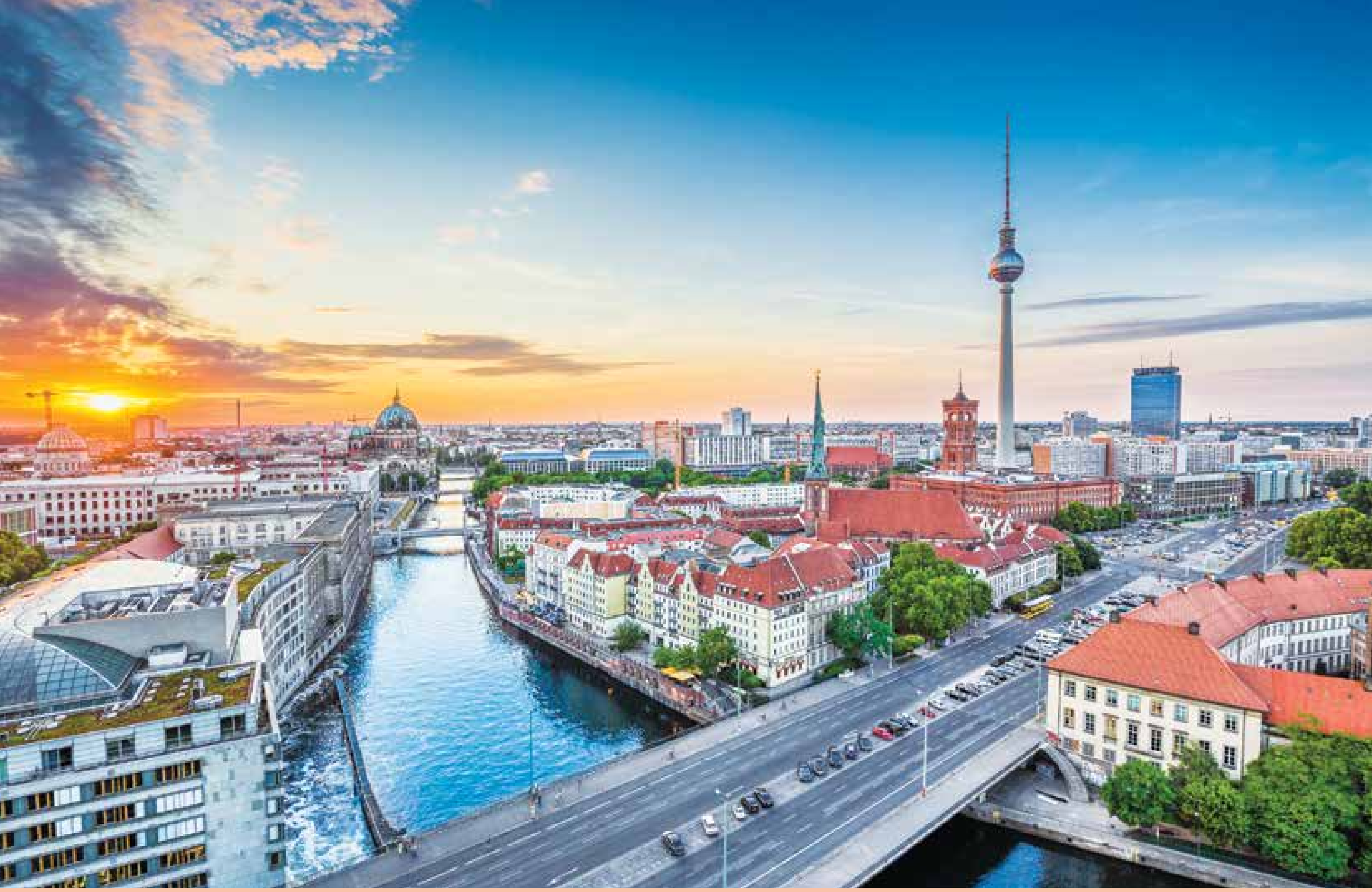

Transfer of Business and Run-Off
Mannheimer Life (2003)

Germany

Background and context

The insurance market in Germany offers an extensive range of products in various lines. In 2003, the life insurance sector had the largest number of insurers (324), followed by general insurance (251) and others in health insurance and reinsurance. Life insurers mainly focused on traditional products with high savings elements such as annuities and pension. The participating cash-value policy was predominant, whereby the investment component was designed with a guaranteed yearly minimum return and a variable non-guaranteed surplus.

In the mid-1990s to 2000s, German life insurers found it increasingly challenging to meet promised investment returns. As the yield on 10-year bonds fell (from 8% in 1995 to around 4% in 1998 until the mid-2000s), life insurers switched to equity investments and were hit by the experience of a slump in capital markets. Life insurers with significant exposure were hardest hit when the Deutsche Boerse AG German Stock Index (DAX) nosedived by 20% and 44% in 2001 and 2002 respectively.

One of those life insurers was Mannheimer Lebensversicherungs-AG (Mannheimer Life), a medium sized German insurer founded in 1922. It mostly sold participating products and expanded rapidly from 1990 to 2000 with premium income and investments registering average annual growth rates of 9.5% and 11.4% respectively. In 2000, it recorded premium income of €413 million ($491 million) with investments totalling €3.2 billion ($3.8 billion). While it continued to turn in a profit of €5.2 million ($6.2 million) in 2000, of substantial concern was Mannheimer Life's investment in equities which had grown from less than 10% to 21.2% of the total portfolio in 2000.

Mannheimer Life's portfolio of participating products required distribution of promised returns of 7.5%, of which between 3% to 4% was guaranteed, which then translated to achieving returns from equity investments of at least 19%. By the time the DAX crashed in 2002, Mannheimer Life's participating interest returns fell sharply.

Resolution actions

Serious solvency concerns led to transfer to Protektor Lebensversicherungs-AG

In 2002, Germany's life insurers launched a private initiative to form Protektor Lebensversicherungs-AG (Protektor) as a safety net scheme. Life insurers agreed to contribute funds to Protektor for the rescue of any distressed member to preserve the confidence of policy owners in the life insurance industry. From this fund, about €240 million ($285 million) was allocated to meet the solvency requirement of the Mannheimer Life's insurance portfolio.

As Mannheimer Life's share price tumbled from €60 ($71) in 2001 to less than €10 ($12) in 2003, it faced heightened risk of failure. Mannheimer Life had attempted to manage losses through a profit-and-loss transfer agreement with its parent, Mannheimer Life Holdings. However, this arrangement fell through. The German regulator BaFin then ordered Mannheimer Life to cease the sale of new policies and on 26 June 2003, announced that its assets and liabilities would be transferred to Protektor.

> ***For the first time ever a life insurer [Mannheimer Life] went into a financial tailspin. In mid-2003 its insurance portfolio was acquired by Protektor, a newly created bailout solution that was funded by the industry***
>
> Federal Financial Supervisory Authority (BaFin)

Resolution of Mannheimer Life's portfolio – Timeline of Key Events

- **Nov 2002** Establishment of Protektor.
- **Jul 2003** Protektor signed the transfer of insurance portfolio of Mannheimer Life. Effective date of transfer: 1 July 2003.
- **Oct 2003** Protektor took over the insurance contract portfolio of Mannheimer Life.
- **Jul-Nov 2004** Protektor opened a bidding but later decided to continue managing the portfolio.
- **2008** Second bidding activity in 2008, stopped after the Lehman crash.
- **Nov 2015** Protektor discussions with investors for transfer of Mannheimer Life's portfolio.
- **May 2017** Annual General Meeting approved the sale to Entis Lebensversicherung AG (Entis).
- **Jul 2017** Contract for the sale to Entis executed.

Portfolio run-off

Protektor decided to implement a run-off scheme given the role of life insurance in Germany and adverse implications on policy owners and society if policies were to be terminated. Life insurance served to compensate for declining pension payments (owing to inflation) under the government's statutory pension insurance system. Other than providing disability insurance coverage, the maturity benefit and accumulated investment returns of life insurance policies were also used to repay housing loans. In addition, in a liquidation process there would be no "fair" way to calculate compensation and it would be impossible for policy owners to obtain similar coverage at the original level of premiums given changes in their age and health over the years.

After assuming Mannheimer Life's assets and liabilities, BaFin confirmed that Protektor would meet all legal obligations against policy owners under run-off. The transfer of Mannheimer Life's assets of €3 billion ($3.6 billion),[82] 344,000 policies and 140 staff to Protektor, was completed in October 2003. This came with a guarantee that Mannheimer Life would cover future losses arising from any misstatements of its financial statements.

From 2003 to 2015, Protektor had run-off about 70% of Mannheimer Life's policies. The remaining 100,000 policies were managed by 70 employees. Since there was no new business, and as the number of policies in-force steadily declined, cost optimatisation in managing the portfolio became more of a challenge.

During the run-off period, Protektor had also continued to source for a solvent life insurer to take over Mannheimer Life's portfolio. After 15 years, on 1 August 2017, Mannheimer Life's portfolio with assets of €1.8 billion ($2.1 billion) was finally transferred to a new insurance company, Entis. All 92,000 remaining policies were guaranteed continuity of coverage based on unchanged conditions. Entis was sold to Viridium Group (Viridium) which specialises in the efficient

[82] Based on Mannheimer Life's audited balance sheet as at 30 June 2003

management of life insurance portfolios in Germany. As at 30 June 2020, Viridium manages a total of more than 4 million administered insurance policies with €60 billion ($67.4 billion) assets under management. The integration of Mannheimer Life's policies into a significantly larger portfolio secured long-term stability and translated into lower administrative costs for Mannheimer Life's remaining policy owners.

Following the failure of Mannheimer Life, in 15 December 2004, Germany's Insurance Supervision Law was amended to prescribe the setup of an insurance guarantee fund to protect the claims of policy owners, the people insured, beneficiaries and other persons benefiting from the life insurance policy. Protektor was entrusted to manage the insurance guarantee fund.

> ***... above all, I want all policy owners to be rest assured that their interests will be protected in the long term, and that they can rely on continuity as part of Viridium***
>
> Dr. Heinz-Peter Ross, Chairman of the Supervisory Board of Viridium Group

Key takeaways

The failure of insurance companies can adversely impact government policies to strengthen social and financial safety nets. For instance, without effective interventions to resolve Mannheimer Life (through transfer of business and run-off), the negative implications of liquidation and termination of its life insurance policies would shatter confidence in the life insurance industry. In turn, this undermines the government's policy of encouraging the German public to invest in life insurance products (besides relying on government pensions) for sustainable retirement.

During times of failure, decisive actions by authorities – in the case of Mannheimer Life, directing its transfer of business to Protektor – are crucial since insurers in deep distress could be less interested in sourcing for any private transfers. It is also essential that regulators have powers to ensure that the transfer of business protects policy owners through interventions such as limiting the cancellation of insurance policies.

In terms of run-offs for life insurance policies, the approach of leveraging key staff and the existing IT platform of failed insurers could contribute to greater operational efficacy. With the resolution strategy of run-offs, immediate liquidity issues would be generally less of a concern as policy owners continue to pay premiums. However, the shrinking run-off portfolio brings with it challenges of cost optimisation and the risk of inadequate investment returns. As demonstrated by the case of Mannheimer Life's resolution, insurance guarantee schemes such as Protektor should proactively source for other life insurers or specialist companies to take over the portfolio and secure long-term continuity of the life insurance policies.