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1992 : AN OVERVIEW OF DEVELOPMENTS TOWARDS EC LIBERIZATION

NICHOLAS P. DAVENPORT

AEAI
Omer Leroy
UNILEVER
Conference Co-Chairman

Risk and Insurance Management Society, Inc.
gh Loader
etra Pak
Conference Co-Chairman

SLIDE 1

1992: AN OVERVIEW OF DEVELOPMENTS TOWARDS E.C. LIBERALISATION.

1992 has been looked at from almost every angle. It has bred a whole new Service Industry: professional pundits who predict how it will impact on those who do the real work. You would be forgiven for saying: "Another 1992 lecture. Do we need more leaves in autumn, more one-armed bandits in Loews casino, more insurance brokers at RIMS?"

Distinguished speakers - even some brokers! - will address specific issues as the Conference develops. My task this morning is to paint the background scenery with a broad brush.

1992 is all about the Consumer. The ultimate beneficiary of the Single European Act and the liberalisation of cross-frontier trade will be the consumer.

Stimulus to competition to the benefit of the consumer will be the means to remove the inefficiencies and restrictive practices in many European industries - in few more so than insurance.

So it's from the buyer's angle that I would like to look at 1992's effect. We read every day about mergers between insurers, between insurers and banks, reinsurers taking over captive managers and loss adjusters. The European insurance world is in a state of turmoil. But what's in it for the buyer?

Before anyone else does, I would like to refer briefly to the Cecchini Report. It says: (SLIDE 2)

"Put simply, consumers will be better off ... They will no longer be confronted, as in today's Community, with enormous price differences depending on their country of residence ... As the item will tend to be produced in the cheapest way, the level of this price will be on a downward journey ... There will also be greater consumer choice as market integration and increased competition lead to differentiated products as well as economies of scale."

It's that last sentence that really relevant. Up to now, in several European markets, tariffs, conditions, and competition have been regulated by statute. There have been very wide disparities in the product on sale, and the buyer's options have been limited and distorted. So what are the benefits that the insurance buyer can expect from "Insurance 1992"? They come under 3 headings: (SLIDE 3)

COST

COVERAGE

CHOICE

Firstly Cost: will the insurance product be cheaper? The Cecchini report doesn't help here: it simply says that Great Britain has the cheapest motor insurance and that everyone else will have to come in line.

The last thing that insurers want to do is to reduce their premium income. They are no longer allowed to have gross tariffs including fixed commissions - only net tariffs and these are not allowed to be "cartelised". So, their first efforts in the face of increased competition will be to maintain income but reduce expense ratios. It must be said that these are far too high. They average about 30% for acquisition and management costs together.

The effort to achieve economies of scale and reduce the expense ratio is one explanation for the feverish merger activity going on right now. The other of course is the rush for market share. It's all very well having the lead in your home market with 15%, but if this is only 1% of the European market it doesn't carry much weight.

Right now, the league table looks like this - (SLIDE 4) but it might look quite different by 1992. "L'Argus", the French insurance magazine, in the nine months from October 1988 to July 1989, counted 40-odd strategic moves within European insurance. Since July 1989 we have seen some big ones too, Sun Alliance taking 15% of Commercial Union, a merger between two large French reinsurers SCOR and UAP Re, Banque Suez taking over Groupe Victoire - itself the recent acquirer of Colonia, and, recently, Allianz's move for Compagnie Mixte. The Pearl in the UK might fall to an Australian predator - or maybe to a European one.

Many of the moves involve French companies, conscious of the need to acquire enough critical mass to become players on the world stage. The most astonishing of all has been the growth by acquisition of Groupe AXA - ten years ago a group of small Normandy mutuals - today, thanks to the takeover of Cie du Midi, challenging UAP for the right to say: "Numéro Un oblige." Some of us thought AXA's next move would be for a major British composite: instead it looks as though Farmers of California will be next. Curiously, only 3 of the 45 manoeuvres I've just identified involve a British company initiating a connection with a mainland European one.

I am puzzled by this. I know the Royal, the Eagle Star, and the Commercial Union have had active "1992" strategies for some time. But they seem to find it very difficult to make the right tie-ups whilst French and German companies seem not to. Continental cross-shareholding systems are always described in the UK as "impenetrable" - they don't seem to be to French or German suitors. In fact due to their status as public companies quoted on the Stock Exchange the British companies are mostly vulnerable to predators themselves and there is considerable bid premium in their share price today. Perhaps the most sobering statistic is that 25 years ago there were 5 insurers in the UK's largest 20 companies. Today there are none.

So, economies of scale brought about by merger will be insurers' first step towards maintaining their profitability. There will be fewer, larger companies. The biggest, those who are genuinely transnational and capable of servicing a multinational's global needs, will be very few indeed.

The key to optimum benefit to the insurance buyer, in ensuring that the gains from this concentration of capacity are genuinely made available to him should be in the hands of the broker. The broker's duty is to unleash the competitive forces between insurers, and the more tariffs, cartels, statutory limitations to coverage disappear, the greater the scope for the broker to act on behalf of his clients.

Pure price competition in anticipation of the opening-up of the market place is already happening. It has been said for example, that German carriers, whilst stressing the loyalty of their German clients, will do anything to beat off competition from other markets.

SLIDE 5

We have been conditioned to accept - although I cannot think why - that there should have been statutory limitations to Coverage. In Germany it has not been possible until very recently to buy broader property cover than Fire, Lightning, Explosion and Aircraft. Some buyers may be happy, and I think many German buyers are, to have limited cover but if you can buy All Risks for the same price why not do so? Or at least get some price reduction for accepting narrower conditions.

It can only be good for the buyer - even if he wants to remain loyal to his insurer - that the insurer should feel constrained to offer the broadest cover available in the whole European marketplace. I know of insurance companies, quite prepared to give All Risks cover in other markets, but only offering limited coverage in their own marketplace.

In terms of Choice, it will become possible, provided all the Member States enact the legislation required of them by Brussels, to choose to insure with a carrier based in another Member State. The instrument to make this possible is the 2nd Non-Life Freedom of Services directive, (SLIDE 6) mention of which is usually enough to send most audiences straight to sleep. I shan't dwell on its technicalities, but I would like to spend a little time looking at it from a practical point of view, again with the buyer in mind.

The Directive has obviously been written from the standpoint of the European buyer seeking to insure his risk, for whatever reason, in another Member State.

I cannot imagine that it was designed to be used by the multinational buyer - seeking perhaps to rationalise his own European Production and Distribution, perhaps creating a European HQ, say in Brussels, and looking for a European insurance programme to match.

Why do I say this when there has been much talk about European programmes and the collapse of barriers to them? Because, I'm afraid, the Directive falls well short of giving us real Freedom of Services, one of the Five Great Freedoms of the Treaty of Rome: which would be the freedom to choose one European location to cover all European risks under one policy.

You can do this under the Directive, but only if you're not in the pharmaceutical, nuclear, haulage, or construction business, in that the Directive does not apply to Pharmaceutical products liability, nuclear civil liability, carrier's liability, nor the compulsory insurance of building works.

And you can only buy your "European programme" for 8 Member States not 12, because Ireland, Spain, Greece and Portugal don't get Freedom of Services until a variety of later dates. As for EFTA states, that is Austria, Finland, Iceland, Norway, Sweden and Switzerland, they may, or may not, follow the EC model, although it should be noted that Switzerland will soon conclude a bilateral agreement with the EC allowing Freedom of Establishment in either direction. So whilst the 1st July 1990 - the date when F.O.S. should come into effect is heralded with much excitement, it will be 1999 before the last of the 12 MS gets full services. Luckily the Exclusions I mentioned before are to be reviewed in 1998, so by the year 2000 we might be getting somewhere near full Freedom.

Just a little more on Freedom of Services. Of course the Risk Manager is not only concerned with mainstream Property/Casualty. F.O.S. should also apply to Motor, if the directive currently in draft is adopted, with the same thresholds as for the Non-Life directive. But the current French presidency has dropped this directive from its programme so it is unlikely to be in force until 1992 at the earliest. Not good news for the multinational buyer. Employers Liability is excluded from the Services directive, so local solutions will still have to be found for this class, in those markets where there is private sector insurance.

Property/Casualty and miscellaneous financial loss are subject to the well-publicised thresholds, whereas Marine, Aviation, Credit and "Suretyship" are all included in the Services Directive, without any threshold.

There is even a "Mass Risks" F.O.S. directive in preparation. DGXV has promised this for the end of the year, although there will probably be some slippage.

In practice, it may also turn out that Freedom of Services is of limited interest to the multinational buyer in any case: whilst some may welcome the chance of one policy in one place, others will still require local service as near to the risk as possible, and some might say that they already have a Global Programme anyway so why do anything special for Europe? Eddie Hester of the Zurich has rightly pointed out in Risk Management magazine that if your international programme consists of a master policy supported by 40 or 50 underliers worldwide, there may not be much to be gained from reducing the number of policies by 8 from next year.

The real impediments to a barrier-free Europe are of course: the lack of a common currency, the lack of a common taxation system and the lack of a common legal system. As to the first, I can only state what appears to be an overwhelming view in European financial circles, especially in the City of London, despite Mrs Thatcher: that is the sooner we get Economic and Monetary

Union and a single European currency, the better.

The lack of a common taxation system is a big problem for European insurance, life insurance particularly, but more specifically in the field of Non-Life Freedom of Services. The Services Directive provides that Premium taxes (SLIDE 7) should be paid, not in the country where the master policy is bought, as we might have hoped for our multinational clients, but in each country where a "risk" is located. So if you have a plant in France, another in Denmark, and another in Germany covered by one policy you will presumably have to allocate national premium to each one - which is what the Directive was supposed to eliminate - and pay premium tax in each country!

Similarly one of the worst "un-level playing fields" is in the non-taxation of insurers' catastrophe reserves - which gives a clear competitive advantage to certain European insurance industries over others.

Finally as to one legal system for insurance, if your risk is situated in more than one country you can opt for any applicable national law to govern your policy provided that the obligatory clauses of the state where each risk is situated are paramount. In plain language that means that you can choose Danish law for the master policy but certain provisions of French, German or British law are paramount for risks situated in those countries.

It has been said that we shall all have to become masters of comparative law, and that the real beneficiaries of Freedom of Services will be the lawyers and the judges. The implementation of the Products Safety directive is a fine example of this. To date ... countries out of ... have adopted the Directive ... with unlimited liability, ... without, ... with State of the Art defence ... without.

One final word on Freedom of Services: we do welcome it as a step in the right direction, but there is still a way to go before it becomes a straightforward instrument, user-friendly and suitable for all our clients. Its main value lies in that by allowing cross-frontier insurance, it achieves the Cecchini objectives of forcing carriers in previously protected markets to align themselves with the best products available in the Community.

So we have seen the dramatic effect 1990/1992 is having in facing a restructuring of the European insurance industry. We have seem some of the benefits we hope that will produce for the buyer. What should the European broker be doing to respond to the challenge? (SLIDE 8) In the top 20 brokers in the world at the moment 8 are US, 11 are European, of which 7 British. 4 of the top 20 belong to UNISON and added together take UNISON to 2nd place. Beyond the big 4 (Marsh, A & A, Sedgwick and UNISON), there is quite a rapid drop into the 2nd Division, whose capability in handling major multinational business could be increasingly questioned.

Of course, it must be said that the trade-off for greater freedom of choice will be greater complexity - there will be more products on offer and much more competition, with, in theory at least, many more insurers to choose from.

(SLIDE 9) The professional, independent broker must fulfil his vocation in acting as a guide through the maze of complexity and competition.

I'm afraid I shall be a little subjective here. We think there are one or two key things the successful European broker must do:

(SLIDE 10)

- <u>Be close to Brussels</u>

Like it or not, a lot of what we will be doing in Europe will be breaking new ground. Expert interpretation of each new Directive, whether related to Insurance, the Environment, or Products Safety will be crucial. Other speakers will be going into these issues in greater depth so I will just say that we in UNISON are monitoring the insurance consequences of European environmental legislation with the greatest care, as we have done for Product Safety. The "Framework Directive" on European Health and safety, adopted in June 1989, lays primary responsibility for ensuring employee health and safety on the employer. Any firm with more than 5 staff will <u>have</u> to either employ competent safety professionals or competent consultants. We are associated with the leading firm of Health and Safety consultants in Europe, whose work will grow in importance in proportion to the growth of European consumer consciousness.

At least for the time being, US fears regarding Fortress Europe, particularly through the inclusion of Reciprocity clauses in Directives, seem to be off the agenda for insurance. Personally, I am delighted - Sir Geoffrey Howe - British Deputy Prime Minister - was right when he said: "If we build Fortress Europe, its first prisoners will be ourselves".

- Be flexible

Some of you will seek a centralised solution to European insurance requirements, possibly involving the unbundling of some of the services normally provided by brokers. Others will continue to require full top-quality local service The alert European broker will be able to respond to a variety of tailor-made solutions falling within this spectrum.

- Offer fully integrated services

We shall want to provide the best European markets for all specialist insurance classes, as well as mainstream property/casualty.

- Be "global insiders"

The successful broker will provide local service to a local multinational's global needs. There will be no "identikit Europeans" in insurance, nor any homogenised, cross-frontier insurance product. Our business is more like the Nescafé model - a different taste for each marketplace, or even as the Chairman of Matsushita said recently: "The new global market segment is the individual". French buyers want French solutions to global insurance problems, German buyers, German solutions - but still bringing to bear global buying power.

- Provide European Risk Management Services

European buyers may not have the same imperatives in financing risk as US buyers do. Brokers should provide all the alternatives available, and there are some exciting prospects developing for captives based within the European community, for example in Dublin. Other speakers will examine these options in greater detail.

- Provide I.T. leadership

Coordination of multinational programmes and their servicing requires increasingly imaginative use of Information Technology. In many cases insurers are not geared up to meet clients' needs for access to data relating to claims, loss reserves, or movements of funds in and out of captives. It is up to the broker to bridge the gap.

- Offer zero-defect service Europe-wide

Industry has had to adapt to Japanese-style Quality with a capital Q. Financial Services in Europe have long been protected from such pressures, and brokers have a major role in enforcing much higher standards so that the sort of claims office, for example, shown in this slide never reappears in European insurance. (SLIDE 11). The very least the insurance industry can do is issue policy documents quickly and in an acceptable format - not the case at present, and we are all guilty.

Finally, in any gathering of insurance professionals, especially one with heavy broker representation, I am reminded of George-Bernard Shaw's remark: "All professions are a conspiracy against the laity". In addressing you today, very much from the buyer's standpoint, I hope I have not been guilty of that. The winners in the 1992 Insurance Race will be those brokers and carriers who manage to most closely match the buyer's own European development, never forgetting that insurance is only one of the solutions to the Risk Manager's problems.

On one final personal note, I have always been struck by the perspicacity of Antoine Riboud, Chairman of the French manufacturer B.S.N., when he said: (SLIDE 12) "My grandfather was local, my father was national, and I have to become European ... it is no longer true that you can remain local and survive."

That, Ladies and Gentlemen, is the challenge that lies before all of us in European Risk Management.