Innovate to accumulate

Domestic and international insurers, along with banks and mutual funds, are investing heavily in product innovation and distribution for the German market. What skills count in winning and retaining customers, and will it be offshore or onshore providers that get the upper hand?

ANKE DEMBOWSKI REPORTS

Matthias Wiegel

LIFE INSURANCE COMPANIES in Germany are facing strong competition from banks, mutual funds and structured products. Until the 1990s, customers tended to see them as a necessary evil, as they appeared boring and inflexible, but safe. But this is changing. "British life insurance companies entering the German market gave the spark for innovation, especially for more flexible tariffs and for a greater focus on performance and equity investments," says Karl Panzer, CEO at Munich-based insurance company LV 1871.

Matthias Wiegel, sales director of Standard Life Deutschland, agrees: "The German market profited from the inspiration of foreign insurance companies. And British life insurance companies bring a high level of investment expertise, with their focus on equity investments. Foreign products – such as British ones with profit policies – can be successful in Germany, as they do not underlie the very strict German regulations. Our target group might be slightly different. Our clients are more performance-orientated than the typical German life product client."

Allianz product manager Andreas Wimmer, who focuses on the exchange of ideas within international groups, does not expect to see foreign players taking up a lot of business in Germany, especially not during the current crisis. "We certainly get a lot of inspiration from our colleagues that work for Allianz group outside of Germany but, in the end, the concept of German life insurance products, with their high level of guarantees and solvency, appeals to German investors."

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Broken boom

During equity markets' purple patch, unit-linked products blossomed in Germany, with new business figures in 2007 up by 32.6% to €1.9 billion in 2007, while the overall market of life products only grew 2.5%. Unit-linked products now have a market share of 31%, according to the *FVL Update 2007* market study conducted by actuarial consultants Towers Perrin. Given that the product name still contains the phrase "life insurance", it appears to be pretty safe to investors but, according to Jan Wicke, CFO of Wuestenrot & Wuerttembergische, unit-linked success is slowing down. "The whole industry has experienced a reduction in sales of unit-linked insurance policies in 2008, as clients do not like to carry market risk during these turbulent times."

Indeed, it is not only the sale of unit-linked polices that fell away in 2008. Traditional life insurance policies also faltered.

"I think that investors currently practice playing safe. Sales in our building society subsidiary have increased by 30%, for example," says Wicke. He thinks that is not a result of the increased transparency due to the new VVG contract law, but a result of the difficult capital markets.

According to Panzer, LV 1871 has seen no reduction in unit-linked policy sales, but he

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believes this is because his company has set up the right product, which slowly enters into the equity market.

"With our unit-linked product Performer Max, the client can give us a single premium, which is at first invested into a money market fund. The client can then choose a time period for the money to be switched from money market funds into equity funds. This can be done over three to 60 months. This way, the client reduces the timing problem and profits from the cost average effect," says Panzer. The money market fund had a performance of 3.34% from January until end of November 2008.

Variable annuities

Investors – particularly German investors – appreciate the security that life insurance products can offer, and this appreciation increases during times of a crisis. On the other hand, there is the issue of longevity. Higher equity market returns are necessary in order to generate sufficient funding for old age provision. Therefore, product providers need to fulfil both goals: guarantees and high performance.

One answer to this problem is variable annuities – products that enable investors to access equities during the savings period and also during the payout period. In the US and Japan, variable annuities are already successful.

They have been a feature of the German market for two years – mainly offered by large international insurance groups such as Axa and Allianz that have the technological capability to manage the necessary hedging strategies, the international network to access all the required product elements, and can profit from economies of scale by developing variable annuities across several markets.

Despite initial indications by the Finance Ministry that it was willing to see variable annuities sold onshore in Germany, it has since changed its mind. All providers of these products will therefore need to be based in countries such as Ireland and Luxembourg. Markus Willmes, head of product development at Axa in Germany says that the company is lobbying for this to change, but until then the French insurer's Germany-variable-annuity business will be based in Ireland, where legal options are quite broad.

"Our Twin Start product was the first variable annuity to be sold in Germany when we launched it in 2006 and it has already proved successful," says Willmes. So far, 200,000 contracts worth €5.2 billion have been sold. The policy holder can choose between the monthly annuity that is guaranteed when buying the policy (and calculated on an interest rate of 3%) or the higher investment pension that can be paid out of the fund volume if markets perform well. The latter is not guaranteed. The investment is either a managed account of funds – managed by Axa Investment Managers in Germany – or the client can choose from a range of individual funds.

A voluntary success: Ruerup and Riester

The old age provision law Altersvermoegens-Gesetz (AvmG) of 2002 has had a big impact on the life insurance industry, as it offers tax incentives on certain products. Riester and Ruerup Plans are voluntary pension provisions that enjoy some tax benefits and need to be certified to comply with the AvmG. Usually, payments for Riester plans are made on a monthly basis, and can be as small as €50 or €100 per month. "Ruerup and Riester products are dominated by German players. This kind of annuity product is precisely where life insurance companies have their core competence," says Wimmer. However, some foreign players are active in that field as well: Axa is offering its variable annuity product in the form of a Ruerup contract as well and, since 2007, as a Riester plan. "But German clients don't see us as a foreign player. They see Axa more as the German subsidiary of a global insurance company," says Willmes.

Riester products, which are designed for the employed, and Bassinette (Ruerup products), which are designed for the self-employed, now account for 41.3% of the unit-linked policies that are sold, according to Towers Perrin. For both products, the German tax system has direct subsidies and/or tax advantages. While the payments into the products can be offset from the taxable income during the savings period, the outcome will be taxed at retirement age.

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Standard Life Deutschland

Axa's subsidiary in Ireland is managing the guarantee, as it does for all variable annuity products Axa offers in Europe. "During the crisis, clients are asking who is providing the guarantee. It is good to have Axa group behind it," says Willmes. "In order to fulfil the guarantee, we are running volatility models, then hedging the equity and interest rate risks via futures and swaps."

Axa only needs to hedge the gap between the investment and the guaranteed level, so hedging costs are between 0.7% and 1.75% of the fund volume per year. "The costs are set and guaranteed when writing the policy, so there is no possibility for us to charge higher costs." Axa's reaction to the current volatility is to observe and re-balance the hedging processes more frequently than before. "Actually, we are down to daily re-balancing, if necessary," says Willmes. Axa accepts single premium payments, as well as monthly premium payments, which is necessary for the Riester plans (designed for the employed), and is also launching a variable annuity product for company pension plans.

High volatilities

In summer 2008, Allianz launched a variable annuity called Invest4Life that allows investors to pick one of two funds. "In addition to normal service charges we have a fee for the guarantee, which is mentioned explicitly in Euros and Cents. With this money we are covering all costs to hedge the financial guarantees in the capital markets," explains Wimmer. Invest4Life only accepts single premium payments and the target group is 55+. The guarantee is given by Allianz subsidiary Data Saving Life Assurance in Ireland.

Edinburgh-based Standard Life, which has extensive experience as an overseas player in the German insurance market, was also readying to launch a variable annuity, but has cancelled these plans in the face of current market conditions. "The high volatilities we are seeing are driving up prices for the guarantees. Because this would make this principally good product less attractive, we postponed the launch," says Wiegel.

The insurer planned to outsource the guarantee management. "If you manage the guarantee in house, it has an effect on your balance sheet. I can't believe the existing providers of variable annuity products are happy at the moment. High volatilities either reduce the profitability of this product or its attractiveness to clients," says Wiegel. "I can imagine that in the future, competition for efficient guarantees will increase and that there will be more development in the field of portfolio guarantees."

Apart from variable annuity products, there are other insurance products that combine a guarantee with participation in an equity index. One example is Allianz IndexSelect, which was launched in July 2007 and enjoys considerable marketing success with 27,000 policies and a policy value of slightly more than one billion euros. For IndexSelect, Allianz Leben is providing the guarantee of the premium payments as well as the lock-in of gains on an annual basis.

"The worst performance of the life product for any given index year is zero," says Wimmer. "Clients are clearly showing an increased focus on guarantees, and they are interested in who is providing the guarantee." As the German market leader, Allianz Leben clearly has an advantage here. "In the end, investors are not so interested in how the mechanics work," says Wimmer. "They want to know how they participate at the index development stage and that the guarantee is given by Allianz Leben." He sees a continuous demand for this product and no unusual surrender activity under the current crisis.

"We can give the guarantee by investing one part of the premiums into our 'Deckungsstock' (the guaranteed fund that underpins traditional German insurance business) and the other part into options, in order to provide the index participation," says Wimmer. "Compared with other life insurance companies, we have an equity proportion that is above average, and we use the equity ratio as a strategic means of increasing performance."

In August 2008, Bayerische Beamten Versicherung (BBV) also launched an annuity product based on index certificates. For its Strategie-Rente XXL product, Deutsche Bank will continuously set up Euro Stoxx 50 certificates that all have the same structure. Depending on the market situation, the equity-to-bond ratio within the product can vary, as the amounts paid in are guaranteed at 100%. The price of the guarantee is that the investor only participates at the price index, so the dividends are used as costs for structuring the certificates.

The most recent product in that field was jointly launched by Deutsche Bank's mutual fund group DWS and insurance group Zurich. Called "Vorsorgeinvest Premium", it uses a CPPI (Constant Proportion Portfolio Insurance) mechanism – and Zurich has even adapted the mechanism so that the guarantee level can be handled on an individual policy level. This is why the mechanism is called iCPPI, the "i" standing for "individual". Depending on the start date, an individual risk budget is calculated for each client that determines the actual balance between equity and bond proportion.

Germany: a tax-driven market

The German financial product market is very much tax driven. Until 2004, life insurance distributors had an easy run, because investors could buy a life insurance contract – whether unit-linked or conventional – as life policies entirely tax-free if held for a minimum period of 12 years. This changed in 2005 when, predictably, new policy figures fell. Now tax payment on life products is deferred until they mature, at which point the gains are taxed.

Despite this, life insurance products will again have a tax advantage in 2009, when earnings, as well as capital gains, from mutual funds, bonds, equities and certificates etc will be taxed year by year at a flat rate of 25%, compared with no tax until maturity.

The mass market of life insurance products – where tax issues are not the main focus – is well covered by German companies. But the high end of the market – where tax issues are the main drivers – is in the hands of a dozen foreign players. Specialised insurance companies like Lombard International Assurance SA, Le Foyer, Fortis and Swiss Life Liechtenstein offer extremely flexible product wrappers with an international touch that appeal to wealthy clients.

Unexpected success

Capitalisation products are also experiencing an unexpected level of success during the crisis. Traditionally used in Belgium and the Netherlands for parking money until the maturing policies pay out, they promise a guaranteed interest for a short period, such as three months. They are, therefore, a surrogate for money market funds – with the added advantage that the performance is guaranteed.

"We consider this product only a parking position, rather than a long-term investment for old age provision," says Panzer. Although there is no high commission to be earned, intermediaries like to use capitalisation products when money comes out of a life insurance contract and needs to be parked until another suitable product is found. "Especially now, during the times of the crisis, people are afraid to sign long-term contracts and we see an increased interest in our capitalisation product Zmax," he says.

LV 1871 guarantees a fixed interest rate for three months – currently 4.25% on its capitalisation products – that is appealing to stressed German investors. As the product's marketing brochure says, "Your investment in Zmax is safe, flexible and enjoys an attractive interest rate. Your money will be with a solid insurance company."

While sales for unit-linked products are, in general, suffering under the crisis, German insurance companies are currently promoting their traditional values and products. "Safety is a central need of mankind," says Ralf Kantak, sales director at Wuerttembergische Versicherung, which has long had the slogan: "Wuerttembergische, a rock in stormy waters."

Market leader Allianz, with its 28.1% market share in new premium income in the first half of 2008, has also witnessed a move towards traditional German life insurance products. "Classical life insurance products are experiencing a renaissance at the moment," says Wimmer. "They are still our most important product line and it will probably stay that way." L&P