

From the Editor

by Michael M. Barth, Ph.D., CPCU

Michael M. Barth, Ph.D., CPCU, is an associate professor of finance and the acting chair of the Department of Finance and Quantitative Analysis at Georgia Southern University. Prior to joining Georgia Southern, he was a senior research associate at the National Association of Insurance Commissioners where he focused on solvency monitoring, risk-based capital, and other financial issues. He worked for the American Institute for CPCU/Insurance Institute of America as a program director for the Associate in Underwriting and has worked as a product manager in the nonstandard auto insurance business. He holds a Ph.D. in risk management and insurance from Georgia State University, and earned his CPCU in 1989.

During the CPCU Society's 2005 Annual Meeting and Seminars in Atlanta, the International Insurance Section sponsored a panel discussion on international insurance issues in Europe. The panel discussion featured presentations on risk management strategies, insurance issues in the evolving markets of Europe, regulatory practices and challenges, and the brokers' perspective. This issue of *IQ* includes summaries of material from each of the four presentations as well as some commentary from the panel moderator, Douglas N. Smith, CPCU. While we cannot hope to condense an entire presentation into a thousand-word summary, we have tried to highlight some of the key points that the four presenters discussed. While many of the themes presented were identical, we have also tried to isolate some of the different perspectives provided. ■

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Moderator's Commentary

by Douglas N. Smith, CPCU, AIC

Douglas N. Smith, CPCU, AIC, west coast regional manager—AIG WorldSource, began his career in the international insurance field in 1973 when he joined AFIA Worldwide Insurance in Los Angeles as a branch assistant. He was transferred to Colombia in 1975 as manager of the Cali office. In 1977, he joined the Los Angeles office of Marsh & McLennan as an international insurance representative. In 1978, he joined the international department staff of Johnson & Higgins in Los Angeles, and later became its manager. In 1989, he became the department manager for

Johnson & Higgins' New York Branch, rising to the position of senior vice president. He joined American International Group in 1992.

He holds the Certificate in General Insurance, the Associate in Claims, and the CPCU professional designations.

I was truly delighted to moderate our panel presentations at the CPCU Society's Annual Meeting and Seminars in Atlanta. In selecting our topic "Insurance and Risk Management in

the European Union and Neighbors," I thought that the time was ripe to discuss Eastern Europe (and the EU's new members) and the challenges involved from a carrier, risk manager, and broker point of view. I was very fortunate to have my fellow International Insurance Section member and former business colleague, **Anthony L. Cabot, CPCU**, who heads up XL Insurance operations in Italy; **Andras T. Koppanyi**, who, until recently was the southeast regional manager for AIG WorldSource (he is now ACE's country manager for

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Moderator's Commentary

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Poland); **Laurie R. Solomon**, who directs The Coca-Cola Company's worldwide risk management operations; and **Philip Gawthorpe, FCII, ARM**, of Aon Risk Services, who leads Aon's Global Business Units, along with other important responsibilities.

As you will note in the following pages, each of the panel members brought a unique perspective to the table. Tony Cabot spoke of the European Union and its insurance regulations; Laurie Solomon gave us a very interesting—and first-hand account—of Coca-Cola's risk management challenges in Europe; Andras Kopppanyi presented a closer look at the EU's new members and the insurance market in eastern Europe in general; and Philip Gawthorpe offered a broker's viewpoint and commentary on the role that recent developments in the United States will play in Europe. All in all, the panelists were very well prepared and excellent presenters.

In our "continuing series" of international seminars, we will be presenting "China and India: Insurance Marketplace Response to Their Fast-Growing Economies" at the CPCU Society's 2006 Annual Meeting and Seminars in September in Nashville, with an equally distinguished and informed panel. Hope to see you there! ■



CPCU Society Annual Meeting & Seminars
September 9–12, 2006
Nashville, TN

Risk Management in the EU

Editor's Note: This article was written based on a presentation given by **Laurie R. Solomon** during the CPCU Society's 2005 Annual Meeting and Seminars. The seminar was entitled "Insurance and Risk Management in the European Union and Their Neighbors." Other participants included **Anthony L. Cabot, CPCU**; **Philip Gawthorpe, FCII, ARM**; **Andras T. Kopppanyi**; and **Douglas N. Smith, CPCU, AIC**.

■ **Laurie R. Solomon** has 20 years of overall experience in the insurance industry. In May 1995, she joined the risk management department of The Coca-Cola Company. She manages the negotiation and implementation of all domestic, international, and global business insurance programs for Coca-Cola. In addition, she coordinates the global premium allocations, and provides budgetary guidance on insurance costs for the company to finance managers around the world. Solomon has helped bring new and innovative risk financing and risk transfer options to Coca-Cola including high retention, finite, and integrated programs. Solomon's group provides consultative guidance throughout the company on insurance and risk-related issues. It provides expertise related to company contractual matters, always ensuring the company is in the best possible risk prevention position.

Prior to joining The Coca-Cola Company, Solomon worked for 10 years with the Travelers Insurance Company in Hartford, CT. During the course of her tenure there, she had new business responsibilities and was the account executive for a significant book of national accounts where she coordinated all services—underwriting, actuarial, loss prevention, RMIS, and claims management. Before leaving the Travelers, Solomon was made an officer of the company and managed Travelers' largest national account at that time. She is a graduate of Brandeis University in Waltham, MA.

Coca-Cola is the largest manufacturer, distributor, and marketer of nonalcoholic beverage concentrates and syrups in the world, with Coca-Cola products being marketed in more than 200 countries worldwide. In order to manage its operations globally, Coca-Cola itself is divided into geographic groups, generally along continental lines. Operations in Europe are split into two divisions: the European Union group, and the North Asia, Eurasia, and Middle East (NAEME) group. The EU group includes most of western and central Europe, while the Balkans and CIS countries are generally in the NAEME group. Nearly a quarter of the volume and one-third of the total revenues come from these areas.

The size of the company must be appreciated to put its risk management challenge into a global perspective. The company has more than \$9 billion in assets, and the bulk of the company's operating assets are located in North America. However, more than 20 percent of those assets are in Europe, Eurasia, and the Middle East. Of those assets, about half are machinery and equipment, and another third are buildings and real assets. In addition to a sizeable investment in assets, there are also more than 34,000 employees in the organization, nearly 30 percent of whom are in the EU and the NAEME groups. Coca-Cola also has a large fleet of vehicles (more than 7,000 in 2005), mostly passenger cars and light trucks.

Given this high concentration of value, one of the key facets of the risk management and insurance purchasing strategy for Coca-Cola is to first prevent losses. The company has a healthy retention program, with large deductibles and blended programs designed to retain a large part of the basic risk within the company. Therefore, loss prevention efforts are directly felt on the company's bottom line. While the company does retain a large portion of its overall risk, it still purchases catastrophe insurance that it hopes that it never needs in order to cap its potential losses. Still, the company relies on effective loss control efforts to maintain the viability of its insurance purchasing program.



■ *Laurie R. Solomon explained how her company effectively uses an insurance retention program and how it impacts loss control efforts.*

Coca-Cola uses captive insurers as part of its overall insurance purchasing strategy. There are two separate captives, both domiciled in Dublin, Ireland. Red Disk Insurance Company Limited (RDICL) is a fully regulated insurance company that writes numerous coverages and lines of business on a direct basis. It issues property policies in 24 countries as well as excess liability policies for European risks, and covers the self-insured retention for a number of worldwide specialty liability lines such as D&O, environmental, fiduciary, and crime. RDICL reinsures risk above its own planned retentions through a second captive, Coca-Cola Reinsurance Company Limited (CCRCL), a non-regulated reinsurer. CCRCL in turn reinsures risks above its own planned retentions with other international reinsurers such as AIG, Lloyd's of London, and Zurich.

Coca-Cola enjoys all of the traditionally cited advantages for using an insurance captive, such as flexibility in policy wording and the ability to provide evidence of insurance to meet local requirements. The size of Coca-Cola limits the ability of typical insurance companies to set up fronting arrangements, so the ability of the captive to meet those needs provides additional stability. There are also a number of

advantages to the use of captives that are not always self-evident. Some of those advantages stem from market conditions, but others arise because of the broad scope of the corporate umbrella. For example, for a large company such as Coca-Cola, an advantage of using a captive is that it provides a formal structure for the collection of premiums and for the payment of claims. In a large, sprawling multi-national like Coca-Cola, the sheer size of the company and the breadth of its international operations has the potential to turn the premium and loss allocation process into an administrative nightmare. By running the risk management process through a captive, the process is streamlined and formalized.

■ *... an advantage of using a captive is that it provides a formal structure for the collection of premiums and for the payment of claims.*

There are some interesting coverage anomalies to doing business in Europe. For instance, there are terrorism risk pools in countries such as France, the United Kingdom, and Spain, as well as catastrophe risk pools in France and Norway. There are also challenges with respect to e-commerce and privacy issues that are not necessarily unique to Europe, but that do differ from those challenges faced in the United States because of the cultural differences. One of the key cultural differences is that Europe is not nearly as litigious as the United States, which changes the atmosphere with respect to the claims settlement process.

There are also compliance issues with various EU directives that affect the risk management program as well. For example, the ATEX ("ATmosphere EXplosif") directive was implemented in 2003 to coordinate health and safety standards for equipment and devices that are used in potentially explosive environments. While full compliance

requirements are being phased in over several years, Coca-Cola immediately began working on a three-year project to implement these requirements, and has completed several initiatives to date that have reduced risk costs significantly. Coca-Cola is on track for full compliance by the June 30, 2006 deadline.

Another risk management challenge faced by Coca-Cola has to do with business continuity planning. The company leadership has been active in its support for business continuity planning, and the opportunity to practice business continuity planning as part of the planning for the upcoming Olympic games in Greece and Italy has provided a number of lessons learned that can be exported to other areas. ■

Insurance and Risk Management in the European Union and Neighbors

Editor's Note: This article was written based on a presentation given by **Andras T. Koppányi** during the CPCU Society's 2005 Annual Meeting and Seminars. The seminar was entitled "Insurance and Risk Management in the European Union and Their Neighbors." Other participants included **Anthony L. Cabot, CPCU; Philip Gawthorpe, FCII, ARM; Laurie R. Solomon; and Douglas N. Smith, CPCU, AIC.**

Andras T. Koppányi is currently the regional manager for the southeast of AIG WorldSource, based in Atlanta. AIG WorldSource provides comprehensive insurance coverages and services on a global basis, for customers ranging from small non-profits to the largest multinational corporations. Prior to working in Atlanta, Koppányi worked in Austria and Hungary for 10 years with AIG, first as regional casualty manager of the Central Europe and CIS Division, and then as general manager of AIG Hungary. His international insurance career also includes various regional management and underwriting positions with CIGNA International and Chubb International in Pennsylvania, New Jersey, and Georgia. He earned a B.A. in Comparative Area Studies and Spanish from Duke University and has completed study abroad at the University of St. Louis in Spain. He is a member of the Southern Center for International Studies and a mentor of the Institute of International Business at Georgia State University.



Thirty-four seminar attendees learned how the risk management business in eastern Europe differs from that of the United States.

To set the stage for this discussion of the current state of insurance in Europe, one needs to take a quick look back at the history of insurance in Europe. Prior to the second world war, the insurance markets of eastern Europe were alive and well, if not always vibrant. During the ensuing 40-year period of the communist era, though, insurance markets in Soviet Union-dominated Eastern Europe as well as those of the Soviet Union itself were essentially government-owned monopolies. In the entire region, there were relatively few carriers, little competition, and virtually no cross-border operations. Although there was some very limited foreign reinsurance and there were a few instances of specialty insurance arrangements for exporters, by and large the markets were localized and closed to the outside. Following the collapse of the communist regimes in that part of the world beginning in 1988, the market landscape has changed, although the pace of change has differed from country to country.

A shift from a state-dominated economy to a free-market economy does not come easily. In Eastern Europe, the first steps to revitalize insurance markets began with privatization of the state-owned insurers.

This required a complete revision in the way that those companies did business, as the introduction of competition into the market meant that new business practices had to be learned at all levels. And in addition to the problems faced by the insurance companies themselves, the regulatory regimes in this part of the world have had to adapt to a new type of system as well. The introduction of a new regulatory regime takes time. The regulators are inexperienced, and the introduction of insurance laws is a time-consuming process. In addition, there are often inefficient reporting requirements and local filings that reduce the attractiveness of these markets. The expansion of the EU in recent years has mitigated this somewhat, but some countries have moved more quickly than others.

In addition to developing local insurance companies to broaden the economy, foreign insurers were allowed to enter these markets as well. While the increase in market competition had its advantages, the shift to a free-market economy also produced a host of inevitable problems. Political power still rested with a relatively small number of individuals, and the introduction of the free market

led to problems with corruption and inefficiency in some local markets. These types of growing pains are typical of free-market economies in their infant stages, but this kind of uncertainty makes it difficult to build up a strong vibrant insurance economy overnight.

Today's insurance market in eastern Europe is still dominated by foreign companies. Interestingly, the predominant players in the eastern European market have been and continue to be the insurance companies of western Europe. The United States has had little impact on this part of the world, and U.S. insurers continue to eschew these markets. Some of this probably stems from cultural differences, perhaps some from the traditional reluctance of U.S. insurance companies to expand internationally. Whatever the reason, the market dominance of the European insurers is a fact of life.

While there have been great leaps in the insurance markets of eastern Europe in the last two decades, the potential for growth in this part of the world continues to be mostly potential. Insurance markets have not expanded at the pace that they could have or should have. For example, non-life insurance premiums are less than 3 percent of GDP in the Czech Republic, and only 1 $\frac{1}{4}$ percent of GDP in Russia. Life insurance premiums are an even lesser portion of GDP. However,

as the economies of the region prosper over time, the insurance markets will be poised for exponential growth.

Currently, as is the case in much of the world, the nonlife insurance markets are dominated by auto insurance. Third-party liability insurance for auto owners is mandatory in many countries, and currently auto premiums make up more than 50 percent of the total premium volume. Commercial property insurance is growing as well, but still has a long way to go. Liability insurance, which makes up a segment of the U.S. market, is relatively unimportant in the eastern European markets and is very rudimentary in coverage. The primary customers for liability insurance are the large commercial risks and/or those with foreign ownership.

As markets continue to expand and as countries continue to join the European Union, the ability of insurers to offer bigger and better products at relatively lower prices will continue to expand as well. In May 2004, Hungary, Poland, Czech Republic, Slovakia, Estonia, Latvia, Lithuania, and Slovenia were added to the EU. As part of the requirements for EU membership, each country's insurance laws must comply with the EU directives. The insurance-related directives have greatly expanded the ability of companies to sell insurance products across national borders, harmonized capitalization requirements, and led to more consistent statutory reporting. The increased competition has had an immediate impact on eastern European insurance markets, opening the door to more companies to expand across national borders. Following Hungary's entrance into the EU, there were more than 150 branch applications by EU insurers anxious to participate in that market.

The risk management industry in eastern Europe is also in its infancy but showing signs of growth. Part of this growth will arise from greater education and training. There is currently no formal organization of risk management professionals such as RIMS or the CPCU Society, but there

are insurer/broker associations in place that perform some of these education and training functions. Insurers and brokers are working toward putting together more effective education and training packages to enhance the ability of customers to purchase more sophisticated insurance products as well as to set up alternative risk management arrangements. For example, MOL, the Hungarian oil and gas company, has set up a captive in Cyprus. A number of the large Russian oil and gas companies have also launched captives to handle their insurance needs as well as to diversify risk by taking on outside clients. Still, even though the risk management business in eastern Europe has a long way to go, it is heading in the right direction. ■



■ *Andras T. Koppanyi presented a closer look at the EU's new members and the insurance market in eastern Europe.*

A European Overview of Insurance Regulations and Requirements

Editor's Note: This article was written based on a presentation given by **Anthony L. Cabot, CPCU**, during the CPCU Society's 2005 Annual Meeting and Seminars. The seminar was entitled "Insurance and Risk Management in the European Union and Their Neighbors." Other participants included **Philip Gawthorpe, FCII, ARM, Andras T. Kopppanyi; Laurie R. Solomon; and Douglas N. Smith, CPCU, AIC.**

■ Anthony L. Cabot, CPCU, has been country manager for XL insurance Italian operations for five years now. As country manager, Cabot is responsible for the relationships between XL Insurance Italia, its clients, consultants, brokers, and all relevant regulatory authorities. Prior experience within the XL Insurance Group also includes sales and marketing manager, West Coast, establishment of the Los Angeles Branch office, and special accounts manager, East Coast (New York City office).

Cabot is a current member of CPCU Society's International Insurance Section Committee and a founding member of the CPCU Society's Europe Chapter. Cabot is also an active member of the Italian Academic Risk Management Association and a regular guest teacher for the University of Verona's master's in risk management program. Prior experience includes stints with Johnson & Higgins in Milano, L.E. Ziminsky & Associates Risk Management Consultants, risk manager and insurance administrator for the Owl Constructor Group, Richard Mills Insurance Brokers, and began his career as an agent for the Farmers Insurance Group. Cabot also spent five years with the United States Coast Guard in search-and-rescue operations in Alaska and California, as well as radio and navigation operations in Italy and Germany.

Anthony L. Cabot, CPCU, began his presentation with a whirlwind tour of Europe in order to set the stage for insurance regulation in that region of the world. Comparisons with the United States are inevitable, but it is important to understand the similarities as well as the differences in the regulatory regimes in order to effectively compete.

Geographically, the European Union is about half the size of the United States (four million square kilometers versus nine million for the United States) but its population is 50 percent larger (450 million versus 300 million for the United States). Both the European Union and the United States have similar GDP (roughly \$11.5 trillion) and both have sizeable insurance markets. In fact, the EU countries have a robust insurance economy, consisting of more than 5,000 separate companies underwriting \$1.1 trillion of premiums, and employing close to one million people.

Unlike the United States, though, which has a common language used in virtually all business transactions, there are more than 20 official languages throughout the European Union, not to mention hundreds of dialects. The fragmentary nature of Europe has by tradition led to a fragmented insurance market, but the emergence of the European Union and the evolution of EU insurance regulation has led to a remarkable evolution in how the insurance business in the European Union is regulated. In the United States, which has many of the same regulatory issues (multiple jurisdictions and legal requirements that stretch across political boundaries), the regulatory regime has still focused on maintaining the status quo of state-by-state regulation of insurance. The European Union has moved in a different direction, toward a more homogenous regulatory framework where a common set of rules has been agreed upon for licensing, capital levels, and technical provisions. Companies that meet these requirements in one EU

country are able to provide insurance services across national borders.

Under the EU system, the European Commission drafts legislation, which goes on to the European Parliament, where they eventually become directives. Directives establish the regulatory standards at the EU level, and individual member countries' laws must comply with those directives. The European Commission monitors individual member states to ensure that insurance regulation is in compliance with the directives. There is a system in place to address violations of directives and/or complaints as well.

There are a number of directives that pertain to life insurers, nonlife insurers, and producers. The directives address a variety of issues, including minimum capital requirements and the level of technical reserves for insurers as well as rules pertaining to the freedom of establishment and freedom to provide services. Insurers that want to begin providing insurance to the public must first be licensed in one of the member states, but once established, they are free to do business across all member states. Individual member states can establish more stringent regulations and apply them to insurers that are domiciled in that member state, but cannot impose them on insurers domiciled in other member states. For example, if Hungary required Hungarian-domiciled insurers to maintain minimum capital standards of 10 million (which is above the minimum established by the EU directives), they could impose that on Hungarian-domiciled companies but not on, say, German-domiciled companies doing business in Hungary. The net effect is a leveling of the playing field for all companies doing business within the European Union.

As with insurance licensing for insurance companies, licensing for insurance producers and mediation services has also been relaxed by the EU directives. Once a producer is licensed in its own home state, it has the freedom to operate in all



■ *Panelists discussed the European Union's efforts to streamline insurance regulation throughout the EU countries.*

other member states as long as it complies with the minimum requirements of its home states. Domicile states can impose stricter licensing requirements on those producers that they directly license, but not on producers operating in their jurisdiction that are domiciled elsewhere.

The freedom of services provisions of the various EU regulatory directives has evolved over time. In the early years of the European Union, there was much talk but little action with respect to lowering barriers to entry across state borders. In recent years, though, the trend has been toward much less talk and much more action. That is, the freedom of services provisions has been implemented, and cross-border insurance services throughout the European Union have become a reality.

While the EU directives have created an atmosphere where cross-border entry into another country's insurance market has become relatively simpler, there are still a number of issues that affect the desirability of participation in these markets and that can create a compliance issue for insurance companies. For example, premium tax rates in the European Union and neighbor countries differ from one jurisdiction to another, and they also differ by the line of insurance. These differences can be very large from one country to the next. For example, premium taxes for property

insurance are more than 20 percent of premium in France, Finland, Greece, and Italy but are less than 1 percent of premium in Sweden, Slovakia, Denmark, and the Czech Republic.

A recent tax ruling, the Kvaerner ruling, has clarified the allocation of premium taxes in the European Union and has limited the ability of companies to game the system through creative allocation of premiums. Premium taxes are applied to net premiums and are subject to close scrutiny by the local taxing authority. Insurers are discouraged from unreasonably shifting premiums from one jurisdiction to the next to avoid paying premium taxes both directly and indirectly. If no premium taxes are paid in a country, for instance, then no direct claims payments can be made. In addition to premium taxes, there are other special fees and charges that look like taxes, smell like taxes, and cost like taxes, but that are nonetheless not taxes. Examples of these types of charges include fire brigade fees, insurance pooling charges, and special insurance funds.

In summary, the insurance markets in the European Union have moved toward a more homogenous market. While there are still some local differences, the bulk of insurance regulation in the European Union has been streamlined and homogenized throughout the EU countries. ■

The Changing Landscape for Insurance Brokers in Europe

Editor's Note: This article was written based on a presentation given by **Philip Gawthorpe, FCII, ARM**, during the CPCU Society's 2005 Annual Meeting and Seminars. The seminar was entitled "Insurance and Risk Management in the European Union and Their Neighbors." Other participants included **Andras T. Kopppanyi; Laurie R. Solomon; and Douglas N. Smith, CPCU, AIC.**

Philip Gawthorpe, FCII, ARM, is a managing director of Aon Risk Services, the retail broking company of Aon Corporation. Based in Chicago, Gawthorpe is the national industry leader for the Global Business Units (GBUs), the national Japan Group practice, and the Inward Investment teams. Gawthorpe's primary task is to ensure that Aon's quality service and client satisfaction standards on global accounts are adhered to throughout the Americas.

Gawthorpe serves on the GBU Worldwide Management Committee and is a member of the Japan Global Board. He represents Aon at industry events, including the British American Chamber of Commerce, the Council of Insurance Agents & Brokers, REBEX, national RIMS, and in publications such as *Risk Management Magazine* and *Business Insurance*. Gawthorpe began his career in the late 1970s in the United Kingdom with Royal Insurance Co., and following stints with insurance brokers in the Middle East and Bermuda, has worked in the midwest United States within the industry since 1985. His career has focused upon all aspects of customer needs in the international arena, including new products and services; education and training; as well as fostering close overall relationships with insurers and other vendors. Gawthorpe holds a master's degree in modern history, and has attained both the FCII and ARM designations.

The focus of this presentation was a discussion of the current brokerage landscape in Europe and the changing face of brokerage in the evolving EU market. Gawthorpe discussed the effect of regulatory pressures on the client-broker relationship, and looked at the cost of some of these new compliance issues worldwide.

Some of the emerging issues in Europe today revolve around consumer protection and the expansion of consumer rights and the increased efforts to enforce health and safety legislation. Another important issue is terrorism risk and the various risk pools that have been developed to address terrorism risk. There is a move toward greater emphasis on enterprise risk management, as well as an expansion of the use of captive arrangements in more and more lines of business. The recent corporate governance scandals in the United States have been felt in Europe as well, and corporate governance is a key driver in the risk management strategies evolving throughout the European Union. All of these factors are changing the landscape for insurance brokers in Europe.

Another important issue is terrorism risk and the various risk pools that have been developed to address terrorism risk.

Regulation has triggered many changes to the insurance broking landscape. The recent emphasis on corporate governance has led to greater compliance issues and to stricter compliance rules than before. The increased competition in the EU countries following implementation of the Freedom of Services directive have expanded the level of competition, especially for cross-border services. This increase in competition is at the same time coupled with the greater regulatory scrutiny and regulatory compliance

requirements, which leads to more uncertainty for brokers.

This is all leading to a change in the role of the broker, away from the traditional role of intermediary toward a newer role as a trusted business advisor. The broker is no longer focusing on managing an insurance transaction but is instead evolving to an advisory role, providing specialized advice to the client on a variety of risks. While hazard risks still play a role, the broker is also expected to provide expert advice and counsel on operational, strategic, and financial risks as well. This new, complex advisory relationship requires that the broker develop a much broader understanding of the client's business model as well as a much better understanding of the broad spectrum of risks faced by business today.

The benefits for the client are obvious. In addition to enjoying greater protection through the value of sophisticated risk management advice, there is an expansion of the client's ability to understand the complex interrelationships between the financial and insurance markets. There is also greater transparency and expanded confidence in the insurance industry itself.

The expanding brokerage landscape can be shown in the growth of premium over the last 10 years. The top 10 brokers have expanded premiums from a little over \$10 billion in 1994 to \$25 billion in 2004. The insurance business is expanding worldwide, with the largest growth (dollarwise) in Europe. However, the Americas and Asia are also showing robust growth, and the worldwide expansion can be seen in the geographic spread of business for the top brokerage firms. While the bulk of the premiums for the top three brokers (Marsh, Aon, and Willis) continue to be concentrated in the United States and United Kingdom, there is a noticeable shift of volume toward these expanding markets in Europe and Asia.

The focus of risk management has changed dramatically in the last decade. In a 1997 survey, the top five risks cited by U.K. risk managers were fire, business interruption, employee risks, environmental, and computer crime. In 2005, the survey results listed loss of reputation, business interruption, failure to change, product liability/tampering, and the impact of regulation as the top five risks.

Retentions have increased as well. In 1995, a quarter of U.K. companies carried retentions in excess of £250,000. By 2005, that figure had risen to nearly 40 percent. The predominant method was through higher deductibles, but there were also significant increases in the use of captives as well as other self-funding mechanisms.

... many non-EU countries are nonetheless moving to align their regulations with those of the EU countries.

Regulatory and cultural landscapes also pose a challenge for global reinsurers. The brokers' markets of eastern Europe show great discrepancies between countries. For example, the markets in Poland and Hungary are vastly different from the markets in the former Soviet Union states, and there has yet to evolve a common regulatory framework. The European Union is providing some consistency, though, and many non-EU countries are nonetheless moving to align their regulations with those of the EU countries. Therefore, homogeneity is slowly evolving as a result. Other challenges in that region include the lack of technical and loss control skills, limited product and industry groupings, limited access to international insurance markets, and limited broker market penetration. Even with these limitations, though, these markets are improving through time, and will continue to evolve as the European market settles.

Regulatory climates in this country have affected the broker landscape as well. In the wake of the Spitzer probe, there are now prohibitions against contingent commissions, pay to play arrangements, reinsurance brokerage leveraging, and inappropriate uses of wholesalers. The post-Spitzer era will feature more regulated contact with brokers and improved corporate governance, but will also come with a cost. The additional level of regulation will result in higher business operating costs. Additionally, as brokers will no longer be earning commissions from insurers, they must turn toward a more fee-based service model, charging clients for every service and discarding the discretionary service model. Also, since brokers are expected to spend 10 to 15 percent of their time in the future on regulatory compliance, this will affect the level of innovation, business flexibility, and services that they can devote to their clients.

In summary, the evolving nature of the brokerage business has brought a number of improvements that have enhanced the value of services provided to clients. Brokers have evolved from simple insurance purchasers to sophisticated business advisors, providing a wide range of consulting services on a variety of risks. However, regulatory requirements are at the same time making those services both more professional and more costly. In the end, clients will receive a wider variety of services, but at a cost. ■

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by Iverne Joan Greene, CPCU, CPIW

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