

prior approval rate system for the first time in California, the repeal of the exemption of the insurance industry from the State antitrust and unfair business practice laws, the extending of the ability to form risk retention groups to insureds with diverse (as opposed to similar) risks, the permitting of California banks to sell insurance, the providing for an elected as opposed to appointed Insurance Commissioner, and the restricting of the ability of insurers to cancel or nonrenew auto insurance. When one studies the specifics of this proposition, the thought comes to mind that it may not only be a result of the aforementioned triumvirate, but it may well be in retribution for them.

In any event, the confluence of all of these phenomena within a short period of time and in the order in which they occurred does provide food for thought. As stated at the outset, many of these hypotheses are just that and not conclusions. I think, however, that these issues are worthy of thought in view of the severity of the bottom line of the schematic and keeping in mind the words of George Santayana that: "Those who do not learn from history are condemned to repeat it."

"1992 AND ALL THAT"

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1. 1992 is a topic of highest interest. There is no meeting with clients when I am not asked about it. Insurers too discuss the creation of the internal market. This is surprising for various reasons:
 - a) Since Reimer Schmidt addressed the CII Conference in 1962 on "The Treaty of Rome, as it affects Insurance" - what a nostalgic heading! - much towards the Common Market has happened, although slowly at first. Consider the much increased exchange of goods within the market. Consider the 4.8 million foreigners living in the Federal Republic (7.9 % of the total population) of whom many are EC citizens and an insurance potential.
 - b) Freedom of Establishment has been with us now for about 15 years. The impact on the German market has been small: For 1986 less than 3.5 % of the market's gross turnover of DM 111 billion (about £ 34 billion at today's exchange rate) can be attributed to EC subsidiaries or branch offices.
 - c) The date set by the 2nd Directive for the creation of free services within the Common Market is not 1992 but July 1st 1990.

1992 however as a keyword has stimulated and inspired many developments, some of which seem to bring rather revolutionary changes to the present framework of our market.

2. As an introduction I intend to recapitulate the situation which existed until now.

Legal backbone of insurance in Germany is the Insurance Supervisory Act of 1901 (Versicherungsaufsichtsgesetz). Insurance supervision in Germany goes far beyond 'freedom with publicity', far beyond supervising solvency margins. It is a preventing system providing a constant supervision of all acts of an insurer in order to ascertain that the insured's claims can be met at all times.

One partial aspect of this strict system is the legal obligation to have all policy wordings or general conditions authorized if an insurer intends to apply them regularly and not just in one singular case. In granting such authorizations the Bundesaufsichtsamt, The Federal Supervisory Authority, until very recently has pursued a policy of market transparency: It required a uniformity of all the market's policy wordings in order to simplify the consumer's choice for his insurance cover: He could restrict himself to comparing prices.

Rating tables or premium tariffs need no authorization with the exception of Life Assurance, Medical Expenses Insurance and still - to be abolished later under some other planned EC Legislation - Motor Liability Insurance.

Under these supervisory principles the German insurance market has developed a number of strong associations, e.g. one for property, one for motor, third party, personal accident and legal expenses, one for life and for medical expenses, one for marine, aviation and transport. Normally all companies underwriting a class of business are members of the respective association.

The associations through their committees have drafted new standard policy wordings and amended existing ones. Some associations also have gathered statistical material from their members and based hereon tariff systems. Rating tables developed with the associations only contain recommended premium rates. They do not bind the member companies. On the contrary member companies are free to deviate from these rates and constantly do so under the pressure of a highly competitive market.

3. Most of this became viewed from a different angle when in 1957 the Act against Limitation of Competition and the Federal Cartel Office were created. As a

general rule this Act prohibits all agreements or recommendations which might restrict competition. Insurance however - as well as banking - is exempt from this rule as far as it is supervised by the Federal Supervisory Office for Insurance. The Federal Cartel Office can only control whether the insurance industry might abuse this exemption.

After the establishment of the Federal Cartel Office the much diverging policies of the two federal bodies proved to be a source of constant conflict. Whilst the Federal Cartel Office pursues a rather purist policy of utmost competition and regards competition as an achievement in itself from which also the insured benefits naturally the Federal Supervisory Office for Insurance although not against competition considers him better off if protected by the various supervisory regulations:

He is to be sheltered against company failures and must be able to assess the best insurance just by comparing prices.

- 4.1 Superimposed on this national conflict are the legal implications which result from the Treaty of Rome's ruling on competition, Article 85. The importance of this Article became evident in January 1987, when the European Court decided that the German Property Insurers' Association contravened Common Market Law by developing rating tables issued as a non-binding recommendation to its members.

Details of this judgement can be found in Gordon Cornish's Summary of the European Court's decisions on insurance in the BILA Journal No. 64 of May 1987.

When Wilko Börner addressed BILA in April 1986 on 'EEC Competition Law and its practical effects on Community Insurance Markets' he already pointed at a growing influence of the German Cartel Office. Since then this tendency has even increased as some examples will show:

- 4.2 An amendment to the Act against Limitation of Competition recently drafted by our Federal Government and still to be approved by Parliament will give the Federal Cartel Office a much tighter control over all cooperation between insurance companies.
- 4.3 In 1988 the Federal Government instituted an independent commission of experts which has the task of finding unnecessary regulations which restrict the influence of the commercial markets. The report of this so-called Deregulation-Commission which will also deal with insurance is still outstanding.

4.4 In mid 1988 the Monopoly Commission, an advisory body with functions different to the British Monopolies Commission, issued its 7th bi-annual report which for the first time contained a special chapter concerned with insurance. The Commission recommended extreme changes in the present supervisory system, e.g. the partial replacement of the tight control of financial security of insurance companies by an insolvency fund.

It recommended the abolition of the obligatory authorization of policy wordings and it also spoke in favour of replacing the present sales system of tied agents by a system of independent brokers. These are only some points of the report which show how much the wind of time has turned.

Some practical changes have already taken place: The Federal Supervisory Office has dropped the requirement of market uniformity of policy wordings. Recently it has agreed to authorize wordings drafted and designed by individual insurance companies. So far this has materialized only with some special clauses and has not modified the authorization policy to any extent.

As a result of the previously mentioned European Court ruling the associations no longer issue gross rating tables, i.e. tables of premium rates which contain a certain percentage for the insurer's cost and his profit. They continue collecting statistical material from their member companies which is then transformed into a net tariff. This each member has to amend and complete by adding his own cost, expenses, profit margin and the like. On the surface this looks like a major deviation from the previous system of gross tariffs. One has to keep in mind that the gross tariffs never were fully adhered to by the insurers. Competition forced them into deviations and many companies either used the tariffs only as a general rating guideline or applied the tariff with a fixed standard discount, e.g. tariff minus 15%.

5. At the end of January 1989 the Federal Ministry of Finance issued a preliminary draft of various amendments to insurance legislation. In Britain you would call it a "green paper".

As expected it contains the necessary amendments to transform the 2nd Directive into German law.

It goes however much beyond this requirement of transformation, dealing with 7 major areas from investments to conflict of laws. Many of the proposed modifications are totally incompatible with the existing supervisory system and more in line with the philosophy pursued by the Federal Cartel Office or the Monopoly Commission.

Discussions have just started, hence it is not clear how many of the proposals will find their way into the final Act. At least in one respect our government deserves some criticism: as the green paper goes much beyond the agreed 2nd Directive it creates new national unharmonised law instead of attempting a unison European approach.

The limited time of today's meeting does not permit a critical analysis of the proposed amendments as much as needed. I shall pick out three points which are of much influence to the shape of our industry.

5.1 The 2nd Directive introduces freedom of services in two steps from July 1990 for insureds with 500 staff, 24 million ECU net annual turnover and a balance sheet total of 12.4 million ECU. These qualifying thresholds are halved with effect from January 1993. Following the preliminary draft the lower thresholds come into effect immediately on the 1st of July 1990.

5.2 Authorization of policy wordings

After the creation of freedom of services policy wordings no longer need authorization if they are agreed with an insured above the beforementioned thresholds. This applies even with purely national insurance treaties, i.e. a German insured and a German insurer insuring a German risk.

For risks below the thresholds, ie the mass market, the 2nd Directive permits the general principle of obligatory authorization to continue. Here however our government feels the need for changes. The preliminary draft offers for discussion three models of a deregulated authorization:

According to *Model A* insurers may, if they so wish, have their policy wordings quality-controlled by the Supervisory Authority and then use them as a "green", i.e. approved, policy. They may however use unapproved "red" wordings with the written prior consent of the insured. The draft considers even a warning to the insureds on those unapproved wordings.

According to *Model B* the Supervisory Authority develops specimen wordings in cooperation with the insurance industry. Insurers are free to deviate from these specimen wordings, but have to advise the insured of it.

Model C provides specimen wordings from which deviations are only possible after consent of the Supervisory Authority or if provided by the specimen wording. Again insureds have to be advised of deviations.

Discussions about the preliminary draft have just started. Thus it is too early to give any forecast which of the three models will be chosen. Model C is perhaps the one closest to the present system although it differs substantially from the present system of strict authorization and market uniformity of wordings. In the present climate I am not even sure whether the choice will be for the least differing model.

5.3 The duration of the insurance contract is a subject very essential to the German sales system.

With the exception of Motor Insurance and some commercial classes insurance contracts in Germany are normally made for a 10 year period. This gives the insured continuity of the premium rate. In many classes he has even the further advantage of a 10% premium discount for a 10 year policy.

Agents who produce most of all non-commercial business are normally paid a high commission if they acquire a new customer for a 10 year period. Commission rates for a householder's policy are often 60-80% in the first year and 8 to 10% in all subsequent years.

As the proposed new legislation voids any agreement which provides a longer than 3 year period a complete restructure of the remuneration of agents will be necessary. What is to happen to existing duration agreements in insurance contracts is a question left open in the preliminary draft. They are an asset to the agent and also to the insurer who has prepaid them by the high commission for the first year.

Shorter durations will certainly mean more fluctuation of insureds from one insurer to the other. This need not be a threat to an insurer who keeps a constant contact with his insured and it offers all those insurers with a strong sales force the chance to acquire new portfolios. Certainly administration expenses and acquisition costs will increase costs finally to be borne by the insured.

6. Whatever shape the proposed legislation at the end of all discussions will have, it has to contain the transformation of the 2nd Directive.
Based hereon I shall try to draw some lines into the future and to evaluate the importance of the new developments to the three parties involved: insureds, intermediaries and insurers.

- 6.1 The *big commercial and industrial insureds*, particularly the multi-nationals, have had access to international insurance markets for a long time. They employ highly skilled insurance staff, they - very common in Germany - have their captive insurance intermediary. Their insurance covers were mostly tailor-made and the premiums charged not overrated by international standards.

Thus I do not foresee any immediate alterations for this group of insureds.

This may be different with *medium-sized insureds* such as smaller commercial firms, municipalities, the church and various religious communities, private schools or hospitals. Their premium turnover is interesting enough to attract more attention particularly of brokers but also of foreign insurers. They are within the scope of the second directive and might expect covers and premium rates different from the present level.

The life of the *individual insured* with his 3-5 personal policies will become more complicated. No longer can he concentrate on comparing prices, in future he has to compare and - difficult to impossible - evaluate the difference of insurance protection. Alternatively he will stay with his agent which, particularly in the early years, I expect most people to do as generally they have experienced a qualified and fast service from their local agent.

The importance of consumer associations offering assistance in the search for the best-value-for-money-protection will grow. We are also going to see more magazines having rating and cover comparisons as a regular feature. Finally brokers who up to now have deliberately left this field unploughed might find this group of insureds worthwhile. All this means extra costs which have to be borne by the insured.

There will be a wider choice of available covers as insurers will make use of their greater flexibility albeit only as a defense against foreign import.

Premium levels which on the whole compare well internationally will rather increase by the extra cost the new system causes. I cannot accept the conclusions of the Cecchini Report which forecasts enormous savings for the consumer.

- 6.2 Of the intermediaries the brokers will benefit most in the long run. The growing complexity of insurance will make more independent advice necessary. So brokers will handle more than the present about 8% of all business. The establishing of new broking firms, the development of the necessary broking

skills will take many years. It might also become necessary to develop special educational programmes for brokers, professional qualifications and perhaps a body which sets and supervises professional standards.

In the meantime the system of tied agents which has been the backbone of the deep market penetration can be expected to keep its valuable role.

- 6.3 For insurers my forecast is optimistic unless their operations are small. The need for more flexibility, for more individuality either in single cases or as a general company policy, will lead to a fairly fast decreasing importance of insurance associations. As a consequence smaller companies which cannot afford the extra costs or are unable to stand on their own feet will disappear from the market.

To all other insurance companies future changes will be more varied, but life also more complex and difficult. The products and the prices have to be reconsidered, the place in the market to be determined afresh. The relationship to customers who in the past have experienced a mostly expert service has to be improved in view of shorter treaty periods.

There is no general ruling of things to be done. All depends on the company's present position in the market, its skills and weaknesses, the company clientele etc. and on the other hand its targets. Much more than today not all companies will be able to offer cover in all classes and everywhere in Europe.

Fixing the targets is a multi-layered problem not only dependent on new EC or national legislation, as important as they may be. General market tendencies cannot be ignored, e.g. towards direct insurance, i.e. selling policies without intermediaries via telephone or correspondence. Another main topic is "Allfinanz", the cooperation between banks and insurance in order to offer the customer all financial services at one point, be it banking or insurance products.

1992 has been the keyword of my paper. I hope I made it clear that we face many more changes than from the creation of the Internal Market.