

The outlook for EU insurance mutuals in the fast-changing EU marketplace

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Executive summary

This document was prepared by Eurofi as an introductory document for the workshop of December 3rd, with the input of the British Building Societies Association, Ethias, Gothaer Group, MACIF, MAIF, Mutualité Française, NFU Mutual, Tapiola and Professor E. Greppi.

1. Context:

Mutual companies have a specific legal statute and specific governance arrangements.

- Mutual companies have no share capital and therefore no shareholders
- They are initially set up and controlled by their customers (their “members”) who have voting rights¹ and can be involved to a certain extent in the governance of the company and in decisions made². Solidarity links exist between members: supplementary calls, possible rebates...

What makes mutuals different from plc or cooperative companies is their legal statute and governance arrangements and not their size:

- Most of them are for-profit companies and insurance mutuals of all sizes exist in Europe as for plcs: from a few million Euros annual premiums written to several billion. In the Top 100 EU insurance companies, 26 are mutuals and 4 are controlled by mutual holdings³.
- Most large mutuals cover all insurance markets (P&C⁴, health, life insurance) and serve all customers far beyond their initial member base⁵. Smaller mutuals are usually still focused on a specific client or product segment or on a region⁶.
- Mutuals have access to capital markets: they can issue subordinated debt or hybrid capital eg to finance their development needs⁷

¹ Equivalent voting rights or weighted rights depending on the company

² eg by electing representatives who participate in the general meetings and board meetings

³ Examples of mutuals part of the Top 100 EU insurance companies: Groupama N°17 (13,5 Bio € premium), Covea N° 19 (12,0 Bio €), Debeka N° 30 (7,3 Bio €)

Examples of insurers with mutual holding companies part of the Top 100: Talanx / HDI N° 21 (10,2 Bio €), Wiener Staetische N° 36 (5,9 Bio €)

Source AISAM (Association Internationale des Sociétés d'Assurance Mutuelle): Gross direct premium written in 2006

⁴ P&C Property and Casualty insurance covers home, car and other general insurance

⁵ For example the MAIF in France originally created by a group of school teachers now markets P&C and life insurance to all customers and is the 74th European insurance group with annual gross premium of € 2,6 Bio, but this is only one of the many examples of such developments in the mutual insurance industry

⁶ This is the same for plcs to a certain extent. According to CEIOPS 4500 insurance companies out of a total of 5300 identified by the CEA (Comité Européen des Assurances) have annual premiums inferior to 10 Mio € (mostly in life insurance) and only 30% of them are mutuals

The mutual legal statute presents certain drawbacks that have led some companies to choose demutualisation to pursue their development strategy⁸. Indeed:

- Mutuals cannot raise share capital. Of course, conversely, their statute preserves them from possible hostile take-overs.
- Mutual companies can merge domestically in many EU countries but cannot use shares to pay for acquisitions⁹. They cannot merge in a mutual form on a cross-border basis¹⁰.

Some large insurance mutuals have chosen to set up plc subsidiaries that they control, to develop new activities, serve new customer segments or facilitate their geographical expansion, while retaining their mutual statute and governance principles (in the parent company). In some cases plc subsidiaries manage a significant proportion if not the quasi-totality of their insurance business and some are listed companies¹¹.

Insurance mutuals represent a significant share of the EU insurance market¹²:

- Insurance mutuals or assimilated companies (ie subsidiaries of mutual insurers or hybrid mutual insurers which are run according to mutual principles) represent at present 25% of the total insurance premiums in the EU and around 65% of the companies active in the EU. In parallel the five largest EU insurance groups, which are all plcs, represent around 55% of the insurance market in the EU and take a rising proportion of the market.
- The penetration of mutuals is variable across EU countries: mutuals have a 20 to 40% market share in 7 EU countries (Finland, Sweden, France, Germany, Spain, Belgium and Denmark). In many countries their penetration is more limited and they do not exist in around 25% of EU countries, particularly in Eastern European countries.

The regulatory environment of mutuals varies across EU countries usually in relationship with their presence in the market. In countries where mutuals only represent a limited share of the market (eg Italy) there is no specific legal framework and in many Eastern EU countries there is no legal framework for mutuals at all.

Strengthening the legal framework for mutuals on the EU level has been a long-standing debate. After different assessments conducted following the implementation of the European Company statute (SE) and the European Cooperative statute (SCE) (a consultation took place in 2003 in particular), the Commission decided in 2005 to abandon the project to develop a European Mutual statute, considering that it was not a priority.

⁷ Some mutuals explain that the process of issuing subordinated debt or hybrid capital may be slower or more complex in certain cases than for plcs due in particular to the rating process which may be slower because mutuals do not fit in with the standard evaluation process due to their characteristics

⁸ Although some mutuals consider that speculation was also a major driver of this choice in some cases

⁹ Mergers of insurance mutuals are possible on a local basis in France, Germany, Belgium, Finland, Belgium, Denmark, Austria... In certain cases eg Germany they can only merge directly within the same insurance branch (eg life), but alternative set ups are possible through plc subsidiaries. In Finland mutual insurance companies can merge with each other or with other types of insurance companies including plcs. Mutual insurance companies can form groups based on an agreement and/or ownership of guarantee capital. Such groups do not have separate legal personality but they are supervised as a group.

¹⁰ Some set ups exist in Europe enabling mutuals to create groups in a contractual form with financial solidarity links (eg the SGAM – Société de Groupe d'Assurance Mutualiste in France) or based on cross-ownership of the guarantee capital (eg in Finland). In France, such groups can affiliate foreign EU companies, in Finland there is a project to provide this possibility, although the practical implementation in a cross-border environment is still unclear to a certain extent

¹¹ One downside is that holding mutual companies are unable to absorb plc subsidiaries (unlike plc holdings) which will probably result in higher own funds requirements for mutuals controlling plcs with the new Solvency II prudential regime

¹² Source AISAM Statistics 2004 and CEA statistics 2006

In parallel:

- Major players in the market are continuing to make their business model and organization evolve: major domestic or cross-border mergers and acquisitions have continued to take place increasing consolidation (eg Axa / Winterthur...), some large mutuals continue to pursue projects to make their organisation and capital structure evolve eg creating plc structures or pursuing demutualization projects (eg MAPFRE).
- The level of integration of EU markets is progressing (although retail markets still remain very much domestic): corporate and re-insurance markets are increasingly integrated, development of retail on-line markets...
- The regulatory framework is also evolving with increasingly pan European regulation eg the intermediation directive implemented in 2007, Solvency II which is under way....

In this context, the Eurofi working group believes that the prospects and needs of EU insurance mutuals need to be reassessed. We examined with a group of representative mutuals listed at the beginning of this paper, the main challenges they are facing at the EU level and the possible needs they may have related to EU regulation to ensure their development in fair competition conditions.

2. Insurance mutuals part of our working group believe that their mutual business model provides specific benefits to their customers and wish to retain it as a key differentiation factor:

The mutual model offers many advantages for customers according to the mutuals consulted:

- Having no shareholders to remunerate or no short term pressure from quarterly results, mutuals consider having more flexibility in fixing prices adjusted according to the costs incurred in the operational management of the business and to the investments required. They believe they can also more easily manage the company with a long term perspective, which enables them to invest in projects with medium or long term impacts¹³ or to develop emerging or long tail businesses¹⁴.
- Their close relationship with their customers who are also members enables them in certain cases to customize more their offering and management of liabilities¹⁵
- Members are involved directly or indirectly in the governance of the mutuals they belong to, which enables them collectively to have an impact on the way the business is conducted

The good economic performance of mutuals in their home markets, according to the figures published by the mutual professional associations for the period between 1995 and 2001¹⁶, tend to demonstrate that these specificities appeal to customers and enable efficient management¹⁷:

¹³ For example investing in prevention or training actions of their members that may reduce car accidents and enable their customers over time to reduce premiums paid

¹⁴ Risks that have to be managed with a long term perspective eg: medical malpractice liabilities, decennial liabilities in construction...

¹⁵ eg insurance for motorcycle drivers, specific casualty management processes for farmers or small business owners

¹⁶ Source ACME study October 2003 « Valuing our mutuality » Average figures 1995 / 2001

¹⁷ Some existing differences in the mix of customers and products between mutual insurance companies and their plc counterparts should nevertheless be taken into account when interpreting these figures

- Average growth of premiums has been higher for mutuals than for plcs in recent years ie between 1995 and 2001: +15% for mutuals in life insurance vs +9% for plcs and +4,3% in non-life vs +3,9% for plcs (per annum)
- Expense ratios (operating costs / premiums) were lower than plcs: 13% for mutuals in life insurance vs 15% for plcs and 20% in non-life vs 24% for plcs
- ROI and solvency margins are similar to those of plcs (although ROIs may not be comparable since mutuals have no share capital)

Many mutual companies wish to retain their statute which they consider as a key success and differentiation factor in the market. They also believe that this alternative business model should be preserved for the added value it may bring to customers and more generally to the economy by stimulating competition with other forms of business (plcs and cooperatives).

3. Mutuals are facing many market and regulatory challenges. These challenges are common to mutuals representing the largest part of the market, although their impact is different depending on the size of the company or its geographical focus:

Some challenges relate to the evolution of the market:

Growth challenges:

- Need for large mutuals or mutuals focused on specific business or customer segments to find new growth opportunities outside of their domestic Western European countries which are mature (particularly in non-life which are stagnating markets) and where the product diversification potential has already been leveraged to a great extent ¹⁸

Efficiency / market positioning challenges:

- Large mutuals need to improve efficiency continuously to face up to the competition from consolidated plc groups. This often involves building scale particularly in more price or cost sensitive markets such as non life insurance, although scale is not the only factor of success
- All players also need to preserve and leverage specific customer relationships, offering and positioning as a differentiator in the market, facilitated by their mutual characteristics.

Others are more of a regulatory nature:

Recognition in EU legislation:

- New or updated EU legislations often do not take into account sufficiently the legal and governance specificities of mutuals. This requires significant lobbying efforts on the part of mutuals to make sure these specificities are taken into account (eg in the preparation of Solvency II, in the implementation of the cross-border mergers directive or in legislations dealing with corporate governance issues)
- Mutual insurance companies are indeed often still assimilated to small businesses meaning their specificities are not sufficiently taken into account at the outset of legislative proposals or evolutions

¹⁸ Mature markets particularly in non-life markets in many Western EU countries with little growth potential and fairly stabilized market shares: yearly growth is around +0 or +1% in most Western countries in 2006 vs 2005

More growth potential in life or health markets but tough competition from banks or specialized insurance companies

Growth potential in Eastern EU countries that do not always have mutual statutes: double digit growth rates in most Eastern European countries in life and non life insurance

Product diversification has been already leveraged in many cases in Western European home countries by large companies

Solvency II challenges:

- Mutual professional associations are active in making sure that the many specificities of mutuals are eventually taken into account in the implementation of the Solvency II reform: ie treatment of hybrid capital items, possible exemption thresholds, possible specific provisions for specialized and long tail players...
- Despite this potential progress, facing up to the Solvency II reform will probably remain a major issue particularly for many small and medium sized insurance companies, far beyond the possible exemption threshold of the reform. Many insurance companies consider indeed that their solvency margins may be doubled or even tripled.
- For small and medium-sized companies this issue is particularly acute since they often do not have sufficient product or geographical diversification, nor sufficient human resources to deal with these issues and have limited negotiation power in capital markets. This will probably trigger a need for many of these companies to seek in particular regrouping opportunities¹⁹ to pool human, financial and operational resources and increase their diversification.
- In addition the Solvency II reform should recognize mutual groups and their specificities to enable them to benefit from the group dispositions of the directive.

4. To face up to these EU level challenges a large majority of mutuals part of the Eurofi working group believe that evolutions in the present EU legislation are required

In summary three main needs were expressed by a large majority of mutual companies consulted (7 participants out of 10):

In order of priority

1. Cross-border regrouping: Enable insurance mutuals to form groups on a local and cross-border basis in a mutual form²⁰ to develop synergies, facilitate cross-border growth and face up to Solvency II requirements

- Large mutuals express the need to build economies of scale and synergies to compete with plc groups that are consolidating and expanding in the EU.
- Building a cross-border mutual group can also be a faster and a more cost-effective option for growing revenues than creating plc or mutual subsidiaries for mutual companies confronted with limitations to their growth potential in their home market
- Some mutual companies, particularly small and medium-sized companies, need to pool resources and access to capital markets and increase their diversification to face up to Solvency II requirements in particular

2. Cross-border development: Facilitate the development of mutuals in all foreign EU markets in a mutual form (setting up new mutuals or serving members on a cross-border basis) through the availability of a mutual statute in all EU countries and more consistent dispositions

- As stated previously, mutual statutes do not exist in all EU markets and in particular not in certain Eastern EU countries which are at the same time some of the fastest growing markets in the EU²¹.

¹⁹ This issue is not specific to mutuals but more problematic for them as they have less tools available than plcs eg limitations in creation of mutual groups in most EU countries, some constraints in access to capital markets

²⁰ Between insurance mutuals but also possibly with other financial services mutuals eg building societies as is being discussed at present in the UK

- In addition differences in existing legal frameworks²² can hinder the development of new mutuals in other EU countries²³

3. Recognition: Ensure a recognition of mutuals in EU legislation to enable the characteristics of mutual to be better taken into account in new or updated EU legislation or to enable countries with no or limited legal framework concerning mutuals to refer to an EU text (eg Italy)

- As mentioned previously, EU legislation often does not take into account sufficiently the specificities of mutuals, according to the companies consulted, and mutuals are quite often assimilated by regulators to small businesses in the preparation of legislations, which is not appropriate since their specificity is a question of legal statute and governance and not of size
- Some mutuals also put forward that the lack of recognition of mutuals in EU legislation raises a level playing field issue with plcs or cooperative companies who have an official recognition on an EU level through the European Company statute (SE) or the EU Cooperative Company statute (SCE) and related advantages.

Some mutuals involved in the Eurofi working group nevertheless considered that improving EU legislation for mutuals was not a priority for them.

- **Some mutuals, focused at present on their domestic market, expressed no need for additional EU legislation (2 participants out of 10)**
 - They consider having sufficient development potential in their home country which is their main focus and stress that legislation is only one of the issues to be solved for companies wishing to develop cross-borders along with different business approaches, taxation systems, cultures...
 - They nevertheless understand that other mutuals with cross-border development projects may have additional needs for specific EU level legal tools

One participant involved in the Eurofi working group was concerned by the impact possible EU legislation could have on domestic mutual legislation

- This participant considers that European development is still a theoretical need at present for the mutuals he represents. For him, there is no practical need for EU legislation in this field at present and that the current legal and economic environment is sufficient for their present local or cross-border development needs (eg domestic mergers or the possibility of developing cross-border partnerships through plc subsidiaries...).
- He is also concerned that an EU level legislation may have a negative impact on domestic legislation which may offset any possible benefits brought to the local players from an EU approach.

5. Possible options to answer the needs expressed were examined.

5.1. The mutuals who expressed the need for additional EU legislation consider that new legal tools are required to facilitate the regrouping of mutuals on a cross-border basis.

²¹ There are no mutual insurance companies in the Czech Rep, the Slovak Rep, Romania, Bulgaria, Malta, Cyprus, Greece

²² Particularly relating to membership requirements, governance or risk management processes

²³ Although the implementation of the Solvency II reform is expected to favour further harmonization of risk management, internal audit and actuarial processes

Mutuals part of the Eurofi working group in favour of evolutions in EU legislation propose developing a specific tool, on the EU level, enabling insurance mutuals to form a cross-border mutual group either through merger, mutual holding or contractual links.

This legal tool should be optional and as flexible as possible and should not impact national legislations. As much freedom as possible should be given to individual companies to define their organization and governance and EU level rules should enable Member States to retain their present dispositions for forming mutual groups (and possibly develop new ones if necessary).

Indeed these mutuals consider that the existing tools on the domestic or EU level are insufficient or inappropriate to respond to the needs expressed above:

- Commercial or operational partnerships can be organized on a cross-border basis (EEIG, distribution partnerships, focused operational partnerships...) but do not lead to enough management integration. Ventures embarked upon thanks to the freedom of establishment and freedom to provide cross-border services principles in place in the EU are also considered insufficient to establish a significant and long term presence in a foreign country
- Plc subsidiaries can be set up by mutuals but such ventures are usually costly and may dilute the mutual nature of the company according to some companies interviewed. Establishing a new mutual is also costly and slow and in many cases it is not easy for the parent company to retain sufficient control on the newly formed company.
- Mergers of mutuals are at present only possible on a national basis.
 - Different legal set ups exist at present on a domestic basis in many EU countries to enable mutuals to merge eg in Germany, France, Belgium... and in France mutuals can create a group in a contractual form with financial solidarity links (SGAM or UGM)²⁴. Some of these legal frameworks allow foreign members to be included eg in the French SGAM, but the fiscal and supervisory modalities are still unclear at present.
 - Mergers of plc subsidiaries of mutual groups are possible on a cross-border basis but this presents limits according to some companies: indeed they consider that although this set up may be sufficient to develop cross-border partnerships it would not enable them to create an integrated mutual group with common management, since the mutual parent companies cannot merge cross-borderly.

Adopting an EU perspective to solve this issue is necessary according to most of the mutuals consulted:

- Local texts, even when they allow foreign members to be affiliated, are most often developed to solve domestic problems and do not correctly take into account a EU dimension or the needs of potential foreign partners or the practices of foreign supervisors. In addition the pace of adoption of local texts with a EU dimension may be insufficient to enable mutuals to face up to challenges that are already happening in many markets and may result in diverging proposals to a certain extent
- Adopting a EU perspective from the beginning should enable to avoid the complexity of having to deal with different supervisors and different (or possibly incompatible) provisions included in different local texts, as well as possible regulatory arbitrage and the difficulty of streamlining differing local texts

²⁴ In addition to the SGAM which enable mutuals to regroup, there is also the UGM in France (Union de Groupe Mutualiste) that enables different mutuals as well as health insurance companies to regroup in similar conditions

These suggestions made by the Eurofi working group do not seem to raise specific concerns from plc companies.

A proposal for a European Mutual statute is being finalized by the mutual professional associations (ACME, AISAM and AIM²⁵) independently from the Eurofi initiative. It contains in particular some dispositions enabling mutuals to create cross-border mutual groups through merger or contractual links. Most participants of the Eurofi working group in favour of evolutions in EU legislation consider that this proposal, developed by the professional associations, could potentially enable companies who choose to adopt this optional statute to solve, in the medium term, the main challenges listed previously. They are particularly in favour of the dispositions related to the possibility to form mutual cross-border groups.

- This proposal is now finalized and will be communicated to the representatives of the future Presidencies of the EU in the coming weeks.
- It is optional and should therefore have no impact on domestic legislations
- This statute requires to be implemented through an EU specific legislation or regulation and could therefore be operational within approximately 5 years

5.2. In the short term, the priorities for the majority of insurance mutuals consulted are to make sure that mutual groups are clearly recognized in the Solvency II reform and that local texts regarding mutual groups are developed in a coherent way:

These proposals should not require modifying existing local mutual legislation.

Recognition of mutual groups in Solvency II

A major issue raised by insurance mutuals on the occasion of the Solvency II debate is the need for a clearer recognition of mutual groups in the Solvency II reform, which at present does not explicitly mention groups that are not based on parent company / subsidiary principles.

Mutual groups are already a reality in some domestic countries (eg France or Germany) formed either through merger or in contractual form (eg Covea in France). These companies are locally supervised as a group. Dispositions to affiliate foreign members exist in some EU markets eg France or are being developed eg in Finland, which could trigger the possible formation of some new cross-border mutual groups. It is therefore essential that these mutual groups are recognized as groups in the Solvency II reform, to enable them to benefit from the group dispositions of the Directive (ie group diversification effect, etc...) and to face up to the challenges described previously.

The definition of groups in the Directive (eg in definitions of groups in Title III article 219) should apply to all mutual groups and take into account their specificities eg specificities in the management structure, in the modalities to combine annual accounts.... In addition the conditions to adequately supervise and control these groups on the domestic and EU level should be defined at the European level.

Coherence in local texts related to mutual groups

When local legal texts that enable the formation of mutual groups with foreign affiliates are developed either through merger or contractual links, one should ensure that these texts are not incompatible.

²⁵ ACME (Association of European Cooperative and Mutual Insurers), AISAM (Association Internationale des Sociétés d'Assurance Mutuelle) and AIM (Association Internationale de la Mutualité)

ACME and AISAM have recently decided to join forces with the creation of a new association for the mutual sector AMICE.

Coherent rules²⁶ should apply for similar regrouping set ups (ie mergers, forming a mutual holding, establishing a group with contractual links...).

Coherent rules should also be proposed for including foreign affiliates and for managing the relationships with these affiliates.

Main questions to be discussed during the workshop:

These issues will be further discussed during the workshop organized at the EU Parliament during the Eurofi conference on December the 3rd. The following questions will be addressed by the panel participants:

- What are the main domestic and cross-border development opportunities for insurance mutuals in the EU and what potential benefits are expected for their members ?
- What regulatory, market challenges and issues do insurance mutuals experience at present ?
- How should insurance mutuals evolve to meet the challenges of Solvency II ?
- What legal tools could be needed to respond to these challenges while ensuring a level playing field between the different market players ?
- What are the pros and cons of a European Mutual statute or of other legal tools?

Eurofi contacts:

Marc Truchet, senior fellow consultant: marc.truchet@icme.com

Didier Cahen, Secretary General of Eurofi: cahen.didier@wanadoo.fr

²⁶ eg rules governing the type of company that can merge or be part of a group, the type of link that can be established, etc...