Asia e-Alert

Milliman

Singapore: 2022 participating fund health check

Introduction

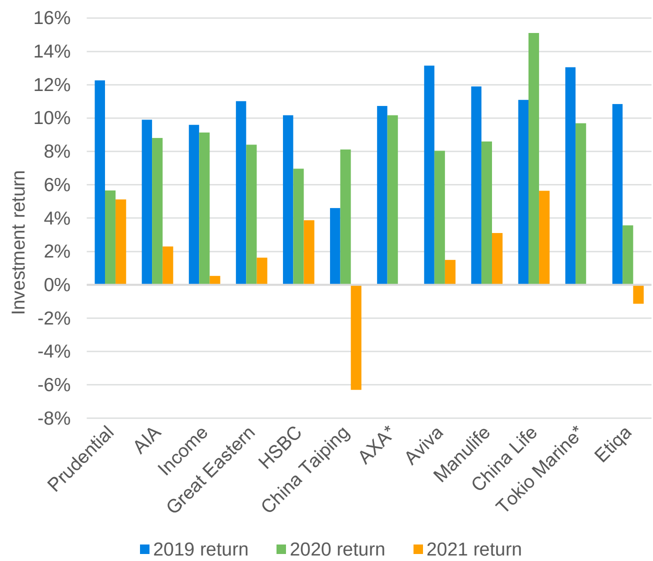
Although financial markets, and the world in general, have recently experienced uncertainty and volatility, 2021 will perhaps be regarded as a more stable year in comparison to years that preceded and succeeded it. For participating (par) business in Singapore, 2021 saw the lowering of the maximum investment return assumption for new business illustrations from 4.75% to 4.25%, and represented the second year of reporting under the new RBC2 capital regime that was introduced in 2020.

In this e-Alert we review the position of par funds in Singapore at the end of 2021, based on public information published in 2022, and compare this to the position at the end of 2020. For information on solvency and capital we have used data from the 31 December 2021 insurance returns as published on the Monetary Authority of Singapore (MAS) website. Information on investment returns and investment mix was obtained from insurers' Participating Fund Updates, published on their websites. At the time of writing we have been unable to obtain 2021 updates for AXA and Tokio Marine, so we have not included the 2021 information for these funds. Where insurers manage separate investment pools within the par fund, or have multiple par funds, we have focused on the investment pool or fund that we believe to be the main fund used for SGD-denominated business, so the figures we show will not necessarily reflect each par fund in totality.

Investments

Figure 1 shows the investment return experience for each par fund in 2019, 2020, and 2021. It shows that most funds experienced strong returns in 2019 and 2020, with much poorer returns in 2021. This general trend reflects how bond yields moved over this period, as well as the performance of equity markets. The year 2019 saw positive equity returns coupled with a fall in yields. The par fund investment returns are on a market value basis, so falls in yields will result in positive returns as bond prices rise. With positive equity returns and rising bond prices, 2019 therefore saw strong investment returns. Except for China Taiping, which is something of an outlier, in 2019 all par funds achieved investment returns in excess of 9.5%.

FIGURE 1: PAR FUND INVESTMENT RETURNS IN 2019, 2020, AND 2021



*2021 information not available for AXA and Tokio Marine

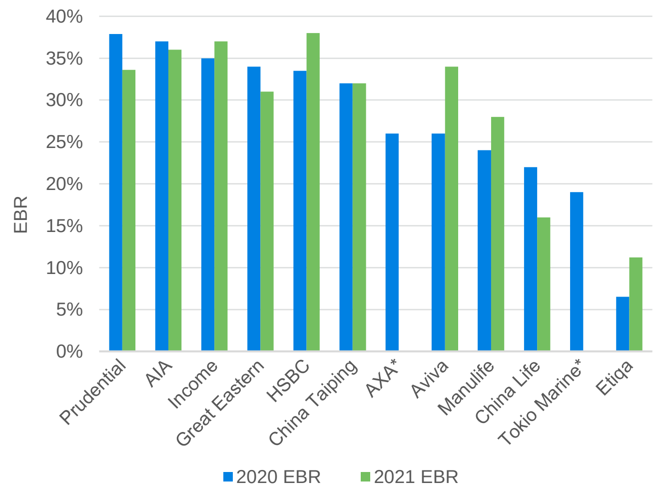
In 2020, the effects of the COVID-19 pandemic caused severe drops in equity markets in the first half of the year, but this downtrend was later followed by some recovery, with the year-on-year returns depending on specific markets. For the Singapore Straits Times Index, the overall returns in 2020 were negative, but the US S&P500 still saw strong positive returns for the year. Bond yields dropped further over 2020, which led to strong positive gains on bond market values. As Singapore par funds typically have a high allocation to fixed-interest assets, the rise in bond prices led to strong positive returns for the par funds, with all funds except Etiqa experiencing returns in excess of 5% for the year, and nine out of the 12 funds achieving returns above 8%.

The year 2021 was a different story. Equity returns were pretty strong, but yields started to rise again. The rise in yields, coupled with the generally high allocation to fixed interest assets, caused a drag on investment returns. Returns for all funds for which we have information, except Prudential and China Life, were less than 4%, and six funds returns were less than 2.5%.

We can also see that there was quite a lot of variation in the level of investment returns between the different par funds each year. This is likely to be due to a combination of factors including: strategic asset allocation; duration of fixed interest asset holdings; use of alternative asset classes; and fund manager performance. The significant changes in interest rates during the last three years, together with the relative high allocation to fixed interest assets in the par funds, may mean that differences in the average duration of the portfolios could have had a significant impact.

Figure 2 shows the actual equity backing ratios (EBR, the proportion of investments allocated to equity and property) for each company's par fund as at 31 December 2020 and 31 December 2021. As these EBRs are based on actual asset allocations rather than long-term strategic targets, they will reflect tactical positions being adopted at 31 December each year. The figures do show, however, that for the group of six insurers with the EBRs at the higher end, the EBRs are typically managed between 31% and 38%. In regards to the funds for which we have information, only Etiqa and China Life have EBRs less than 28% as at 31 December 2021.

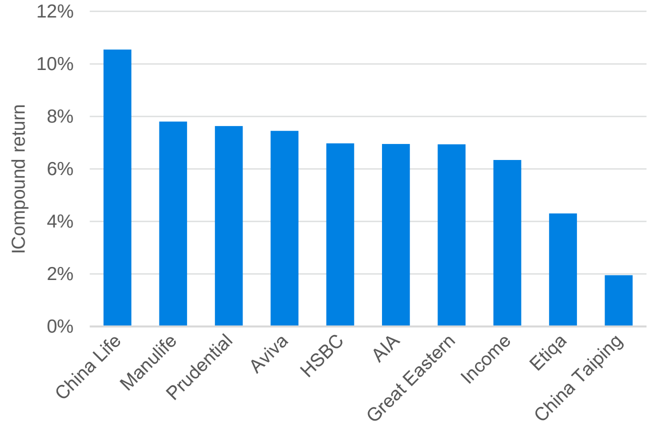
FIGURE 2: PAR FUND EBRS AT 31 DECEMBER 2020 AND 2021



*2021 information not available for AXA and Tokio Marine

Although there is quite some variance in investment returns between the different insurers' par funds each year, when we look at the annualized compounded returns over the three-year period covering 2019, 2020, and 2021, as shown in Figure 3, we can see that the annualized returns for six of the funds are within the range of 6.9%p.a. to 7.8%p.a, with Income slightly below this range, at 6.3%. China Life, Etiqa, and China Taiping all appear to be outliers, but we note that these are the three newest par funds in the market, and their returns could be affected by timing effects of new money coming into the funds that are growing from small nascent fund sizes. The lower return observed for Etiqa could be related to its lower EBR, with limited equity content dampening the fund investment returns compared to other funds with higher equity content.

FIGURE 3: ANNUALISED INVESTMENT RETURNS BY PAR FUND* OVER THREE-YEAR PERIOD 2019 TO 2021



*Excludes AXA and Tokio Marine as 2021 information not available

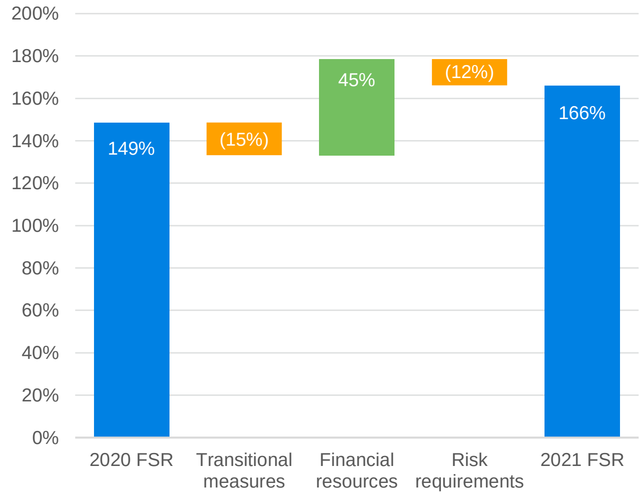
It should be noted that observed investment returns over a specific three-year period will not be a guide to how the funds have performed over longer periods, or how they will perform in the future, and we will discuss the experiences of 2022 so far later on in this e-Alert. However, we can say that fund performance over the three-year period of 2019 to 2021 has, in the main, been relatively strong, with most funds experiencing higher investment returns over this period than the current and previous maximum allowed investment return assumptions for policy illustrations of 4.25% and 4.75%, respectively. As mentioned earlier, 2021 returns were lower than the previous two years, and less than 4% for all but two insurers. If bonus scales had been broadly at the affordable level at 31 December 2020, then the underperformance in 2021 would have put pressure on those bonus scales.

Solvency and capital

The year 2020 was difficult for par fund solvency in Singapore. The introduction of the new RBC2 solvency regime coupled with falling interest rates led to a squeeze on fund solvency ratios. The MAS introduced some transitional measures to help smooth out the impact in the change in discount curve methodology under RBC2, but we still saw some insurers having to make material capital injections into the par fund surplus accounts to help support the fund solvency ratios. Despite the unwinding of the remaining transitional measure support over 2021, fund solvency ratios as at 31 December 2021 appear much healthier than they did a year previously. This also includes selected funds appearing to repay some of the previous year's capital injections to the surplus account.

Figure 4 shows an aggregate level picture of the change in par fund solvency over 2021, summing the financial resources and risk requirements across all the par funds in the Singapore market. It shows the aggregate level fund solvency ratio (FSR) increased by 17% over the year, from 149% to 166%, and that included overcoming the fall of 15% caused by the unwind of the remaining transitional measures.

FIGURE 4: CHANGE IN INDUSTRY LEVEL PAR FUND FSR OVER 2021



We can see that the increase in financial resources over 2021 has led to an increase in the FSR of 45%. Whilst there will be several factors influencing the financial resources, it is likely that the increase in government yields will turn out to be the biggest factor. The resulting increase in the risk-free discount rate would have caused the guarantee liabilities to reduce, which would then increase the provision for non-guaranteed benefits within the financial resources. The rising yields would also have caused fixed interest assets to fall in value, but typically the assets would have a shorter duration than the liabilities and we have seen that the investment returns over the year were still broadly positive.

Another factor that may have also led to the increase in financial resources is due to companies implementing capital efficiency measures, such as introducing or extending matching adjustment portfolios, extending the duration of their assets to reduce interest rate mismatching risk charges, or employing financial reinsurance arrangements to reduce guarantees. Writing new business with lower guarantees could have also helped to increase the provision for non-guaranteed benefits.

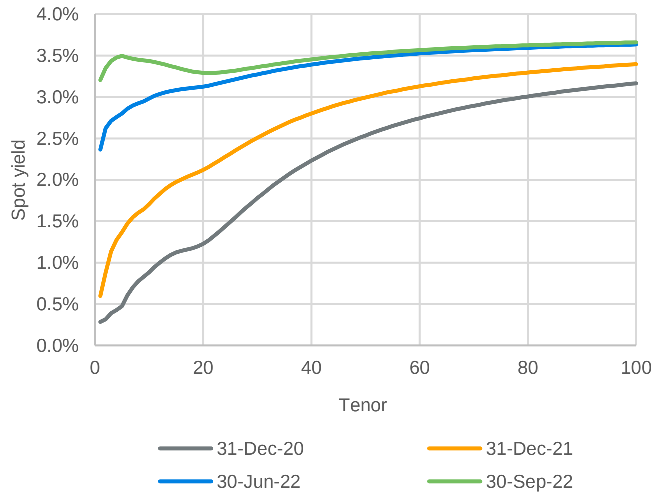
Although there is an increase in the aggregate risk requirements over the year, which brings down the aggregate FSR, the risk requirements increased by 7.5%, which is less than the increase in fund investments of 9.1%. This indicates a reduction in the size of the risk requirements as a proportion of the total investments, which could also be an indication of insurers implementing measures to improve capital efficiency during 2021.

Conclusions and future outlook

Broadly, 2021 could be considered a good year for participating business in Singapore, as there was a significant improvement in fund solvency over the year, which was the pressing issue of 2020. Investment performance for all but two funds was, however, below the upper rate used for recent new business illustrations, so this could have put pressure on bonus supportability. Taking the last three years in aggregate, investment performance has been well above those upper illustration assumptions.

The year 2022, by contrast, has seen some extreme changes in the economic landscape, with sharp increases in bond yields—much higher than the rises in 2021 and the falls in equity markets. Figure 5 shows how the RBC2 SGD risk-free yield curves moved during 2022, as well as the positions at the end of 2020 and 2021, highlighting the change in bond yields. It is worth noting that the rises were particularly significant at the short end of the curve, with an overall flattening of the curve over the year.

FIGURE 5: RBC2 SGD RISK-FREE SPOT RATES AT DIFFERENT VALUATION DATES EXCLUDING ANY ADJUSTMENTS



The rise in yields causes fixed interest assets to fall in value, which adds to the fall in equities. We are therefore expecting investment returns for 2022 to look quite bad for all par funds. In theory, the rise in yields would lead to an increase in the expected future returns from fixed interest assets, which should in turn offset the negative effect to current values when considering bonus supportability. However, this would depend on the extent to which future return expectations were already allowing for increases to the returns from fixed interest assets due to future yield rises. Coupled with the fall in equity values, we expect that there will be pressure on bonus supportability in 2023 bonus reviews, which may lead to many insurers having to cut bonus rates.

Although the fall in asset values will have a negative impact on fund solvency, the effect of the rise in yields on the value of guaranteed benefits and expenses is likely to mean that fund solvency will remain healthy, and could even improve. The increase in the illiquidity premium allowance from 55bps to 75bps for corporate bond allocation will also have a positive impact on fund solvency levels.

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