Current Issues in the German Life Insurance Industry

Hong Kong, March 23, 2005

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Outline

- Market Overview
- Opportunities
- Threats
- Conclusion
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History

- Tariff market until 1994
  - Conservative pricing parameters
  - Conservative investment policy
  - Extensive profit-participation
- Actuarial profession had to be built-up
  - Foundation of DAV
  - Predecessor DGVM
  - Formal actuarial training established
Number of Contracts in Force in Thousands

Sum Assured in 2004: 2,305.9 Bill. €
Structure of the Number of Contracts in Force in 2003

- **Endowment**: 15,010
- **Annuity**: 2,525
- **Unit Linked Endowment**: 4,509
- **Unit Linked Annuity**: 1,6249
- **Life Protection**: 282
- **Others**: 52,959

Legend:
- Endowment
- Annuity
- Unit Linked Endowment
- Unit Linked Annuity
- Life Protection
- Others
Gross Premiums Written in EUR Million

+ 1.2 %


50.500 52.505 58.749 61.225 62.387 65.018 67.655 68.402
New Business
Premiums in EURO Thousands

Growth-rates 2004:
- Total: +12.4%
- regular premium: +41.2%
- single premium: -12.7%

Average annual development of premiums 1992 – 2002 (inflation-adjusted): 4.7%
New Business by Type of Insurance

number of contracts in %

- Other life insurance: 29%
- Annuity insurance: 23%
- Endowment insurance: 28%
- Unit-linked life insurance: 21%
Capital Market Crisis

Recovery of the stock market

Low interest environment

DAX

yield on federal bonds over 10 years
Situation in the Capital Market

- period of economic sluggishness during the last 3 years:
  
  equity exposure in 2000 : approx. 18 %
  equity exposure in the 3rd quarter of 2004 : approx. 8 %
  considerable amount thereof hedged

  
  shares as long-term fixed assets
  avoiding write-off

- little difference between capital market interest rate and guaranteed interest
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Declining Birth-Rates...

Number of births per 1000 inhabitants

Average EU: 10.6

- Ireland: 15.5
- France: 12.7
- Netherlands: 12.6
- Danemark: 12.0
- United Kingdom: 11.6
- Luxemburg: 11.5
- Sweden: 11.0
- Finnland: 10.8
- Portugal: 10.8
- Belgium: 10.7
- Spain: 10.7
- Austria: 9.5
- Italy: 9.4
- Greece: 9.3
- Germany: 8.6

Source: Eurostat
... and Increasing Life Expectancy

![Graph showing life expectancy trends in men and women for Germany (West), Japan, US, France, Italy, and Switzerland from 1960 to 2000.](image)
Decreasing Working Population has to Support More and More Retirees

2005

2050?
Net statutory pension will decrease from about 53% of the average income in 2005 to about 43% in 2040.

Source: Prof. Raffelhüschen, University of Freiburg
Income structure of 2-persons-pensioners’ household

Source: Miegel/Börsch-Supan (1999)
### Share of Insurance & Pensions in PFA*

<table>
<thead>
<tr>
<th></th>
<th>United Kingdom</th>
<th>United States</th>
<th>Germany</th>
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<tbody>
<tr>
<td><strong>PFA</strong></td>
<td>4,828 Bill. €</td>
<td>26,533 Bill. $</td>
<td>3,059 Bill. €</td>
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<tr>
<td><strong>Insurance &amp; Pensions</strong></td>
<td>64% 3,078 Bill. €</td>
<td>32% 8,535 Bill. $</td>
<td>23% 718 Bill. €</td>
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* Personal Financial Assets in Bill. € / $, 2002
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  - New Retirement Savings Law
  - Solvency II
  - Changes in Law on Insurance Policies
  - Changes in Insurance Supervision Law

- Conclusion
New Retirement Savings Law
German Pension System: 3 Pillars

* private life-insurance with fiscal incentives and financial government aid
** private life-insurance with fiscal incentives
New Retirement Savings Law

New taxation system of life insurance products and pensions follows a “3-layer-model”:

**Investment products**
- Premiums from taxed income, taxation of benefits
  - Endowment insurance
  - Annuity insurance if lump-sum is paid out
  - Reduced taxation of annuities

**Funded additional provision**
- Full downstream taxation
  - Riester products
  - Corporate pensions schemes

**Basic provision**
- Transition to downstream taxation
  - State pensions
  - New funded annuity product ("Rürup annuities")
Solvency II

- Risk-orientated approach which encourages and gives incentives to insurance undertakings to measure and manage their risks individually
- Increase harmonisation as well as come up to a consistency across the financial sectors and, in principle, supervise products containing similar risks in the same way leading to the same solvency requirements
- Facilitate efficient supervision of insurance groups and financial conglomerates and avoid regulatory arbitrage
Solvency II: Three-Pillar Approach

**Pillar I**
- Minimum capital requirements
- Target capital
- Minimum solvency margin
- Internal risk models

**Pillar II**
- Standards for prudential supervision
- Risk Management
- Internal controls
- Stress tests

**Pillar III**
- Public disclosure
- Market Discipline
- Transparency

IFRS/HGB
Solvency II: Individual Model vs. Standard Model

**CEIOPS**
(Committee of European Insurance and Occupational Pensions Supervisors)

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### Specification

**Individual Model**
Can only be certified/accredited if consistent with the company’s risk-management-system

**Standard Model**
Designed to encourage development and use of individual models

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### Consequence

**Individual Model**
More realistic estimation of needed risk capital by taking management decisions into account

**Standard Model**
Cautious assumptions tend to overestimate need of risk capital
Solvency II: Road Map

- **Phase 1**
  - **2001**: Initiation of Solvency II by EU-Commission, Start of Phase 1: Analysis
  - **09/2003**: Formal end of phase 1: Treatment of contents
  - **02/2004**: Foundation of CEIOPS
  - **since 01/2004**: Application of Solvency I

- **Phase 2**
  - **End 2005**: European guide-line draft
  - **until 2007**: Transcription of Basel II to national law
  - **until 2008**: Transcription of Solvency II to national law
  - **from 2009 on?**: Application of IFRS
Changes in Insurance Contract Law as of 2008

Most critical proposal:
- Guaranteed minimum surrender values
- Limited surrender penalties

Consequences:
- Decreasing performance of insurance products
- ALM is getting more important
Changes in Insurance Supervision Law

- Extension of the share of liabilities to be covered by approved assets
  - As from 1.1.2004
    - policyholder’s cash deposits
    - vested current boni
    - vested terminal boni
  - As from 1.1.2008
    - Total terminal bonus reserve
    - Non-vested bonus reserve
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