

OECD Seminar

Reforming Pension Protecting Schemes

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TOPIC 2

Premium setting under new funding arrangements

Martin Hoppenrath
Chairman of the Board of Management
Pensions-Sicherungs-Verein
Cologne

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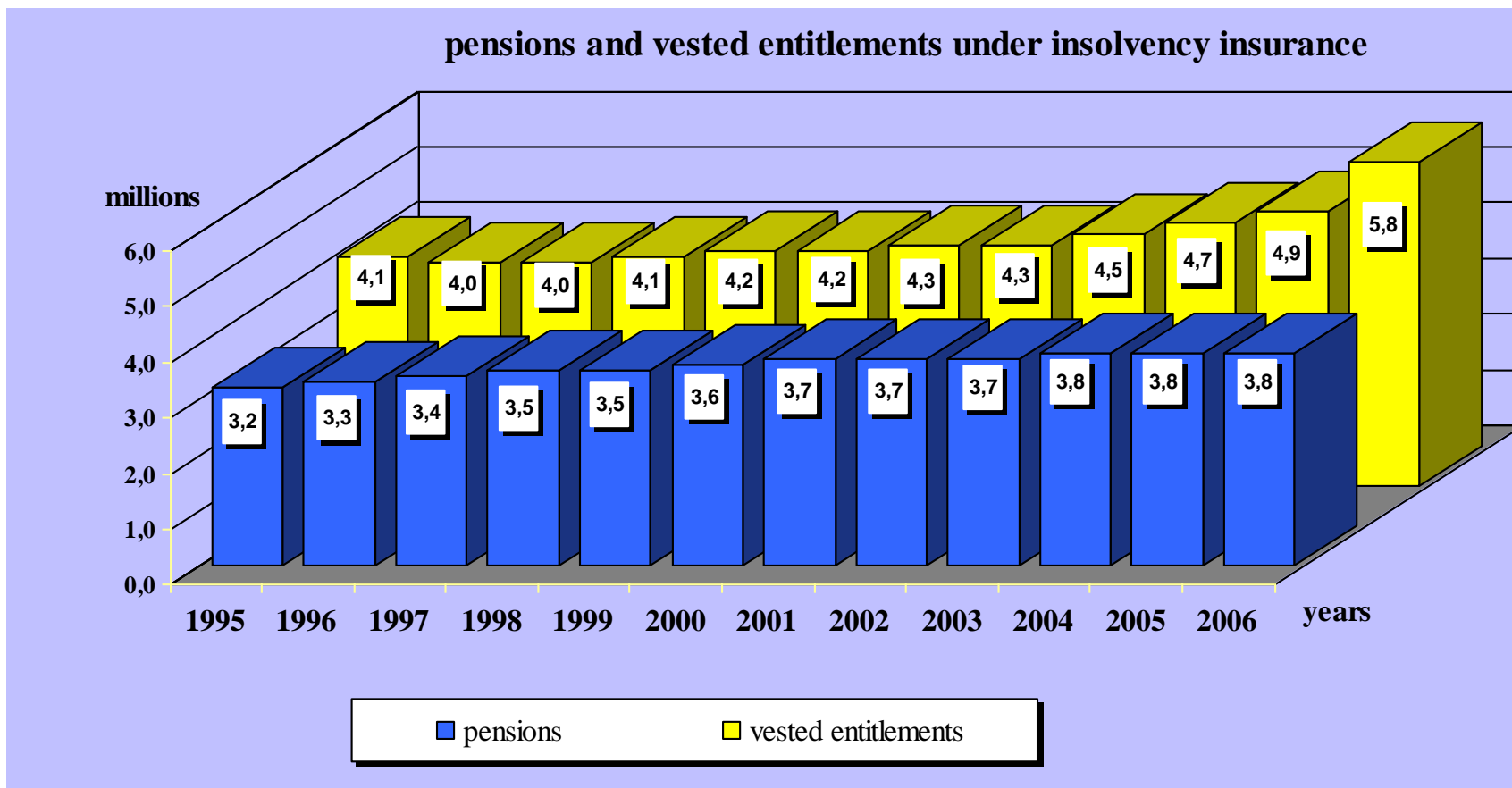
1. Introduction

The PSVaG is not a government authority!

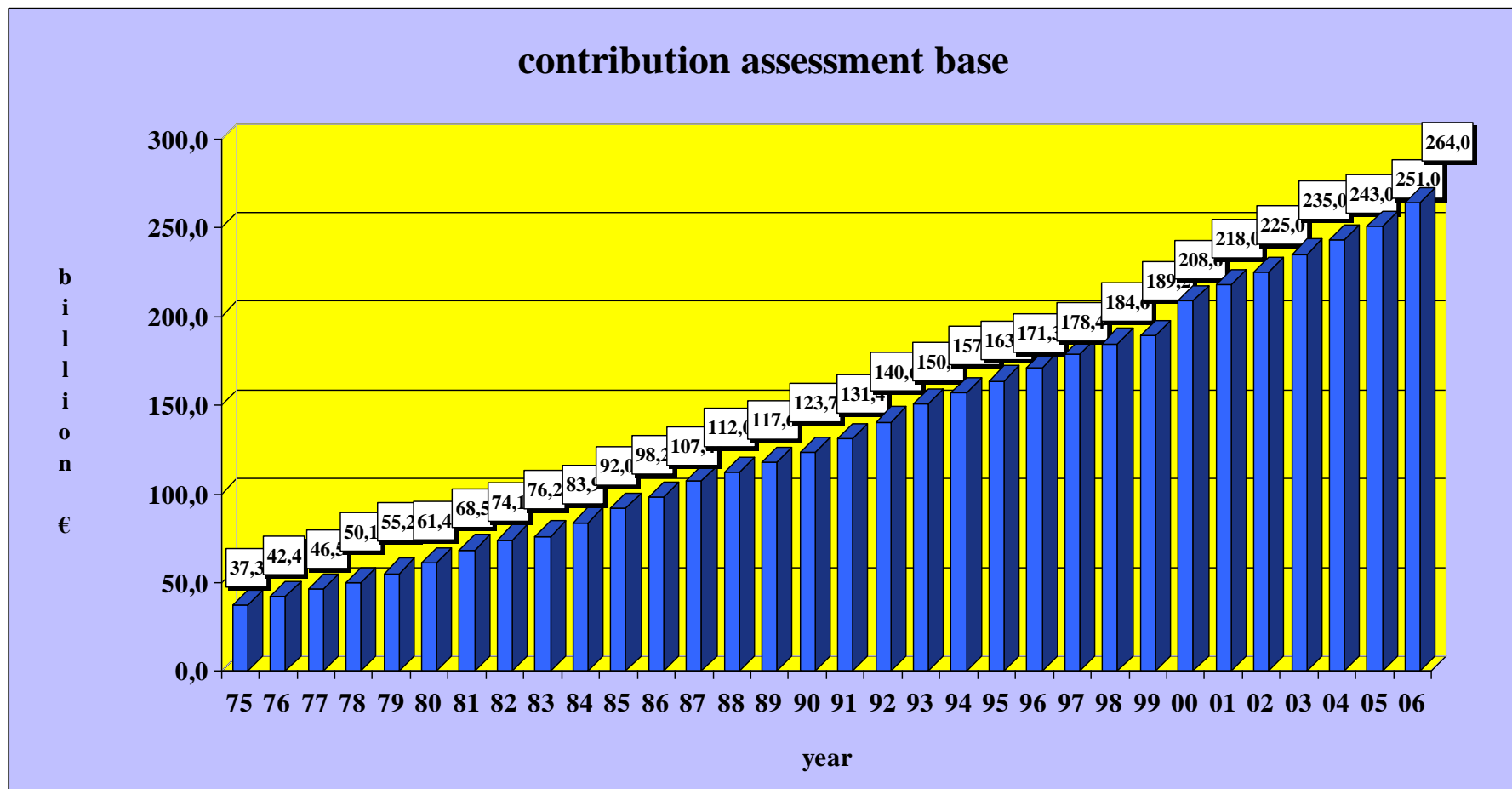
It is a self-financed-organisation of employers!

- Established at the end of 1974
- On January 1st, 2002, PSVaG assumed similar responsibility for corporate pension insolvency in the Grand Duchy of Luxembourg
- Mutual organisation
- Authorized to levy contributions under public law
- Organized under civil law

1. Introduction

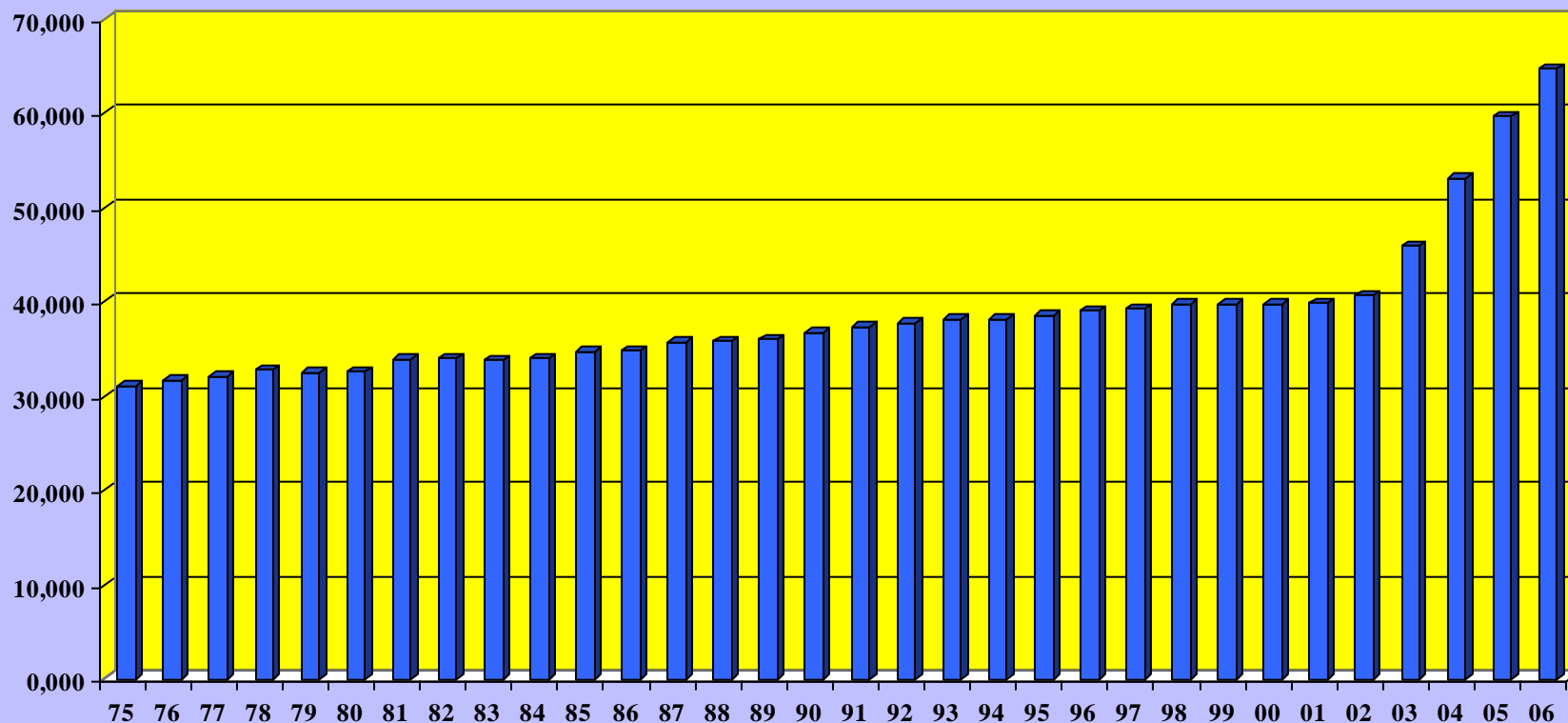


1. Introduction



1. Introduction

number of member firms



1. Introduction

Insolvency insurance covers four different types of financing for employee pension benefits:

- Direct pension pledge within the book-reserve-system
- Support fund (Unterstützungskasse)
- Direct insurance with revocable rights or policy loans
- Pension fund (since 2002) - contributions are reduced by law to 20 % of their normal size

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2. Premium setting until 2005 - Pension value apportionment system

- Statutory insolvency insurance for corporate old-age pensions was based on the pension value apportionment system.
 - Payable pension benefits → capital covered in the year of insolvency
 - Conversion cases, i. e. vested entitlements become payable pension benefits → capital covered in the year in which benefits become due
 - Other vested entitlements → not covered
 - The financing system was a need-based covered system

2. Premium setting until 2005 - Pension value apportionment system

- Vested entitlements registered at 31 December 2005 for which the benefits will be payable within the next 30 years
 - Approximately 167,000 entitlements
 - Majority of case - due to the age structure within the next 10 - 15 years
 - Total cash value of these entitlements:
 - 2.2 billion €
 - computed with a base interest rate of 3.67%
 - Called: „old obligations“

2. Premium setting until 2005 – Pension value apportionment system

- Corporate pensions plans have been subject of many changes during the past several years
 - Away from fully insured pension schemes in favour of non-insured or only partially insured pension schemes
 - Danger of a thinning of the contribution base
 - The option of transferring pension obligations to pension funds will probably accelerate this trend
- Question
 - As to whether a system of this kind
 - In which certain liabilities were shifted into the the future
 - Still represented a viable basis of future financing?

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3. New premium setting – complete capital coverage

- Decision of the PSVaG in April 2005:
Conversion of the existing financing system to a full capital coverage system, that means:
 - First: Members of the PSVaG finance in the year of the employers insolvency the entire amount of claims:
 - The cash value of current payable benefits and
 - The cash value of vested entitlements
 - Second: The retroactive financing of the vested entitlements from previous insolvencies - „old obligations“

3. New premium setting – complete capital coverage

- The essential law came into effect in December 2006
- Contributions must cover
 - Total cash value for pension benefits to be payed
 - Difference between the total cash values of the vested entitlements resulting from insolvencies registered by the end of the calendar year and those registered by the end of the preceding calendar year
 - Administrative costs
 - Payments to the compensation fund designated by the supervisory authority (BaFin)
 - Payments to the loss reserve account pursuant Art. 37 of the Insurance Supervision Act (VAG)

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3.1 Total cash value of pension benefits to be payed - unchanged

- Total cash value of pension benefits to be payed includes
 - All pension assurances by insolvent employers for which benefits became payable prior to insolvency (current benefits)
 - Conversion cases – benefit claims for vested entitlements accruing from insolvencies in previous years
- Cash values are
 - Sufficient to pay the benefits for life
 - Computed in accordance with actuarial principles
 - Base interest rate
 - Prescribed by law
 - In effect for life assurance companies
 - Until 31 December 2006 : 2.75 %
 - Since 1 January 2007: 2.25 %

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3.2 Difference in the total cash values of entitlements - new

- The amount of the vested entitlements to be financed annually
 - In addition to current claims
 - Is computed using the differential financing method
 - The difference in the cash values reflects
 - Additions to existing entitlements, i. e. entitlements from new insolvencies
 - Deletions from existing entitlements, i. e. cases in which benefits become due (conversion cases)

3.2 Difference in the total cash values of entitlements - new

- The need for additional financing of entitlements
 - Total cash value of entitlements at the end of the current calendar year
 - Minus
 - Total cash value of entitlements at the end of the preceding calendar year
- Approximately 113 million € for 2006
- Other elements reflected in the difference
 - The accounting interest rate
 - Any possible valuation differences

3.2 Difference in the total cash values of entitlements - new

- Base interest rate for entitlements prescribed by law
 - One third higher than for pensions
 - Until 31 December 2006: 3,67 %
 - Since 1 January 2007: 3,00 %
- Justification of a higher interest rate
 - Interest rate applied to pension values is calculated conservatively
 - Surplus interest would be earned
 - These interest gains would benefit only current and future contributors
 - Employers who have converted to non-insured pension schemes or schemes with a lower contribution base would no longer benefit from relief from these interest gains, or would benefit only at the lower base

3.2 Difference in the total cash values of entitlements - new

- Different base accounting interest rates
 - 2.25 % for payable pension benefits
 - 3.00 % for entitlements from 2007
 - 3.67 % for entitlements from 2006 and for the „old obligations“
- Retroactive financing is required (due to the lower interest rate)
 - When entitlements become payable benefits
 - To be included in the contributions for the respective current year
- The financing system remains a need-base one

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3.3 Retroactive financing of „old obligations“ - new

- Financing 2.2 billion € over 15 years period by employers
 - Who had to pay contributions in 2005
 - According to their individual contribution assessment bases for 2005
 - Total contribution assessment base for 2005: 251 billion €
- Contribution rate to finance the „old obligations“: 0.866 %
 - 15 equal annual instalments due on 31 March each year
 - Over the 15 year period it is 0.0577 % each year
 - Employers are entitled to pay the entire amount at any time during the 15 years period discounted for early payment
 - Discounted total payment on 31 March 2007 was mandatory for those employers whose computed annual instalment was 50 € or less

3.3 Retroactive financing of „old obligations“ - new

- PSVaG sent to 59,000 employers one-time contribution notices for financing „old obligations“ in late January
 - 27,000 with annual instalments of 50 € or less
 - 32,000 can choose to pay annual instalments or the discounted entire amount
 - 16,000 payed the discounted amount
 - Only 16,000 remained for annual instalments
 - How many of them will pay the discounted amount within the next years ?
- Currently over 800 millions € cover about 35 % of the cash value of the vested entitlements
 - calculated at 31 December 2006: 2.3 billion €
 - 690 millions € are be payed for the „old obligations“
 - 113 millions € are financed for the vested entitlements in 2006
- Complete capital coverage will be reached at 31st March 2021, the end of the 15 years period

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4. New approach to evening out developments in contribution rates

- New legislation also provides for a method for evening out peak contribution rates
 - If the amount to be financed by contributing employers in a given year exceeds that of the preceding year
 - The difference can be distributed over the current and the following four years
- This will make it possible to ensure more consistent contribution levels over time

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5. Closing remarks

- Additional capital gains
 - Will offset the higher contributions to an increasing extent
 - After a certain period of time, contributing employers will pay lower in future
 - Depending on developments in interest rates in the capital market

The End

Thank you for listening

Look at www.psvag.de.

There you will find short versions
of the annual reports of the last years in English.