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FOCUS 2000: REINSURANCE IN THE YEAR 2000

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- o Reinsurance has evolved from a tool that was primarily a risk management one to one that encompasses elements as a financial management tool. This session examines the possible state of the reinsurance marketplace in the year 2000.
  - -- What will companies use reinsurance for?
  - -- What are the expanded and future roles that reinsurers will play?
  - -- What are the effects of "globalization" and 1992 on the reinsurance marketplace?
  - -- What are the implications for the reinsurance actuary?

MR. KIN K. GEE: I am particularly pleased that we have a diverse panel of experts to share with us their views and outlooks on the reinsurance marketplace, and since this year's meeting has an international theme to it, I'm particularly pleased that we have a speaker from the newly unified Federal Republic of Germany. Speaking of the international theme, I was particularly intrigued with the comments made by our keynote speaker yesterday, James Schlesinger, regarding his assessments of the options that the U.S. had in the Mideast crisis. He went through the three options, and none of them were particularly appealing. I guess you can say that President Bush is caught between Iraq and a hard place. But, on a more serious note, I guess most of us are aware of the Mideast crisis on a personal level, as are those of you who are in the military reserves are particularly concerned; the impact that it's had on the stock market; the price of gasoline, and so on. But I was recently made aware of a new particular concern on a personal level at the Pleasure Island. I was having a conversation with an elderly, retired gentleman, who I think is an actuary. Like most of us, he was concerned about the Mideast crisis, and it wasn't until about five minutes later, that I understood his cause for concern. It turned out that one of his wishes is to be buried in Jerusalem. With the crisis and the threats that Saddam Hussein has made on Israel, his concern was whether Jerusalem would still exist for him to be buried in, when his time comes. So I was intrigued. This gentleman didn't look particularly Jewish, and with so many beautiful cities that could be chosen as a final resting place, why Jerusalem? And he said, "Well, you know, you're an actuary. You could appreciate this. It's got the highest probability of resurrection."

It was in *The Tempest,* I think, that William Shakespeare wrote, "The past is prologue." With that in mind, what I'd like to do is take us back about 10 years to 1980 and just very quickly highlight some of the issues and topics that affected our industry, our

* Mr. Schürg, not a member of the Society, is Director of RheinMain Ruckversicherungs in Wiesbaden, Germany.

economy, and specifically -- reinsurance to kind of lay the background or a backdrop for a starting point for our panel of speakers. Back in 1980, we were seeing the impact of many forces and trends. I think, certainly, the continued effect of inflation, consumerism, deregulation, the baby boomers, their purchasing power in real estate, and so on, all had direct impact on life insurance. We started to see the proliferation or the product revolution of single premium deferred annuities (SPDA), universal life, interest-sensitive products, products that were meant to replace other companies' life insurance, reentry term, graded premium whole life, and so on. We saw in risk classifications the emerging issues of smoker or nonsmoker distinctions, mandatory unisex rates, and so on. We still saw the residual impact of the Federal Trade Commission (FTC) report on the return on the life insurance product. On the tax front, we were still under the three phases of the 1959 Act, and in fact, some of the companies in mergers and acquisitions still have to be a little bit careful of phase three liability. We still had elections under Section 820 on the treatment of modified coinsurance. We had the 818(c) election, the adjustment to net level premium reserves. I think many of you in reinsurance remember how important this was in supporting some of the rates of the low premium products. We still had the Menges 10 for 1 approximation on the reserve valuation rates, and so on. Ten years later, we've seen quite a change in our industry. We've seen the decline, and now the revival, of whole life policies. We've seen the level premium term products coming back: the five, the seven, and the ten year level premium term products, and so on. We've seen several changes in our tax laws, including for the first time, life insurance being defined. It used to be that we kind of knew what life insurance was, and now it's actually defined in the Code. We've seen the dramatic impact of AIDS for a short time, and I think some of that impact is still being felt, and the tremendous decrease in a relatively short time of the testing limits set by the reinsurers. We've seen low rates and capacity shortage on some of the products such as second to die. So, with that as a backdrop, I'd like to introduce our panelists. The first speaker will be Greig Woodring, who is Executive Vice President at General American. He heads up their reinsurance division and has been in the reinsurance arena for more than 10 years. An interesting thing is that when they first sat down and decided what they were going to do in the reinsurance operation several years ago, they took a strategic look in terms of where they wanted to be. I think, with the exception of perhaps one company in the Mid-Atlantic, every one of the targeted companies is now a client of General American. Greig will speak from the viewpoint and the outlook of a large, leading U.S. reinsurer.

MR. A. GREIG WOODRING: Reinsurance in the year 2000 -- sounds like a pretty safe topic to me. No one here is going to be able to prove me wrong for 10 years, and by then, we'll be talking about reinsurance in the year 2010. But I promised Kin that I'd make a good faith effort, at least, to be about as accurate as the average economist. So bear that in mind. Kin capsulized some of the dramatic changes that occurred in the last 10 years. And I think one thing we can safely say is that the changes that occur in the next decade will probably be at least as many and as big. I suppose axiomatically, the changes that affect the direct writing primary companies will also affect the reinsurers. And there are a lot of forces, and forces for change going on in that arena right now. We could talk about consolidation, regulatory tax issues, capital shortages, globalization, competition from banks, etc. Rather than try to touch on all those areas, I think I'll speak mainly from the perspective of what reinsurers do, and how that might change in the future, between now and 2000. One of the roles, perhaps the most traditional role for a reinsurer, is that of mortality risk taker. Clearly, mortality risk taking will be an important part of reinsurers' lives in the year 2000. That's not going to change. But there are a number of market and external forces that are changing slowly the nature of mortality risk we take. First of all, I can mention AIDS, only to say that by the year 2000, we might finally have a handle on what's going to happen with AIDS. By then, we'll at least know what the course of that epidemic is. But there are other changes that are happening, too. I think one of the major ones is in the way that policies are being sold right now in the upper income markets. Estate planning seems to be the tool for the 1990s. There will still be some key man insurance, some buy/sell type sales made but estate planning seems to be where the upper income agents are selling. And that, unfortunately, from a reinsurer's perspective, means that second to die is going to be here to stay, I think, in larger and larger numbers. It also means, I think, that there's going to be a rapid inflation in the size of policies sold in that upper income marketplace. And I'd look for a continuing rapid increase in the large policies that we see today. Of course, that all means mortality is going to be a little bit more volatile, and capacity is going to be a little bit more important.

There are also a lot of changes in the underwriting area. First of all, we could talk about genetic testing. At this point, I think we can say that genetic testing will be available. There'll be a lot of genetic tests available. And the only question is, how we're going to be using it as an industry, and how we're going to be able to use it. Genetic testing opens up a lot of political dimensions to the insurance business that haven't been opened before. And I don't think anyone can foresee what's going to happen in that arena. Another thing that I could predict for the year 2000 is that most of the direct writing companies are going to have artificial intelligence systems for issuing policies and underwriting. I think that's the way things are heading. And by the year 2000, we might see at a primary company, their artificial intelligence computer system calling up their reinsurer's artificial intelligence computer system to access a sophisticated medical database that's maybe maintained by the reinsurer in conjunction with a research hospital or a medical college.

Another aspect of underwriting that's changing is that we've seen a lot of increase in ages issued. We're starting to underwrite, in estate planning areas, a lot of 70 year olds, 80 year olds, even upper 80 year olds, and 90 year olds, at times. That also puts a lot of pressure on underwriting, because there's very little data to support some of the assumptions that are made. There's also another thing that happened recently, and that's the proposed tax changes favoring group life. I suspect that the meaning of that is that we're going to see a lot of crossbreeding and hybrids of individual and group life, where people are trying to call products group life in order to take advantage of the tax break. That means probably simplified underwriting, or less underwriting, or no underwriting, and mortality that's in an unknown category, sort of a cross between individual and group.

The second role that reinsurers have played, and most notably they've played it in the 1980s, has been in the surplus relief market as financial manager and surplus supporter. I think the reinsurers in that marketplace are already beginning to subtly modify their role to that of more of a capital planner, and almost a banker for the industry. I think that we'll continue to see migration in this direction as the financial reinsurers increasingly become proactive and integrate their operations with the planning processes of the direct writers. This is a marketplace, obviously, that regulatory and tax issues can bear strongly on. And those forces are, of course, very unpredictable over the short term. But, nevertheless, it's the marketplace that is there because the need is real. And I think it will be filled in some fashion. And I really look for financial reinsurance to be much stronger and substantially greater in the year 2000 than it is today, and reinsurers will play a bigger role in it.

What about other risks that reinsurers take on? Certainly, reinsurers have taken on a lot of other risks besides just the mortality risk. The first thing that comes to mind is, of course, lapse risk. We've seen a lot more different types of risk assumed by reinsurers in recent years. And I think that's something that's going to continue on into the future. We've seen a lot more first dollar quota share treaties. We've seen a lot more interest in reinsurers taking investment risk, annuity coinsurance and things of that nature. The annuity marketplace is one that's just going to continue growing for the next decade. You can bet that there's going to be a demand for somebody to assume some investment risk along the way. And I think reinsurers will begin to take on all kinds of risks. In the year 2000, I suspect that they may see themselves as risk takers, pure and simple, not just mortality risk takers, but any kind of risk takers. And they may have specialized departments for different investment or other risk taking features. In fact, we could say that a large reinsurer with a talented staff may find that working closely with a certain primary writer through all the phases of development, marketing and distribution, sharing in wide ranges of risk, can greatly increase the value added that they bring to that client. And that may be a key phrase, because it's a tough marketplace at times. It could be that special arrangements and special deals will turn out to be the most profitable area of activity for reinsurers because they can use their skills best and bring more value added to the picture.

Finally, let me discuss one role for reinsurers that doesn't exist much now, and hasn't existed much in the past. But I think it is something that may be looming on the horizon. You can consider a large life insurance company as a totally vertically integrated organization. They control everything from the product development, to the marketing distribution and sales, to the administration, to the factory, to the investment management, and to the risk management, in one place. In any industry, there are pluses and minuses to being vertically integrated. Obviously, you can control, you gain stability, and you gain reliability of sources. On the other hand, there are also some negatives. If you eliminate the vertical integration and split the components up into pieces, just as in any industry, you gain closer access to the market, and more market sensitivity. And you also gain a significant decrease in overhead, all up and down the line, because you don't have to oversee a whole big operation. So the management levels decrease considerably. I think the insurance industry is kind of ripe for breaking apart a vertically integrated organization into some pieces. And we all know companies that are better at some functions than others. And obviously, an optimal solution would be to find a partnership or a joint venture where someone is, perhaps, the administrator, and someone is the marketer, or someone is the investment risk manager, and someone is the marketer. Ways of joint venturing such as that, I think, will become more common. The reinsurers are in a nice position to facilitate this sort of joint venture activity because they're in the marketplace all the time, and they know the capabilities of the various companies. They can also take on a lot of these risks themselves. We're beginning to see some of this activity occurring as we see agents talking directly to reinsurers, bypassing the insurance mechanism, thereby forming a marketing arm, which you could call a company, that doesn't perform many of the functions of a company. You can see situations where companies are reinsuring or joint venturing with other companies. Even though they're not professional reinsurers, they're still performing the reinsurance function. And I think by the year 2000, this could be another area of activity for reinsurers, that is, putting together partners, taking on certain roles in the delivery of insurance to the marketplace.

MR. GEE: Our next speaker is Steve Kraysler. Steve is Senior Vice President and Chief Actuary of Hudson Life Re, a U.S. subsidiary of Scandia International. Steve started his actuarial career at John Hancock, ultimately becoming the Chief Executive of their nonlife insurance and reinsurance operations, both domestic and international. Prior to joining Hudson, Steve was Managing Director at Wolper Ross, a leading and probably the largest distributor of life insurance in the industry. Steve is a graduate of M.I.T. and the Stanford Executive Program.

MR. STEPHEN F. KRAYSLER: The best definition that I have heard that distinguishes an optimist from a pessimist is that a pessimist is an optimist with information. Not only do I accept this definition, but I'm willing to declare that I'm quite optimistic about the future. Naturally, I explained this to Kin when he approached me about participating on the panel. And I said, "What would you like me to talk about?" Kin looked me straight in the eye and he said, "Read my lips." He said, "Substitute impressions for demonstrations."

Given our mission then, I trust that my remarks are accepted in the spirit of stimulating discussion and thinking, because they are not at all intended to create controversy. I mention this, not just because the future doesn't always come out the way we want, this is obvious if we look at the state of the U.S. economy today, but also because there are forces acting on our industry which are so powerful that their evolution into an ultimate state is inexorable. The consequences of such development may not necessarily be pleasant for everybody in this room.

As a "boutique" reinsurer, Hudson's conceptual approach to how the future unfolds is probably more important than accuracy of prediction. It enables us to position ourselves to give greater service to our clients.

Essentially, we view the future as a state that, gradually, emerges from the jostling of a number of competing or supporting forces acting with different strengths and pointing in any number of directions. The more fundamental a force is to the particular area of interest, the more powerful effect it will have on that sphere's future development.

Let's take a look at some of the environmental factors that influence our business. For regulation and taxation, I include a foreign component. In other words, I have assumed that the global economy is a fact of life. Events in Eastern Europe are examples of how quickly potential barriers can erode. Stockmarket crashes in the U.S. and Japan, the U.S. banking crises, and the decline in residential property values will probably, during the next decade, keep consumers to the "fear," as opposed to the "greed," edge of the risk versus reward spectrum. Under such circumstances, rating agencies will play an even more prominent role. Regulators will have to get tougher, but they will also have to become much more focused on areas of solvency and risk measurement. The "glass wall" concept suggests that we try to look at the many regulatory and political barriers that exist in our business as glass walls, rather than brick walls. This approach has the virtue of liberating our thinking so as to "see" the world beyond them, but does not diminish the realization of either hurdles that must be overcome, or the needs of security and safety that must be satisfied.

Meanwhile, personal computer technology is advancing so rapidly that the actuary will be virtually freed from cost restraints. His ability to model will be limited only by his imagination. Actuaries will probably continue to push each new chip to its limits, and probably, no other external factor will have as profound an impact on the development of our profession. Breakthroughs in molecular biology and genetic engineering will not only effect selection of risks, or create antiselection opportunities but clearly will have a major impact on the course of morality improvements. In terms of competition, we can expect it to intensify with plenty of potential new entrants poised for barriers to fall. So, all of this can be summarized by the following. Powerful forces are already in motion, and the beginnings of the future are already here. As for an initial state, we are persuaded that the industry is in the midst of a long-term process of consolidation. This includes not only companies that will go out of business, but medium-size and large companies which are already selling blocks and even lines of business. Critical mass issues will lead smaller and medium-size companies to form strategic alliances, so as to survive and prosper. In order to form useful alliances, or conform strategically to the environment, companies will, at least conceptually, unbundle the means of production.

Even in the year 2000, distribution, that bane of the home office actuary's existence, will still be one of the most critical aspects of the life insurance industry. The high cost of distribution has probably created more surplus management problems than any other factor in our business. Distribution must become efficient and we do not mean getting an agent to sell 30 high cost policies a year instead of 20. Here, we mean efficient from the customer's point of view, in the sense that, at the margin, products with discounted acquisition costs can be made into financial instruments. In turn, this can create an almost urgent need for the customer to buy. This concept has spawned a number of megadistributors who, with extremely small staffs, write thousands of policies, billions of face amount, and hundreds of millions of dollars of premium each year, and I'm probably low by a factor of 10.

Of course, lower commission products are not universally embraced by the established agency forces at most life companies. Nor has coexistence with such "boat rockers" within companies been the usual outcome of the many political battles that have been fought. Nonetheless, enough companies have already realized that there is a side of the coin other than having to pay higher and higher commissions on products that must be "sold" because their economic performance is so poor. They are also finding themselves in a stronger strategic position because the easier a product is to sell, the less leverage the distributor has. Meanwhile, their risk taking competitors are becoming more vulnerable to future replacement. Over the long term, you can bet the compelling economic arguments will be a driving force when it comes to distribution.

Two other areas -- product design and valuation -- are very closely related, and in trying to separate them, I have probably had to use too much artistic license. Both, however, are key areas of the global battleground, where banks and insurance companies are staking out positions. The ultimate resolution of these conflicts can only occur when a general theory of financial risks and guarantees is developed. Then, banks and insurance companies will be special cases of the general theory, defined on a basis that measures a particular organization's exposure to a multiplicity of risk components. The development of the general theory is a major historical opportunity for the actuarial profession.

Those of you who are members of the Investment Section will not be surprised when I say that a merging of actuarial and financial technologies is well underway. Significant papers on option theory have been published in the *Transactions*. But more and more, we are seeing articles and seminars by actuaries in the areas of duration, convexity, yield curves, swaps, puts, calls, default rates, required spread on assets for SPDAs, etc. This is all part of a process that we call atomization. We visualize the breaking down of risk components, say of C-1 and C-3 risk, into smaller and smaller particles. On the asset side of the balance sheet, banks and investment banks have been the leaders in this area in terms of developing what are often called derivative products. Actuaries will play an increasingly important role, not only in atom smashing, but also by incorporating them, to a much greater extent, into insurance products.

On the liability side, stochastic modeling on individual supercomputers will lead to the atomization of mortality, morbidity, longevity, and expense particles. This will lead to rebundling of some of these components into, say, liability duration units that will be repackaged with asset components. Assuming that the general theory has been developed, this kind of repackaging will lead to products which will surely cut across the lines of our present day financial institutions.

If we assume that actuarial technology will be advancing significantly, we cannot expect the sophistication level of consumers to remain constant. The result will be products with greater transparency in terms of loads and performance. This will put further downward pressure on distribution costs. As political and regulatory barriers fall, we suggest that there will be rapid exports of successful designs from one country to another, with a much higher level of international cooperation among actuaries.

In the valuation area, the most powerful driving force is the necessity for risk-based capital requirements. Many actuaries will say this is the valuation actuary concept and that much work has been done by the Combination of Risk Task Force, the Committee on Valuation, etc. Of course, they're right. However, think for a moment. Why should this be imposed only on the life insurance business? The banking industry is developing capital requirements of this sort, and supposedly, they will be globally consistent. Inevitably, to the extent that the risk components are the same, the capital requirements must be the same, no matter what the industry, and no matter what the political jurisdiction. Industry arbitrage, then, will disappear. And devices such as the FDIC will either be phased out or will have to be made available to the insurance industry. This should also lead to a broadening of the official actuarial purview. Perhaps actuaries by the year 2000 will be required to set the loan loss reserves for commercial banks.

As product design moves further along the path of atomization, valuation actuary approaches will also become more and more molecular and, compared to today's level of actuarial practice, scenario testing will be utilized to the nth degree. The combination of more advanced valuation actuary approaches and more sophistication and focus in the regulatory area will lead to a more clearly delineated transfer of risk in financial reinsurance transactions.

To remain at the cutting edge of these developments, reinsurers will certainly have to invest heavily in actuarial research and development on a continual basis. How, though, will reinsurance relationships be affected? Without question, the old sense of partnership will return to the business. It will be too complex for the type of guessing games that still occur in today's coinsurance and YRT environment. As the industry consolidates and more alliances are formed, the reinsurer will gradually assume the role of merchant banker. By putting his own capital into the deal, whether it be a leveraged buyout (LBO), acquisition, block sale, coinsurance, unbundling, rebundling, or other kind of packaging, the reinsurer can lend credibility that no other player can provide. As these deals involve more parties, there will also have to be a much better rationale for who gets what. In our scenario, the only environmentally consistent outlook is that the risk takers will be appropriately rewarded.

At least from our perspective, it appears that reinsurers will continue to play a critical role in the management of risk even as the concepts of risk and risk-based capital become more refined and spread across the financial services industry on a global basis. Surely, if what we envision is anywhere near correct, the future will be bright for those actuaries who are willing to embrace our traditional roots by harnessing themselves to the emerging technologies.

MR. GEE: Last, but certainly not least, is Armin Schürg, our third speaker. Armin is the Director of the life reinsurance subsidiary of the R&H Insurance Group, which is probably the third or fourth largest insurance group within Germany. Just to give you a perspective on that side of the company, in 1989 the R&D insurance group had about $3.2 billion in gross premiums, and about $13 billion in what they call capital investment, which loosely translated is total assets. It has about 8,500 employees. Armin has been in the insurance business since 1962, and he currently heads up that reinsurance operation. What's interesting is his formal education, that of a mining engineer, and I can vouch for that from the way he goes through a reinsurance proposal.

MR. ARMIN SCHÜRG: I want to thank you for offering the opportunity of casting together with you a look at life reinsurance in the years to come.

The events in the eastern part of Europe in the Fall of 1989 are an example of how difficult it is to forecast developments in our fast moving times. Nobody, not even politicians nor economists, ever predicted the sudden change assuming the far-reaching proportions that have taken place. Similarly, no one can tell today to what extent the Gulf crisis is going to affect the work market.

FOCUS 2000: REINSURANCE IN THE YEAR 2000

Since the year 2000 will be the year of my retirement, and my forecast if wrong or right will then no longer affect my career, I will dare to express my subjective views on the topic of reinsurance in the year 2000.

My reflections will be confined to the European and U.S. markets, and their interactions. Asia, and particularly the closed shop Japan, are not included, as this is a much wider scope which requires thorough knowledge. Presently, two outstanding events are dominating the European life insurance market. Event one is the liberalization of the European market, and event two, the reunification of Germany. You can imagine that I, as a German, am pleasantly affected by this change.

The liberalization that will take effect in 1992 in the European Community will open markets of controlled economies under state regulations. They will be open to expanding and financially strong foreign groups, offering modern products, and these groups are mainly a combination of ventureships between banks and insurance companies. I will look into the consequences on the life reinsurance market at a later stage.

On the 3rd of October the two German Parliaments ratified the Treaty of Unification. This is a silver lining to 108 German insurance companies. There will be 16 million additional people. Excluding those over 55 years, there will still be approximately 12 million possible policyholders. The question is, what priority of the personal needs will life insurance hold? In the early stage of development, there will be an immediate but limited demand in policies covering loans and mortgages, for example. The number of life insurance policies will jump as soon as cars, furnishings, electric equipment, etc., correspond to today's standard of living. I'm expecting the life insurance boom at the end of the 1990s and the beginning of the year 2000.

How does the reinsurer prepare to meet the future requirements?

In the last few years, we can observe a tendency which doesn't make me, a reinsurer of a medium-sized company, depressed but thoughtful. Financially strong reinsurance companies are buying medium-sized and small reinsurance companies to an extent we have never experienced before. Of course, the question of the right to exist concerning small and medium-sized companies can be controversially discussed.

The international life insurance market is experiencing increasing marching of profit. Increases in premium incomes in the double digits, as was customary in the past, have become more and more rare. New business has become more and more expensive, due to qualified services supplied and to closely calculated rates of reinsurance premiums. I hope you don't get me wrong. I'm not lamenting as lobbyist of the life reinsurance business. I do see the pressure of costs and competition to which a direct insurer is exposed. And the reinsurance premiums, which are indeed balance sheet items of expense, always attract the insurers' attention in the everlasting efforts to cut down expenses.

But now we jump into the year 2000. Let us call back to mind the figures of the year 1988. And what's most striking? There is not one country of the former Eastern Bloc mentioned in 1988. I'm thinking especially of the USSR, a country of a population of 283 million. China will not even be ready for life insurance in the year 2000.

What happened in the USSR? In 1990, the free market system was introduced totally, and not gradually, as was attempted before. Gorbachev realized that having a gradually free market system is as impossible as being partially pregnant. In this country, a reinsurance field has grown to be cultivated in the year 2000, to be cultivated by the direct insurer as well as the reinsurer, involving unimaginable investments.

How successful is the harmonization of the Common Market? Quite independent of certain inflationary tendencies, the sum insured per capita has grown considerably. The private insurance industry will benefit from the gradual reduction of Social Security benefits, which had curtailed growth. Nevertheless, I don't think that the present 12 member states of the European Community will have significant growth in the reinsurance sector. The growth in premium of the reinsurance market is at a standstill, because first, nonproportional reinsurance is capturing the market, and second, the direct insurance companies are increasing their retention dramatically.

What does this mean to the large European reinsurance companies? Eastern Europe, and now as before, the United States and Canada, offer growth prospects. Though some of the European reinsurers have received a bloody nose in the United States and Canada, they will still be present on this continent in the year 2000. I believe there will be even more, and they will become more active than before. The American reinsurance companies have a chance in Eastern Europe, providing they are willing to make capital available for the active development of the life insurance market.

Let us turn to the question as to what kind of reinsurance companies we will find in the year 2000. We will again see the familiar faces of large, financially strong companies. The faces will look well-fed. Even small reinsurance companies can be nutritious. I'm sure that those large reinsurance companies are going to survive the next 10 years and become even larger, but only if they are willing to invest -- to invest in economic developments, in technical and marketing services, in life reinsurance companies, and so on. Many small and medium-sized life reinsurance companies will disappear or will rotate in the universe as satellites of large reinsurance companies. Sorry if I offended someone. I didn't mean to do that. There are certainly some small and medium-sized reinsurance companies that will survive. And I keep my fingers crossed for the company I'm working with which belongs to this group.

Why do they survive? The companies I'm thinking of are owned by direct life insurance companies and have the function of an affiliate. I place these companies on a level with reinsurance departments of life companies running an active reinsurance business. They survive because they placed group-owned business on a reciprocal basis or they are supported by a generous parent company that, for its part, uses the reinsurance companies for adjusting the balance sheets. Only business of bad quality will pose a problem to them as the reciprocity will be of similar quality.

What about life brokers in these times? They do survive. And they live even better than 10 years ago, provided that they settled on the American continent. Why are they doing so well? First, they have extended their function as consultants. And that, with your help, the help of qualified actuaries, and expert advice, sells well in these days. Second, they have expanded their markets. Europe is one example. There they will find a vacuum. At present, I cannot think of one European broker who engages to an appreciable degree in the life reinsurance business.

What type of products will the life reinsurer face in the year 2000? In the industrialized countries, there will be a decline in traditional products such as endowment and term insurance. The slogan will be financial services! Authority and regulations still existing in the U.S. will then no longer divide the activities of bankers and insurers. Links with banks will result in new products. These products will be even more fantastic than those we presently know as variable life, variable universal life, and variable annuities, for which reinsurance support is hardly required. What else do the reinsurers find their scope for activities? At this point, I won't mention the jumbo risks because they involve the subject of risk, and subjective risks create mixed feelings in me. I believe that special insurance products, such as long-term care, dread disease, accident and health, and last survivor, will give reinsurance a remarkable boost. Insurance covers we cannot even visualize today will join the wide range. I'll mention unemployment insurance just to suggest the trend.

What will happen in countries with less developed insurance markets -- Eastern Europe, for example? In the year 2000, some countries of these regions will belong to the European Community market. Even Russia may become a member. The traditional standard products such as whole life, term, and endowment assurance, will dominate in these countries. Subject to growing capital expenditures in the initial stage, the traditional products are likely to be reinsured, on a modified coinsurance basis, to finance new business commissions. This situation calls not only for the reinsurer's service, but also for his capital. Financing this business will be a question of competition between reinsurance companies and banks. By this time, banks will have reasonably become more active in the insurance sector, with considerable success. Marketing companies will also make their appearance. More than ever, the climate for investing in Europe will be adventurous in the year 2000. The rates of interest will become more attractive in this region than those of the United States, as a result of steadily rising capital expenditures. The main problem will be, of course, the protection against inflation and currency risk.

MR. GEE: I guess what you're saying is that more European reinsurers will continue to come to the United States even though, obviously, a lot of the U.S. domestic reinsurers are owned by Europeans, (Cologne, Munich, and so on). What you said is also pretty interesting. The Eastern world would now offer reinsurance opportunities for U.S. reinsurers because whole life and endowments are products that U.S. reinsurers would be interested in. So certainly business can go both ways, not just U.S. business going offshore, but perhaps U.S. reinsurers establishing some sort of venture, possibly with European reinsurers. It's pretty encouraging. I heard some good comments in there. Greig mentioned perhaps a greater emphasis on group and Armin announced that perhaps even China would be ready for life reinsurance. So I'm going to plan on my retirement in the year 2000 by being the first group life representative in China, and getting a major case of over a billion lives. I'd like to open the floor up for questions or comments.

PANEL DISCUSSION

MR. ANDRÉ CHUFFART: A comment about China. I met one of the executives of the state company over there. And, in fact, they have already 80 million policies in force, life.

MR. GEE: That's on an individual basis, though.

MR. JAMES D. MAUGHN: This one's directed primarily at Armin. But it's certainly for anyone. I'm wondering about the changes within the European Community in 1992, and whether or not they will lead to a commonality of the social kinds of government provided programs. Specifically, whether or not taxation schemes will become more common between the countries, as well as their effect on policyholder benefits. And if that's so, about how long might it take for that to occur?

MR. SCHÜRG: I don't understand the last part.

MR. MAUGHN: I'm asking whether or not the programs that the governments provide, the social benefits provided, will become more common. And then, if they do, whether the taxation schemes amongst the countries, and specifically with respect to policyholder benefits, will become treated more consistently.

MR. GEE: If I can rephrase it. A lot of the Scandinavian countries, in particular, have provided for the insurance benefits of their population. And the question is whether that kind of social benefit will expand to more and more of the European, and I guess non-European, countries. If that is the case, the tax scheme and the taxation of income that is on a general basis now, will change perhaps as a result of that.

MR. SCHÜRG: You know that we, in Germany, have no taxation of the profits of life insurance policies but we expect, because we need a lot of money for the reunification, that this is a part where taxation is possible in the next few years. And also, in the liberalization of the European market, there must be equal taxation for all these profits. I believe that in a few years, we will have the taxation of the profits of life insurance policies in Germany.

MR. KRAYSLER: But, Armin, will there be a change in how products are distributed, or the kind of products, or the level of products that will be distributed, if indeed, the government sector picks up more in terms of coverages or insurance needs of the population? For example, one of the talks that we have here is providing a national health plan in lieu of a private plan. Obviously, you've got a private sector that's providing the products to meet the needs of the consumer. And then you've got, perhaps, the public sector, the government, that could step in and provide them, using tax revenues to support them, taking away premium income from insurance companies. Will that change, and do you see any impact of that changing?

MR. SCHÜRG: Well, we had last week or 14 days ago, the Minister of Health in Germany, Dr. Blüm, ask the insurance companies for new products, mainly in the health section. So we expect also, in this insurance system, change from the government to the private industry.

MR. ZANE STAIT-GARDNER: A question for Armin. You talked much about potential in Europe for reinsurers in Eastern Europe. I wonder, with the developments in 1992, when there may be more uniformity in insurance regulations, if there is not also going to be opportunity because of a disruption in Western Europe. For example, the more competitive products that are sold in the U.K. market would be quite attractive in Germany. Does this not offer opportunity also for reinsurers?

MR. SCHÜRG: That's a good question. But what I told you is a very subjective opinion. I think that in highly industrialized countries, like Western Europe, they need less reinsurance than in countries where the insurance market starts. I think financial services is the main product which they need. They want to save taxes. And they want to have a compact of insurance and bank products. And for these products, I think reinsurance is not so necessary. That's my subjective view.

MR. STAIT-GARDNER: But the U.S. is certainly a well-developed insurance market. There's a lot of reinsurance in the U.S. market. If more risk-type products were sold in continental Europe, surely that's a huge market for reinsurance.

MR. SCHÜRG: That's right.

MR. STAIT-GARDNER: In which case, it surprises me that European reinsurers are so interested in the already difficult U.S. market, as opposed to looking at the potential in Western Europe.

MR. SCHÜRG: I think it is because the possibilities of growth are higher in the U.S. market than in Europe. But let's wait and see what happens in the next two years in the Eastern part.

MR. GEE: Let me try and comment a little bit on that. I think there are still certain areas or certain needs that the U.S. reinsurance market has that perhaps are not met completely by U.S. domestic markets. For example, in the second to die market, with the exception of the Prudential and perhaps Metropolitan, there's still a capacity shortage because we're seeing some very large face amounts. Obviously, these are estate planning type products and so on. Seeing policy applications for $10, 20, 30, or 40 million is not really unusual. I think the U.S. market is pretty much up to its capacity, and there's still a need for more. And I think perhaps the Europeans may provide some added capacity over what the U.S. is doing. There are also other areas in which the U.S. domestic reinsurer has been a little bit shy in providing coverage. For example, on universal life insurance, traditionally, the reinsurance has been either YRT or coinsurance on the cost of insurance. And, while it's difficult to do a coinsurance on the premium, I think we're seeing some of that being done, or some interest by European reinsurers to do some of that. The ceding company does want it because obviously, on a coinsurance basis, you reduce the leverage of the company. You do pass on some of the investment risk to the reinsurer, and you get some financing to the extent that your acquisition costs exceed the premium. So I think there are reasons why Europeans are looking to get more U.S. business.

MR. MELVILLE J. YOUNG: I know some of my friends in the room might disagree with me, but I think that the United States is one of the countries, Canada is another, in which the insurance companies have somehow sold the concept of people taking care of their loved ones, and not looking for tax advantage products for their own benefit. But ultimately, they are taking care of their loved ones in case they're not around to take care of them. U.S. and Canadian insurance companies and salesmen have gotten that point across to their constituents, but I think that in many of the other places around the world, you see products that are sold significantly to a market where the buyers are looking after their own benefit. They're getting some tax advantages. They're ultimately going to use the money themselves. And the obligation to people trying to market in those countries is to try to change the thinking around to get those people to think about providing for others. If we can make that sale, then that's going to open up some reinsurance opportunities. But first the sale has to be made. And certainly, if that sale can be made, it's going to be a very big opportunity for reinsurers, because every time new products enter a new market, people are unsure, and insurance companies are unsure about marketing those products, and look for reinsurance help.

MR. GOTTFRIED O. BERGER: I think there is another answer. You have to look at the structure of the insurance industry in Germany, as compared with the U.S. or Canada. First of all, in Germany, and I believe it's the same case in most European countries, the number of direct insurance companies is much smaller. More importantly, the German insurance industry is a family affair. They are familiar with Allianz, and Allianz owns almost all German companies. If you are a reinsurer in Germany, there's virtually no chance to increase your business in Germany. You have to go outside.

FROM THE FLOOR: I think there is one simpler reason. Basically, I don't know if the German insurance market is totally free. Their regulations are so restrictive that you couldn't compete with a product that might be good for the consumer, the way it is right now. But I think that'll change.

MR. SCHÜRG: I would also like to say that more precisely in the next decade, there will be a change in the need for reinsurance in Europe. They will not necessarily look for capacity, because they have the capacity, but will look for services. And I think that's where the new market could be an opportunity for the reinsurer, to help the British company to define or design a product, and sell it in another country. And that will obviously be possible only for a relatively large company. A small company will not be able to give these services. And I think that is the most important change which will occur in Europe, that there is really a need for services. That is important. And the second point I would like to mention is in respect to underwriting. Everybody understands that underwriting will change. And I would like to mention the following point. Gene therapy. I think that the underwriters in the next 10 or 15 years will be confronted by totally unknown, up to now, risks. That is, children who were or are affected with some genetic disease, will be perhaps prevented from getting sick, or having manifestation of the disease. They will arrive at the age of 20 or 25 and buy life insurance, or want to buy life insurance, and the underwriters will be totally lost because they will not have seen this disease among standard applicants. And that is a technical problem which could affect all insurance companies in the next 10 or 15 years.