Eidgenössische Finanzmarktaufsicht FINMA
Autorité fédérale de surveillance des marchés financiers FINMA
Autorità federale di vigilanza sui mercati finanziari FINMA
Swiss Financial Market Supervisory Authority FINMA

Occupational pension schemes of life insurance companies

Group life reporting 2017: transparency report

Key points

Foreword

The abridged English version of this report contains the key points. The full version of the report is available in German and French at https://www.finma.ch/en/documentation/finma-publications/reports/transparency-report-second-pillar/.

Key points

Occupational pension schemes: the role of private life insurers

Occupational pension schemes are managed and safeguarded by occupational pension institutions, which are legally autonomous and subject to the Federal Act on Occupational Retirement, Survivors' and Disability Pension Plans (OPA).

Private life insurers which take on the risks and capital management responsibilities of occupational pension institutions in full or in part (group life insurers) are subject to the Insurance Supervision Act (ISA). They assume part or all of the risk coverage and capital management from occupational pension institutions by reinsuring and providing full or partial coverage of the risks which the latter cannot or do not want to assume. These group life insurers manage approximately one-fifth of all pension assets totalling CHF 1,030 billion, insure risks of almost half of the 4,09 million active insured persons (including those with only risk cover), serve around one-fifth of the 1,11 million pensioners and satisfy most of the demand of SMEs for full coverage insurance solutions.[1] In doing so, group life insurers play an important role in the occupational pension system.

Group life insurers operate in a strictly regulated area of social insurance. In this context, FINMA is mandated to ensure that the assets entrusted to them for occupational pensions are secure. Guaranteed insurance obligations are comprehensively covered by separate tied assets which are subject to strict investment requirements with respect to quality, risk diversification, permitted asset classes, risk management and administration.

Group life reporting and minimum ratio

The group life report prepared by life insurers active in the occupational pensions sector focuses solely on this part of their business.

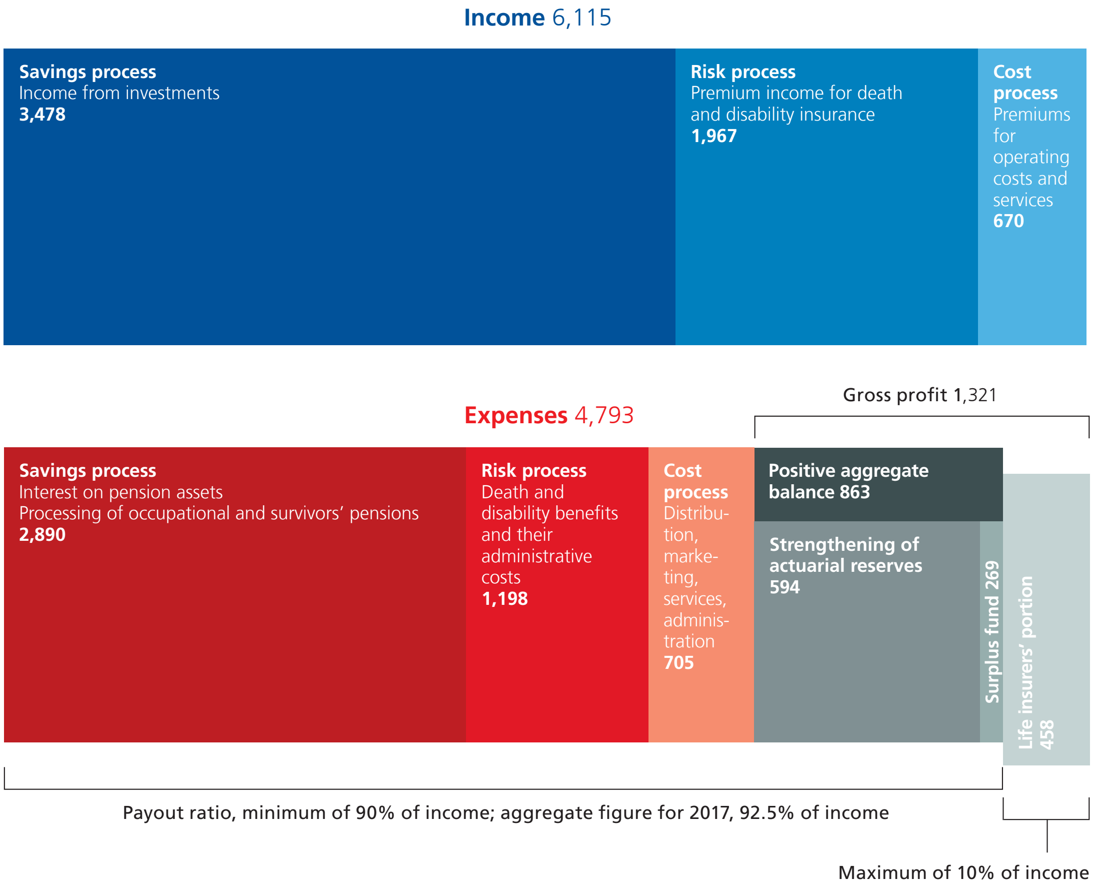
The operating statement comprises the balance sheet items and income statement items and includes statistics and other information, as well as a technical segregation whereby income, expenses and gross result are split across the savings process, the risk process and the cost process. This increases the transparency of income and expenses in occupational pensions, particularly regarding compliance with the rules on calculating and distributing the surplus.

The income and expenses for the three processes are set out in Figure 1. The gross result is divided into the positive overall balance (which is allocated to the insured occupational pension institutions and their insured persons) and the group life insurers' share. The minimum ratio is the share which must be allocated by law to the community of insured persons. The Federal Council has ruled that 90% of income – i.e. at least 90% of premium income (excluding savings premiums) and investment income – must normally be allocated to the community of insured persons (Art. 147 ISO). Savings premiums are credited in their entirety to the insured persons.

[1] Allianz Life, AXA Life, Baloise Life, Helvetia Life Insurance, PAX, and Swiss Life still offer full coverage insurance (as at 2017).

Distribution of the gross result from group life business: at least 90% of the income goes to the community of insured persons and at most 10% to the life insurers (Figure 1)

Figures for business subject to the minimum ratio from the 2017 group life reporting (in CHF millions)



Income, expenses and result, 2013–2017 (Figure 2)

In CHF millions	2017	2016	2015	2014	2013
Savings process					
Income	3,816	4,767	5,186	5,351	4,951
Expenses	3,146	3,271	3,329	3,354	2,798
Result	670	1,496	1,857	1,997	2,152
Risk process					
Income	2,463	2,528	2,594	2,624	2,621
Expenses	1,454	1,452	1,418	1,395	1,429
Result	1,009	1,076	1,176	1,229	1,192
Cost process					
Income	754	754	757	744	729
Expenses	773	757	797	824	823
Result	–19	–3	–40	–80	–94
Summary of the three results					
Savings process result	670	1,496	1,857	1,997	2,152
Risk process result	1,009	1,076	1,176	1,229	1,192
Cost process result	–19	–3	–40	–80	–94
Gross result (group life reporting)	1,659	2,569	2,994	3,146	3,250
Strengthening technical reserves[2]	–612	–1,592	–1,847	–1,651	–1,797
Net result	1,047	977	1,147	1,494	1,453
Breakdown of the net result					
Assignment to surplus fund	493	375	509	808	775
Operating result[3]	554	602	638	686	678
Net result	1,047	977	1,147	1,494	1,453

Income, expenses and result for 2016: sharp fall in investment income

2017 is the thirteenth consecutive year in which private life insurers have accounted for their occupational pension scheme activities in their group life reporting. The key focus of business during the past year was on financial stability and on ensuring that insurers can meet their commitments in the long term in view of the prevailing very low interest rates.

Following the difficulties encountered in 2008, they reported an overall positive result for the ninth consecutive time. Figure 2 shows the results of the savings process, risk process and cost process. They give

[2] Strengthening actuarial reserves minus release from strengthening of technical reserves.
[3] The operating result corresponds to the life insurer's share of the net result.

an aggregate gross result of CHF 1,659 million, representing a year-on-year fall of CHF 910 million. This is primarily due to poorer results from both the savings and the risk processes.

Life insurers strengthened their technical provisions by an aggregate sum of CHF 612 million (2016: CHF 1,592 million). This gives a net result of CHF 1,047 million, of which CHF 493 million goes to the surplus fund, leaving an operating result of CHF 554 million. This means that the operating result declined once again, despite a further increase in total assets.

When the additional technical provisions during the reporting year are included in the savings process, the savings process remains just barely in positive territory. The declining results in the savings process are, however, offset by declining but still good results in the risk process.

In view of this trend, group life insurers scaled back their growth in full coverage insurance and concentrated instead on reinsuring death and disability risks.

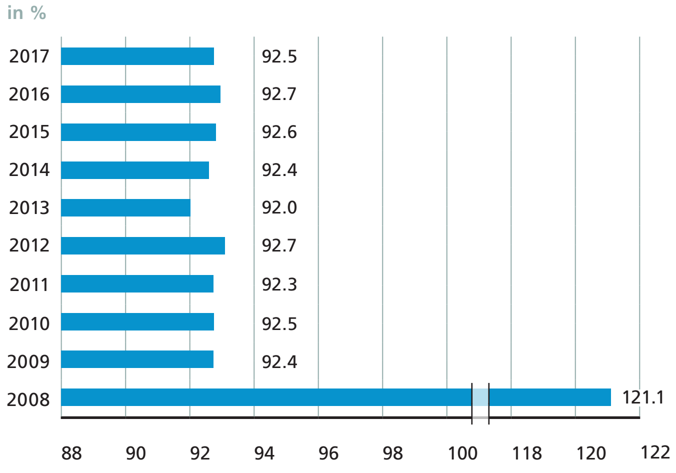
Payout ratio for 2017

For group insurance contracts with a statutory minimum ratio, the aggregated payout ratio for 2017 was 92.5%, remaining stable and above the statutory minimum of 90%.

An aggregate sum of CHF 493 million (2016: CHF 375 million) went to the surplus fund for the benefit of insured occupational pension institutions and the persons they insure. This increase can mainly be attributed to significantly fewer reserve reinforcements having been necessary than in the previous year.

Life insurers active in the occupational pension scheme sector reported an aggregate annual pre-tax result of CHF 554 million for 2017 (2016: CHF 602 million) in their occupational pension business. The annual result from the occupational pension business is incorporated in the enterprise result; a decision on the appropriation of the result is then made at corporate level.

Payout ratios since 2008 (Figure 3)



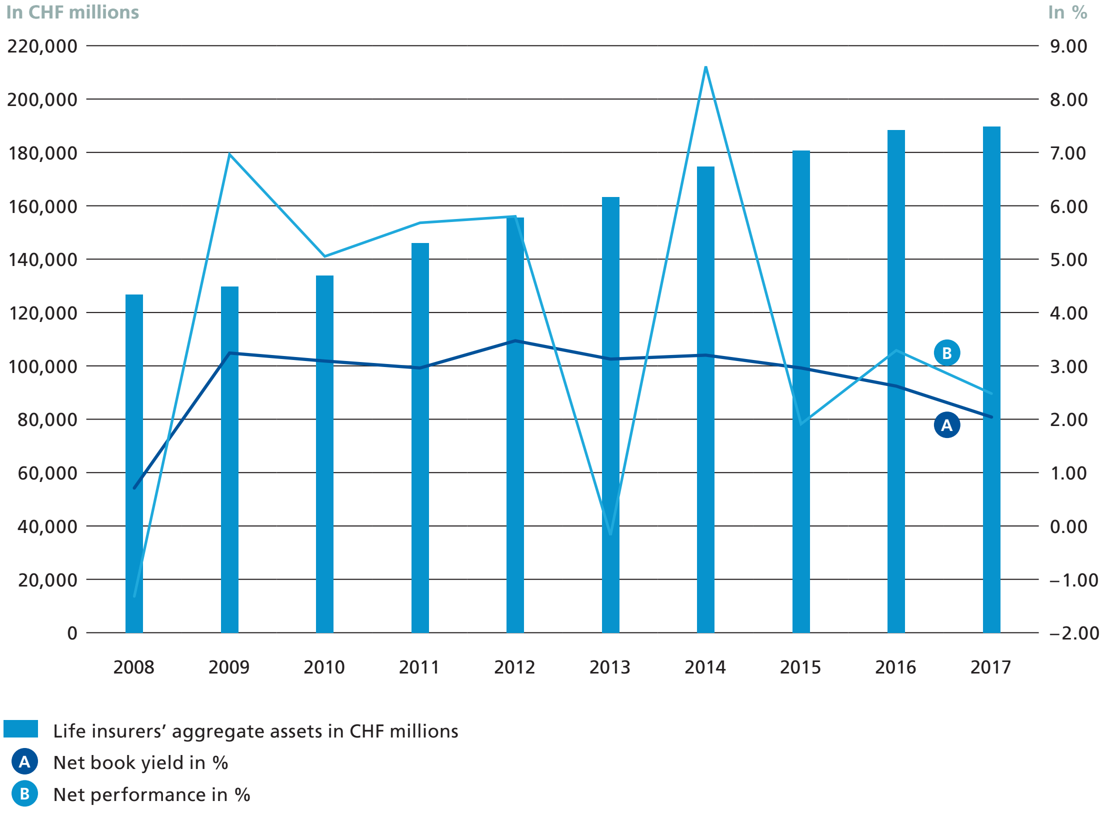
Savings process burdened by the need to strengthen actuarial reserves for annuities

Life insurers produced positive results in the savings process, with revenues minus expenses yielding CHF 670 million (2016: CHF 1,496 million). However, it was necessary to reserve CHF 648 million (2016: CHF 1,629 million) to strengthen the actuarial reserves for old-age and survivors' pensions and to close coverage gaps in the case of pension conversions.

At 2.04%, the net return on investments (book yield) was slightly lower than in previous years. Between 2008 and 2017, the average return was 2.74% (average from 2007 until 2016: 2.87%). Taking account of the changes in the value of the investments, performance stood at 2.48% (2016: 3.29%).

The high proportion of fixed-income securities (77%) is indicative of the types of investment made. As the

Aggregate assets, net book yield and net performance of group life insurers, 2008–2017 (Figure 4)



return on new investments has declined considerably since 2010, it is becoming ever more difficult, when reinvesting pension assets, to finance the statutorily prescribed interest guarantees on retirement savings (minimum interest rate) and on the actuarial reserve (previously referred to as guaranteed pension conversion rates) with low-risk investments in the capital market.

The longer this situation persists, the more pressing these challenges will be for life insurers and for the occupational pensions system in general.

Asset management costs (as a percentage of the market value of investments) remained at the previous year's level of 25 basis points in the reporting year.

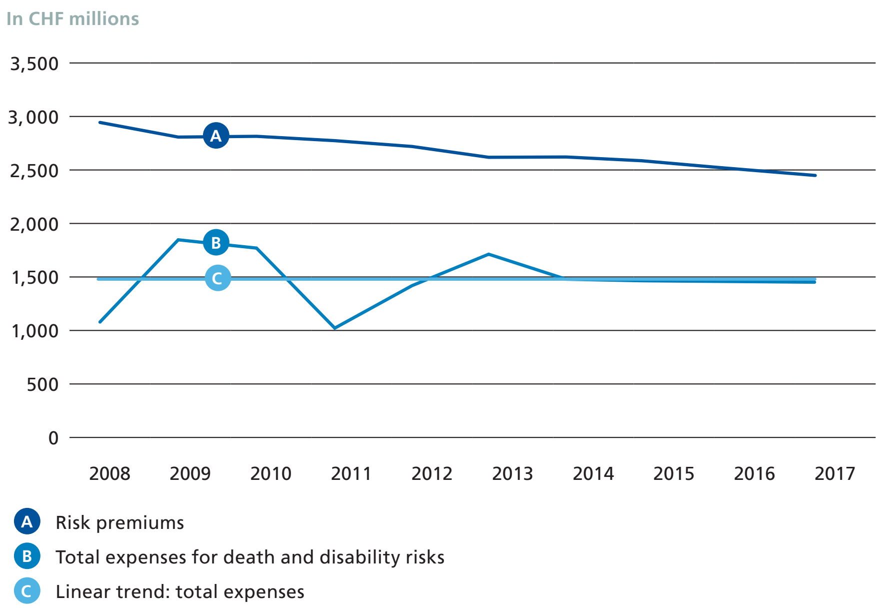
Risk process: relatively stable results for death and disability risks

Costs and claims expenditures in the risk process remained stable in the reporting year compared with the previous year, and risk premiums were reduced further. The result (gross) in the risk process fell slightly from CHF 1,076 million to CHF 1,009 million. The risk process is therefore the main contributor to the gross result.

Cost process virtually in balance

The results in the cost process were slightly negative when aggregated across group life insurers. While group life insurers had reported a cost deficit of CHF 195 million in 2009, this deficit was only CHF 3 million in 2016. The deficit rose slightly to

Premiums and total expenses in the risk process, 2008–2017 (Figure 5)



CHF 19 million during the reporting year, while the reported per capita operating costs rose to CHF 320 (2016: CHF 314). This increase during the reporting year is mainly due to a one-off effect at one group life insurer.

As management costs for active insured persons, pensioners' collectives and vested benefits policies can be different, FINMA has been requiring operating costs to be broken down by cost unit since 2012. The per capita figures for 2017 were:

Active insured persons	CHF 405
Pensioners	CHF 430
Vested benefits policies	CHF 70
Total	CHF 365

The difference between the CHF 365 resulting from the income statement and the CHF 320 resulting from the cost process is explained mainly by how claims management costs are recorded, they are included in costs in the income statement but they are recorded in the risk process for the technical breakdown.

Per capita costs differ considerably for each life insurer, with reported management costs per capita varying substantially depending on the life insurer's business model.

The total distribution and acquisition costs of CHF 230 million break down as follows:

Commissions for brokers and agents	CHF 100 million
In-house sales force commission:	CHF 86 million
Other acquisition costs:	CHF 46 million

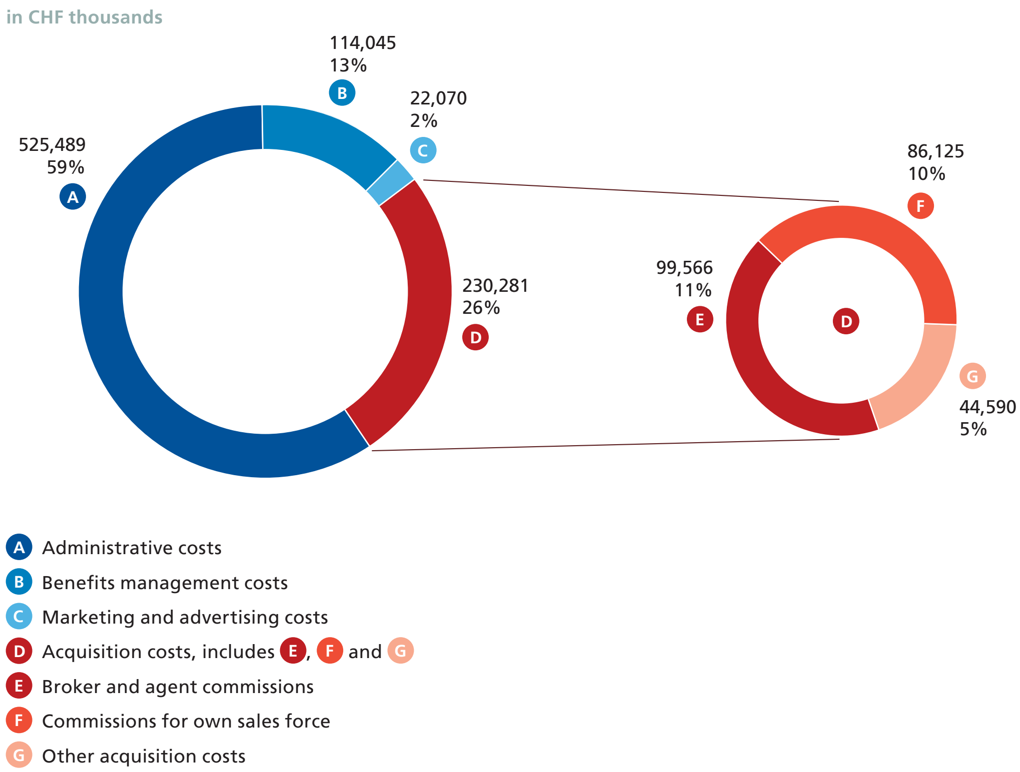
The breakdown of distribution costs – data which FINMA has been collecting since 2013 – has shown that group life insurers generally use internal and external distribution channels, although to greatly varying degrees. On average, group life insurers spend 28% of their costs on distribution, marketing and advertising and 72% on general administration and claims management, as shown in Figure 6.

Distribution costs per active insured person came to CHF 124, slightly less than in the previous year (2016: CHF 126). They accounted for 1% of the gross premium volume generated in 2017.

Technical provisions: significance and function
All life insurers must ensure that their technical provisions are sufficient to meet their commitments (Art. 16 ISA). Technical provisions consist of retirement savings, actuarial reserves for current pensions, and further provisions allocated to the insured persons. Insufficient technical provisions must be strengthened so that the obligations from insurance contracts can be met over the long term. This requirement offers the most sustainable protection to insured persons and also builds trust in the Pillar 2 pension system under the Insurance Supervision Act (ISA). One of FINMA's main responsibilities is to ensure that this requirement is met at all times.

Insufficient provisions must be strengthened in line with the approved business plan. Provisions have to be strengthened with the results from the three processes or with the organisation's own assets. Risk pooling across the processes is fundamentally important to any insurance activity because it enables insurers to channel resources to areas where there is risk exposure. Group life insurers must review their technical provisions at least once a year to confirm that they have been correctly calculated in actuarial terms and can sufficiently meet the insurers' contractual obligations sustainably, permanently and securely. Assignments may be made to the surplus

Breakdown of distribution and advisory services costs, 2017 (Figure 6)



fund only once the technical provisions have been adequately covered.

Technical provisions: falling interest rates have necessitated strengthening measures

Actuarial reserves for annuities and other technical provisions (except retirement savings) were valued based on current biometric assumptions and valuation interest rates, which averaged 1.34% at the end of 2017 (2016: 1.43%).

Retirement savings further increased by CHF 0.9 billion, reaching a year-end total of CHF 101.1 billion. The interest rate for mandatory pensions was 1.00%, while the average rate for supplementary pensions was 0.41% (2016: 0.79%; only guaranteed interest). Participation in the surplus generated must also be included.

Actuarial reserves for current old-age and survivors' pensions have risen substantially once more (8%) and now total CHF 38.6 billion. The increase is partially driven by group life insurers' obligation to strengthen their actuarial reserves on account of higher life expectancies and lower interest rates. This affects not only current pension benefits but also losses from future pension conversions because of excessively high conversion rates.

The surplus fund: function and trends

The surplus fund is an actuarial balance sheet item to free up surplus dividends for occupational pension institutions and their insured persons. A total of CHF 539 million (2016: CHF 673 million), or just over half of the surplus fund, was allocated to these occupational pension institutions and their insured persons. This shows that the surpluses generated in one year were passed on rapidly to the insured persons. During the reporting year, CHF 493 million of the net result was allocated to the surplus fund (2016: CHF 375 million).

Transparency facilitates market comparison

Transparency resulting from the disclosure produces a positive effect. Key indicators (e.g. for costs, dividend policy and investments) highlight the strengths and weaknesses of market participants and allow for comparisons, which in turn benefits companies and employees that are looking for pension solutions. However, the limited range of products available in the group life market makes it difficult for many occupational pension institutions to switch to another provider or even find a full coverage insurance solution at all. Virtually all group life insurers have cut back on writing new business, and in some cases they are actively reducing their portfolios. This was also clearly reflected in the premium volume of the market, which declined again compared to the previous year (2017: CHF 22.4 billion, 2016: CHF 23.3 billion, 2015: CHF 24.8 billion, 2014: CHF 24.7 billion, 2013: CHF 24.3 billion). Insurers are not looking to take on new business, presumably because the risk-to-return ratio is not attractive for investors.

Abbreviations

CHF Swiss franc
ISA Swiss Federal Act of 17 December 2004 on the Supervision of Insurance Companies (Insurance Supervision Act; SR 961.01)
ISO Swiss Federal Ordinance of 9 November 2005 on the Supervision of Private Insurance Companies (Insurance Supervision Ordinance; SR 961.011)
SME Small and medium-sized enterprise

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