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COMPARATIVE PRODUCT SURVEY: EUROPE

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Recorder: HUBERT B. MUELLER

- o A survey of products and product-related issues in the European market, including:
  - -- Products
  - -- Distribution systems
  - -- Pricing technology
  - -- Taxation
  - -- Industry issues

MR. MARK A. TULLIS: To put things in perspective, I have a few charts looking at Europe as a market and then at the individual countries in Europe as separate markets. These charts are a few months old, so for the ones showing amounts in U.S. dollars, you should increase the European figures relative to both the U.S. and Japan, to account for recent changes in the exchange rates.

Chart 1 shows the size of the European market. You can see that the population of the European Economic Community (EEC) is almost as large as that of the U.S. and Japan combined. On a gross domestic product (GDP) basis, we have the EEC countries virtually level with the U.S. Using more recent exchange rates, the EEC might be 25% higher than the U.S. However, in life premiums, the EEC lags significantly behind both the U.S. and Japan, even when using more recent exchange rates.

In talking about the EEC, it is not necessarily correct to think of Europe as a homogeneous life market. Historically, there have been significant national barriers to entry. Future differentiation can be expected, due to differing sales techniques, market acceptance and the underlying tax motivation of many life products, which drives a large portion of life insurance sales.

Chart 2 shows that there are three countries, namely the U.K., France and West Germany, which account for nearly three fourths of the life market in the EEC, while the remaining nine countries only account for a combined 25% of premiums.

Chart 3 shows life insurance premiums as a percentage of GDP for the EEC countries, U.S., Japan, Sweden and Switzerland. You can see the wide variation, particularly among the EEC countries. Of the three dominant European life markets, the U.K. has by far the greatest penetration.

** Mr. Instance, not a member of the Society, is Senior Executive/Actuary Department of United Friendly Life in London, England.

CHART 1

The new European market is large by any standard

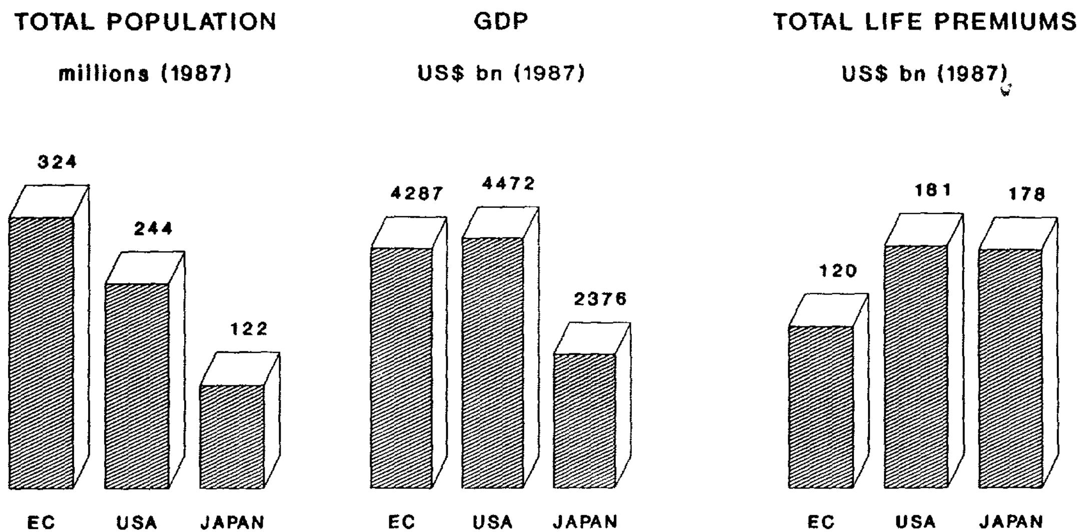
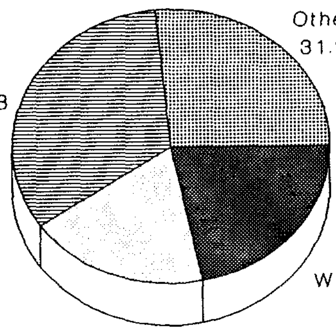


CHART 2

Three fourths of the life market is in three countries

EC LIFE PREMIUMS, 1987
US$ bn



Other:	US$ bn
Spain	14.18
Netherlands	7.08
Italy	4.27
Ireland	2.07
Belgium	1.97
Denmark	1.90
Greece	0.20
Portugal	0.13
Luxembourg	0.07

Total EC: US$ 120.2 bn

Generally, Europe is relatively underdeveloped in terms of market penetration ...

LIFE ASSURANCE PENETRATION

Premiums as a Percentage of GDP (1987)

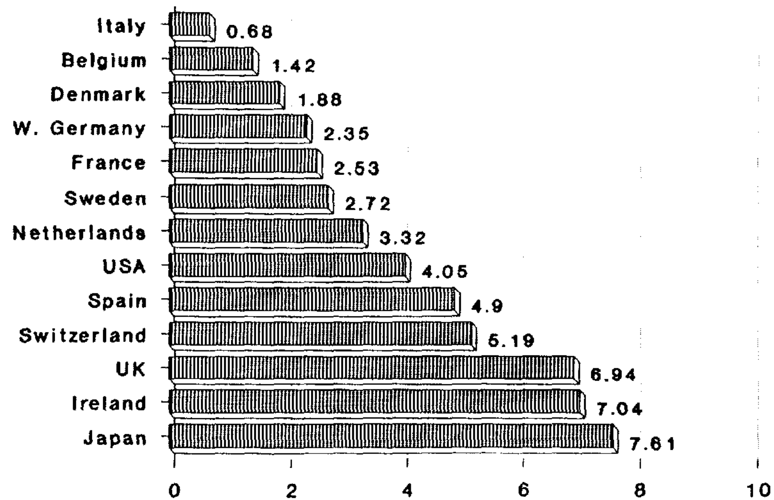


Chart 4 shows annual growth rates for the past few years among the same set of countries. Once again, there is a large variation within the EEC, from tremendous recent growth in Spain to the more mature markets of The Netherlands, Belgium and West Germany. Overall, recent growth in the EEC life markets has been concentrated in some of the less dominant markets.

Finally, if you look at life insurance premiums per capita (Chart 5), you once again see the tremendous variation among the European countries, ranging from almost $700 per capita in the U.K. down to only $20 per capita in Greece.

Our panel has chosen to concentrate on the six dominant life markets of the EEC, namely the U.K., Germany, Italy, France, Spain and The Netherlands (in order of presentation).

MR. JOHN INSTANCE: Within the U.K market, I am going to restrict my presentation to just the individual life products. U.K. life products can be split into two broad groups, which can be defined in U.K. terms as nonlinked and linked business. Nonlinked business includes conventional participating whole life, endowments, deferred annuities and nonparticipating term insurance. With linked business or variable life assurance, benefits and/or premiums are related to the performance of separate assets or unit funds. Linked business would usually cover protection and personal pension business.

NONLINKED PRODUCTS

Nonlinked products are dominated by participating endowments, and to a lesser extent, deferred annuities. The three customer needs these particular products meet are home mortgage repayment, retirement provision and to a minor extent, other long-term savings.

The key feature of the U.K. participating business is that it is an equity-based product. To be competitive in this market, the ratio of equity assets to liabilities needs to be close to 100%. Equity assets include common stock and property (office blocks, retail properties, and industrial units). Property might be about 25% of that, and common stock would make up the rest. As a result of this heavy equity base, companies writing this type of product maintain very high surplus ratios. Typically, surplus ratios for a major participating life office should be as much as 50% of liabilities. My company actually has a current surplus ratio which is close to 100% of liabilities.

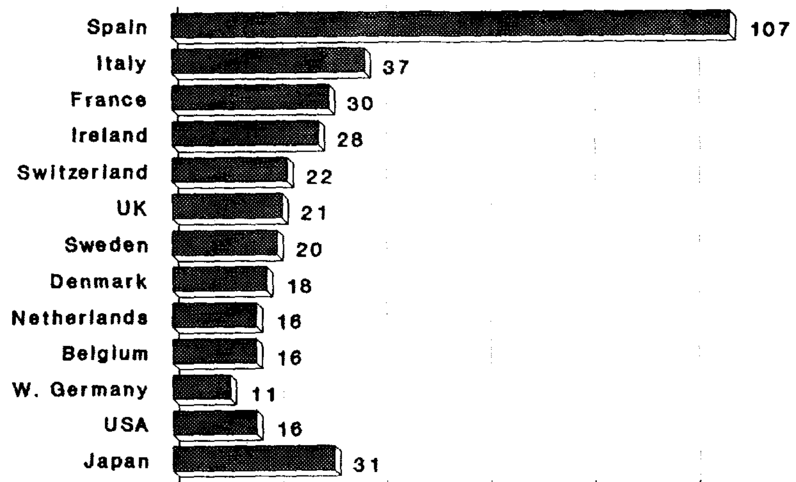
Given that type of equity base, the participation is generally granted in two forms. The first form is a reversionary bonus, which is granted as a percentage of sum assured. Typically, this reversionary bonus is split into two components: a reversionary bonus on the guaranteed sum assured, plus a percentage of the existing vested reversionary bonuses. This system is called a super compound bonus system. The common practice is to pay more bonus on the existing bonus, so the participation is heavily skewed towards the rear of the contract. The second component of the participation is a terminal bonus payable on claim payment only.

The selling message of participating contracts is the smoothing of equity returns over long periods, thus protecting the policyholder from the fluctuations of equity markets.

CHART 4

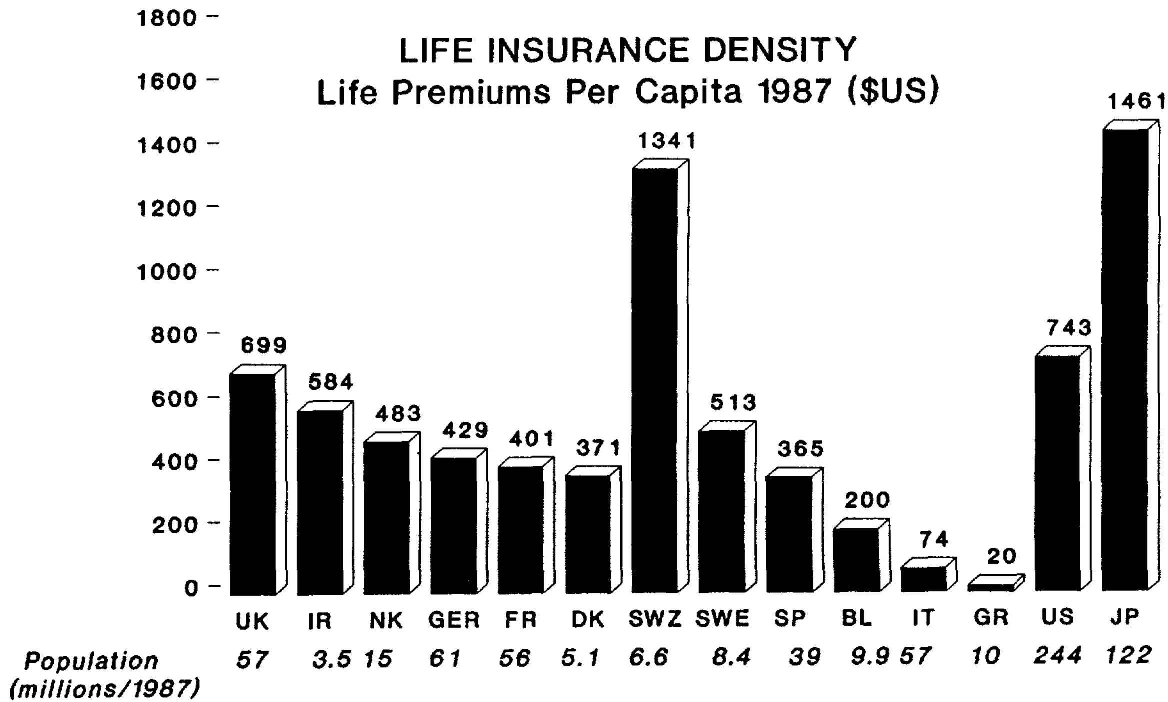
Growth in market density varies enormously ...

COMPOUND ANNUAL GROWTH IN LIFE PREMIUMS



(US$ Base)

... And in terms of insurance density



Bonus scales change only slowly over time, with the reversionary bonus scale changing very slowly -- indeed there is some pressure to ensure that reversionary bonus scales are smooth upwards only. The terminal bonus scales may change more quickly, but in theory, only in small stages.

Chart 6 shows the claim proceeds of a participating contract. The typical maturity proceeds for a participating 25-year endowment are made up of: (1) 20% guaranteed sum assured, (2) 30% reversionary bonus, and (3) 50% terminal bonus.

There are usually no surrender value guarantees, and the actual claim guarantees are quite limited.

The structure of the participating product makes it particularly attractive for both mortgage repayment and retirement provision.

Napoleon may have said Britain is a nation of shopkeepers, but in recent years, we have become a nation of homeowners, with some 70% of domestic properties owner-occupied. This is part of the national psyche, but is also encouraged by major fiscal concessions, with tax relief available on mortgage loans for owner occupation and no tax on any capital gains on the home.

Use of an equity-backed savings mechanism to repay the capital element of the mortgage is attractive in the long term as it is generally expected that equity returns exceed fixed interest returns. Coupled with the smoothing out of the actual equity capital value fluctuations, the participating endowment is a particularly attractive mortgage repayment vehicle.

Retirement provision also has attractive fiscal concessions with tax relief available on contributions, investment income on pension products exempt from tax and part of the benefits being free of tax. Participating pure endowments and deferred annuities are therefore attractive vehicles for retirement provision as equity savings should outpace inflation to provide enhanced long term returns which are enhanced by the smoothing of equity capital values.

LINKED PRODUCTS

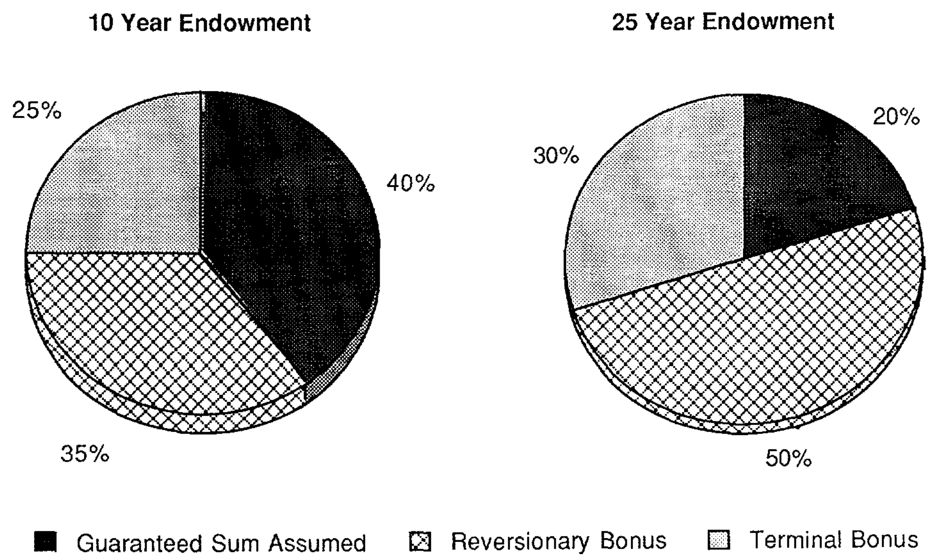
Linked products were originally developed in the early sixties by the mutual fund "unit trust" industry to take advantage of the available fiscal advantages attached to life insurance products. The main fiscal advantage was the tax relief one used to receive on premiums paid into a life insurance plan. This fiscal advantage was taken away in 1984. Unit linked products were rapidly developed by the new entrants to the market, as they allowed life companies to offer equity based contracts similar to the conventional participating business. By passing all or most of the investment risk on to the policyholder, the new life companies eliminated the need to hold a large surplus ratio, thus making market entry and growth easier.

Linked products have developed rapidly to cover all market sectors, with companies now offering term insurance on a linked basis, whole life protection, critical illness or dread

CHART 6

COMPARATIVE PRODUCT SURVEY: EUROPE

United Kingdom Products – Make Up of Claim Products



disease, long term disability, savings, mortgage repayment, retirement provision and just plain investment contracts.

The typical current product design is a large front load with little or no allocation of premium to the asset funds for up to two years. My company has just introduced a new range of unit linked products, where the front load is in fact taken out for three years. This front load covers the acquisition costs of writing a contract and also will hold most of the profit linked companies are going to make on that contract.

After the initial large front load, a full 100% of premiums will be allocated to the unit funds. Deductions are taken from the unit funds to meet the annual cost of risk benefits and policy maintenance costs.

Since the U.K. market is essentially an investment-based industry, margins on mortality and other risk charges tend to be low.

Essentially, companies take big investment margins on participating business and very small mortality or expense margins. This has also been reflected in linked products. Typically, margins will be very small on the risk coverage, approximately 5-10% of the expected mortality.

DISTRIBUTION SYSTEMS

Distribution of life assurance is now polarized between independent financial intermediaries or insurance brokers who are the agents of the policyholder or potential policyholder (IFAs), and agents of individual life insurers. This polarization was introduced in 1988 as a result of the Financial Services Act, which regulates the marketing and sales of life insurance. It is designed to eliminate any sort of uncertainty in the mind of the applicant over whose interest the person selling the life insurance was acting in.

Independents control around 30% of the U.K. market and are subject to the "best advise principle," which means that as well as selecting the product type most appropriate to their client's needs, they must choose the best product within that class. Of course, best may not necessarily mean cheapest, as service level, financial stability, ownership and past performance may be of importance. Increasingly, however, the IFA market is dominated by well established larger insurance companies, with mutuals having some advantages. The days available in the 1970s and early 1980s, when a market entry strategy for a new life insurer was based on selling products through brokers by offering high commissions are probably gone. The number of IFAs is currently declining, because the cost of compliance with marketing rules is heavy. We can expect to see a continuing reduction in the IFA market, with it being dominated by the larger, nationally based insurance brokers.

Agency distribution networks, currently controlling around 30% of the market, can be split into two broad categories: individual direct sales forces and tied agents. Individual direct sales forces are controlled sales organizations of individuals. They may be salaried but frequently are wholly or mostly enumerated by commission on sales. Such sales forces vary in size from around 200 or 300 to several thousand. Apart from the debit based companies, and perhaps one or two of the Canadian companies, the largest sales forces are relatively new. Some are very new, two of the largest being less than ten years old.

The second category of agents is the tied agent. Originally, they were called independent insurance brokers, but only dealt with a limited selection of companies, often receiving enhanced commissions. That practice was outlawed in 1988, and tied agents were forced to tie to individual companies. In addition to these groups of independent insurance brokers, the building societies, or savings and loan organizations, and most of the banks as the main providers of mortgage loans and therefore major distributors of mortgage related endowment products fall under the category of tied agents. As tied agents are usually corporate entities, the insurer can only exert a limited amount of control over tied agents in contrast to an individual salesforce. Banks and building societies control about 20% of new sales.

Agency networks are also subject to the "Best Advice Principle," but this is limited to recommending the most appropriate product of their sponsor.

Although not having to worry too much about relative product performance when using this type of distribution network, individual salesforces are difficult to manage and develop successfully. The number of tied agents is limited, and they are mostly already tied to some other insurer.

PRICING TECHNIQUES

There are approximately 100 life insurers in the U.K. at the present time, with the largest having a market share well under 10% of new business. Profit testing techniques are widely used in all new product development. The industry is reasonably profitable, although very competitive in its search for distribution.

Distribution costs are high. Direct sales renumeration to brokers or agents typically approaches 100% of the first year premium for a mortgage policy, and 70% for a retirement product. In addition, many companies are not as efficient as they or their profit test assumptions would like to be.

Participating contracts are generally more profitable than linked business, since the high rates of equity return over the last 10 or 15 years have lead to high investment profits. The passing of the investment risk to the policyholder for linked business means that the scope for investment profits is small.

Traditionally, life assurers in the U.K. have attempted to minimize mortality and other risk profits because of the nature of the participation methods used. This tradition has continued into linked business, partly because risk coverages have tended to be low in the market and generally close to current risk cost rates which are charged with only limited margins.

TAXATION

For tax purposes, life insurance business n the U.K. can be split into two major product categories, basic life insurance and pension business.

As far as the individual is concerned, basic life products have generally no tax implications for him, provided the product meets certain qualifying rules. These qualifying rules cover the term of the policy (which has to be greater than ten years), the relationship of the risk benefit to the premium (the sum assured has to be at least a certain multiple of the premium), and the frequency of payment (premiums have to be paid at least annually). Even if these rules are broken, there is likely to be no tax implication for most individuals, as proceeds are free of basic rate taxes (currently 25%).

Proceeds are only liable for tax at the difference between the higher rate and the basic rate. The higher rate is 40% at the moment. However, less than 10% of taxpayers in the U.K. pay tax at the higher rate. Although there is no tax on policy proceeds, the life company has to pay tax on the investment income it earns, so that the internal interest roll-up to the product is credited after tax.

Insurers pay tax on policyholders income (investment income) at the basic rate of tax, and a corporation tax rate on the shareholder's share of income (approximately equal to the profits on the business) which ranges from 25-35%. To summarize, there are only limited fiscal penalties on saving through life assurance as opposed to direct investment. In addition, life insurance expenses are tax deductible. Since acquisition costs are spread for tax relief purposes, premium rates generally only reflect the after-tax cost of expenses in practice.

The fiscal concessions for individual pension business are much more generous. Premiums are deductible in full, interest on the inside roll-up is tax free, and part of the proceeds may be taken as a tax-free capital sum at retirement. The balance of the benefits taken at retirement are taxed as earned income when received. The life insurer only pays tax on his pension business profit, so there is no need to pass the tax benefits on to the policyholder.

INDUSTRY ISSUES

The current issues affecting the market are concerns about the strength of distribution networks. The IFA networks are shrinking and concentrating. The banks are starting to develop salesforces targeted on their customer bases generally being tied to a subsidiary life assurer. There are pressures on growing and maintaining salesforces.

The opening-up of the wider European market is also a cause of some concern as U.K. life assurers feel that they are tax disadvantaged compared to other companies domiciled in European countries on two counts.

First, U.K. companies cannot compete directly in a foreign country because the U.K. tax is heavier. Second, U.K. residents might take advantage of offshore insurance opportunities which are taxed more favorably.

In addition, market entry is more difficult in other European countries because of excessive regulation creating barriers to entry and tight control of existing distribution networks by domestic insurers.

The growth in regulation of the marketing of life assurance through the Financial Services Act remains a major concern, with disclosure of commissions and expenses being a major issue at the present time.

MR. ASHOK A. GUPTA: To say that one couldn't necessarily view Europe as one market is a huge understatement. There are probably more similarities between the West German insurance market and the U.S. insurance market than there are between West Germany and the U.K. I am going to concentrate purely on the West German market, as I think it may be a bit premature to look at East Germany.

MARKET CHARACTERISTICS

The West German market is the second largest life market in Europe after the U.K. Life premiums have been growing in importance for a number of years and are accounting for a greater proportion of GDP now. They accounted for 2.5% of GDP in 1988, but that level of penetration is still only half that of the U.K. and also lower than that of France or Holland. Life premiums as a percent of GDP have been growing steadily at an annual rate of 7-8% in recent years. This steadiness is a characteristic feature of the West German market.

Another major characteristic of the market is the German's attitude towards inflation. Germans have had their personal savings destroyed twice this century by high inflation; this has generated a tremendous fear of inflation. This fear of inflation characterizes the market. About 90% of German savings go into insurance, bank deposits and bonds. Very little goes into stocks.

West German life insurance companies are authorized by the Bundesaufsichtsamt fuer das Versicherungswesen (BAV). The BAV is comprised of people from the major life insurance companies. Regulation is geared towards solvency. The German market is almost closed to new entrants. Only eight new companies have been set up there since 1983, and none of them has been especially successful. This closed nature is exacerbated by the complex corporate structures of German companies and the complex cross-holdings between institutions, although this may be starting to break down.

Generally, the market is unsophisticated and the regulatory system leads to change only occurring very slowly. There is very little innovation. Corporate taxation is very high, at about 80% of the cost of direct earnings. There is an aging population which is forecast to decline, so there will be heavy pressure on the state pension scheme.

SOCIAL SECURITY AND TAX CONSIDERATIONS

There are two major factors influencing the purchase of life insurance. One is the inadequacy of the state and employee pension schemes, which leads to significant demand for insured private pension plans. With the decline and the aging of the population, we expect further weakening of the state pension scheme, which should increase opportunity for private schemes.

Other factors include tax concessions and savings rates. There is a tax rate of 53% on earnings above 130,000 Deutsche Mark (DM), approximately $85,000. However, there are substantial tax benefits. Both husband and wife (if employed) may get tax relief on the first 6,500 DM of insurance premiums, although most of that amount is typically used up for health insurance and car insurance premiums.

In addition, the proceeds of life insurance are tax-free for policies with durations of 12 years or more, and there are no premium taxes.

DISTRIBUTION
With regard to distribution (Chart 7), tied agents dominate the market. Most of the established life companies rely upon tied agents for the bulk of their business. There are approximately a quarter of a million agents competing for about $25 million households, so the market is very competitive. Many of the agents are only employed part-time. Both tied and multiple agents are commission renumerated, but there is a trend from tied agents who work for one company to multiple agents who effectively act as brokers.

The largest sales force is owned by Allianz, who have 7,000 full-time agents and 37,000 part-time agents. Many companies have increased sales through links with banks. Brokers, comprising 18% of the market, are concentrated in a few areas, such as commercial, industrial and group business. Currently, there are only 140 insurance brokers who are registered with the association of German insurance brokers. To be registered, one has to be an independent broker for three years. Another five years further experience in life insurance prior to that are also needed.

All of the major banks have some involvement with an insurance company, either through a corporation agreement or some kind of joint venture. Deutsche Bank recently set up its own life company, which has been very successful so far. This could cause a lot of change. Finally, direct marketing has had some success in the individual market. The trend is for direct marketing companies to have the most competitive premium rates.

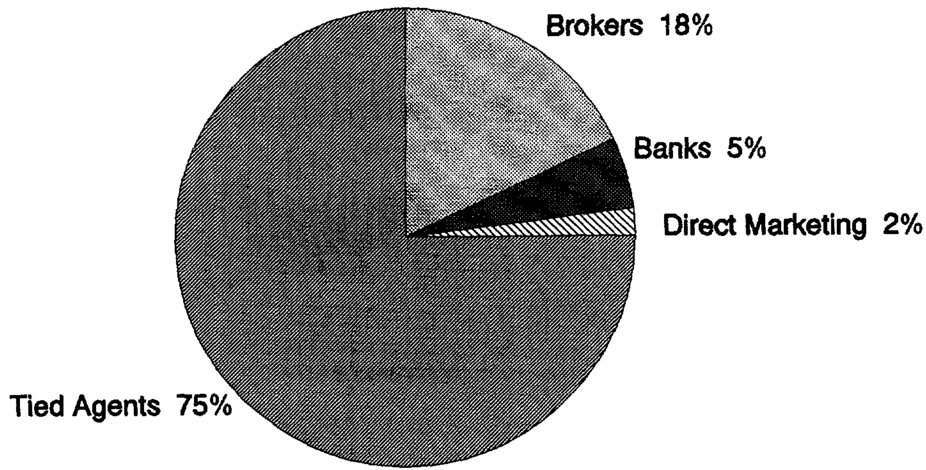
PRODUCTS
Looking at products, endowment and savings products dominate the market (Chart 8). There is some term and disability, some group and little other, which comprises unit linked and pensions. I would like to discuss these in some more detail, starting off with endowments.

Most of the endowment products have terms of 20-30 years. They are written to age 60 or 65, and typically used to supplement the state pension. For tax reasons, there are also some 12-year term products. There are also some contracts which are sold in conjunction with mortgages, with approximately 15% of mortgages being backed by an endowment plan. There is very little single premium business. The trend is for the newer contracts to be dynamic, with insurance premiums increasing in line with a fixed index. On the 20-30 year endowments, the policyholder will get a return of 6-7% per annum over the 20-30 years. This doesn't seem very high, but it's high when compared to German inflation rates.

Term products are gradually replacing whole life. Term plans are participating, with bonuses paid in form of rebates, dividends or offset against the premium. Most products

Germany -- Comparative Product Review

Distribution

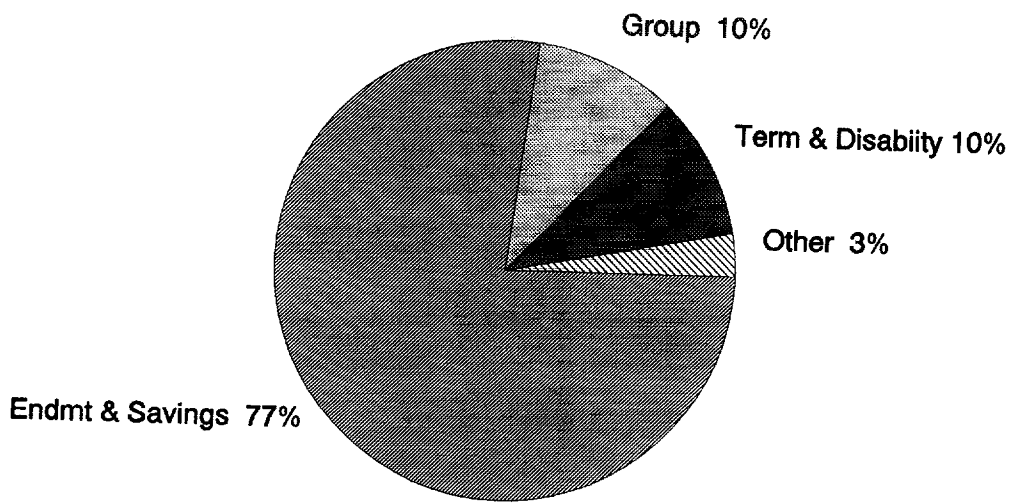


PANEL DISCUSSION

CHART 8

Germany -- Comparative Product Review

Products



1988 In-Force Premiums

offer a surrender value. In fact, it is compulsory to have a surrender value after ten years. These plans tend to have conversion options.

There is some individual disability insurance, due to the recent publicity over difficulties in financing the state pension scheme. Group insurance comprises only a relatively small proportion of the market. Most of the group products are term, but there is also some credit life and disability.

PRICING PHILOSOPHY

Finally, looking at the pricing philosophy in Germany, strict regulation really means strict. Some examples:

1. Business plans, which must contain your contract terms, must be adhered to by law.
2. There are standardized policy wordings.
3. Premium rates must be calculated using specific mortality, interest and expense assumptions. The interest rate is 3.5% and actual mortality is roughly half of that assumed.
4. You must have a surrender value after one year.
5. You must allow a paid-up plan, and all your policies must be participating, unless the contract duration is less than five years.

As you can see from all that, it is very difficult to achieve any sort of competitive advantage through product differentiation.

Competition occurs mostly through the bonus rates. Typically, 97% of profits are returned to the policyholder. Competition has driven up bonus rates to that level. For a new company, it is compulsory to return at least 95% of profits to the policyholder. Bonuses are paid in a variety of ways, either as a single premium addition to the benefits, a reduction in the premium, or in cash.

This 97% makes it look as though the shareholder gets very little, but shareholder participation is actually enhanced through other techniques, either though delaying the bonuses, through the use of bonus reserves or through the use of reinsurance affiliates or subsidiaries. Needless to say, commissions are also controlled.

To summarize the German market, it embodies the class Teutonic virtues of prudence, order and solidity.

MR. ALAN WATSON LOCKIE: An earlier slide showed us that Italy is a very limited life market. The penetration of the life insurance companies is still very low. Part of the reason for this is that the products on offer in Italy, namely endowments, deferred annuities and term insurance, are fairly basic.

Deferred annuities all tend to have cash options. Although offered, the annuity option is rarely used. The reason for this is that the terms for the annuity options are very poor. In essence, annuities and endowments are therefore synonymous, the only real difference between them is the benefit on death. Deferred annuities tend to return the premiums without interest, rather than having a higher sum insured. Profit participation is basically the excess interest over that assumed in the premium basis. If your premium basis assumes that you are going to earn 3% and you earn 10% instead, a portion of the excess is returned to the policyholder through an increase in benefits, and quite often, the premium is increased on the same ratio, which will further increase benefits later.

Term insurance represents a growing portion of the market, but when you start from almost nothing, it's not difficult to grow. Insurers changed premium rates about a year ago, cutting them dramatically. However, most of the Italians don't believe they are going to die, except possibly as a result of an accident. Therefore, life insurance is mostly used as a savings vehicle, with endowments that are fairly short term, about 15 years on average.

Chart 9 is an attempt to show the market share of the major life companies in Italy. The dominant player is the state-owned company INA, which has about 26% of the market-share of premiums. Second is Generali, which is quite a large international company, and next is a company called Alleanza, which is majority controlled by Generali. So, you can see that half the market is controlled by only two companies. There is a big drop to the next biggest companies, RAS (8%) and Fiderum (4%). Other companies account for 37% of marketshare. All in all, there are 70 life companies in Italy at the moment, and the number is growing. However, as you can see, the market is dominated by only a handful of companies.

DISTRIBUTION

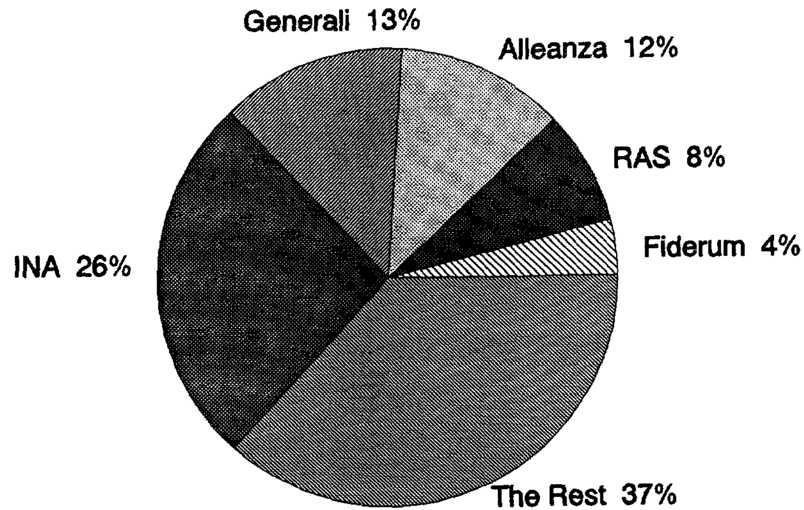
This has major implications for the distribution of business. Most of the business is sold by general agencies, which are effectively full-time agents with a lot of part-time or subagents working underneath them. These general agents handle both life and property casualty business. Indeed, most of their business is property casualty. Any life business they sell is considered to be icing on top of the cake and is not generally a major portion of their commission income. The general agents dominate each specific geographic area. If you have a contract with Generali as a general agent in a specific area, you have rights to commission on every product that Generali sells in that area, regardless of whether your agency has sold it. These general agents like that situation, and they are not keen to change it.

Therefore, one of the major problems the life companies are facing is just to break away from the strangle hold of this distribution system. One of the reasons the number of companies is growing is because a company can set up a subsidiary, and call it something else. That subsidiary will not be tied to the particular agency agreement with the company's general agent for those areas.

There is not a great deal of insurance being sold by banks at the moment, but there is a lot of movement in the market. How effectively the Italians will actually sell insurance through banks remains unclear. There are a large number of banks, none of which being particularly big, but they have seen the success of bank distribution elsewhere, so they are keen to join that. They may become a more dominant force in the future.

CHART 9

ITALY-- Market Share of the Major Life Companies



PRICING
The types of products are very limited, and that is controlled. Pricing is also strictly controlled. ISVAP is the government's supervision department, and ANIA is the Association of Insurers. You can either go to ISVAP direct and try to get approval for the premium rates you want, but that may be a long process. Alternatively, you can follow the basis that ANIA has agreed upon with ISVAP, in which case you should get approval very, very quickly.

For endowments, you have a choice of the interest rate you may assume, typically either 3% or 4%. Most business is priced at 3%. The mortality is a population mortality, and there are specified expense loadings. The valuation basis is in essence a net premium valuation, using the premium basis interest and population mortality. A recent law in 1986 has allowed companies to defer acquisition costs over a 10-year period, but this is rarely done.

TAXATION
Individuals may deduct insurance premiums up to 2.5 million Lire per year from their taxable income (approximately $2,000). However, you have to pay the premiums gross, and then wait about six or seven years for the Italian tax authorities to refund the tax relief. There will be a prize for the first company that actually finds a way around that problem, because I think they will do very well in the market. This tax limit also acts as a major barrier to selling policies with a premium bigger than 2.5 million Lire a year. Companies are desperate to find ways to increase the size of their average policies sold.

There is also a tax on the maturity of a product. However, this tax decreases after about 12 years, so that after 15 years' duration, the tax is relatively low. For that reason, policies tend to have an average term of 14 or 15 years. Very few policies run any longer, because the Italians won't trust you with their money for too long. Companies are typically taxed on profits at corporation rates which are in the 40-50% range, depending upon the size of the company.

ISSUES
Finally, the major issue facing the Italian market is agency distribution. Companies will have to find a way to break the strangle hold that the general agents have on them. There are various agreements between the companies and the bodies of agents, which will be renegotiated over this coming year. Negotiations are deliberately breaking down on the part of the companies, which even resulted in a national agents' strike in March of this year. However, it didn't last very long, because if you don't collect premiums, you don't get any commissions.

Banks are another major issue, but there is still a lot to be resolved. A major concern for the Italian companies is the single market of Europe. They do realize that their market is relatively primitive compared to some others. They have a long way to go, so they are very nervous about foreign insurers coming in and taking a large share. Whether that will be the case, given the problems of distribution, remains to be seen.

MR. TULLIS: Having been to the U.K., Germany and Italy, we are about to take you on a trip to France. I'll turn it back over to John Instance.

MR. INSTANCE: There are three major product types sold to individuals in France at the current time. The first kind are guaranteed growth bonds, which would be broadly equivalent in U.S. terms to single premium endowments. Essentially, these are lump sum contracts offering high guaranteed interest rates. They provide no mortality risk coverage and are sold very passively, relying on the fiscal advantages of life insurance in France. They are sold both by life insurance companies and by the life insurance operations of the major banks.

One of the reasons behind the success of guaranteed growth bonds is the fact that French bonds offer very attractive yields. Inflation rates in France are only 3-4%, but you can get 10% on a French government bond. This may result in a 7% real rate of return, which makes these policies look very attractive as an investment.

The second major type of products is personal pension plans. As was said about Germany, individuals in France are very worried about the ability of the state to continue to meet a high level of State retirement income provision. Long term regular premium endowments, usually participating contracts, are used to supplement state benefits on a individual basis -- commonly on what is called an open-group scheme. An open group is a collection of individual policies where group membership is only conditional on owning an insurance policy -- there is no other affinity. Participation in France, like Italy, is usually granted in proportion to the policy reserve, as an additional interest credit on the net premium reserve.

Finally, unit linked or variable life business is slowly developing in France, currently at less than 10% of the market. One company has a very significant market share, about a third of that. Growth has been constrained in recent years because of the volatility of the French equity market in recent years. In particular, the equity crash of October 1987 had a big psychological impact on potential customers.

DISTRIBUTION

For distribution (Chart 10), the key factor is that banks control 50% of new life sales in France. Direct sales forces control 30%, tied agents 10%, and independent intermediaries only 10%.

Banks have developed extremely rapidly on the back of a single premium market -- they have really created a new market. They sell very passively over the counter, mostly through their extensive branch networks. Although perceived as inefficient, they still manage to gain a large amount of the market very quickly.

Direct sales forces are individually based and rewarded through commissions on sales. Tied agents are similar to those in Italy.

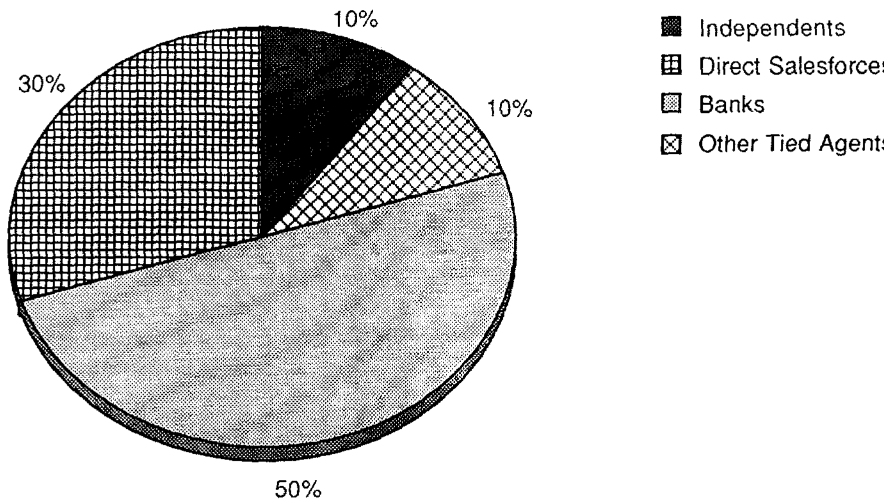
Generally, they are property/casualty agents with territorial exclusivity, just as in Italy. Every small town in France will have a number of agencies for various companies. They offer life business of their sponsor as a sideline to their major property/ casualty business. It is hard to see how many of them will survive in the longer term, but especially in rural areas of France, there is significant cultural reenforcement of their role.

PANEL DISCUSSION

CHART 10

COMPARATIVE PRODUCT SURVEY: EUROPE

France Distribution – Distribution of Sales



The independent sector is very small in France, thus making market entry strategies difficult to implement. There is no regulation of the market in terms of commissions or sales practices. French life insurance was historically a fixed tariff industry just like some other countries in Europe, with everyone charging the same rate and competing (if such a word is appropriate) on service and participation. This is now largely gone. Regulations now require preapproval of individual life products which can make product innovation difficult, and certainly time consuming and irritating. The regulators tend to be fairly low level, civil servants. However, the next two or three years may well see this requirement being lifted, to make product innovation more attractive and easier.

PRICING TECHNOLOGY

Product pricing techniques in France are typically not particularly advanced. I don't think anybody uses profit testing. Traditional life insurers capital has not generally been a constraint, although solvency margins for the bank based life assurers are a problem, given their success. The new guarantee growth bond products are much more based on investment matching, so perhaps traditional profit testing techniques are less appropriate for these types of products.

TAXATION

In general, France is extremely attractive fiscally. It is as stable as Germany, and it is profitable. Distribution is expensive and unsophisticated in terms of pricing and products. All individual life assurance products are treated similarly for tax purposes. There is no differentiation between life and pension, business as there is in the U.K.

The policyholder is entitled to tax relief on 4,000 French Francs ($800) of life premiums, at 25% of his tax rate. There is now no premium tax on savings through life insurance. This was lifted last year, but still exists on disability insurances. On maturity after at least ten years, there is no tax on the claim proceeds. Investment income earned by the life insurer can be credited gross to the policyholder reserves. Hence, for the policyholder, life assurance is a very attractive long term savings/investment medium. Companies pay tax on corporate profits at standard corporate tax rates.

INDUSTRY ISSUES

Looking at industry issues, the rapid growth of banks in the life industry has caused some concern among the existing established life insurance channels. There is increased pressure to secure distribution channels through developing the direct sales force, probably at the expense of tied agents.

As is true for most other countries in Europe, the industry is concerned that with the opening up of the wider European market, other European insurers may steal a march through product innovation. However, the limited access to distribution channels for these other companies suggests that this problem is probably more apparent than real.

To summarize, France is a very attractive market in which to sell insurance at the moment. It is certainly less competitive and frenetic than in the U.K., and almost certainly more profitable.

PANEL DISCUSSION

MR. TULLIS: Now, Ashok Gupta will take you from that fiscal paradise, France, over the Pyrenees to Spain.

MR. GUPTA: There are some similarities between the Spanish and the Italian market, but not too many. However, if there are two markets in Europe which are similar, I think these are the two.

Until the 1980s, insurance companies in Spain tended to neglect life insurance, and insurance companies concentrated on property/casualty insurance. This is partly because the benefits provided by the social security system were sufficient for most of the population. There were a number of companies who specialized in funeral insurance. This was widespread throughout Spain, although these companies provided more than just the insurance. They tended to provide a lot of the funeral-related services too, including the supply of plots.

Since the end of the Franco era, there has been the emergence of a middle class. This middle class has a need for protection benefits, such as term and accident insurance. Some companies started to sell these products, as it was profitable and attractive. Some foreign entrants introduced new products, such as endowments. Up until then, Spaniards had tended to save through bank deposits, so initially they viewed endowments with a bit of suspicion. However, since 1984, we have seen a lot of change take place, particularly among middle and upper classes. The overall situation now is still that of a nonsophisticated market with low, but increasing demand for life insurance.

In previous charts regarding the relative insurance penetration and insurance density, the figures for Spain were distorted by the inclusion of single premium business which is highly volatile. If you strip that away for reasons I will come to, the level of penetration is only about 0.5% of GDP, which is a quarter of that of Germany or an eighth of that of the U.K. Nevertheless, the growth even without the single premium business is about 25% per annum.

MARKET CHARACTERISTICS

Looking at some characteristics of the market, there is very high unemployment, and a high level of government borrowing. A strong underground economy exists, which leads to a lot of hot money moving around the market, which tends to impact the level of single premium business being written. There has been increased competition since Spain's entry into the EEC in 1986.

The market is highly fragmented, with more than 275 banks, including Spanish and foreign savings and credit banks. There are 475 insurance companies, of which 60 are foreign. There are 145 of these insurance companies that are life companies. There are strong links between the banks and the insurance companies, with the banks owning insurance companies which account for 90% of the market. The market is highly fragmented. On top of that, it is also regionalized, with centers in Madrid, Barcelona and Valencia, which tends to increase the fragmentation.

The market is still unsaturated, with life premiums per capita in 1987 equaling only $88 for Spain, compared to $700 for the U.K. Life insurance is still very much a sideline to nonlife.

In common with many other European countries, state pensions are high and the government is having difficulty supporting these. They require state subsidies. Soon, we expect a re-examination of the benefit contribution levels, which must be good news for life insurers.

SOCIAL SECURITY AND TAX CONSIDERATIONS

In Franco days, Spain was a low tax economy. Taxes have since been increased. Tax levels are currently in the middle of the range for EEC countries. Given this underground economy, avoidance and evasion of taxes are major problems, with fiscal authorities chasing the hot money around the system and trying to improve their collection performance.

There are tax deductions for insurance premiums, for policies with terms greater than ten years. Death benefits are largely free of tax.

DISTRIBUTION

Chart 11 shows new life premiums, both annual premiums and single premiums, where single premiums have been multiplied by a 10% factor. The main channel, as you can see, are agents. There are two types of agents, namely general agents and direct sales forces. General agents sell life and nonlife policies and work solely for one company. As in Italy, they have geographical exclusivity. General agents may use other local agents as well. However, these local agents have little life expertise, selling mostly automobile and property insurance.

Some direct sales forces have been set up by foreign companies, such as Nationale Netherlanden. They are mostly concentrated in Madrid and Barcelona, since in a lot of the other areas, the market is just too small to support a full-time agent. There are some insurance companies such as Mapfre which sell through branches. Mapfre has 1,200 branches and about 5,000 part-time agents who are attached to the branches and renumerated by commissions.

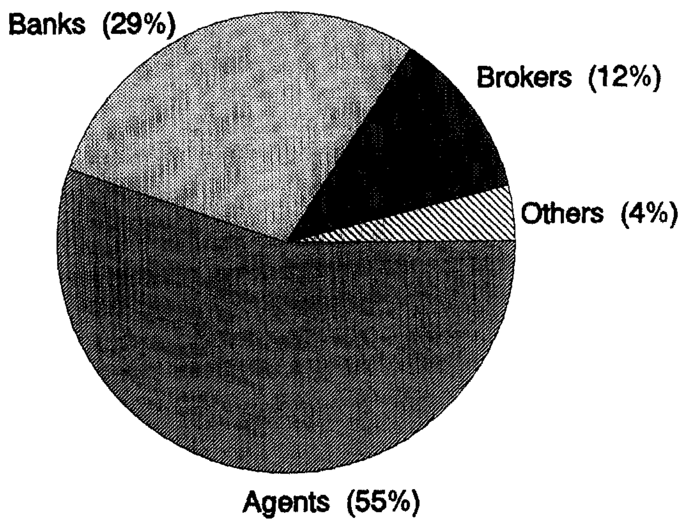
Many of these life companies are owned by banks, so they use the bank's networks to distribute their products. In particular, banks are very heavily into the single premium market, controlling 90% of it. Single premium business is volatile, mostly moving around from institution to institution, and from type of institution to type of institution, although the banks are starting to broaden their range of products that they sell to consumers.

There are two types of brokers, namely small local brokers who specialize mainly in nonlife and larger brokers who specialize in group insurance. Other categories include predominately direct mail. Direct mail has not been very successful in Spain, partly as a result of the regionalization, partly due to the poor quality of mailings and partly due to the poor quality of the mailing lists available.

CHART 11

Spain -- Comparative Product Review

Distribution



PRODUCTS
More than half the business is individual (Chart 12), and most of that is participating. The rest is mostly group life and some group pension.

Individual participating products are mostly endowment plans. Both regular premium endowments and pure endowments are available. These are sometimes sold to meet pension needs. Universal life is sold by a few companies, but not really with any success.

Nonpar plans are mostly term annuities. Term plans generally include waiver of premium or double accident benefit as riders. Most of the competition occurs in the savings market, so there is not a lot of pressure on term rates.

Group life insurance is fairly common. Typical levels are two times salary for managers and one time salary for workers. There is some group disability insurance, but that is usually only linked with pension plans.

The state pension scheme is earnings related, but there is a cap, which varies by type of employment. Until 1989, there had been a cap on some occupations. This cap increased the scope for private pension schemes, particularly for the higher paid employees. The pension schemes tend to be integrated with the social security schemes and are usually sold as bundles of individual terms.

Finally, the single premium market grew from virtually zero in 1985 to nearly $600 billion pesetas (which is about $6 billion) in 1988, and has since fallen to $2 billion in 1989. Most of this is really hot money, which came from the banks into the insurance industry. The authorities are now in the process of chasing it from the insurance industry, e.g., by banning short term single premium plans.

PRICING PHILOSOPHY
The supervision was very strict prior to 1984, but that has since been liberalized. Companies need to register premium basis and rates with the DGS, but generally, the premium rates are approved if they comply with previously approved norms. Alternatively, you may justify them in line with some experience or some statistics. Generally, approval is automatic if you hear from the DGS within 30 days.

All products other than term must have earned a surrender value after two years. For profit sharing, bonuses tend to be given as an increase in benefits, either to the sum insured or to the sum of insurance premiums. Companies return 90-95% of investment profits through bonuses, but they tend to retain the mortality profits. There is complete freedom on the type of bonus companies pay, as long as they are clear and communicated to the policyholder.

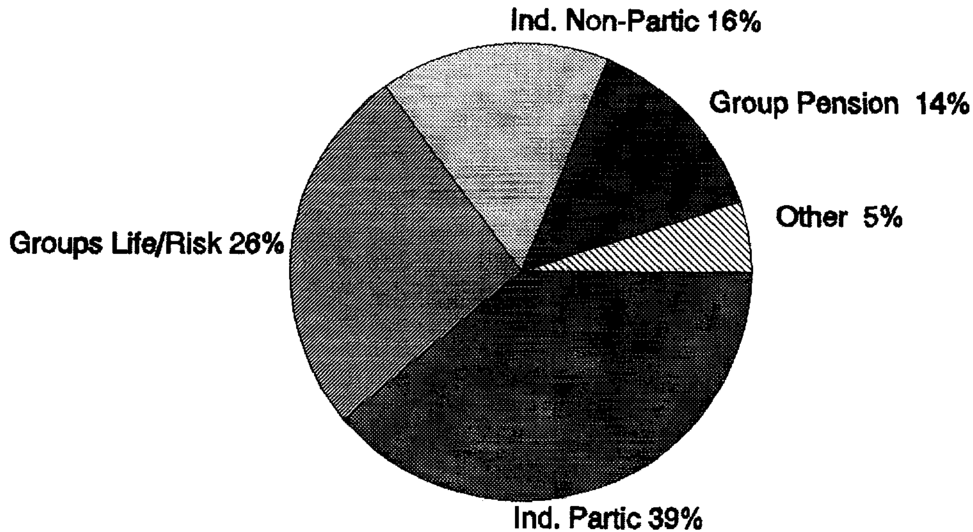
Similar to France and to many other countries in Europe, profit testing is not used to a significant extent. Despite that, the market is still quite profitable, but not excessively so. To summarize Spain, I think that despite rapid growth and entry into the EEC, the Spanish market is still really fragmented and underdeveloped.

MR. TULLIS: Finally, Alan Lockie will examine The Netherlands.

Spain -- Comparative Product Review

Products

1987 Premium Income



MR. LOCKIE: The Dutch market is generally considered to be a relatively open and free market, though I must confess I do have some doubts about this as we will see later.

PRODUCTS

There is a wide range of products available in the Dutch market. Endowments and deferred annuities tend to take a large bulk of the money. People do actually take the annuity option, because it is a lot more competitive at the retirement age than in Italy. They tend to participate in the profit of the company by having the excess interest earned on the reserves distributed as a reversionary bonus. Sometimes, mortality profits are also added on to increase that reversionary bonus, but that varies from company to company.

Long term disability (LTD) is very common in the Dutch market, probably more so than in most other European countries. Benefits are generally payable to a normal retirement age of 65. Interestingly, most companies have no control over whether the person is disabled or not. They must follow a decision from the government as to whether that person is disabled and should then be entitled to state disability benefits. Companies also allow for proportional payments, e.g., if the government says you are 40% disabled, they will pay a 40% benefit.

For political reasons, a lot of people were considered disabled and not unemployed about 10 or 15 years ago. Holland has one of the highest rates of disability in the world. A lot of insurance companies lost an awful lot of money on long-term disability business because they lost control of the claims. Unusually for most European markets, premiums are now renewable and can be increased due to experience. Experience is currently a lot more profitable than it was.

Variable life business is sold mostly by subsidiaries or branches of U.K. companies. Variable life is a growing area, with some of the more dominant resident companies of the Dutch market now starting to sell linked business.

A savings mortgage is a uniquely Dutch product. When you take out a mortgage, you only pay interest on the amount of the loan, for the entire duration of the loan. Then, you take out an endowment policy with an insurance company, who will then pass most of the premium straight back to the lender. This creates the same cash flow to the lender and gives some profit margin to the insurer. Since the policyholder can take advantage of tax relief on the interest payments, he (she) is substantially better off, because he (she) has paid a lot more in interest than under conventional repayment. This has proved to be a major boom product over the past few years in Holland and will continue to do well.

DISTRIBUTION

Distribution in Holland is very much dominated by the brokers. Brokers are independent agents who have to undergo certain qualification tests and have certain experience before they can call themselves insurance agents. Direct mail is reasonably well developed. The largest seller of health insurance sells mostly by direct mail and one or two other companies also concentrate in this area. Sale of insurance through banks is one of those areas which is just developing. Banks may become a dominant force in the

Dutch market, particularly when you start looking at the mortgage products. However, there has been little in the way of arrangements sorted out so far.

PRICING

In theory, you have freedom of pricing. Companies can price the product as they want and sell, within reason, more or less what they want. In practice, there is a marked lack of competition.

Chart 13 shows the market shares for the various companies in the Dutch market. Nationale Netherlanden, AEGON, AMEV, and Delta Lloyd are the big four. Central Beheer, which comes next, is one of the direct mail companies. The major companies have a large share of the market, and in practice they operate a cartel. They have an agreement that they will charge the same for the same products, and that they will not necessarily introduce a new product without any agreement from their fellow members.

Most other companies then follow this cartel, so that effectively, almost all the products look the same. It is possible to be outside the cartel, as one or two companies are. Term insurance exists in the Dutch market, and some of the "pirate" companies outside the cartel have smoker/nonsmoker rates. This means that nonsmoker rates are substantially cheaper than those sold by the cartel. If you had genuinely independent agents, these companies should sell a lot of term insurance, but that is not so. They hardly sell any term insurance. Indeed, one company I know of that has smoker/nonsmoker differentials still sells 25% of its term insurance business to smokers, despite the fact that they are more expensive.

I have yet to find an explanation for this from my colleagues in Holland, but it says a lot about the independence of some of the agents and the distribution system.

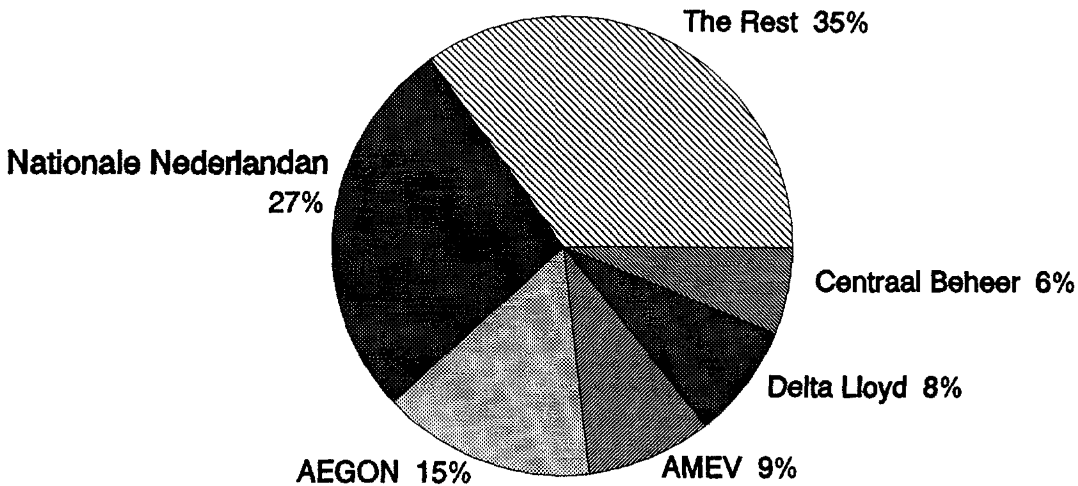
TAXATION

Taxes are a very important consideration to Dutch life insurance business. There is a major overhaul of life insurance tax in Holland at the moment known as the "Broad Revaluation." It is likely that the qualification for premium relief and tax-free benefits on the pensions, and to a limited extent, long term disability, will be reduced and tightened, but you may still get premium relief on those. Instead, the benefits payable as an income at retirement will be taxed. This produces quite a significant amount of single premium deferred annuity business at the end of each tax year, since one can get full tax relief up to about $8,000 premium on your deferred annuity. With tax rates currently in the 60% range, you can see that this is quite an effective way of saving.

For basic life insurance products, there will be a tax on proceeds in the future. It remains to be seen how some of the other products will survive. It is also important to note that because of the tax relief on interest payments, it is very advantageous to try and structure your own personal affairs with several loans and get interest relief on those.

Finally, the companies themselves are taxed on the profits they declare. Although their basic life insurance reserves are dictated by the supervisors, there are all sorts of

NETHERLANDS -- Market Shares of Various Companies



fluctuation reserves they can set up to smooth out their results. Part of the broad revaluation will probably change that.

ISSUES

To summarize the key issues for the Dutch market, broad revaluation of the tax system is the main talking point at the moment. When the authorities sort out the final details, they may introduce it at the beginning of next year, but more likely at the beginning of 1992. That will have a major impact on the way products are structured and possibly on how they are sold. Mortgage business will continue to be very popular, and savings mortgage business should continue to grow.

Variable products should grow as well. Nationale Netherlanden and AEGON have just launched some unit linked products, more or less in step with each other. These are not as up to date as some of those sold by the British companies operating there, but I think we will see a growth of variable products in the Dutch market.