

FEW CAPTIVES IN COPENHAGEN

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DENMARK'S underwriting industry is almost as old as those of Germany and Britain, since it began in 1731 with the foundation of a fire insurer, Kjøbenhavns Brandforsikring. Such a tradition implies that it must be a saturated market, and the future of Danish insurance will therefore much depend on the level of adaptation to the framework of the European Community.

In this respect, Copenhagen has somehow got the reputation abroad for being an ideal base for captive companies — largely because our four Nordic neighbours remain as yet in EFTA rather than the EC. In fact, there are few captives in Denmark (although several Danish companies may have such offshoots elsewhere) and no dramatic growth in hosting them is expected.

On the other hand, Denmark belongs to the most developed insurance market in the world both in terms of variety of insurance products offered and premium per head of population where it ranks twelfth in the world in total business for 1988, according to Sigma, and fourth within the EC countries.

The total direct premium income in 1989 amounts to 20 500 million Danish crowns for non-life and 13 300 million crowns (Kr) for life. As in most other markets, no official statistics of the ceded inland reinsurance business are available, but as a general rule about 15% of all direct non-life insurance is reinsured.

The total number of companies registered on the Danish market in 1989 was 226. This number has been relatively constant over the years, also when it comes to the number of foreign owned companies. The exact breakdown of companies is 79 shareholding companies, 101 mutuals and 46 foreign companies.

Given the level of market development in general, one can conclude that Denmark must be regarded as a saturated market both in terms of annual real growth in insurance premium and the number of companies offering insurance. When it comes to market players, the Danish market is dominated by a few very big, direct groups of companies. This applies like-



wise to Sweden, Norway and Finland, while tiny Iceland can be regarded as a special case. Its population of only 240 000 is served by about 14 companies — which rely heavily on reinsurance abroad.

Even so, the ratio per head is about the same as in Denmark. Here, the league of non-life companies (seen as groups) is led by Baltica whose gross premium income in 1989 was 3955 million crowns. This was almost 16% of the market and closely following was Hafnia with 14% plus. If the

next eight companies are added — including Lærerstanden at less than 2% — this accounts for three-quarters of the Danish market.

The reinsurance market too is dominated by a handful of large companies. In terms of gross premiums for the same year, the top five were:

Nordisk Re	Kr1563 million
Copenhagen Re	Kr933 million
Hafnia Re	Kr447 million
Alm. Brand Int.	Kr372 million
Tryk International	Kr228 million

If we look at the results of the direct fire and marine business which is normally reinsured, 1990 produced the following results.

The total compensation for damage paid by the insurance companies in 1990 rose by 6.2% to 1300 million crowns and at the same time the number of fire claims increased to 434. Electrical claims are occupying a clear first place both in terms of number and compensation paid. Also, "carelessness with fire" practiced by artisans is clearly the next important cause of claim. A substantial part of these claims are caused by use of oxy-acetylene burners and blow-lamps.

Although the international competition continues to affect the Danish hull business, there are signs of a turning point and the renewal for 1991 resulted in an increase in premium of approximately 13% on an average. The year 1990 was characterized by the catastrophe on board *Scandinavian Star* where 158 people lost their lives under tragic circumstances. Further-

more a total loss was registered in respect of: *Eal Diamond*; *Carl Egede*; *Condor*; *Maersk Yare*; *Naparutaq*. These ships together with a number of smaller claims leave the companies with a substantial loss.

The cargo business for 1990 showed a satisfactory experience as was the case in previous years. The storm in January last year caused one of the largest claims of the year, as a cargo of wires shifted during transportation from Hamburg to Chittagong. A provisional reserve of 17 million crowns has been estimated.

After several years of discussion as to whether the direct companies should write insurance for flooding, Denmark's government set up a committee to investigate the needs for

to compete in the single market.

Amendments were adopted to the Insurance Companies Act in 1989 and gave the insurance companies access to apply their skills to related areas and to offer total packages including financing. Two bills followed in January 1990 providing further liberalization which again were followed up with new amendments in May the same year giving companies access through subsidiary companies to other business activities under the control of the Financial Supervisory Authority.

This puts the insurance companies in a position to compete with banks and savings banks. Also general managers of insurance companies are now permitted (by approval of their board of directors) to own, manage or participate in the operation of business enterprises outside insurance.

The EC insurance directives which have already been implemented, and those still to come, will also result in more foreign companies operating on the Danish market, and correspondingly, Danish companies will have greater access to other EC countries.

More than 60 insurance companies from other member states have already advised the Danish financial supervisory authority that they wish to be able to write policies in Denmark direct from their own country. Most of the 60 companies are, however, already established through general agencies in Denmark.

Another important consequence of the EC legislation in the future will be that the Danish real interest tax must be expected to be removed, since otherwise there is a serious danger that hundreds of millions of crowns in pension savings will go to companies located outside Denmark. The tax yield from the real interest tax today amounts to 20 000 million crowns yearly and has become an important source of revenue for the state.

According to Tillinghast's 1991 *Captive Directory* there were a total of about 3066 captives in the world last year and the total number has been relatively constant over the past few years. An approximate figure reflects the fact that there are different ways of defining what a captive is and it is difficult to keep track of all companies that are established or withdrawn from the market.

The definition of a captive insurance company normally used is: "A closely held insurance company where insurance business is primarily supplied by and controlled by its owners, and in which the original insurers are the principal beneficiaries".

In the case of Denmark the relatively broad definition could lead us to include a number of mutual direct insurance companies as captives. These companies are, however, not included in the Tillinghast directory. Out of the total number of captives in the world only 21 are stated as being registered in the Nordic coun-



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Copenhagen's most famous captive.

such a coverage especially considering the needs of the western coastline of Jutland. The committee has now given its recommendation to establish a national pool, and the Danish parliament is expected to pass the bill for its establishment during 1991.

The practical administration of the pool will be taken care of by a public council *Stormflods-rådet* representatives from a variety of public organizations and the Danish Insurance Association. The funding of the insurance will come from a fee of Kr10 on all insurance policies covering fire. The *Stormflods-rådet* will decide whether a certain event is to be covered, and the insurance companies will be responsible for the loss adjustment.

By law until a few years ago Danish registered insurance companies were only able to engage in insurance business. This strict policy compared unfavourably to most other EC members and limited Danish companies' ability

tries: eight in both Sweden and Finland, two in Norway and three in Denmark.

It should, however, be noted that several major Scandinavian industries have established captives abroad in the traditional captive centres like Luxemburg and Guernsey, and the total number of companies is about 90.

Why is the number of captives registered in Denmark relatively low? Without going into details about the other Scandinavian countries one must, however, assume that many of the reasons mentioned below are valid all the way from Reykjavik to Helsinki. First of all, it should be known that the Insurance Company Act in Denmark does not distinguish between a captive company or other insurance companies. In other words, a captive company registered in Denmark has to follow the exact same rules and regulations as a regular insurance company.

The only *financial* motivation for setting up a captive in Denmark is therefore to save on costs in comparison with a regular insurance company plus gain more control of cashflow. An insurance premium from a non-captive company can normally be split into a risk premium, a premium safety margin, administration costs, acquisition costs and profit. By establishing a captive the saving will typically be on the acquisition costs and by deploying the profit back to the owner of the captive.

To reach significant saving on the acquisition costs and profit compared to a non-captive company, the annual premium income should be at least 8 million to 10 million crowns, and there are very few Danish companies that have this level of annual premium payments. One recent example of a public company for which it seemed uneconomical to establish a captive was the Association of Danish Electrical Powerworks.

Another advantage of establishing a captive is also that the captive can combine its insurance exactly to fit the owner's or sponsor's needs and thereby only pay for the coverage needed. Ten years ago "fitting to the owner's needs" was normally a benefit when establishing a captive, but the competitive climate today is different, as most big direct insurance companies (or brokers) are much more responsive in solving individual needs for a certain company or for a specific type of companies.

Today we also see several policies developed by direct insurers specifically for one client who is offered a substantial saving compared to the coverages available some five years ago.

Better management of risk is also often considered an advantage that comes with the establishment of captives. This is true, but what many founders of captives do not seriously take into account in their calculation is that the precautions can be established as an internal activity without necessarily establishing a captive.

Finally, as previously mentioned in connec-

tion with the definition of captives, Denmark is in the unique situation of having several mutual companies that come very close to the definition of being a captive. Examples of these are: Glarmestrene which does insurance for all window-glass repair companies; Galt A/S, the insurer for farmers' co-operative slaughterhouses; and the Danish Municipalities Mutual Insurance Company (*Kommunernes Gensidige Forsikringselskab*).

All these companies provide insurance coverage that especially meets their policyholders' needs and at a real cost — passing a profit or loss back to their members through reduction or increase in the annual premiums. One can therefore say that some of the market needs for captives are already covered by the mutual companies.

The development of Denmark as a more attractive centre for the establishment of captives in the future will require a change in the Insurance Act to give competitive advantage to captives versus the general registered insurance companies, or alternatively, better the terms in form of taxes and so forth for the whole Danish insurance industry to take up the competition with the traditional captive centres like Bermuda, Cayman or Guernsey.

Denmark's membership of the EC will, however, prohibit such a development since the Danish insurance laws must comply with the EC laws and regulations being fully implemented in 1993. Also, looking at the Scandinavian markets, Sweden has now applied for EC membership. Norway and Finland will most likely follow, judging from the latest negotiations between the EFTA countries and the internal political climate in each country.

It can therefore be concluded that development of captives within the EC countries in the future will most likely stagnate or be reduced unless future regulations from Brussels make it more attractive to establish captives within the common market compared to the traditional captive locations outside the Continent.

As the insurance industry becomes more and more international, the demand for the establishment of insurance companies outside the EC will increase, and one of the developments one can foresee is the increase in the number of insurance companies that offer consulting services in establishing captives in non-European markets. ■

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