



INTERNATIONAL BUSINESS AND PROFESSIONAL
MAGAZINE OF THE YEAR 2006

Strategic**RISK**

ROUNDTABLE

TRENDS IN GERMAN INDUSTRIAL INSURANCE AN INSIDE-OUT PERSPECTIVE



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Trends in German Industrial Insurance – an inside out perspective

Large German industrial companies are worried about the efforts of the EU Commission to set up stricter rules for industrial insurance along the lines of consumer protection systems. This was one important conclusion to come from the roundtable discussion, to which StrategicRISK had invited well-known experts. These large consumers do not want to be 'protected' but can see only negative consequences in increased regulation.

The insurance industry also has to accept criticism. In particular the claims handling in D&O cover is being strongly criticised by insurance buyers and risk managers. But basically, it turned out that insurers and their large clients have worked out a functional relationship, professionals on both sides appreciate each other. The buyers welcome the downward price trend after they had to cope with many years of hefty price rises.

It is also clear that the big companies do not want to see a trend in the market where the number of providers on the insurance side will be even further decimated in the long run. They are looking for reliability, a high level of knowhow and the widest possible range of choice among providers.

Herbert Fromme, Insurance Correspondent, FTD

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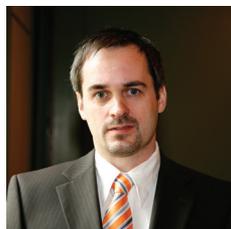
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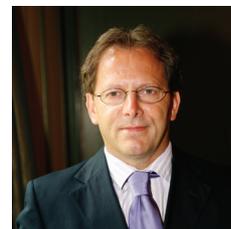
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WE ARE AFRAID OF A POSSIBLE MISUSE OF THE CONSUMER PROTECTION IDEA IN INDUSTRIAL INSURANCE, IN WHICH THIS THOUGHT IS OUT OF PLACE

RALF OELSSNER

RALF OELSSNER: Good day, ladies and gentlemen, colleagues. We all know what we want to do. We want to talk about the future of German industrial insurance. If you agree, we will start with Europe, and thus with the EU Commission's analysis of the industrial insurance sector.

I expect that most of us have read the 164 pages of the sector analysis mucho con gusto. If not, the summary will do just as well. Mr Schlicht and I recently had two discussions in Brussels which made us sit up and take notice. The subject was one part of the results of the sector analysis, namely that of co-insurance.

The authors of the sector analysis have very specific ideas about the future of co-insurance, as we know it and as we also need it in certain larger fields.

We are afraid of a possible misuse of the consumer protection idea in industrial insurance, in which this thought is out of place, we are old and ugly enough to direct our own affairs. Here it is possible that a tool that we need will be over-regulated or even taken right out of our hands. The bigger the risks are, particularly in catastrophe cover, so much more do we need co-insurance. In Brussels they imagine that this is very easy, that everything can be done by one insurer and whatever he cannot carry will be passed on to reinsurance. That seems to us

to be a rather simplified way of looking at things. Are Mr Schlicht and I on the wrong track when we assume that we need the tool of co-insurance for large risks, or not? Here I would be glad to have the views of the colleagues.

GÜNTER DRÖSE: I think I have a good example from a market which functions completely differently, namely the USA. After a big takeover, we had placed a property policy – let's say after the German model – actually in the US with a total of only four insurers involved. There were two which were primarily aimed at the American market, and two which were more strongly involved in Europe.

We had a loss arising from 11 September. There were arguments towards the end, but all in all it was a relatively simple matter; as you know, it was around \$1bn. If we had had to regulate following the American guidelines – with umpteen layers and complicated structures, with varying demands by insurers per layer, differing deductibles, sub-limits and so on – we would probably still be arguing today about who paid what, when and where.

The cost savings alone in the claims handling are considerable. I can see no disadvantages on the placing side, the rate was competitive, probably even more so than the average we would have received on the American market.

RALF OELSSNER: Mr Allerdissen, your body language seems to indicate that you agree.

HANS-JÜRGEN ALLERDISSEN: Yes, I won't disappoint you. One of the reasons why I prefer co-insurance as it has existed so far, is because I want in all circumstances to promote the leadership ability of all participants. If complicated contracts are always led only by one primary company over a long period, and the actual risks are handed on to reinsurance, then the number of those who can be regarded as alternative leaders will in the long run become considerably fewer.

HANS JÖRG SCHILL: That would then have the disadvantage that there would be less competition. However, Brussels want to have more competition.

HERBERT FROMME: Or the reinsurers take over the whole risk straight away, as they are beginning to do now. They let a subsidiary or another company do the fronting, and then take the complete risks. The reinsurers can take the whole thing and share it out.

RALF OELSSNER: Good, but then we still see the aspect of lack of competition, only this time on the reinsurance side.

Maybe we could look at it for a moment from the other side. In London we have the principle of vertical placement. This is relatively unknown in Germany, for reasons which I simply cannot follow; and people go pop-eyed when somebody in Germany talks about vertical placement. We have a big policy, with a German leading company. For more than 50 years this has been Allianz. What Allianz as leader does not keep itself, we put into a pool and it is offered internationally. A double



vertical placement: once about the premium for a share, and then also for the deductions to be paid by the buyer. Why don't we have that in Germany?

I'm speaking here about a combined hull and liability policy in aviation. That is \$40bn hull value and \$2.25bn liability limit any one incident, that is property and liability cover. That is sold in detail in the individual sectors. Why doesn't that function in Germany?

We choose a leader, and with our agreement the leader seeks out other insurers who will share the risk.

HANS-JÜRGEN ALLERDISSEN: Or we look for them ourselves.

RALF OELSSNER: Or we do it ourselves. In Brussels, they see the danger of agreements which will distort the market and the competitive aspect.

EDWIN MEYER: I have also had great problems with the abolition of co-insurance, because this does in fact naturally lead to a complete distortion of competition. We as a company have very global, international placements. The size of these risks, and also the dangers, call for partners who also want to take over part of the risk. It is already difficult enough to find competition in this field.

HERBERT FROMME: Where is the difference? You complete a contract now with, for example, Allianz and say: Dear Allianz, the part you don't carry yourselves we would like to have so and so to act as co-insurers. In future you could have a say in the choice of reinsurers or of primary insurers who are also active as reinsurers.

IF WE HAD HAD TO REGULATE FOLLOWING THE AMERICAN GUIDELINES WE WOULD PROBABLY STILL BE ARGUING TODAY ABOUT WHO PAID WHAT, WHEN AND WHERE

GÜNTER DRÖSE

HANS-JÜRGEN ALLERDISSEN: It is precisely here that I see an additional danger from the viewpoint of the client. I have always said, whether as insurer or as insured: don't put all your eggs in one basket. There are times when even reinsurers totter or fail, and there are also good reasons for this. That means that I really ought, as client, to keep a check on how the primary insurer has organised its reinsurance programme, what comes under facultative cover to which reinsurer, what remains in the end in facultative reinsurance cover. How do I deal with long-tail risks for the period of the risk cover? I believe that to be as good as impossible.

The only remedy is to atomise the risk, that is direct it ourselves into different baskets. If one of them falls away, then the others are still there, still sound. Otherwise I have no control over the matter, and for large risks I believe that is just not acceptable.

EDWIN MEYER: Such regulation would automatically lead to the insurer developing its own model, while actually we do that. We would like to say, we want that as quota share, we want to make the programme. In property/casualty insurance I work in three markets, the European, the English and Bermuda. The varying premiums which can be structured into a programme,



WE HAVE NO BASIC PROBLEM WHATSOEVER THAT THE EU COMMISSION CARRIES OUT THIS INVESTIGATION

GÜNTER SCHLICHT

all the special factors which are important at specific times and can lead to considerable savings depending on the scope of the programme – we would lose all these.

WOLFGANG FADEN: Could it be that the insurance industry in Brussels is treated quite differently from others? We have already seen, in connection with cover for pharmaceutical risks and Brussels' ruling on Gerling and HDI, that the decision actually leads to less competition rather than to more expansion. This would probably also again lead to a further constriction of competition, because – if the principle were all or nothing – other companies would not be in a position to take part in the negotiations. They will say they cannot carry the risk alone, they cannot reinsure it alone, or they don't want to have the gross premium in their balance sheets. This is also true for top companies. I would like to see the insurer who wants to have a PML for €1bn gross in the balance sheet if a loss arises. That means that there will be more and more insurers who are not in a position to act as leading insurer. They will also drop out as co-insurers. If a co-insurer says: I don't feel capable of managing

the business but I would like to offer capacity, and would also like a right to give my opinion, so I'll make suggestions about the wording and about the premium level – all that would be lost. Therefore I put the question whether we should in principle talk about a constriction of competition.

RALF OELSSNER: It's like this: we cannot really follow the thought pattern which exists in Brussels in this area. It is probably for us just as much a matter of getting used to the idea as the theme of insurance is for some politicians. A body which looks at the varying levels of profitability of European industrial insurers and from that draws the conclusion that Europe-wide competition for industrial insurance does not function properly, with that body you cannot really follow other ideas.

GÜNTER DRÖSE: If it were really as they think it is, then all companies which today show large profits would have to work in sectors where there is no competition. That means, the Commission would generally have to intervene whenever a lot of money is earned in one market or another, whether it is car manufacturers or banks. It would have to say: Hey, that is no real competition and there we have to act. With Solvency II, I see in any case a trend coming, that the Commission in the end sets out how high the profits of an individual company can be, without it violating some competition idea of the Commission.

RALF OELSSNER: That supports my old thesis of state-regulated technical underwriting.

HERBERT FROMME: Now I must come to the aid of the Commission. European industry has been screaming loudly enough that it is badly treated by brokers and insurers. What is coming now is a reaction to Spitzer. I can remember that after Spitzer the industry, including the DVS, beat the drums pretty loudly against the brokers, saying they had treated the clients badly. There the Commission said: Let's have a look at things.

So you started to meddle a bit, and afterwards you get worried. In addition there are two points. The first is the trend to re-regulation, both on national and EU levels, in particular affecting the insurance industry. Secondly, the lobbying work of both insurance industry and insurance clients was bad, in Berlin and also in Brussels, otherwise things like that don't happen. You always have to look and see who started the fire, what came out of it and who afterwards cries 'fire!'.

RALF OELSSNER: Gently, Mr Fromme. For DVS, the remuneration of brokers is as immaterial as it can be.

HERBERT FROMME: It sounded different then, Mr Oelssner.

RALF OELSSNER: Slowly! What the DVS spoke out about was criminal activities such as bid rigging. The brokers' remuneration is really immaterial to us. What we do not want, is a lack of transparency and criminal activities like bid rigging. Otherwise, the brokers can do to us what we permit them to do.

HANS-JÜRGEN ALLERDISSEN: I would like to go back again

to the original question of competition and the influence on it of the suggestions from Brussels. We all know how many insurers write such risks. A primary insurer that wants to take part in this sort of risk, and has to keep to the Brussels model, has to acquire suitable capacity on the reinsurance market before it makes an offer. Otherwise it has no chance of placing the risk. That means that I do not get any competition, I always get the same conditions from the same reinsurers.

GÜNTER SCHLICHT: I would just like to say one thing about Mr Fromme's remark – you lit the fire and now you must live with the consequences. Briefly to firefighting, we did in fact light a fire in the sense that at the beginning of the decade we spoke out against restrictions of competition in the German industrial insurance market, and we made ourselves very clear. We still believe that this was the right thing to do. It did have a follow-up in legal cartel matters, which is not yet over. However, I think that when such things happen it is our job to light fires. We also have no basic problem whatsoever that the EU Commission carries out this investigation. On the contrary, we welcome that, and we also believe that it brings together a lot of sensible things. What we are talking about today was not directly mentioned in the report, but in discussions. And here we are of the opinion that it is moving in the wrong direction. One other comment: From time to time we get the impression that insurers have also lit a few fires on the question of co-insurance. The comment was made here and there that if the cartel office's findings were upheld, then we must consider whether we can continue to do co-insurance at all. We see no material background for this whatever. There have never been any disputes about co-insurance, nobody has ever claimed that this was relevant for cartel law.

WOLFGANG FADEN: That would also influence the knowhow. The knowhow of an insurer increases with the company regularly dealing with the risk. If a company can no longer negotiate with Deutsche Bahn, with Deutsche Bank, Lufthansa, Arcelor Mittal and others, then over the medium and long term the knowhow will decrease dramatically. In my opinion, this also leads automatically to a restriction of competition.

GÜNTER SCHLICHT: We do not really want to light a fire, to come back to this metaphor, since representing this theme vehemently to the Commission can actually mean that you give a push to regulation, and that is not our intention.

RALF OELSSNER: Now there are in this sector analysis a few other results. What has proved to be no longer so relevant in the medium term, as almost to be expected, is the subject of the length of contract periods. In Austria, Slovenia and Italy, there are contracts with periods reaching up to 10 years. These arose mainly because the market wanted to secure the retirement pensions of brokers, that was the actual background. But that is no longer regarded as a hot subject. Then we now have horizontal co-operation. We said in Brussels that we were clear about the idea of the Group Exemption Regulation, and this also has a time limit. However, from practice we cannot draw



THE KNOWHOW OF AN INSURER INCREASES WITH THE COMPANY REGULARLY DEALING WITH THE RISK

WOLFGANG FADEN

any conclusions that indicate any misuse. Insurers say that if the Group Exemption is terminated, when it no longer exists, then there will be for insurers an area which is not exactly without legal rules, but in which we are not certain any more what we can do, and then we prefer not to do it.

GÜNTER DRÖSE: It is interesting that another EU regulation lays down that as banks we need insurance contracts which run for at least two years. According to Basel II, a bank must at all times have insurance cover with one year cover ahead. At each point in the year I have to have insurance cover for one year ahead, that means that on 30 December I not only need cover up to 31 December but to 30 December of the following year. That is, incidentally, inconsistent with the capital requirement, which you only have for one year. But that means that we cannot work with annual contracts at all, we need two-year contracts.

RALF OELSSNER: Over and above that, Mr Dröse, it should be left to an industrial insurance client whether he takes out a contract with his leading insurer for two or three years. I regard highly the principle of Vollkaufmann, which means that as full-grown businessmen we are responsible for our actions, and the old principle caveat emptor, the client should watch out for

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EUROPEAN INDUSTRY HAS BEEN SCREAMING LOUDLY ENOUGH THAT IT IS BADLY TREATED BY BROKERS AND INSURERS

HERBERT FROMME

himself, that is very pronounced with Vollkaufmann.

HANS-JÜRGEN ALLERDISSEN: I believe that one aspect of the market, or one segment, has dropped completely out of sight, namely the so-called project cover. When I set up an infrastructure project, then I have to keep the cover going for the total period of construction and I cannot change direction in the middle. That is technically impossible and completely absurd as far as the risk is concerned. Here I must be allowed to bind an insurer for a longer period. Anyone who ignores this, does not know the world.

HERBERT FROMME: One of the things in Germany that has annoyed me for years is that everyone swears about Brussels, but no-one is properly organised to have his voice heard. The EU Commission has a clear agenda for the insurance sector, Mr McCreevy is very strict there. The German insurance industry fights most of all with the federal government about life insurance. But at the European level, neither insurers nor insureds have any agenda for Brussels. That produces an imbalance. The German industry should think a bit here, the European industry has to pull itself together and set up strong

lobbies. This has so far been centred on Berlin, but the music is played in Brussels. Nobody looks in that direction, or when they do, they do it too late. But then there is a lot of aggravation.

RALF OELSSNER: I believe that in general you are quite correct in what you say. The question is, though, how does one change things? The Bundesverband der Deutschen Industrie is represented in Brussels with both staff and an office. The insurance buyers association Deutscher Versicherungsschutzverband is naturally not, it is represented via FERMA, or at least it tries to be. FERMA as an association is much too weak to have any effect in Brussels. Now and again you can see in associations a parallel to German politics. While Britain and France are well-known for sending their top people to Brussels, German politicians regard Brussels as a rubbish dump for people who are no longer good enough for Berlin and for whom Berlin has no more use.

HANS-JÜRGEN ALLERDISSEN: How the insurance industry, but also we as big clients, present ourselves in Brussels – and here I agree basically with Mr Fromme and Mr Oelssner – here we have to improve our position. But I have no easy answer.

However, I will give an example of where the interests of industry in regard to Solvency II are identical with those of insurers. That is the question: where does over-regulation start? Because Solvency II – and this has not been sufficiently clear in public discussions so far – also applies to captives. That means that the Solvency requirements do apply 100% to our captives. I ask myself where this makes sense, and why haven't we made this clearer before? Here a company insures itself and is in a completely different situation from an insurer who covers the general public. Nevertheless, we have not managed to get that across to Brussels.

RALF OELSSNER: We have certainly articulated this to the German supervisory authority BaFin.

HANS-JÜRGEN ALLERDISSEN: Yes, but not so that it had any effect.

RALF OELSSNER: We have managed to create a relatively high level of understanding at BaFin, but it cannot make a stance against the other supervisory authorities in Europe. The British Financial Services Authority marches ahead with a very rigid position. When you meet the people, they are nicest people on earth, but when you read the regulations they issue a cold shudder runs down your spine. The majority of regulatory offices in the EU follow the lines of the FSA. Therefore what is ahead of us will also apply to captives. I have for years been strengthening the equity capital of our captives, simply to be sufficiently prepared for when Solvency II eventually comes.

HERBERT FROMME: May I ask whether that is the only or the most important criticism of Solvency II which you have? In your view, are there good things also in it? The idea is to provide the same chances for insurers, level playing field, and risk prevention. The insurer must be solvent when something explodes. Is that what you want, or was the current system also adequate?

HANS-JÜRGEN ALLERDISSEN: I have been following with considerable interest the discussions about the ratings that will then still be necessary. I ask myself, what else have the rating agencies done in the past than just to check this? One of the two would then have to become redundant, and disappear. Of course it is for the insured important that in the case of a claim, particularly with long-tail risks, the insurers stand firm, there is no question about that. As far as it goes, Solvency II is certainly also acceptable, if it is sensibly done. However, as Mr Oelssner has said publicly, if it means that it produces an almost identical premium situation, that would be negative.

RALF OELSSNER: At least I asked the question of whether that could be.

HANS-JÜRGEN ALLERDISSEN: If it were so, then of course it would be a step in quite the wrong direction.

GÜNTER DRÖSE: If you look at Solvency II and Basel II, there is also the question of the financial conglomerates. That will be really interesting later with the way equity capital is allocated. The FSA has already promised that it will push for banks to give insurers in their groups as much capital as possible. How that can all be organised, that I regard as reading the tea leaves, although it is naturally presented as a mathematical model of high precision.

EDWIN MEYER: For me, the question is always: why are we actually doing this? Why do we have Sarbanes-Oxley, Basel II, why are we going to get Solvency II? The reasons are clearly to be found in specific cases, Enron and others. They have led to investors' trust in parts of the American economy being shaken.

If I have a captive, when it is consolidated and if that is acceptable to the experts, is it also acceptable to those investors who read the annual report?

We ought to say that there is an insurance company, but the aim of this company is actually a rather different one, and also in balance sheet terms, the influence of this company on the parent company is less. But is that really true? What would happen if we found no reinsurance for the captive, but have given the captive an environmental risk with a capacity of €500m?

HERBERT FROMME: Mr Allerdissen, you have just asked what the rating agencies have been doing up to now, if not that? One can find reinsurers and insurers who speak relatively positively about Solvency II. One reason for this is that they hope Solvency II will weaken the influence of the rating agencies. They are sick and tired of rating agencies.

At some point in time, they are going to feel the same way about the supervisors. But for the time being they believe that Solvency II gives them a clean system that they themselves can calculate. Then they make a deal with the supervisory authority, and then they can forget the rating agencies – or so they hope.

A second point. One interesting aspect of Solvency II will be that international diversification across EU borders will lead to less need for capital. A sensible insurer who wants to grow



SOLVENCY II WILL BRING SOMETHING EVEN IN THE BIGGEST COMPANIES, NAMELY THE LINK BETWEEN THAT WHICH CAN ACTUALLY BE ACHIEVED BY THE COMPANY, AND THAT WHICH IS NEGOTIATED ON THE FRONT LINE WITH THE CLIENTS

ANDREAS BERGER

properly, will therefore have to grow outside his own country. That means that the number of insurers who have pan-European activities will increase. Do you welcome that?

RALF OELSSNER: The excitement among some insurers and reinsurers, to get away from these troublesome rating agencies at last, reminds me a bit of the Polish satirist Stanislaw Jerzy Lech. He said, now you have gone headfirst through the wall, what do you plan to do in the neighbouring cell? Whether things will now, through state supervision, be better than what we have had so far – I have my doubts.

HANS-JÜRGEN ALLERDISSEN: Perhaps the effect on capital of the international diversification in Solvency II explains why we suddenly have in Germany so many new providers coming from abroad. However, I am afraid that this has not increased the number of potential leaders. This will take considerable time. And I can see an opposite trend, also triggered by Solvency II. Because we know that the capital support has to be higher where the volatility is greater. Our risks are naturally

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AS A PRACTITIONER OF RISK MANAGEMENT I KNOW THAT SUCH RULES AS SOLVENCY II DO PROVIDE CONSIDERABLE INTERNAL SUPPORT IN PROCESS CONTROL, INTERNAL AUDITS AND SO ON

EDWIN MEYER

more volatile than those in a wider business. That means that if on the one hand the demand for capital drops because one goes outside the country, then I ask myself whether one then writes industrial insurance, of all things, with its high volatility which then has to be given greater support.

HERBERT FROMME: In the years 2004–2006, industrial insurers in the whole of Europe or in the whole world earned more than at any other time in history. Their pockets are bulging. That has a positive effect on them, even if a flatter phase comes now. I do not think there will be any lack of capacity.

GÜNTER DRÖSE: Every company which wants to receive a decent rating and the stamp of approval from the supervisory office, has to produce high profits as security for the company itself and for the capital market. I do not know how society can deal with this strange gap so that all companies can show 20% return on their equity capital. That means, if this is the consensus that the whole financial industry at some point will have been implemented in the whole world, and if the supervisory offices everywhere agree to that, then nobody has a right to complain if the insurance industry in future achieves high profits, over and above the three record years.

RALF OELSSNER: Anyone who wants to earn more than 5% has to take risks. I do not know whether that can be done in full measure under Solvency II.

HERBERT FROMME: Exactly.

RALF OELSSNER: Mr Fromme has put the question, in the sense of the German poet Erich Kästner, of where is the positive side? What do we see as possible positive points in Solvency II? For me personally I draw a parallel between the Christian faith and the real-life situation of the church. The ideas of the faith are themselves good, but the practice, the institution, the mechanics – there we may have certain doubts. That is perhaps putting things a bit high, but the basic thought is clear.

Of course securing adequate solvency for the carrier of our risk is important and we welcome it. We do not need to have a big discussion, but the side effects – here I am not quite so sure that absolutely everything is in the most elegant form and the most welcome form for the client.

ANDREAS BERGER: I would like to make a point for Solvency II. Standard & Poor's and other agencies found out early on that there is movement in the international industrial insurance market and a need for ratings. In the German market this started in 1997, when the first models appeared. The instruments which were available got more and more powerful, but they were only used by those companies which were internationally active, and by the brokers who assisted in choosing the companies.

Now the following is happening. First and foremost, discipline in the companies is being secured. Solvency II will bring something even in the biggest companies, namely the link between that which can actually be achieved by the company, and that which is negotiated on the front line with the clients. We have got better here, and the market is doing that now as a whole. Automatically, companies for whom rating has not been a relevant instrument up to now will also adopt this way of doing business.

GÜNTER DRÖSE: I see this slightly differently. According to what I know from the Bundesbank and BaFin, it has never been the aim to secure the existence of an individual company with these regulatory models Basel II and Solvency II. They have given the crystal clear explanation that if anyone goes under in competition, then he goes under, and it is not their job to secure the existence of an individual company. The aim is solely the systemic risk, to ensure that the collapse of one company does not mean the collapse of all. A single company can go under, why not? If we do not have that any longer, we should really start to say that all carpenter shops fall under a directive laying down that they have to make a profit, that each tyre manufacturer has to make a profit, and so on. Then the whole state is being regulated, then we have a planned economy. That cannot be our aim. The individual company must have a chance to be successful or unsuccessful.

HERBERT FROMME: That does not work with insurers,

definitely not. That is true of banks. With insurers, the regulators have specifically said they aim to prevent any individual insolvency, at least the continental Europeans.

GÜNTER DRÖSE: Yes, the English are shouting loudest in favour of Solvency II.

HERBERT FROMME: BaFin is afraid of nothing more than a failing insurer. That is the worst that could happen to them, and for this it accepts that competition is restricted in certain sectors, that is all the same to them.

EDWIN MEYER: I certainly welcome the fact that, as a result of Solvency II, risk management processes are taking place within the insurance companies. We often have the problem, if we go into individual lines, particularly when they are not one of the top lines, then we ask ourselves the question, why is there still such a fluctuation in the setting of prices?

HERBERT FROMME: Mr Meyer, if you as a client receive a first questionnaire from an insurer which has been drafted according to Solvency II, your support could perhaps weaken a bit.

EDWIN MEYER: That could be. But I say that, as a practitioner of risk management I know that such rules as Solvency II do provide considerable internal support in process control, internal audits and so on. I expect success here from Solvency II. For me, it is really again and again a question of the price setting of the insurer. It can be arbitrary, although today it is more and more affected by global events. The question is, how can it be that a product cost up to 40% or 50% more a few months ago than it does now? Either somebody stated a wrong price then, or the price is wrong today. The banks have their Libor, and there one says just so many basic points higher and so many basic points lower. Even if the Libor itself fluctuates, there is at least some orientation.

RALF OELSSNER: Mr Meyer, I hope I never have to work in a situation where it can be said, that's the right price. I love this insecurity, I love this volatility. To say that there is a right price, and that perhaps over a period of several years – for God's sake. That is the work of the devil!

EDWIN MEYER: But then why is it not the work of the devil in the banks?

RALF OELSSNER: I do not know. I don't know anything about banks.

REINER HOFFMANN: Mr Oelssner, I can reassure you that there will certainly be no market price for risks, even in several years time. The problem is simply one of solvency. That costs money, and it is influenced not only through the risks, which are in any case very complex, but also through the degree of diversification. In addition: the models which we use as a market are so sensitive, and our demands are so high, that the aspect of chance is actually always included. This also explains



THERE WILL CERTAINLY BE NO MARKET PRICE FOR RISKS, EVEN IN SEVERAL YEARS TIME

DR REINER HOFFMANN

why, apart from market processes, these prices for insurance or industrial insurance will always be volatile.

RALF OELSSNER: Yes, now I am reassured. I feel much better.

WOLFGANG FADEN: I wanted to look at the exciting question of whether growth strategies will change in connection with Solvency II. Allianz has again recognised the profitable growth aspect, following a self-ordered period of growth restraint, that is also true for industrial insurance, and we have also planned profitable growth for Germany. The real question is, whether it is still possible to grow in Germany in view of the fact that growth abroad will have a positive influence on capital needs because of diversification. When I take Allianz Global Corporate & Specialty, we have around €1bn gross premium in Germany. If I were to say how much of that we lost on 1 January after renewals, without having made any mistakes, it sounds alarming. These are simply mechanisms which we cannot prevent. This is partly because of clients who carry more risks themselves and also due to company mergers. Industrial insurers can no longer operate at all without doing so internationally, because on the one hand industrial clients are active all over the world, and on the other hand the relatively saturated German market ultimately won't produce the same growth as in the new emerging economies.

HERBERT FROMME: We have just spoken about the three good years in industrial insurance. Why did you let the insurers get away with it, so that they earned so much? Mr Meyer, why

STRATEGIC RISK ROUNDTABLE



AFTER 11 SEPTEMBER 2001, WE HAD TO ACCEPT A TRIPLE RISE IN PRICE

HANS JÖRG SCHILL

did you pay so much for insurance?

EDWIN MEYER: Yes of course, it is the same as with the weather. We always work from a basic value. In recent years we have clearly seen a reduction in premiums. The only answer I can give to the question of whether the premiums are still too high, is to say that at the time of signing our contracts we were happy with the price setting.

HERBERT FROMME: Did the insurance industry try to intimidate you by using 11 September 2001?

EDWIN MEYER: At that time I was on the insurance side myself. Things did in fact happen that had not previously been regarded as possible. For instance, it is an unimaginable scenario for our global economy that all aircraft should be grounded. In the risk management area, I had for the first time the impression that the world recognised the link between insurance and such risks. Obviously one does not want to have an 11 September for this to happen. The first result was the development on the stock exchanges. Before, more had been earned through the stock exchange than through underwriting, everybody believed they would still make profits with a combined ratio of 110%. That the insurance industry reacted in a knee-jerk fashion in 2001 to 2003 led to the situation that in 2005 in spite of Katrina, Wilma and Rita in the USA they finished up with \$44bn profits, despite losses of \$66bn from the storms.

RALF OELSSNER: I would like to follow up here. The answer cannot be so general. The markets differ considerably. If there are no storms, nothing happens in Bermuda. Then they are rolling in gold. If you then look at the lines where some of us are active. Of course we all were surprised in early 2001, to say the least, without letting it show. The market for property/casualty was then completely down the drain, the rates were so low they were beyond imagining. One can understand that insurers used the opportunity provided by 11 September to do some basic education.

OK, we resisted this as strongly as we could. But it still came very heavily. Before 11 September I paid \$19.5m for aviation insurance; from 1 October 2001 it was \$120m. After such a steep rise you do not get back to the starting point in a few years. That cannot be done, as we all know. That only goes in a flattening-out process, one that is as steep as possible, but that does not happen from one day to the next. And we could have no better argument than to say: you have eaten your fill for three years, that is enough, now let us talk about rates.

HANS JÖRG SCHILL: I think we were indeed intimidated in 2001, but that comes from our work as an airport operator. The airlines would have stayed grounded if they had not been able to prove cover they had beforehand. It would have been the same for us. At that time we had to accept a triple rise in price. In the last three years, from a narrow base, we have been able to negotiate the prices a little bit downwards. But you can never say what is the right price.

HANS-JÜRGEN ALLERDISSEN: We did not experience the fluctuations quite so strongly. Certainly we moved with the market trend, we experienced the peaks and lows in the same way, whereby the trend now is downwards. I believe that this will continue. What we found much more annoying were the exclusions and limitations in cover.

GÜNTER DRÖSE: We do not have typical industrial business. But we also have special risks. In the last 25 years, we did not really have any major price fluctuations in the fundamental insurance programmes. The exception is clearly the period following the World Trade Center. Here we naturally also had a similar multiplication as in aviation. That flattened out. As far as the conditions are concerned, I agree with Mr Allerdissen, that is actually the only tool that the insurance industry had. When the industry sees that there is a specific accumulation, or recently particular loss scenarios, then they exclude that from the cover.

HERBERT FROMME: One of the reason why the prices rose as they did was the increase in reinsurance rates. Reinsurers had to raise their prices because they over-reached themselves in 1997 to 2001 with liability business in the USA. They provided cover too cheaply and fell flat on their faces. Why do you as clients do that, so that again and again you are called on to pay out sharing the burden of old losses? All the asbestos claims were paid out to the clients 20 to 40 years later.

EDWIN MEYER: That is certainly a good question. At the same time we are an international company.

HERBERT FROMME: So you could have insured yourselves cheaply at that time?

EDWIN MEYER: That must be the conclusion to be drawn. When you are a company the size we are, when you observe the development of Arcelor and Mittal Steel, then I can tell you that we are in the middle of a consolidation phase, and the insurance markets are reacting extremely positively. We have no problems with the scope of the cover, on the contrary the insurers work very well with us to really find the right cover for our risks. We have no limitations in the conditions offered to us, and capacity and price are also OK. I welcome the readiness of insurers to really re-estimate the risk Arcelor Mittal as a new company, that is not to make the mistake of simply adding Arcelor and Mittal together, perhaps deducting 10%, and that is the price. Instead of that, the risk is being studied.

RALF OELSSNER: I think you have to analyse the origin of the exorbitant profits, where they actually come from. And then we should have a look at whether those are the lines in which we have policies with these insurers. If that is the case then you can really say: My goodness, perhaps we should rather sell books or become librarians. But I do not think that such extremes bring us any nearer to the answer.

HANS-JÜRGEN ALLERDISSEN: I would support that. On the one hand we do not let ourselves be led into ruin like sheep to the slaughter. We certainly react to such market phases, we increase the retention for captives, we might raise the retention at the base; to this degree we also use our own tools. Over and above that, I also ask where the profits have been made. I believe that industrial insurance continues to contribute to profits. But in precisely this sector where we are active, the risks balance out over time. We ask ourselves, what is it worth to us to have the balance sheet security which we buy there with money. We look at that sensibly and then say: that is worth it, but that is not.

ANDREAS BERGER: I would also like to point out that it is definitely difficult to say just where exactly these profits in the industrial insurance business come from. At AGCS we have the happy situation as a self-contained risk carrier that we can report our industrial business separately. We show a combined ratio of 92% for 2006. Everyone can see our results, everyone knows how much capital lies behind them. For a self-contained entity that's not bad going in terms of transparency.

RALF OELSSNER: We are all agreed that things are going well for you. Allianz has come to meet us by setting up AGCS. Now we can have a serious talk with them when industrial insurance profits are too high.

GÜNTER DRÖSE: I think that the high profits are necessary as a preparation for Solvency II. That has been carefully planned.



I THINK THAT THE HIGH PROFITS ARE NECESSARY AS A PREPARATION FOR SOLVENCY II

GÜNTER DRÖSE

With Solvency II, the following will happen. Then you have basically the same system as in the USA. There is an interplay between premiums, capacity, capital and reserves. Those are the four aggregates. Added to this are of course rating agencies, the capital market, shareholders, the clients want something too, and the supervisory office. That cannot function together at all, so everyone is preparing themselves so that they have stable returns at the highest possible level. Otherwise you will be punished by all participants.

RALF OELSSNER: I propose that we look now at D&O.

HANS JÖRG SCHILL: That can be dealt with fairly easily. If it comes to a claim, the insurers point to an exclusion, if not to a violation of the pre-contractual duty to disclosure. If that does not come in, then it was intentional.

D&O is in principle an insurance under the motto, private individuals have to be protected when it comes to a catastrophe. That is of course very important for our big industrial risks. It is of course clear that this also covers the financial interests of the company. But whenever people who had a case talk about this, it is the same thing: exclusion, violation of duty of disclosure, intention. Therefore we have to be prepared that we have to go into the field with a whole lot of lawyers when it

STRATEGIC RISK ROUNDTABLE



WE DECIDE VERY CAREFULLY WHICH MARKET WE APPROACH WHEN WE BUY D&O

HANS-JÜRGEN ALLERDISSEN

comes to D&O losses.

HANS-JÜRGEN ALLERDISSEN: In Germany we have the special situation that we insure internal claims. Internationally, D&O is organised a bit differently. That leads to a completely absurd situation for the insurer, who at first wants to refuse the claim, that's how we know the insurers. He first has to say, intention or deliberate breach of the norms by that particular organ of the company which is in the line of fire. Then he will say next, here there was a deliberate breach of the norm, or there was intention. If that cannot be proved, then he must say the opposite, that no, the man did not even act negligently, he has nothing to reproach himself with. This contradictory behaviour comes with the construction of the German D&O policies. It is a particular difficulty and can lead to farcical situations.

HERBERT FROMME: D&O insurers have in recent months certainly paid out one or other claims, but have not paid others. There were high payments for DaimlerChrysler, a payment with VW and also with WestLB. So it appears that insurers do not always get away with their triad of reasons for refusal.

RALF OELSSNER: The question is, Mr Fromme, how the

settlements you mentioned were reached. The English organisation AIRMIC, the equivalent to DVS, has a new theme in the meantime. They discuss the willingness of insurers to pay justified claims, not claims but justified claims. That one has to check and catalogue that at all was the thing that struck me most this year. With the three claims you mentioned, compensation was paid because there was an incredible amount of pressure, which we here cannot possibly imagine. That is not compensation according to the policy.

HERBERT FROMME: Well, why do you buy the rubbish, if they are not going to pay?

RALF OELSSNER: Because basically we trusted insurers.

GÜNTER DRÖSE: You can turn that round in a completely different direction. When will the German lawmakers understand that changes to the rules governing joint stock companies are needed? Many politicians who talk about globalisation, do not understand when it comes to the content. Otherwise they would see that German companies can only acquire good top personnel when they have the same choices as their foreign competitors. Every person asks, before he even applies, how is my liability covered? Then if in Germany he is told, you can forget it, you are left out in the rain. So the law has to be changed so there is the possibility of a deed of release. As long as that does not happen, it will continue to be a drama.

HANS-JÜRGEN ALLERDISSEN: I want to look a bit in the direction of the lawmakers. We are at present experiencing the discussion in the Cromme Commission about managers' salaries. There is one particular matter, that settlements made when a contract is cancelled before it runs out should also be limited. But no-one in politics considers also limiting at least the internal liability of the managers. Why is that not being done in parallel? Then we get into a completely different discussion, and then one can perhaps find sensible solutions. And I am only talking about internal claims.

As far as the actual D&O cover is concerned: we decide very carefully which market we approach when we buy D&O. In particular against the background of regulation in the cases you mentioned. You have to ask yourself whether there are differences between the markets in the way they handle D&O claims, and I believe I can see these.

HERBERT FROMME: Are the proposals now being made, such as the introduction of a direct claim of the company against the insurer, any help? Or is that marketeering?

HANS JÖRG SCHILL: No, in my view that is not marketeering, but it is very important.

HERBERT FROMME: Mr Faden, will Allianz also offer that in future?

WOLFGANG FADEN: I cannot at the moment say what the developments will be like. But to come back to claims handling,

I think I can only speak for German insurers. It is not true that German insurers are suspected generally of not acting correctly, no matter in which sector, and thereby also in the interests of the client. The insurer tries to give fair compensation, based on the contract. That is easier with property/casualty, but more difficult with business interruption. It seems to me that the case with D&O is even more difficult. But I resist the fact that the suspicions are continually being supported that, particularly in the D&O sector, insurers are more inclined not to regulate correctly.

HERBERT FROMME: The gentlemen are firmly convinced that it is so, it is not a suspicion.

WOLFGANG FADEN: Why should that be particularly in D&O?

HANS JÖRG SCHILL: The Germany chief of a big insurance company told me that for 95% of D&O clients he has to have a combined ratio of 0% in order to cover the remaining claims volume. And that could indicate why claims handling is so bad with D&O.

WOLFGANG FADEN: That is also true of other sectors in the market.

GÜNTER DRÖSE: I have a suspicion. There are relatively few providers of D&O, it is not like cover for chemical risks where you can buy €2.5bn or €5bn. But if the worldwide capacity is small, where does it actually come from? There are just a few reinsurers who are certainly extremely exposed. My suspicion is that the driving force is the reinsurers, when it comes to the way a primary insurer treats claims.

RALF OELSSNER: Precisely that. Perhaps one more hint: a D&O insurer active in Germany told me that he wished he did not have to insure D&O any more. The reason is the specific claims handling for D&O cases. If he has one of them, he can pack away all other lines for that customer, the account is then ruined. There has to be something in the specific claims handling of D&O losses.

GÜNTER DRÖSE: Where do the many court cases come from? They come on the one hand from insolvency procedures. If the insolvency receiver comes in and sees that there is a D&O policy in force, then he says, hey, let's sue the insurer. Then there is the question of how the market in Germany develops. As it does in America? Or as in England, where nothing will be paid. I know this from colleagues in the banking sector, they often had such cases, but nothing was ever paid out.

EDWIN MEYER: The loss ratio for D&O in the USA went back strongly in 2005/2006, and this is at least partly attributed to the Sarbanes-Oxley factor.

RALF OELSSNER: The ratio in Europe, Mr Meyer, was published in the sector analysis report of the EU Commission.

GÜNTER SCHLICHT: The combined ration in 2005 was 62%, that was ascertained by the report.



A D&O INSURER ACTIVE IN GERMANY TOLD ME THAT HE WISHED HE DID NOT HAVE TO INSURE D&O ANY MORE

RALF OELSSNER

HERBERT FROMME: That is good money. May I put another question in this connection. EPLI (employment practices liability insurance) and the German anti-discrimination law or Allgemeines Gleichbehandlungsgesetz. Is that a real theme for insurance, or a marketing bubble from the insurers?

GÜNTER DROESE. The offer to insure these risks was originally made in America. There it is more or less a must for large companies. The problem also exists in England, to a certain extent in Australia. It will come, the question is only to what extent, and every company will have to consider what precautions it takes.

RALF OELSSNER: I think that for quite a long time EPLI will not mean as much here as it does in the USA or Britain. But the AGG will surely also mean that there will be certain regional adjustments in EPLI cover. So far those claims which have appeared have had more the character of Abmahnvereine, dubious associations that make money by claiming to watch unfair practices and charge high legal fees for that. They try to utilise the law by encouraging people that they feel affected by the AGG.

HANS JÖRG SCHILL: For us it is so, that all leading employees have been prepared through extensive training. So that we do not see this as such a huge theme.

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I WOULD SUGGEST CHOOSING THE COUNTRY WHERE THERE IS THE MOST KNOWHOW, AND AT THE MOMENT THAT IS CERTAINLY BRITAIN

EDWIN MEYER

EDWIN MEYER: All that is of course looking at it from the German standpoint, and Mr Oelssner as chairman of DVS must surely also take a stand in this direction. With our company, 52 different nationalities now sit at one table during the management meetings. There it is my job as risk manager to make sure that our company does not suffer any losses from these risks, even if they are in different stages of development in different places. Here the question has to be put, whether a company really has to insure the risk. With this insurance, I am more concerned about the defensive character, the supporting character. For me the main ground is not the financial aspect, but the fact that I have someone who helps me to cope with such claims and also to regulate them.

Perhaps one short tip with regard to D&O. So far it went without saying that when you live in Germany, it is said, your legal base is Germany. But here we must ask the question, does your place of jurisdiction have to be Germany? Or are there reasons for choosing another place of jurisdiction and to consider the advantages and disadvantages. At the moment we are in the process of consolidating a Dutch holding without production with a Luxembourg-based company with production. There Luxembourg as a place of jurisdiction is not necessarily prepared to regulate a €500m D&O claim. Europe offers many possibilities, if one is ready to move one's policies and one's place of jurisdiction somewhere else.

HERBERT FROMME: What would you suggest? Estonia? Gibraltar?

EDWIN MEYER: No, I would suggest choosing the country where there is the most knowhow, and at the moment that is certainly Britain.

HANS-JÜRGEN ALLERDISSEN: With regard to EPLI. The trend to an international operation has caught up with us, we are active in more than 90 countries. Where it is necessary, I think one should consider taking out EPLI cover. However, I think it is even more essential, also in Germany, to firmly put the theme into the minds of managers. That is the first step. In addition we are also active in third party business for other clients. I give them precisely the same advice. If you are generally based here, then you should first sort out your risk control.

GÜNTER DRÖSE: The difference, though, is the deductible. Deductibles in the USA are much higher than those which we have here at present.

EDWIN MEYER: One theme which I find important is disclosure with D&O. We have 330,000 employees in 60 countries, we have \$190bn in insured investment volume. And then

somebody expects us to find somebody to complete this questionnaire and sign it. You can only solve this problem by telling the insurers, that won't work.

RALF OELSSNER: We are nearly at the end of our discussion. Perhaps we can just pass the question round regarding the subject of environmental liability. There are many models available. But they are individually not so well-known that one could discuss the deficiencies of these models. Do you see that differently, Günter?

GÜNTER SCHLICHT: We could certainly say a few things with regard to the model of the Gesamtverband der Deutschen Versicherungswirtschaft. There are two basic observations. First, it is certainly a positive sign when an association is in a position to agree on a model policy before the law comes into force. The model does not satisfy all cover demands. But I have to say, realistically we could not expect that or we did not expect that. The model has its weaknesses, the model is cautious on a number of points, I will not list them all because we do not want to discuss them concretely now.

HANS JÖRG SCHILL: Just one comment: losses of the insureds are excluded. That cover can be re-purchased. Isn't that once again the usual method of the insurance industry?

GÜNTER SCHLICHT: Yes, we can again see here the basic model that we have known for many years. The model is certainly not what clients would want as perfection. But now the challenge goes to the companies. The clients at the moment have to rely on qualified providers to come bit by bit nearer to the cover they need, whereby each part of the cover needs must also be thought through to the end.

This is a new liability, of course the scope of liability is down on paper, but where the focal points are will only show over the next few years.

HANS-JÜRGEN ALLERDISSEN: I would like to make three demands to the insurance industry in this connection. First, there will have to be discussions with the insurers about how far they will use intention as an objection when it comes to claims under the environmental laws.

The second point is the question whether only accidental events can be insured – that is so in the GDV model – and this by far not enough from the insurers' side.

The third point, which has not surfaced in this discussion, is the question of how the D&O insurance copes with this. Here we are dealing with public-law demands, which can also be directed against the different organs of a company. The D&O policies have the usual exclusions. I can imagine, because here the environmental protection organisations can go to court without having suffered a direct loss themselves, that they might often sue these organs, particularly from the political point of view. Then the question arises: what do D&O insurers do in such a case?

RALF OELSSNER: Gentlemen, thank you very much indeed for your readiness to participate so freely in this discussion.