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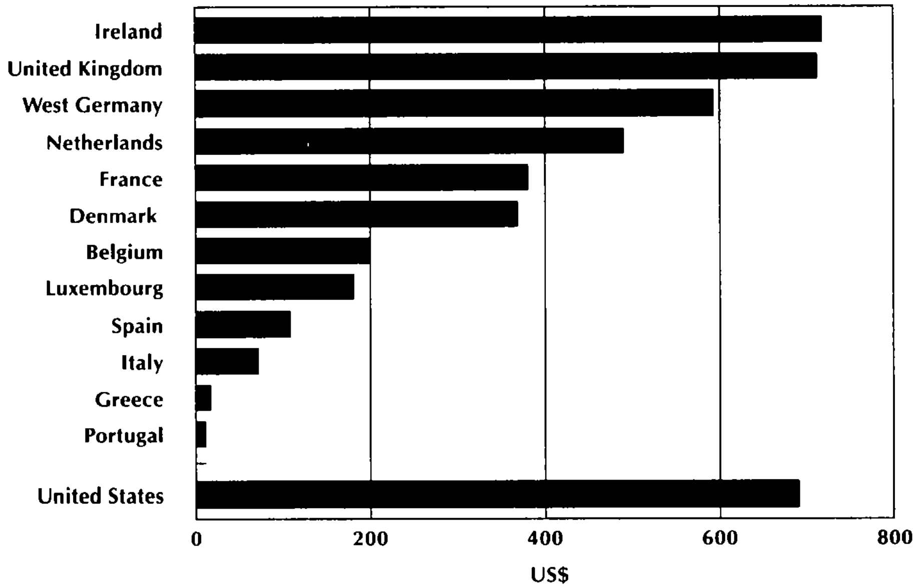
The impact of 1992 on life insurance in the European market

by Alan Lockie

Life Premiums Per Head of Population 1987



The passage of the Single Europe Act with the aim of introducing a true common market across the European Community (EC) by December 31, 1992, has prompted much activity and strategic rethinking among many companies within and without Europe. The life insurance industry has been no exception to this, and the past year or two has seen a significant number of changes in ownership, joint venture agreements, and new company developments.

The basic concept of 1992 is that any organization within the European Community will be able to sell its goods or services in any other Community countries without being subject to unnecessary tariffs, taxes or restrictions in the country in which it is selling. However, while the will to introduce such freedom is there, it is particularly difficult to determine how such a system should operate. Therefore, while it is likely that December 31, 1992, will see genuine freedom of management for most physical goods across Europe, it is unlikely that many retail financial services, life insurance in particular, will see a genuine freedom by then.

Currently, any Community company has the right to establish a life insurance company in any other Community country subject to the local rules for establishment and control of business. While most rules for establishment are common across Europe, thanks to the 1979 Freedom of Establishment Directive, local rules in each market can differ widely. While U.S. companies dealing with 50 states would consider dealing with just 12 countries fairly easy, the difference in regulation across the Community is much wider than that within the United States. Countries such as the United Kingdom, Ireland, and the Netherlands have fairly liberal supervisory regimes, which are unconcerned with the nature of the insurance contract but which examine reserves held by companies to ensure they remain solvent. Countries such as Germany or Italy have an opposite practice that centrally determines the policy terms, conditions and premium rates so there is little or no difference between policies sold by various companies. For example, all life insurance policies in Germany are the same at issue, and companies compete on the level of bonus (dividend) returned to policyholders. Which system offers the better combination of consumer protection and value for money is a matter of debate. The difficulty of reconciling such opposite viewpoints into a workable, and politically acceptable, format slows progress toward the necessary legislation.

Currently, the main proposal is the draft First Life Services Directive. The main thrust of this relatively unambitious document is to establish the concept of freedom to accept "own initiative" business. This directive would allow a company to accept business from residents of other EC countries only if such residents seek the business on their own initiative. Most people realize this will be a rare event, and given that the draft directive also limits the ability of companies to advertise across borders, not much "own initiative" business is expected.

The concept of 1992 has become a hot topic for European companies, engendering activity either in anticipation of conducting business across borders or as a defensive measure. However, even when true freedom of service emerges, a number of difficulties would face any company wishing to sell in a different country. The prime difficulty is the need to secure an effective distribution channel enabling companies to sell their products elsewhere. With Europe's diversity of cultures and languages, it would be unrealistic for a company based in Denmark, for example, to expect to sell to people in Greece using Copenhagen as a base. Therefore, companies have sought distribution channels in each country by several means: acquiring existing companies; entering into joint venture agreements with existing life (or general) insurers; or establishing new companies. Also, the nature of many of Europe's capital markets can make it difficult to purchase a company outright on the open market, and often a different approach is adopted. Many Europeans are comfortable with taking cross shareholdings between companies and developing a relationship with each other. These relationships are used to exchange ideas and provide training for each other's staff. Many believe that such joint ventures and cross shareholdings will lead to a much more uniform European market for life insurance.

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European market cont'd

In the light of this activity, what have been the most popular countries for new ventures? The graph shows the relative premiums per head of population throughout the EC countries in 1987 (the latest year available) and, for comparison, the same figure for the United States. These figures indicate that life insurance has yet to make its mark in Southern European countries. Interestingly, recent years have seen substantial growth in life insurance business within these countries, which indicates the vast gulf between south and north in this respect only a short while ago.

This relative lack of penetration within the Mediterranean countries has prompted many people to seek to establish or to acquire companies there. However, the current cost of acquisitions is high, and the quality of the remaining targets is not necessarily in accordance with the prices demanded. It also is important to note the relative level of social security within each country and the relative attractions of alternative means of saving, short or long term. Markets where life insurance is subject to strict control may not offer the best prospects for new entrants seeking to do something different.

So where do the market opportunities lie? Undoubtedly, many EC markets are open to new entrants. Such entrants may succeed if they bring with them new product ideas, marketing skills, sales training, and information technology knowledge.

Perhaps the long-term impact of 1992 will be to produce two types of life insurance companies. The first would be the large multinational with establishments of some form in most if not all EC countries selling products locally and across borders where appropriate. The other type would be the small niche player providing a specialty product, possibly using a specialist distribution network in a relatively small area. The companies likely to fail are medium-sized national insurers, too large to consider themselves niche players but too small to expand into Europe. The management of such companies may seek to protect themselves by acquisition, merger or offering their companies for sale. The competitive restructuring continues to escalate.

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The cost of environmental risks

by Margaret Wilkinson Tiller

Environmental issues are often in the news these days. Issues range from what should be cleaned up, to which clean-up method is appropriate, to who will bear the clean-up cost. Actuaries should be aware of environmental issues, how these issues influence actuaries' financial estimates, and how actuaries can help make informed decisions on environmental issues.

The exposure

Environmental risks are everywhere. Humans are part of the ecological community and are constantly interacting with it by our very presence. Every decision we make (or refuse to make) affects the environment. Even a seemingly innocuous decision to buy a book affects how much paper a paper mill produces, which in turn may cause additional air and water problems.

For this article, all environmental risks are assigned to one of three categories: occupation, local environment, and substance abuse.

Occupational environmental risks are job-related. They can range from "sick office syndrome" for office workers, to chemical exposure in manufacturing plants, to air pollution exposure for road maintenance workers.

Environmental risks associated with the local environment surround us where we live. This category includes exposure to hazardous waste dumps, air pollution from local plants, and radioactive fallout from a nuclear accident.

In the third category of substance abuse, the primary example is cigarette smoking, which affects not only smokers but those around the smoker.

The first step in any environmental risk assessment is to determine what the exposures are for the particular situation. This is usually done by an environmental risk consultant who draws on engineering and risk-management expertise.

An exposure analysis determines to the extent possible the following:

- what can be harmed,
- any conditions or situations that can cause or increase the chance of harm (hazards), and
- any active causes of loss (perils).

Consider the situation of an underground tank containing a petroleum product. One thing subject to harm is the water table under the tank (the what). The age and physical condition of the tank are factors that affect the chance of a loss (hazards). The active causes of loss include a tank leak (peril).

The second step in an environmental risk assessment is to determine to the extent possible whether any potential problems have already occurred. For both potential and current problems, the alternatives are explored, and the "best" solution(s) selected.

The cost

To help determine which alternatives are most reasonable, cost estimates should be considered. In addition to dollar costs, there are other parameters that are difficult to estimate on a dollar scale, such as the quality of life.

Occupation – The direct cost of occupational exposures is often handled through workers compensation insurance. Occupational exposures also can be handled by other means, such as office retrofitting.

Workers compensation costs are part of the employer's cost of doing business. As such, they are passed on to consumers of the employer's products or services. Occupational exposures also may indirectly affect other types of insurance, such as life insurance. If lifespans are shortened because of occupational exposure, life insurance claims may be paid out sooner than anticipated.

Local environment – Most big environmental risk news stories center around local environmental risks. Chemical wastes in particular can be a great health hazard, are costly to clean up, and can result in large liability costs and indirect costs. Indirect costs include decreased housing values, increased use of medical insurance, and reduction in lifespan.

Current regulatory mechanisms, such as Superfund, are probably inadequate to meet the costs of abandoned hazardous waste sites. Addi-

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