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Slovakia—From an Actuary's Viewpoint

by Graham Luffrum and Maria Bilikova

Slovenská spoločnosť aktuárov

SSA

Slovak society of actuaries

Editor's Note: The year 2005 marks 10 years since the actuarial profession began its rebirth in the small Central European country of Slovakia (pop. approx. 5.5 million). Here we look at some of the issues facing the profession and its association the Slovak Society of Actuaries.

1. Short historical background

Slovakia is part of the former Czechoslovakia, a country formed after the collapse of the Austro-Hungarian Empire at the end of World War I. In between the two World Wars, Czechoslovakia had a flourishing insurance industry and an actuarial profession to go with it. The only insured lives mortality tables in existence in Slovakia today date from this period. After World War II, and then in 1947, the full imposition of a socialist economy brought about the end of the (private) insurance market and also the actuarial profession. Remnants of the profession continued to exist only in the area of demography.

The 'velvet' revolution in November 1989 brought an end to the socialist economy and the start of the re-emergence of a private insurance industry. Slovakia became an independent state on Jan. 1, 1993 and the process of development of a modern insurance industry gathered further pace, with the entry into the market of subsidiaries of a number of foreign companies. In the early days they were mainly from Austria, but now they are also from Holland, Germany, the United Kingdom and the United States. Finally, in 2002, the former state insurance company was sold to a leading German insurance company.

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2. Pension reform

As in most continental European countries, the state pay-as-you-go system is in a poor way. The current right-wing government has finally had the courage to reform it. The first, and perhaps most painful step for most people, has been to increase the retirement age, albeit phased in, to 62 for both sexes. Also, women have lost their right to retire earlier according to their number of children. Again this is being phased in. It is anticipated that a further increase in the pension age, perhaps up to 65 for both sexes, will become necessary before too long, if the system is to avoid total collapse.

The second stage of the reform involved the setting up a new three-pillar pension system as of Jan. 1, 2005. The first pillar is the current pay-as-you-go scheme, itself amended as of Jan. 1, 2004. The second pillar takes the form of personal savings accounts. New entrants to the workforce will have their pension contributions, including those made by their employer, split 50/50 between these first two pillars. Current members of the workforce have until June 30, 2006 to decide whether to stay entirely within the current pay-as-you-go scheme, i.e., the first pillar, or to switch to the new system.

The third pillar, which already existed prior to the current reforms, consists of supplementary pension arrangements. In order to further encourage people to provide for their own retirement, the Government changed the tax law on Jan. 1, 2005 and introduced tax deductions for various forms of long-term savings (life insurance, mutual funds, long-term banking products).

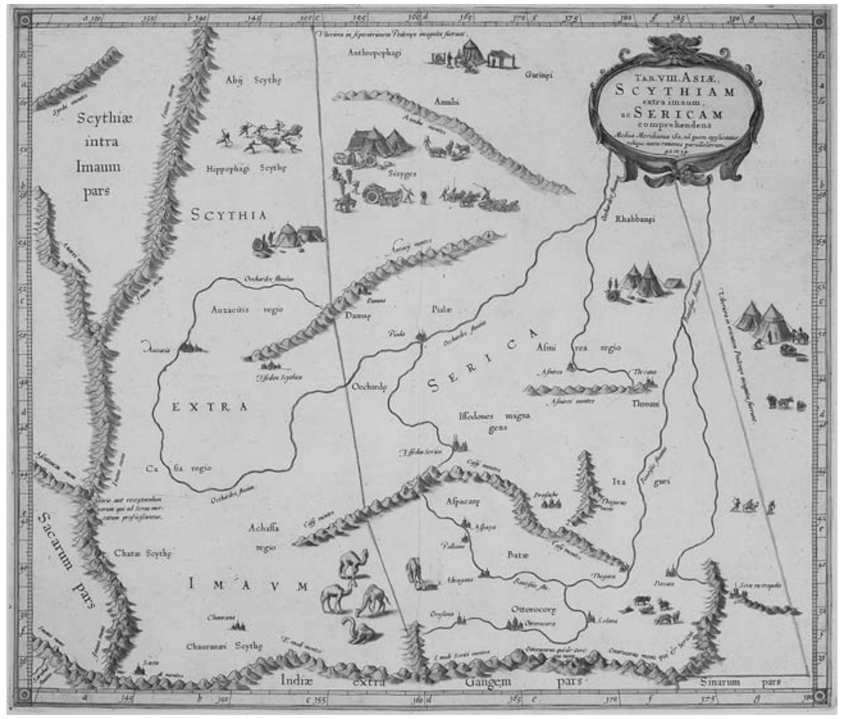
By the end of 2004, eight management companies were set up to administer and invest the money in the personal accounts under the second pillar. At retirement each person will use the money accumulated in his or her account to buy an annuity from an insurance company to add to the pension from the first pillar.

The management companies offer a choice of three investment funds: conservative (money-market investments), middle-of-the-road (government bonds) and adventurous (equities etc.). The Financial Market Authority, which amongst others supervises insurance companies in Slovakia, has the task of supervising these companies.

The nature of the reform leaves open some interesting questions. Perhaps the most important, is how will those who have the option to switch to the new system make their choice? The management companies will want to persuade as many people as possible to switch, but for many they would be better off staying entirely in the current pay-as-you-go system. The government also is keen for the reform to be successful and hence would like to see as many people as possible switch. It is, however, aware that for older members of the existing workforce the new system will not necessarily provide them with a higher pension. Unfortunately, it is not saying where the dividing line, in terms of age, is. At the time of writing (June 2005), almost 1 million people out of a total workforce of 2.2 million have opted to switch to the new system.

A second question is the choice of investment strategy. Contributors will be able at the start of each year to change the type of fund in which they invest their contributions. The rules require that an individual has his/her contributions in only one fund, which stops someone from splitting between funds. The fund management companies and the Government assume that people will start with the adventurous, switch later to the middle-of-the-road and finally as retirement approaches move into the conservative fund. Is this though, the best strategy to adopt? At the time of writing (June 2005) some 1.27 billion Slovak Crowns (about $40 million) has been contributed into the three funds combined—about 5 percent in the conservative fund, 31 percent in the middle-of-the-road fund and 64 percent in the adventurous fund.

A further question relates to the annuities that insurance companies will offer. Under the pay-as-you-go system, pensions increase according to the higher of inflation or the increase in average earnings, a method that the government accepts will have to be reformed at some stage. Will insurance companies be required to offer annuities with the same increases? If so, how will they price them and reserve for them? How will the companies allow for mortality changes? There is room for significant improvement in mortality rates in Slovakia over the next few decades. The Ministry of Labour is aware of some of the issues here and is actively consulting with both the insurance industry and the actuarial profession.



The map above shows an old landscape view of the villages that existed in Slovakia at one time.

3. Insurance

The insurance market in Slovakia is still relatively underdeveloped. In 2004, total written premiums amounted to some 19 billion Slovak Crowns (about $600 million) in life and 29 billion Slovak Crowns (about $900 million) in non-life. Despite this, there are over 20 companies authorized to write business. The market is, however, quite concentrated. The largest company had a 28 percent share of written life premiums in 2004 (the top four companies had a combined share of 70 percent) and 50 percent of non-life premiums (the top two companies had a combined share of 73 percent). Over 40 percent of the non-life business relates to compulsory Motor Third Party Liability (MTPL) coverage.

Slovakia has a system of Responsible Actuaries, modelled, as the name suggests, on the German *Verantwortlicher Aktuar*. Every insurance company, both life and non-life, has to have a Responsible Actuary whose main role is to prepare a report for the Financial Market Authority every year. The content of the report is set out in legislation and includes the

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requirement to give an opinion on the financial condition of the company.

The Financial Market Authority maintains a list of people who can be Responsible Actuaries. To get on this list, an applicant must be university educated, have a clean criminal record, have practical experience and pass a special examination. The latter is meant to test actuarial knowledge as well as knowledge of the insurance law and insurance accounting. It consists of a three-hour written examination and a half-hour oral examination.

There is no requirement to be a member of the Slovak Society of Actuaries. This is a pity as the education requirements of the Society are more onerous and in particular meet both the IAA and the *Groupe Consultatif Actuariel Européen* requirements. In practice, however, almost all the people on the list of Responsible Actuaries are also members of the Society. We believe that the others are members of actuarial societies in other countries.

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4. Medical expenses

The state health system is currently going through a period of reform. The main change so far has been the introduction of modest charges for visits to a doctor and for each prescription, daily charges on admission to the hospital and mileage charges for transport by ambulance. The next layer of changes will see the introduction of different charges for different illnesses. The whole cost of serious illnesses, heart disease for example, will be met by the health system, whereas the patient will meet the entire cost of avoidable illnesses, like influenza, for example.

The Government is keen to see insurance companies offer complementary medical expenses insurance that will cover all these charges and also allow patients to have better hospital accommodation, food and the ability to queue-jump. At the moment, such insurance products exist only in a limited form.

5. The actuarial profession

Some important dates in our short history

January 1994 – First Actuarial Diploma Course–Actuarial Mathematics and Statistics–was held in Slovakia in the Faculty of Economic Informatics of the Economics University (FEI EU) in Bratislava.

March 28, 1995 – Participants in the above course set up a Club of Insurance Mathematicians under the auspices of the Slovak Association of Insurance Companies.

June 28, 1995 – The club's members decided to set up an independent body: the Slovak Society of Actuaries (SSA).

March 27, 1996 – The membership approved the final version of the SSA Statutes.

April 2, 1996 – The SSA was officially registered with 32 founding members.

August 2004 – Membership of the SSA exceeds 100.

Education

The first diploma course was followed by a second diploma course in April 1995 to September 1996—Actuarial Mathematics and Insurance. Both of these courses were funded by the British government, with the British actuarial profession providing many of the lecturers. With respect to both these courses, Society members played a role not just as participants, but also as organizers and lecturers.

From May to June 1997, there was a further Postgraduate Diploma Course—Actuarial Mathematics and Pension Insurance. This was organized by the FEI EU, with funding from the European Union.

All these courses were aimed at those who had already graduated from university and were already doing actuarial work. This enabled them to gain valuable theoretical and also practical knowledge.

The year 1997 also saw the start of a series of biannual seminars—Insurance Mathematics in Theory and in Practice—organized jointly by the Department of Mathematics of the FEI EU and the SSA.

Since the start of 2004, the SSA has been organizing a regular series of Continuous Professional Development (CPD) activities. These take the form of seminars on current topics of interest to members. The presenters have also included guest speakers from outside of Slovakia. It is the aim by the end of 2005 to set up a formal scheme of CPD that will include a requirement for Full Members of the SSA to attend a professionalism seminar.

In early 2005, the membership of the SSA approved a formal structure for initial actuarial education, the main plank of which is a set of detailed syllabuses. This will not only help to visibly improve the professional status of actuaries, but also allows the SSA to apply to become a full member of the IAA and of the Groupe Consultatif Actuariel Européen.

Status and recognition of the profession

Up until 1999, the SSA's main concerns had been in the areas of education and international contacts. From 1999 onward, most effort has been put into trying to improve the status of the profession, in terms of getting the SSA recognized as a fully professional body representing actuaries in Slovakia and getting the term "actuary" accepted in the legislation.

The first step was the approval on April 16, 1999 of a Code of Conduct for SSA members. Then the term "Actuary" was inserted, thanks to an amending law aimed at bringing Slovak legislation more into line with that in the EU, into the then existing law on insurance. SSA members helped in drafting the role, status and responsibilities of the actuary.

Following this success in getting actuaries recognized in the insurance legislation, the SSA worked at improving its relations with the Ministry of Finance and the Financial Market Authority. At the same time it worked at increasing the acceptance of the SSA by employers of actuaries—insurance companies.

The improved cooperation with the Ministry of Finance bore fruit during the preparation of an entirely new law on insurance in 2001. This new law was needed not just because of economic and legal changes, but also by the need to align Slovak legislation with that of the EU in the run-up to EU membership.

The new insurance law came into effect on March 1, 2002. It significantly extended the rights and duties of the actuary in insurance companies and in particular introduced the role of Responsible Actuary mentioned in Section 3.

Membership in international actuarial associations

The SSA has been an Associate Member of the IAA since 1997. In April 2005, it applied to become a full member of the IAA and a member of the Groupe Consultatif. Besides the education changes already mentioned, this has required changes to be made to the Statutes and Code of Conduct, and also the introduction of a formal disciplinary procedure and a procedure for approving standards of practice.

The future

Due to the increased volume of activities and duties relating to actuaries, the SSA decided early in 2004 to set up a number of working parties to deal with specific areas. To date there are working parties dealing with the preparation of actuarial standards of practice, initial and continuing actuarial education, adequacy of reserves and pensions. □

Graham Luffrum is a member of the Board of the Slovak Society and works in the Department of Mathematics, Economics University in Bratislava, Slovakia. He can be reached at grahamgl@stonline.sk.

Maria Bilikova is the current President of the Slovak Society of Actuaries and works in the Department of Mathematics, Economics University in Bratislava, Slovakia She can be reached at bilikova@dec.euba.sk.