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## Session 40OF European Insurance Market Update

**Track:** International  
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*Summary: What issues do European life insurers face?*

- *The European Union directives have been in effect for some time*
- *The Euro is being introduced*
- *Crises are occurring in foreign financial markets*

*How have these and other happenings affected the life insurance marketplace in Europe? How have these affected the actuarial profession in Europe?*

*This session updates North American actuaries on these and other European insurance marketplace issues.*

**Mr. Michael E. Gabon:** We have an all-European panel. First up will be Seamus Creedon. Seamus was born in Dublin. He's a Fellow of the Institute of Actuaries, a Member of the SOA of Ireland, a Member of the CIA, an Associate of the SOA, and a Member of the AAA. He worked at Abbey Life to start out his career. He joined the Bank of Ireland. He's been working in the life market, and he currently works for KPMG in their London office, involved in several projects with the European insurance market.

Following Seamus will be Andrew Chamberlain. We're actually very lucky that Andrew is able to participate. Andrew is with the government actuary department in the U.K.; they are an advisor to the FSA, which was formed to oversee regulatory matters. He worked for Aetna Life in the U.K. and was a director at Hill Samuel.

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†Mr. Chamberlain, not a member of the sponsoring organizations, is Chief Actuary at the Government Actuary's Department in London, England.

He's been with the government actuary's department for about four-and-a-half years. Andrew will provide a regulator's perspective.

And last, but not least, we are lucky to have Godfrey Perrott here. Godfrey is a principal at Milliman & Robertson's Boston office. He grew up in England and moved to the U.S. in 1964. He's undertaken many different assignments since then. So, without further ado, Seamus will start us off.

**Mr. Seamus Creedon:** I'm not sure whether it was brilliant foresight on Mike's part to choose an Irishman who works mostly in London but has a home in France to talk about life in the European Union (EU). In that capacity I have the opportunity to observe at firsthand the different attitudes of at least three different countries to the EU. The Irish, like most of the smaller European countries, are enthusiasts for the union—the EU generally has been very generous to them—and they are also very keen on the recent economic and monetary union. The British are somewhat more skeptical, and my impression of the French attitude is that it lies somewhere in between.

The European life market is big. In 1996, the EU countries—France, U.K., Germany, Netherlands, Italy, Spain, and some of the other smaller European countries—in total added up to a market that rivaled and exceeded in size that of the U.S. The currency rates may have moved a little bit since, but very broadly the EU market continues to lie at about the same size as that of the U.S. and Japan. So shouldn't you be thinking about coming to Europe before Europeans come to you?

I think there are two questions for us to think about and return to perhaps in the discussion. First, should this session really be about life assurance in the EU or should it, as I believe, more properly be about retail financial services in the EU? The second question is more difficult, and a key issue for anyone thinking about Europe in commercial terms: At what pace and at what stage will French, German, and British customers think of themselves as having become European consumers? The analogy's not perfect, but the EU is a bit as if the states on this land mass had been fighting among themselves for several hundred years, not just one civil war but two civil wars in a short space of time, and then embarked on a project to bring themselves together. There are traditions of culture and history that have developed independently that make this a very complex project, and certainly it will be the case today that most people, particularly in the larger countries, do think of themselves first and foremost as nationals of those countries and only secondarily as Europeans. But attitudes are changing, and it was a wise Frenchman who said we tend to overestimate the pace and impact of change in the short term, but we tend to underestimate the pace and the impact of change in the long term.

I'm going to begin by covering all too briefly the major European life insurance markets. These six vary in terms of their states of maturity, products, and distribution systems and are a reasonably representative sample of the 15 EU markets. Having covered each in turn, I will try to draw out some of the similarities and some of the differences in terms of thinking about the EU market as a whole. I will move on to deal with the particular issue of retirement provision, the demographic time bomb, and the European Commission's plans for accelerating the development of the single market.

France is Europe's largest life assurance market, a position it has attained only in recent years. That has been fueled by the rapid development of bancassurance in France. It is important to underline that that development in turn largely has been due to banks selling essentially banking-type products with a life assurance wrapper. That has contributed to most of the growth of bancassurance in France, but the latest figures I've seen suggest that the bancassurers in France are not far short of two-thirds of new premium income in that market.

The traditional distribution systems of the salesforces and general agents are well organized and managed but under pressure in cost terms from the bank channel and indeed from direct business. The French regulators do operate a prescriptive system, which I think is biased against change and foreign entrants. Having worked with clients looking at that market, it's not the most hospitable regulatory body in Europe. The French banking system, although well developed in terms of service and technology, financially is not particularly strong. At one stage the banking system was nationalized, and it has tended to operate on a lower capital base than many of its European counterparts.

France is an integrated national market in contrast with Germany, as I'll come to explain. It is a market in which essentially the same products and marketing techniques work in Paris, Northern France, and Southern France, so it is very much an integrated market. It has a socialist government that professes to operate socialist measures. The one that seems most economically offensive is the current drive towards a maximum 35-hour week, but there is in France a strong tradition of private property and private wealth, so in practice the country is not as socialist as the government espouses. The leading life assurance companies are CNP, AXA, Credit Agricole, and AGF-Allianz.

Germany is the largest market in the EU in terms of population, but it has an underdeveloped financial sector. It was Bismarck back in the late years of the 19th century who invented social security in Germany, and there is a tradition of reliance and expectation that the social security system will provide for unemployment and for retirement. Germany's tax rates are high. Tax rates following reunification with

very special levies and so on reached the 60% level on significant tranches of income.

In distribution the life assurance market is still dominated by the tied agents of the major companies, although there is a growing broker advisor sector. As more Germans have wealth to manage, they are keen to look for independent advice and not to rely on the traditional agent. Germany is perhaps unique in Europe in terms of the relative unimportance of bancassurance in that market. The banks have been very successful with mutual funds but have not been particularly successful in bancassurance. There is a suggestion that they haven't tried too hard in that their equity, or large chunks of their equity, of the commercial banks is owned by the major insurance companies.

The German retail banking system is very fragmented. There's a major mutual component in terms of local savings banks all over Germany that operates with state guarantees. Deutsche Bank, for example, of which most of us will have heard, has recently acquired Bankers Trust. Deutsche only has, I think, just under a 10% share of the retail market in Germany. So it is similar with the U.S. in terms of the fragmentation of the German banking system, although the strong mutual component is a difference.

The life assurance market similarly is fragmented, although that is starting to change, and many life insurers in Germany do form part of loose or tight groupings, and there is a process of consolidation underway. A point to make in understanding Germany is to remember that it's a very decentralized market. In contrast with the integration of France, Germany is a real federal system. It only came together as a country in the late years of the 19th century. And Germany also is chauvinistic. I've known people working in Germany for 10 and 20 years, and they'll still be regarded as protective by their local neighbors. It's said of Germany that a consumer in Hamburg will not buy insurance from a Bavarian company, for example, which reflects the fragmented character of that market. And the Swiss are the only foreigners whom Germans are prepared, it would appear, to trust with their hard-earned funds. The leading life assurance companies are Allianz, Ergo, R&V, and Volksfursorge.

Moving on to the Mediterranean markets and Italy, which is one of the immature markets, there isn't a tradition of strong financial services sector in Italy or, indeed, Spain, as I'll later explain. Italy is, in part, at least in the southern portion, quite an underdeveloped economy, and there's a tradition of a lack of confidence in entrusting savings to the financial sector. Italy operates an extremely generous social security system, but generous to the point where increasingly its sustainability is doubted. For that reason the life assurance market is now starting to grow fast

from the very low base. Because it's an immature market there's reasonably well-developed foreign involvement from other continental countries. The prospects for life assurance and for mutual funds depend heavily on the consolidation of the banking sector. Until recently the Italian banking system also was very fragmented, but it is now coming together. The leading life assurance company Generali is in some ways hardly an Italian company at all in that its roots trace back to the Austria Hungarian empire; Generali is very much an international company. The other leaders are INA and RAS.

The Spanish market in some ways is similar to that in Italy, and it's probably not surprising that the country that invented the word *mañana* didn't have a tradition of savings and investment until quite recently. The Spanish economy was, for many intents and purposes, frozen during the Franco era but is now booming quite fast as Spain has engaged with Europe. In contrast with Italy, as I just mentioned, the Spanish banking sector consolidated relatively early, and the Spanish banks are quite strong. A few of the banks are significant forces not only in banking but in the insurance markets.

The traditional insurance sector was very fragmented, again like Italy, with a tradition of foreign involvement. There's some similarity with France in that tax-sensitive bancassurance has been a spur for growth in the insurance market. Spain is attractive in terms of the rapid rate of growth in its economy. It has been underdeveloped but is growing very fast, a rapidly improving economy.

Returning to Northern Europe, the Netherlands, although in U.S. terms it might not be described as liberal, in continental European terms it definitely has the most liberal style of economic management and has been among the more efficient of continental European economies. It reformed early in a typically Dutch way. As Linda Emory said at another session, the Dutch have a tradition of looking beyond their own borders of international trade, and that has been as true of the financial sector as of other sectors of their economy. Equally, they have a tradition of personal investment and of investment internationally in equities. A characteristic that the Dutch market shares with the U.K., and indeed Ireland, is a strong, independent, intermediary sector. Brokers account for a significant proportion. I think it's still more than half of the Dutch life insurance market, although bank channels and direct channels are growing strongly in Holland as well. The Dutch companies—ING, Aegon, Interpolis, CGU (Delta Lloyd), and Fortis—have been internationally oriented and big investors in the U.S. life insurance industry.

Margaret Thatcher's legacy to us in the U.K. has been a market-oriented approach to economic management that has certainly won the argument at least for the time being. Like the Dutch, as I mentioned, the U.K. as an island nation has a tradition

of international orientation and international trade and particularly has always operated a very open retail financial services marketplace. The U.K. is very receptive to new entrants in terms of both insurers and fund managers, almost uniquely so in Europe. The life insurance sector in the U.K., I think I would have to say, peaked in terms of its performance in the 1980s, and the outlook going forward looks negative from hereon in, particularly in terms of margins. The U.K. composite sector has destroyed shareholder value over the last 20 years. It's a sector that has consolidated, but by 1995 Guardian, Royal, and Commercial Union had all disappeared. They're reappearing now. CGU (Delta Lloyd) at least has reappeared as the industry has consolidated.

Within U.K. financial services there's been a tradition of mutuality dating back to the 19th century in both insurance and in retail financial services more generally. The building society sector had effectively become a mutual retail banking sector, but what is happening now is that demutualization is well underway in the U.K. and there is a question as to whether any significant mutual sector of any scale will remain. U.K. financial services are very competitive, and one of the areas that is rapidly growing at the moment is products of a passive investment character. Mutual funds and insurance-based products with indexed investment or with quantitative investment styles are growing rapidly, and there's a real skepticism as to whether active investment management can justify its existence.

The U.K. has been to the fore in responding to consumers' pressure by introducing a strong system of regulation of the financial services industry, again something which we may want to return to in discussion. I think it still depends on the passage of the enabling legislation, but the U.K. has for all intents and purposes a single regulator that operates both the consumer protection regime and the solvency monitoring regime for all of the financial services industry. So, our financial services authority is rather like a super SEC. The new feature of the insurance market in the U.K. is government involvement in product design. Partly as a response to the industry's shooting itself in the foot, the government has taken a hand in prescribing standards for, for example, the charges that may be made on particular types of product. This isn't general to life assurance yet, but it's been brought in for an individual savings account that is the latest tax-supported savings product in the U.K., and it appears likely to be brought in for individual pensions planning going forward. That's the principal factor that makes the outlook for the life assurance industry particularly negative in terms of margins. For now, the leading companies are Prudential, Standard, and Equitable.

The banking sector also has been consolidating in the U.K., and there's evidence to suggest that the banks have developed an appetite for mopping up what remains of the life insurance sector. U.K. banks started their own life insurance subsidiaries in

the 1960s and 1970s but have now decided that in order for them to capture a greater share of the personal sector financial balance sheet they might as well go ahead and acquire existing life assurance companies.

So what does that tell us about the European market? Well, there are indeed similarities and differences between the various European markets. Some of the challenges and issues are common across all of Europe. The need to make private provision for retirement income as an alternative to state-managed, pay-as-you-go social security is an issue that exists to different degrees and in different forms for just about every EU market. In most cases, the boundaries between the traditionally separate sectors of retail financial services are coming down, and we are seeing certainly in the U.K. and in other countries essentially a single retail financial services industry.

Competition is a strong feature. As Godfrey will go on to tell us, we're not yet seeing much business actually being sold across borders, but we certainly are seeing competition in the market for corporate control and the emergence of integrated European financial service groups. Cost pressures from new entrants with new ways of doing things, and from consumers, and the government's response to consumerism is an issue in most European markets, and disintermediation, the growth of mutual funds and unbundled products at the expense of life assurance, again is an issue in most European markets. A very similar list of concerns could be compiled for the U.S. market. Those challenges certainly are common across all the European countries.

The differences reflect the different traditions. Consider distribution channels. I mentioned, for example, the strong broker sector in the Netherlands as compared with strong tied agent channels in Germany. Those reflect the different histories of the different markets. Economic management styles are as different as between more market-oriented economies such as the U.K. and, to a lesser extent, the Netherlands and Ireland and the more corporatist economies, particularly Germany. Attitudes to risk, particularly in the investment area, differ. The German attitudes, for example, are influenced by a turbulent economic history early in the century. Germans have a preference for bond investment, for example, whereas in the U.K. and in the Netherlands there's a preference for equities.

Tax systems have evolved very differently in terms of rates and incidents of tax, and the pressure to harmonize both systems is a very live and controversial issue, which I'm sure both Godfrey and I will touch upon. Countries also differ in terms of their approach to social security and welfare, in terms of how those histories have evolved differently.

I want to deal again briefly with developments in merger and acquisition (M&A) activity. There are three different dimensions of M&A activity in European financial services: in-market/in-sector, cross-market, and cross-sector. Most activity has been in-market and in-sector. For example, the acquisition by Lloyd's of TSB was a very significant consolidating development in the U.K. banking and financial services market. That's the kind of activity that the stock market likes best because the potential for savings is usually reasonably clear and can be reliably achieved. I don't think that in-market and in-sector consolidation is by any means a passing trend. I think it's going to continue in the U.K. and inevitably there's going to be pressure for it to spread within Europe. But we are also seeing at a growing pace cross-market M&A activity, particularly where one of the parties is in the U.K. This, too, can offer potential for worthwhile shareholder value-oriented savings.

What are some of the significant transactions? The Aegon acquisition of U.K.'s Scottish Equitable proved to be a good deal for Aegon, which gave them the appetite to do much more of the same again. I guess the jury is still out to some extent on what Commercial Union's acquisition of Group Victoire delivered for what are now CGU shareholders. Allianz-AGF was already operating in France. So that is in some ways the characteristics of both a cross-market and an in-market transaction. AXA has been an aggressive acquirer, most recently GRE of the U.K., and has recently announced substantial job losses on the back of that. Just this weekend, as I opened my newspaper on the airplane over here, I saw that my old stable, Bank of Ireland, is apparently about to merge with Alliance Leicester of the U.K., which will be a significant cross-border transaction. The main debate is about where the head office will actually be.

We also are seeing growing in-market for cross-sector activity, most famously, the creation of ING and Halifax's acquisition of Clerical Medical in pursuit of long-term assets and a position within the broker marketplace. I think that the cross-sector/in-market area is the one that is probably going to grow the fastest over the next two or three years.

This is an actuarial meeting. So a discussion wouldn't be complete without making at least a brief reference to some of the actuarial issues that exist across the European market. As is the case here in the U.S., equity-indexed products are becoming increasingly popular in Europe. They offer the potential to reconcile the different attitudes to risk that I described earlier. Risk classification is an area that is growing in sophistication. We are seeing preferred life products. We're seeing what's called geodemographic pricing, whereby a new entrant such as Virgin will apparently vary its prices according to whether one lives in the south of England where mortality is lower or in Scotland where apparently people are a good deal less healthy. I have some concerns about that. I'm not sure pricing should reflect

influences that people are not in a position to control, although I guess it could be argued that one can move from Scotland to the south of England.

Longevity risk has been an issue in European countries. Mortality improvement has evidenced some signs of acceleration in recent years, and this has been an issue in not only the U.K. but also in Germany in terms of insurer solvency. The actuarial profession I'm afraid has been playing catch-up in terms of dealing with the financial implications of improving mortality. Asset/liability management is becoming more sophisticated. We're seeing more interest-sensitive products. This is an area where I think Europe still has a good deal to learn from some of the techniques that have been developed in the U.S. over the last 15 years or more.

Another actuarial dimension is that new entrants and banks increasingly are prepared to price for relationship or lifetime value, which has not been a tradition in the insurance industry itself. Long-term care is an area that is not as yet significant, and there are actuarial challenges in terms of product design and pricing of that particular risk. Risk-based capital management is also an issue in Europe. As I will explain, the EU is dissatisfied with its present, fairly simplistic standards and may be moving towards adopting approaches that you would recognize from the U.S.

I was asked very briefly to touch on mutual recognition of qualifications in trying to build an internationally capable actuarial team in London. This is something with which I'm becoming familiar. The EU is making progress with mutual recognition of diplomas but perhaps more slowly than it would like or would be ideal from the point of view of the single market, and there's a concern that not all countries are playing the game. The U.K. certainly has been making it easy, for example, for French actuaries who are trained in a very different tradition to affiliate ultimately to the U.K. Institute. These are some of the dimensions in which the commission is anxious to see more transparency and better practice in terms of mutual recognition of diplomas.

I said I'd return to the demographic time bomb. This is a real issue, and I think it can be argued that this is a real potential threat ultimately to European unity. The proportion of the population 65 and over as a proportion of those age 15–64 and, therefore, presumed to be economically active, will rise significantly from 1990 to the year 2030. Germany is approaching 1 pensioner, effectively, for every 2 workers. Other countries are not too far behind with the exception of the Portuguese and the Irish, who have relatively younger populations than their European counterparts for a variety of reasons. This is a time bomb.

What provisions have been made so far in terms of creation of private pension funds? Only the U.K., Denmark, the Netherlands, and Switzerland have done so.

There exists a significant private pension sector. In Germany, Belgium, France, Italy, Portugal, and Spain the private pension provision has been virtually nil to speak of. Merrill Lynch has done very useful research in this area to show the capitalized value of the liabilities that have effectively been accumulated by the U.K., Denmark, the Netherlands, and Switzerland. They're very significant relative to any explicit national debt at present. And it's the differential impact of this issue across countries that arguably is a real threat to European unity.

The solution is not obvious and indeed is an issue for each country to find for itself, but what the European Commission has been trying to do is to harmonize the regime for pension provision across Europe. Pensions are certainly the last major area of financial services that haven't been addressed in terms of European thinking or legislation, and the commission is proposing a plan that would address issues of prudential supervision of pension funds, the removal of obstacles to labor mobility within Europe in terms of systems for acquisition of pension rights, and perhaps ultimately some greater coordination of pension tax systems. There's quite a variation in practice as I suspect Godfrey's going to enlarge upon.

Within the last few weeks Commissioner Mario Monti, who I suspect is not going to be commissioner for too much longer, has published what I think is an important plan for acceleration of the development of the single market. It seems to be gaining support for this in the European financial services industry. I won't go through the plan in detail, but it consists of a number of elements, one addressed at wholesale markets in terms of integrating the EU capital market because it's recognized that without the removal of obstacles to integration there won't be a capital market in Euro of anything like the depth and quality that the dollar market represents here in the U.S.

The second element of the plan is open and secure retail markets to facilitate in the Euro environment consumer purchasing across borders and a common regime of consumer protection across Europe. The third element of the plan is to improve the art of supervision of the financial sector across Europe. I won't steal Andrew's thunder by enlarging too much on this, but I'm sure we would agree that there's plenty of room for bringing the level up to what we in the U.K. would feel is something close to state-of-the-art. And a particular issue there, which you may come back to, is the question of solvency margins for insurers. The fourth element of this plan, and the one that I think the U.K. has the greatest difficulty with, is a common regime of taxation. Here in the U.S. you probably understand better than we do in Europe the limits on the extent to which taxes can differ between, for example, individual states here and in Europe between individual countries. We have had the opportunity to work with clients from the U.S. and elsewhere who are looking at the potential benefits of the single European market, and we've

learned some lessons in working with clients. Some strategies definitely appear to us to have the potential to work better than others. We believe it's important in thinking about Europe to be very clear what you bring to the table. Your balance sheet isn't enough. What really is the competency that you can export to Europe in the area of asset management, products, operations, and information technology? There are real competencies in these areas, but it does need to be thought through quite carefully.

It is important to understand what Europe is and is not and the pace at which it's moving, at least to seek to understand it. None of us can predict the future, but that has a definite influence on how you should try to configure operations in terms of what should be backstage. What can really be on a Europe-wide basis? And what has to be front-of-house and oriented towards the different national markets? We believe it's important to develop options for both acquisition and organic development and to think carefully about the strategies in those areas. The big risk is actually acquiring too small, which is a waste of time. You can't really cross a chasm in two leaps. But we also encourage clients to be patient. Europe is a work-in-progress and is going to take some more time.

**Mr. Andrew Chamberlain:** I'm going to take you through one of the practical things essentially happening just at the moment in the EU, and it's all about "98/78/EC." As somebody from Britain, I always find the American way of talking about major pieces of legislation by the names of the congressman or senators or whoever sponsored it very, very confusing. However, it's very easy compared with trying to remember what 98/78/EC might be. Indeed, what is a European directive? What is it all about? What does it do? And how does it do it? The battle becomes a little bit clearer as we go on.

What are European directives? Well, first of all, they're a type of legislation. That's the easy bit. They're proposed by the European Commission. That is a body which is sometimes rather incorrectly described as the European Civil Service because it's headed by political figures nominated by their governments who hold office for a period. It is the central core of the administration of Europe. It's approved by the European Parliament, which is directly elected by the people of Europe, and it's approved by the council of ministers, which is basically each of the different countries having a weighted vote in a council with one minister there per country. A directive typically mandates some sort of action on member states. It does not usually become automatic law. It must be implemented by each of those member states. The significance of that will become clearer as we go on.

So what is directive 98/78/EC? It has this marvelous description: "a supplementary supervision of insurance undertakings in an insurance group." It sounds fairly

innocuous and awfully boring, but it's going to have some tremendous implications. Particularly, it may have very significant implications to any non-European insurer who decides that it wants to run a European insurer. What can I say about it? Well, it is supplementary. It adds supervision where there is a supervised insurer. It doesn't attempt to supervise bodies that are not already supervised. At least that's what it says. Some of the effects might appear differently. It is supervision of the insurance undertaking in the EU itself, and it does look roughly at the whole group that the insurer belongs to.

What does this piece of legislation do? Well, first, it empowers and requires the regulator of the insurer to consider its group. Now, just a piece of information for those of you who are not that familiar with Europe. Under what is called the third directive of the insurance we have something called home state supervision. That means that a direct insurer who is authorized to write insurance business in his or her home state and is supervised in that home state and subject to a few small formalities can do business throughout the EU. So it has one regulator no matter how many countries it may be operating in.

Second, the directive provides for the insurer to give necessary information on related companies. It places an obligation on them. Now, this is something that's familiar in the U.S. context where U.S. companies are often obliged to give information on related companies elsewhere in the world. This is slightly newer in the European context and very new in a U.K. context. The directive goes on to provide powers to verify the information. This isn't quite European regulators traipsing around the world checking up on related companies, but there are various methods of verification included. Finally, the directive provides for regulators to cooperate. There is certainly a high degree of cooperation between regulators in the EU, but this also provides certain cross-sector cooperation as well as wider cooperation between regulators of two separate insurance companies in the same group in the EU.

How does this directive set about achieving its objectives of this wider group supervision? The first area is a series of measures on the supervision of connected party transactions. These connected party transactions can be anything, whether it be loans, mutual guarantees, cross-investments, cross-reinsurance, or cost-sharing agreements. Now, this could have very wide implications on various forms of financing that were designed to create capital out of nothing. Many of these may cease to operate. And it provides for an annual report to be produced by the insurer on all such transactions. I would suggest that nothing in the context of EU legislation is complete without having to produce some sort of annual report. There's also a group solvency test. It includes within the group external insurers outside the EU applying EU standards of solvency. It moves up to insurance

holding companies. You keep moving upwards until insurance is no longer dominant in the group. When I was studying this, this gave me great relief because some of the companies I look after are ultimately owned by General Electric here in the U.S., and I thought if I had to go all the way up to the top of General Electric trying to look at the solvency as if they were a European insurance company, I would have to resign.

Let's give a bit more focus to this group solvency test because I think it's the part that will have the most significant implication for any U.S. insurer with a European subsidiary. The test is designed to eliminate double counting of capital. I don't think anything is very controversial there. It applies European standards to all insurers in the group. The reserving standards for life assurance in particular are generally fairly conservative throughout Europe. They're modeled on what I will call the U.K. and Irish system, the Irish having inherited it from us when they left us, but it's basically a fairly prudent reserving standard. It's not applied quite so prudently at the moment by all the EU states, but it's moving in that direction. There is a tier of solvency capital on top, some of which is certainly double counting. Some of the measures just simply don't exist that ought to exist, so it's a bit of a mixture. It brings reinsurers in the group into the same test, which in the U.K. they largely are anyway, but in the rest of the Europe they largely are not.

There is a marvelous provision that says that the regulator of the European insurer can accept comparable requirements of non-European Economic Area countries for a subsidiary. Don't ask me what that means. I haven't the slightest idea what it means. This is something that will probably become a feature of different states because there is no clear indication in the directive as to what "comparable" may mean. At one end it may mean the same. At the other end it may mean we trust the regime in the alternative country. I think that at the moment it looks as if it's going to be a matter for this implementation phase where each member state puts it into their local law. This may vary across countries. And there are three different methods for conducting this group solvency test. The member state may choose which one to apply. They all look as if they ought to be the same, but by the time different accounting practices have been applied they could have quite radically different effects, or so the experts tell me.

Let me give a very brief run-through of what this particular directive is and speculate a little bit more on what it might mean. It could mean that it actually makes a real difference where a group from outside Europe actually chooses to establish its subsidiary for operating in Europe because different members states may implement some of these provisions in quite different ways. It will make comparatively little difference when you look downwards to subsidiaries of a European insurer set up in several of the states. If you have sister companies under a common holding

company that are operating in different parts of the world, things start to get rather more difficult, and all you need to trigger the effects of this directive is to have one direct writing insurer within this particular group. Now, there are a number of groups that are predominantly reinsurance groups, including some very, very big ones who thought they were all outside the regulatory net, but they have one subsidiary operating somewhere in Europe that is a direct writer to the public, and that brings them within the orbit of this piece of legislation.

No one knows yet what member states will do about publishing the information they receive. Most of the information that's received in the U.K. by the regulator is placed on the public record. Will this supplementary information be on the public record? It hasn't been decided. Will other states put it on the public record? Pure guesswork. If some do and some don't, will this actually give a competitive advantage to the group that establishes itself in Country A against Country B? Who knows? Of course, how long would that advantage last anyway? When the European Commission sees it's being implemented in different ways, all of which may be actually within the letter of the directive, they're almost duty-bound to come forward with some sort of revised directive that's designed to eliminate those differences.

Finally, I can't resist the challenge that was cast down at me as to why the U.K. is generally skeptical about Europe. I thought Seamus actually answered a lot of that during his presentation when he talked about the financial services industry and showed why some of the things that go on in Europe aren't exactly popular. Things like the support ratio and so forth also give concern. Also, when it comes to these European directives the U.K., I think, is something like second or thereabouts in Europe at the efficiency in implementing them. The French, if they get a directive they don't like, tend to forget about it. The British don't do that. We play the game according to the rules, so we implement it in full.

But I think there's another slight reason why at the moment Europe's not that popular. We heard Stuart Varney's keynote speech about the U.S. economy and how vibrant it is. A lot of statistics were quoted about Western Europe, unemployment rates, and various other economic factors. How many times did he mention the U.K.? He didn't. Why? Because although we're not quite motoring at the pace of the U.S. economy, the U.K. economy has more in common with the U.S. economy at the moment than with the rest of Western Europe, and that's been true probably since World War I. There's a saying that if Wall Street sneezes, London catches cold. Well, the reverse is true to a certain extent as well. When Wall Street is buoyant, London does pretty well too, and the U.S. and U.K. economies still walk very much more in line than the U.K. and the rest of Western

Europe. So, we aren't saying anything too controversial. I hope that gives you some of the answers to Seamus' question.

**Mr. Godfrey Perrott:** I'll try to address some of the last pieces that Seamus and Andrew haven't covered. As Seamus said, Asia, North America, and Europe have similar sized life insurance premiums. For the rest of the world, the percentage is much smaller. When you look at Europe it is totally dominated by the EU. Outside the EU, it's almost entirely Switzerland.

France is the dominant or the largest life premium. I should note that these are primarily what we would think of as statutory premiums in the U.S. France is so large because its annuity-type products introduce some bias. If you look at Eastern Europe, Russia is the largest, which is no surprise, but after you go to Poland, Czechoslovakia, and Hungary, it gets very small indeed.

What is the Euro? Most of you by now know what it is. It was introduced as a concept on January 1, 1999. You can get Euro-denominated credit cards. It locks all of the exchange rates among the participating countries. But there are no coins. There are no banknotes. And that will go on for three years, which strikes me as an awfully long transition, but I guess it's going to take the different countries three years to decide on how to design banknotes. It has some interesting connotations which I'll get into in a minute for debt financing, and this connects to taxation of life insurance. It hasn't had any direct effect on life insurance markets yet, although interest rates have converged, which raises other interesting issues. Seamus and Andrew both talked about tax unification and how different countries don't like it, but it's something that will happen. On the other hand, tax unification in the U.S. is not nearly as homogeneous as people tend to think.

I used to live in Washington, and the state of Washington had a 9% sales tax and no income tax. The state of Oregon had zero sales tax and had an income tax equal to about 10% of federal income tax. Yet it really didn't seem to do that much across the border. There were certainly people living on the Oregon border that would buy their groceries in Oregon, and there were people working in Portland that would live across the border in Washington, but it didn't really have that much effect.

One of the concepts of Europe driving from the Euro is cross-border distribution, and there was a lot of talk when Directive 3 was produced, but in reality very little has happened and I think the reason is obvious. Seamus commented that people from Hanover would not buy policies from people from Bavaria. If the Germans will not buy policies inside Germany, they're even less likely to buy policies outside of Germany. So, there is a significant cultural barrier. There still is a language

barrier. We joke that England and the U.S. are separated by a common language, but the different EU states are far more separated by uncommon languages. Law and bureaucracy are different in different countries, and, in particular, insurance is largely, but not entirely, governed by commercial law or contract law, which again is almost entirely case law. In theory all you have to do is codify the law and then you'll have a uniform law across countries, but all you have to do is look at any state legislature or Washington and see what happens when you go to codify the law. You basically open it up. Everyone sits down at the poker game and starts playing, and it takes a very long time with a lot of lobbying.

I think Seamus has already commented that tax and social security are not harmonized. In particular, social security is very different. There have been some niche markets that really are transborder. High net-worth individuals are much more cosmopolitan than the main markets, and multinationals obviously are looking to shop in one place. One of the results of the Euro, and its very dramatic if you look at it over time, has been harmonization of interest rates and, in effect, general reduction of interest rates. The Euro rate right now is about 4%, which is even lower than the U.S. rates. The smaller countries and the southern countries historically have had higher inflation and higher interest rates. Spain, for example, has 6% guarantees in what is in effect a 4% market. The French, being pragmatic, just changed the guarantees on new money which helps some, but the old money is still rolling over.

The U.K. has had an experience that I don't believe we've run into in the U.S. yet, but I think we will, which is that the old annuity guarantees that all of us were convinced were so awful that no one would ever exercise them are starting to become real guarantees. Interest rates have come down to where a 3.5% guarantee is not that bad, and mortality has dropped so dramatically that the mortality guarantees 20 years ago on annuities are very dangerous today. We believe that that's been a major driver for some of the demutualizations in the U.K. Europe, by and large, does not have guarantee funds as is typical in the U.S., so if companies become insolvent, everyone starts pointing fingers, and there's no automatic mechanism to take care of the policyholders. My colleague in London asserted, and then I'll let Andrew reply or rebut, that the regulators are concerned, but very little action has occurred.

What's happening with asset strategies? Unit-linked policies, which have been very common in the U.K. and had much earlier and greater penetration than variable has had in the U.S., are spreading to countries where they traditionally were not popular. Unit-linked policies are essentially very similar to variable policies. They're not identical, but they're close enough to think of them that way. Some of the strong companies, which is I think interesting from a U.S. perspective, are

looking to mismatch by investing in equities to back fixed-interest contracts, and the Europeans in general are, I think, significantly behind the U.S. in the use of derivatives either to enhance yield or enhance duration.

One of the questions that Mike had raised was privatization. There have been two privatizations in France, and one in Poland.

There are also privatizations in such notable insurance capitals as Croatia and Egypt. Even though we're talking about primarily the EU, several countries in Eastern Europe, particularly Poland, Czech, and Hungary, are approaching EU standards and will probably be part of the EU in the near future. Interestingly enough, in the Polish market, CU, which is now CGU, is the second-largest player, and Poland is their largest market outside the U.K. They have made a niche of developing there. The Czech market has some problems.

**Mr. Chamberlain:** In the U.K. we don't have guarantee funds, but there is a scheme for protecting policyholders that would give them at least 90% of the value of their policies, and it's financed by a levy against insurance companies as and when necessary. The scheme was brought in about 25 years ago, and there's been 1 very small levy in respect to life insurance in the whole time of it. There is a protection scheme if it ever became necessary.