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An Introduction to the Polish American Market

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Author's Note: In the decade since the demolition of the Berlin Wall and the collapse of the hard-line authoritarian regimes of Eastern and Central Europe, there has been a complete rewriting of the political, social and economic landscapes in these countries that would not have been possible 10 years ago. Not all countries have grown in the same way, and many started from different points in terms of economic development. Generally those countries closest to Western Europe had the most developed economies (e.g., Hungary, the Czech Republic), and those furthest had the least developed economies (e.g., Bulgaria, Belarus).

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Perhaps the most interesting of these countries is Poland, due to its size and the rapid developments of its insurance and pensions markets in the past decade. Poland may be viewed as a development template that other Eastern and Central European countries might follow.

Background

Poland is a parliamentary democracy with a population of just under 40 million people, covering an area of just over 300,000 square kilometres. Gross Domestic Product (on a purchasing power parity basis) is approximately US$330 billion or US$8,500 per head (compared with Bulgaria US$6,200, Czech Republic US$12,900 and USA US$36,200). Real economic growth has been steady since 1992, averaging about 5% a year—the best in the region. Annual consumer price inflation declined from an annual rate of over 30% in the mid 1990s to around 5% today. Similarly short-term interest rates declined from over 25% in the mid 1990s to around 13% today. The Polish currency is the Zloty (symbol PLN), which is fully convertible for trade purposes. The Zloty has declined considerably against the dollar in recent years, from around 2.27 PLN per U.S. dollar in 1994 to around 4.00 PLN per US dollar at the end of 2001.

The Polish economy remains diversified, with industry as the largest contributor, representing approximately 25% of GDP. In terms of employment, the largest sectors are agriculture and industry, each with about 25% of the workforce. The total workforce is approximately 17 million, with unemployment at about 16%. Poland's main imports and exports are manufactured goods and machinery and transport equipment. Its largest trading partner, by a considerable distance, is Germany with its former major trading partner, Russia, a long way behind.

Poland's population has increased by over 90% since the Second World War, however the rate of growth has slowed considerably in recent years and may now be slightly negative. The population, like that of many European countries, is aging, with approximately 25% of the population under age 18, 25% aged 65 or over, and 50% between ages 18 and 64. Average life expectancy at birth has shown slow, but consistent, improvement over the last 50 years, with current life expectancy at approximately 70 years for men and 78 for women.

Economic Liberalisation

Poland has moved from being an authoritarian regime to a liberal democracy, whilst pursuing a policy of liberalising the economy, with no major problems. Privatisation of small and medium-sized companies has lead to the development of a vibrant private sector. The two main concerns of Poland's post-communist governments have been to ensure security and to modernise the economy through integration with the rest of Europe, and the European Union (EU) in particular. The first of these aims was, at least partially, achieved in March 1999, when Poland, along with Hungary and the Czech Republic, was granted full membership in the North Atlantic Treaty Organization (NATO).

Membership in the EU took longer to negotiate and is having more direct impact on the individual lives of Poles and on the Polish insurance industry. Entry into the EU is expected around 2004. The perceived benefits of membership are unrestricted capital flow, unrestricted movement of labour, and aid in restructuring the economy, particularly reducing the agricultural share of GDP. The popularity of membership has declined recently, due in part to the suggestion that there should be a transitional restrictive arrangement regarding the mobility of labour and also because of the threat of unrestricted foreign purchasing of land.

Life Insurance Industry

The insurance industry in Poland is currently regulated by a quasi-independent body, the Panstwowy Urzad Nadzoru Ubezpieczen (State Office for Insurance Supervision), which generally conforms to EU-style regulation. But it is proposed that the Insurance Supervision merge with the Pension Funds and Banking Supervision to create a single body for Supervision of Financial Institutions. All insurance companies in Poland must now be either joint stock companies or mutuals, and there must be a separate capitalisation of life and non-life companies, not just a separation of funds. Polish insurance laws have been largely based on EU regulations in preparation for Poland's entry into the EU.

Poland's Insurance Law of 1990 allowed the establishment of 100% foreign-owned insurance companies. In January 1999, the market was opened up to foreign insurers' branch operations. Branches require a licence from the finance ministry and must deposit half the minimum capital requirement required for Polish insurers to cover future obligations. Funds at least equal to the solvency margin corresponding to business transacted in Poland must be kept in Poland.

Insurance was a state monopoly until 1988 with two companies, PZU and Warta, providing all insurance cover based on a Soviet model. PZU provided domestic insurance cover and Warta covered hard currency business and reinsurance. The insurance monopoly was broken before the general liberalisation of the economy.

The Polish life insurance market grew rapidly during the 1990s, at over 20% a year, resulting from increasing disposable income, the need for financial security, more innovative and attractive products, and better marketing techniques. Penetration remains low with a life insurance penetration of less than 1% compared with an EU average of 4% and penetration of 10% in the U.K., the highest in the EU. The Polish insurance market remains small in international terms; estimated life premium income for 2000 was PLN 8.3 billion[1]. However, compared with other Eastern European markets, Poland is the second-largest market after Russia for both life and non-life insurance. The life insurance market comprises approximately 25 companies including one mutual. The largest life insurance company is PZU Zycie, a subsidiary of PZU with a new business market share of over 50%. The next three largest insurers are Commercial Union Zycie, Nationale-Nederlanden Polska, and Amplico Life (AIG): all are foreign-owned and specialise in selling individual unit-linked life insurance contracts. The four companies account for over 90% of the market.

PZU dominates the market. It has a good range of products, a high level of expertise, it continues to have excellent links with state-owned industry and stoutly defends its market position. One reason for its continued market dominance was the mistaken view that PZU had a state guarantee. PZU's expansion was hindered by a low level of solvency. In 1991, PZU was transformed into a joint stock company wholly owned by the state Treasury. There were several attempts to privatise PZU, but political considerations hampered them. The primary reasons for privatisation were to reduce the state involvement in the insurance market and to increase PZU's level of solvency.

Table 1

TOTAL PREMIUM MARKET SHARE OF POLAND'S LIFE INSURANCE COMPANIES (BASED ON SIX MONTHS 2001)

PZU Zycie	53%
CU Zycie	19%
Nationale Nederlanden	11%
Amplico (AIG)	10%
Allianz Zycie	1%
Zurich	1%
Ergo Hestia	1%
Warta Vita	1%
Others 1%	

In 1999, the Treasury invited bids for a 30% stake in PZU, and several major international insurers from Europe and the US expressed interest. The 30% stake was bought by a consortium lead by Eureko, a Pan European insurer. The 30% stake cost approximately PLN 3 billion. In October 2001, Eureko thought it had reached agreement with the Polish government to buy an additional 21% share in PZU, giving it a 51% stake, with plans to float PZU by the end of 2002. However, as of mid January 2002, that deal was not finalised and was still being discussed by Eureko and the government.

Commercial Union Zycie was set up in 1991 and has grown rapidly to become the second-largest life insurer in the market with over one million policies in force. The vast majority of the company's business is in individual unit-linked contracts, where it has a new business market share of over 50%. The company (as will be discussed later) is also the leading private pensions provider. It has over 6,500 active agents and more than 70 branches and representative offices. The company also sells some bancassurance through two banks: BZ WBK and BPH. Nationale Nederlanden, the third-largest life insurer in Poland, has 4,000 tied agents and sells both endowments and unit-linked policies. It has a potential for bancassurance development through Bank Slaski, one of the larger Polish banks, which is controlled by ING. Amplico Life, owned by AIG, was set up in 1990 and also specialises in individual unit-linked life business.

There is no domestic market for life reinsurance in Poland. Sums assured are generally small and most new business is unit-linked. The total life reinsurance premiums are approximately 2% of the direct market.

Distribution in Poland is dominated by company branch networks and tied agents. PZU has the largest and most widespread network, but it also works through independent agents and brokers. The overall volume of broker-generated life insurance business is limited, but growing.

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[1] PLN 1 billion equals approximately 250 million U.S. dollars and 285 million Euros.

Bancassurance, so far, has not been successful in Poland. Generally there has been a clash of cultures between banks and insurers when insurers try to sell products through bank networks. It is highly likely that further attempts at running different variants of bancassurance will be tried. Direct marketing was recently introduced into the Polish market, but it is too early to measure its success. Television and radio advertising is used to sell life and personal lines of insurance with some success.

A wide range of protection products are sold in Poland. These are used, amongst other things, for loan protection. There is little demand for mortgage loan protection, as few houses are bought or sold, due to high interest rates. Term assurance accounts for about 4% of life insurance sales. With-profit endowments are a traditional savings vehicle and are still offered by some domestic insurers.

The market for unit-linked individual life insurance is growing rapidly, as people seek a haven for their savings, offering real returns and products with a greater transparency than traditional with-profits products. There are no tax incentives to encourage the purchase of insurance investment products. Foreign life insurers have dominated the unit-linked market due to superior products and marketing, high levels of service and a greater reputation for financial strength than many local companies. The unit-linked products are typically front-loaded with about three to five investment fund choices.

Pensions Marketplace

Poland, like many countries, is attempting to roll back the state's involvement in pension provision and to encourage private pension provision. Poland has undertaken wholesale reform of the pension system and its funding. A pillar pension structure was introduced in April 1999. The state will continue to provide a state pension (Pillar I), but has introduced the private sector to provide funded pensions on a compulsory basis (Pillar II) as well as on a voluntary basis (Pillar III).

Membership in the new Pillar II scheme is mandatory for workers born after 1967 (comprising about 1.5 million workers), optional for those born between 1948 and 1967, and not available to those born before 1948. Members of the Pillar II pension can choose which Compulsory Open Pension Fund (COPF) they will belong to.

The contributions for Pillar I and II pensions are collected through the Social Insurance Institute (ZUS). ZUS's systems proved inadequate to the task of setting up 13 million accounts to record employees' contributions and seven million accounts for pensioners. The full implementation of the Pillar II pensions was delayed for several months due to ZUS's administrative shortcomings.

To manage a COPF, a specialist pension company, called a PTE, needs to be formed. Licences for PTEs also allow Pillar III pensions to be written. For commencement of operations in 1999, 21 PTE licenses were granted. The leading insurance companies in the market either applied for licenses themselves or formed joint ventures with banks. Only one licence was allowed per insurer. Competition was fierce for business, and by the end of 1999, 9.3 million people had signed up for COPFs, with CU and PZU being the two largest providers, with 1.9 million and 1.7 million members, respectively.

The CU PTE (which is owned 50% by CU Zycie, 30% by CGNU, and 20% by two Polish banks, BZ WBK and BPH) is the most successful PTE company. The banks give the company considerable additional distribution flexibility. The merger of CU with Norwich Union in early 2000 required that Norwich Union's PTE operation be sold, as insurers are only allowed to own or partially own only one PTE company. The top five COPFs captured around two thirds of the whole Pillar II pension market.

Pillar II pensions are a success despite some initial problems with ZUS's administration systems. The market received a one-time boost with the introduction of Pillar II pensions, but is unlikely to substantially increase in terms of number of members. It is estimated that, to make a PTE company profitable, it needs 400,000 to 500,000 members to achieve economies of scale and recover its investment on items such as IT systems and distribution. Most PTE companies have not achieved this scale, and some will probably have to merge to maintain profitability and to retain members. So far, Pillar III pensions have had limited take up.

The Future

The Polish insurance market has shown considerable growth over recent years, which will likely continue as the economy grows and the life insurance market develops and increases its penetration. How PZU performs under its new ownership (regardless of whether Eureko obtains majority control) will likely dominate the future shape of the life market. The success of foreign insurers may encourage new entrants to the market and Poland may be used as regional base for existing insurers to increase their presence elsewhere in Eastern Europe. For example, Eureko and PZU have bid for Slovakia's top insurer, Slovenska Poistovna, and wish to expand into the Czech Republic and the Ukraine. Bancassurance will likely succeed to a greater degree, if the challenges of conflicting bank and insurance cultures can be overcome. The investment returns that companies can generate, and whether these are sufficient to provide adequate pensions, will ultimately determine the success of the PTEs and Pillar II pensions. In the short term, there is likely to be a degree of consolidation amongst PTE companies, as they attempt to generate economies of scale. □

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