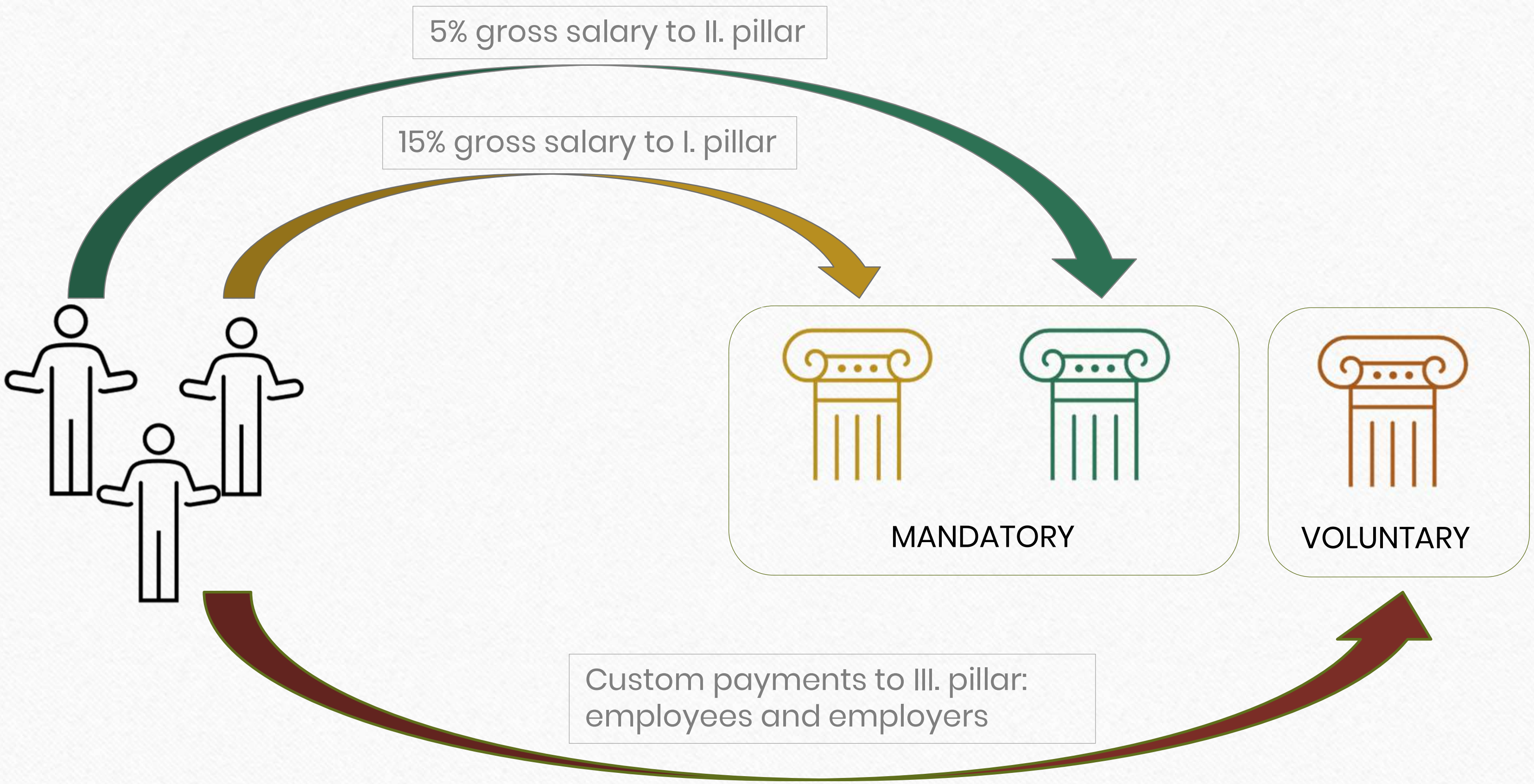
Pension insurance contracts in Croatia

Regulation and reporting for Pension insurance companies

AAE Pensions Committee – Meeting: March 31 2022

Pension system – overview



II. pillar

Accumulation phase

- 4 pension funds
- Not paying pensions
- Pure DC approach
- AuM ≈ 130 bln HRK
- On the date of retirement, savings are transferred to state budget for PAYGO pension or to PIC (pension insurance company) to buy lifetime annuity, depending on what's better for pensioner

Payout phase

- 2 Pension insurance companies for payout phase (cca 30 employees in both)
- For lump sum received client must buy lifetime inflation linked annuity (single, joint, guaranteed period, value protection)
- The retiree chooses PIC and annuity type he wants (or need to take according to law restrictions)
- AuM ≈ 2 bln HRK
- According to EIOPA's classification: „Pure DB approach" with CPI inflation guarantee
- More than 90% of new business is from mandatory pension insurance

III. pillar

Accumulation phase

- 8 open and 20 closed pension funds (occupational)
- Pure DC approach
- AuM ≈ 7 bln HRK
- On the date of retirement, a programmed withdrawal (usually 5 years with a lump-sum 30%) from the fund or savings are transferred to the PIC to buy temporary or life annuity

Payout phase

- 2 Pension insurance companies for payout phase
- The retiree chooses PIC and annuity type he wants
- Temporary annuity – financial contract
- Life-time annuity (single, joint, guaranteed period) – insurance contract
- Managed separately from the mandatory insurance
- According to EIOPA's classification: „Pure DB approach"
- PICs cover only one risk - longevity (diversification)
- Less than 1% of new business coming from closed funds (IORP II)

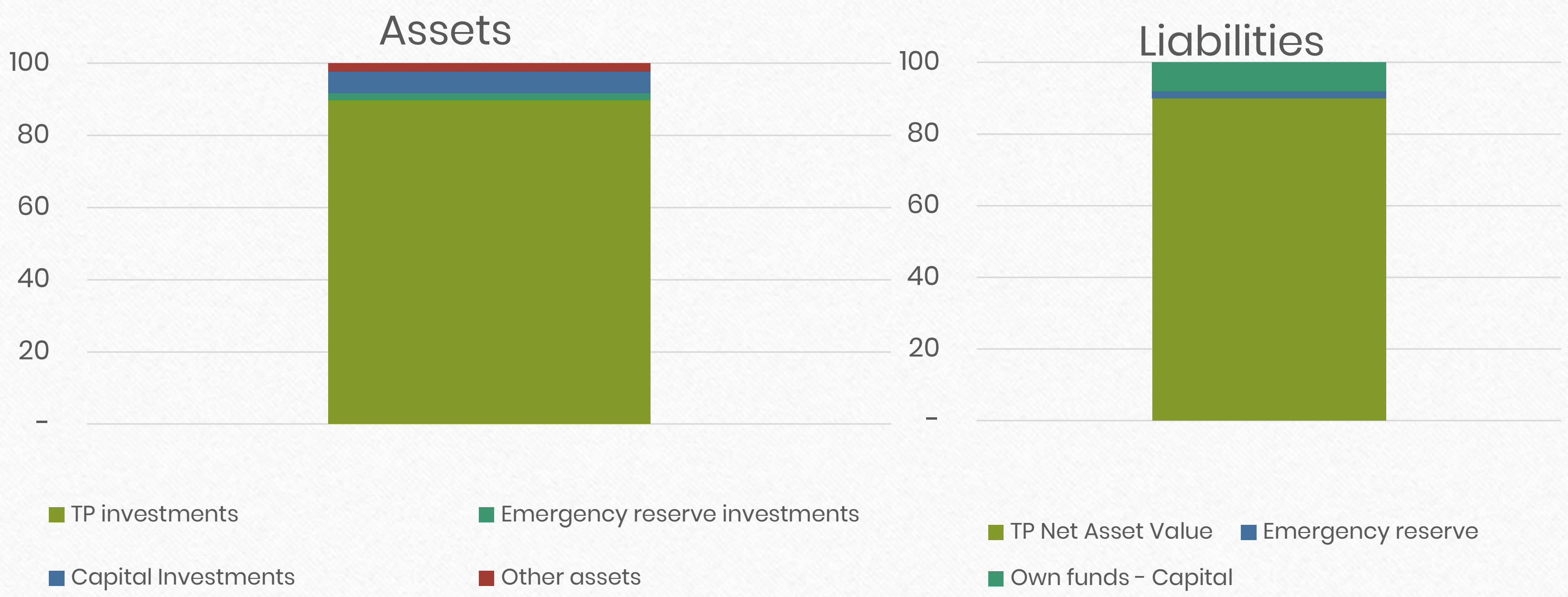
Pension insurance company – legal framework

- Law on PICs: based on IORP II Directive (capital requirements 4% of TP)
- Accounting and financial statements: based on IFRS 4 (insurance companies)
- BUT:
    - change of technical provision is the change in the Assets of the portfolio (The assets must be at least equal to calculated actuarial TP)
- BUT 2:
    - P/L of the Company comes from collected fees, financial result from own funds and paid expenses of the company

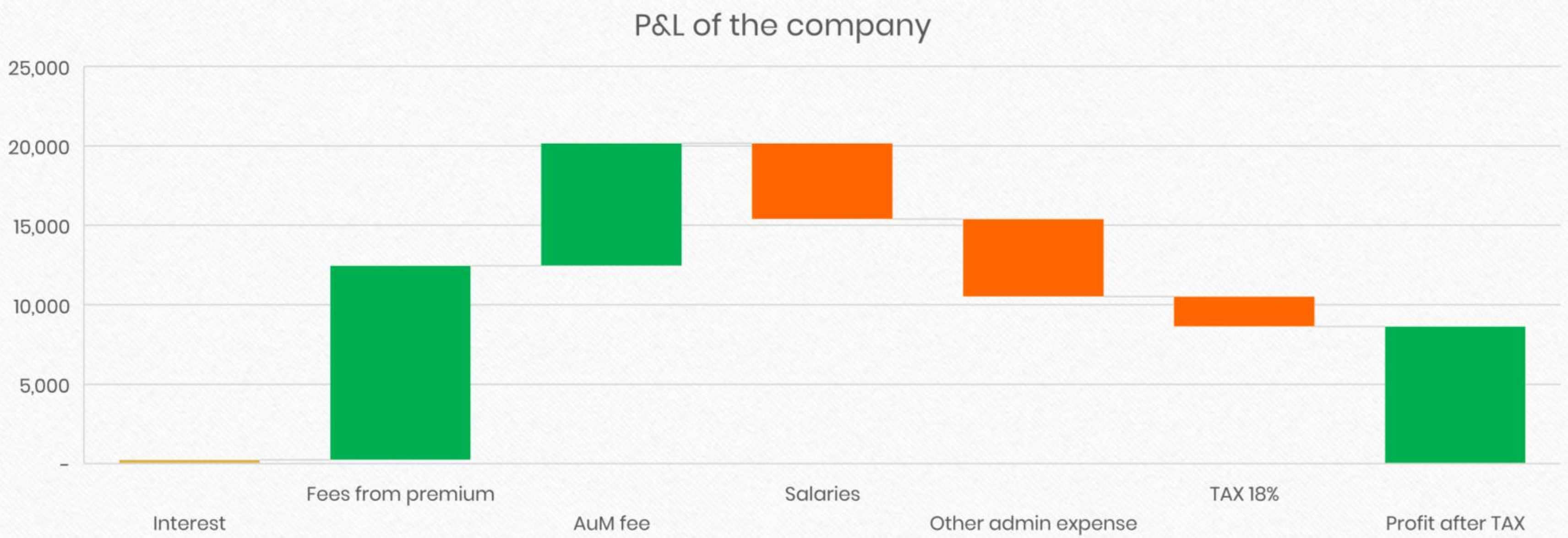
Pension insurance company

- By Law there are limited fees in contracts in mandatory pension insurance
- Non-insurance fee: Asset Management Fee (similar as in funds)
- Surplus sharing – surplus in performance of the portfolio goes to the clients and in the emergency provisions
    - *The profit-sharing mechanism is mandatory for 2nd pillar pensions and there is detailed regulation regarding when and how much of the profit should be allocated to pension beneficiaries. For other products, profit sharing mechanism is discretionary to the pension provider.*
- Investment limits strictly prescribed (70:30)
- LAT performing – if inadequate costs → increase in Assets covering TP → this is illogical: consequence is potential surplus sharing, and not covering of future higher costs

Balance sheet - simplified



P&L - simplified



Pension insurance company – surplus sharing

- "Surplus of TP" is calculated as a difference between fair value of Assets to cover TP and actuarial calculation of TP
  - the value of the assets to cover TP must be **at any moment** at least equal to the amount of required coverage
  - Value of the Surplus changes according to returns on Assets and/or the change in the actuarial TP
  - If Surplus of the **overall** portfolio is:
    - < 0 → cover from ER* (if any) and own funds (capital) non-refundable;
    - >15% of required coverage (TP) → readjustment of pension rights (attribution to the clients ¾, and filling the ER ¼)

ER - emergency reserves, when attributing surplus to the clients, 3/4 goes to clients and 1/4 goes to emergency reserves

P&L Example

Positive result of insurance portfolio

Position	Amount
Premium	100.000
Claim (annuity)	-10.000
Inv. Result	8.000
Expenses	-1.500
Change of TP	-90.000
Result	6.500
BoP surplus	3.000
EoP surplus	9.500

- No effect on the P/L of the company
- Positive result of 6.500 will remain in the surplus to be attributed to the clients

Negative result of insurance portfolio

Position	Amount
Premium	100.000
Claim (annuity)	-10.000
Inv. Result	-3.000
Expenses	-1.500
Change of TP	-90.000
Result	-4.500
BoP surplus	3.000
EoP surplus	-1.500

- If surplus is negative, the company must compensate the loss from its own funds
- P/L of the company will be decreased by 1.500

Insurance Company or Pension fund

Why PICs are not an insurance? – IFRS4

- No profit for Company from insurance risk
- All technical and investment result belongs to the policyholders
- Profit of the company = Contract fees + AuM Fee – Expenses
- Asset Management Fee

Why PICs are not a fund (service provider)? – IFRS15

- The company guarantees the payment of pensions – longevity risk, inflation risk
- Funding ratio must be always greater than 100%
- Any lack of funds to cover TP the company must cover immediately, and that money cannot be returned to the owner

Pro and contra IFRS 17

For pension insurance contracts in Croatia

IFRS 17 pro’s and con’s within current regulation

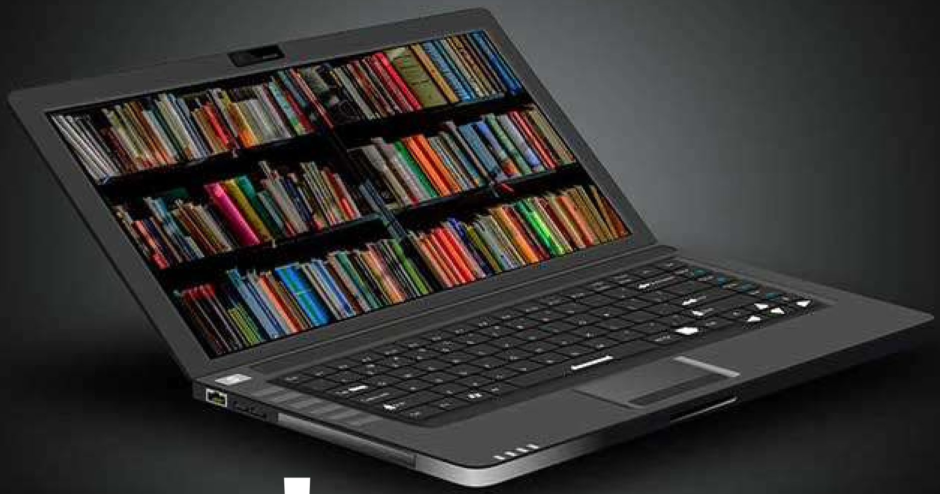
PRO

- Comparability with other finance industries – separated insurance **result** from investment **result** and separated insurance **revenue** from investment **revenue** in financial statement
- More transparent if insurance portfolio is profitable or onerous (creating profit or loss)
- More transparent (explicit) Risk adjustment for non-financial risks
- Market discount curves – better ALM (OCI option)

IFRS 17 pro’s and con’s within current regulation

CONTRA

- Implementation costs (IT systems, additional HR, etc.) vs. benefits gained – limited Fees by Law → potential of onerous business – by Law prohibited further contracting
- CSM – only the difference between defined fees (limited by Law) and real costs, all profit (technical and investment) belongs to the policyholders
- Limited methodology of releasing of the CSM – new business pressure
- Calculation model issue – GMM vs. VFA (treatment of future attribution of surplus to policyholders, AM fee)
- Annual cohorts – surplus sharing defined by the law based on performance of the whole portfolio (temporary financial annuities in or out?)
- Calculation of Technical (Mathematical) provision is still necessary – needed for solvency calculation (4%) and Asset Management fee calculation



Thank you!

Questions?