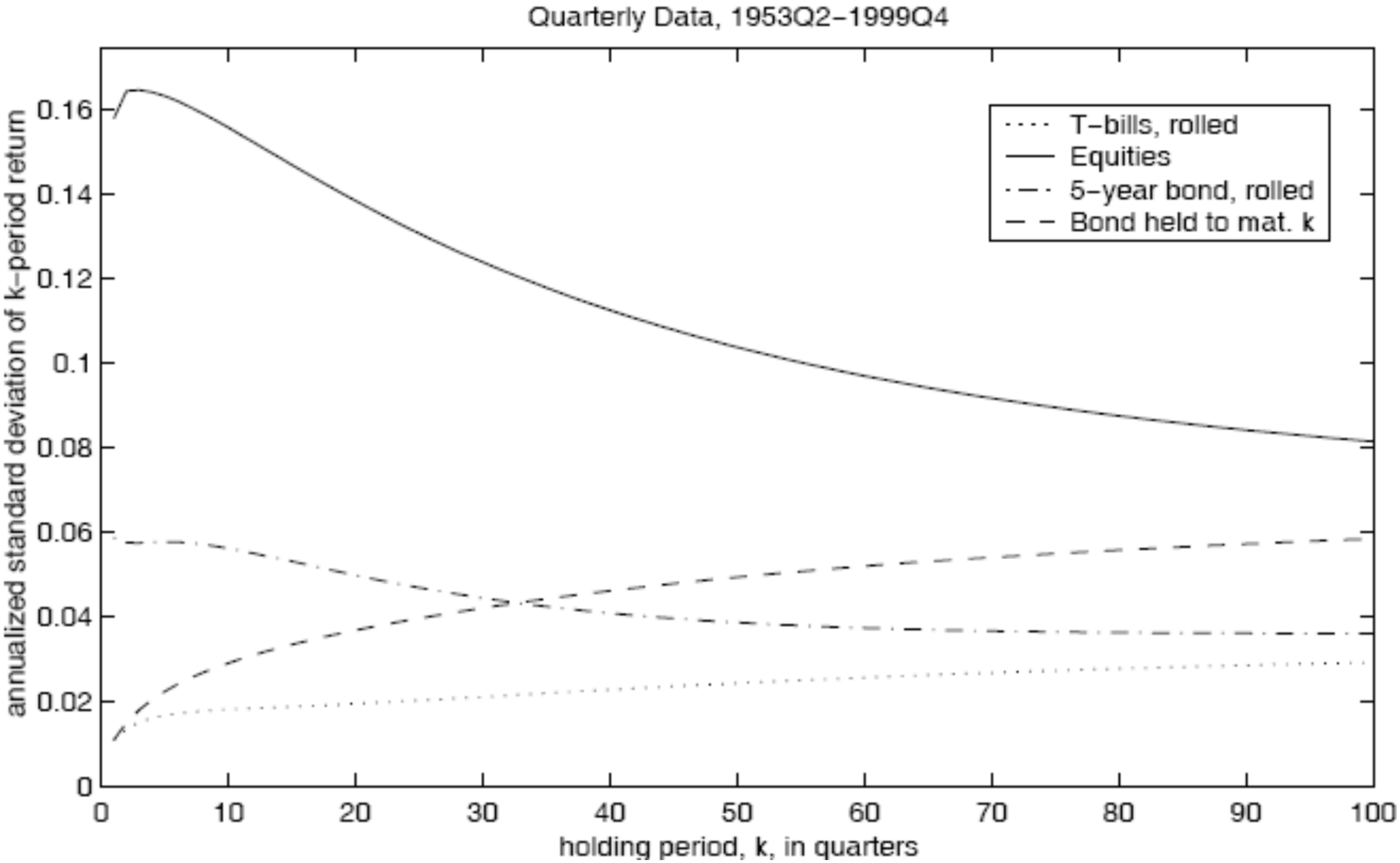
- Heterogeneous destiny of generations of savers.
- Market failure: Markets cannot organize risk sharing with future generations of savers (Diamond (1972)).
- By mutualizing financial shocks across generations, life insurers and pension funds could partially cure the failure. But this requires a public intervention to reduce savers’ opportunistic behavior: tax advantage.
- Gollier (2008): Potential benefit of intergenerational risk-sharing equivalent to raising the annual return of saving by 1%.
- The current assurance-vie system is a second-best:
  - The incentive is too small and the contract is too liquid, thereby forcing insurers to limit IRS.

Time horizon and optimal portfolio risk

- Long-term savers are in a better position to smooth short-term financial shocks on their wealth by small changes in consumption over a long period.
- There is some mean-reversion in equity returns. Equity is relatively less risky for longer holding periods.
- These two effects makes long-term savers less risk-averse. It is socially desirable that they bear a larger fraction of the macro risk.
- Intergenerational risk-sharing organized by life insurers and pension funds should induce them to take more risk.
- On the contrary, French life insurers are now massively invested in bonds (mean maturity around 6 years).

USA: Campbell-Viceira (2002)



Liquidity of assurance-vie

- Although most households with an assurance-vie contract are long-termists, the euro contract is very liquid.
- Therefore, estimating the maturity of life insurers' liability is France is a complex matter.
  - They potentially face an insurance run in case of an abrupt increase in interest rates.
- Moreover, there is a ratchet effect coming from the rule that returns are offered on an annual basis rather than at the termination date.
- The extreme liquidity, the guaranteed return and the ratchet effect forced French insurers to invest in safe, liquid assets, in particular when the interest rate converge toward the guaranteed return.
  - It's not SII fault! It's the fault of the characteristics of the euro product;
  - The inability of SII to produce an "intergenerational risk analysis" framework is a second-order problem.

To whom should we offer portfolio insurance?

- We cannot have the cake and eat it. Combining the ratchetted guarantee, the large return and the liquidity is impossible.
  - When one guarantees a 0% return and interest rate=0%, one should take zero risk…

- Someone must bear the macroeconomic risk. We cannot provide portfolio insurance to 100% of the population.
  - It makes little sense to offer it to the wealthiest fraction of the population.

- SII will force French insurers to reconsider this triplets of characteristics. The premium associated to the guarantee (portfolio insurance) will have to be better/actuarially priced.
  - At equilibrium, only a minority fringe of the population should purchase the insurance (Leland (1980));
  - As long as this problem is not fixed, it will not be possible to create a market for more efficient contracts (« eurocroissance »?).

Recommendations

- A market for long-term saving remains to be created in France.
- A revised SII regulation that better recognizes the creation of value of life insurers as providers of intergenerational risk-sharing should be proposed.
- This regulation should induce insurers to price their contractual guarantees in an actuarially fair way. This will reduce the attractiveness of the euro contract.
    - As long as this is not done, other initiatives are doomed to fail.
- The market will then be in a better position to create efficient LT saving products, conditional with a stronger fiscal incentive to fight savers' opportunistic behavior.
- Assurance-vie is a mass/vanilla product with a limited value creation from advising customers. Management costs/fees should be more compressed.