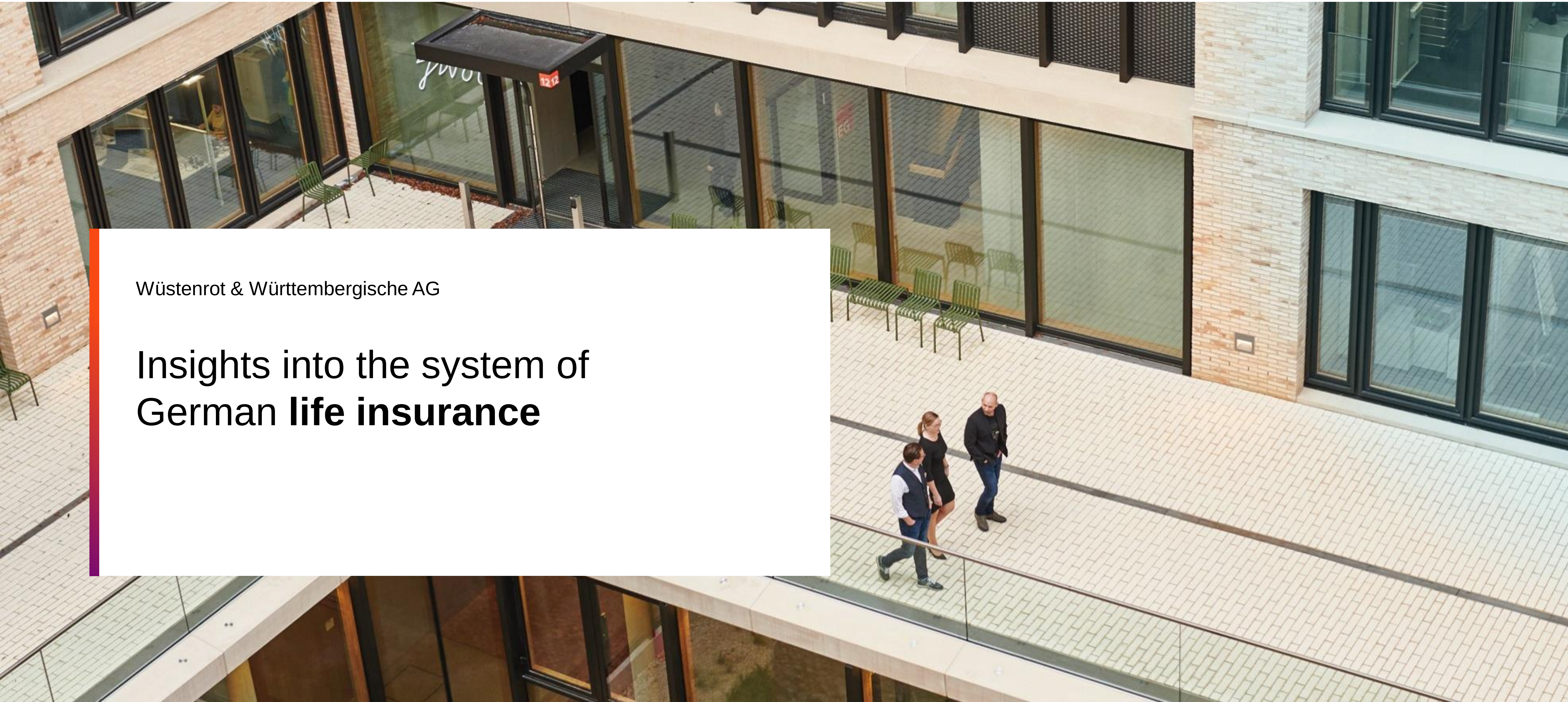
w&w gruppe



Wüstenrot & Württembergische AG

Insights into the system of German **life insurance**

What is German life insurance

Life insurance

Life insurance includes insurance policies that serve private old-age provision or cover so-called biometric risks such as death or disability. They are an integral part of the financial security of private households. From the moment the contract is concluded, the insured have the certainty of being financially protected.

~82m

Number of contracts of life insurances in Germany

2022

~€171bn

New business in Germany

2022

Source: Gesamtverband der Deutschen Versicherungswirtschaft (GDV)

Purpose and types of life insurances

Purpose

Protection of surviving dependants against biometric risks such as death or disability

Build up capital for private old-age provision

Three types in the system of German life insurance

Term life insurance

The insurance only covers in case of the occurrence of the insured biometric risk

\+

Private pension insurance

The insurance only covers from the beginning of retirement

=

Combining the benefits:

Endowment life insurance

The insurance covers in case of the occurrence of the insured biometric risk or when the contract expires

There are different possible configurations for each type of insurance. Furthermore, various supplementary insurances can be integrated in the particular contract (e.g. disability insurance, supplementary accident insurance).

w&w gruppe

Benefits of the German life insurance

Life insurances are insurances of the person. The insurance policy is an agreement about an insurance benefit that will be payed out to the policyholder or another entitled person in case of the occurrence of the insured event.

- The insurer has to serve the benefits that were guaranteed when the contract was concluded for the whole contract period.

- The amount of the insurance premium depend on various factors. These include:
  - the desired extent of the sum insured respectively the monthly pension
  - the state of health
  - risk factors, e.g. smoking and high risk sports
  - the duration of the contract
  - the selling and general administration expenses
  - possible supplementary insurances

Term life insurance – basic characteristics

Purpose	A term life insurance provides financial protection for surviving dependants against the policyholder's biometric risks such as death or disability, especially if the beneficiary is economically dependent on the policyholder. Furthermore, a term life insurance can be used as a loan collateral, e.g. for a real estate loan.
Insurance benefit	In case of the occurrence of the insured event the insurer pays out the sum agreed in the policy to the designated person. A term life insurance only covers in this exclusive case.
Beneficiary	Not only family members can be named as so-calles beneficiaries, but also any other person such as a business partner. The surviving dependants receive the insurance sum even if the insurance premiums has been paid only for a short period of time. But the payout only occurs if the insured event happens during the insured period.
Process sequence	The insurance premiums are only paid for the case that the insured event occurs. They are not intended to create asset accumulation. Therefore the insurance premiums are comparatively low. The insurance benefit does not mature at the end of the insurance period if the policyholder is still alive. Also the insurance premiums will not be paid back as they were used up for the assumption of risks. The policy expires.
Taxation	Term life insurances principally are subject to fiscal promotion.

w&w gruppe

Private pension insurance & endowment life insurance – the idea behind

Statutory pension insurance

Intergenerational contract in transformation – less and less contributors need to finance more and more pensioners due to demographic change

State pension will not last to maintain the accustomed standard of living in old age

So-called „pension shortfall“ means the percentage share the last net income before retirement exceeds the statutory net pension

Private old-age provision

Additional private old-age provision necessary to be sufficiently provided in retirement

Various possibilities to make private old-age provision

Private pension insurance

Endowment life insurance

Private pension insurance & endowment life insurance – characteristics

	Private pension insurance	Endowment life insurance

Purpose	▪ Build up capital for private old-age provision in the form of a lifelong pension payment
	▪ Guaranteed benefits make old-age provision calculable and protect against the risk of premature capital consumption
		▪ Combining the benefits and the protection of term life insurance and private pension insurance
		  ▪ Protection of surviving dependants against the policyholder's biometric risks
		  ▪ Build up capital for private old-age provision
		▪ Possible use as a loan collateral in certain cases

Insurance benefit	▪ Receipt of a lifelong pension payment during retirement	▪ In case of occurrence of the insured event (death of the policyholder): Payout of the sum agreed in the policy to the designated person ▪ In case of expiration of the policy: Payout of the sum agreed in the policy to the policyholder
Capital built up	▪ Capital built up consists of paid-in premiums, a guaranteed interest rate and surpluses generated by the insurer ▪ Guaranteed interest rate for new contracts is currently 0,25 % and valid for the full duration of the contract	

w&w gruppe

Private pension insurance & endowment life insurance – characteristics

	Private pension insurance	Endowment life insurance
Beneficiary	▪ Own person (policyholder)	▪ In case of occurrence of the insured event (death of the policyholder): Designated person ▪ In case of expiration of the policy: Own person (policyholder)
Security	▪ Security needed for policyholders due to long contract duration over decades ▪ Life insurance companies required by law to invest the customer‘s asstes under fixed rules including security, rentability, liquidity and adequate diversification ▪ Entire business operations of domestic insurance companies supervised by the German Federal Financial Supervisory Authority [BaFin] including safeguarding the legal and financial interests of all policyholders	
Flexibility	▪ Given the long contract duration: No need to cancel a policy for the customer in case of payment difficulties (e.g. unemployment, paternity leave) ▪ Several possibilities to adapt the policy and reduce the premiums such as cancelling supplementary insurances, deferring the premiums, reducing the sum insured, releasing from premium payments, freeze dynamic tariffs, offsetting premiums with surpluses	

w&w gruppe

Private pension insurance & endowment life insurance – characteristics

	Private pension insurance	Endowment life insurance

Subtypes	▪ Unit-linked pension insurance
	  ▪ Savings component of the premiums is invested in funds
	  ▪ Chances and risks für the policyholder due to participating in price gains and price losses
	▪ Immediate-annuity policies against payment of a single premium
	▪ State-backed Riester pension and Rürup pension
	▪ Extensions possible through integration of various supplementary insurances
		▪ Joint life insurance
		  ▪ two (or more) people jointly insured under one policy
		  ▪ benefits are paid to the surviving partner or upon expiry of the contract
		▪ Unit-linked life insurance
		  ▪ Savings portion of the premiums is invested in funds
		  ▪ Chances and risks für the policyholder due to participating in price gains and price losses
		▪ Extensions possible through integration of various supplementary insurances

Taxation	▪ Fiscal benefits for the payouts at the age of retirement	

w&w gruppe

How life insurances calculate their tariffs

Life insurer promise and guarantee a future benefit

Mortality table

A mortality table is a demographic model. It shows the probability for each age and separately by gender that an insured person dies before getting older one year.

Individual factors

For each contract individual factors of the insured person are taken into account, especially the state of health and risk factors such as smoking and high risk sports. The amount of insurance an the duration of the contract are included, too.

General factors

The selling and general administration expenses of the insurer and possible supplementary insurances influence the insurance tariffs.

Life insurance	How likely is it that the insured person dies during the contract period?
Pension insurance	For how long the pensions probably must be paid?

As result of the calculation the amount of the insurance premium is determined.

w&w gruppe

Capital sum to be expected

Cashflow

Secure and insecure insurance payments

Guaranteed benefits the amount of which is fixed definitely when the contract is concluded

- Savings component of the regular premiums (~80% of the premiums) – remaining ~20% of the premiums are intended for general administration expenses and risk coverage
- Guaranteed interest[1] – currently 0,25% (status as of 2023)

The guaranteed interest fixed at the start of the contract applies for the whole contract term. Possible amendments over time exclusively concern new contracts and not existing contracts.

Profit participation the amount of which is insecure when the contract is concluded

- Surplus from investments (interest surplus & valuation reserves)
- Final profit participation
- Risk and cost gains

Essential legal basis for the German system of profit participation is the so-called minimum transfer directive

1) Insurers cannot determine the guaranteed interest by themselves at will. The level of the interest rate is limited indirectly by the so-called maximum interest. The maximum interest is determined by the Federal Ministry of Finance and depends on the general interest level. Usually, guaranteed and maximum interest are consistent so the two terms tend to be used synonymously.

The German system of profit participation (explanation of terms on the following page)

Insurance premiums

Savings component
~80% of the premiums – increases the credit amount directly

Risk component
Cost component
~20% of the premiums

Risk gains

Unused part of the risk component

Cost gains

Unused part of the cost component

Gross profit

Includes risk gains, cost gains and interest surplus

The insurer has to respect the minimum transfer from gross profit to provision for premium refunds, at least an amount of:
90% interest surplus + 90% risk gain + 50% cost gain

„net interest“

Investment result

Interest surplus
Capital gains not needed for guaranteed interest or additional interest reserve

Guaranteed interest
Directly allocated to the individual contract

Allocation to the additional interest reserve
A part of the capital gains is allocated to the additional interest reserve

Capital investment

The insurer has one common investment for all customers, tariffs and policies.

Additional interest reserve
The reserve makes it easier for the insurer to achieve the guaranteed interests. Customers benefit indirectly.

supports

Individual contract at the end of the contract

Guarantees benefits savings component & guaranteed interest	100.000 €
Additional benefits of surpluses	+ 30.000 €
of final profit participation	+ 4.000 €
of valuation reserves	+ 500 €
Total:	= 134.500 €

Provision for premium refunds (PPR)

Tied part of the PPR/ running profit participation
Contains monies that are credited to the individual contracts within the next policy year

Free part of the PPR
Contains money intended for future profit participation

Final profit participation fund
Contains financial means intended for the final profit participation. They are given to the customers not before the regular contract end or the pension start date.

Participation in the valuation reserves
Customers have to participate in the valuation reserves. As a rule, parts of the final profit participation fund are reallocated to a so-called basic share in the valuation reserves.

w&w gruppe

The German system of profit participation – explanation of terms of the previous page

Savings component	Part of the premium (~80%) that is left after deduction of selling and general administration expenses and insurance benefits.
Risk component & risk gains	Part of the premium that is statistically used to provide the insurance benefits. If less policyholders die before the end of the contract, endowment life insurances generate risk gains. Private pension insurances generate risk gains, if policyholders die earlier as calculated.
Cost component & cost gains	Part of the premium that is used to cover the selling and general administration expenses. If these expenses are lower than originally calculated due to an effective cost management, cost gains are generated.
Interest surplus	The savings component flows into the capital investment. If the capital investment generates more than needed for the guaranteed interest, an interset surplus results.
Additional interest reserve	In times of low level of the interest rate life insurer have to establish a so-called additional interest reserve to ensure the guaranteed interest in the future.
Provision for premium refunds	Provisions for premium refunds are provided in the balance sheet for future profit participation. They are not matched to individual contracts yet and serve as a buffer to compensate earnings volatility.
Final profit participation	Part of the payout at the end of the contract that exceeds the guaranteed benefits.
Participation in the valuation reserves	At the end of the contract the policyholder must participate in the valuation reserves from capital investments that were generated during the contract term.

APPENDIX

Life insurance has its origin in ancient Rome

Ancient Rome	In ancient Rome so-called “burial societies” [„Beerdigungsvereine“] arise, which support the surviving dependants financially
700 AD	In Germany guilds grant benefits in the event of sickness, death and disability
1762	Foundation of "Society of Equitable Insurances on Lifes and Survivorships" in London, the oldest life insurance in the world
1827	Gothaer sells the first life insurance in Germany
1833	Foundation of „Allgemeine Rentenanstalt zu Stuttgart“ – predecessor of today’s Württembergische Versicherung

w&w gruppe