INSURANCE MARKETS WITHIN WESTERN EUROPE: AN ANALYSIS OF RECENT STRUCTURAL CHANGES

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Historical Background

The historical development of most national insurance markets in Western Europe has tended to follow a similar pattern. Apart from the supply of marine and other insurances related to international trade, most insurance companies have evolved from local origins. This is because insurance companies, being in a service industry, compete primarily by responding to the needs of their customers. As industrial and commercial customers extended their enterprises to a wider regional and then national networks of operations, so insurance enterprises followed. Furthermore, as the larger corporate customers expanded internationally, insurance companies were again under a competitive pressure to set up overseas operations, at first through agencies and then as foreign branches and subsidiaries, when the scale of operations justified a more substantial local presence. This expansion of the larger insurance companies, both domestically and internationally, was often accompanied by mergers and acquisitions, in order to obtain the local expertise to service client needs, but also to build up quickly a commercially viable operation. Study of the histories of individual insurance companies reveals that some take-overs were - as they are to-day- reactive; large companies acquired other companies primarily because their competitors had recently made similar acquisitions.

Before the second world war, the geographical representation of the major European insurance companies tended to be mainly in overseas colonies. Another way of looking at this is that those insurance companies which had built up international networks of operations had their head offices in those

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countries that had overseas empires, viz U.K., Netherlands, France, Belgium, Italy. One interesting characteristic of this international presence was that although representation in other Western European insurance markets existed, it was limited in scope, consisting of agencies of small branches. This reflected again the fact that their corporate customers were not operating to any significant degree in these countries; difference in language, in commercial practices, in legal systems and in currencies all mitigated against this. There were exceptions to this among countries where languages and traditions have been closer, especially in the German and French spheres of influence. With respect to insurance, there was an additional deterrent to expanding across Europe: regulatory systems often discouraged, directly or indirectly, any significant entry by foreign companies.

With the changing economic and political environment within Western Europe, this pattern began to change in the late 1950's and in the 1960's. This reorientation was also prompted by changes elsewhere. Prospects in former colonies began to look less promising, as the economic nationalism began to emerge after political independence, with limits being placed on foreign ownership and with the creation of state-owned insurance and reinsurance companies, sometimes with the nationalisation of the indigenous insurance industry. Hence European expansion gradually became more of a commercial reality, or rather, a commercial necessity for those insurance companies with ambitions outside their own national markets.

Western European insurance markets in a global setting

It is useful to look at the overall size and growth of the insurance markets within Western Europe in the wider global context. This is done in Table 1 for the years 1970 and 1992. These markets taken together grew faster than those in North America, a fact that holds even if another numeraire rather than the US dollar is used and if allowance is also made for differences in local inflation rates. The relative decline of the North American markets largely reflects the fact that these markets grew much more quickly in the 1950's and 1960's, and subsequently have exhibited signs of maturing. It will be apparent that insurance markets in Japan have shown very rapid growth, and so too have other Asian markets.

Table 1

Spending on Insurance in Western Europe relative to the Global Market 1970 and 1992 (measured by gross premiums)

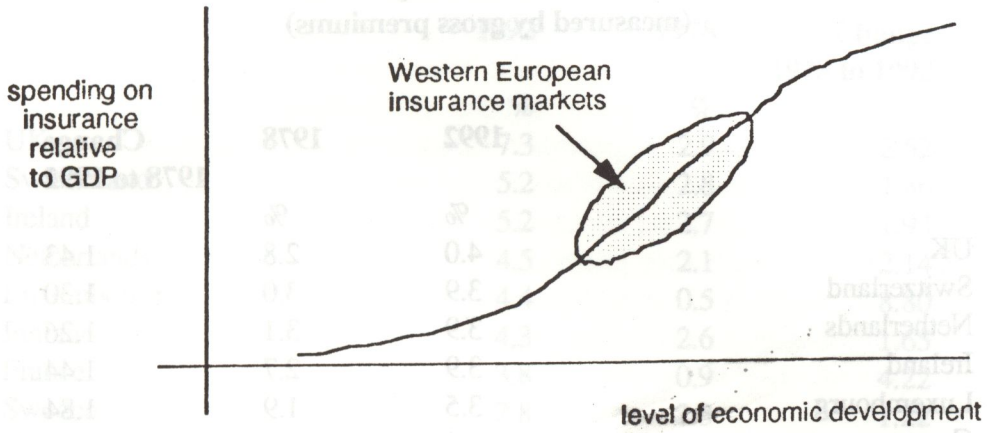
	Non-life insurance		Life Insurance	
	1970	1992	1970	1992
	%	%	%	%
North America	63.2	46.48	61.9	30.28
Western Europe	27.5	32.74	20.4	29.12
Central & Eastern Europe	n/a	0.44	n/a	0.12
Japan	4.9	12.00	12.2	30.77
Rest of Asia	1.8	3.84	2.6	6.14
Rest of world	2.6	4.50	2.9	3.57
World market(%)	100.0	100.00	100.0	100.00
World market (US$million)	66,094	697,503	44,053	768,436

Source: derived from Sigma (Swiss Re) and UNCTAD publications

Statistical analyses of insurance markets show that over time the demand for insurance grows at a faster rate than national GDP: insurance is thus in economic parlance 'an income elastic good'. And there is some evidence to suggest that the growth of insurance markets follows a pattern as depicted in Fig 1 below[1]. European markets are mapped onto this graph.

[1]See, Carter, R.L. and Dickinson, G.M. (1992), *Obstacles to the Liberalisation of Trade in Insurance, pages 175 - 179*

Fig 1



In Table 2 we can see the actual pattern of growth across the various national insurance markets in Western Europe. It is evident that spending on insurance, both personal and corporate, relative to local GDP increased across all countries between 1978 and 1992, with a faster growth for life insurance than for non-life insurance. This faster growth of life insurance spending largely reflects to a significant degree a growing recognition by ageing population of the need to make long-term retirement provision, a process which has been encouraged by national governments wishing to transfer some of the burden of future income maintenance from social insurance systems onto the private sector. Insurance markets in Southern Europe have been growing at a faster rate than those in Northern Europe, reflecting largely a catching up process.

Table 2
Non-life insurance spending relative to local GDP in Western Europe 1978 to 1992 (measured by gross premiums)

	1992	1978	Change 1978 to 1992
	%	%	
UK	4.0	2.8	1.43
Switzerland	3.9	3.0	1.30
Netherlands	3.9	3.1	1.26
Ireland	3.9	2.7	1.44
Luxembourg	3.5	1.9	1.84
Germany	3.5	3.0	1.17
Austria	3.5	2.9	1.21
Belgium	3.3	2.8	1.18
Norway	3.2	2.9	1.10
France	2.9	2.6	1.12
Sweden	2.8	2.1	1.33
Spain	2.7	1.4	1.93
Portugal	2.7	2.2	1.23
Denmark	2.5	2.4	1.04
Finland	2.3	1.9	1.21
Italy	2.2	1.8	1.22
Greece	1.0	0.8	1.25

Life insurance spending relative to local GDP in Western Europe 1978 to 1992

	1992	1978	Change 1978 to 1992
	%	%	
UK	7.3	2.9	2.52
Switzerland	5.2	2.8	1.86
Ireland	5.2	2.7	1.93
Netherlands	4.5	2.1	2.14
Luxembourg	4.4	0.5	8.80
Finland	4.3	2.6	1.65
France	3.8	0.9	4.22
Sweden	2.8	2.3	1.22
Norway	2.3	1.5	1.53
Germany	2.3	2.1	1.10
Denmark	2.2	1.9	1.16
Belgium	1.7	1.1	1.55
Austria	1.5	0.9	1.67
Spain	1.4	0.2	7.00
Portugal	1.1	0.2	5.50
Greece	0.9	0.1	9.00
Italy	0.8	0.3	2.67

Source: derived from Sigma (Swiss Re)

It would be too difficult here to go into detailed reasons why these variations exist across national markets. They reflect a complex interplay of factors: differences in the historical pattern of economic development, the structure and ownership or industry or commerce, demographic and cultural influences, and the degree of pervasiveness of social insurance systems.

Structural changes within insurance markets

Until the early 1980's, a general characteristic of most insurance markets within Western Europe was that they were dominated primarily by domestically-owned companies. At the same time, market concentration was

not high, even in the smaller countries. In part this reflects the fact that in many countries insurance is purchased directly or through agents tied to particular insurance companies. Many types of insurance are standardised products, particularly in non-life insurance, and hence there is less opportunity for insurance companies to increase their market shares through product differentiation. Moreover, in a number of countries, competition has also been governed by price agreements ('tariffs') which the national regulatory authorities have encouraged or required since they wish to keep up the level of insurance prices, because experience has shown a principal main cause of bankruptcy is inadequate pricing. And even where product differentiation has been possible, such as in life insurance and private pensions, no patent laws exist and hence new products that come onto the market can quickly be copied by competitors. Due to the above factors, individual insurance companies have found it difficult to increase their market shares significantly through organic growth. Take-overs and mergers have become the main means of corporate expansion. Particularly since the 1950's, there have been spates of mergers and take-overs within many European insurance markets. A common feature has been for larger insurance companies with access to capital from stock markets to acquire smaller companies. Regulatory authorities too have often preferred to see an insurance company that has run into financial difficulties being taken over by a stronger insurance company, rather than see it formally go into liquidation.

At the beginning of the 1980's there were approximately 3500 independent groups, but this number had fallen to some 2500 by 1993. Despite this reduction, it is clear that there are still a large number of insurance enterprises across western Europe, certainly larger than in the commercial banking sector. Within many countries there has been a tradition for mutual and co-operative insurance companies to exist; many of these are small in size and because of their ownership characteristics have been able to maintain their corporate independence.

During the last decade, under the impact of greater deregulation and the 1992 programme, which was aimed at stimulating the progress towards a more economically integrated European Community, competition within insurance markets has increased. Insurance companies entering other European markets have contributed to this increased competition. In addition, corporate and personal consumers have become more pro-active in their decision-making and

thus prepared to change insurer or agent for price and/or product reasons. To some extent, this increased competitive pressure has also come about because of the greater role that banks have been playing as intermediaries for insurance products, especially for individuals and small businesses. The larger insurance brokers have also become more active across European markets and as professional intermediaries offering independent advice and providing a variety of risk management services, they have strengthened their contacts with corporate buyers of insurance, thus reducing consumer allegiance to their existing insurers. Information and communications technology has also had a gradual transforming effect on the competitive conditions within national markets, since better managed insurance companies have been able to use these new technologies to secure production and distribution advantages over their lesser adaptive rivals.

Even so, market concentration within national markets is not high. This can be seen in Table 3 for the twelve EC countries in 1989. Market concentration has not changed significantly during the early 1990's, except for some life insurance markets where bank-owned insurance companies have been increasing their market shares.

Table 3
Market Shares of major Insurers In EC Countries in 1989
(By premium Income)

Non-Life Insurance

	Largest Company	Largest 3 Companies	Largest 10 Companies
Belgium	10.2%	28.1%	55.6%
Denmark	16.2%	36.4%	67.4%
France	10.3%	29.7%	61.9%
Germany W.	10.9%	18.0%	36.7%
Greece	21.6%	42.0%	68.4%
Ireland	16.0%	33.2%	77.2%
Italy	11.3%	25.5%	51.2%
Netherlands	10.5%	23.0%	48.6%
Portugal	13.2%	37.4%	79.2%
Spain	4.9%	13.6%	31.4%
United Kingdom	10.7%	27.3%	64.6%

Life Insurance

	Largest Company	Largest 3 Companies	Largest 10 Companies
Belgium	23.8%	50.4%	88.0%
Denmark	23.0%	53.2%	88.6%
France	12.1%	33.3%	68.1%
Germany W.	13.4%	25.4%	47.9%
Greece	39.5%	70.5%	93.1%
Ireland	42.0%	57.5%	83.7%
Italy	23.2%	52.1%	78.4%
Netherlands	21.7%	41.9%	70.4%
Portugal	13.2%	31.7%	82.5%
Spain	32.0%	51.7%	69.3%
United Kingdom	7.2%	20.3%	42.6%

Source: Sigma (Swiss Re); Insurance Federations in individual EC countries; individual company accounts.

Entry of foreign insurers into national markets

One notable feature of the structural changes within insurance markets during the 1980's has been the increasing penetration of national insurance markets by insurers from other parts of Western Europe. Table 4 below provides a grouping of the extent to which the market shares are held by foreign-owned insurance companies in 1991. Foreign penetration was greatest in the developing markets of Southern Europe, especially Spain, Italy and Portugal, and in the smaller more open markets of Northern Europe, Belgium, Ireland and Luxembourg. For historical reasons, Austria has a high degree of penetration. On the other hand, Sweden, Norway, Finland and Switzerland have relatively low market shares held by foreign interests, due largely to regulations restricting the foreign control of local companies.

Table 4
Foreign share of domestic insurance markets in 1991
(Branches and locally controlled companies)

	Non-life insurance	Life Insurance
Above 50%	Ireland	Ireland, Portugal
40% to 50%	Austria	Luxembourg
30% to 40%	Belgium, Spain, Luxembourg, Netherlands	Austria
20% to 30%	Greece, Italy\ Portugal	Belgium, Netherlands
10% to 20%	Denmark, France, Germany, UK, Norway	Denmark, Germany, Greece, Italy, Spain, UK
5% to 10%	Switzerland	France
Under 5%	Finland, Sweden	Finland, Norway, Sweden, Switzerland

Source: OECD and author's estimates

There has been a mix of reasons behind the increasing regionalisation of European insurance markets. First, the larger insurance groups, which have been the prime movers of these structural changes, have seen diminishing returns from expansion within their domestic markets, compared with perceived opportunities in the wider regional market. This has been especially so for the major insurance groups in countries based in northern and central Europe,wishing to position themselves in the emerging markets in southern Europe. Second, the wider economic and commercial integration within Europe has provided an additional incentive. Seeing their major corporate customers expanding originally, insurance companies were under a competitive pressure to extend their networks in order to supply the requisite on-the-spot services demanded by these customers. In supplying insurance services, a local presence is needed to provide pre-sales services (risk assessment and product tailoring) and post-sales services (loss assessment and the prompt settlement of claims).

If one identifies which insurance groups have been promoting this regional expansion, one finds that it has been to a significant degree the larger quoted companies with access to the stock market capital, But there have been also large mutual insurance companies, which have been involved too in this regionalisation process, viz. Axa (France), Aegon (Netherlands) and Mapfre (Spain). But closer analysis shows that these large mutual companies have been able to finance their expansion by making innovative changes to their financial structures in order to raise the necessary external equity capital. French state-owned insurance companies have been very active participants. They have been able to effect this international expansion by drawing on funds made available to them from the French state-owned banks, and more recently by raising some equity finance through partial privatisation.

It has not just been the larger insurance groups, with the access to capital markets and with the experienced management capable of running international operations, that have been extending across the European market. Medium-sized insurance groups have also participated in the process, often joining forces through strategic alliances and joint ventures. They have done so in order to keep up with their larger rivals. These strategic alliances and joint ventures have, however, usually been second best solutions. And

indeed a number of them have not worked out in practice, because of conflicts in corporate objectives and in corporate styles.

In analysing the strategies of European insurers in more detail, one must also make the following distinction. Pan-European networks have only been commercially necessary to service corporate customers, especially their non-life insurance needs. For personal customers, there is no such commercial imperative and so insurance companies have entered individual European markets on a more selective basis.

Foreign expansion through take-overs

Because take-overs have been the principal means by which foreign penetration of European insurance markets has taken place, further discussion on this seems appropriate. The author has estimated that there were between 1984 and 1990 about 171 cross-border take-overs and joint ventures; a take -over being defined as one where over 50% of the issued shares of the company has been acquired. Cross-border mergers have been very few in number, the only major one being the merger between the Groupe AG (Belgium) and AMEV (Netherlands) in 1990

The distribution of these take-overs by size is given in Table 5. Most of the acquisitions have been small, with over 80% having a market value less than 50m Ecus. Take-overs have featured much more prominently than joint ventures or acquisitions of minority states. Where possible it has generally been the preference of large insurance enterprises to obtain full control of a local company or occasionally where the retention of a significant minority interests affords a major compensating marketing benefit. As these acquisitions have taken place they have induced further structural market change. The acquisitive actions of the pro-active insurance companies have prompted the less dynamic peers to follow their initiative. Behaviour among insurance companies has often exhibited a herd-like characteristic, especially in take-over activity, Moreover, small to medium-sized companies, and in a few cases larger companies, wishing to avoid being acquired have set up a variety of defence mechanisms. These defence mechanisms have included cross-shareholding arrangements, the issuance of preference shares with significant voting rights or changes in the articles of association to disenfranchise targeted

shareholders. Another consequence of this take-over process has been that small to medium-sized companies have themselves decided to merge in order to avoid unfriendly advances.

Table 5
Size distribution of insurance company cross-border take-overs, mergers and joint ventures within the EC, Switzerland and Sweden 1984 to 1990

Value in Ecus	Number of transactions
1000m and over	4
500m to 999m	3
200m to 499m	11
50m to 199m	13
under 50m	140 (est.)
	171 (est.)

Source: G.M. Dickinson, 'Insurance Sector' in 'Market Services and European Integration', European Commission, 1994

Although most of the large European insurance companies have been involved in take-over activity, some have been more active than others. If one were to take two groupings that have been particularly active, one would identify the large quoted Swiss companies and the state-owned French companies. The Swiss, having a strong domestic currency and a relatively small domestic market, have not been surprisingly active. Equally aggressive have been the state-owned French insurance companies, viz UAP, AGF, GAN. The activity of the French state companies reflects in part the fact that they wished to make up lost ground, since their overseas expansion was held back after their nationalisation in the 1950's. However, there is no doubt that French insurance companies, and indeed French enterprises as a whole, have taken a more positive view of the benefits to be gained in the long term from the European regional market.

The links between banks and insurance companies

One of the features of the last decade in Western Europe has been the changing relationship between the insurance and banking systems, which in many countries has historically been kept apart through government regulation. With greater deregulation within the financial system, and the ensuing greater competitive pressures within both the banking and insurance industries, the boundaries between insurance and banking have become more blurred. Banks, and to a lesser extent insurance companies, have begun to diversify their activities into each others' territories. The process of change has not been limited to market entry; through greater product innovation, new substitute products have emerged for the more traditional insurance and banking products. The growth of the investment sector, particularly the growth of private pension funds and mutual funds, has intensified this area of competitive interface.

One particular area of development has been the role that banks play as marketing outlets for insurance. The entry of banks (commercial, saving and mortgage bank) into selling insurance has been the feature of most European countries in recent years. The form of the relationship has varied. Sometimes the bank has set up a distribution agreement with a particular insurance company and sometimes a new insurance company has been formed as a joint venture, with the insurance company managing the underwriting and claims function and the bank managing the marketing functions. However, over time banks have realised that the marketing of insurance, especially life insurance and private pensions, is a profitable activity and a number of the larger banks have gone one step further. They have used their holding company structures to set up their own wholly-owned insurance companies or have bought existing insurance companies.

It has not always been the banks that have been initiating these changes. The larger insurance companies have also seen the benefit of using the reputation of banks to sell their products and to increase their market shares. Moreover, the large pan-European insurance groups when entering another European market have seen cross-border tie-ups with local banks as an efficient means of market penetration.

It is interesting to observe that insurance companies are much less able to act as distribution outlets for banking products. This is because insurance companies have historically tended to be less close to their customers, often using insurance agents and brokers as their links with customers. This contrasts with banks where the distribution and production operations have always been integrated. This lower degree of contact with the customer, and indeed in some cases a poorer reputation, has meant that insurance companies have been less able to market banking products, even if they had wished to.

While banks have set up or acquired insurance companies, there have been a few cases of insurance companies setting up or acquiring smaller banks, although it must be said that these acquisitions have been much less frequent and on a lower scale than in the case of bank diversification strategies.

One has seen recently in the Netherlands that the relationship between banks and insurance companies has gone one stage further, with mergers between the two. The merger of Nationale Nederlanden and NMB Postbank group to form the ING group and the merger of the second largest Dutch bank, RABO, with the insurer, Interpolis, are the notable cases. The Dutch regulatory authorities approved these mergers. Whether mergers between insurance companies and banks will be allowed to become a general feature within Europe is still an open question. Central banks and the regulatory authorities are likely to be worried about the undue concentration of power and the potential vulnerability to the financial system as a whole arising from such a concentration. An interesting economic question is whether a financial system is potentially more or less stable over time if there are fewer yet stronger financial conglomerates compared with a system that is more diffuse.

It should also be noted that there has been a strengthening of the interface between insurance companies and banks in other areas apart from the marketing and production of insurance. The insurance sector has increased the underpinning role that it provides to banks as financial intermediaries. This support has manifested itself in the form of a growing supply of credit risk transfer facilities, through credit insurance and various types of financial guarantees. In addition, through their investment activity in the bond and swap markets, life insurance companies have indirectly assisted the banks to

manage their interest rate risk exposures and as major purchasers of bonds arising from loan securitisations have thus assisted them in their liquidity management.

Less pervasive role for the state

The relationship between the state and private insurance sector within western Europe has always been one of relatively close contact. The intensity of interaction between the private insurance sector and the government has varied across western Europe, reflecting different political and economic traditions.

In recent years there has been a general trend across western democracies for governments to play a less pervasive role in social insurance than have hitherto. This reflects in part political changes, but it also reflects the fact that governments are unable to justify to voters the higher taxes (or state borrowing) necessary to support this government role. In recent times a major change has been the transfer of more of the responsibility for income maintenance programs within social security systems onto the private insurance sector. This has been particularly evident in the fields of pensions, health-care financing, workmen's compensation and other disability insurance programs. The cost of supply of these social insurance programs, in the face of ageing populations with high expectations, has been a major determinant of this shift. In most countries in Western Europe there exists some form of tax incentive to encourage this process of transfer. These tax subsidies are viewed by governments as a good investment for the tax payer, since the taxes foregone are expected to be more than offset by lower tax support needed in the future. Not only have governments sought to encourage the role of the insurance sector, but they have recognised the need for a more co-ordinated approach between the state and private insurance sector. This gradual shift away from the state to the private sector is something which should provide a major stimulus to the growth of the private insurance sector in the rest of the decade and beyond.

In the area of non-life insurance, there has also been evidence that governments wish to transfer more responsibility to the private sector. One such area is export credit insurances, particularly those related to short-term

credit risks. It is gradually being recognized that the private sector has better information systems for pricing such insurances and can spread the attendant risks more effectively through national and international reinsurance networks.

Privatisation of state-owned insurance enterprises

Government-owned insurance enterprises have existed in competition with private insurers in a number of European countries for many years. They have usually reflected nationalisations since the second world war. State-owned insurance companies have existed in France, Greece, Portugal, Italy, Ireland and certain Lander in Germany. In recent years there has been a general move towards privatising these state-owned enterprises. There are other factors apart from changing of political attitudes. One of which has been that companies need to raise external capital to finance their growth, whether to expand within their national markets or in the wider regional market. Since the late 1980's, the state-owned companies in Portugal and Ireland have been returned to the private sector, and the French and Italian state-companies are currently in the process of privatisation.

Although the state-owned insurance enterprises in Europe are moving more and more into private ownership, it is worth noting the extent to which they have competed in the recent past on level playing-fields with private sector companies. For the most part state-owned enterprises have not sought to undercut private sector firms through unfair price competition. The only area one could argue that unfair competition has existed is in the field of government procurement, where government-owned enterprises have been required to purchase their insurances with state-owned insurance companies. But what has been a source of contention within the European insurance industry is the fact that state-owned companies, especially the French, have been expanding across Europe through take-over activity, while they themselves have been immune from take-over. This market asymmetry has not just been confined to state [owned] insurance companies; it also applies to large mutual companies which are also capable of acquiring other insurance companies while being bid-proof themselves.

Wider global expansion by European insurers

While the corporate strategies of the major European-based insurance companies since the early 1980's have had a strong emphasis on Western Europe, this geographical diversification has not been restricted to the region. A number of insurance groups, without an existing presence in North America, have sought to extend their activities in these markets, with the main emphasis being on the US life insurance market. There has also been a diversification into the fast developing markets in the Far East and Latin America, and in securing market positions in the emerging economies of central and eastern Europe.

One noticeable exception to this global expansion is their limited role in the Japanese market. A number of the larger European insurance groups would have liked to have entered the profitable Japanese insurance market, but have found this difficult to achieve, since the Ministry of Finance in Japan has been restrictive in granting licences to new companies to operate. Many of the larger Japanese insurance companies have not been available for acquisition, either because they already form parts of large trading groups or are mutual companies. In any event, it would have been difficult to acquire even smaller quoted Japanese insurance companies, in view of historically high Japanese stock market levels and the strong yen. A few of the larger European insurance companies have during the early 1990's managed to obtain a licence to set up new operations in Japan, but the market share currently held by the European insurance companies is under 1% in non-life insurance and negligible in life insurance.

Non-European insurers entering Western European markets

Although no firm statistics are available, it can be said that the inward flow of direct investment into European insurance markets has been much less than the outward investment by European insurance companies. It is worth commenting on the market behaviour of major US and Japanese insurance groups during the period. US and Japanese insurers have not been as seriously intent on expanding their operations into Europe. There are a number of reasons for this. In the case of the United States, there are only a few truly international insurers, viz. AIG, Aetna, Chubb, CIGNA, Hartford, and these

have been pursuing a cautious policy of expansion, mainly through organic growth rather than through acquisition. The European operations of many of these US insurers exist primarily to serve the regional subsidiaries of multinational firms and hence there has been less need to obtain significant local market generation through acquisitions, although there has been an emerging interest since the early 1990's in securing stakes in the growing life insurance markets. Moreover, the low stock market ratings of many U.S. insurance companies, due to the poor profitability in their domestic market, would have inhibited the raising of the necessary capital from the stock market to finance any ambitious overseas incursions. For the most part, U.S. insurers, even those with adequate financial resources, have been more concerned in building up their regional networks through establishing new companies. The market share of the Western European insurance market controlled by U.S. insurers in 1993 was under 4% for non-life insurance and under 3% for life insurance.

Japanese insurers have operated in a protected and profitable domestic market and have no such financial constraints imposed upon them. Nevertheless, because of the buoyancy of their own domestic market, there has been less need for them to look elsewhere for expansion. Many of the Japanese non-life insurance have traditionally used the networks of major international insurance brokers to service the operations of their multinational clients in Europe and recently have extended these networks to include some of the major insurance companies. Japanese insurers have sought to operate through strategic alliances and joint ventures in order to tap the local expertise of insurance brokers and companies. The activities of the Japanese insurance companies in Europe reflect an interesting contrast with other Japanese industries. Insurance products or production processes do not require advanced technology; the main attributes of commercial success are having effective marketing and distribution networks, adequate local information to underwrite and price products, and an in-depth knowledge of the local regulatory, tax and reinsurance environment.

The creation of a common market in insurance within the European Union

The creation of a single common market in insurance has its roots in the Treaty of Rome in 1957. From the outset a view was taken that liberalisation

of regional insurance markets should take place in two main stages. The first stage was to grant an insurance company in one member state the right to set up a branch or a new subsidiary in another, i.e. the right of establishment. The second stage was to grant the right to insurers to sell their products on a cross-border basis, with the concomitant right of customers to buy cross-border. A separate directive for reinsurance transactions, life and non-life, was introduced in 1964, covering both establishment and cross-border business; this was introduced speedily because reinsurance transactions, being intrinsically international in nature, already enjoyed a good deal of commercial and regulatory freedom.

The first directives, granting the right of establishment, were agreed in 1973 for non-life insurance and in 1979 for life insurance and by the mid-1980's had been introduced into the national legislation of most EC states. The implementation of these directives was a lot slower than originally planned. Despite their protracted introduction, the directives have worked well, with insurance companies being granted licences to operate in other member states without undue delays. One key reason why member countries within the European Community agreed to the directives and proceeded with their implementation was that non-domestic insurance companies would have to operate within the prevailing national regulatory system.

What has proved much more difficult to agree and implement has been the second directives: freedom for cross-border transactions, both life and non-life. One key difficulty was the regulatory concern with the protection of local policyholders, including legal issues concerning the choice of law in case of disputes and minimum standards for customer protection in the event of insurer insolvency. There were other reasons, particularly differential taxes on premiums and mechanisms for collecting these taxes. Directives to allow some cross-border business were introduced in 1988 for non-life insurance and in 1989 for life insurance. But these directives were highly circumscribed and would not have permitted a significant flow of cross-border business to take place. By 1992 a common market in insurance had yet to be created, as had been planned, but a third generation of insurance directives had been agreed that embodied the necessary conditions to create such a market.

A central feature of these new directives was an attempt to move the regulatory focus of control from the home country. In other words, an insurance company with a head office in one member state would only need to comply with supervision in its own country, for its establishment and cross border business; this is apart from business conducted through subsidiaries, which must operate under host country control, since they are local insurance companies. One aspect of these new directives was that they would not only permit freedom of access to markets on a cross-border or establishment basis, but also addressed issues of competition policy within national insurance markets. There was a requirement that minimum price agreements known as 'tariffs' would have to be phased out and so too would the prior approval for the introduction of new insurance products. Compulsory insurances would, however, still remain tightly regulated. In addition, greater freedom would be allowed to insurance companies in the investment of their funds and this is important for life insurance companies, since freedom of investment is necessary for product innovation, as well as allowing them to compete with other suppliers of long-term saving products.

At the end of 1994, most member states of the European Union had implemented these third insurance directives into their national insurance legislation, with some delays being granted to the newer entrants, such as Greece and Portugal, and with a few deregulations in particular areas. Given the history of protracted negotiations, it has been surprising how comprehensively and speedily national governments and regulatory authorities have implemented even the most liberal aspects of the directives into their legislation.

Under the European Economic Area Agreement in October 1991, these insurance directives will be extended to EFTA countries, but as all the major EFTA countries, with the exception of Switzerland and Norway, have voted to join the European Union, this will help speed up the implementation process.

Future scenario for European Insurance Markets

There are grounds for arguing that during the rest of the 1990's, national insurance markets within Western Europe will become more concentrated.

It is reasonable to speculate that the number of independently-controlled insurance groups could fall from the present level of about 2500 to under 2000 by the end of the decade. The pattern of concentration is likely to differ from what prevailed in the 1980's and early 1990's. A key factor for this difference is that most of the insurance companies that were willing to be acquired have already been purchased, while those that do not wish to be purchased have set up defence mechanisms against predatory attack. Hence any further concentration can only take place for the most part through agreed take-overs and mergers. The larger insurance companies will need to persuade the owners and management of the benefits of being acquired, but this should be feasible. Ironically, gaining management agreement for a cross-border take-over is often easier than for a domestic take-over, since existing management positions in the acquired company are more likely to be protected.

There will continue to be pressure on some of the smaller companies, including mutuals, to merge, in order to pool their financial and human resources in the interests of survival. And with greater competition, it is possible that the rate of insurance company insolvencies will increase, which will still tend to be handled in many European countries by the regulatory authority finding a financially sound domestic insurer to acquire the failing company. Even though there is likely to be further concentration within the European insurance industry, there will still remain a significant number of small insurance companies. Apart from reinsurance and the provision of insurances for large multinationals, there are no clear economies of scale in insurance production or distribution, and so smaller companies can specialise in product and consumer niche markets.

It should also be noted that most of the larger European insurance groups have now set up their own networks across western Europe. But it is likely that as the deregulation process extends to new members some of the larger European insurance groups will seek to enter some of the more protected markets within Scandinavia. While there remain restrictions on the foreign control of local insurance companies in Sweden, Norway and Finland, this will continue to deter large scale entry; but even here under existing political agreements these restrictions on foreign ownership will be phased out during the next few years. In addition, medium-sized insurance companies that have

not hitherto ventured significantly outside their domestic markets are likely to do so, even if in a less ambitious way than their larger peers, possibly in collaboration with other medium-sized insurance groups that also do not have the financial and management resources to go it alone.

A notable feature of the take-over activity within Western Europe during the last decade has been that there have been few cross-border take-overs and mergers between very large insurance groups. There have been one or two intended cross-border mergers but they have not materialised because of difficulties in resolving differences in corporate style and in deciding on where ultimate management control will lie. Because of the shortage of suitable small and medium-sized targets for take-over, it is possible that during the second half of the 1990's, some of the large insurance groups may decide to embark on agreed mergers. These mergers could well be within national markets or cross-border. If they occur, these mergers will be second best preferences, as they will be seen as the only way of gaining a dominant position quickly in regional, and indeed in global markets, as most of the larger companies have wider international operations. There is no overriding commercial need for such mergers to take place. However, if one or two of these mergers do take place, this will inevitably cause a reaction across the industry, with other groups feeling that they must respond. Under this scenario, there would be a much more rapid restructuring of the European insurance industry, with an attendant increase in market concentration.

The new regulatory freedoms to buy and sell insurances on a cross border basis will gradually add an extra competitive dimension to markets. But there is a limit to the extent to which cross-border business will replace business supplied through local establishments, since in providing insurance services there is often a commercial need to have an on-the-spot presence. However, for certain standardised insurance products, which are commodity -like in nature, and for particularly well-informed consumer segments, cross-border insurances will inevitably grow. In some cases cross-border business will take place, with support being supplied by an existing establishment; in this way the local branch or subsidiary can provide the necessary on-the-spot services.

What is also clear is that the large insurance brokers will play an important catalytic role in the speed of change in the growth of cross-border business. Insurance brokers can supply the requisite on-the-spot services through their own networks of offices, including claim settlement services. In addition, banks themselves could play a similar role with respect to personal insurances, by buying insurances on a wholesale basis from a major foreign insurer and then packaging it to sell to their local customers. A key determinant of the speed with which cross-border business takes place will be advances in comm unication and information technologies. But with the greater compatibilities of networks, lower costs and greater consumer awareness of these technologies, there is little doubt that cross-border business will increase in the future.

Private insurance can be expected to be given a major stimulus in nearly all markets in Western Europe by the reduced role of the state in the provision of social insurance programmes. Irrespective of political preferences with in individual countries, the burden on state finances of providing benefits to ageing populations with high consumer expectations will increasingly prove too heavy for governments to bear alone. The present trend for governments to encourage a greater role for the private insurance sector can be predicted to continue; this will be reflected in a rapid growth of private pensions, private health insurance and long-term care schemes.

Diversification into Central and Eastern Europe

As the economies of former communist countries in central and eastern Europe expand, due in part to inward foreign investment by multinational firms, and with increasing privatisation of state-owned industries the demand for private insurance will grow. Insurance companies and large insurance brokers already with a limited presence in these markets will extend the scale of their operations and those not operating there already will enter to take advantage of the market potential. It is likely that there will be a similar pattern to what took place in the emerging insurance markets in Southern Europe in the 1970' s and 1980's. And it will not just be European insurance companies that will be entering these markets. Larger insurance companies from North America and Asia, some of which have recently set up operations, can be expected also to play a more active role, prompted in part

by the need to provide local servicing to their multinational clients operating in the region. Some of this market entry will be in the form of joint ventures with national insurance companies or with Western European insurance enterprises which already have a local operation. As in other insurance markets, the management culture within foreign insurance companies will determine the preferred mode of entry. Those insurance companies with a management emphasis on control will wish to set up their own operations or acquire local enterprises; others with a more co-operative style will be prepared to operate through joint ventures or strategic alliances. However, regulation already exists in most of these countries restricting 100% foreign ownership of local insurance companies and encouraging joint ventures, and there still appears to be political pressure in these countries, at least in the short term, not to change this legislation, in part because a more sudden switch from communism to capitalism is psychologically difficult for the population to accept. These constraints on foreign ownership and control will go in the longer term; indeed for those countries that aspire to become members of an enlarged European Union, existing competition rules will require them to go.

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