

Document Number: 05 / 2005  
Publication Date: 29.07.2005

# FMA CIRCULAR

  

## CONCERNING NEGATIVE RISK PREMIUMS

**DISCLAIMER:** This circular does not constitute a legal regulation. It is intended to serve as guidance and reflects the FMA's legal interpretation. No rights and obligations extending over and above the provisions of the law can be derived from circulars.

The FMA has been prompted to state its position on the issue of the extent to which negative risk premiums are permissible in the case of occupational group insurance products in relation to occupational disability.

If insurance undertakings offer pension commitments under occupational group insurance schemes with low occupational disability pensions compared with the cash value of the old-age pension to which the insured person would be entitled or compared with the available coverage capital, this can result in high negative risk premiums.

This is illustrated by the following example:

In the case of a defined contribution model, provision is made for the payment of a pension from the available capital in the event of an old-age pension being due. In the event of occupational disability, the occupational disability pension is based on regular benefit payments made from 30% of the available coverage capital, with this occupational disability pension being transferred to an old-age pension in the same amount upon the party concerned reaching the age as of which an old-age pension may be paid. The pension paid to surviving dependents amounts to 30% of the pension of the beneficiaries. If the employment relationship is terminated prior to the occurrence of a benefit event, the vested amount will be paid out pursuant to Article 6c para. 1 of the *Betriebspensionsgesetz* (BPG; Company Pension Act).

When benefits are paid out for occupational disability, a large portion of the available life/health insurance provision is forfeited in such models in favour of the technical account balance of the *Deckungsstock* of the occupational group insurance. If no benefit event occurs with regard to occupational disability within a calculation period, the beneficiary (entitled) receives a technical premium ("negative risk premium"), due to the fact that had he received benefits relating to occupational disability, he would have lost a portion of the available coverage capital. This premium is credited to the beneficiary (entitled) and thus results in an increase in future benefits. In order to be able to reach the level of old-age pension benefits anticipated for such a rate, negative risk premiums must be credited.

However, it is a prerequisite that a corresponding number of cases of occupational disability occur, as this is the only way in which the necessary capital will be freed up to finance these

negative risk premiums. If these cases of occupational disability do not occur, there will therefore be systematically negative technical account balances.

If the employment relationship is ended before a benefit event occurs, a considerably higher benefit will be due under such models than in the case of occupational disability.

The subjective risk that the individual beneficiary could influence the amount of benefits received by applying for an occupational disability pension or for payment of a vested amount is not excluded in standard occupational group insurance contracts and is also not a risk that can be easily excluded (proof of “non-occupational disability” in the case of vested benefits).

Even assuming that the subjective risk could be excluded, it should nevertheless be noted that using the normal invalidity probabilities for the assessment of negative risk totals is problematic from an actuarial perspective. These probabilities were constructed for the risk case and cannot therefore simply be applied without further ado extensively and systematically to the complementary risk. In particular, the fact that the generally applied invalidity probabilities are known to be influenced by labour market effects and tend to be too high among those age groups close to pensionable age in particular means that their application is not appropriate from an actuarial perspective. Separate calculation of positive and negative risk premiums in the technical account balance, even if the subjective risk is excluded, is also required for due diligence reasons vis-à-vis all beneficiaries within the *Deckungsstock* of the occupational group insurance scheme.

The occurrence of negative risk amounts is basically a component of standard actuarial calculation methods. Consequently, their occurrence is not something that necessarily needs to be criticised. What is problematic is the systematic use of negative risk premiums to increase old-age pension benefits on an extensive scale.

Basic actuarial methods that make provision for extensive negative risk amounts in relation to any benefits paid for occupational disability reasons are contrary to the recognised actuarial principles applicable to pension commitments and are therefore not permitted. Pursuant to Article 81k para. 4 of the *Versicherungsaufsichtsgesetz* (VAG; Insurance Supervision Act), the calculation of the life/health insurance provision should be based on recognised actuarial methods and, in accordance with Article 18 para. 3 VAG, the premiums for newly concluded insurance contracts must be sufficient on the basis of actuarially reasoned assumptions to

guarantee the long-term fulfilment of the obligations arising from the insurance contracts, and in particular be sufficient for the establishment of appropriate technical provisions. Furthermore, pursuant to Article 24a para. 1 VAG, the responsible actuary must ensure that the rates are set and the technical life assurance provisions are calculated on the basis of the applicable provisions and actuarial methods.

Additionally, in the case of pension commitments involving a very low occupational disability pension in relation to the level of old-age pension where the occupational disability pension then transfers to an old-age pension in the same amount and where the survivors' pension is calculated as a percentage of the occupational disability or old-age pension, the level of the survivors' pension can be very low. This is obviously not in keeping with the intended aim of Article 18f para. 1 no. 2 VAG.