



Guarantees in Germany: Where are we and does it make sense?

Alexander Finke, ERGO Group AG

Johannes Lörper, DAV



About the speaker

- **Johannes Lörper**
 - *Member of supervisory board VPV*
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- Date of birth: 16.09.1953
 - Member of DGVFM since 1986
 - Member of DAV since 1994
 - Board member DAV 2004-2019
 - Incoming president DAV 2009-2011
 - President DAV 2011-2013
 - Various positions at Cologne Re 1981-2001
 - Board member of various insurance companies of ERGO 2002-2016



About the speaker

- **Alexander Finke**
 - *Head of Risk Management ERGO Leben Klassik*
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- Date of birth: 06.12.1970
- Member of DAV since 2003
- In different roles ERGO Group AG since 1999
 - Actuarial department 1999-2007
 - Strategic asset allocation 2009-2014
 - Risk management since 2015
- ERGO Group AG

Agenda



- **Where are we and why are we here?**
- What does this mean for companies and clients?
- What can we do in the future?

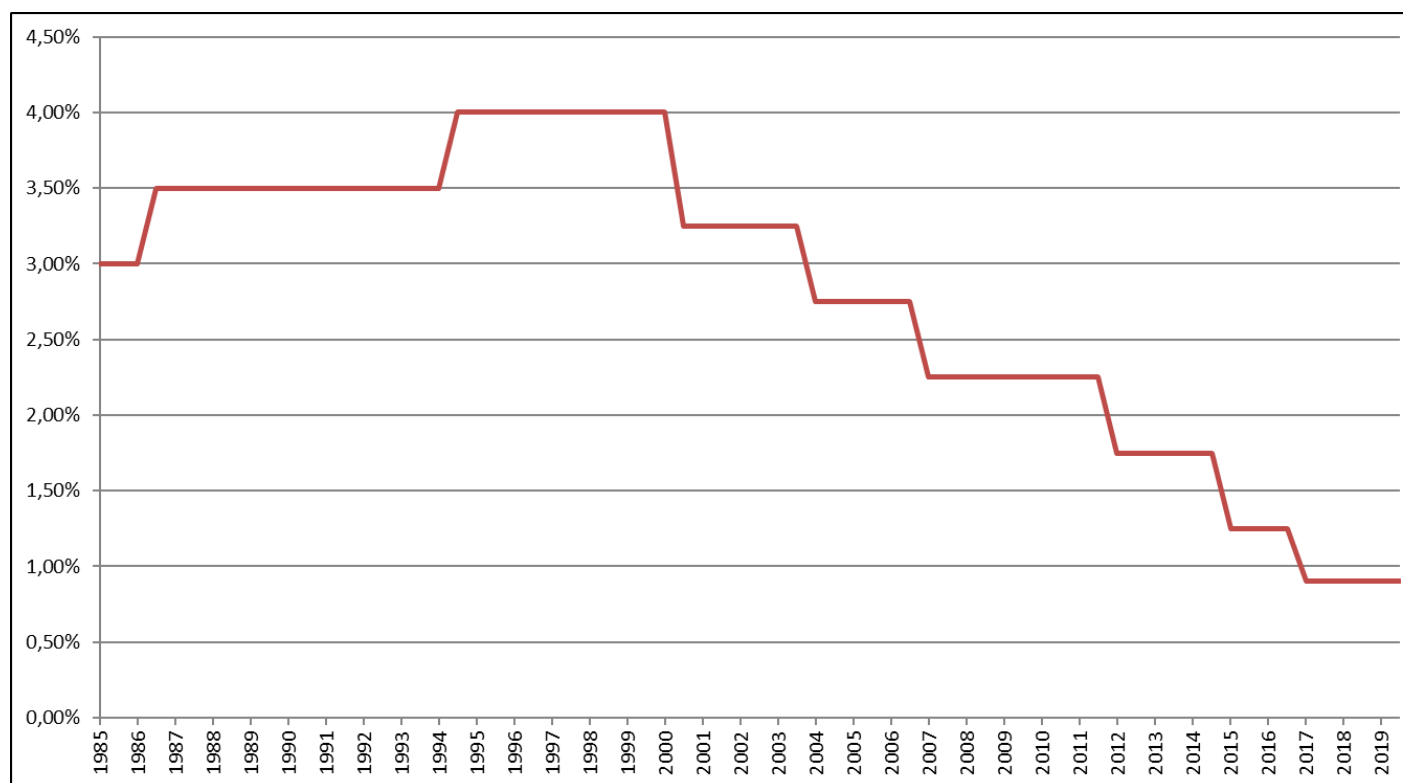
German life insurance market was very traditional



- Extremely regulated until 1994
- The portfolio of german life insurance companies consists mainly of with profits endowment and annuity products
- Interest rates, mortality/morbidity assumptions as well as expence loadings are guaranteed

High guarantees in existing portfolio

- Guarantees on interest rates were declining from 4,0% in the mid-nineties to 0,9% currently. Guarantees are legally required for nearly all employee benefits.



High guarantees are expensive

- In a life portfolio in today's environment it is necessary to cover high guarantees with appropriate assets (duration)
- An example of the cost of a financial guarantee

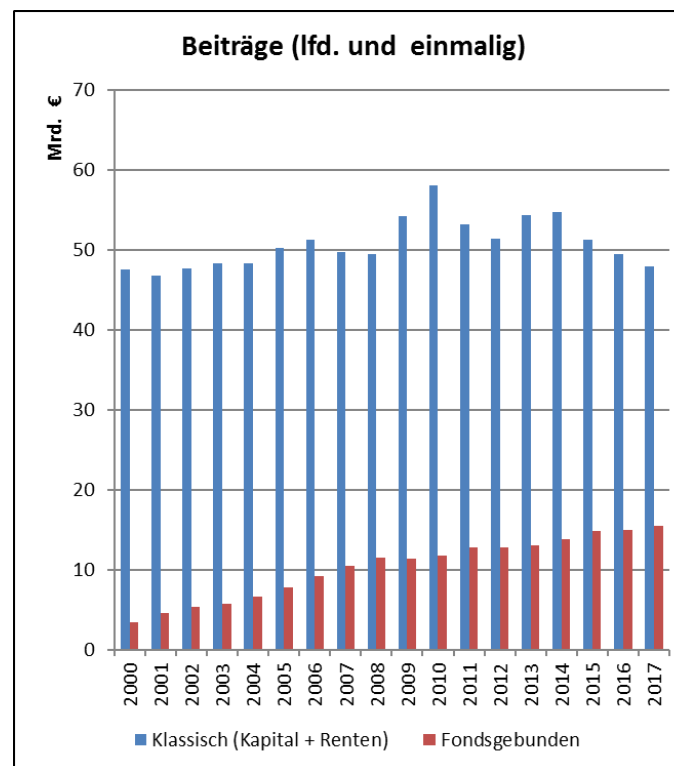
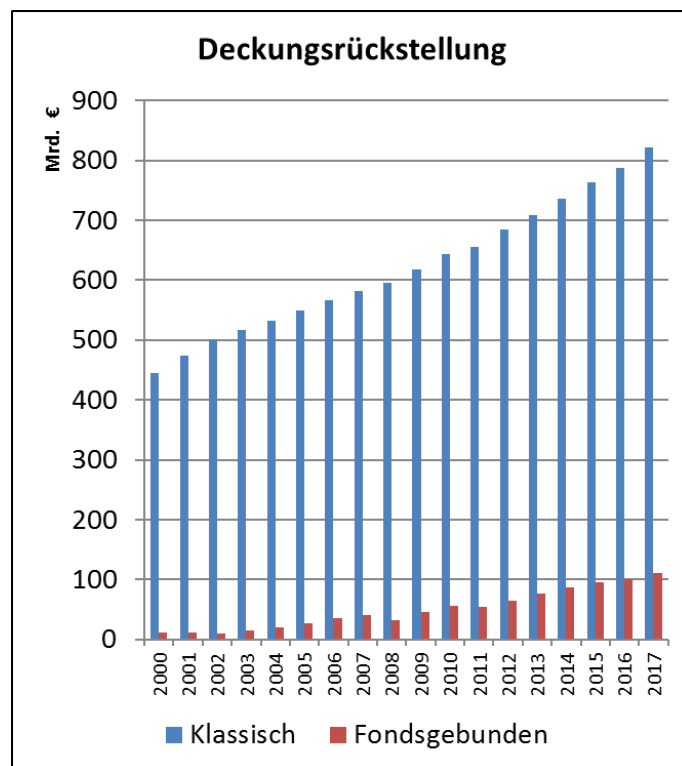
We do not only guarantee the interest for premiums we already obtained but also for future premiums.

If I want to guarantee a future premium in 5 years for a timespan of 10 years. Therefore I have to pay today a premium of about 2% of the investment (to buy a receiver swaption; Market price at 30.03.2019)

- Risk taking (e.g. bonds with low rating, equities) which generates a risk premium can be problematic
- Illiquidity premium can be obtained

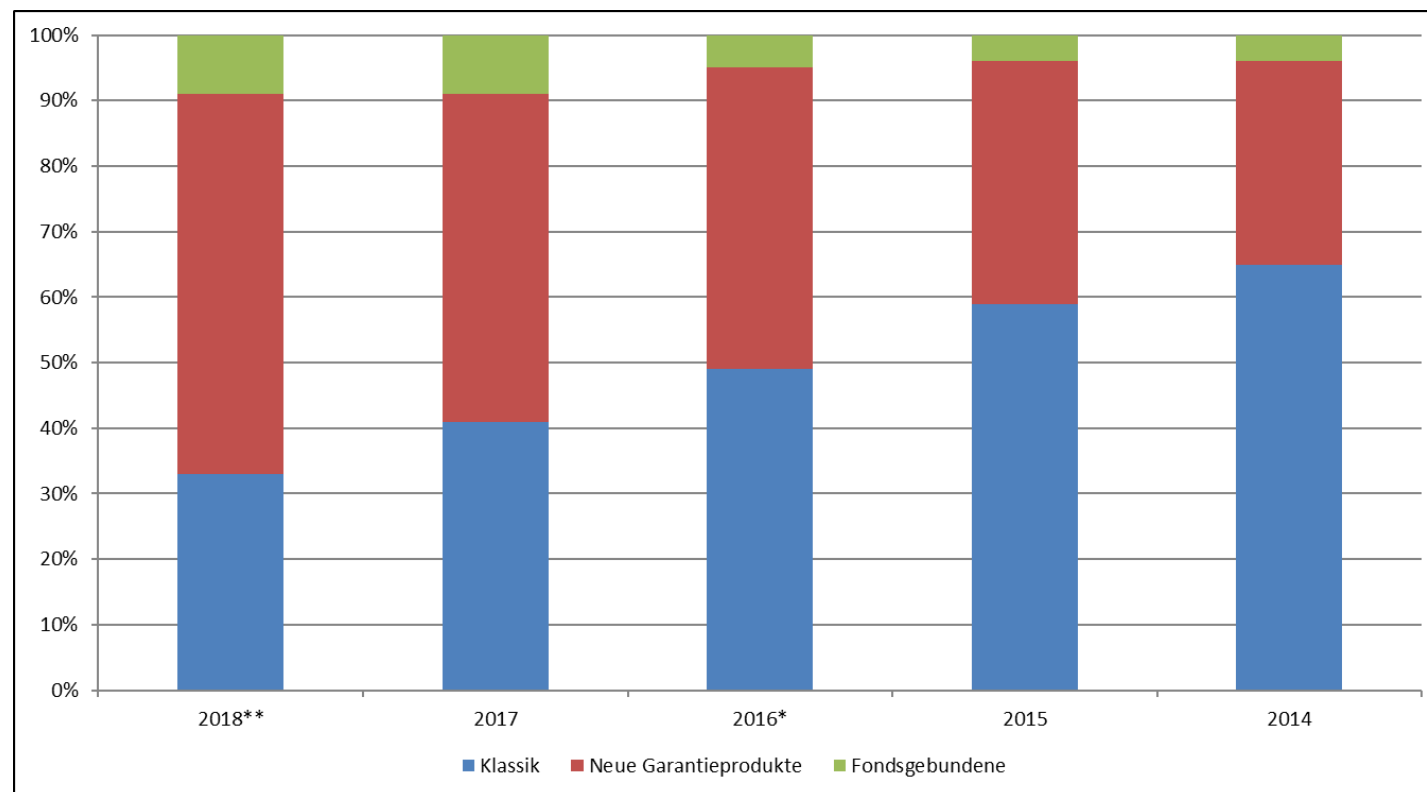
Unit linked business only picked up recently

- Unit linked business did not play a role until the 90's. The stock crisis in the early 2000s in combination with the low interest rates led to an investment portfolio dominated by long running fixed-income securities.



Recent trend towards hybrid products

- For the business written in recent years guarantees which are not important in the selling process were reduced in favor of:
 - Reduced guaranties on surrender values
 - Avoidance of guarantees on profit participation
 - Reduction of guarantees for the pension payment phase



Low interest rate led to government action

- Obligation to establish additional interest reserves in 2011
“Zinszusatzreserve”
- The formula led to a very fast growth of this reserve, so there followed an
- Adjustment of the formula for the additional interest reserve in 2018
- “Korridormethode” to reduce the additional needed reserves
- New employee benefits scheme without guarantees

new type of employee benefits schemes

- Introduction of a new type of employee benefits scheme where guarantees are not only not required but explicitly prohibited.
- German legislator actet with the so called “Betriebsrentenstärkungsgesetz” on 17th August 2017
 - Employers organisation and unions are responsible for the implementation
 - Purely defined contribution commitments for pensions
 - Guarantees are explicitly prohibited
- No transactions so far
- Further development has to be seen

Agenda



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Benefits of nominal guarantees are questionable



- In Inflation scenarios nominal guarantees are useless
- In times of low interest rates the guarantor may default
- What the client needs is “inflation proof” development
- Unfortunately inflation linking cannot be guaranteed for regular premiums

Why were the guarantees so high?

- At the time given the guarantees were not considered to be high at all
- The major selling argument was profit participation
- There was the fear that in the context of the EU-Deregulation in 1994 non-german companies could enter the market with high guarantees

The german life insurance is in a dilemma

- The customer wants a good investment performance
- When the companies promise this for not guaranteed products the customers trust is decreasing
- They want guarantees
- This does not work because high guarantees
 - Lead to investments in nominal values with long maturities
 - Reduce possibilities to produce additional values and guarantees
 - Cause high sensitivity to inflation
 - In total the typical duration of a german investment portfolio is about 10 years

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What can we do in the future

- For retirement products trust is essential
- To gain trust in the insurance product there must be transparency
- One way is to establish transparency of the investment process.
 - Make the investment rules clear
 - Use Index linking
- Another way is to build trust by including partners like employers and unions
 - This idea was pursued by the government for pension schemes
 - In a similar manner could proceed insurance companies
 - This idea is not flying yet
- If in such concepts guarantees have to be given they can only be an “hygiene” factor and not more!

Thank you very much for your attention!

Contact details:

Alexander Finke

address: Ergoplatz 1
 40477 Düsseldorf

phone: +0049 (0)211/477-6086

mail: Alexander.Finke@Ergo.de

web: www.eca2019.org