

Risk-Based Pension Supervision - German Approach

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Risk-Based Pension Supervision- German Approach

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1. Germany's Pension System

- Germany's pension system is based on a three pillar approach:
 - **statutory insurance** (1st pillar)
 - **occupational pension schemes** (2nd pillar)
 - **individual pension provisions** (3rd pillar)
- For a **typical (median) retiree household**, pensions are paid by:
 - 1st pillar: **85%**
 - 2nd pillar: **5%**
 - 3rd pillar: **10%**

1. Germany's Pension System

	Pillar 1	Pillar 2	Pillar 3
	Statutory insurance	Occupational pensions	Individual pensions
Financing and coverage of claims	Current pensions financed by charges of the working generation and taxes	Current pensions and claims covered by assets	Coverage by capital
Organisation	State controlled	Privately organised	Private
Obligation	Obligatory	Partly obligatory; occupational	Voluntary
Institutions	Social-security institutions	Unterstützungskassen, Pensionskassen/-fonds, life insurance companies, employers	Mutual funds, banks, life insurance companies

1. Germany's Pension System

	Pillar 1	Pillar 2	Pillar 3
	Statutory insurance	Occupational pensions	Individual pensions
Amount of provision	Pensions based on contributions	Pensions based on the commitment of the employer and/or on the development of investment	
Regulations on assets	no long term capital coverage, no investment regulation	investment regulation depend on the chosen way of implementation	Rather liberal, dependent from chosen institution

2. Occupational retirement provisions

- **Voluntary** system. In some areas, there are **collective agreements** providing for **obligatory** occupational retirement provisions or **financial incentives** for employees for deferred compensation.
- Since 2001 pensions reform, employees have had a **fundamental right to deferred compensation**.
- Occupational pension plans provided in Germany are **defined benefit**.
- About **15.3 million employees** had occupational retirement provision in March 2003.
- There are **five** different types of implementing occupational pensions.

2. Occupational retirement provisions

	Direkt- zusage (book reserves)	Unterstüt- zungskasse (support funds)	Direktver- sicherung (direct insurance)	Pensions- kasse (pension institutions)	Pensions- funds (pensions funds)
Individual claim against the pension facility	No pension facility	no	yes	yes	yes
Legal right to continuation with individual contributions on termination of employment	no	no	possible	possible	possible
Guaranteed minimum interest rate	no	no	yes	yes	no
Collection of assets	Internal	External	External	External	External

2. Occupational retirement provisions

	Direkt- zusage (book reserves)	Unterstüt- zungskasse (support funds)	Direktver- sicherung (direct insurance)	Pensions- kasse (pension institutions)	Pensions- funds (pensions funds)
Investments restrictions	none	none	yes	yes	virtually none
Insolvency insurance by Pension Security Association (Pensions- Sicherungs-Verein VVaG)	yes	yes	Subject to conditions	no	yes
Supervision	no	no	yes (by BaFin)	yes (by BaFin)	yes (by BaFin)
Supervised entities			160	109	24

3. Motivations for Risk-Based Approach to Supervision

The reasons for moving towards a **risk-based approach** are mainly:

- **Equity crisis** including the **increasing volatility** on the capital markets
- **Low yield** environment
- Integration of all three sector supervisory authorities to **one single integrated market supervisory authority**
- Improvement of **allocation of supervisory resources**
- Future requirement of **Solvency II** in Europe

4. Adoption of Risk-Based Supervision

4.1 Measures

The **following measures** were introduced:

- Scenario calculations/forecasts
- Amendments to section 341b (2) of the Commercial Code
- Policyholder protection corporation (PROTEKTOR and MEDIKATOR)
- Two new supervisory returns
- Stress tests

4. Adoption of Risk-Based Supervision

4.1 Measures

- Detailed rules on investment management and internal control procedures
- Reduction of maximum guaranteed rate of interest
- Special commissioner
- Supervision of holdings

4. Adoption of Risk-Based Supervision

4.2 Stress tests

Stress tests

- Have been introduced **in 2002**.
- Aim at **identifying** those insurance companies that do not operate an appropriate investment policy.
- The stress tests scenarios simulate a short-term adverse development on **capital and real estate markets**.
- Depending on the result of these scenarios the insurance company is subject to **certain notification obligations** towards BaFin.

4. Adoption of Risk-Based Supervision

4.2 Stress tests

- Scenario (**A 35**): decrease in the market value of shares by 35%
- Scenario (**R 10**): decrease in the value of fixed-income securities by 10%
- Scenario (**RA 25**): simultaneous decrease in the market value of shares by 20% and in fixed-income securities by 5%
- Scenario (**AI 28**): simultaneous decrease in the market value of shares by 20% and in the market value of real estate by 8%

4. Adoption of Risk-Based Supervision

4.3 Risk Scoring System

Risk Scoring System

- Should enable the classification of the supervised entities into risk classes (**traffic-lights model**) in all stages of the supervisory process by using quantitative key figures and qualitative criteria.
- Risk classification is currently done via **methodological survey**.
- Assessment of “**impact**” of the supervised entity on the market and “**quality**” of the supervised entity.
- As a result, the supervised entity can be classified into one of the possible fields of the following **risk matrix**.

4. Adoption of Risk-Based Supervision

4.3 Risk Scoring System

high	3A	3B	3C	3D
medium	2A	2B	2C	2D
low	1A	1B	1C	1D
impact quality	high	high	low	low
	medium			

4. Adoption of Risk-Based Supervision

4.3 Risk Scoring System

- Results of risk classification have been used for supervisory planning in 2006, namely the planning of the **on-site inspections**.
- It is envisaged that in the long term an **automatic assessment** system will be introduced.

Thank you for your attention! Q&A?

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