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1992 : AN OVERVIEW OF DEVELOPMENTS TOWARDS EC LIBERIZATION

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Mr Chairman, Ladies and Gentlemen,

How are insurers meeting the challenge of 1992?

The single European Market 1992 - a challenge which will also change the insurance industry radically, since the freedom of establishment and services proposed for the end of 1992 will create totally new operational areas and opportunities.

With freedom of establishment for non-life and life insurance ensured to a large extent back in the seventies by the first Directive, it is now a matter of taking the second step and following freedom of establishment with freedom of services, thereby placing twelve insurance markets with more than 320 million consumers in the melting-pot.

The first step in this direction coming into effect as early as 1.7.1990 is the EEC Non-Life Services Directive, with which industrial business, in EC jargon large risks, will be liberalised.

Large risks are differentiated from so-called mass risks according to the size of the insured:

- 300 employees
- 25 million DM balance sheet total
- 50 million DM turnover

Thresholds which will be halved as from 1.1.1993, whereby two out of three of these criteria must be fulfilled to fall under this definition of large risks.

To give you some idea: the first stage encompasses approximately 50% and the second more than 70% of industrial business in the EEC.

The next development will be the liberalisation of mass risks, namely private lines business. It is expected that the EC commission will have presented a draft Directive for this by the end of 1989.

Well-laid plans, praiseworthy intentions, which nevertheless have in part created a certain amount of confusion if one considers current discussions on the internal market. Some Highlights:

1. The range of attitudes of insurance companies towards 1990/92 varies from inertia coupled with total ignorance to hectic activity. The latter is expressed particularly in numerous planned, imminent, actual or failed purchases and sales, mergers and co-operation agreements.
2. All insurance companies expect to gain advantages from the internal market, however at the same time are fearful of strong competition in their own countries.
3. Numerous movements in the insurance market would not agree that the framework of the internal market has changed: after all, freedom of establishment has existed for more than 10 years and even the acquisition of foreign insurance companies has been possible for a long time.

Here the psychological factor in project 1992 is evident, the result of a perfectly staged advertising campaign, reactions to which are at times exaggerated.

4. Prophecias about the effects of the internal market are vague and appear at times to be not quite credible. Thus the "Cecchini Report on Advantages of the Internal Market" estimates the financial savings for the consumer in the insurance sector at DM 45 billion. This estimate is based on the assumption that in the long run premiums will find a level around the average of the four most favourable insurance markets. In Germany Industrial Fire Business is attributed with the highest potential for cost-cutting of 43%. One glance at the technical results in this class over the last few years makes this prognosis absurd.

With this background in mind the question arises for the practitioner as to how the protagonists in the insurance market, insurance companies, insurance brokers, insurance agents and policy holders themselves, are reacting to these changes, that is to say, how are they meeting the challenge of Europe 1990/92.

Are the insurers, brokers staying within their home markets, or are they moving into foreign ones? Which markets are the instigators of this activity, which markets form their targets? How do they go about it, via a locally established office or via services, do they buy a foreign insurance company or do they set up their own?

It is unrealistic to assume that with the onset of the internal market all insurance companies with an office in the EC become European insurers with EC-wide operations. Neither will every insurance company from outside the EC pour into the single European market to take its share of its imagined benefits.

According to a survey by the Insurance Institute of the University of Cologne, the majority of insurance companies will confine their activities to their home market, even given a legally defined internal market.

Please do not get the wrong idea: we are talking here mainly of smaller insurance companies with a small market share which are geared to regional business and which have neither the necessary know-how nor the requisite financial resources for the internationalisation of their business activities.

Argumentum e contrario: the minority of insurance companies which aspires to EC-wide activities consists of large companies, which are predominantly already active today internationally.

At the Gerling-Konzern, we had already broken through the narrow confines of the home market in reinsurance business in the mid-fifties and set up offices abroad. However, we have also been represented in the field of industrial direct business since the end of the sixties with our own branches in every industrial country. To that extent 1990/92 is already history for us.

However, growth is not only a question of quantity but above all of quality. It was therefore only logical that we started in the early days to look for ways of offering the industrial clients a comprehensive service extending beyond simple insurance cover and consisting of auxiliary measures.

Recognising that industrial companies had neither the staff nor the organisational structure to acquire sufficient know-how for their own risk control and to remain up-to-date, we began 20 years ago setting up Consulting Institutes with specialists in all scientific disciplines. Since 1987 our clients have been served centrally by the Carling-Institut für Risikoberatung, known as GRIPS. Our middle-term goal is, however, to set up consulting companies in every industrial country, to enable us to offer the client independent risk consultancy on the spot.

I have touched on this point in my paper because I feel it is important when addressing the subject in question.

The orthodox but proven vehicles with which insurers are also able to meet the challenge of 1990/92 are, of course, equally important in the future namely - in short - adequate capitalisation, underwriting capacity, security, liquidity, financial stability and service.

Where security is needed, the insurer must be on the spot and with innovative ideas and expert backing, survey risks, reduce them, overcome them, help to avoid and control them. This is more than insuring, it is problem-solving, on which there will be even more dependence in the future.

All strategies concerning the EC will, however, be hard to put into effect and may eventually fail, without well-trained staff. Particular attention should, I feel, be paid here to foreign languages. Besides the mother tongue, working knowledge of at least two other languages is necessary, as has recently been confirmed by a large Belgian broking house who have included this requirement in their list of pre-requisites for new recruits.

The tendency towards internationalisation is intensifying world-wide. Hostile takeover bids involving ridiculous prices are the order of the day, as happened in France recently. All this must be seen in connection with a desire to improve one's vantage point at the start of the internal market in 1990/92.

Which then are the markets instigating this activity and which markets form their targets?

Surveys show the most attractive market to be Spain. The average growth rate of Life Assurance business of 32% a year between 1982 and 1986 has roused the interest of foreign insurers. There is no end to the list of takeovers of Spanish insurance companies. Thus, for example, the Union Ibero Americana, the CA De Seguros Bilbao and the Servantes have changed hands.

This rapid development is due in large measure to the comparatively low density of insurance in international terms, rising income combined with a higher level of savings, ailing pension schemes and declining confidence in the State's social system. Bank mergers too play an important part - the largest Spanish insurance companies are controlled by banks.

In second place is Italy, where premium income almost doubled in the last five years. In 1987 alone Life Assurance premiums rose by at least 40%. Here too the reasons lie in a relatively low density of insurance, poor pension plans and dubious state welfare benefits.

Perhaps surprising is that France is in third place. This is explained not least by the reorganisation of the nationalised insurance industry and by the proposed liberalisation of its supervisory law. What is noteworthy too is that French insurance companies have, up to now, concentrated extensively on their home market. It is true that the need to make up for lost time abroad has been recognised, however concrete steps are only taken in rare cases.

Places four, five and eight are occupied by the highly-developed insurance markets West Germany, the U.K. and Holland, which are valued less on account of growth potential than for their high profitability. Interestingly, these markets are producing the most activity with regard to the internal market. Better opportunities for development abroad combined with a firm grip on financial resources are decisive factors in this.

In contrast, the protagonists in the under-developed insurance markets remain largely domestically oriented.

The middle ground is occupied by the threshold countries, Portugal and Greece - Number nine is Switzerland, a non-member country, and further down the list come Turkey, Belgium, Austria, Luxembourg, Ireland and Denmark.



Ireland and Luxembourg are well-known for their flourishing captive markets, a phenomenon which, to the detriment of other countries, has arisen on account of the introduction of tax incentives in general, particularly when setting up technical reserves.

Once the target market has been chosen, the question remains as to what form the business should take: a locally established office or cross-border services? To buy or to found a new company?

Concerning a local office: here the insurer maintains business premises abroad where risks are underwritten and a portfolio of insurance built up. The office can take the form of a branch with no independence in law, or a legally independent subsidiary company.

It is true that an office is comparatively expensive, however this is compensated for by the "hold" on the clients. The insurer with a local presence is best informed about the market and the consumer, is able to adapt to national and local market practices, as well as overcome linguistic and cultural obstacles.

Once the insurer has decided to step up his activities abroad by establishing a registered office, the question is then whether this should take the form of a legally dependent branch or a legally independent subsidiary.

A definite trend is emerging in the market towards the legally independent subsidiary. Numerous legally dependent branches have already been converted. A decisive factor is that according to comments by those concerned - a legally dependent branch always bears the stigma of being inferior and foreign. However, the supervisory bodies in various EC countries have also recently declared that they prefer a legally independent subsidiary to a branch, and indeed they are even applying pressure in this direction. Certainly a legally independent subsidiary is more cost intensive and, of course, requires its own capitalisation.

How then does one acquire the said subsidiary or branch? Does one open up the foreign market by purchasing an existing company or by forming a new one of one's own?

The strategy of purchase leads quickly to imagined success. A share in the market is achieved in one fell swoop. This strategy is therefore particularly suitable for entry into developed markets with a high density of insurance. Here it is very difficult to obtain a market share under one's own steam.

The decision to buy causes considerable financial demands on the company; this explains the numerous increases in share capital in recent times. Besides the search for a suitable and reasonably priced company to purchase, there are often legal hurdles to overcome as well. For example, there is the new Finnish Law on Control by Foreign Capital, which limits the share ownership of foreigners in insurance companies to 40% and their voting rights to 20%.

On the other hand, if one were to opt for the Formation Strategy, the investment is spread over a longer period. This way is particularly suitable for entry into under-developed but growing insurance markets where a position in the market can be built up with less opposition.

International experience shows the strategy of purchase far outweighs the formation strategy, which is expressed in the, in my opinion, panic-like activity of some market participants.

A further alternative is Cross-border services. Here the insurer underwrites the risk in his native country and provides insurance cover for the client abroad. This is achieved either by the foreign client approaching the insurer on his own initiative, or by the insurer engaging intermediaries abroad. Business through freedom of services certainly involves lower costs, although it must be asked what sort of business materialises in this way. As a rule these will only be industrial risks, that is, with professional clients experienced in the insurance business, so-called "Vollkaufleute". On the other hand, private lines business is limited to small segments. The English saying "All business is local" is a fitting description of this problem. The insurance market is, at least insofar as private lines business is concerned, a seller's market, not a buyer's market.

Time and again it is heard said that insurance brokers are the true winners in the single European market. Lively activity, above all on the English broker scene, as shown by the merger of Willis Tabor with Stewart Wrightson and of Minet International Professionals Ltd. with Funk International GMBH, etc. support this thesis. Without doubt, the spectrum of products in the internal market is

becoming broader and therefore more complex. The internationally oriented broker can meet the higher demands of the client for advice, but that is not necessarily always the case.

Interestingly, the current position of brokers varies greatly from country to country. The proportion of industrial risks placed by brokers in Germany of approximately 25% does not compare with the international markets of the U.S.A., U.K., France and Belgium. There the proportion is well over 50%, at times even exceeding 80%. This is the background behind the saying "Germany, the International brokers' dream".

The development of the market can be summed up as follows:

Insurers pursuing private lines business abroad prefer to set up an office in the relevant country. In contrast to this, some market participants, namely brokers, are obviously expecting good results in industrial business through cross-border services. But even here the same applies: market penetration requires local presence. Foreign markets cannot be conquered solely via the insurance broker.

In conclusion, I would summarise the following five points:

- Firstly : The single European market is both an opportunity and a challenge for all players.
- Secondly: The large insurers are intensifying their internationalisation, the smaller companies remain nationally oriented.

- Thirdly : The attraction of an insurance market is determined by its current profitability and its growth potential. The most active countries in the single European market are those with a mature insurance market (West Germany, U.K., Holland) who tend to be aiming at the under-developed markets with future potential (Spain, Italy).
- Forthly : With private lines business the preference is for a local branch office and, increasingly, a legally independent subsidiary. For entry into mature insurance markets, purchase of an existing company is the most suitable method, with less developed markets setting up a new company oneself is to be recommended.
- Fifthly : With Industrial and commercial business, insurance brokers in particular expect success from cross-border services. But here too the same applies: market penetration is only achieved by local presence.
- Viewed as a whole: the "Jeux sans Frontières" will become exciting, and as with all games there will be winners and losers - but you don't need me to tell you that.