

NATIONAL REPORT FOR GERMANY
for the 14th Conference of the
INTERNATIONAL ASSOCIATION OF CONSULTING ACTUARIES
Hong Kong, October 1994

In the past few years the area of social security and occupational pension programs has mainly been developed and influenced by the state pension reform act of 1992 (Rentenreformgesetz 1992) and the jurisdiction of both the European Court of Justice and the German supreme courts.

1. State Retirement System

In the Federal Republic of Germany (FRG) with only a few exceptions all employees are mandatory insured by the state retirement pension program.

Next to the state health, unemployment and accident insurance, the state retirement pension program is the most important component of the German Social Security System. The state retirement program grants life annuities upon age or disability retirement as well as survivors' pension to spouses and orphans. In addition, rehabilitation measures aimed at integrating the disabled back into the working population are also funded by the retirement program. Both contributions and benefits are related to gross-earnings limited by the Social Security Ceiling (SSC) of currently DM 91,200.-- p.a.

After a full contributory working life, the program provides a replacement ratio (ratio of retirement to active income) of between 40 and 50 % on a gross basis or between 60 and 75 % on a net after tax basis. Spouses benefits are practically always 60 % of the insured person's pensions. Due to Germany's reunification the state retirement pension system has to carry an additional load by granting benefits to pensioners of the former GDR (at present about 80 % of the benefit level in West Germany) without having gained additional funds of a sufficient order. Pensions to inhabitants of the so called New States are gradually increased to the western level; this goes of course along with additional cost.

Contributions to the state retirement pension system - currently 19.2% of earnings up to the SSC - are paid half by the employer and half by the employee. However, the medium- or at least long-term stabilisation of the financial situation of the system which was aimed by the Rentenreform 1992 would probably fail in case that unemployment continues to increase.

2. Company Pensions

- 2.1 In many details company pensions are influenced by the state retirement pension system. If for example a company pension plan grants age, disability or descendants' benefits these benefits usually become due when the corresponding benefit payment from the state system commences. As I already explained in my report for the 13th conference in Vancouver, the Rentenreform 1992 will on the long run lower the state retirement benefits significantly. An other feature of the reform where the equalisation of the normal and earliest retirement age (age 62) for both genders; before, females could draw an early retirement pension as from age 60 and males as from age 63. Also, an actuarial reduction factor of 0.3% per month of early retirement was introduced. For the period to the year 2006 for males and 2014 for females transitional regulations apply.

Since many company pension schemes were matched to the retirement ages prevailing before the reform act, they had to be adjusted not at least in order to avoid disadvantages with respect to the tax deductibility. Also the European jurisdiction on equal treatment affairs, especially the judgement of May 17th, 1990 (Barber Case), caused the need for deleting all discriminatory benefit and eligibility definitions for one or the other gender from company pension plans. Equal treatment has at the least to be achieved for times of company service as from May 17th, 1990. Incorporating all these necessary modifications into the existing pension schemes was often accompanied by a complete redesign and actualisation of the rulings very often assisted by Consulting Actuaries.

- 2.2 The Support Fund (Unterstützungskasse) - one of the four common German financing vehicles of company pension schemes - experienced significant tax related changes. Before, the maximum tax-deductible contributions of an employer to a Support Fund were linked to the average pension in payment during the corresponding fiscal year. These tax regulations were very often subject to misuse and many employers had over-funded their Unterstützungskasse. Therefore, legislation redefined the maximum tax-deductible contributions by linking them to projected pension entitlements of active employees which have attained at least age 30. Also, for reinsured Support Funds some inadequate tax advantages have been erased.

In the case of some companies these changes created the need for a Consulting Actuary, since the firms saw themselves no longer in the position to run the computations of the relevant tax-related figures. On the other hand there were companies using a Consulting Actuary in or-

der to make up arised disadvantages by appropriate reorganisations of their pension systems.

- 2.3 On April 28, 1992, the Federal Supreme Labour Court (Bundesarbeitsgericht - BAG) rendered a judgement which is probably the most relevant for occupational pension plans since years. It affects section 16 of the German Pension Act which contains the obligation of the employer to adjust pensions in payment to cost of living increases every three years. An adjustment could basically only be waived if the company is in severe economical trouble and then still the situation of the beneficiary has to be taken into account. While before April 28, 1992 an employer only had to adjust for cost of living increases during the three years prior to the adjustment, the jurisdiction now obliges the company to adjust for the entire increase in cost of living since the very first commencement of the pension payment. This means that the employer has to make up prior insufficiently large adjustments as soon as the company's financial situation has recovered. Over all these leads to significant additional costs.

The indicated judgements and the restrictive tax legislation cause an decreasing interest of employers to grant company pensions. This can also be seen from the situation in the New States where company pensions are still only little under discussion. In the western states employers seek for possibilities of lowering their pension cost (by decreasing benefits or closing plans for new entrants). In view of the relatively high rate of unemployment even among graduates from universities, the role of company pension schemes in hiring qualified employees is regarded as to become less important.

3. Life-Insurance

In 1993 the 3rd EC-directive for life-insurance companies has been announced which aims at the harmonisation of the common European market. Being an admitted company in one EC member country an insurer may now offer its products in every other member country of the community as well. In doing so the insurer is supervised by its domestic supervisory authorities.

Before, a foreign insurance company had to found an own legal entity in Germany in order to offer its products. Also, those products needed the approval of the German Insurance Supervisory Body. After the 3rd EC-directive becomes effective such approvals are no longer required.

The 3rd EC-directive also brought some deregulation concerning the investment constraints for life-insurers, introduced a limited choice to increase the

discount rate used for premium and reserve calculations and waived requirement of tariff approval prior to market introduction. In effect, this will lead to lower insurance premiums but in turn also to lower surplus profits to be granted to the insured individuals.

Regarding labour law and tax issues the legislation of that country will be relevant in which the services are delivered.

The 3rd EC-directive and the corresponding German laws will become effective as at July 1, 1994. For the German consumer the opening of the market will cause a variety of products which is hard to oversee and to compare.

4. Other Insurances

With respect to other insurance fields of business than life-insurance the harmonisation of the common European market will bring similar advantages and disadvantages to the German consumer as described before. Again it is the variety of products that will cause difficulties in choosing a specific offer based on an informed decision.

As a little example I would like to mention that an insurer A will underwrite a windstorm and hail insurance contract for damages caused by storms as from wind speed grade 5 while insurer B will only insure for damages as from grade 6 and insurer C even only as from grade 7. Since the consumer will probably not be able to judge on the encountered risk or will have problems in finding the differences in the insurance contracts, he will have difficulties in making his choice.

5. Investments

More than 70 % of the assets related to company pension systems are invested internally in operating assets and not funded externally. Thus Asset Consulting Services are not very important in this area. In the case of insurance companies and Pensionskassen Consultant Actuaries are involved only to a little extend since most of these institutional investors did not realise yet the conjunction between the characteristics of liabilities and assets.

Over all the investment strategy of German insurance companies and Pensionskassen can be regarded to be very conservative. The equity portion lies on average below 10 % despite the fact that this asset class on average outperformed fixed interest stocks within the last years or even decades. Next to real estate investments fixed interest stocks represent the by far dominating asset class.

6. Health Insurance

The current contribution rates to the state health insurance system average at about 13 % of gross-earnings up to the contribution ceiling of currently DM 68,400.--. Contributions are borne half by the employer and half by the employee. A restructuring law which became effective in 1993 urged mediciners to a more cost oriented policy in the prescription of medicaments; also hospitals have been subject of cost lowering programs. The restructuring law resulted in 1993 in a surplus in the state health insurance of DM 10.4 billion facing a deficit of DM 9.4 billion in 1992. The result was that in 1994 at least some sick-benefit funds lowered their contribution rates. Despite this positive development the government continues in analysing ways to further decrease the costs in order to allow for a stable contribution rate on the long run.

As from 1995 the cost for nursing the aged and handicaped will no longer be carried by the state health system. Instead, a state nursing insurance system will be introduced effective January 1, 1995. In the first place only benefits for nursing at home will be granted, as from July 1, 1996 also nursing in charity houses will be covered. The contribution rate amounts to 1 % (increasing to 1.7 % as from July 1, 1996) of gross-earnings up to the health insurance contribution ceiling (DM 68,400.--) and are again splitted equally between employer and employee. In order to avoid additional labour cost for the employer one state holiday (perhaps 2 as from 1996) will probably be waived.

When retiring, German pensioners remain members of the sick-benefit fund they belonged to as actives. Contributions are made from their total retirement income where the state retirement pension system pays half of the contributions corresponding to social security pensions. Contributions related to company pensions are entirely borne by the pensioner; however, there usually a reduced contribution rate applies. Those contributions are collected and deducted by the former employer granting the pension. With this exception the employer bears no other obligation with respect to the health insurance after retirement of an employee.

7. Other Issues

7.1 Book Reserves for long-service gratuities

A from 1.1.1993 employers that grant long-service gratuities for their employees may build up tax-favoured book reserves.

Because this kind of company benefit is very common and legislation requires an actuarial approach for building the tax-favoured reserves this is an important field of activity for the Consulting Actuary. Since our conference in Vancouver we pretty much investigated in developing appropriate valuation programs for long-service gratuities. As for most of the company pension these liabilities are internally funded.

7.2 *Solidarity Surcharge to Income Taxes*

The reunification of Germany resulted in an extraordinary high rate of unemployment and caused extremely high public expenses. Since the current public income from income taxes can not cover these expenses the government plans to collect a 7.5 % surcharge on income taxes as from 1.1.1995. Together with the contributions for the new state nursing this leads to a further decrease of the ratio of net after tax to gross earnings. The only positive effect is the resulting relative improvement of the net replacement ratio. On the other hand for most of the Germans the net take home income continues to shrink, especially in real terms caused by the - for German relations - historically above average rate of inflation (about 3% p.a.).

7.3 *General Information*

In the past years the following statistics were recorded in Germany:

- a) Exchange rate:
1 US\$ = between DM 1.40 and DM 1.80
- b) Inflation rate:
between 3 % and 5 % p.a.
- c) Average gross earnings increase:
between 0 % and 4 % p.a.
- d) Interest rates on fixed interest securities in the last two years:
between 5 % and 8 % p.a. (This also holds true for April 1994 where the interest rate for short-term maturities was close to 5.5 % p.a. and for long-term maturities close to 6.5 % p.a.)
- e) Rate of unemployment in April 1994:
western states 8.4 % and eastern states 16.2 % (slightly decreasing trend)