Asia e-Alert

Milliman

Singapore: 2024 participating fund health check

Introduction

In this e-Alert we review the position of participating (par) funds in Singapore at the end of 2023, based on public information published in 2024, and compare this to the position at the end of 2022. For information on solvency and capital we have used data from the 31 December 2023 insurance returns as published on the Monetary Authority of Singapore (MAS) website. Following the merger of HSBC Life Singapore and AXA Insurance at the end of 2022, the MAS website only included the return for the former AXA business as at 31 December 2022 and includes them as merged in the 31 December 2023 returns. For the purpose of assessing industry-level changes in capital we have taken the 31 December 2021 figures for HSBC as a proxy for the figures as at 31 December 2022, noting that it makes up less than 1% of the total industry par fund assets, and is therefore not expected to materially impact the industry-level analysis. To distinguish between the two par funds now managed by HSBC Life we will refer to the par fund that was formerly managed by AXA Insurance as the "HSBC (II)" fund, consistent with how HSBC refers to the two funds in its external communications.

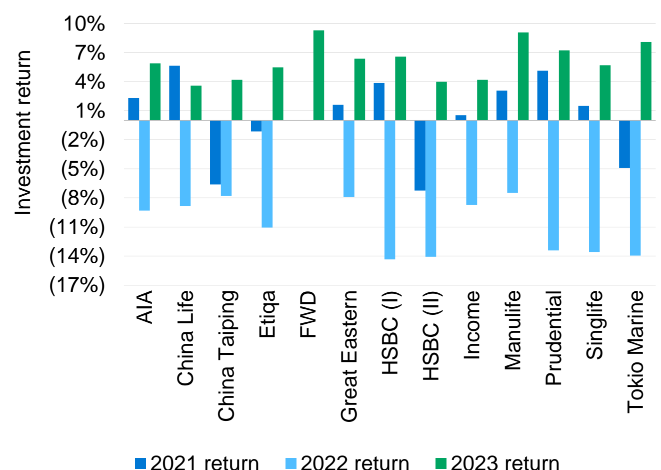
Information on investment returns and investment mix was obtained from insurers' participating fund updates, published on their websites. We have been unable to obtain the participating fund update for Etiqa, so have instead obtained the same information for its par fund from the latest product summary for its Enrich Income product. 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.

In 2023 we saw the launch of FWD's par fund. We include the information on this fund for 2023, as available, but there will be no figures for previous years.

Investments

Figure 1 shows the annual investment return experience for each par fund from 2021 to 2023. We can see that returns in 2023 were generally quite good, with all but four funds experiencing returns of 5.5% or higher. The exceptions to this were China Life (3.6%), HSBC (II) (4.0%), Income (4.2%) and China Taiping (4.2%). The positive returns in 2023 are a rebound, to a degree, from the very negative returns experienced in 2022, which were driven predominantly by the sharp rise in interest rates over that year.

FIGURE 1: PAR FUND INVESTMENT RETURNS FOR 2021 TO 2023

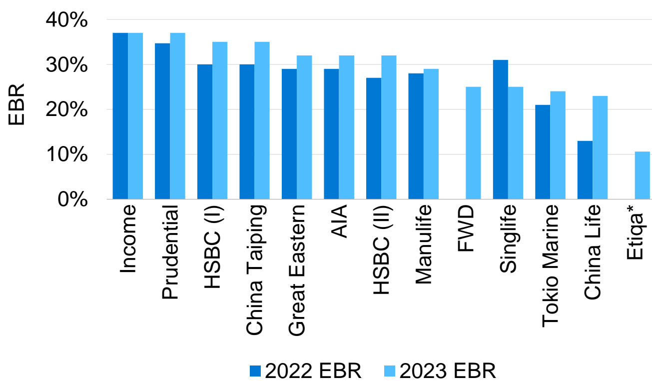


In 2023 we saw Singapore Government Security (SGS) yields drop for tenors of between five and 15 years, but they rose for the longer tenors at 20 years and beyond. Overall, the movement in interest rates was less severe than we have seen in 2021 and 2022, so the effect of bond prices on investment returns will have been less significant than in the previous two years. Equity returns were positive for most markets in 2023 and together with the income from fixed interest assets will have been the driver for the positive investment returns observed in 2023. Corporate bond spreads, in general, also narrowed in 2023, which will have resulted in some positive market value gains.

Equity returns at a global market level were very positive in 2023, in particular in the US, where the S&P 500 grew over 20% on a total returns basis, but Asian equity market returns were much more muted. The difference in investment returns between different funds could be a reflection of the difference in strategy to global equity markets, with those that invested more heavily in the US and a broader global market doing better than those with a more Asian market focus. The use of alternative asset classes, such as private equity and credit, could also have helped boost the returns for some companies more than others.

We might expect the investment performance of the funds to be linked to the split of each fund's asset allocation between equity and bonds and the relative experience of equity markets and interest rates, but this does not seem to be the case for 2023. Figure 2 shows the actual equity backing ratios (EBRs), the proportion of investments allocated to equity and property, for each company's par fund as at 31 December 2022 and 31 December 2023. We can see that the four funds that had the lowest investment returns in 2023 are evenly spread across the range of EBRs, from high (Income) to low (China Life). It should be noted that the EBRs presented are based on actual asset allocations, rather than long-term strategic targets, and so reflect tactical positions adopted as at 31 December each year. There could have been variations in these tactical positions throughout the year.

FIGURE 2: PAR FUND EBRS AT 31 DECEMBER 2022 AND 2023

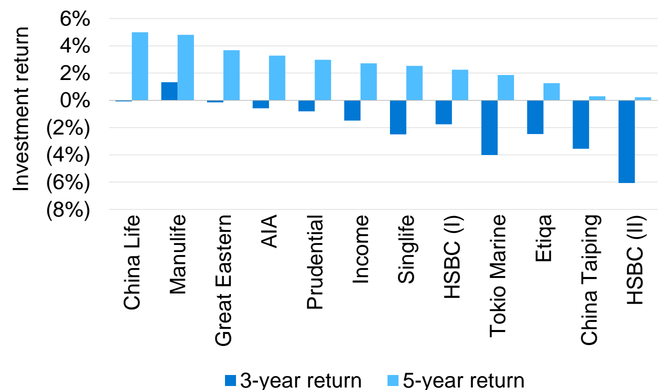


* We were not able to obtain 2022 information for Etiqa.

Another observation we can make is that in general we have seen an increase in EBRs over 2023, with Singlife being the only fund that has reduced its equity content. This could reflect insurers' more positive outlook on equity markets than they had at the end of 2022, which is consistent with the experience we saw in our 2023 par fund health check,[1] where we noted that EBRs had reduced over 2022.

Par policies are long-term insurance policies and the ability to support policyholder benefits, both guaranteed and non-guaranteed, will depend on the long-term investment performance of the par fund. To get a view of the longer-term investment performance we have calculated the annualised investment returns for each par fund using a geometric average of the returns over the past three- and five-year periods to 31 December 2023, as shown in Figure 3. It should be noted, however, that observed investment returns over selected specific periods will not be a guide to how the funds have performed over longer periods, or how they will perform in the future.

FIGURE 3: ANNUALISED INVESTMENT RETURNS BY PAR FUND FOR PAST 3- AND 5-YEARS TO 31 DECEMBER 2023



Poor investment performance in 2022, and to a lesser extent 2021, has dragged down the average returns, in particular the three-year averages. Only China Life and Manulife have had five-year returns that have exceeded the current (effective from 1 July 2021) and previous maximum allowed investment return assumptions for policy illustrations of 4.25% and 4.75%, respectively. If funds cannot achieve the investment returns assumed in policy illustrations, then they may be unable to afford the level of non-guaranteed benefits illustrated and may need to cut bonuses. For funds with historical returns of less than those used in point-of-sale illustrations, it will be necessary to earn higher rates of return in the future to make up the difference to prevent the need for bonus cuts.

With interest rates in the last couple of years being higher than they have been since the 2008 global financial crisis, we do see companies having higher investment return outlooks than the 4.25% and 4.75% illustration rates. The challenge, however, may be that for policies with shorter remaining terms to maturity, such as short- to medium-term endowments, there may not be enough future time to earn the excess returns required to make up for the poorer recent past performance. For policies with long remaining terms, such as whole-life

1. Lee, W.Y., Bryant, A. & Ong, S.L. (October 2023). Singapore: 2023 Participating Fund Health Check. Asia e-Alert. Retrieved 16 December 2024 from https://www.milliman.com/en/insight/singapore-2023-participating-fund-health-check.

products, the increased future outlook could outweigh the poor past experience such that future bonus affordability looks quite healthy, despite the poorer recent investment experience.

There could also be a difference in the impact between products with reversionary bonus and cash dividend structures. For products with cash dividends, or any income benefits, the paying out of benefits during a period of poor investment performance will have crystallised the losses from this period. For reversionary and terminal bonus products that ultimately pay out all of the benefits on exit, however, the potential to earn higher future returns on the assets before being paid out in the future provides an opportunity to recover more of the past losses. The actual impact to bonus rates on different products will depend on the companies' approaches to cross-subsidy and smoothing.

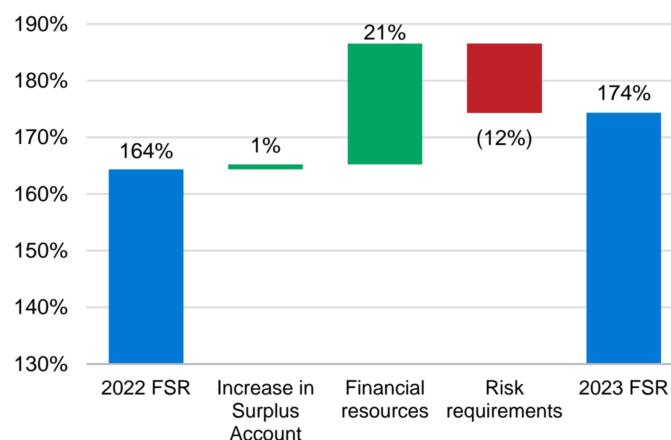
Solvency and capital

With the strong investment performance in 2023 we would expect a positive impact to par fund solvency levels, and that is what we have seen for most companies. Excluding the shareholder capital support in the Surplus Account (SA), fund solvency ratios increased for six of the par funds, but reduced for four (we are excluding HSBC here due to the inconsistency resulting from its merger with AXA, and FWD as its fund was new in 2023). However, two of the funds where the solvency ratio reduced were Income and Etiqa, which experienced very small reductions of (1%) and (3%), respectively. China Life and Tokio Marine had more material reductions in fund solvency ratios (excluding SA) of (23%) and (44%), respectively. However, we do note that both of these funds increased their EBRs over the year, which would tend to increase risk capital requirements.

In terms of the SA, we saw a material reduction of SGD 139 million in AIA's SA, indicating that it felt this additional shareholder capital was no longer required. We note that AIA's par fund had the highest fund solvency ratio (FSR) of all the par funds in Singapore when excluding the SA. Conversely, Tokio Marine's SA increased by SGD 335 million, which appears to be in reaction to the drop in its FSR (excluding SA). Overall, as at 31 December 2023, there were six par funds with SAs contributing more than 15% to the FSR: Manulife (19%), Etiqa (45%), HSBC (51%), Tokio Marine (52%); China Life (61%) and FWD (410%). In FWD's case this will be a result of its new status, having only established its par fund in 2023. Manulife, Etiqa and China Life par funds would all have FSRs in excess of 150% without the SA, so are not reliant on the SA to meet regulatory solvency requirements. The Tokio Marine and HSBC par funds would, however, have FSRs of less than 100% without the support of their SAs, so are relying on this shareholder support to meet par fund regulatory solvency requirements.

Figure 4 shows an aggregate-level picture of the change in par fund solvency over 2023, summing the financial resources and risk requirements across all the par funds in the Singapore market. It shows that the aggregate-level FSR increased by 10 percentage points over the year, from 164% to 174%, driven by a strong increase in the financial resources, partially offset by a smaller increase in the risk requirements.

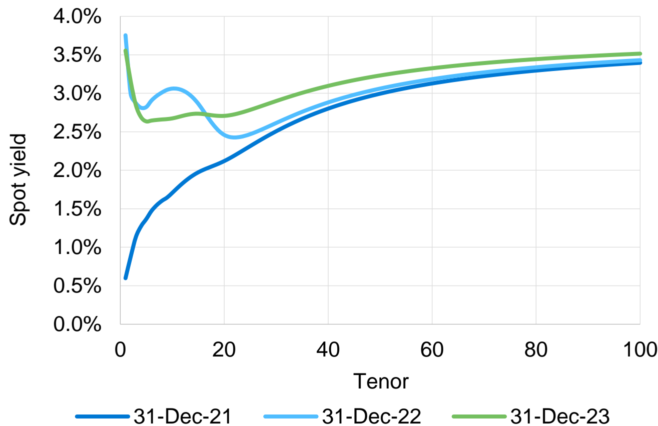
FIGURE 4: CHANGE IN INDUSTRY-LEVEL PAR FUND FSR OVER 2023



We can see that the change in financial resources over 2023 has led to an increase in the FSR of 21%. There could be many factors that are causing this, but one is likely to be the strong investment performance over 2023. Where investment returns exceed risk-free rates, this will generate surplus that increases the financial resources. It will be offset, to some extent, by the distribution of surplus to policyholders (via bonuses) and shareholders, but as the investment returns were particularly strong for many of the funds it is likely that this would outweigh the distribution of surplus.

Another factor that could have led to an increase in the financial resources is the change in the yield curve between 31 December 2022 and 31 December 2023, as shown in Figure 5. Although the yields for terms up to 15 years fell over the year to 31 December 2023, the 20-year yield increased, which leads to the yield curve being higher for all terms from year 17 onwards. The increase in this longer end of the yield curve is relatively slight but will still have had an impact on the policy liabilities, which tend to have quite long durations. The higher yields will have resulted in a reduction in the guaranteed liabilities and therefore an increase in the available capital.

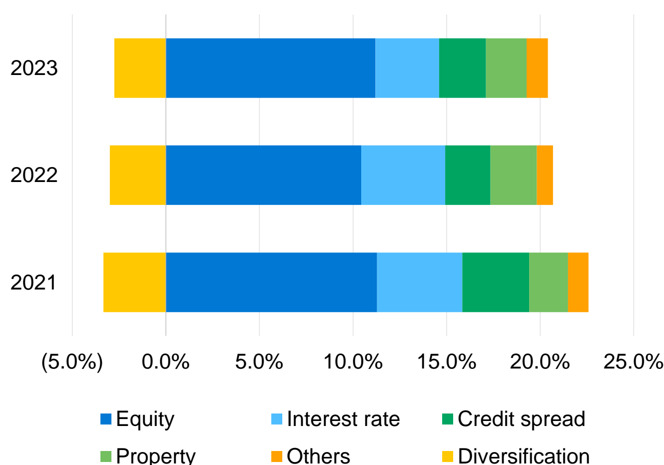
FIGURE 5: RBC2 SGD RISK-FREE SPOT RATES AT DIFFERENT VALUATION DATES EXCLUDING ANY ADJUSTMENTS



Note that yields beyond 20 years are extrapolated based on an ultimate forward rate, as prescribed under the RBC2 regulations.

The positive impact on the financial resources has been partially offset by an increase in risk requirements. When we analyse the movement in risk requirements over 2023 we find that there was actually a small decrease in the C1 risk requirements, possibly due to the rise in interest rates, with the increase in the risk requirements coming from an increase in the C2 asset risk requirements. Figure 6 shows the breakdown of the par fund C2 risk requirements at an aggregated industry level in 2021, 2022 and 2023, as a proportion of the total par fund investments. The aggregate C2 requirements decreased from 19.2% of total par fund investments in 2021, to 17.7% in 2022, but have then remained at 17.7% in 2023. Despite remaining at the same proportion of the investments, risk requirements have increased as a proportion of the surplus because the investments have grown due to the positive investment performance over the year, and hence this has had a negative impact on the fund solvency ratio.

FIGURE 6: INDUSTRY-LEVEL BREAKDOWN OF PAR FUND C2 RISK REQUIREMENTS AS A PROPORTION OF TOTAL INVESTMENTS 2021-2023



Looking at the breakdown of the C2 risk requirements, we can see that there has been an increase in the size of the equity risk requirement, which is consistent with the observation that companies have increased their equity allocations over 2023. Offsetting this has been a decrease in interest rate risk. Typically, par fund liabilities will be longer than the duration of the assets, so a reduction in the amount of fixed interest assets held (to fund increased equity content) would not be expected to reduce interest rate risk. Instead, the reduction in interest rate risk requirement could be a sign of insurers improving their interest rate matching, possibly by increasing the durations of the fixed interest assets that they hold.

Conclusions and future outlook

The strong investment performance in 2023 will have come as a welcome response to the poor returns experienced in 2022 but, other than for the funds at the top of the five-year performance charts, strong returns will need to continue for several years to make up for the adverse returns in 2022. To the extent that companies are relying on strong future returns to support current bonus levels, if these returns are not achieved on a year-on-year basis, then bonus levels will need to be reviewed.

The current illustration investment returns assumption cap of 4.25% will mean that, where companies have been able to sell new policies in 2023, the positive experience for new business could enable increases to bonuses for these policies. In practice, however, any such increases would be expected to be deferred due to smoothing. In time we could see insurers rewarding these policies for the good experience, but this would depend on the degree of cross-subsidy employed and we may instead find that the positive experience for these policies is used to offset some of the poor experience on older policies. Insurers will need to carefully consider the degree of such cross-subsidies and maintain fairness between groups of policyholders.

At an industry level, fund solvency levels remain robust. With the new Risk-Based Capital Framework 2 (RBC2) in place for three years now, insurers appear to be more settled on how they manage their capital positions under it. We do note, however, that there are a couple of par funds that are relying heavily on shareholder capital support in the Surplus Account to meet the regulatory minimum fund solvency ratio of 100%.

Solutions for a world at risk™

Milliman leverages deep expertise, actuarial rigor, and advanced technology to develop solutions for a world at risk. We help clients in the public and private sectors navigate urgent, complex challenges—from extreme weather and market volatility to financial insecurity and rising health costs—so they can meet their business, financial, and social objectives. Our solutions encompass insurance, financial services, healthcare, life sciences, 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

© 2024 Milliman, Inc. All Rights Reserved. The materials in this document represent the opinion of the authors and are not representative of the views of Milliman, Inc. Milliman does not certify the information, nor does it guarantee the accuracy and completeness of such information. Use of such information is voluntary and should not be relied upon unless an independent review of its accuracy and completeness has been performed. Materials may not be reproduced without the express consent of Milliman.