18 October 2013

Deutsche Bank AG
Winchester House
1 Great Winchester Street
London EC2N 2DB
Tel: +44 20 7545 8000
Direct Tel +44 20 7545 1903
Direct Fax +44 20 7547 4179

THE JOINT FORUM
BASEL COMMITTEE ON BANKING SUPERVISION
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS
INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS
C/O Bank for International Settlements
CH-4002 BASEL, SWITZERLAND

Deutsche Bank comments on Joint Forum Paper on “Longevity risk transfer markets: market structure, growth drivers and impediments, and potential”

Dear Sir or Madam,

Deutsche Bank welcomes the opportunity to provide comments on the above consultation.

Overall we support the conclusions and recommendations set out by the Joint Forum in its paper. Clearly, rising life expectancy is positive for society but the challenges associated with longevity risk increase as a result. While longevity risk transfer (LRT) markets may raise systemic risk concerns in the future given their potentially large size, they may also make an important contribution to managing the longevity risks faced by corporates and the public sector. Devising a regulatory regime that is balanced across sectors and is internationally consistent is therefore important.

The paper places a significant emphasis on systemic risk arising from banks accumulating longevity risk. We note that banks are mostly intermediaries of longevity risk and tend rarely to keep it on their balance sheets. They hedge themselves against longevity risk, in many cases because of the associated capital charges for holding unhedged risk. Banks must hold Basel III capital against derivatives transactions in general, and longevity swaps would fall under this definition. Hedging transactions by banks, which transfer longevity risk to third parties, are almost always collateralised to reduce counterparty risk, and furthermore, are well diversified to institutional investors and reinsurers. As is the case with banks, it is important that the end holders of longevity risks are adequately capitalised.

We do not agree with the paper’s argument that there is an important difference regarding counterparty risk between insurance and swap transactions. This is based on the assumption that the risk ceding party in longevity insurance is exposed to an insurance company only, whereas for swaps, the risk may be distributed more broadly, yet may return to the swap intermediary (such as an investment bank) in case of a tail event. However, as mentioned above, counterparty risk can be reduced by collateral. Further, insurance companies offering longevity insurance will very often distribute risk to a number of counterparties via reinsurance agreements or swaps. Any systematic risk arising from the accumulation of longevity risk within the reinsurance market is therefore of equal if not more significance compared to the banking system. Ensuring consistency across sectors is important especially as the development of transfer mechanisms into
capital markets by banks could also reduce potential capacity constraints among reinsurers.

In terms of scope going forward, we would suggest that index swaps should be considered amongst the types of transactions that are used today to transfer longevity risk. They are certainly the lesser used instrument for longevity risk but nevertheless represent an important part of the evolving toolkit.

We support further examination of the regulatory treatment of longevity risk. As mentioned in the Joint Forum paper, Deutsche Bank is active in the LRT market and has invested significant resources to establish an infrastructure for booking, monitoring and managing longevity risk. We would therefore be happy to share our thoughts on the matter and discuss enhancing the regulatory regime if that would be helpful.

Yours sincerely,

Andrew Procter
Global Head of Compliance, Government and Regulatory Affairs