Review & Preview

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Sector
Non-Life

Additional Information

2011 Best's Briefing:
European Investment Stress Test Flags Sovereign Debt Risk

2011 Special Report:
Solvency II – Rating Implications Issue Review

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European Non-Life Sector Approaches Economic, Regulatory Turning Points

The European non-life insurance sector is approaching critical moments, with economic, regulatory and market forces set to severely test individual companies and the industry as a whole. Ongoing recession in many countries, volatile financial markets and the sovereign debt crisis have buffeted the industry. Companies are racing to meet changing solvency and accounting rules. Soft markets persist, dampening pricing and profitability.

• Stubbornly low interest rates are placing pressure on insurers' results, offering no relief from weak underwriting results driven by flat to downward pricing trends.

• More economic twists, such as inflation spawned by an expansion of the money supply by central banks and governments as a tacit form of default on significant and, in some cases, unsustainable sovereign debts, could trouble non-life insurers.

• The slow-moving implementation of the European Union's Solvency II directive has been costly already and promises to further strain insurers with its potentially stricter risk-based capital requirements.

• Germany has fared better economically than many of its neighbours, and German non-life insurers saw premiums increase in 2010 by 0.9% to EUR 55.2 billion, though technical results deteriorated.

• Results for 2010 improved in the French non-life sector, and 2011 is developing favorably with rate increases in both personal and commercial lines and low catastrophe-related losses.

• The Italian non-life sector has sustained legislative, regulatory and judicial blows that directly cut into insurers' results.

• Despite economic and pricing pressures, Spanish non-life gross premiums written rose slightly in 2010, ending two years of shrinkage.

European Insurance – Top 10 Composite Companies (2010)
Ranked by net premiums written.
(EUR Thousands)

Rank	Company	Country of Domicile	NPW
1	AXA S.A.	France	EUR 81,425,000
2	Assicurazioni Generali S.p.A.	Italy	65,771,000
3	Allianz SE	Germany	63,709,000
4	AVIVA plc	United Kingdom	40,174,843
5	Zurich Financial Services Ltd	Switzerland	33,415,197
6	CNP Assurances	France	31,431,000
7	Prudential plc	United Kingdom	28,266,343
8	ING Verzekeringen N.V.	Netherlands	25,841,000
9	PREDICA-Prevoyance Dialogue du Credit	France	21,838,165
10	AEGON N.V.	Netherlands	19,238,000

Source: A.M. Best Co.

Decisive Moments

The European non-life insurance sector is approaching critical moments in multiple spheres – economic, regulatory and market – that will amount to a severe test for individual companies and the industry as a whole. Economic stresses continue to buffet the industry in the form of recessionary conditions, volatile financial markets and an ongoing sovereign debt crisis across the continent. Changing solvency and accounting rules are stretching the capacity of companies to comply. Meanwhile, soft market conditions continue to dampen pricing and restrain profitability.

The economic outlook could hold more twists, including the worrisome prospect of inflation as governments and central banks expand the monetary supply as a tacit form of default on significant and, in some cases, unsustainable sovereign debts. Casualty insurers, with their long-tail liabilities, in particular have much to lose in such a scenario. For now, it is persistent low interest rates that are placing pressure on insurers' results.

The halting march toward implementation of the Solvency II directive for European insurers is continuing, and while it may be delayed, it will take effect eventually, at great cost to the industry in time and resources. New accounting standards under development add a further layer of complexity as insurers adjust to new regulatory and reporting requirements.

Underwriting results show growing tension between deteriorating loss experience on one hand, and resistance by markets and regulators to price increases on the other. Rates are moving modestly upward in a few lines, but overall the pricing environment remains flat to declining.

I. Economic Stresses

Volatile financial markets in July and August of 2011 highlighted to European insurers and reinsurers the increasingly challenging investment and economic environments in which they operate. Slower growth in Europe's major economies has increased the threat of a double-dip recession and exacerbated the sovereign debt crisis in a number of Eurozone countries – namely Portugal, Italy, Ireland, Greece and Spain.

A.M. Best does not employ a sovereign ceiling, but sovereign debt downgrades are considered when assessing an insurer's financial strength. Perhaps more important, a sharp economic downturn in these countries directly harms insurance companies' business prospects, performance and capitalisation.

A.M. Best performed a stress test using its proprietary capital model, Best's Capital Adequacy Ratio (BCAR), and incorporated a haircut of European sovereign and corporate debt (based on the European Banking Authority stress test guidance issued June 9, 2011). Also incorporated were valuation haircuts on equity and real estate investments sufficient to take account of subsequent market falls. The stress test creates a scenario that insurance companies may face if the economic and debt position in the Eurozone becomes much worse.

Among the high-level results of the stress test were:

• Companies with the largest exposures to peripheral European debt were hit hardest by the stress test. Many major European (re) insurers have progressively reduced their exposures to Portugal, Ireland and Greece in the past year, leaving sovereign debt of these countries at only about 1% of total investments and less than 10% of shareholders' funds of the insurers tested. In isolation, these now reduced exposures did not have a significant impact once stressed, but larger exposures to Italy and Spain resulted in greater falls in risk-adjusted capitalisation. Italian and Spanish sovereign debts represent approximately 7% of total investments and more than 50% of shareholders' funds of these companies, with Italy in particular representing an important market among large European (re)insurers.

• Companies with higher asset leverage experienced greater falls in risk-adjusted capitalisation under the stress test. Asset leverage was highly correlated to the level of life business the insurer writes.

Companies with higher exposures to equities as a proportion of shareholders' funds also were adversely affected, with recent declines in equity markets expected to hit profitability.

Many of the insurers investigated are listed and under normal market conditions have ready access to the capital markets. However, the financial crisis of 2008 demonstrated that under extreme negative economic conditions, raising capital can quickly become prohibitively expensive or even impossible if the markets freeze up. It is now difficult to predict how the markets would react to a significant worsening of the Eurozone crisis, but from a credit rating perspective, A.M. Best does not assume low-cost access to the capital markets under such circumstances.

Other factors that serve to mitigate this heightened risk exposure include hedging activities, with some insurers acquiring equity options to hedge tail risk. Exposures to Italy and Spain in particular reflect insurers' matching of assets and liabilities within different Eurozone countries as they deposit cash in local investments to support local business written. These companies will not generally take on foreign investment risk in pursuit of yield. However, risk-adjusted capital, as measured by BCAR, has been observably reduced for companies with large exposures to these markets, and this cannot be ignored or simply written off as a cost of doing business there.

The recent bond-buying programme by the European Central Bank of Spanish and Italian debt has resulted in falling yields, but the situation remains precarious because of the various political factors involved with resolving the crisis. In the event of default, non-life insurers' capitalization would take the greater blow, because their liabilities would remain constant even as their bond portfolios reduced in value. In addition, insurers have both indirect and direct exposures to potentially troubled sovereign debt. Though their direct holdings may be modest, they also have major holdings in European banks, which have far greater direct exposure to sovereign debt and would be damaged more severely by default. Debt-related problems for European banks would

Exhibit 1

European Insurance – Top 20 Composite Companies (2010)

Ranked by total non-banking assets.

(EUR Thousands)

Rank	Company	Country of Domicile	Non-Banking Assets
1	AXA S.A.	France	EUR 694,542,000
2	Allianz SE	Germany	609,286,000
3	AVIVA plc	United Kingdom	431,810,383
4	Assicurazioni Generali S.p.A.	Italy	422,439,400
5	Legal & General Group plc	United Kingdom	378,121,728
6	AEGON N.V.	Netherlands	332,303,000
7	ING Verzekeringen N.V.	Netherlands	325,764,000
8	CNP Assurances	France	319,543,400
9	Prudential plc	United Kingdom	304,491,005
10	Zurich Financial Services Ltd	Switzerland	283,473,791
11	PREDICA-Prevoyance Dialogue du Credit	France	226,839,196
12	Standard Life Plc	United Kingdom	179,930,430
13	Friends Life Group PLC	United Kingdom	142,614,795
14	ERGO Versicherungsgruppe AG	Germany	139,253,900
15	BNP Paribas Assurance S.A.	France	130,381,900
16	Swiss Life Holding AG	Switzerland	115,996,534
17	Ageas N.V.	Netherlands	99,166,700
18	Groupama S.A.	France	96,391,000
19	Insurances of Societe General *	France	86,095,015
20	Scottish Widows plc	United Kingdom	79,223,048

* Asset total shown is the sum of Sogecap and Sogessur.
Source: A.M. Best Co.

Exhibit 2

European Insurance – Top 20 Composite Companies (2010)

Ranked by net premiums written.

(EUR Thousands)

Rank	Company	Country of Domicile	NPW
1	AXA S.A.	France	EUR 81,425,000
2	Assicurazioni Generali S.p.A.	Italy	65,771,000
3	Allianz SE	Germany	63,709,000
4	AVIVA plc	United Kingdom	40,174,843
5	Zurich Financial Services Ltd	Switzerland	33,415,197
6	CNP Assurances	France	31,431,000
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8	ING Verzekeringen N.V.	Netherlands	25,841,000
9	PREDICA-Prevoyance Dialogue du Credit	France	21,838,165
10	AEGON N.V.	Netherlands	19,238,000
11	Eureko B.V.	Netherlands	19,139,000
12	BNP Paribas Assurance S.A.	France	18,588,100
13	ERGO Versicherungsgruppe AG	Germany	17,457,200
14	Groupama S.A.	France	16,722,000
15	MAPFRE S.A. *	Spain	13,574,438
16	Societe de Groupe d'Assurance Mut Covea	France	13,473,671
17	Fondiaria - SAI S.p.A.	Italy	12,615,373
18	Insurances of Societe General	France	11,567,787
19	R+V Versicherung AG **	Germany	10,922,000
20	ACE Limited	Switzerland	10,344,057

* Total premium shown excludes MAPFRE RE, Compania de Reaseguros, S.A.
** Premiums shown include those of R+V Re.

Source: A.M. Best Co.

not only hit insurers' holdings in these banks, but also could cause renewed paralysis in the credit markets – yet another hazard for insurers to contemplate.

The uncertainty of the situation and its potential resolution lead A.M. Best to underscore the importance of carefully monitoring the exposures of each credit in the coming months. Companies with an elevated investment risk exposure may come under pressure if the situation deteriorates further.

A worsening of the economic or investment landscape in Europe, without mitigating actions taken by company management to offset these heightened risk characteristics, could result in an increase in negative outlooks or downgrades for (re) insurers operating in these markets. In a weak economy, policyholders are quicker to file claims, and these are more likely to be inflated or fraudulent, as was seen during the depths of the financial crisis in 2008 and 2009. For multinational insurers, heavy catastrophe losses of late have increased the pressure to seek rate hikes. But attempts to increase premium rates meet heightened resistance in a weak economic climate, as insureds are less able to pay the higher rates – if they are able to afford insurance at all.

All of this is occurring against the backdrop of low interest rates and volatile equity markets – with considerable downside potential if the European debt situation deteriorates. One potential consequence of such a scenario would be inflation if countries pursue a policy of monetary expansion as a form of implicit default. In this case, insurers that would not have been able to accurately price expectations of long-term inflation into current rates would be dealt a further blow to profitability. All of this adds up to an environment that well diversified and capitalized insurance groups would be able to withstand, while pure non-life insurers may be sorely tested.

II. Regulation in Flux

Solvency II remains near the top of insurers' regulatory agendas, but with talk that Solvency II capital requirements may not take full effect until 2014, uncertainty persists around this issue. A recent pronouncement by the U.K. Financial Services Authority suggests that Solvency II requirements will be switched on for insurers on Jan. 1, 2014, with the regime transposed into local law by the start of 2013. This would in effect make 2013 the true test phase for companies implementing the standards and justifying their minimum capital requirements (MCRs). Meanwhile, other jurisdictions seeking Solvency II equivalency would gain more time to align their regulatory regimes with the new standards.

Any delay would be welcome news for many smaller companies that face a challenge to meet the new capital requirements or adopt their own, internal models. Larger insurers, however, may chafe at the delay after marshaling the resources to comply with Solvency II. They may see their preparedness as a competitive advantage they would like to press, and opportunities for mergers and acquisitions may arise as the new standards expose some companies' vulnerability. The delay also may lessen the shock to the system for some companies.

Large groups stand to gain distinct advantages from the new regime, among them a diversification benefit in calculating their solvency capital ratios (SCRs). Smaller companies lack the resources to build their own capital models and so will have to use the standard model, which will penalize them in comparison with larger insurers that are able to produce their own, internal models.

It should be noted that in stress testing conducted in March by the European Insurance and Occupational Pensions Authority with national regulators, an overwhelming majority of insurers were found able to meet their MCRs under the adverse scenario that was posed – one involving sharp drops in interest rates, equities and real estate markets, coupled with sharp increases in bond spreads and, for non-life insurers, a shock loss. Insurers that find themselves under strain from Solvency II requirements will have a number of options, many of them difficult to execute or unpalatable:

• Raise more capital – but this may be problematic, depending on the state of the financial markets when it is time to make such a move.

• Buy more reinsurance, a potentially expensive option depending on the level of capacity in the market.

• Enter a merger transaction or place the company up for sale. Consolidation is a likely result of the implementation of Solvency II, as some companies will need to sell and others will find opportunities to diversify without incurring the steep capital charges assessed on new operations built from within.

• Enter a voluntary runoff.

• Write less business or attempt to diversify.

• Invest in less risky assets, which would reduce risk charges but also cut into profitability.

Mutual insurers face a range of issues, some in common with small insurers in general, but others that are unique. Some mutuals operate in loose networks that share a common brand for marketing purposes, and these may be ripe for consolidation as members feel the strains of meeting compliance and capital requirements.

Implementation costs for Solvency II in general have bordered on prohibitive for some companies. The total cost across the European Economic Area (EEA) is thought to exceed the EU's estimate of EUR 3 billion. The transition to Solvency II has not been seamless for insurers. Among the myriad issues they face:

• Shortages of skilled capital modeling personnel.

• Documenting modeling and enterprise risk management (ERM) processes.

• Significant implementation details to be worked out, including group risk, premium provision and risk margins.

Meanwhile, insurers are concerned that their national regulators may be similarly hard pressed to assemble the resources to enforce Solvency II or assess companies' capital models.

Certain non-EU jurisdictions are moving aggressively to achieve equivalence with Solvency II. Bermuda and Switzerland are among the first to come up for consideration. But the consequences of nonequivalence aren't clear, and some EU countries may choose to simply focus on the parts of a given insurance group that are under their jurisdiction, rather than seek to influence the operations of an entire enterprise with headquarters outside the European Union.

Awaiting IFRS 4

Overlapping with implementation of Solvency II may be the effort to implement a new International Financial Reporting Standard (IFRS) for insurance. The latest exposure draft of IFRS 4 is targeted for publication near year end or in the first quarter of 2012, with a goal of implementation by Jan. 1, 2015. Effectively, this would require insurers to be using the standards as of Jan. 1, 2014 to create a comparable basis for their 2015 reporting.

A principal target of this latest draft is to align the reporting of insurers' assets and liabilities so that both are market based or otherwise approximate a present valuation – a far more daunting task for insurance liabilities than for insurers' assets. Measurement of liabilities would arguably be more subjective and based more on estimates under the new regime. This will potentially create greater difficulty for smaller insurers or companies with growing books of business. Specifically, insurance contracts would be valued according to the expected present value of future cash flows, adjusted for uncertainty as to amount and timing and with a residual margin.

This, if it proceeds as planned, would place an added drain on insurers' resources in terms of staff time, opportunity cost, consulting fees, information technology and reporting. And the trouble may lie not merely in the overlap of these two challenging projects, but in the effect of IFRS reporting on insurers' ability to raise capital – at precisely the time when Solvency II may create the need for an infusion.

III. Major Markets Seek Sound Footing

Germany

German non-life insurers saw premiums increase in 2010 by 0.9% to EUR 55.2 billion (see **Exhibit 4**), but technical results deteriorated in a continuing soft market, with the combined ratio up 2.6 percentage points to 98.2%, according to Gesamtverband der Deutschen Versicherungswirtschaft (GDV) (see **Exhibit 5**). Competition in the motor market and poor claims experience, mainly due to Windstorm Xynthia, contributed to the weakening performance. Other losses during the year stemmed from a severe frost near the beginning of the year and flooding along the Neisse and Spree rivers in the spring.

In motor, rates have increased slightly and premiums were up 0.5% in 2010, but the market remains competitive and unprofitable, with the combined ratio for 2011 expected to be around 105% after reaching 107.4% in 2010. Prospects are brighter for profitability in the property market, where insurers are looking to recoup last year's losses, which included a combined ratio of 112.2% on coverage of private buildings. Premiums were up 1.5% for private property insurance in 2010. But any rebound in the segment may in turn attract more players and generate renewed competition.

Other drivers of growth in the non-life sector were credit, general accident and legal protection insurance, while premiums for transport and general liability were down.

Overall, Germany has fared somewhat better economically than many of its neighbours, with economic growth of approximately 3% expected in 2011. This offers the potential for knock-on effects in the insurance market if the general level of economic activity remains strong into 2012.

France

Results for 2010 were better than in 2008 and 2009 for the mature and competitive French non-life sector, and 2011 is developing favourably with rate increases in both personal and commercial lines and low catastrophe-related losses. Total net income for the sector was EUR 3.3 billion in 2010, according to the Federation Francaise des Societes des Assurances (FFSA). Barring major adverse developments in the financial markets, such as a sovereign default, A.M. Best believes 2011 and 2012 both may show improvement.

Exhibit 3

German Non-Life – Top 20 Insurers (2008-2010)

		Gross Premiums Written (EUR 000s)			Gross Combined Ratio (%)		
Rank	**Company**	**2008**	**2009**	**2010**	**2008**	**2009**	**2010**
1	Allianz Versicherungs-AG	EUR 9,234,993	EUR 9,100,348	EUR 8,943,094	96.7	97.9	104.2
2	AXA Versicherung AG	2,761,377	3,258,686	3,176,351	94.9	98.6	105.6
3	R+V Allgemeine Versicherung AG	2,499,426	2,604,750	2,716,359	102.2	104.6	105.5
4	HDI-Gerling Industrie Versicherung AG	2,486,178	2,523,548	2,529,877	93.8	107.8	100.3
5	Allianz Global Corporate & Specialty AG	2,232,700	2,338,663	2,408,614	83.7	84.3	90.3
6	Generali Versicherung AG	1,714,132	1,690,410	1,623,888	99.1	96.4	97.7
7	ERGO Versicherung AG	1,590,135	1,676,390	2,643,064	88.7	95.8	95.3
8	Gothaer Allgemeine Versicherung AG	1,414,553	1,400,400	1,402,370	99.3	98.9	100.6
9	LVM Landwirtschaftlicher Versicherungsverein Muenster a.G.	1,355,477	1,389,557	1,458,399	88.6	99.1	103.1
10	Wuerttembergische Versicherung AG	1,286,856	1,304,758	1,324,110	102.2	91.8	98.8
11	HUK-COBURG Haftpflicht-Unterstuetzungs-Kasse a.G.	1,318,470	1,299,109	1,319,392	88.3	94.3	100.1
12	VHV Allgemeine Versicherung AG	1,179,025	1,264,793	1,373,671	100.4	103.9	102.3
13	SV SparkassenVersicherung Gebaeudeversicherung AG	1,176,167	1,201,832	1,201,210	101.8	105.2	101.5
14	R+V Versicherung AG	884,788	1,146,733	1,371,189	101.2	100.1	102.4
15	HUK-COBURG-Allgemeine Versicherung AG	1,097,393	1,121,797	1,168,984	82.4	91.4	96.3
16	AachenMuenchener Versicherung AG	1,031,380	1,020,231	1,029,609	93.2	94.1	91.2
17	Westfaelische Provinzial Versicherung AG	998,278	1,017,757	1,027,338	91.3	92.4	96.5
18	Bayerischer Versicherungsverband Versicherungs AG	935,868	977,694	1,026,060	91.1	108.7	108.9
19	Provinzial Rheinland Versicherung AG	962,834	956,226	950,092	85.4	86.2	91.3
20	Landschaftliche Brandkasse Hannover	947,530	954,041	960,457	91.9	94.6	101.4
		EUR 37,107,560	**EUR 38,247,723**	**EUR 39,654,128**			

Source: A.M. Best Co.

Overall, non-life premiums were up 1.5% to EUR 45.7 billion in 2010, according to the FFSA (see **Exhibit 7**), and they were up another 4% in the first half of 2011. Motor rates have begun to turn, moving results toward break-even after successive years in which the combined ratio exceeded 100%.

The struggle toward profitability remains difficult, however, with new challenges arising. For example, a recent EU directive has outlawed the use of gender in setting motor rates. The result is likely to be an overall increase in rates as insurers seek to spread the cost of insuring, for example, young male drivers across the entire population of insureds.

The overall non-life combined ratio of 99.6% marked an improvement from 100.9% in 2009, but still was barely profitable (see **Exhibit 8**). Reserves were strengthened considerably to EUR 134.5 billion from EUR 127.2 billion.

While non-life underwriting remains under severe pressure from rising claims in motor and home insurance, there is little relief at hand in the tepid investment environment, where interest rates are low and equities markets are unreliable sources of income. Investment income was up slightly in 2010 to EUR 1.7 billion, but it remains well off its peak of EUR 2.3 billion recorded in 2007. French insurers currently have 12% to 13% of their portfolios in equities. They have invested conservatively, and ironically are paying the price in their large fixed portfolios and their holdings of troubled sovereign debt from countries such as Portugal, Italy, Ireland, Greece and Spain.

Italy

The Italian non-life sector saw its technical result deteriorate sharply to a loss of EUR 447 million in 2010, compared with a loss of EUR 67 million in 2009. Non-life premiums in Italy were down 2.4% in 2010 to EUR 35.9 billion, led by declines in motor (see **Exhibit 9**). The motor line, with its mandatory third-party liability line of business, dominates Italy's less mature market, accounting for about 55% of non-life premiums.

Exhibit 4

German Non-Life – Gross Premiums Written (2008-2010)

(EUR Billions)

	2008	2009	2010
Property	EUR 14,583	EUR 14,962	EUR 15,139
Marine	1,730	1,689	1,775
Credit & Surety	1,387	1,400	1,541
General Liability	6,826	6,836	6,782
Motor	20,372	20,057	20,158
Private Accident	6,359	6,389	6,411
Legal Expenses	3,204	3,206	3,248
Roadside Assistance	156	162	165
Total	**EUR 54,617.00**	**EUR 54,701.00**	**EUR 55,219.00**

Source: Gesamtverband der Deutschen Versicherungswirtschaft

Exhibit 5

German Non-Life – Combined Ratios by Line (2006-2010)

(%)

	2006	2007	2008	2009	2010
Private Property	91.8	109.7	95.6	92.6	98.9
Non-Private Property	92.6	100.1	95.2	92.8	99.8
Marine	89.2	89.8	95.7	104.0	95.8
Credit & Surety	60.5	72.0	77.9	90.8	56.9
Third-Party Liability	85.4	89.3	89.1	90.7	91.1
Motor	95.4	98.1	101.6	103.3	107.4
Accident	86.1	79.8	78.2	79.3	80.3
Legal Expense	99.1	97.8	95.5	99.0	99.6
Total	**91.4**	**95.7**	**94.9**	**95.8**	**98.2**

Source: Gesamtverband der Deutschen Versicherungswirtschaft

Exhibit 6

German Non-Life – Claims Ratios by Line (2006-2010)

(%)

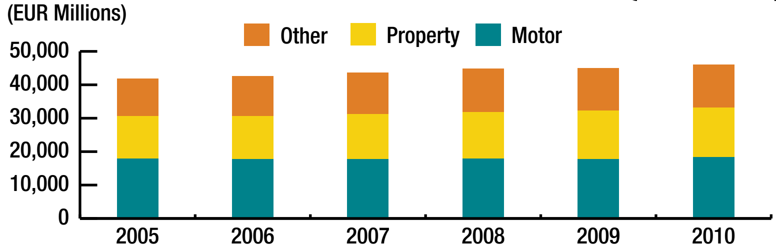
	2006	2007	2008	2009	2010
Private Property	63.9	82.0	68.0	64.3	69.6
Non-Private Property	72.8	80.4	75.0	72.1	78.0
Marine	62.0	68.6	68.1	65.5	64.0
Credit & Surety	50.9	51.9	70.9	76.7	43.1
Third-Party Liability	65.4	64.5	67.0	67.5	69.5
Motor	88.4	91.8	96.0	97.0	99.6
Accident	57.4	56.9	57.1	58.2	60.2
Legal Expense	72.4	70.7	71.2	75.0	71.9
Total	**74.1**	**78.6**	**78.8**	**78.5**	**80.3**

Source: Gesamtverband der Deutschen Versicherungswirtschaft

Exhibit 7

French Non-Life – Gross Premiums Written (2005-2010)

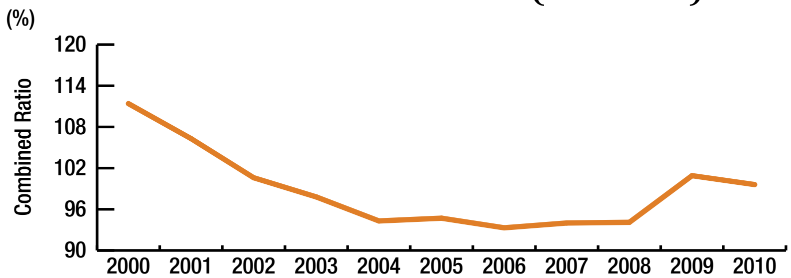
(EUR Millions)



Source: Fédération Française des Sociétés d'Assurances

Exhibit 8

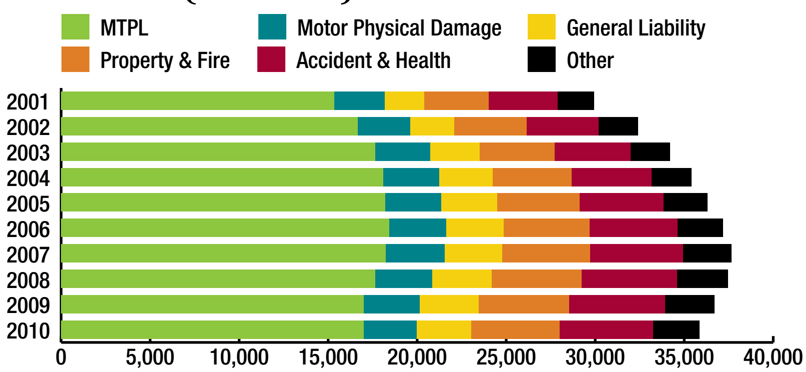
French Non-Life – Combined Ratio (2000-2010)



Source: Fédération Française des Sociétés d'Assurances

Exhibit 9

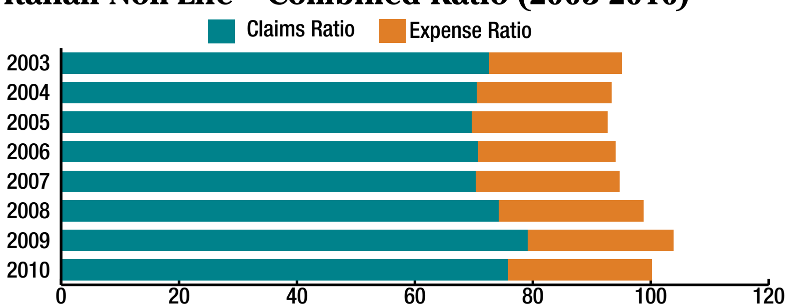
Italian Non-Life – Gross Premiums Written by Line of Business (2001-2010)



Source: Associazione Nazionale fra le Imprese Assicuratrici

Exhibit 10

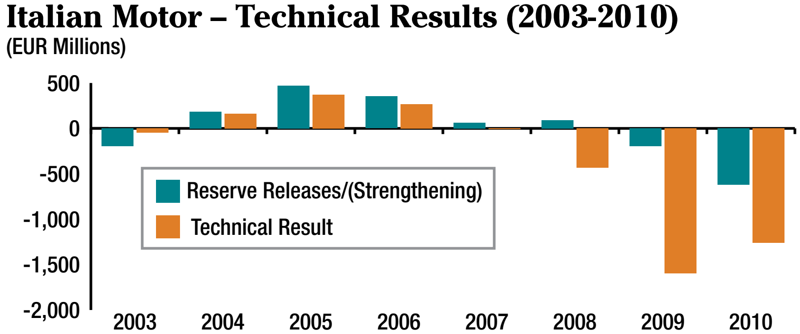
Italian Non-Life – Combined Ratio (2003-2010)



Source: Associazione Nazionale fra le Imprese Assicuratrici

Exhibit 11

Italian Motor – Technical Results (2003-2010)



Source: Associazione Nazionale fra le Imprese Assicuratrici

The sector has been besieged by legislative, regulatory and judicial actions, including the Bersani law, which effectively requires premiums to be set at a household level rather than by individual insured. This allows higher risk drivers to be insured under the cover of lower risk members of a given household, shielding them from the risk premium insurers otherwise would charge. When companies attempted to increase overall motor third-party liability (MTPL) rates in response to this measure, the government launched an antitrust investigation into the market.

Meanwhile, a recent court ruling in Milan has been widely adopted across Italy, introducing a more rigid structure for settlement of bodily injury claims that has driven claims costs upward. Also, increasing fraud, driven by a weak economy, has been a further drag on the non-life sector's results, especially in southern Italy.

There has been little relief on the investments side. Yields on Italian government bonds approached 7% before the European Central Bank stepped in with a buying programme, and companies have been suffering with unrealized losses.

Spain

Despite a challenging economic environment and ongoing price competition in the Spanish market, non-life gross premiums written (GPW) achieved a slight recovery of 0.2% in 2010, ending two years of shrinkage in premium volume (see **Exhibit 12**). According to figures released by the Dirección General de Seguros y Fondos de Pensiones (DGSFP), the Spanish regulator, aggregate non-life premiums reached EUR 31.8 billion in 2010 (though still below 2007 premium levels). Non-life technical results were down by 2%, representing only 10.9% of premiums, 0.1% less than in 2009. While this minor drop is due mainly to a contraction in overall demand and a small deterioration of financial results, solvency margins remain high throughout the non-life market at 3.4 times the minimum regulatory requirement.

In 2010, only a few classes of business saw increases in their premium volumes. In particular, health insurance premiums grew by 4.2%, reflecting a general perception of the increased relative importance of this type of insurance in households' monthly expenses amid current economic conditions. Technical accounts improved by 4.5% to 5% after a 6 percentage point recovery of the non-life market's combined ratio, which had started worsening in 2008, reaching 96% because of a reduction in claims and stable financial returns.

Property premiums grew by 3%, although the main lines responsible for this positive trend are the personal property lines, which grew around 5% from 2009. Meanwhile, most commercial property lines followed the trend of a slow but steady drop from previous years, except fire (+6.5%), pecuniary loss (+10.3%), contingency (+3.7%) and theft (+7.1%). The combined ratio for the class increased 4 percentage points to 97.1% (see **Exhibit 13**), mostly due to a bad claims year in the industrial sector, which accounts for 20.9% of property lines premiums.

In motor insurance, despite new car sales growing 3.2% during 2010, vehicles were driven less, as deduced from a decline in fuel consumption and less traffic registered at tolls, while average motor policy prices reached their lowest point since 2000. As a result, motor insurers in 2010 experienced a reduction in premiums of 0.9% (compared with a reduction of 5.5% in 2009). Notwithstanding the fall in premiums, the combined ratio of the class improved by 0.6 percentage points, reaching 96.4% in 2010.

The Spanish insurance market still faces important challenges related to an underlying contraction of demand and a drop in overall consumption. Prospects for growth will be offset by strong competition and substantial pressure on pricing. Nonetheless, a number of factors may affect this trend:

Exhibit 12

Spanish Non-Life –
Financial Indicators (2009-2010)

Percentage of gross premiums written.

	2009	2010
Gross Premiums Written (EUR Billions)	31.75	31.82
% Change	-2.6	0.2
Retention	85.9	85.2
Gross Claims	70.7	70.9
Gross Expenses	21.5	21.6
Net Claims	72.8	72.1
Combined Ratio	93.9	93.8
Financial results	4.9	4.6
Technical results	11.0	10.9

Source: Dirección General de Seguros y Pensiones

Exhibit 13

Spanish Non-Life –
Major Classes of Business (2010)

(%)

	Share of Gross Written Premium	Combined Ratios
Property	28.6	97.1*
Personal	12.8	–
Commercial	9.9	–
Miscellaneous	5.9	–
Motor	36.7	97.0
Accident & Sickness	22.3	96.1**
Funeral	5.3	90.9
Liability	5.4	66.9
Marine	1.8	89.1

* Estimate of personal and commercial lines.
** Health only.
Source: A.M. Best calculation based on Investigación Cooperativa entre Entidades Aseguradoras y Fondos de Pensiones.

- The slow but steady deterioration of companies' technical margins.

- New increased capital requirements derived from Solvency II.

- The change in the EU directive on motor insurance, abolishing differential gender treatment in the quotation process.

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