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Life insurance in Europe – heading towards 1992

by Camilo Salazar

Traditionally, the European life insurance market has been characterized as complex, protective, and difficult to penetrate for foreign companies. However, recent developments within the European community, as 1992 approaches, are forcing a reevaluation of these concepts.

The European insurance market is not homogeneous. Differences in culture, language, economic history, and political environment have, over the years, shaped local insurance markets typical to each country.

In terms of size, the most important life insurance markets in Europe are England, France, Spain, Germany, and Italy. There are significant differences between these markets. England, for example, traditionally a more sophisticated financial center than any other country in Europe, has a more sophisticated life insurance market as well. Unit link products, approximately described as variable products, are well established in that market. Spain, on the other hand, has basically a pension-oriented life insurance market, both on an individual and a group basis, with whole life and endowments products that provide some kind of guaranteed income upon death or retirement. Life insurance companies in France compete directly with banks for life insurance and investment products premium. Term, credit life, and single premium investment products are common. Germany's products are basically somewhat complex participating endowment and whole life products.

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Competition, communication and cooperation

by David G. Hartman

(Ed note: Following are excerpts from the Presidential Address of David G. Hartman to the Casualty Actuarial Society Annual Meeting, November 9, 1988)

Earlier this year the CAS Constitution was amended to reflect a revised statement of purpose. It reads:

> The purpose of the Casualty Actuarial Society is to advance the body of knowledge of actuarial science in applications other than life insurance, to establish and maintain standards of qualifications for membership, to promote and maintain high standards of conduct and competence for the members, and to increase the awareness of actuarial science.

...During this past year there were two notable competitive events that occur only once every four years. They are the Games of the XXIV Olympiad in Calgary and Seoul and the U.S. presidential election. Unfortunately, the summer Olympic games will likely be remembered more for its scandals than for the triumphs and culminations of years of sacrifice, with personal best records for many participants. The presidential campaign has been one of the most negative ever, with personal attacks flying between George Bush and Michael Dukakis. The upcoming election on November 21 here in Canada has not been the most gentlemanly either.

As noted, one part of the purpose of the CAS is "to promote and maintain high standards of conduct and competence for the members." How

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Spotlight on the Centennial

Actuarial organizations hire PR firm to make most of celebration

As part of its ongoing efforts to increase the public profile of the actuarial profession, SOA has joined with four other actuarial organizations to publicize the 100th anniversary of the profession in North America.

The Task Force on the Promotion of the Centennial and the Role of the Actuary, composed of representatives from the AAA, CIA, CAS, CAPP, and SOA, has hired the public relations firm of Daniel J. Edelman, Inc., to attract the attention of the media and opinion leaders to the event. The Washington, D.C., office of this national firm will have responsibility for the Centennial account.

While the focus of the public relations efforts will be the Centennial Celebration meeting June 12-14 in Washington, D.C., the Task Force has approved a campaign to publicize the Centennial throughout the year.

Here are some highlights of the public relations campaign:

- The theme "Forecast 2000" will be used to unify Centennial events.
- To focus attention on news-making topics featuring traditional and nontraditional applications of actuarial science, four "Forecast 2000" Centennial forums will be held. Forum topics will be Health/Long Term Care (April, Miami); Investment and Asset Management (July, New York City); Pensions and Employee Benefits (September, Los Angeles); and Environmental Risk (October, Toronto).

In advance of these forums, actuaries specializing in these topic areas will be asked to answer opinion surveys on newsworthy trends in their specialties. Survey results will be distributed to reporters in the general and trade media. This approach will position actuaries as experts, stressing their involvement in policy-making. The variety of forum topics and sites will help reach different journalistic "beats" (such as investments and environmental) in different U.S. and Canadian regions.

- The Task Force on The Future of the Actuary/The Actuary of the Future will release its report at a press conference in the National Press Club in Washington, D.C., during the Centennial meeting. The report will focus journalists' attention on the many ways actuarial science can be utilized.

Kit Moore is chairperson of the Task Force. Other members are William Ferguson, George Morison, and Burt Jay. SOA Director of Communications Linda Delgadillo and AAA Director of Public Information Erich Parker also serve on the Task Force.

Life Insurance cont'd

In other countries, including Greece, Switzerland, and Portugal, the market offers basically endowment, whole life, term, and annuity products.

Characteristics common to products in almost all European countries are profit sharing and solvency margins. The profit-sharing concept is based on the financial profits in excess of the valuation interest rate generated by the assets supporting the reserves for a specific product. The application of this concept varies by country and product, but it can be defined in general terms as a policyholder participation on the excess yield over the valuation interest rate. The way this profit sharing is vested to the policyholder also varies.

Solvency margins are defined as assets of the company free of all foreseeable liabilities, less any intangible items such as paid-up share capital, statutory reserves and free reserves not corresponding to underwriting liabilities and any carry-forward of profits. Minimum solvency margin requirements are defined in terms of the mathematical reserves, gross, and net retained net amounts at risk.

Another contrast to U.S. practices is the modified treatment of reserves. In England, for instance, the prevalent method is the Zillmer reserve method, which modifies the net level reserves for each duration during the life of the policy by a percentage of the net amount at risk. France uses a different modification based on a modified net level premium, and in the prospective reserve formula, the factor for present-value-of-future-premiums is increased by a percentage, usually 9%. Some countries use net level reserves.

Europe is also referred to as a "tariff" market; that is the market is highly regulated, to the point that the government dictates for all companies the valuation basis (pricing mortality in some cases must be according to 100% of the prevailing population mortality table). The government also dictates the expense loading to be used, the commission levels, the profit sharing structure, and even the gross rates to be used for each kind of product. It means, for example, that if two companies sell a 10-year term product, the two products will be virtually identical with the same rates and commission scales. This structure leaves little room for flexibility and innovation. Some competition is introduced by allowing some flexibility as to how much profit sharing can be distributed to policyholders.

The degree of "tariffication" varies from country to country. In most European countries, the government tariff may stipulate valuation requirements in terms of mortality and interest rate to be used. In Germany, commission scales, expense loading, and profit sharing structure are submitted to the government for approval. In some countries, approval guidelines are so narrow that for all practical purposes it is a strict tariff with little flexibility. In France, the government tariff is very flexible, to the point that it does not seem to be a tariff country. In Denmark, the government tariff calls for uniform rates but allows market flexibility on bonus and profit sharing structure.

Also, the tax implication to the policyholder varies by country. In most countries life insurance premiums are partially tax deductible. Some countries also impose a value-added tax on life insurance premiums, and these tax rates vary from country to country.

Over the last few years, as world economies have become increasingly interconnected, economic pressures have been moving the European community toward general commercial standardization for goods and services among the different local markets to force more competition and enhance productivity. These changes and their future impact on the European life insurance industry undoubtedly represent opportunities for both European and non-European life insurance companies.

The goal is to achieve a truly European Common Market by December 31, 1992. It is a drive for economic unity among the member

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countries (Belgium, Denmark, France, Germany, Greece, Holland, Ireland, Italy, Luxembourg, Portugal, Spain, and the United Kingdom). The result could be a market of over 320 million consumers with commercial barriers completely eliminated or vastly reduced.

These changes are being implemented through several directives enacted by the Council of the European Communities. Once ratified by the European Parliament, these directives become law in each of the member countries.

This program for economic unification was launched in 1985. For the first three years, bickering and politics among governments hampered any substantial progress. Until recently, for example, almost all directives needed unanimous support in order to be adopted.

The turning point came in July 1987 when the member countries ratified the Single European Act, the first amendment to the Economic European Community (EEC) founding charter, the Treaty of Rome. This Act not only endorses the program for economic unity and a unified market but also establishes a system of majority voting on member states. This new rule removed a major roadblock and sparked the dramatic recent progress that virtually ensures most of the directives will become law in each member state as they are ratified by the European Parliament.

Two of these directives specifically address the insurance industry. The first directive deals with nonlife insurance business such as marine, aviation, and transport risks, credit and surety insurance, fire, general liability, property damage, and financial loss. Ratified in June 1988 and due to be fully in force by 1990, it allows cross-border trade in nonlife insurance for companies of a certain size and capacity. This directive could affect an estimated 70% to 80% of all nonlife insurance written in the European community.

The second directive deals with life insurance business and should be ratified and fully implemented by 1992. This directive deals with the "coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct life assurance." It affects life insurance products, annuity products, supplementary insurance coverages for both life insurance and investment products, noncancelable permanent health insurance products, capital redemption products, management of group pension funds, and other group insurance products.

The most important implication of this directive, as with the nonlife directive, is that any life insurance company licensed and headquartered in any of the 12 member states will be able to conduct business in any other member state via a representative agency or branch office. It allows a company properly licensed and headquartered in, say Spain, to sell life insurance products in Spain as well as the other 11 member countries, and possibly other European countries as well.

The concept of solvency margins is defined in this directive and is intended to place specific emphasis on the financial soundness of the operation to ensure the company's financial well-being. Technical reserves, including mathematical reserves, are to be determined according to rules fixed by the country in which the company is to be domiciled. These reserves are required to be covered, with a certain level of flexibility, by equivalent and matching assets localized in each country within the community where the company is conducting business.

The directive also prescribes rules and regulations for branches and agencies established within the European community of companies whose headquarters are not located within the community. Such companies must comply with solvency margins and guarantee funds requirements mentioned above according to the business being conducted in a specific country within the community, with the assets related to those amounts invested in the country.

The implications of the life insurance directive are far-reaching and its implementation raises some very serious issues. One of the most serious obstacles to successful implementation of not only this directive, but all the other directives as well, is how to harmonize the existing different tax structures of each country for goods and services. Life insurance premiums, for instance, have a 5.15% tax in France and 4.4% in Belgium but are not taxed in England and Holland. This inequality is even more pronounced on the general side where fire insurance in France is subject to a tax of 15% to 30% but is not taxed in England.

As mentioned previously, once a directive is approved by the European Council, it becomes law in all member countries, which in turn are responsible for implementation and enforcement.

The transition to this new world will not necessarily be smooth. Increasingly, consumer groups, companies and institutions are complaining to the European Parliament about the lack of compliance by some countries with directives already approved and endorsed by these countries. The vested interest of some countries in delaying implementation or enforcement to protect domestic interests is clear if we look, for example, at the specific situation of premium taxes for life insurance business. England, which imposes no tax, would be reluctant to impose a 5.15% premium tax, as in France, because it would make life insurance more expensive for the consumer. At the same time, France would probably be reluctant to eliminate the premium tax, as in England, and give up 5.15% in tax revenue, unless it can be compensated elsewhere. This very issue will have to be resolved when the directive for life insurance is taken up by the European Parliament for debate and approval.

Change is imminent although most likely not at the speed envisioned by the Europern Parliament. It is unrealistic to think that many decades of protectionism practiced in some degree by most European countries will be eliminated or vastly reduced within four years. Recent developments already hint at a "scaling-down" of some of the provisions of the life insurance directive in recognition of the fact that perhaps change is occurring too fast. The life insurance industry, like many other industries, will have to adapt to this change and recognize new opportunities. Competition from abroad will intensify in countries that have known little of it in the past. At the same time, these foreign competitors will have to learn to operate in a market long ignored.

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