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INTERNATIONAL REINSURANCE

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Recorder: CHARLES E. MOES, JR.

- Overview of the extent and form of international reinsurance activity
- Reporting, regulatory issues, remittance of payments, currency exposure
- Accepting reinsurance of business issued in other countries from a United States perspective
- Underwriting standards: United States versus foreign countries
- Management of foreign risks from a United States perspective

MR. CHARLES E. MOES, JR.: Each panelist is going to talk about different items that have been listed in the preliminary agenda. Also each speaker brings a different perspective to this matter of international reinsurance. We have Steve Clinton, who is from the Lincoln National, and obviously they are an assuming company in the marketplace. We have Andrew Giffin, who is with Tillinghast, and he brings the consultant's point of view; and Joe Kolodney, who is with Alexander & Alexander, and he brings the intermediary's point of view.

We decided to tackle it in alphabetical order, so we will start out with Steve Clinton of Lincoln National. He has 15 years of experience in international reinsurance. He has three primary areas of responsibility. He's the second vice president of international reinsurance with the responsibility for formulation of international underwriting policy. He's an account executive on behalf of Lincoln National for Asia and northern Europe, and he's also an account executive for Remark, an Amsterdam-based joint venture that is involved in the direct marketing business. He has traveled extensively on behalf of Lincoln National to Latin America, the Caribbean, Asia, and Europe. He has a BA from Centenary College of Louisiana and a master's and a Ph.D. from the University of Kansas, where I believe he majored in Spanish and French, so I think that helps to explain his interest in international matters.

MR. STEPHEN T. CLINTON: I want to talk to you about Lincoln's international operation and try to put it into the context of the topics. I'm going to try to concentrate on certain areas that they've asked me to talk about, which are some of the

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regulatory issues we face -- risk selection matters -- but it's pretty difficult to do all of this in the time allotted. Recently, I gave a talk on the risk selection matter alone. I'll try to do as best I can and hit on some of the high points.

I want to talk to you about Lincoln's international reinsurance operation. We actually started out in Latin America. Our first client was a company that some of you may have heard of -- Seguros Monterrey -- where we signed our first treaty in 1941. We also started out in Colombia and Central America. The first person to become really interested in international reinsurance was a guy who was an ex-Jesuit who had spent some time in Latin America and was fluent in Spanish. It occurred to him in about 1940 that with the troubles that were sweeping the European continent, it might be an opportune moment to enter the market and so we did.

We have very deep roots within Latin America. At one time, we could probably be called the Latin American reinsurer with a toehold in the rest of the world. Almost every employee for Lincoln at that time who was in the international reinsurance division was bilingual. And, if you were to step into our offices, you would find that much internal business is conducted in Spanish; so we have retained that particular heritage, although we have evolved quite a bit since then. In the early 1980s and late 1970s, we began to diversify very deliberately into other markets. We consolidated our Latin markets by withdrawing from certain markets, such as Nicaragua and Colombia.

Our first treaty actually was signed in 1940, which was with Seguros Monterrey in Mexico. In 1975, we opened up a regional reinsurance office in Manila, the Philippines. Actually, we have a company which goes back to 1936 in the Philippines called at that time the Lincoln Philippines, which has now been bought by Jardin Matheson. We have an office in Toronto, Canada. We established an office in Europe in 1990 called the European Reinsurance Branch. I will touch on some of these points in just a moment.

As far as what we consider to be our mission or vision, we are dedicated solely to the international reinsurance market, working almost exclusively with indigenous companies worldwide. With the entrance of some of the U.S. companies into these markets, we have done some reinsurance with them and, of course, would continue to be working in that market as the opportunities present themselves. We have determined to be a major reinsurance competitor in those markets in which we choose to compete. We have chosen not to compete in certain markets. I would just name Australia as one. We figure that in order to be a major competitor in the Australian market, we would need to have a very strong and very extensive local presence; so for various reasons we have decided not to do that.

Our regional service centers are located in Mexico City, Toronto, Brussels, Belgium, and Manila in the Philippines. Canada is our largest single international market and operates as an autonomous national market. We have a rather large office in Toronto, at least by reinsurance standards, about ten individuals, with full underwriting, actuarial and representation capabilities. We also have a market in the English Caribbean, which goes back many years.

The countries in Latin America where we are presently operating include Mexico, Dominican Republic, Costa Rica, Panama, Venezuela, Paraguay, Chile, and Argentina. Latin America is still a very important part of our operation. We see a lot of changes coming about in Latin America. You've heard the name Argentina mentioned in several of the speeches given at this meeting. This has also been a very important part of our future, at least conceptually. We have ten new accounts in Argentina and as that market grows we expect to grow with it. The Chilean market has been a very interesting market for us with the privatization of the pension plans. The individual life market there has been very buoyant and we continue to see good things ahead for Chile.

We do have a market share in Europe. It is primarily concentrated in the southern countries of Spain and Italy. Europe is a growth market for us. Obviously the competition in Europe with the European reinsurers is quite keen, but we do see a role for Lincoln in the European reinsurance market. Russia has a question mark on it. We are working on a reinsurance style joint venture in Russia which is based on salary deduction business in Siberia. At this moment, as we speak, some individuals are working on setting up the licensing requirements in Russia. We believe that there's a relatively decent chance that this venture is going to work out. We'll just have to see. It has been a fascinating experience for me. I have been very intimately involved with this particular venture and I have learned that there are some big cities in Siberia with some big private industrial conglomerates.

Our market in the Far East is very buoyant. You have heard talk of the Far East, I am sure. There's a varied picture. It ranges all the way from, of course, the Japanese market, which is one of the largest and the most important insurance markets in the world, to Thailand, which is an emerging market. There is tremendous interest right now in Asia from companies outside of Asia. This has, of course, been of interest to us also. We continue to believe that the Asian market will be a market of the future. There are a lot of growth possibilities in countries such as Malaysia, Indonesia, and Thailand, and we see a pretty good future right now for the Philippines. We believe that the Philippines is finally getting their political situation under control.

I want to talk a little bit about our lines of business. Our primary line of business is individual life reinsurance. This is our core business. We also do group life and health. We do some individual health. I would mention here, for instance, that the Korean market has been very good to us as far as individual health business is concerned through a composite type of product which combines cancer insurance with life, accidental death and some other types of benefits. This product has been a very big sales success in Korea and we have benefited from that.

Most of our business is done on a yearly renewable term (YRT) or what we call a risk-premium basis. We would do some modified coinsurance, but it is sometimes difficult to do internationally for a number of reasons. One reason is because many regulators simply reject it out of hand. Another reason is the currency fluctuation problems, currency differentials can cause you to be out of equilibrium in terms of your assets and liabilities.

Some of the support areas that we maintain facilities in would be actuarial services. Of course, management information is extremely important to us. We also have a large operation dedicated strictly to administration and providing administrative services to our clients. We have recently downloaded all of our business from our mainframe and have now gone over to a personal computer (PC) LAN-based system, which is much more suitable for the international marketplace simply because our range of products is so large.

We have a lot of special challenges. One of those is long distance communications. I can not express to you how the fax machine has revolutionized our business over the years. I can remember years ago traveling internationally and when you were out of the home office -- you were a one-man band. Now with the fax, you are really in touch; it has truly globalized our ability to provide services and representation to our clients. The other thing about long distance communications, however, is that we deal with many clients who are working while we sleep or are sleeping while we work; so this complicates matters and it means that we have to use the fax machine and other means of communication such as international courier services very frequently.

There are a lot of cultural differences, of course, which come about and I want to talk about a few of these in detail, but I am going to slip to the nationalistic practices part, which I think maybe will fit in a little bit more with some of the things that I'm talking about. Some countries do have a local cession requirement and Taiwan is one instance of this. There is a requirement in Taiwan that the first surplus of reinsurance has a local cession requirement of 60%. The second surplus has a local cession requirement of 10%. Indonesia would be another type of nationalistic practice in which it was a market that was exclusively dominated by the local reinsurer called Umumre, which is now known as Indore. Even though foreign reinsurers can operate freely within Indonesia, there is still a nationalistic feeling that they must cede locally; so Indore is almost always a participant in the account. The same thing would apply to Korea. In the Korean market, there is a company called Korean Reinsurance Corporation (KRC), which invariably will participate in any cession that comes from a local company. In Mexico, there is a company that receives a very small percentage of each local cession and this is a joint venture of the local companies.

Now, there is a linkage in many of these markets with nonlife business which is a competitive challenge for a company such as Lincoln, which is a specialist in life reinsurance. We very often are competing with companies that have shares in both the life and nonlife part of the business. Many of our companies are what we call composite companies, meaning they operate on both sides of the product spectrum, and this is definitely a competitive challenge for us long term.

THE COMPETITION

The international reinsurance business is a very competitive business, and I can give you one short illustration of that. I was once in Asuncion, Paraguay in a hotel called El Chaco which is so intimate that they even mark your wine bottle and put it aside if you don't finish it over dinner so that when you come back into the restaurant the next day, they will give you the same bottle of wine that you opened the day before. I was in my room and one of the things that we often do, particularly in countries such as Latin America, is look in the Yellow Pages for the addresses of insurance companies so that we will be sure that our records are up to date. I opened the phone book up to find that all of the life insurance Yellow Pages had been torn out of the phone book, indicating that I had been preceded by one of my competitors in the international reinsurance field.

There is an insurance boom going on right now in developing markets. This has, of course, meant that there are a lot more markets open to life reinsurers than there once were. It has made the competition all that more intense. To give you some idea of how intense the competition can be, an emerging company in Argentina can get a quote from eight to nine international reinsurers for their individual life business; so it is a highly competitive business in which there is a lot of interest.

The client relationship aspect of the international reinsurance business is probably one of the most interesting and I think one of the most gratifying parts of the business. There is a tremendous emphasis placed upon the personal aspects of a business relationship. We started with many of our clients at the embryonic stage of their business. We were able to provide what we think were fundamental services at a key moment in their development, and this has meant that we have developed very close relationships both on a personal and business level over the years. In many cultures, the relationships are as important as the business aspects.

I want to talk very briefly about currency fluctuation, because that was one of the topics that I was asked to touch on. We don't hedge too much unless we find ourselves in a net asset position in a particular currency and that can happen, for instance, on a modified coinsurance deal. We might find ourselves with a heavy investment, so to speak, in another currency. We will at that time hedge, but we generally don't hedge. We just take our chances, because we're not in the currency market business. We have enough broad exposure that we believe that when one currency is going up, another perhaps will be going down, so our goal is to keep the currency factor neutral.

I'm going to talk to you a little bit, and I'll conclude with just a few of what I think are interesting numbers. People often ask us, "What has your experience been like in the last 50 years in the international reinsurance business." We've developed some statistics, but we don't use them as mortality studies. They're not actuarially refined. Rather, they are working documents that give us a directional sense of where our portfolio is going. Our portfolio is heavily influenced by our exposure in developing markets in Latin America and in Asia. I should mention one other thing about these numbers. They are based on number of claims as opposed to amounts, because any reinsurance portfolio is going to be made up of a fairly large number of jumbo cases and one large claim, of course, can throw your results off. So for the purposes of this study, we tend to look at it more in terms of number of claims.

Acquired Immune Deficiency Syndrome (AIDS) is a negligible component of our international mortality experience. That does not mean that we do not think that AIDS is a problem. It just means that we think there are probably reporting problems and what we are seeing or what we are not seeing is all of the AIDS claims that are occurring. Right now, it is far less than 1%, at least to our knowledge, of our claims experience internationally.

Deaths caused by circulatory illness are lower internationally than in the domestic market. This is something that we have known for many years. Our current studies tend to confirm this. There are a lot of possible explanations for this. One of them is that the rate of accidental death is higher, so some of those people are dying before they might have lived to die of heart disease. Another possible reason is that the lapse rates are higher, so you do not have as many elderly people with insurance policies as you might in a typical domestic portfolio, which is our basis of comparison.

Deaths caused by cancer are lower internationally than in the domestic market. We think the explanations for that may be similar to what I just said about circulatory illness. Deaths caused by homicide are higher internationally than in the domestic market. Some of our studies in certain countries such as Mexico would indicate a homicide rate of approximately 20 times the U.S. rate. This is a global rate, but it is a problem for us. It is something that we have to deal with. I could tell you some anecdotes about all of the problems that we've had with homicide in our international portfolio over the years. Deaths caused by accidents are approximately double the domestic rate. This varies from country to country, but this is generally our experience internationally.

CONTESTABILITY

In the automatic portfolio, 20% of the claims are contestable. In contrast, the facultative experience has improved markedly from 30% to less than 10% for years 1989 and 1990. One of the reasons that we think this has happened is we have tightened up somewhat on our facultative underwriting criteria, particularly in the area of financial underwriting, and we think that we're beginning to see the results of this after many years of working to improve this ratio.

MR. MOES: Some of those mortality and cause-of-death observations are quite interesting. At the risk of repetition, for those of you who were in the underwriting update session, there will be in the International Section newsletter's next edition a brief article comparing Mexican mortality with U.S. mortality on an insured basis. Obviously it's not an extremely rigorous comparison because the face amounts are somewhat different, but it does give some interesting insights into the differences in mortality. I think U.S. companies that are plunging into Mexico with the assumption of the same mortality as we have in the United States may or may not be in for some surprises.

Our next speaker is Mr. Andrew Giffin. He is a principal of Tillinghast, the esteemed consulting firm. He works out of the Boston office. Andy specializes in multinational insurance organizations, new foreign venture business plans, cross-border operations, domestic market strategies, competitive market analysis, bank and insurance combinations, and organizational design. His recent clients have included major foreign and domestic insurance companies and other financial institutions. Prior to joining TowersPerrin in 1983, Andy served as a consultant to the Harvard Institute for International Development in Indonesia. He was also a director of management services for the NAIC. He was a deputy commissioner for the Massachusetts Division of Insurance and chief counsel for the Pennsylvania Insurance Department. He holds an MBA degree from Boston University and a law degree from the University of Wisconsin. He also has authored several articles on the strategic management of domestic and foreign insurance companies.

MR. ANDREW F. GIFFIN: I would like to talk about reinsurance as it's positioned in foreign market participation, not so much specifically from a reinsurance perspective, but from a broader perspective of the potential role of reinsurers in the evolving world market. There is a question as to how much opportunity there is for reinsurance business from a number of perspectives. Steve mentioned a hotly contested competitive market out there and some question of the level of capacity and whether there's overcapacity, which I think Joe will touch on as well. I would like to focus a little on the reinsurer participation and the development of direct writing elements of the market and look at some of the opportunities in that area. To do that, I would like to look very briefly at some world trends in the market, how reinsurers fit with those trends, market opportunities in some of the developed countries, and also market opportunities in some of the less developed countries. Finally, I'll discuss some structural options that I think have a significant influence on the opportunity.

World trends obviously is a very large topic, so I am going to try to focus on three specific world trends that I think heavily influence what the opportunities are. One is global standardization. Another is sort of the reverse of that, local specialization, and finally a brief look at some of the growth potentials around the world.

GLOBAL STANDARDIZATION

The whole idea of globalization seems to me a matter of a certain amount of myth and a certain amount of reality. The myth is this notion that to be global or to follow a globalization track means to be everywhere. Talking with Royal, for example, some years ago, I discovered some of the people were talking very expansively about being the one true global company; that is, being everywhere. Well, Royal is not quite what it was a few years ago and it's had a fair amount of difficulty for various reasons. I think that ambition has changed somewhat.

I think part of the problem is that globalization really, in terms of what is useful, means something rather different; and that is that there are actually lots of opportunities for international standardization of various activities within various sectors of the market. It is that standardization across many countries that is the valuable aspect of globalization rather than an aspiration for covering every major market or every market of any significance in the world. Now, why is that so?

We have had over many years convergence in the areas of business, politics and culture. Politics, perhaps, is the most obvious one in recent years since 1989 with the fall of communism, the shared concerns in the world since that time in areas like Somalia and Bosnia, the development of regional pacts of countries with the European Community and the North American Free Trade Agreement (NAFTA) Treaty, and there are various others around the world. So certainly politics is bringing together a lot of things that have been separate nationally over time.

This has been fostered also in terms of culture. Communications technology has allowed us to share a great deal of our diversity. We're not using television and other media to learn about each other for the purpose of homogenizing, of being all the same, but rather sharing our diversity as expressed in things like the availability of various cuisines in restaurants in various cities of the world. So we're gaining through the diversity and not losing through getting rid of many of the good things about the different cultures around the world; so that's bringing us together as well.

In business, one of the best examples of convergence is the rise of the Japanese economy which has been built not so much on the Japanese national market, but more on the participation of Japanese companies in the development of businesses through foreign market participation -- consumer electronics, automobiles, and various other kinds of things. In various ways we're coming closer together as a world in business, politics and culture. In terms of business, part of the outcome is that price and quality are surpassing national loyalties as a basis for how we choose which products we buy. Certainly one good example is the U.S. auto market where Japanese and Korean cars were once perceived as the cheapest models on the market and now. The Japanese are moving into the luxury car markets and are perceived as having the higher quality in many aspects at a competitive price.

Those are very powerful kinds of movements and we see examples of the development of worldwide markets, of converged markets in a lot of areas. The obvious one is travel, which is international by its character with hotels, airlines, and that sort of thing. We see luxury goods in airport boutiques -- Gucci bags, Rolex watches, and all sorts of luxury goods at an international level. It also has penetrated the mass market with companies like Benetton and Casio and The Gap and all sorts of others where there's a basic product which is acceptable in many cultures at the same time.

Computers, semiconductors and processors are clearly a world market as are tools for manufacturing, robotics, and joint ventures for things like drug development when it's difficult in one national market and through one distribution system to make that work economically. This is a long-standing development of standardization which goes back many centuries. The important thing about what's happening is the speed of the change. The speed of the opportunity for business standardization is accelerating very quickly.

Let's look at this then as it applies to the insurance business. One of the important characteristics of the opportunity for global standardization in business is to have a product that has a basic similar need for people in different cultures and countries. Insurance fills that in its general characteristics in terms of things like retirement savings, death protection, and disability, where UNUM is spreading worldwide in terms of offering that kind of coverage in its specialty, long-term savings. Basically, the needs are the same, but at the same time there are some very important cultural differences which we have to recognize. Global investment both at the retail level in terms of the growth of the use of international funds within things like variable products, unit-linked type products, and also global investment used by corporate finance for efficiency in managing money is a major area of opportunity for global standardization.

Now we get into some of the other areas of the insurance business systems. We talked to one major U.S. company that uses the same basic system in four different countries in different parts of the world and their view is that approximately 80% of the administrative system is the same for all those four countries and about 20% needs to be modified for the product differences from country to country. That's indicative of a major opportunity for standardization across country lines.

In risk management, the opportunity is more a matter of the process of evaluating risk and less a matter of making the same assumption. Steve was talking about some major differences in assumptions you would need to account for in international markets. Certainly Lincoln National and others can apply similar kinds of risk assessment mechanisms and processes, but has to be very much aware that there are differences country to country and region to region.

We can export product concepts. Historically, many parts of the world that were a part of the old British empire use products that are basically developed from U.K. models. Similar things have happened in places like Latin America with U.S. models of products, so there's been a lot of influence and we often tend to focus on the differences. In fact, there's a lot of similarity product to product and there's an opportunity there for applying standardization in some form, again, with the adaptation of the local market.

In organization management, I think this is an area where American companies in particular have an opportunity that they haven't tapped very effectively. That is, we make fairly good use of computer technologies and other technologies and have developed some interesting ways of managing the business which, if adapted to local cultures, which is the part I think we don't do quite so well, could be very powerful in some of the areas of the world that have fairly sophisticated markets. However, administrative development and management development are well behind us.

I think if you look activity by activity in terms of what it takes to run an insurance company, you'll find a substantial amount of area of potential standardization where you can use similar kinds of processes across country lines with appropriate adaptation in the countries. Now, who is using this sort of approach as a central part of what they do? Actually, there are not a great many examples. I'd say AEGON is one; it is building sort of a framework for how they extend internationally. The other Dutch companies, Internationale Nederlanden (ING Natned) and Fortis, are moving in that direction. Probably the clearest philosophical statement about that comes from Claude Davia, the Chairman of Axa. Axa is at the point of making some major strides to try to develop that sort of thing. It is a bit behind in terms of the development, although the philosophy is there.

The traditional large multinationals – the Zurich, Allianz, Generale, UAP – are much more traditional in general, although companies like Generale have multinational pooling arrangements with Aetna, a PC pooling arrangement with the Continentals; so they're beginning to use some joint venture kinds of relationships to share some basic approaches to the business and extend that into other markets.

I'm suggesting then that there are significant opportunities for standardization, but there are also some opportunities that have to do with the requirement of local specialization. The primary globalization constraint, if you think about it, is regulation that occurs in countries in different ways. Japan and Germany have been very difficult to enter because of an intense regulatory system that makes it difficult to do anything new and different which attracts attention in the market. But there are very strong trends towards deregulation in the European Community (EC) as the U.K/Netherlands style of a more open market approach is replacing a very tightly controlled system in places like Germany. Now, this is not going to change overnight, but it is going to continuously change and open up new opportunities in places like Germany.

In Japan, they're revising the laws with respect to the powers of life companies and property and casualty (P&C) companies in terms of extending them into new lines of business, looking at the powers of banks, and that's going to have a revolutionary effect on the Japanese market. Again, it will not happen overnight, but it is going to happen continuously over a period of time.

Now, there are practical constraints in moving into foreign markets such as public perception of the way the business is run, differences in attitudes about investment versus protection, different attitudes about whether we are in this for profit or we are in this for growth, and during particular periods of time these can make a significant difference and need to be taken into account. As Steve mentioned, a variety of cultural and language issues need to be taken into account.

If you think about going into a foreign market, if there is an opportunity for expansion and the choice is between a domestic organization that does not have any experience in life insurance or pensions or whatever you're getting into, and compare that with the kind of experience a life company or a pension operator has with the complications of those businesses, I think there are some significant advantages, if the cultural issues can be overcome, to going into new markets and adapting to those situations. In the situation we have now, there are many rules being changed.

There is a new pension law that just passed in Italy and is now in the process of being implemented. How does a local life insurance company in Italy respond to a new pension law? It will need to change its whole focus of the way it does business. If you can take process into an environment like that and adapt to the new conditions, then it is possible to, I think, have some advantages. There are advantages of just having no baggage, of being free to adapt in new markets and not have to follow the old pattern that you may be stuck in a local market.

Fortunately, along with standardization and opportunities for localization, there is growth potential. I think we have talked a little bit about this. There is fast growth in Taiwan, Korea and Indonesia in ranges of 10%, 20%, and 30% with life insurance. In Italy, a very developed market, there is substantial growth – 22% growth in 1991 in the life market. Spain has been a growing market, and there's the whole Eastern European scene where things are growing very quickly. Also, Latin America, Mexico and Argentina are growing. Mexico had a 25% growth in premium in 1991. There are a lot of areas where there is significant growth potential and the question is can you put together the global standardization, the local adaptation, and apply that in that environment.

Now, in the developed countries we are looking more at a move away from some of the traditional endowment and life kind of products where the real growth is in more simple products – for example France and Spain had major growth in the market through a very simple bank product. There was growth in traditional life business, but as an add-on to the major growth in the bank area. When considering opportunities, I think there is a favor toward the nontraditional entry as opposed to getting involved in the traditional markets as they have been.

Where do reinsurers fit within this picture? If we look at reinsurance per se, reinsurance has the advantage of going into a new market as entry with a limited infrastructure. You don't have to build all the basic infrastructure of a direct writing company. It can be used for a basis for market intelligence to learn something about the market and then you can decide later whether you want to be involved in a direct way also.

The reinsurance environment. I am curious about the people in the reinsurance business and whether an observation sounds appropriate to you. There is a sense that when getting into either reinsurance or the direct business, reinsurers do have an advantage because they have a perspective which is a bit broader than the traditional direct writer; that is, a reinsurer has to deal with a variety of different companies that do things a variety of different ways. To the extent that they have a foreign market experience, as was described with Lincoln National, for example, there is a lot of market intelligence already gathered. People with reinsurance experience can take advantage of the standardization kinds of things and be a bit more adaptive than some of the traditional direct writers, particularly in reinsurance, but also in the other markets. You have to be very careful about market risk assessment. Somebody described a situation in which they thought they were in pretty good shape insuring Supreme Court Justices in Columbia, upper-crust sort of people, and these are the right kind of people for us to insure. However, they had a little problem with the risk in that particular case.

In Russia, you have the problem of nationalized insurance from the past. Russians are good about premium collection and are not quite so good about claims management, risk assessment, reserving, and things like that. You do have to be quite careful. You have to know who your direct writer is if you're a reinsurer and perform careful due diligence. Then the question is, is there a future for a reinsurance market or is it too competitive? Should you consider something else and use your experience more in the direct area?

Let's discuss developed market opportunities. Basically, many of the older European markets, such as the U.K. and France, are experiencing slower growth. Germany has some growth much stimulated by the changes going on in that country. There's also active market development within the EC because EC companies are having to face the fact that they're coming into a single market; so there's active development of the gaps in the market. Also, the EC is the home of most of the major multinational insurers that have lots of international experience. Also, European reinsurers are seeking new life markets, as several are getting out of the P&C business. In terms of developed markets such as Europe, I think there are more difficult opportunities, particularly if you're seeking to enter on your own.

Let's look at the less-developed market areas; we mentioned Italy with rapid growth in premium, but there is low penetration because of various historical reasons. So there is substantial room for growth, particularly with the new pension law coming on board and particularly in the northern part of Italy. Another example, probably somewhat less known, is a Southeast Asian country, Indonesia. It has some 180 million people, very rapid development, and is sort of following the same track as Korea and Taiwan. Now, you're not going to insure 180 million people very quickly. They insure approximately 4-5 million people, but there's probably a market in the order of 30 million, which makes it a reasonably large size country for insurance. There is significant opportunity in some of those markets. Mexico is stimulated by the NAFTA Treaty, economic stabilization, and we've heard about growth in that market.

Again, I think the focus should be on nontraditional markets -- the use of banks and retirement savings in the less developed countries. I think that is an opportunity to get into the market more quickly than the process of actually building up an agency force step-by-step. In the more developed markets, it's an opportunity to break away from tradition; so where you have heavy competition and opportunity to get into the market, in a way that would be more difficult if going into the traditional side of it.

Let's look quickly at what your structural options are if you decide to go in. Direct entry. You are taking everything on yourself: high up-front costs and fairly significant risks. You have to be willing to take the time for the maturation of the business and whether it's reinsurance or a direct entry, unless you happen to have a great deal of knowledge about that country from prior experience. An alternative acquisition is possible, perhaps, to get some experience that way; but the question is do you really know what you're getting. If you do not have experience in the company, do you know you're buying something of value or not?

Joint venture provides another approach. If you are thinking in terms of reinsurance, there is the immediate opportunity of sharing reinsurance; that is, risk pooling between a foreign and domestic company. There is an opportunity for sharing market intelligence in both markets or the variety of markets you collectively share. There is opportunity for cross-market entry. We've talked to Europeans who are not terribly excited about the U.S. life market in general. But if you're looking at a very specialized kind of entry such as access to U.S. reinsurance markets in cooperation with somebody who knows something about the market, that's a bit more attractive to them than a general entry.

Then you have to consider the risk and profit-sharing aspects. The benefits are access to the market and risk sharing. The cost is you need to learn to share control and profit. Here, again, I think there may be an advantage for reinsurers who have to do that in cooperation with their clients on a regular basis.

How do joint ventures fit into this trend? It seems to me that they are particularly well suited to the developments in the world as we see them. There is an opportunity to share standardization and local advantages, and to put together the right combination which is, I think, critical to success in the future. It is possible to access growth markets through a local combination. It's possible to break the baggage barrier. For those of you who have had experience with joint ventures, one of the advantages is you tend to be able to do things that you wouldn't necessarily do by yourself because you have to cooperate and find new ways to doing things. So it allows you to kind of break away from the traditional ways of doing things.

It provides access to some of the emerging nontraditional growth markets and here's an area where it's possible to apply insurance expertise with a foreign bank or with a U.S. domestic bank who's looking to develop in some foreign markets; we've had some experience with domestic banks, stockbrokers, and other financial institutions looking for entree into other markets and using insurance as part of that process.

Here, again, it requires sharing of resources, risks and rewards; you need to develop the skills for joint ventures as well.

What are the opportunities for reinsurers in foreign markets? There may be some significant opportunities on the reinsurance side, but I also think it's important to consider using the skills in the direct marketing side. In general, to sum up, the trends seem to favor foreign market participation through globalization, localization and high growth opportunities – growth both in particular country situations and also through nontraditional markets, even some of the more developed markets. And, reinsurers are particularly well-positioned, I think, from the breadth of their experience, the way they do business and the nature of their business to be active in this area. Finally, I think that joint ventures offer significant advantages in making this happen.

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MR. JOSEPH F. KOLODNEY: What am I doing here? Steve Clinton has a Ph.D. which I'm in awe of, and Andy Giffin is a doctor of law. I just have a bachelor's degree in political science and history. To put an international flavor to this, "buenos dias," "buòn giorno," "gutten Tag," "ohio," and "dobroye." That was an international reinsurance introduction. The problem of coming last is that some of your better material has been generally trampled over by the preceding speakers, but we'll see if we can address some of the topics that are on the agenda.

I would say that, as a broker, we represent the ceding companies' interests in securing reinsurance and, because of our access to 50 different marketplaces, we think we can facilitate that process with a minimum play on company management time, which is always wearing, especially if you're working on a project where you don't have a lot of background and depth of experience in resourcing for your needs, especially in the international area, as well as the domestic area.

Lee Sherman Dreyfus, who was the keynote speaker, talked effectively about the globalization of the developed world economy and talked about the importance that America as a research and development country has played in the formation of a lot of cultural and economic trends. I think that both Steve and Andy will probably concur that in the last 20 years the presence of mass communication like television, the dissemination of a lot more media, and the use of English as an increasing international language for conducting business, has served as a set of transmission lines that bring countries together. I think basically the markets that are in the process of being developed are, in effect, a reaction to the ripple effect that all of this new technology has been playing in the development of the developed countries and now moving into the secondary tier and then ultimately into the lesser developed countries over the next decade or 20 years.

Let's discuss the extent and form of international reinsurance activity. We were discussing this a little bit earlier; I think my colleagues agree that there is no well-documented literature to talk about international life reinsurance activity. So as part of the oral tradition of our industry, somewhat akin to gargling, I am passing this on to you. We're confining our remarks to the life insurance area, even though, as many of you are probably aware, the property and casualty reinsurance business is much more dependent on international reinsurance facilities. You have huge exposures because of Japanese and New Zealand earthquakes, the recent World Trade Center liability and property damage as in Hurricane Andrew. The P&C international reinsurance community has taken it on the chin heartily in the last several years. If you look at the results out of Lloyd's, you see the impact that the presence in the international reinsurance business can bring.

Life reinsurance is really conducted in just about all countries, but there is one country for which I will give you a short anecdote where I found it wasn't conducted -- Paris. I was at an international meeting in Paris in 1980. I was riding over to a reception on the bus and seated next to me was a very distinguished looking gentleman who I had not yet met so I introduced myself. At that time I was with the General Re Group and this gentleman turned to me and he said, "I am with Varta, the Polish insurance company." Now, obviously I am an American who's used to dealing in 50 states with 1,200 or 2,000 legal reserve life insurance companies. In Europe there are about 200 companies. It's kind of a step backward to think that in the whole country of Poland there's only one insurance company. I explained to him that my work was in the life reinsurance business. He was smoking one of the Eastern European paparazzi cigarettes, holding it in the European fashion between thumb and forefinger. He looked at me, inhaled, blew smoke and said, "We have no life reinsurance in Poland." Now that may change in coming years, but at that time there was only one insurance company and no life reinsurance in the whole country. It shows there are market limitations, especially if you're operating under a totalitarian system.

The U.S. market is probably the largest risk market in the world. We build our business on the human life value. Most countries build their businesses on save now, invest, and the human life value, while certainly not minimized, is not as emphasized. A couple of years ago, I read in *The Wall Street Journal* an article bemoaning the fate of the current generation of ownership of French vineyards, because in France they have a capital tax. Upon the death of the individual, every asset and all personal wealth is subject to a tax. As a result, a lot of the current vineyard owners in France are probably going to have to sell, or their beneficiaries are going to have to sell the vineyards to raise the taxes to pay the death duties.

In the United States, we know what we have to do to satisfy estate tax needs. We buy a lot of life insurance and plan ahead and use all kinds of trusts and estate planning vehicles. While you might not be able to get as much money as you want for a particular purpose, at least life insurance can be a very important product in deferring or diminishing the burden that such a responsibility would bring. Even though we're seeing in this globalization or world economy a movement of countries and people into economic unions, like the European Economic Community (ECC) and the European Free Trade Association, there is significant product differentiation in each country which is important for reinsurance consideration.

The United Kingdom as a market is a combination of investment and risk products. In France, they have a tremendous burgeoning of deferred products which generates tremendous cash accumulations and are sold under the label of life insurance. Retentions in the continent can be somewhat small. Retentions in the U.K. could approach U.S. levels. The continental markets such as France, Germany, Italy, Holland, etc., are more savings and investment oriented.

As we mentioned earlier, banks in Europe play a much larger role than the life insurance businesses. The regulatory restrictions we have in the United States separating banks from insurance are really unique to our society. These interactive activities in Europe are known as bank excellence or alphenons and they represent the synergy between banks and insurance. Company retentions in these markets are somewhat lower because of the nature of the types of products sold.

Consumers may be provided with tax deductions specifically for certain required or discretionary insurance coverages. They might have to take off the top of their income enough money to buy personal coverages, homeowners or automobile insurance, and perhaps an allowance to start putting money into some kind of an investment-oriented life insurance product.

Local market conditions would frame international reinsurance strategies. Continental reinsurers are both mortality reinsurers and financing reinsurers. Since a lot of European products are asset cash value accumulating, they create a heavy reserve strain. That, coupled with acquisition costs, necessitates ceding commissions from reinsurer to ceding company that may run as high as 140-160% the first year.

As a result of relatively moderate risk retentions, European companies tend to participate more in pools and alliances. There also are shareholding interests between reinsurers and primary companies which, in part, may dictate where reinsurance is ceded. Companies like Allianz have a significant shareholding interest in Munich RE and vice versa. The Swiss RE Group has a shareholding interest in a lot of primary companies. We think of Swiss RE as a major reinsurance company, but in reality they have a lot of interest in primary businesses.

There is a differentiation that should be observed between what we would call professional reinsurers and reinsurance divisions of primary companies. There are a lot of European companies that use their reinsurance as bartering tools to diminish the cost. The major international insurers like the Munich, the Swiss RE, the Mercantile and General, Miguel, Cologne, and Scora all have well-established worldwide facilities to handle larger risks. The smaller- to medium-sized companies or divisions of primary companies use their excess business to trade or reciprocate, in addition to accepting net retention shares of risks from other companies.

The caution I would put out as far as entering into reciprocal reinsurance arrangements, which can be effective from an ultimate cost reinsurance viewpoint, is that it can be a good economic decision if you're not uncomfortable in accepting risks from sources where you have no relationship. The reason results may be good is because premiums are considerably higher than in the United States, although new products are coming out now for which we can see a trend, especially on the risk and term insurance side. There seems to be an emerging scenario of the kind of competition we started experiencing in the United States about 10 or 15 years ago.

Generally, the motivation for purchasing products in Europe is more of an accumulation investment rather than pure mortality. In a reciprocal agreement, you can have profit commissions back and forth and sort of a gentleman's agreement to balance accounts if one or an other party goes into a loss position. We have negotiated transactions and helped U.S. companies into European arrangements, which has helped expand the U.S. capacity and provided more favorable economic turns not typically provided in the U.S. market on certain products and risks.

Tax regimes vary from country to country. This may also influence the action of the international reinsurers, as some of these countries may provide favorable treatment on reserves or actually provide economic incentives to bring in reinsurance from outside the home country. Culturally, many international companies are very long-term oriented and are prepared to invest accordingly. By the nature of the business, international reinsurers work in multiple currencies, which is not common in the United States.

I think that probably one of the hurdles that a company going into the international reinsurance business has to confront is the reality that they're dealing in currency exposures and liabilities, and assets may change. If you're in an investment situation with a company, an original terms transaction where you deposit the reserves, you have a potential currency problem. That's probably one of the hardest entry barriers; if you're just starting from the U.S. dollar base, you're making significant potential investment in involving yourself in other areas of the world where you must deal in local currency.

As Steve and Andy said, new reinsurance opportunities are emerging in the Pacific Rim and the Far East. There are recent changes in the government and stronger economic planning. NAFTA in Mexico is indicative that that market, which I guess was in a shambles about ten years ago, is now coming back and is more viable. Several U.S. companies have established joint ventures in Mexico and are trying to penetrate the middle class Mexican marketplace and looking for positioning over the long term. South America is somewhat checkered as certain political and economic instability in several countries mandate a somewhat cautionary approach. I think Steve probably highlighted the areas of interest where there seems to be the most upside potential – Argentina and Chile.

Mechanisms of international reinsurance are very similar to our own: risk premium reinsurance; coinsurance, sometimes called original terms reinsurance; modified coinsurance where you take it on original terms and deposit back the reserve to the ceding company; financial reinsurance, which I label as more portfolio reinsurance; and financing, which is to provide the high level of ceding commission and new business going forward, as you would on a continuous treaty.

Let's talk a little bit about accepting reinsurance of business issued in other countries from a U.S. perspective. I guess there are some factors in here and one question is why? Why does a U.S. company want to accept reinsurance and business issued in other countries? What is the company's motivation? Does it want some international exposure? Is it interested in building relationships overseas as a foundation for potential expansion? Is it a question of being a little aggressive in using what they perceive as underutilized capacity? Is it viewed as an opportunity to diversify their risk exposure base and enjoying a superior return than what they might get in their own domestic market?

It is important to understand and be comfortable with the location of the business, the type of product that you may be reinsuring, the currency aspect, local underwriting standards, the rates and method of reinsurance, the willingness to have reserves deposited back to the ceding company in local currency, if required, the impact of inflation and its effect on recovering an investment, the amount that you are comfortable in accepting as a liability, and homicides and accidental death claims. When you're operating on a very remote basis, claims could be a problem.

We used to have an office in Mexico City, which was an indigenous office. All our underwriting, administration, marketing and accounting was conducted down there. We had a very good guy who was intimately familiar with the Mexican marketplace. As a result of his efforts, we know we saved claims on at least five bodily substitutions; so that's an aspect that is somewhat foreign to our culture in the United States. While I'm not saying it's a cultural ethic outside the United States, it's an environment where one must be very attentive to both risks and rewards and knowledgeable claims investigations on site.

You should try to have a sufficient understanding of the environment from where the risk is coming and the reliance on the knowledge of the assuming company staff and underwriter. It's possible to experiment in a small way, but hopefully that small experimentation will result in building a database and a knowledge base that makes you more comfortable about getting involved further. Also, one must look at the financial strength of the ceding company or reinsurer that you're accepting business from and have an understanding of how it does business.

I worked in Spain for awhile and there was a whole state of interest in selling smaller Spanish companies to international insurers who wanted a presence in that marketplace and the question that kept on coming up is how many sets of books were there. You never really had a handle on all the liabilities or the quality of assets and some companies made some unfortunate investments and got burned as a result.

The acceptance of business from outside the United States by U.S. companies is not only tied to the country, but also the underwriting standards and the product they're in. The accepting company needs to rely on the professionalism and integrity of ceding company management, whether primary or reinsurance, if questions involving foreign language considerations emerge and the assuming company has no real language expertise. Some companies talk about getting involved in the European business, but when you ask them how they're going to look at a French claim or a German claim or whatever you realize it could be a potential problem. That's why I think Andy's concept of a joint venture or a hand-holding operation where you build a relationship with a couple of partners on which you can rely and who can rely on you is maybe an advantageous path to take to gain entry into this marketplace.

I am going to concede immediately to Dr. Clinton who is more knowledgeable about underwriting standards than I am, but I just want to give you a little once over as to how I look at what the market represents. Underwriting is influenced by policy provisions in local cultural orientation, even though I believe there's a fairly homogeneous approach to risk selection because of the support of reinsurers who operate internationally and the fact they will establish and guide underwriting standards in their evolution from country to country. Most of the life insurance companies in the world do tend to rely on reinsurance arrangements. The quality of relationship between themselves and their reinsurers, especially on the underwriting side, is dictated by an acceptance of an agreed methodology of how to do risk selection.

The U.S. is a little bit unique because in our lust for ever more predictable mortality results, we keep on carving up that standard class to the point where there's not a lot left of a broad standard class; everybody is into super preferred, non-smoking, physically fit, long-living applicants. As a result, in order to justify some of the mortality assumptions we make, we keep on getting more and more tests and examinations to give that assumption credibility. Most countries outside the United States generally go standard versus substandard and now there's an increasing trend for smoker versus nonsmoker.

Steve indicated that Lincoln has an operation where their principal thrust is in the southern tier – Spain, Italy and Greece. I think my recollection is correct. You find a lot more smokers in that part of the world than you do up in northern Europe. You can get into French taxi cabs and you'll see signs that say no smoking. In Spain and Italy, everybody smokes. Certain countries can obtain underwriting information such as lifestyle and sexual habits not available in the United States because regulation restricts these lines of inquiry. There also are organizations in Europe that specialize in rating substandard risk pools.

AIDS has highlighted an underwriting problem which foreign countries have had to come to grips with in the last several years. Testing limits, I think by U.S. standards, are considerably higher, but many countries allow unlimited contestability in their policies, which means in effect that if, in fact, somebody does misrepresent on the questionnaire and they die, it is very possible that the entire benefit could be denied a significant number of years after the policy has been accepted. The higher testing limit may be offset by exceptionally specific lifestyle and habit questions, along with questions on the types of tests the proposed insured has had.

One interesting thing is that the type of large case market we have in the United States is not as extensive in Europe. As a result, while we tend to be seriously concerned about the jumbo limit issue in the U.S., it is not generally an issue in most European environments. They just do not see that aggregation, that accumulation. Let me talk very briefly, because I begged off discussing reporting regulatory issues, remittance of payments, and currency exposure.

What I have found is that there is not a lot of uniformity of reporting. There is certain basic information which is going to be transmitted between ceding company and reinsurer, but some of it could be computerized and some of it could be manual. There seems to be a lot more manual transmission between ceding company and reinsurer on reporting records. Hopefully this is going to change as technology makes reinsurance administration easier.

We should also be aware that from the U.S. perspective, the U.S. had tax treaties in different countries. There's an excise tax consideration involving outgoing reinsurance which ceding companies should be aware of, and which may impact the financial strength of a deal or it may be a handicap to getting it consummated. There is a currency exposure issue, a transaction of a very large magnitude, where you're really doing a major treaty involving this heavy ceding commission for reserves deposited back that may justify the use of some derivative product or hedging strategies. But you cannot go out too long hedging strategies on currency. It's generally a short-term result.

You can see the evolution of a more common market in Europe. Europeans have an interested population that appreciates the fact that there has not been, except for what is going on now in Bosnia and Herzegovinia, a war in Europe since 1945. While preserving their own national identity, they like the idea of being able to buy goods from country to country, minimum cross-border interference, and taking advantage of pricing of products, especially in the insurance area. The EEC has launched several directives. The latest one, I guess, is the third life directive, which is being implemented; but there is still some instability.

I have said for several years that the one thing that Europe is ultimately going to have to confront is the fact that the EEC has 12 countries in it. It's very difficult to keep 12 sets of books if you're dealing in 12 different currencies. I think they're moving toward a standard European monetary unit. They started with the ECU, but as a result of contemporary economic conditions, England had to get out of the rate stabilization program. Italy and Spain are probably going to be devaluing so I believe they are out. This is going to be another evolutionary trend. But at some point, I believe that, as the global scenario continues to be more interactive and there is more interdependence country to country on goods and services, there is going to be a natural evolution to some form of consistent monetary unit that you can use in international transactions. On that note, I am going to terminate my remarks and allow questions.

MR. GIFFIN: Well, the Indonesian market really did not have much of a life market. It was sort of an industrial life market up until about 1987 or 1988. AIG came into the market. The government had been thinking about authorizing life joint ventures. It had nonlife joint ventures for some time and had not gone into life joint ventures with national companies, so it was limited to a national company market. From 1987 on, companies began to come in. I guess the most dramatic move was ManuLife that came in and really did a very good job of building a market of individual life insurance and some pension business in a very awkward set-up of trust funds and things.

It has now passed a pension law and the combination of general development. The pension law and the beginnings of the development of a life market growth have drawn a number of U.S. and other companies into the market, by establishing joint ventures. That is a market on top of rapid economic growth, fairly good economic control of inflation and other broad economic factors and generally stable politics. The current President of Indonesia was just reelected. He is a revolutionary leader in power since 1965 and nearing the end of his career, so there is an issue of transition. It has been a favorable market for rapid development and it continues to be.