

Major Challenges for the German Secondary Market

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Agenda

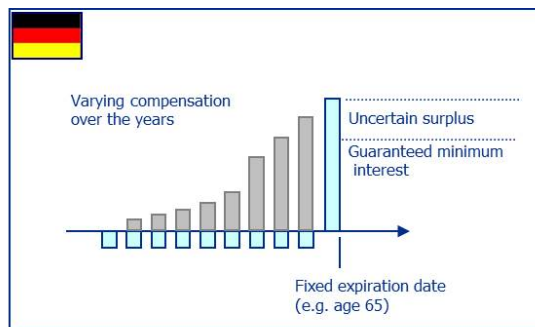
- “Purchase barometer” on high – how can policy supply be boosted?



- Insurer financial strength – a growing problem?
- Ongoing low interest rates – lower insurer performance imperative?

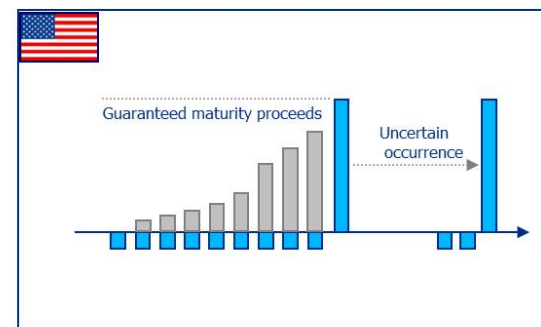
Comparison between the German and US-American secondary market for life insurance

The German secondary market for life insurance (endowment policies and annuities) is comparatively young and came into being as late as 1999. There is no secondary market for term life insurances.



- Expiration date known
- Reliable interest known
- Additional bonus (not guaranteed)

Reduced correlation
to the capital market



- Expiration date unknown (death)
- Maturity proceeds known
- Longevity risk

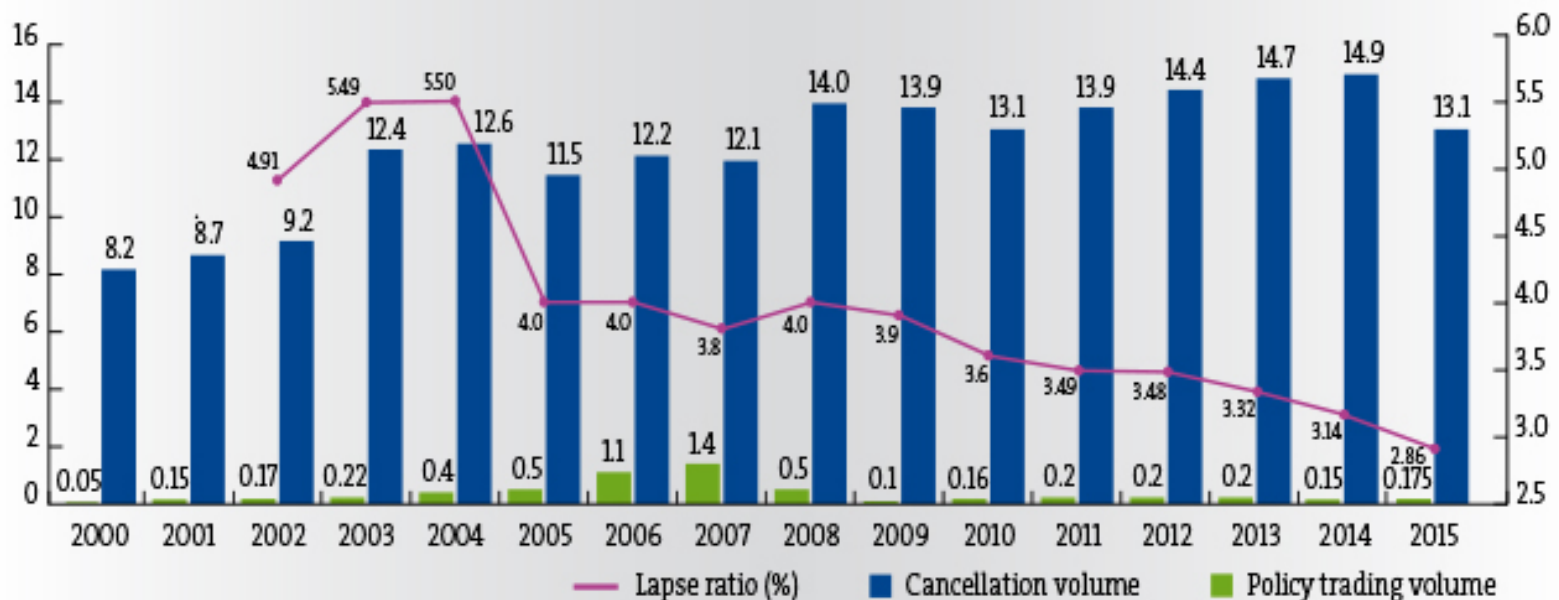
Almost no correlation*
to the capital market

*with buy-and-hold strategy

Slight decrease but market potential for buyers still high

- Surrender volume in 2015: EUR 14.9 bn – purchase volume on the secondary market only at EUR 175m

Development of cancellation volume (in EUR billion)

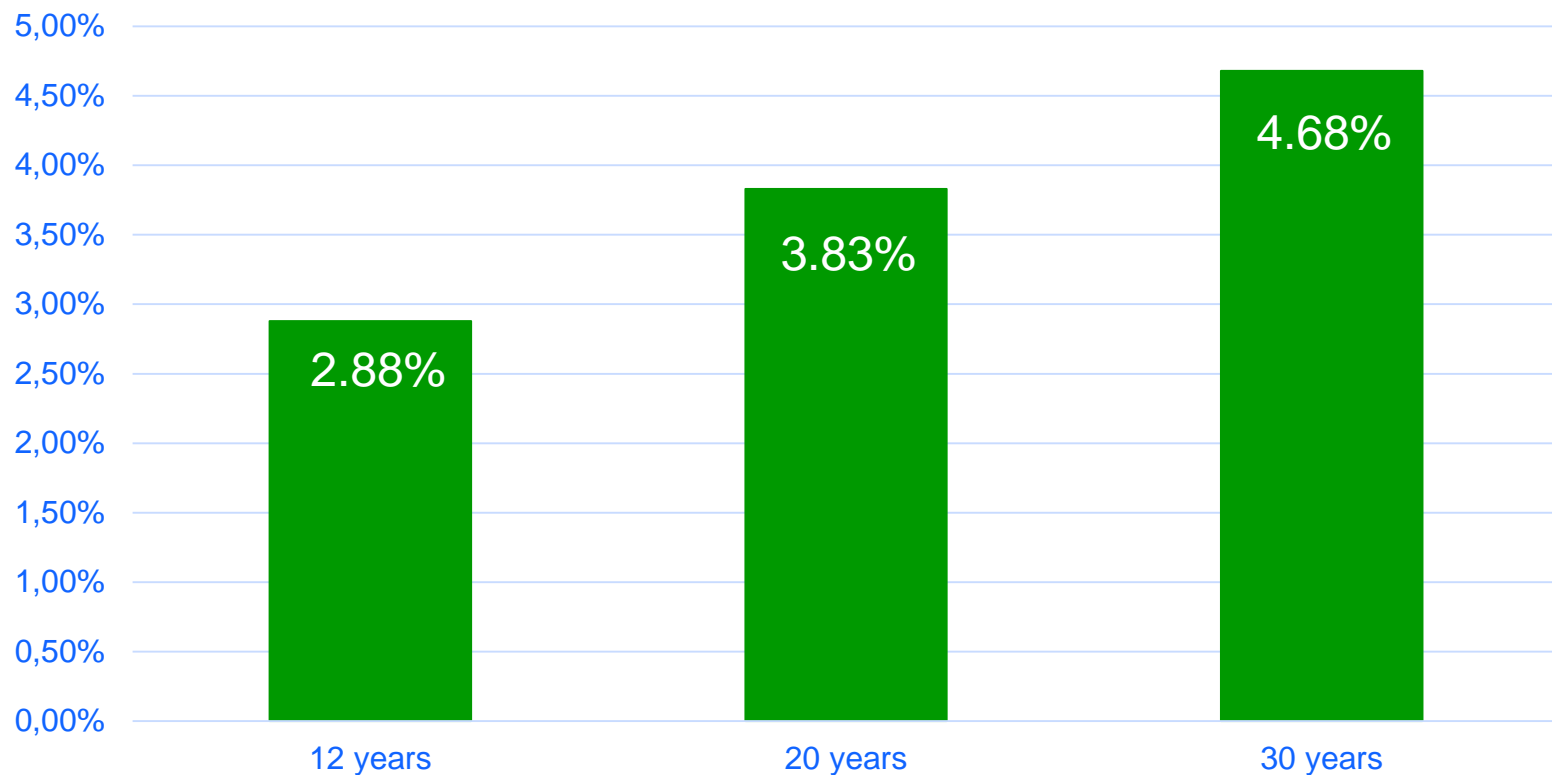


Source: BVZL / *GDV

Source: GDV/BVZL

German life insurance market: secondary market buys most profitable policies – secondary yields are even higher

Primary Market Premium Based IRR in %



Source: Map-Report no. 873 May/2015 "Yields for maturing policies"

Demand for suitable secondary market policies currently lies far over supply

- Purchase volumes increased to approx. EUR 175m in 2015, but fell still far below the BVZL's and its members' expectations
- Due to the scarcity of policies, currently high purchase prices
- The BVZL is working towards increased awareness of the secondary market among consumers: to make it easier for policyholders to determine current chances of acquisition, the BVZL publishes a “**Policy Purchase Barometer**” on its website
- Action plan of BVZL members
 - Increase consumer awareness of advantages of a policy sale over surrender (through the media, consumer protection agencies)
 - Active education about methods of the pseudo secondary market
 - Stream-line processes – demonstrate ease of use and quick processing

BVZL Transparency Initiative was successful!

- BVZL has been the first association in Germany to analyze the value statements of almost all German insurance carriers; issue of standard requirements in early 2015
- In March 2016 the German Insurance Association (GDV) issued guidelines for increased transparency focusing on the wording and content of insurance contracts and value statement
- The German consumer protection issued a request catalogue for value statements in July 2016, blaming insurance carriers of sending “useless letters”
- These initiatives will lead to greater transparency in policy valuation, both for consumers and BVZL members

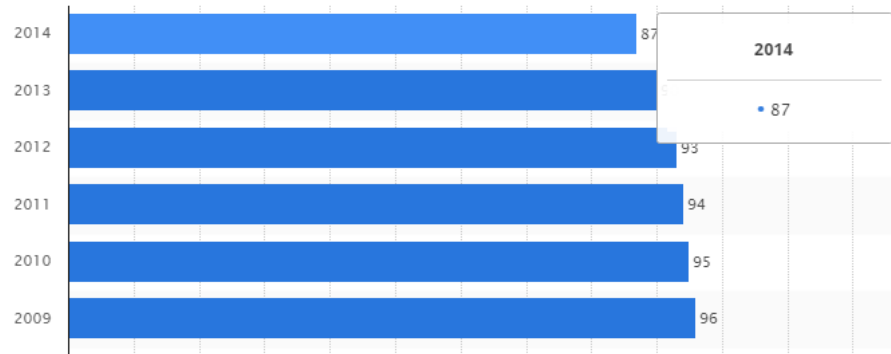
The German primary life insurance market in figures

- Number of in-force life insurance policies; approx. 85,9m (≈ 1.1 policies per person); more than 50% being annuities, followed by endowment policies (39.7% in 2014*)
- **Only about 15% are term life insurance policies**
- Premium payments in 2015: EUR 93.7 bn (-1.1% on 2014)
- 37% of new contracts in 2015 were products with guaranteed interest (although the current maximum interest rate is just 1.25% - only 0.9% from January 1, 2017 onwards)
- **German insurers expect moderate downturn of the life segment in 2016**
- Number of policy surrenders at a historic low (2.9%), corresponding surrender volume is EUR 13.1 bn (EUR 14.9 in 2014)

Source: GDV, German Insurance Association; * not all 2015 figures have yet been published

The German life insurance market – ratings

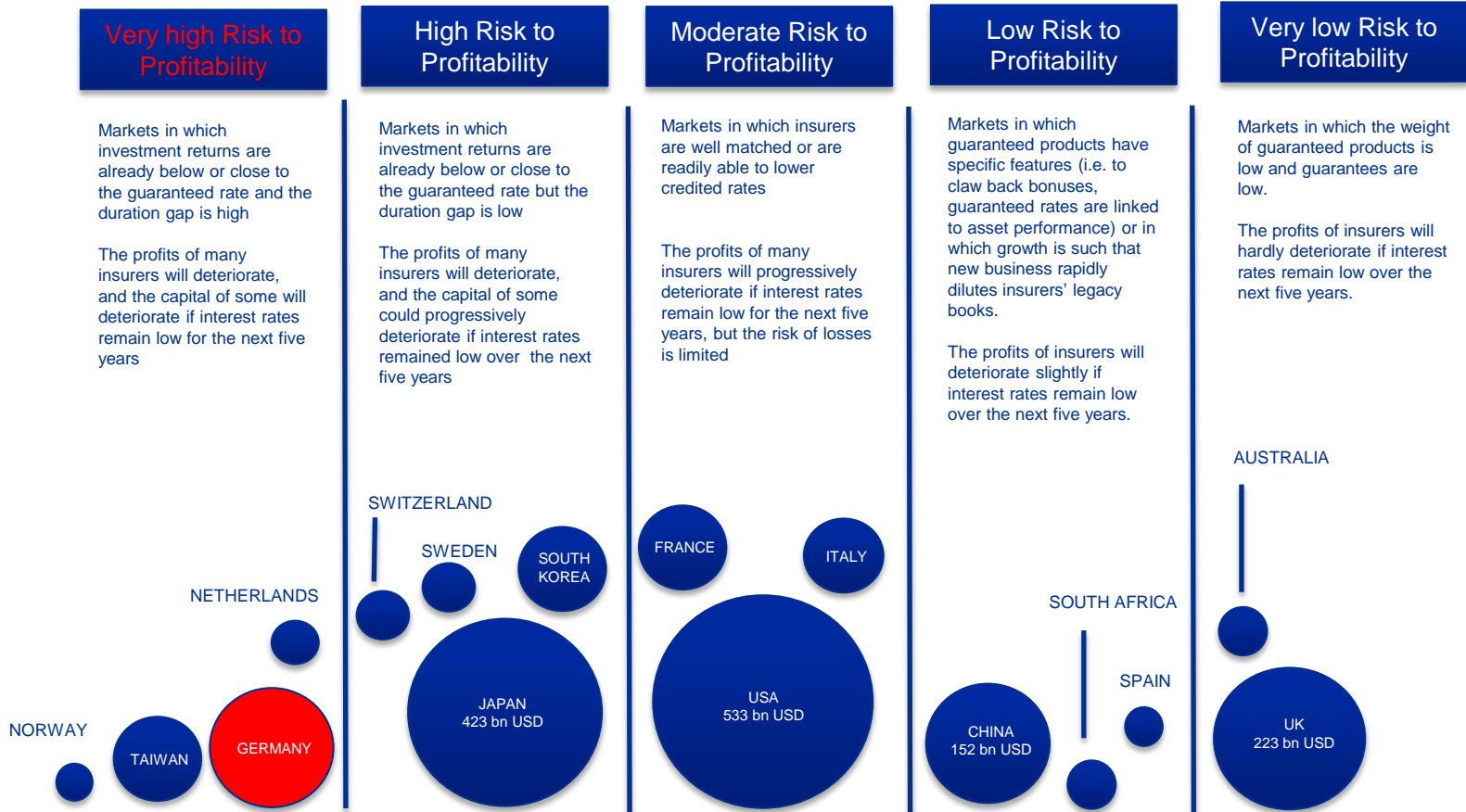
- Number of life insurance carriers: 84 as per 12/2014



- According to rating agency Moody's, in almost no other country are payment obligations towards customers as high and the investment mix as unfavorable as in Germany.
- Moody's sees a significant risk for Hannoversche Leben, Swiss Life, HDI, Credit Life, Axa, HUK Coburg, Inter and Familienfürsorge, as one third or more of their existing in-force policies are „older“ policies with guaranteed interest rates of 4%.

Source: statista; Moody's

Moody's Global Risk Categories for Life Insurance



Source: Moody's (premium volume in USD bn)

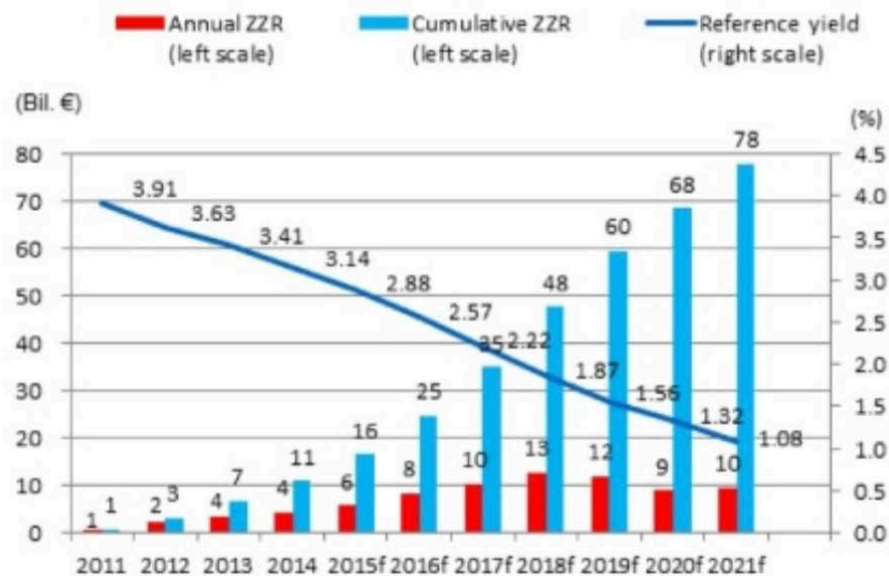
Results of BaFin study (May 2016)

- First results of quantitative Solvency II compliance study have been submitted to BaFin (German Federal Financial Supervisory Authority)
- “Day 1 reporting“ covers solvency balance sheets submitted on 1 January 2016
- Only three German insurance carriers did not meet “Day 1” Solvency II requirements

These three insurers are now being closely monitored by BaFin and have already undertaken measures to strengthen their balance sheets

Building of interest reserves (ZZR) a huge challenge

Annual And Cumulative ZZR Expenses For German Life Insurers Rated By S&P Global Ratings



- German insurance analyst Assekurata even projects a cumulative ZZR of more than EUR 150 billion in 2021

- S&P states in May 2016 that German insurers have to build up an additional EUR 78bn in interest reserves for their in-force business
- According to S&P, the build-up of these reserves should be feasible for all rated insurers
- The so-called “ZZR” will lower vulnerability of German insurance carriers in an ongoing low interest environment

Source: S&P 2016/Assekurata: Market View Life Insurance 2015/2016

Insurers have the tools needed to react to the challenges

- They benefit from low capital costs i.e. issue hybrid debt at all comparable lower spreads
- Diversify product environment – reduce %age of standard guarantee products
 - Reduce guarantee levels on paid-in capital
 - Offer more unit-linked/fund-based products
 - Offer hybrid solutions – unit-linked funds allow higher yields – built-in guarantees limit the risk
- Increase efficiency/streamline distribution (new distribution channels)
- Widen investment scope for standard endowment policies/shift the investment volume from very high percentages of state or public debt into higher-yielding asset classes like corporate debt or project/infrastructure finance (i.e. Allianz investments in energy projects)

Conclusions for the German secondary market

- German secondary policies are still a highly attractive asset class
 - Unique and attractive risk/return ratio, especially for “in-force” policies
 - Built-in inflation protection
 - High liquidity through intrinsic put option
 - Challenges for German insurance carriers seem to be manageable
 - Investor protection through German legal protection mechanism (Protector)
- Challenges
 - Relatively low purchase volumes
 - Regain market shares from “Pseudo Secondary Markets”
 - In case of a fast-rising interest rate environment: floater character of policies is a positive feature, however long duration of insurers’ assets

Thank you for your attention!

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