Singapore: 2021 participating fund health check

Introduction

2020 was an extreme year for financial markets and the world in general. It was even more challenging for insurers in Singapore as these extreme financial conditions coincided with the introduction of the updated risk-based capital solvency framework (RBC2) that came into force from 31 March 2020.

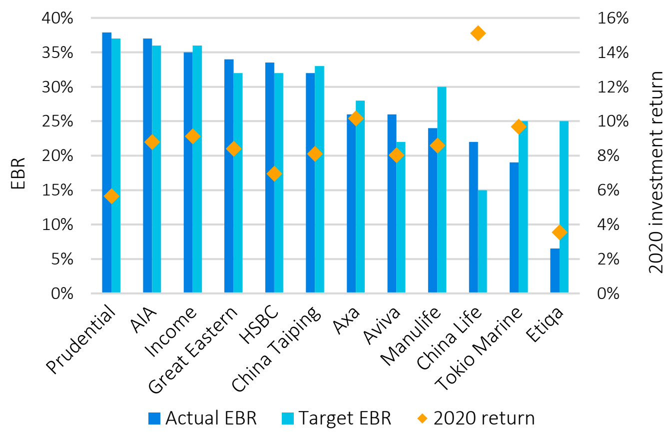
In this e-Alert we review the position of participating (par) funds in Singapore at the end of 2020, based on public information published in 2021. Information on investment return and investment mix was obtained from product summaries from the compareFIRST website (focusing on whole-life products). For information on solvency and capital we have used data from the 31 December 2020 insurance returns as published on the Monetary Authority of Singapore (MAS) website.

Investments

Figure 1, shows the actual and target equity backing ratios (EBR, the proportion of investments allocated to equity and property) for each company's par fund as at 31 December 2020. These figures are based on what each insurer discloses in their product summaries for new whole life policies. Some insurers split the investments of the par fund into smaller sub-portfolios to back different product types, so these figures do not necessarily reflect the investment strategy for each par fund in totality. For Aviva, a new investment pool has been set up for the new products being sold, so the product summary only contains information on its target investment strategy. For Aviva's actual EBR and investment return we have used figures for its "Long Term pool A" from its 2020 bonus announcement FAQ document, as published on the Aviva website. This is the same for Manulife, where we have used information from its "Participating Fund Update For 2020" published on its website.

Despite challenging market conditions because of the pandemic, investment returns in 2020 appear to be generally quite good, with all funds except for Etiqa's earning over 5.5%. If we look at the whole of 2020, equity markets recovered in the second half of the year giving positive returns for the year. Also, bond market values appreciated significantly from the fall in interest rates during 2020, further supporting positive returns for the funds. The longer the duration of the bond portfolios, the greater this effect will have been.

FIGURE 1: PAR FUND EBRS AND 2020 INVESTMENT RETURNS



We might have expected to see some degree of correlation between EBR and the investment returns for each fund over the year, but this is not the case. Given the quite significant interest rate movement over the year, it is possible that it is this effect that is dominating the market movements, with the relative investment returns reflecting the average duration of each fund's fixed-interest assets. The particularly high return for China Life's par fund relative to the others could be a result of its nascent stage. Its fund grew significantly in size over the course of 2020 (investments more than doubled in size) and new money coming in during the second half of the year would have benefited from the strong equity gains as markets recovered, without being impacted by the earlier equity losses at the start of the year.

At the other end of the scale, Etiqa had a lower return than the others. We can see that it has a much higher allocation to cash and bonds than its target strategic asset allocation, and if the bonds were of quite short duration, possibly in an attempt to manage risk requirements, then they would not have benefited from the gains from interest rate falls, as well as only benefiting from limited equity returns.

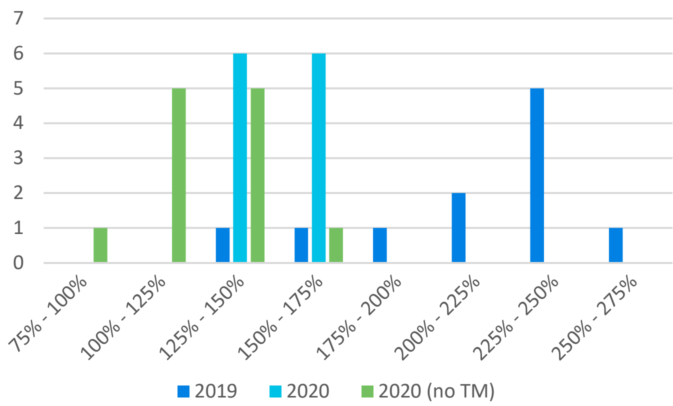
Looking at target EBRs, we can see that most insurers have targets between 25% and 40%. Aviva's is slightly lower at 22%, but China Life is an outlier, with a much lower target of only 15%, which is much lower than its current EBR of 22%. Most of the other companies are relatively close to their target EBRs, except for Tokio Marine and Manulife, which are 6%

below their targets, and Etiqa which is 18% below its target. These could be reflecting short-term capital management actions as a result of the challenging economic conditions in 2020, or possibly tactical investment positions that reflect a negative outlook for equities in the short-term.

Solvency and capital

Figure 2, below, shows the number of par funds in each range of fund solvency ratios (FSR) as at 31 December 2019 and 31 December 2020. The introduction of RBC2 on 31 March 2020 coincided with the increased economic volatility linked to the global COVID-19 pandemic. The MAS recognised the increased challenge created by this timing and introduced an allowance for some temporary transitional measures (TM) that will run-off over the period to 31 December 2021. As the TM are temporary, we have also shown the results as at 31 December 2020 excluding those TM.

FIGURE 2: NUMBER OF INSURERS WITH PAR FUND FSR IN EACH RANGE



We can see that there has been a significant shift downwards in the level of FSRs from 31 December 2019 to 31 December 2020, with the shift being even more significant if we exclude the temporary TM. The introduction of RBC2 was expected to lead to a reduction in FSRs so it is important to recognise that the 31 December 2019 FSRs are not directly comparable with the 31 December 2020 FSRs. The change to the RBC framework does not, in itself, make the funds any less strong, and part of the challenge is to recalibrate what a healthy FSR is under RBC2.

We can, however, compare the results to regulatory solvency intervention levels. The minimum required FSR under RBC2 is 100% and we can see that if we excluded the TM, then the par fund FSR for one insurer would be under this level, requiring additional capital support to be provided from shareholders. Looking at the 2019 and 2020 solvency returns for each par fund more closely, we can see that additional capital support has been injected to par funds during 2020, based on the change in the size of the surplus accounts. For four companies the increase to the surplus account during 2020 exceeded SGD100 million with the total increase for the industry amounting to SGD2.2 billion.

The movements in FSR from 2019 to 2020 shown in Figure 2 do not, then, give the full picture, as the downward movement is being cushioned by transfers from shareholders to the surplus accounts. Instead, we can look at how FSRs change if we exclude the surplus account from the financial resources, as shown in Figure 3, below. It should be noted that any risk requirements associated with surplus account assets are still included in the FSRs presented, so there will be an understatement of the FSRs relative to if the surplus accounts were removed from the funds completely.

FIGURE 3: NUMBER OF INSURERS WITH PAR FUND FSR IN EACH RANGE - EXCLUDING SURPLUS ACCOUNT FROM THE FINANCIAL RESOURCES

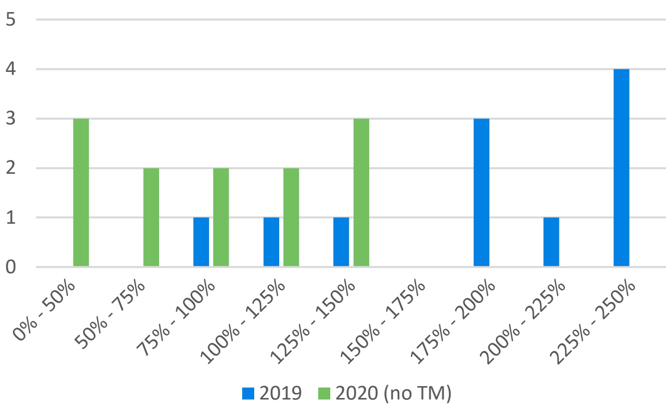
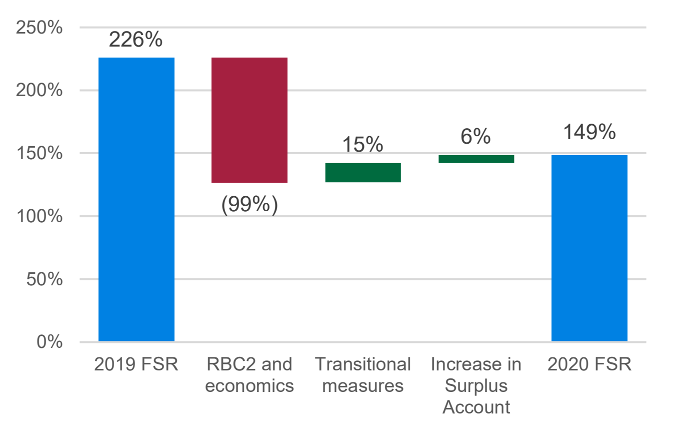


Figure 3 shows us that without the surplus account support in the financial resources (and without the TM), seven of the 12 par funds would have an FSR below 100% as at 31 December 2020, whereas at 31 December 2019 only three of 11 par funds would have FSRs below under 175% without the surplus account support. Some of the par funds are quite young, having been set-up in the last ten years, so it would not be unusual for these to require initial shareholder capital support. However, such support may be less expected for the more established par funds.

At an aggregate level, summing across all the par funds in the Singapore market, the industry level par fund FSR has decreased from 226% at 31 December 2019 (based on RBC1) to 149% at 31 December 2020 (based on RBC2 with TM). This represents a drop of 77% in total, but in Figure 4, we can see that if we stripped out the effects from the TM and increases to surplus accounts, the drop would have been even larger at 99%.

We are unable to split the 99% fall between the impacts of changing to the new RBC2 framework and the effects of the changes in economic conditions from 31 December 2019 to 31 December 2020. However, from our discussions with industry practitioners we believe that the implementation of RBC2 was expected to cause par fund FSRs to drop by around 60%, which would mean that economic factors have caused an approximate drop of 40%. This analysis is quite crude as it ignores other factors that will have impacted on FSRs, such as new business and any changes to bonus rates, which have not been considered, however we believe it gives a high-level assessment of the impact that economic factors have had in 2020.

FIGURE 4: CHANGE IN INDUSTRY LEVEL PAR FUND FSR OVER 2020



Conclusions

The introduction of RBC2 and the economic impacts of the COVID-19 pandemic have put pressure on the solvency levels of par funds in Singapore. Several companies have had to provide capital support from shareholders via the surplus account to support the solvency levels in the short term. Other management actions, such as cuts to bonus rates and the introduction of matching adjustments, may have taken longer to develop and are likely to have been implemented in 2021 to improve solvency, although the effects of bonus cuts may only improve solvency positions gradually.

While par fund investment returns in 2020 appear robust, there could be challenges for companies in the future due to the lower interest rate environment. This could be particularly challenging for the par funds with lower equity content as the yields available on fixed interest investments will be low. Funds where actual equity content is below the target level, may also struggle to meet their target positions without putting further pressure on their solvency position, due to the higher risk charges that apply to equity investments under RBC2.

In the current environment, finding ways to optimise solvency is going to be very important for par fund operators. Use of matching adjustments, derivatives, asset-liability management, and other investment strategy techniques, as well as bonus management and product design are all going to be important tools for insurers to consider in managing their par business going forward.

Milliman

Milliman is among the world's largest providers of actuarial and related products and services. The firm has consulting practices in life insurance and financial services, property & casualty insurance, healthcare, and employee benefits. Founded in 1947, Milliman is an independent firm with offices in major cities around the globe.

milliman.com

CONTACT
Wen Yee Lee
wenyee.lee@milliman.com

Alex Bryant
alex.bryant@milliman.com

Shir Lynn Ong
shirlynn.ong@milliman.com