HARMONIZATION OF INSURANCE LEGISLATION IN EUROPE*

This subject comes up for discussion principally because of the progress towards harmonization of insurance legislation currently being made in the six countries of the European Economic Community. But the venue of the discussions covering the whole of western Europe is the Insurance Committee of the Organization for Economic Cooperation and Development with its headquarters in Paris and much progress remains to be made towards harmonization or liberalization. But the case for liberalization, from the point of view of the consumer, is considered to be amply demonstrated by instances of substantial differences in price and quality of service which exist between one country and another, e.g., in premium rates charged for a particular risk or in the promptness in settling claims.

Liberalization of insurance services is not, of course, of benefit only to the consumer, but is also of value to the whole economy of a country in that international competition can be expected to stimulate the national industry and make it stronger and more competitive. Since 1950, therefore, O.E.C.D. has been working towards abolishing restrictions in the field of insurance. The difficulties are considerable, and two approaches have been used:

(i) measures to allow contact, across frontiers, between insurers in one country and policyholders in another.

(ii) measures to allow insurers to cross frontiers and pursue their business in other countries.

Also, since 1950, certain general principles on the supervision of insurance, concerning access to insurance activities and their exercise, have been agreed by O.E.C.D. Member countries, but these represent little more than the lowest common denominator of what is currently acceptable to Member countries - and so many reservations have been entered that one wonders how much real progress has been made towards liberalization.

There are, of course, a number of substantial obstacles in the way of liberalization. Not least of these is the tenacity with which countries (including the U.K.!) stick to their present arrangements for supervision. In general, supervision on the continent is more restrictive than in the U.K., the main motive

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* An article based on an address given to the Association on 26 March, 1968, by Mr. C. M. Stewart, F.I.A., F.S.S. (Government Actuary's Department).

being the protection of the policyholders, and of third-parties who would benefit under insurance policies - and many countries are not content only to offer such protection, but impose it by prohibiting their residents from directly taking out an insurance contract in any other country. The necessity for insurance control of some kind is universally recognised and there is no question of abolishing it, but there is room for difference of opinion on the extent to which State intervention is justified.

One very important factor is the very large funds accumulated by life assurance concerns, which represent a very large part, in some countries, of the personal savings of the people. The authorities wish to keep these sums in their own territory for the benefit of the national economy as a whole and, in some cases, for investment in State loans or loans deemed by the State to have priority. There are, however, two factors present here. It seems perfectly reasonable to propose that the savings generated in a country should be retained in that country's capital market, partly for purposes of economic development and partly to ensure that insurance liabilities accepted in a particular currency are matched by assets in the same currency. There is, however, room for two points of view on the desirability of State direction of investment if the terms of such investment are different from those pertaining in the market.

Other considerations which provide obstacles are balance-of-payments problems, and the desire to protect national insurance industries (some of which may be partially State owned) although it is said that the protection of a domestic industry against foreign competition impairs its ability to adapt itself, as well as its efficiency. But a major difficulty is found in the different tax law in Member countries both as regards policyholders paying premiums, and insurance concerns receiving premiums, accumulating reserves and investing the proceeds. There are considerable disparities and, under conditions of full liberalization, countries in which taxation is high would clearly not be competitive on the international market and would be likely to lose customers to countries with a more favourable tax system.

It is clear that real progress towards liberalization will only follow some measure of harmonization of the legislative provisions and regulations governing the supervision of insurance. The first step along this path was, necessarily, to determine the facts and this was the aim of the Working Party under the Chairmanship of Mr. Paratte of Switzerland which was set up by the O.E.C.D. Insurance Committee and whose extensive survey of insurance legislation was published in 1963 under the title "Supervision of Private Insurance in Europe".

The second step was the setting up of three new Working Parties to study the financial guarantees which are, or which should be, required of insurance concerns. Two of these relate to non-life insurance; the first, under the Chairmanship of Mr. Homewood of the British Board of Trade, is dealing with the verification of technical reserves, i.e., reserves for outstanding claims and unexpired risks, and the second, under the Chairmanship of Mr. de Florinier of France, is deciding what additional guarantees should be held, i.e., corresponding to the 20% or so of premiums prescribed in the U.K. in Sections 79 and 62 of the Companies Act, 1967. Mr. Homewood's Working Party has made certain proposals on motor vehicle insurance and is now looking at the other classes. Mr. de Florinier's group is handicapped by being to some extent dependent upon the outcome of the discussions in the Homewood Working Party and probably also by the fact that a similar horse is currently being ridden in the E.E.C., and the Six, who are members also of O.E.C.D., must be careful to reach the same conclusions in both places!

The third Working Party, under the Chairmanship of Mr. Buol of Switzerland, is making parallel though in some respects very different studies in life assurance and is at present working very hard trying to reconcile the methods and practices in use in the different countries.

The work of these groups will, of course, fall a long way short of clearing all the ground necessary for liberalization, and the Insurance Committee has a proposal before it for a number of other working parties to be set up to deal with new studies on the following subjects:

(i) Uniform rules for valuing assets.

(ii) Security equilibrium of insurance portfolios through the stability offered by reinsurance.

(iii) Common rating criteria for the calculation of premiums.

(iv) Standardization of accounts, etc.

(v) Assets which may be used for covering reserves and solvency margins.

(vi) Uniform methods for obtaining statistics which would be comparable between the countries.

(vii) Basic policy conditions in the different classes.

(viii) The effectiveness of the courts of law for enforcing judgments of an international character,

(ix) The taxation systems of the various countries and a proposal for a programme aimed at establishing equivalent taxation treatment in the field of insurance.

This is an impressive list and it helps to show the size of the task with which the Insurance Committee is faced.

Parallel with these studies, the Common Market Six are pushing ahead with their own plans for coordination, and are finding the same difficulties. The problems are to be solved in accordance with Article 3(h) of the Treaty of Rome which stipulates that for the purpose of achieving a harmonious development throughout the Community "the activities of the Community shall include, under the conditions and in accordance with the timetable envisaged in this Treaty ... the approximation of the respective national laws to the extent required for the Common Market to function in an orderly manner" -

Insurance is to be considered under two broad headings:

(i) the right of establishment

(ii) the abolition of restrictions on the freedom to provide services.

On (i), Article 52 provides that restriction on the freedom of establishment of nationals of one Member state in the territory of another shall be abolished by stages during the envisaged transitional period of 12 to 15 years. Freedom of establishment includes the right to engage in insurance business, to set up and manage undertakings under the conditions laid down for its own nationals by the host country, thus avoiding discrimination. To this end Article 57(2) provides that the E.E.C. Council shall issue directives for the coordination of the legislation, regulations and administrative rules of member states.

On (ii), Articles 59 and 63 provide for the progressive abolishing of restriction on the freedom to provide services and for the issue of the necessary directives.

The general programme of directives on insurance was published in 1962 and aimed at the following timetable:

(i) Freedom of establishment for reinsurance by 1963.

(ii) Freedom of establishment for direct insurance by the end of 1965 for non-life insurance and the end of 1967 for life assurance.

(iii) Freedom of services for direct insurance by the end of 1967 for non-life insurance and the end of 1969 for life assurance.

Freedom of establishment for reinsurance was actually achieved in 1964 but none of the other aims has so far been achieved. The tasks facing the E.E.C. Commission are enormous and it is not surprising that progress has been slow, especially as political crises tend to delay technical work.

Although the target dates for achieving freedom of establishment have not been met, a draft of the non-life directive was published in October 1966 and showed the kind of steps envisaged. The directive applies to virtually all non-life classes, requires supervision to be undertaken by the appropriate national supervisory authority, and makes provisions for ensuring the solvency of companies. Specifically this means that insurers must have, in accordance with stringent formulae, adequate technical reserves, solvency margins and guarantee funds, precisely the matters under study in the Homewood and de Florinier Working Parties in O.E.C.D.

In the field of life assurance no draft directives have yet been published but, according to an article published in Germany in July last year, the E.E.C. Commission had almost completed the draft of a directive to limit the conditions of authorization and activity for agencies and branches of life insurance concerns (the so-called "maximum conditions") and had started work on a draft directive for the co-ordination of the legal and administrative regulations for the entry and activity of life insurance. The first directive, aimed at removing obstacles blocking free activity in the E.E.C., is to be restricted to a limited period. It is therefore a preliminary to the later coordination directive. According to an E.E.C. press release issued in June 1967 the Commission hoped to present the directives on life assurance to the Council before the

end of 1968 but up to now there has been no agreement on how the solvency of a life assurer should be assessed.

The problem of composite companies and "specialization" has not yet been discussed very deeply in O.E.C.D., but it has been a very important issue in E.E.C., where the non-life directive is well advanced. The matter was discussed in a paper in the "Common Market Law Review" of December 1966 by Mr. F. Salomonson, a Member of the Dordrecht Bar. He pointed out that in Germany, France and the Netherlands the law requires life assurance to be carried out by a separate company. This is not required in Belgium and Italy, but even in those countries life policyholders do not share the risks inherent in general insurance written by the composite companies, since the law requires a separate system of administration (gestion distincte). In Belgium and Italy wholly separate accounts must be maintained; the assets which stand against liabilities and the minimum capital required in order to conduct the business must be specially "earmarked" as belonging to the life assurance branch and are available only to meet liabilities arising under this class. Thus, there is a de facto separation of assets in Belgium and Italy but in these countries the factual separation is not reflected in corporate separation.

Whether an Italian composite company is entitled, within the general framework of freedom of establishment, to open a branch office in, say, Germany to conduct both life and general business, has given rise to much debate. The Italians and Belgians would see no objections, but the other member states (especially Germany) would be violently opposed. What then is to be done? Salomonson thought that a solution might be offered if a Belgian or Italian company wishing to operate in another E.E.C. country could continue to be subject, even in respect of its foreign business, to Belgian or Italian Law. But the other national authorities would not accept this and Salomonson concluded that it is "a remarkable fact that the executive authorities are so much more stubborn than the judicial in their attachment to the exclusiveness of jurisdiction".

Next, a compromise proposal was considered, under which a composite company would be obliged to set up a separate administration for life insurance in those countries which insist on specialization. The detailed conditions would be laid down by agreement between the supervisory authorities of the headquarters country and the host country, and would aim at ensuring a system of security equivalent to that applying to national companies. The Germans have opposed this suggestion too with vigour. The 1966 Report of the German Insurance Supervisory Service stated that:

"...the safeguards in the Belgian compromise proposal are insufficient. Effective protection for the claims and expectations of German policyholders could be achieved only by an extensive amendment of the legislation. A system of guarantees equivalent to specialization must be created. Only in this way would it be possible to guarantee that the assets of the life insurance branch of a composite company would be reserved exclusively for the life policyholders and not used to satisfy the creditors of the non-life branches. Finally, the authorisation of foreign composite companies to transact business in Germany would lead to internal discrimination because of the resulting competitive advantages over German concerns to which the principle of specialization applies".

It is interesting to note this German opinion that composite companies have competitive advantages over specialist companies. But the German supervisors' reaction is to ban composite companies. I wonder if it would not be at least as logical in the circumstances to abandon the requirement for specialization, assuming that this can be done without jeopardizing the security of life funds?.

A further suggestion has now been made towards solving the problem of specialization. Multi-class companies wishing to operate in countries requiring specialization would be allowed to have a branch either for life assurance or for general insurance (the choice would be left to the company concerned) but it would not be allowed to do business in the other class, or classes, except through the medium of a subsidiary company. At the same time, measures would be taken to facilitate, as far as possible, from both the legal and financial points of view, the creation of such subsidiary companies on the condition that these remained under the absolute control of the parent company.

The E.E.C. Committee discussing this problem has agreed that the Six supervisory authorities should reflect on the possibilities of such a proposal and, in the meantime, the Committee of European Insurers (C.E.A.) has been asked to consider the practical details of its application.

Although O.E.C.D. has not yet come face to face with this difficulty, it will do sooner or later, because it is not only the

E.E.C. Six which are divided on whether or not specialization should be insisted upon. Countries which currently insist upon specialization are France, Germany, Holland, Ireland, Norway, Sweden, Denmark (new companies since 1959), Switzerland and Portugal (mutuals only; composite companies are allowed). On the other hand, the United Kingdom, Italy, Belgium, Luxembourg, Austria, Greece, Turkey, Spain and Iceland allow companies to write both general and long-term business.

The Swiss supervisory authorities made clear their views on the need for specialization in their answers to the Paratte enquiry for O.E.C.D. They stated that the requirements of the supervisory authorities were due mainly to technical and economic consideration, but also to legal considerations; the characteristics of life assurance (the long duration of contracts, the accumulation of policyholders' savings in the technical reserves and the difficulty in taking out another policy at a late age with another life assurance company should the first company become insolvent) made it necessary to have particularly strict rules. Such rules might be frustrated if life assurance concerns were also allowed to undertake general business which was subject to the risk of catastrophe. Conversely, if mixed life and general business were allowed, the statutory provisions regarding life assurance could be prejudicial to the other classes. For instance, all the best investments might be earmarked as security for prior claims under life policies, to the detriment of the technical reserves of the other classes. Another consideration was that in the non-life classes the investments had to be more liquid than in the case of life assurance.

In Germany there is no explicit legislation requiring specialization but its imposition is the long-established practice by the Federal Insurance Supervisory Service. To quote from the book The Freedom of Establishment of Insurance Concerns in the Common Market by Dr. Bernt Bühnemann, published in Karlsruhe in 1967, "This rests on the recognition that risks of the various insurance classes are different and that the function of life insurance, in relation to other branches, is different. Because of the long term contract, the life insurer is more a trustee than a merchant adventurer and the function of life insurance as a means of capital saving makes special protection essential. Although specialization was introduced for reasons of state supervision... life insurance has developed more favourably than other classes. This is noted in other countries where specialization applies.

Thus, an apparently competitive disadvantage is compensated by greater activity".

The observation that the competitive disadvantage of the specialist life assurance company is compensated by greater activity is interesting and one wonders whether the same opinion is held in the U.K.

The position on specialization in the U.K. is not absolutely clear. Companies are allowed to write both long term and general business if they wish and, to quote Section 3 of the Insurance Companies Act, 1958, "... a fund of any particular class ... shall be as absolutely the security of the policyholders of that class as though it belonged to a company carrying on no other business than insurance business of that class". Furthermore, the 1958 Insurance Companies (Forms) Regulations prescribe that both the company and the auditors must certify that "no part of any such fund has been applied, directly or indirectly, for any purpose other than the class of business to which it is applicable". The general intention therefore is clearly similar to that of the authorities in Switzerland and Germany as already described, and there is little doubt that the different classes of policyholder in a composite company do receive equitable treatment. What is not clear is what would happen in the event of a company having to be wound up, for example, as a result of heavy claims on the general branch following some catastrophe. A life assurance fund typically includes fairly large reserves intended to ensure that the policyholders should continue in future years to receive bonuses on about the same level as at present. These reserves have been built up from the life policyholders' own premiums and, in the words of the Act, should belong to them as absolutely as if the company did not have a general branch, yet there is considerable doubt that this would be the position in law - even if the company had segregated the assets belonging to its life fund, something which, rather surprisingly perhaps, it is specifically excused from doing in a Proviso in Section 3 of the 1958 Act.

The problem is an important one in the context of the present discussions on liberalization of insurance business in Europe, and it would be well worth study by B.I.L.A. as it is clearly a legal problem.

There are many differences between the supervisory procedures in the U.K. and on the continent. In many continental countries, life assurance premium rates must be submitted for the approval of the authorities, unlike the "freedom with publicity" approach in the U.K. under which the company (on the advice of its actuary)

decides for itself what premium rates it will charge (although market pressures have a large part to play in this also). In Sweden the authorities go further by insisting that all policyholders must share in the profits (so that there is no non-profit cover available) and it is even laid down how the profits are to be distributed.

In most continental countries, life assurance liabilities must be calculated on bases laid down by the authorities who often supervise the actual process of actuarial valuation, whereas in the U.K. the company's actuary will decide on the basis and then submit to the Board of Trade a summary of what he has done (in sufficient detail, however, for his work to be scrutinized by the Government Actuary).

With the exception only of the Netherlands, continental countries lay down rules concerning the types of investment permissible to insurance companies and how they are to be valued. This contrasts with the position in the U.K. where, apart from minimal conditions designed to prevent abuse or excessive risk, companies have complete freedom of investment and may value the investments at any figure they wish subject to it being possible to certify that they are fully of the value stated in the balance sheet (which is taken to refer to the market value for those stocks which are marketable).

The concept of market value is well known in the U.K. because we have in this country a very substantial and very active market both in fixed-interest investments and in ordinary shares, and both types of investment are found in large quantities in insurance companies' portfolios. This is not generally the case on the continent where often fixed-interest loans are made direct to the borrower and remain in the company's portfolio until maturity. An active "switching" policy, which is common in the U.K., would be almost unheard of.

So far as ordinary shares are concerned, the continental markets are very much smaller than in the U.K. and investment in ordinary shares is generally regarded as being very risky and not at all suitable for life assurance companies (except for their "free" reserves). Undoubtedly even in the large U.K. market, which is kept buoyant by large institutional investors including the insurance companies themselves, there are risks in investing in ordinary shares but the "cult of the equity" has gained such a large measure of acceptance in the U.K. that there would probably be popular outcry if the State decreed that insurance companies should not participate in this form of investment which has proved very lucrative in past years. By issuing unit-linked policies, of course, companies avoid

much of the risk but this type of policy has not yet caught on on the continent.

These and many other differences between one country and another, and very often between the U.K. on the one hand and the bulk of continental countries on the other, are under detailed discussion in the O.E.C.D. working parties. In due course, perhaps, these discussions will be seen to have played their part in paving the way for progress on the harmonization of insurance legislation in Europe but it is not an easy path we tread.

Stop Press

We are pleased to give early intimation that plans are now well in hand for an International Colloquium to be held in London in the summer of 1969. The subject will be a European-slanted life topic. We hope to announce further details at a fairly early date.

All enquiries concerning the British Insurance Law Association should be addressed to the Honorary Secretary, 21-24, Chiswell Street, London, E.C.1.