

The insurance industry in Germany 2006

Premium growth in the insurance industry is affected by the overall economic situation, particularly in property/casualty insurance. In life and health insurance the market force is also influenced by changes in the legal and tax environment. Consequently, very different parameters prevail in the European insurance markets. There are currently only a few markets in which we are active where projections exist for 2006. We will therefore be concentrating in more detail on the trends in our home market of Germany in the following sections.

The insurance industry was only able to benefit to a limited extent from the pleasing economic development recorded last year. Overall premium income was up by 2.2 %, which is not much more than the figure recorded in the previous year. The debate on the healthcare reform and fierce competition, especially in motor insurance, had a dampening effect on premium growth.

Life insurance in 2006

The reforms undertaken to the state pension systems over the past years have had a major impact on making the population realise the necessity in taking out additional private cover.

Indeed, the insurance industry has been given a key role in setting up additional funded pension schemes. Apart from the returns, aspects such as security and reliability, in particular, are becoming increasingly important for the customer. Here, life insurance can come up with a unique combination. Only its products ensure against biometric risks like death, getting old or invalidity, and offer guaranteed benefits at the same time. Also, a stable rate of growth over the course of time means that life insurance cover is ideal as a central tool for old-age provision. Against this background there was a positive trend. Premium income was up 3 to 4 % to € 78.3bn (75.2bn).

As regards private provision for old-age, there has been a continued trend towards annuities compared to endowment policies over the past few years. Following

amendments to legislation in the form of the retirement income law, the parameters of annuities have been improved considerably; their significance as an attractive pension tool has therefore been reinforced.

The success in the number of **state-assisted “Riester” pensions** sold shows the growing importance of private provision for old-age. In 2006, almost two million new policies were taken out. Basic pension cover, also referred to as the “Rürup” pension, which was introduced last year, was strengthened considerably by the fact that the premiums became fully tax deductible.

Endowment cover is also still very much attractive, as it is a combination of a guaranteed benefit and cover for surviving dependants, and also offers flexible possibilities for different purposes of cover. Apart from the traditional insurance products, the unit linked policies assume an important place in the pension market; it enables customers who are prepared to take a higher risk to participate directly in the opportunities posed by the capital markets.

There has also been a considerable boost to company pension schemes over the past years which have become a significant integral part of old-age provision.

The basic framework of **direct insurance and retirement funds** (Pensionskassen) have been improved still further as a result of new transfer agreements which have been in force since the end of 2005. Transfers of cover as a result of changing jobs are now valid with both these types of cover and there are no adverse effects in terms of tax between direct insurance cover and a retirement fund. The trend away from defined benefit pledges to defined contribution pledges remains uninterrupted. This is illustrated by an ever increasing demand for employer-financed models in all forms of cover.

Private health insurance in 2006

Private health insurance in 2006 was merely a matter of the debates revolving around the Law on the Increase in Competition in the National Health System. Due to the fundamental different views towards the reform methods held by both partners of

the German coalition government, it was an extremely difficult process to come to any kind of decision. During the course of discussions private health insurance was even threatened at some stages by a virtual abolition. Although a lot was able to be avoided or at least mitigated, there still, however, remain considerable risks for the business model of private healthcare cover. Following the never-ending debates on the reform and the uncertainties felt by potential customers as a result, it has indeed had an adverse effect on business development of private health insurance.

Nevertheless, private health insurance in 2006 experienced a rise in premium income of 4.2 % to around €28.5bn (27.3bn). This growth is, however, mainly derived from the sales of supplementary insurance policies as well as adjustments to premiums for comprehensive health cover. New business in comprehensive health cover was, by contrast, once again very moderate in 2006. Apart from uncertainties caused by politics this was also a result of demographic trends which led to a fall in potential new customers.

Property and casualty insurance in 2006

Property and casualty insurance was unable to benefit from overall improved economic activity in 2006. It was once again evident here that any positive effects resulting from economic activity take some time before the effect is felt in the insurance industry. Furthermore, the price competition in motor insurance and industrial property insurance left its marks. Following only a slight ultimate drop in premiums recorded last year, 2006 saw a more significant fall of -1.1% to €54.8bn (55.4bn).

On the other hand, expenses for damages in the financial year under review rose yet again, up to €39.9bn (39.6bn), representing a 0.8 % increase. As a consequence, the claims ratio prior to runoff was up 1.1 percentage points to 74.0 %. In spite of the combined ratio rising to 93.0 % (90.9 %), the insurance industry was once again able to make good underwriting profits in 2006. These figures for the market are based on gross figures in accordance with the German Commercial Code (HGB), so are not really comparable with IFRS figures.

Price competition is particularly fierce in **motor insurance**. The segment with the highest premium income recorded a 4.1% drop in premiums, down from €22.0bn to €21.1bn. Expenditure on claims for the year under review remained virtually on par with the previous year at – 0.3 %. The combined ratio was just a little under 100 %.

In 2006 a particularly varying trend was recorded in the **different lines of non-life insurance**. Overall premium income rose slightly, up 0.2 % to €14.2bn (14.2bn). A decline was recorded in industrial fire lines of business where premiums fell by 6.0 %. On the other hand, an increase was recorded for premium income in other non-life lines of business; technical insurance was significantly up, by 5.0 %, growth of private non-life insurance product lines was somewhat lower at 1.5 %.

Growth in **general liability insurance** dropped to 0.5 % (4.2 %) as a result of the cessation of the adjustment effect stemming from 2004 still having an effect last year. Premium income for **personal accident insurance** increased from €6.0bn to €6.2bn, which represented a growth rate of 2.5 % (1.1%) compared with previous year's figures. Premium income for **transport insurance** was stable.

Legal expenses insurance in 2006

In 2006 the German legal expenses insurers attained a growth in premiums of 2.0 %, meaning that overall premium volume rose to €3.1bn. This made the legal expenses line of business one of the strongest growth sectors within composite insurance. The growth in premiums is, however, predominantly due to the mechanism of premium adjustments, of which virtually all legal expenses insurers have taken advantage.

As regards payment of claims, the situation stabilised in the year under review after the Modernisation of Costs Law (KostRModG) came into force in 2004. Whereas a rise of 16.7 % was recorded for 2005, payments of claims were down by 3 % as a whole for the year under review. Compared with the previous year there was a slight improvement in the claims ratio which stood at 74.0 % (74.2 %). At 102.0 % (101.9 %), the combined ratio was a little more than the previous year as a result of higher operating costs. It should be noted here, too, that these figures for the market are

based on gross figures in accordance with the German Commercial Code (HGB), and so are not really comparable with IFRS figures.

Legal parameters

The German insurance industry has been affected by a number of proposed bills which will have an effect on our business, notably in respect of tariffs and product design, customer relations as well as the business processes of companies. Various European and global initiatives in the field of supervisory law have altered the parameters and will continue to provide for a restructuring of the regulatory landscape in future.

The federal government intends to adapt the **German Insurance Contract Act (VVG)** to jurisdiction set out by the Supreme Court and to consumer protection needs deemed as being modern by passing a fundamental reform. The main points of the reform are, for example, the duty by insurance companies to provide information and advice prior to and during the time of signing for a policy. In addition, the duty of disclosure by the policyholder prior to signing the policy agreement is to be relaxed and sanctions to be abolished even in the case of gross negligence. Furthermore, it is intended to reduce the maximum term of insurance cover in the field of composite insurance from five to three years, as well as granting the claimant a direct claim against the insurer with compulsory insurance. Finally, the bill envisages the abolition of the so-called policy model; under this model, the policyholder is sent the consumer guidelines together with the policy. In future the customer is to receive all contractual information before he or she signs the agreement.

As regards life insurance, the VVG reform means that standards laid down by the German Federal Constitutional Court are implemented, which had been assigned to legislature with the judgements dating back to 26 July 2005. The judgements concerned endowment insurance with policyholder bonuses as well as the portfolio transfers between insurance companies. The Federal Constitutional Court had stipulated that hidden reserves are taken into account with policyholder bonuses as well as more transparency and competition among life insurers.

The proposed legislation currently envisages that upon termination of contract 50 % of hidden reserves accounted for by the individual policyholder must be allotted. More detailed deliberations stemming from spring 2006, which would clearly have threatened the business model of life insurance are no longer being pursued by legislature. These were that hidden reserves had to be appropriated as a binding agreement every two years on the basis of their prevailing fair value.

Another focal point of the reform concerning life insurance policies is the topic of early surrender. To date, none or very little surrender values arise in the initial years of a policy as acquisition costs are amortised according to the Zillmer method. It is currently foreseen that the costs are evenly spread out across the initial five years. The problem appears, however, that these regulations are also to apply to the existing insurance portfolio with effect from 1 January 2008 in line with the current bill on reform. This means that the insurer's basic calculation would be changed ex post. It remains to be seen whether this is rectified during the ongoing course of legislation.

As regards private health insurance, the VVG reform is intended to open up the parameters for a claims and health management as well as giving insurers the opportunity to provide further services. The law is due to come into force on 1 January 2008 and to apply to all existing insurance policies as from 1 January 2009. The new regulations governing private health insurance can be implemented on existing policies as early as 1 January 2008.

The **General Equal Treatment Act (AGG)** has been in force since 18 August 2006 and is partly based on four EU directives concerning the protection against discrimination which were passed between 2000 and 2004. It is intended to prevent or abolish discrimination for reasons of race, ethnic origin, sex, religion, ideology, a disability, age or sexual identity. The act particularly affects the insurance industry in their role as employers but also as insurers and bearers of risks. As far as employers are concerned, new duties have been imposed which can result in liability risks as well as potential claims for compensation.

The new regulations of the General Equal Treatment Act, which are significant to the insurance industry, are valid as from 22 December 2007. Thereafter premiums or

benefits for men and women may only differ if the sex is a determining factor. The assessment of risk must be based on relevant and precise actuarial and statistical data. Costs incurred as a result of pregnancy and motherhood may in no way result in different premiums or benefits. Varying treatment on account of religion, ideology, disability, age or sexual identity is only permitted for insurance cover if it is based on recognised principles of a risk-adequate calculation.

Finally, the **Law on Revising Insurance Mediation** will probably come into force on 1 April 2007 with which the federal government will be implementing the EU directive on insurance mediation which dates back to 2002. The new law results in fundamental changes for insurance sales forces. Under trade law insurance agents will, in future, require a licence which will also depend on whether they are adequately qualified.

Insurance agents will not need a licence if they are only working on behalf of one or several insurance companies, provided that the insurance products are not in competition with each other. Furthermore, insurance companies must assume unlimited liability for the agent in respect of his role as an agent. Yet another key issue of the mediation law is the extended duties pertaining to the advisory and documenting aspect. The insurance agent must provide advice geared towards the needs of the customer and based on the situation and justify every piece of advice which he provides for a particular insurance. In this respect he is to provide the customer with a clear and understandable document. What is more, insurance companies may only work with agents who are registered in a central and public list of agents.

In May 2006 legislation was passed pertaining to corresponding decrees on setting up the **statutory security fund for life insurers**. The fund has been set up to protect the customer in case the life insurer goes bankrupt. The duties and powers of authority of the statutory security fund were assigned to Protektor Lebensversicherungs-AG. In addition, the German life insurance industry has renewed its voluntary declaration of commitment and continues to abide by its pledge to guarantee the security of life insurance cover and the protection of policyholders over and above statutory protection. These measures have resulted in the trust in the

security of the product life insurance being reinforced. Apart from life insurers deregulated retirement funds (Pensionskassen) can also join the statutory security fund.