

The Danish pension industry – an actuarial view from the Danish FSA

Actuarial Association of Europe

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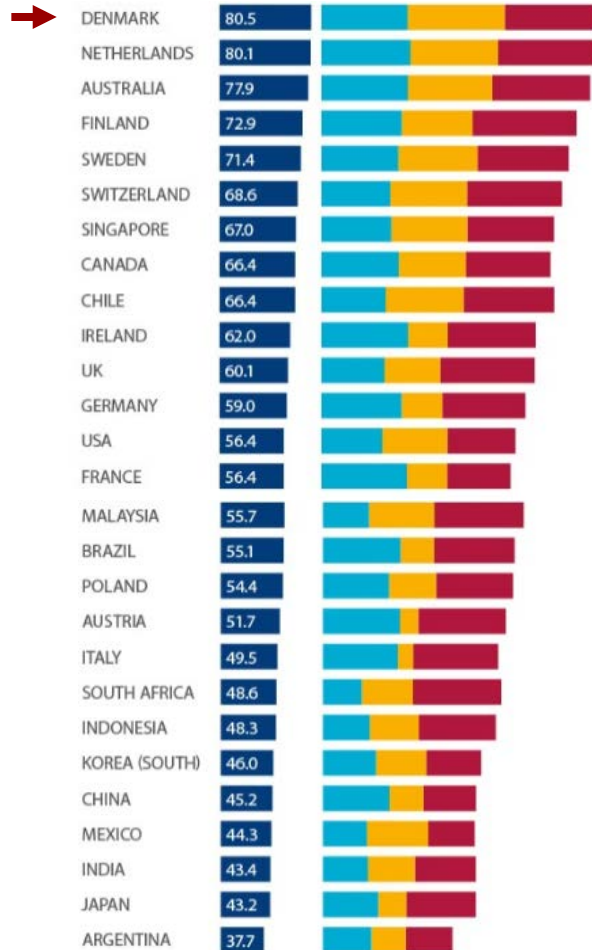
Chairman of the Board of the Danish Financial Supervisory Authority

Agenda

- **Best pension system in the world**
 - **Fit and proper in periods of economic upturns**
 - **Pensions when the guarantees disappear**
 - **Alternative investments are growing in size**
 - **Two-dimensional longevity benchmark**
-

THE BEST PENSION SYSTEM IN THE WORLD

Best pension system in the world...



Mercer:

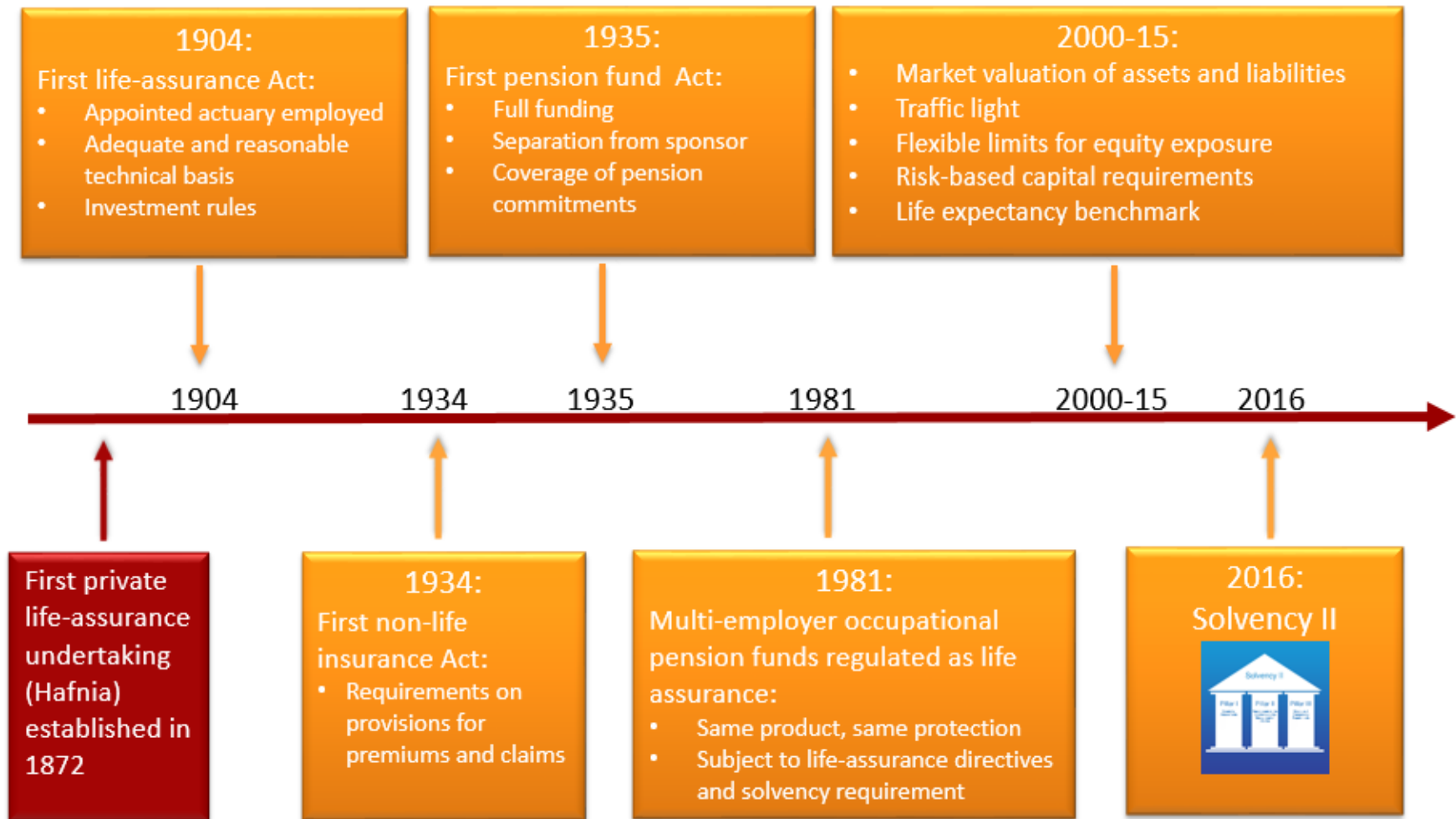
The overall index value for the Danish system could be increased by:

- *raising the level of household saving*
- *introducing arrangements to protect the interests of both parties in a divorce*
- *increasing the labour force participation rate amongst older workers*
- *providing greater protection of members' accrued benefits in the case of fraud, mismanagement or provider insolvency (2015)*



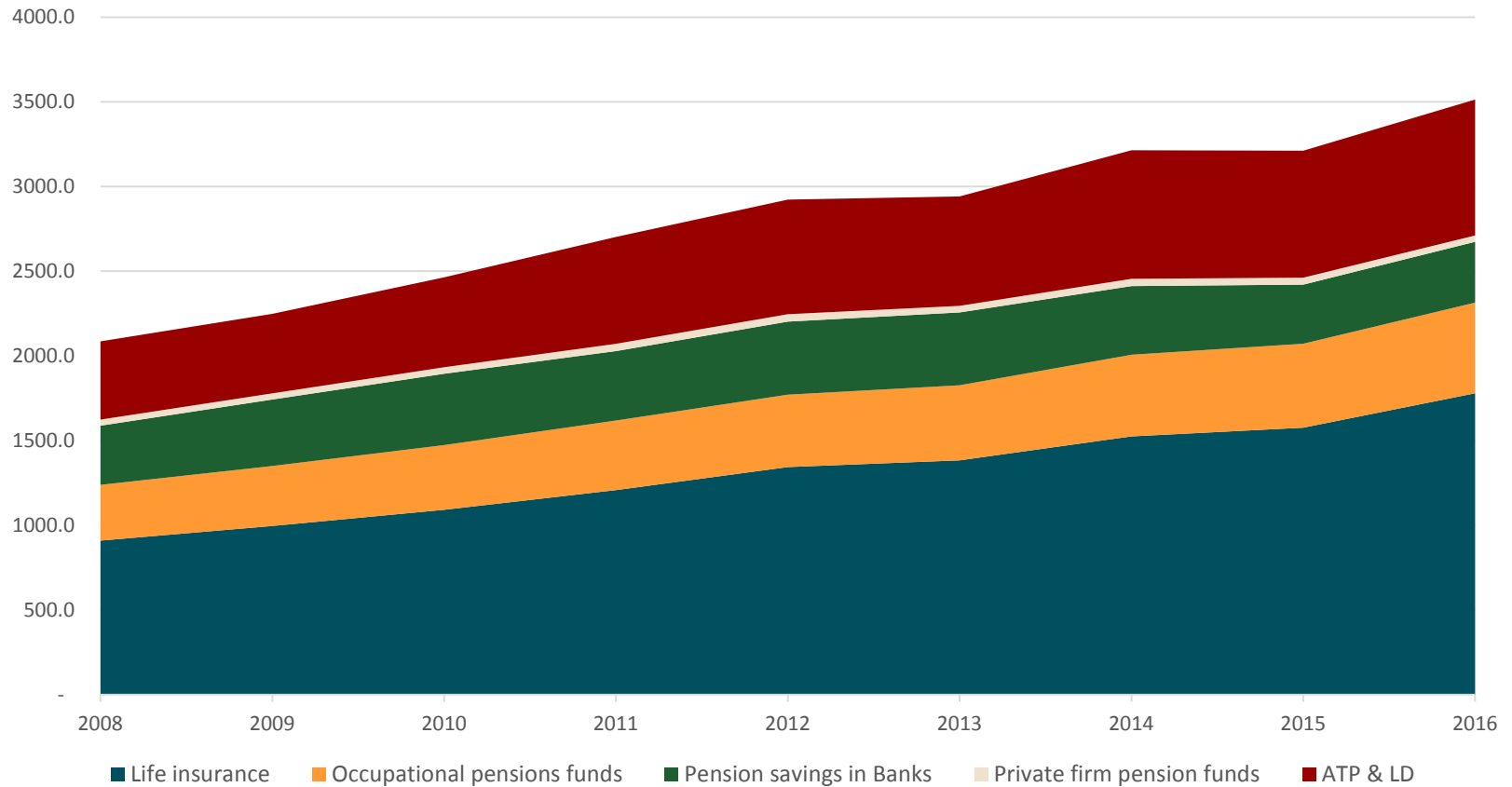
....still room for improvement 3

Regulation – historical overview



Market structure – pension savings

The Danish Pension Liabilities (Billions DKK)



Typical pension products

Overall structure

- In Denmark, the product is typically sold as "bundled" ie. savings together with insurance coverage
- The product can be taken out either directly (individually), by an employer or as a result of the labor market agreements
- Two main groups for the savings element:
 - Average return
 - Market return
- Most people now pay 12-15-20 % into a DC-scheme – no DB schemes

FIT AND PROPER IN PERIODS OF ECONOMIC UPTURNS

Director General: Strong boards must prevent new economic crises

FINANSWATCH

Forside **Pengeinstitutter** Forsikring Pension Realkredit Mere ▾

FINANSWATCH > FINANSNYT > PENGEINSTITUTTER > TILSYNSBOSS: ...

Tilsynsboss: Stærke bestyrelser skal forhindre ny krise

AF DANIEL HEDELUND
Offentliggjort 07.11.16 kl. 12:00

For at minimere skaderne i ny krise er det afgørende at have stærke bestyrelser i finansielle virksomheder. Det siger Finanstilsynets direktør, Jesper Berg, som ønsker en principiel debat om reglerne for bestyrelsesmedlemmers egnethed og hæderlighed.



Jesper Berg, direktør for Finanstilsynet. Foto: JON NORDAHL/FINANSTILSYNET



Relaterede artikler

Finanstilsynet kan få langt større ret til at fyre bankdirektører

Tilsynet: Derfor kan vi fyre en direktør

ANNONCE

Enhanced requirements of directors and KFHs

- 2012: Increased focus on qualifications of the board of directors
 - self-assessment requirement
 - collective competence requirement
- 2017: Fit & proper requirements for key function holders
 - SIFIs and basic course for board members
 - in credit institutions and insurance companies
- Mostly focus on “proper” and not so much on “fit” until now



Focus on fit & proper in periods of economic upturns

**Step 1: Conference
in Nov 2016**

**Step 2: Discussion paper
in May 2017**



A new toolbox for the Danish FSA?

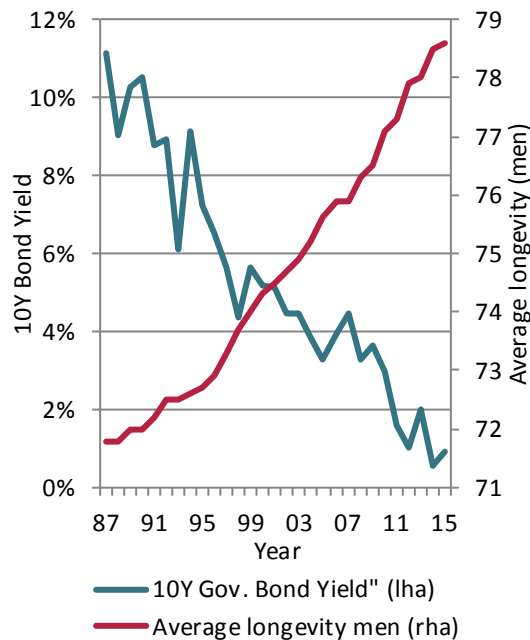
- Using interviews as a part of the fit & proper assessments?
- Penalties to increase the incentive amongst directors to take responsibility?
- Focus on mapping qualifications and responsibility in the board of directors and the executive board?
- Raise the standards for being fit for
 - Management?
 - Key Function Holder?



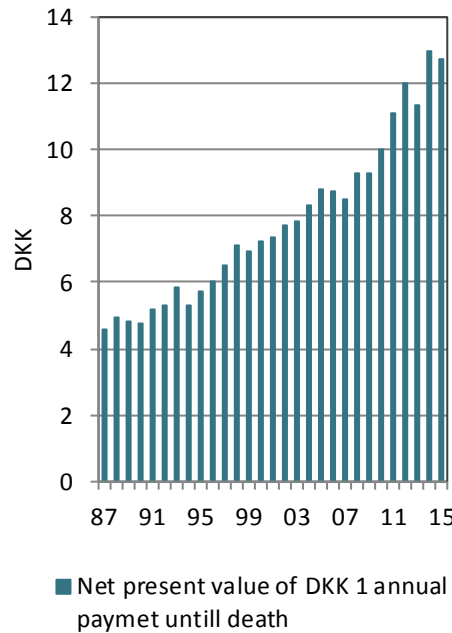
PENSIONS WHEN THE GUARANTEES DISAPPEAR

Low yield, longer longevity and regulation is changing the pension sector

Falling yield and higher longevity....



...increases the value of pension obligations...

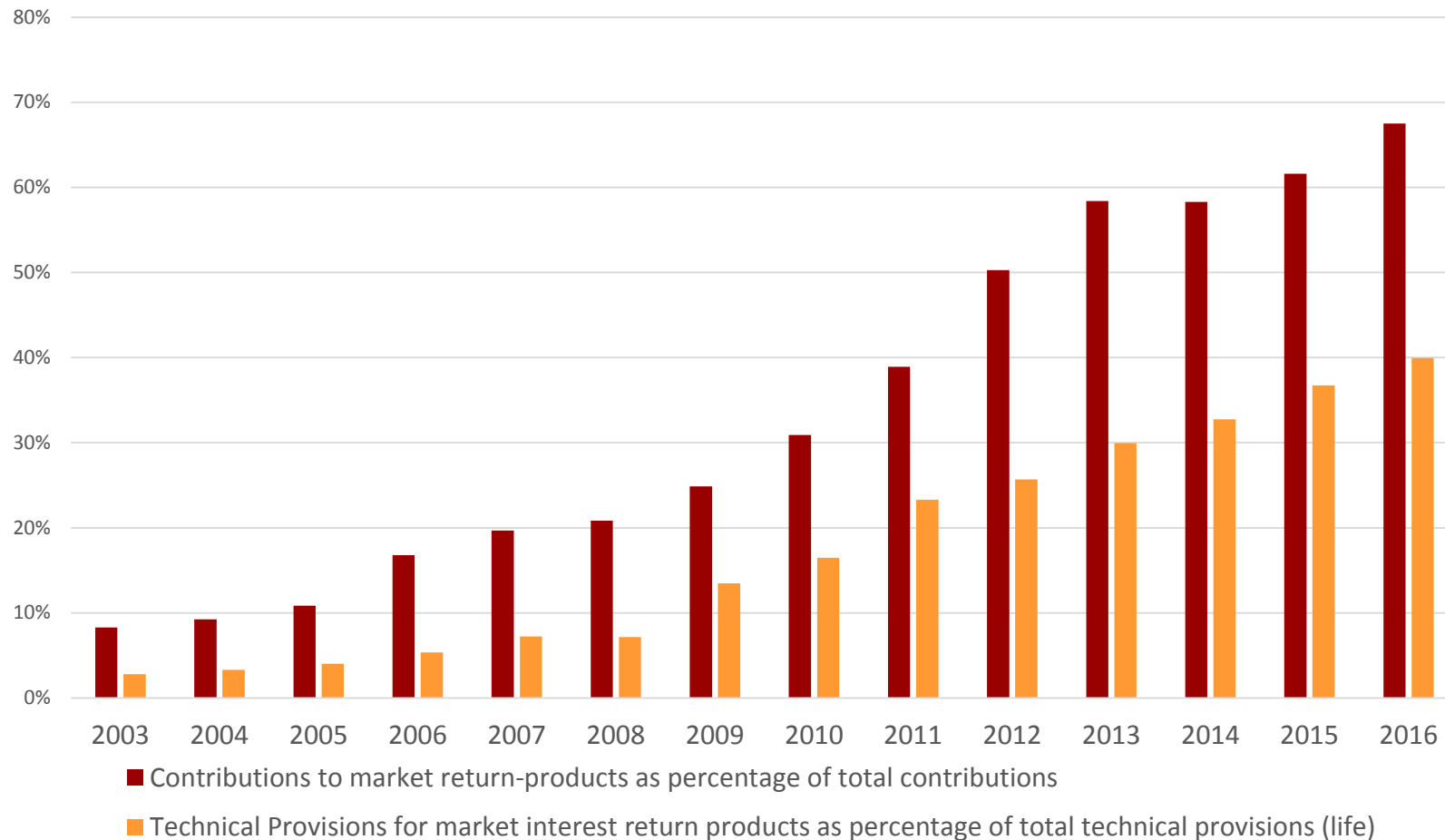


..and the capital requirement increases



...and initiate a shift towards un-guaranteed products 13

Development for market return products (unit-link type and life-cycle type)

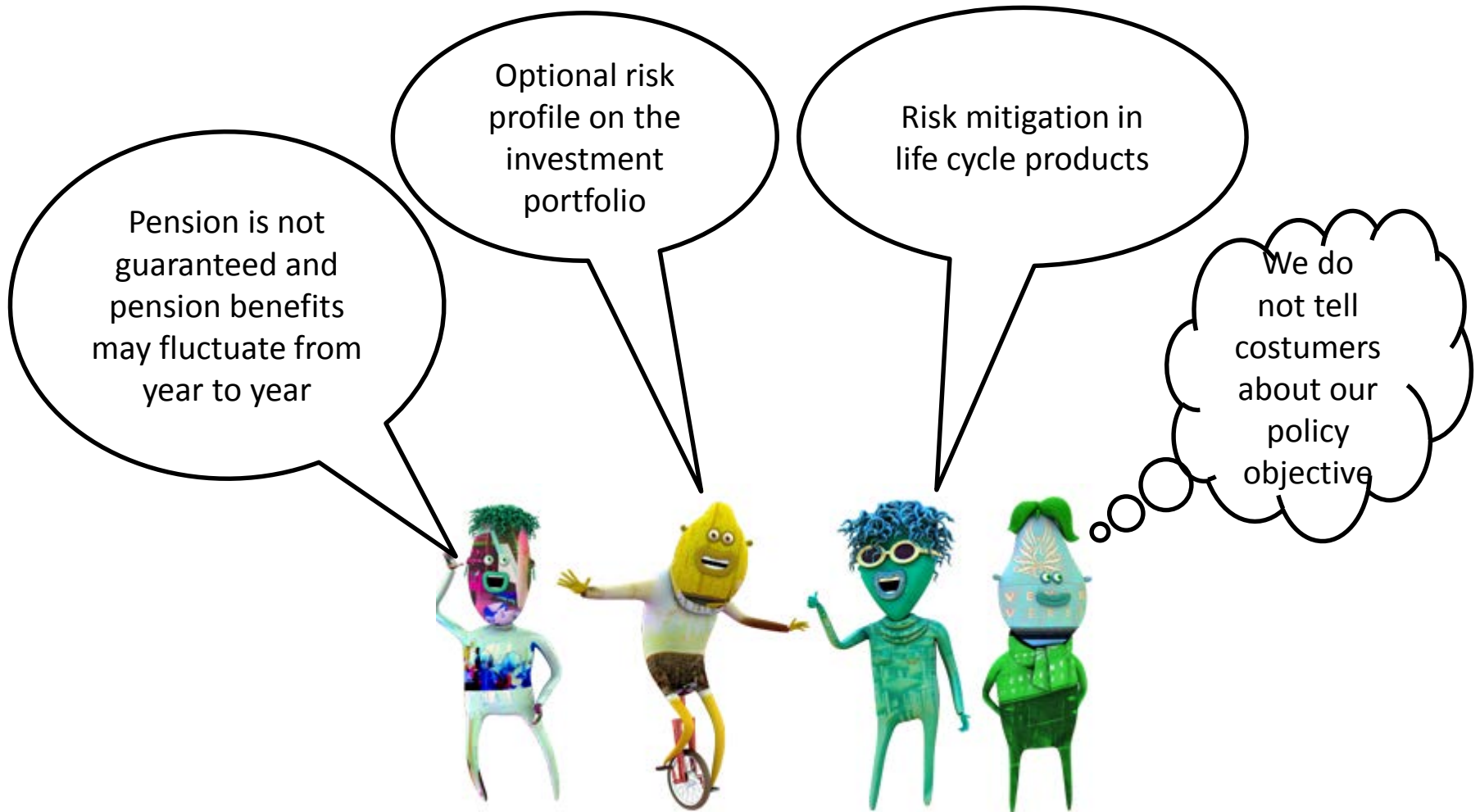


Prudent Person Principle

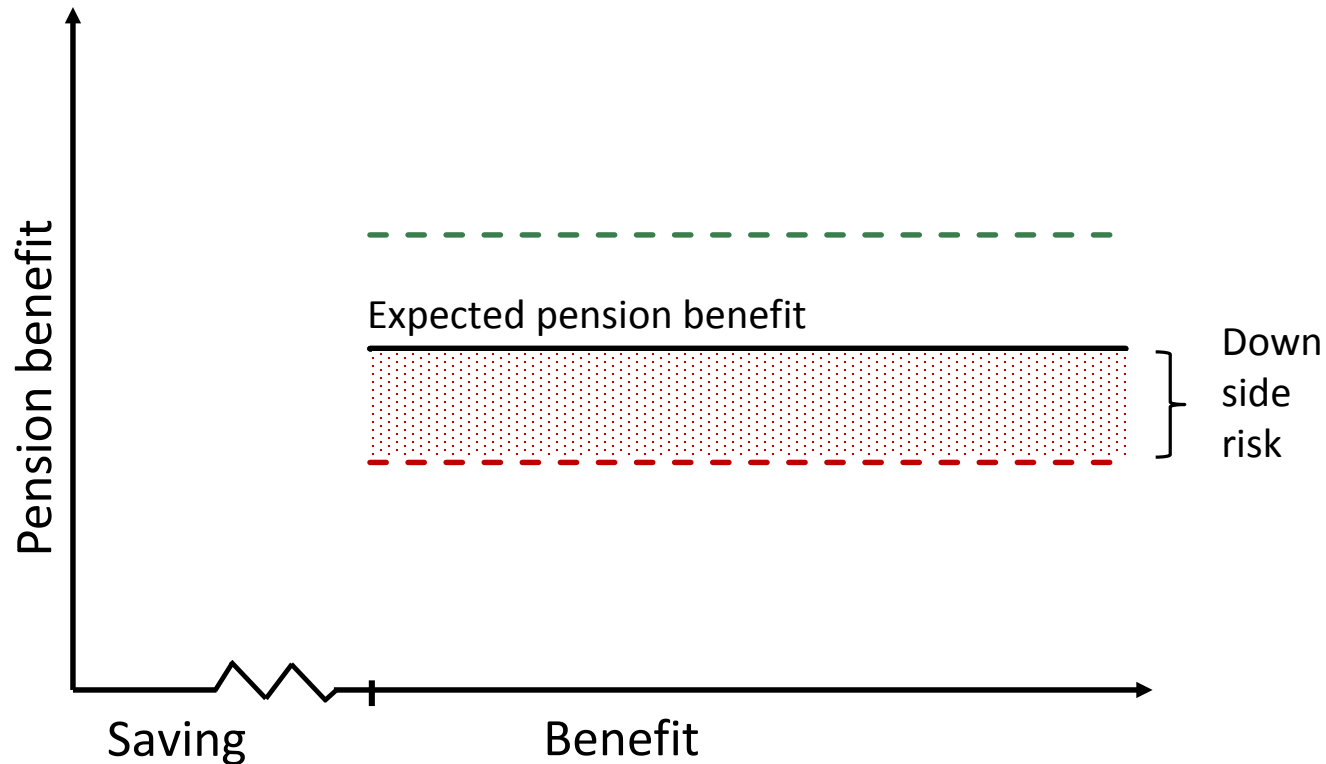
From the Solvency II-Directive:

- Assets held to cover the technical provisions shall be invested in the best interest of all policy holders and beneficiaries taking into account any disclosed policy objective.
- Insurance undertakings shall only invest in assets and instruments whose risks the undertaking concerned can properly identify, measure, monitor, manage, control and report about.

What is the disclosed policy objective in un-guaranteed products?



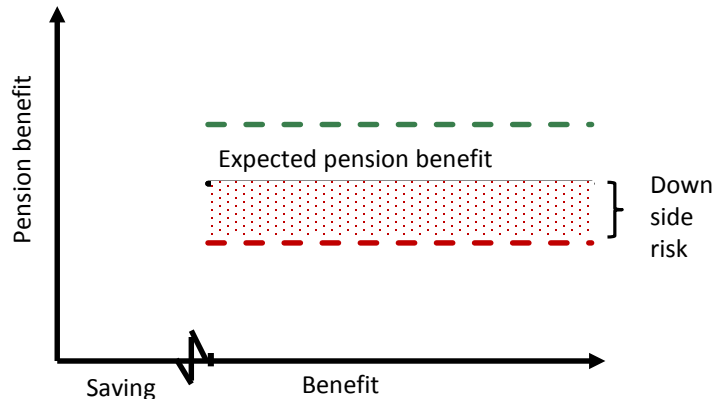
What is the utmost important information?



Dicussion paper issued...



Consumer protection in un-guaranteed products



Possible approaches:

- Should there be a requirement for the company to take a more precise position on the product characteristics of the un-guaranteed products?
- Should there be a requirement for information to customers about the annual pension benefits and the risks associated with this?
- Should there be legislative limits for the risk in relation to the annual retirement benefits that a company may apply in a given product?

ALTERNATIVE INVESTMENTS ARE GROWING

Alternative investments in short

Alternative investments are:

- Illiquid investments
- Do not trade on regulated markets
- Does not have a market price but is mark-to-model
- Risks are difficult to identify and measure
- Requires special skills to understand and handle
- Some of the investments are "asymmetric" in return

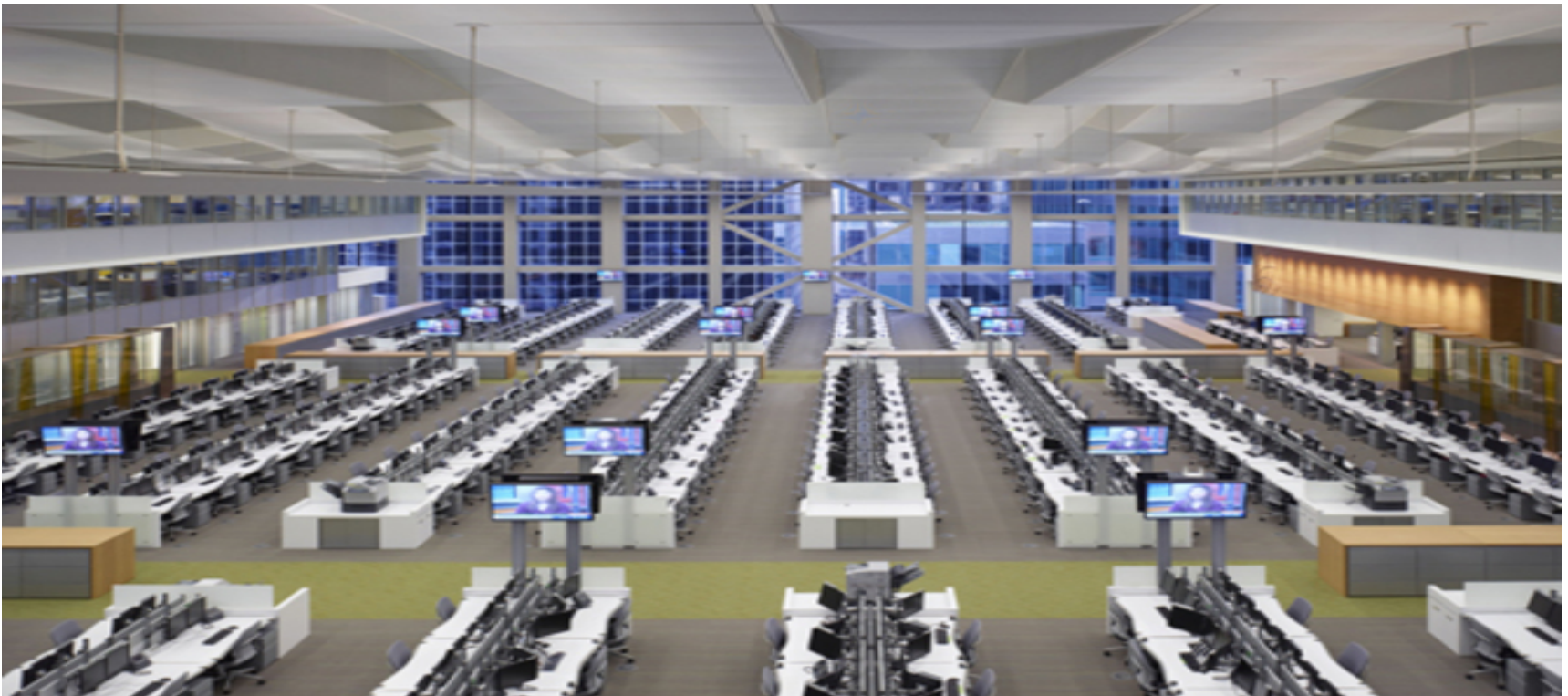


Examples



What does it take to understand these business cases? 22

Pressure on the organization and the governance structures



"There's no such thing as a free lunch"

Financial risk

- Illiquidity risk
- Correlation risk
- Portfolio risks
- Valuation risk

Commercial risk

- Business case risk
- Geographical risk
- Cultural related risk

Other risk

- Political risk
- Legal risk
- Manager risk
- Model risk
- Reputational risk
- Operational risk

Recent headlines from Investment & Pensions Europe

PensionDanmark, Danica invest \$300m in new ship leasing fund

20 March 2017 By [Rachel Fixsen](#)

Danish pension funds [PensionDanmark and Danica Pension have backed the launch of a \\$300m \(€279m\) shipping fund run by Navigare Capital Partners.](#)

PensionDanmark has put \$200m into the vehicle, it said. Navigare has also invested in the fund – Maritime Investment Fund I – which will buy, lease, and sell ships.

...

AP Pension invests DKK500m in green energy fund

17 July 2017 By [Rachel Fixsen](#)

Denmark's AP Pension is investing DKK500m (€67.2m) in a new infrastructure fund focusing on European and US renewable energy assets, alongside other big Nordic and UK investors.

...

PensionDanmark, PKA, Lægernes in \$550m Africa infrastructure fund debut

9 August 2017 By [Rachel Fixsen](#)

PensionDanmark, PKA and Lægernes Pension have launched an African infrastructure fund with a newly created company, AP Møller Capital.

The Danish pension funds have committed US\$550m (€468m) and hope to increase this to US\$1bn by bringing in other Danish and international investors.

...

ATP, PKA, PensionDanmark, Industriens back DKK1bn farming fund

20 February 2017 By [Rachel Fixsen](#)

Four of Denmark's biggest labour-market pension funds have agreed to invest DKK500m (€67.2m) in a state-backed fund to lend money to the country's farming businesses. ...

We as supervisors are concerned:

- That many new and big investment mandates are given
- If the necessary skills are present
- If the companies understand the risk / return ratio
- How the companies make their valuation



The next step

- We are preparing a discussion paper that will aim at specifying our requirements for alternative investments
- After a public hearing of the discussion paper we expect to issue a guideline on our expectations for the management of alternative investments



TWO-DIMENSIONAL LONGEVITY BENCHMARK IN DENMARK

What is the Danish FSA benchmark?

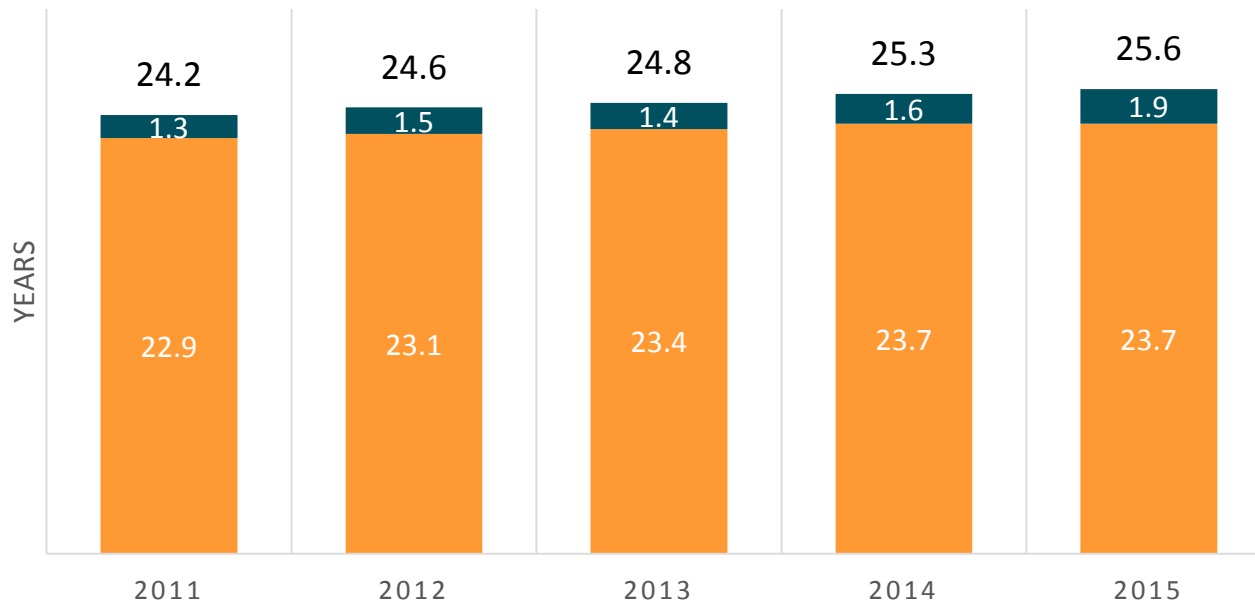
The benchmark consists of two components:

1. A benchmark for current observed mortality
 - What is the mortality of an x-year old person today?
 - Based on information about insured lives from the Danish Centre of Health and Insurance
2. A benchmark for expected future improvements in life expectancy
 - What is the yearly reduction in mortality an x-year old person will experience during his/her lifespan?
 - Based on the total Danish population

Development in life expectancy for the Danish FSA benchmark

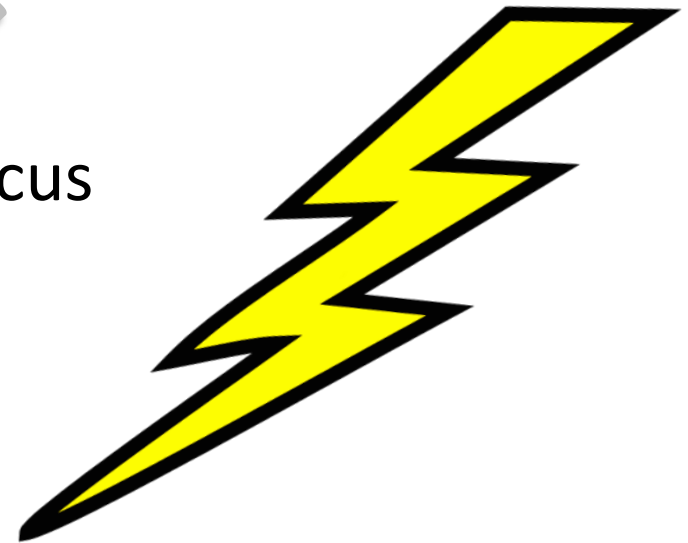
■ Effect from the current observed mortality ■ Effect from the expected future improvements Total

- Development in the life expectancy of a 60-year old male since the introduction of the benchmark



Another view on the privatization of the pension risk

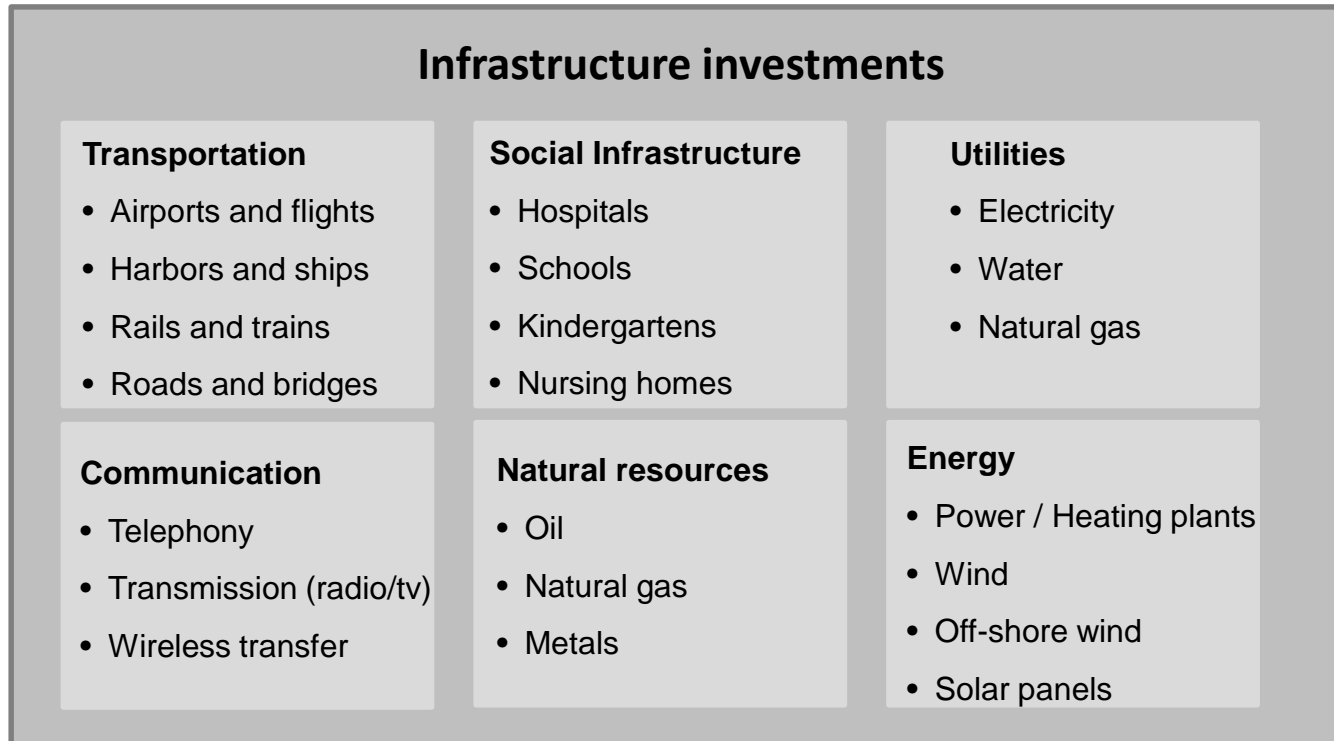
- Solvency II loses its role as the risks are borne by the customers.
- The future of the actuary is threatened by the fact that the focus now moves to the asset side.



THANKS!

APPENDIX

Investments in infrastructure can be many things



Alternative investments in different product types

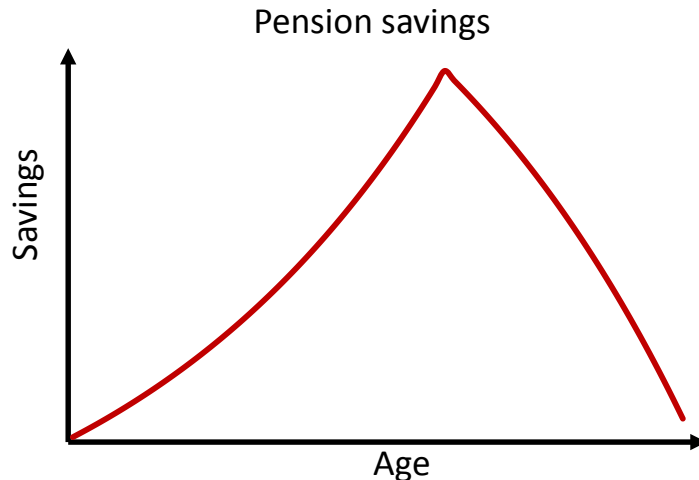
PERCENTAGE OF ALTERNATIVE INVESTMENTS IN AVERAGE RETURN-RATE AND MARKET RETURN PRODUCTS, Q2 2017



What is pension?

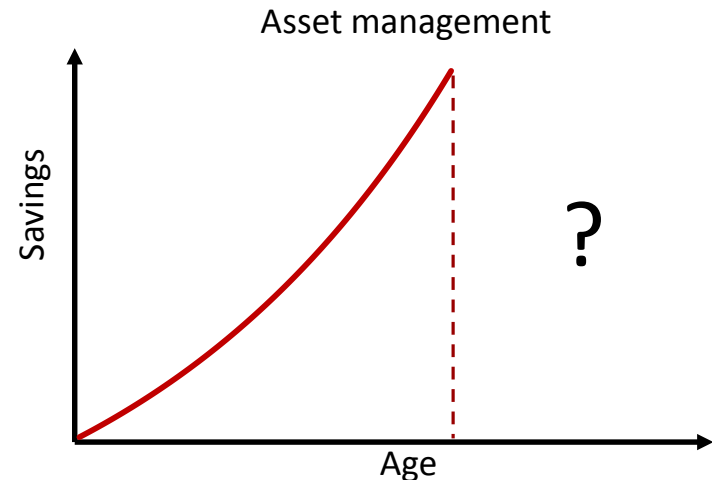
Pension savings:

- Savings and benefit phase
- Typically sharing of longevity risk
- Solvency II



Asset management:

- Savings
- No sharing of risk
- MiFID



Consumer protection if pension savings applied to MiFID...

... customers with portfolio asset management agreements should be fitness tested*, i.e. that it is necessary to investigate whether the product is suitable for the customer based on individual information about the customer:

- Knowledge of and experience with the product
- Risk appetite
- Investment objectives and horizons
- Economic ability to bear a possible loss



*)Investorbekendtgørelsen §16

What is alternative investments?

Alternative investments are illiquid financial instruments that are typically not traded on a active market.

Alternative investments are typically direct investments in equity, loans or commitments.

Compared to traditional investments, alternative investments also differ significantly in terms of the degree of investment complexity and the security of the underlying cash flows.

The menu of assets is getting more diverse?

Types of assets

- Bonds
- Stocks
- Real estate (residential and commercial use)
- Private Equity
- Infrastructure
- Agriculture and forestry
- Credit (structured lending, direct lending, distressed debt..)
- Hedgefunds



Supervisory focus on alternative investments on all on-site inspections

- From the beginning of 2014 we have asked questions concerning alternative investments on on-site inspections, mostly to understand the strategy and the expected development and the reasoning behind individual investments
- All our on site inspections are concluded with a report to the company and public statement covering the main findings. In practically all reports and statements we comment on alternative investments

Public statement about inspection in Nordea Liv & Pension, livsforsikringsaktieselskab A/S

...

Nordea Liv & Pension expects to increase the proportion of certain alternative investments in the future.

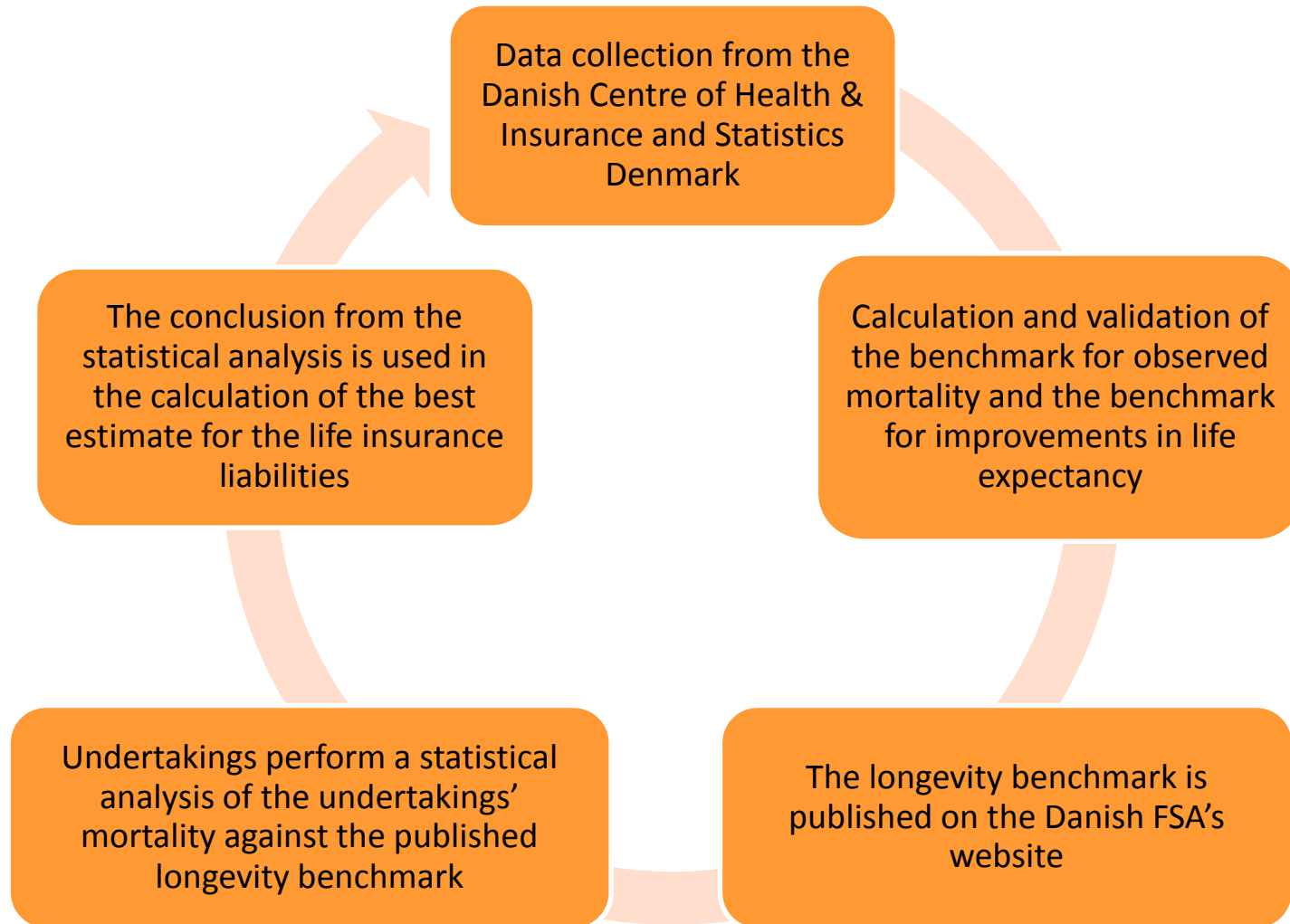
Finanstilsynet has therefore provided the company with a risk statement that this requires continued ongoing focus from the Board of directors and the Board of management, in particular to ensure the correct valuation of alternative investments, satisfactory risk-adjusted returns, ongoing evaluations of investments made and risk management on a satisfactory basis.

...

On site inspections with focus on alternative investments

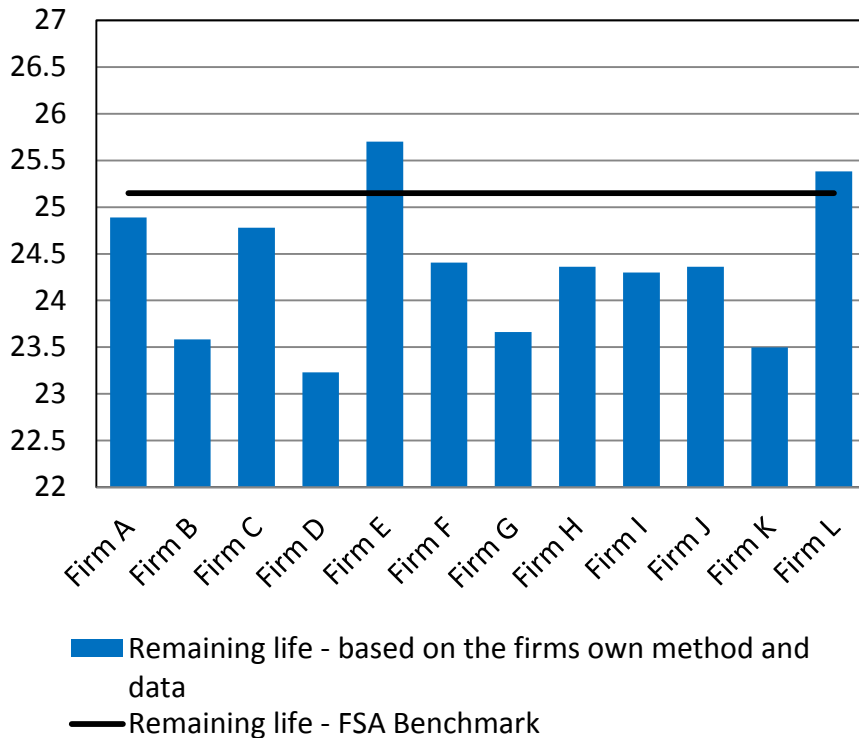
- Performed on-site inspections with specific focus on credit in 2016. Performed by the credit experts from our banking area
- Main findings: reactions on missing governance structures and risk management

Yearly process for the Danish FSA's longevity benchmark

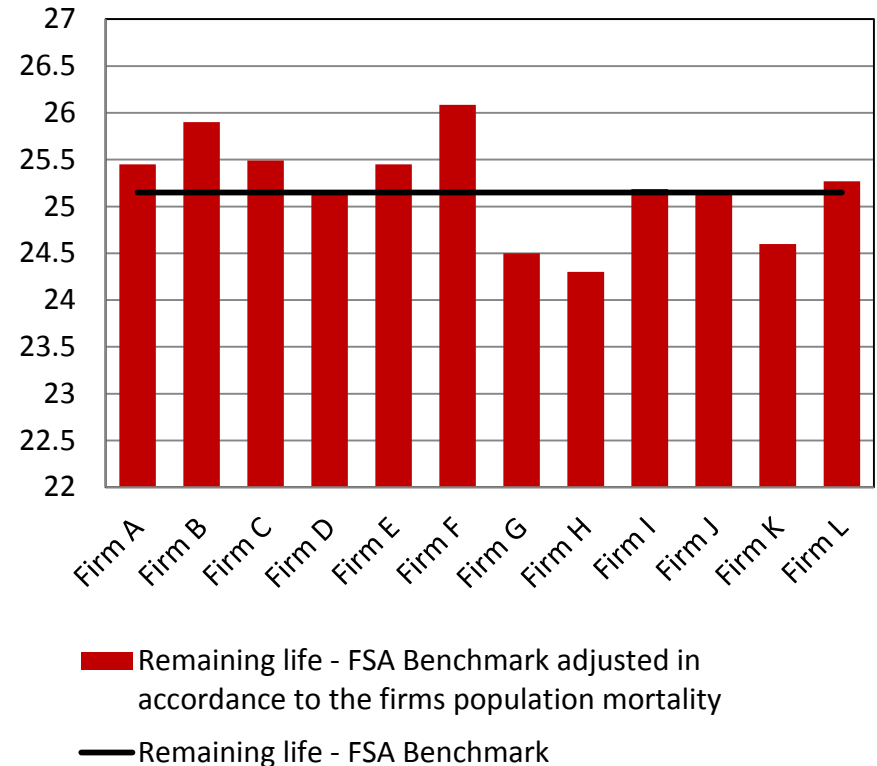


Pre and post the longevity bechmark

**Remaining life 60-year-old
(average of both sexes)**



**Remaining life 60-year-old
(average of both sexes)**



The differences in life expectancy are now smaller and justified 43