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Résumé de l'article

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Property and Casualty Insurance:

Will It Remain the Most International Canadian Financial Services Market? *

by

Christopher J. Robey**

Nous publions ici le texte d'un discours prononcé par l'auteur au Conference Board du Canada et qui traite de la mondialisation des services financiers et, plus précisément, du rôle que les divers intervenants canadiens pourraient jouer dans les années à venir.

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Introduction

"Globalization" is the theme of this day, specifically what happened to it. Well, I can tell you that it is alive and well in Canadian property and casualty insurance, if you are a foreign company operating in Canada, but almost a non-starter if you are Canadian.

In looking at the international influences on the Canadian property and casualty market, I shall start by seeing where we are at the moment, take a brief look at how we got here and then spend some time with my crystal ball to suggest where we may be going.

To-day's insurance market

Market influence is best measured, I think, by direct premiums written. On this basis, the following table shows the

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* Delivered to The Members' Forum of the Financial Services Research Program of The Conference Board of Canada on October 20, 1993.

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distribution of the Canadian market by nationality of the ultimate owner of the insurers operating here. All numbers are taken from various Stone & Cox publications and information on ownership from a variety of sources.

Country of Origin	Number of Companies or Groups	Percentage of Market	Direct Premiums Written (000)	Percentage of Market
Canada	53	41%	$5,836,289	34%
U.S.A.	42	33%	$3,049,829	23%
U.K.	14	11%	$3,522,482	22%
France	5	4%	$1,272,437	8%
Switzerland	3	2%	$1,120,075	7%
Total	117	91%	$14,801,112	94%

Canadian companies as a whole have the greatest influence, with 41% of the companies in the market, writing 34% of the premium. These numbers exclude government insurers.

The split is different, however, when we look at the numbers broken down by major class.

Country of Origin	Direct Premiums Written (000)	Percentage of Market
Automobile		
Canada	$3,167,909	40%
U.K.	$1,733,447	22%
U.S.A.	$1,238,398	15%
Switzerland	$667,598	8%
France	$581,485	7%
Personal Property		
Canada	$1,228,467	43%
U.K.	$583,957	20%
U.S.A.	$463,530	16%
France	$245,197	8%
Switzerland	$150,004	5%

Commercial Property		
U.K.	$611,257	29%
U.S.A.	$538,022	25%
Canada	$473,967	22%
France	$192,647	9%
Switzerland	$133,336	6%
Liability		
U.S.A.	$412,707	30%
U.K.	$405,146	29%
Canada	$250,113	18%
France	$149,174	11%
Switzerland	$99,727	7%

Canadian companies are clearly stronger in the personal lines market, with 40% of automobile, which is mainly personal, and 43% of personal property. However, in the commercial lines, they are noticeably less well represented, third to the British and American companies in commercial property, with only 22% of the market, and in liability, which is mainly commercial, with 18%.

Even this is somewhat misleading, since Canadian companies are sparse amongst the largest, even when, taken collectively, they have a larger share of the market.

In automobile, Co-operators Group is the only Canadian company in the top six, although four others round out the top ten.

Company	Nationality	Automobile Premiums (000)	Percentage of Market
General Accident	U.K.	$752,981	9.39%
Zurich	Switzerland	$600,304	7.49%
Co-operators	Canada	$569,578	7.10%
Royal Insurance [1]	U.K.	$491,966	6.14%
State Farm	U.S.A.	$408,775	5.10%

1 Includes the Canadian operations of Sun Alliance.

International Nederlanden	Netherlands	$380,753	4.75%
Economical	Canada	$370,396	4.62%
Dominion of Canada	Canada	$346,927	4.33%
Wawanesa Mutual	Canada	$318,075	3.97%
London Insurance Group	Canada	$300,482	3.75%

The same ten companies lead the personal property market, although the Canadian companies are higher in the list.

Company	Nationality	Personal Property Premiums (000)	Percentage of Market
General Accident	U.K.	$238,235	8.25%
Co-operators	Canada	$171,160	5.93%
Economical	Canada	$166,894	5.78%
Dominion of Canada	Canada	$140,262	4.86%
Royal Insurance[2]	U.K.	$133,342	4.62%
International Nederlanden	Netherlands	$127,509	4.42%
Zurich	Switzerland	$124,306	4.31%
Wawanesa Mutual	Canada	$122,899	4.26%
London Insurance Group	Canada	$116,389	4.03%
State Farm	U.S.A.	$113,226	3.92%

The picture changes when looking at commercial property. Only four of the ten leaders in personal lines appear in the top ten commercial property writers, and the only Canadian group is the Co-operators.

Company	Nationality	Commercial Property Premiums (000)	Percentage of Market
Royal Insurance[2]	U.K.	$211,862	9.96%
Continental East	U.S.A.	$140,739	6.62%

2 Includes the Canadian operations of Sun Alliance.

Zurich	Switzerland	$124,268	5.84%
General Accident	U.K.	$119,030	5.60%
Lloyd's	U.K.	$99,281	4.67%
Commercial Union	U.K.	$98,743	4.64%
Co-operators	Canada	$98,334	4.62%
Laurentian General	France	$90,842	4.27%
AIG	U.S.A.	$82,409	3.87%
Guardian	U.K.	$68,205	3.21%

In liability, only three of the ten largest personal lines writers are in the top ten and none of the top ten is Canadian. Co-operators is the largest Canadian group, in thirteenth place with $42.7 million of direct premiums.

Company	Nationality	Liability Premiums (000)	Percentage of Market
General Accident	U.K.	$120,390	8.71%
Royal Insurance[3]	U.K.	$111,682	8.08%
Zurich	Switzerland	$92,665	6.70%
AIG	U.S.A.	$80,752	5.84%
Simcoe Erie	France[4]	$71,113	5.14%
Continental East	U.S.A.	$68,120	4.93%
Chubb	U.S.A.	$65,809	4.76%
Guardian	U.K.	$60,543	4.38%
Laurentian General	France[5]	$60,117	4.35%
Lloyd's	U.K.	$57,147	4.13%

Why do Canadian-owned companies, while strong in personal lines, play only a minor role in commercial lines?

To try to answer that question, we should go back to looking at the market as a whole.

[3] Includes the Canadian operations of Sun Alliance.

[4] Simcoe Erie is still technically Canadian owned. However, GAN of France has bid for all the outstanding shares and enough have been tendered to give it control.

[5] Laurentian General is 50% Canadian owned and 50% owned by the French Groupe Victoire. However, an agreement has been signed which should make it 100% owned by the Groupe Victoire at the end of the year.

When I started looking for the answer, I expected to trace it back to the greater dependence of Canadian owned companies on reinsurance because of their lower equity to premium ratio. However there is little more annoying than facts which get in the way of a good theory.

It turns out that Canadian owned companies retain 84% of their gross premiums, compared to 80% for the market as a whole, and Canadian companies have total equity equal to 50% of their gross premiums written, the same as the market average.

We must therefore look elsewhere for the answer.

Two possibilities which come to mind are that foreign companies brought their commercial expertise with them and that they are also more likely to write the Canadian operations of international risks. While both of these are true, they do not seem to be enough of an influence to account for the difference.

Instead of trying to find out why Canadian companies write less commercial business, I decided to look for a reason why they concentrated more on personal lines—something in their underlying philosophy which would lead them to a marketing strategy which would produce the market split we see.

There are ten Canadian companies with direct premiums of more than $100 million and five of them would have a natural affinity for personal lines. Two of them are mutuals—Economical and Wawanesa—one is part of the co-operative movement—Co-operators—and another of the credit union movement—Desjardins Group. The fifth is the subsidiary of a life company—La Capitale.

Of the five others, only Guarantee Company of North America and Dominion of Canada have enough history to make it worth looking into their background. Guarantee Company of North America specializes in surety business and Dominion of Canada presumably simply chose personal lines as its main concern at the outset.

The other three are the Fairfax, London Insurance and Canadian General groups, all three recently formed collections of disparate companies.

If the background of most of these companies explains why they are strong in personal lines, it does not explain why they have not used that base to move more strongly into the commercial market.

No answer stands out, but if we massage the numbers a little, some indication emerges. If we take the Co-operators, Desjardins, Dominion of Canada and the mutuals, we find that equity is only 36% of gross premiums, not too comfortably above the 33 1/3% norm of the Office of the Superintendent of Financial Institutions. It is as if the companies were so successful at marketing their personal lines that they did not have enough capital left to penetrate the commercial market, where capital is more important to obtain the capacities needed.

There is another reason, I think, and it does relate directly to the ownership of the companies. Most British and American companies followed their clients to Canada. They already had the expertise in commercial business and a certain base of business on which they could rely. While local skills are essential, the international base also allows them to draw on specialist expertise which would not be justified by their Canadian operations alone. Finally, there is some comfort in knowing that there is more money than what is just in Canada. This is certainly less of a factor to-day, when the parents are stretched thin, but it has served them well in the past.

But why have Canadian companies not followed the example of their competitors by expanding into foreign markets themselves?

One reason is the limitations imposed by reinsurance. Reinsurers operating in Canada are mainly foreign owned and therefore their mandate is limited to Canada. They cannot follow their Canadian clients abroad, so the Canadian company must buy reinsurance for a foreign venture from scratch, which is difficult and expensive.

But I think the lack of a few Canadian companies dominating their local market is a more important factor. They have always had to fight to hold their ground at home, which has not left a lot of energy for foreign activities. A certain feeling of inferiority is undoubtedly also a factor. Having foreign companies dominate your own market must make it intimidating to contemplate moving into their home territory. And personal lines, their specialty, is the most difficult to penetrate in another country.

Canadian life companies have operated in a market in which they were protected from foreign takeover by government action, and they are now amongst the major companies in their field worldwide. Compare also the difference between Canadian and American banks. Canadian banks have expanded into many foreign jurisdictions. American banks, on the other hand, restricted since the depression to a limited area of operations, have, for the most part, not expanded outside the United States. The same is true of Canadian insurance companies. While the limitation in their sphere of activity was not imposed on them by government, it was by their marketplace.

Few Canadian companies have expanded outside Canada. Commonwealth and Wawanesa are the only two still with foreign operations which come to mind. Free trade with the United States has not changed this and the addition of Mexico is not likely to make a difference either.

Will this change in the future? Will Canadian companies find a role for themselves in the commercial market? Or will the foreign influence on the local market increase? Before we look at that, let us take a moment to see what brought us to where we are.

The development of market share

Industry publications only group companies as Canadian, British and American and foreign when calculating market share. I know of no public source which splits the "American and foreign", which is unfortunate, since I think this is where the greatest change has taken place.

American companies which have withdrawn from the market in the last ten years include:

Company	1983 Market Share	Comments
Travelers	2.95%	taken over by the Zurich.
Fireman's Fund	2.21%	taken over by the London Insurance Group.
Home	1.52%	taken over by AXA.
Safeco	1.36%	taken over by Dominion of Canada.
U. S. Fidelity	0.87%	taken over by Canadian General.
Aetna Life & Casualty	0.73%	taken over by Laurentian Group.
Employers of Wausau	0.52%	became the Metropolitan.
Crum & Forster	0.46%	taken over by General Accident.
Federated	0.33%	taken over by Fairfax.

Between them, these companies wrote 11% of the total direct premiums written in 1983.

Europeans, or companies which are now owned by Europeans, took over most of them, the exceptions being Fireman's Fund, U.S. Fidelity and Federated, which Canadians bought, and Employers of Wausau, bought by another American group which subsequently pulled out itself. Some of the American companies are still operating, but at a level much reduced compared to before the sale.

Before we get out the crystal ball to see if this trend is likely to continue, we should look at the other segments of the market—reinsurers and brokers.

Reinsurers

The reinsurance market is almost entirely foreign owned. The only Canadian companies writing reinsurance are Toronto General, part of the Canadian General Group, and Co-operators.

With the disastrous results of the international reinsurance market in recent years, brought on by an unprecedented series of natural catastrophes since 1987, large amounts of capital are now needed to write an international volume. And writing a one country account, except perhaps in a country as large and diverse as the United States, leaves a reinsurer at the mercy of local market conditions, with nowhere to go if there is no money to be made at home.

Although none of the natural catastrophes happened in Canada, these same results have resulted in the withdrawal from the Canadian market of seventeen reinsurers since 1988, fourteen of them in the last two years. After including a few new arrivals, there are now forty-one licensed companies writing Canadian reinsurance, compared to fifty-seven in 1988.

It is not surprising therefore that all the major reinsurers in Canada are part of large international groups, the two largest in Canada, Munich Re of Canada and Canadian Re being subsidiaries of the two largest reinsurers in the world.

There is certainly a place for a truly Canadian reinsurer, but it is unlikely now that one will emerge, unless a consortium of Canadian insurers or other financial institutions is willing to put up the money needed—a minimum of $50 million. This would be the perfect time to do so, since reinsurance prices have never been higher and the prospect for profit in the next few years is excellent. But an earthquake in Vancouver or the St. Lawrence Valley would wipe that out, so the risk is definitely there.

Insurance brokers

Two segments of the market which are often overlooked are the insurance and reinsurance brokers. I use the word brokers to include all those who place insurance with more than one insurer, without making a distinction between the broker and the independent agent.

There are thousands of insurance brokers across Canada, but the vast majority of them are small, handling personal lines and small commercial business locally, often family operations passed down from parent to child. These are all Canadian and in terms of numbers and probably premium handled, Canadians dominate the insurance broker market.

There are also the national brokers, which control the commercial market, particularly for the medium and large risks. The two largest are American. The third, and the largest Canadian broker, is Dale-Parizeau, a tier below the other two. After Dale-Parizeau amongst the Canadian brokers comes Morris & Mackenzie, less than a third the size of Dale-Parizeau. So, while Canadians dominate in numbers, the major brokers controlling the commercial market are mainly foreign owned.

No Canadian brokers have operations outside Canada, working instead through international agreements to provide foreign service to their Canadian clients.

Reinsurance brokers

The reinsurance market is much smaller, and there are only four brokers of any size. The largest is B E P International, the company I work for, and the only one of the four which is Canadian owned. We are a sister company of Dale Parizeau.

The other three are:

Sterling Universal, part of the Alexander & Alexander Group, the largest insurance broker in Canada and second largest in the world.

Guy Carpenter, part of the Marsh & McLennan group, second largest in Canada and largest in the world, and

Sedgwick Payne, part of the Sedgwick group, third largest in the world and in the top five in Canada.

B E P International is the only Canadian company to lead its sector, although it does not dominate it. It is also one of the few Canadian insurance operations with foreign activities, having offices in Jersey City and Seattle and collecting 40% of its revenues from the United States.

There are a number of other companies doing some reinsurance broking, but not a significant amount. And some foreign brokers operate in Canada from outside the country, since it is an unregulated market.

The future

I do not think that we shall see a new Canadian reinsurance broker emerge in the next few years, nor a new foreign one for that matter. It is a highly competitive market, with barely enough business for the four major players as it is. And, if anything, it is a shrinking pie.

Nor does it seem likely that a second Canadian insurance broker will emerge to challenge the market leaders. And, as already mentioned, it would need a group of substantial backers to launch a new Canadian reinsurer.

But what about insurers? Is there the prospect of Canadians gaining more control over this end of the market?

There are five major influences on the Canadian insurance market at the moment:

The sluggish economy, which is holding back the development of genuine new business and thus lengthening the current unprofitable cycle, while at the same time producing low interest rates, which removes the crutch insurers have relied on in the past few years.

Catastrophe reinsurance prices, which are straining insurers financial statements and may start disrupting certain regional markets.

Changes in Ontario automobile, which generates a quarter of the premium written by private insurers and is becoming harder and harder to write.

Changes in financial services legislation, which has the potential to produce a major shake-up, but has not yet.

Worldwide rationalization of the industry, which is producing giants in Europe as companies realign their interests.

Let us look at these influences one by one.

The economy

The sluggish recovery from a long recession means that there is little real new business to soak up insurers' desire to increase their premium volume. They must therefore obtain new business by taking someone else's renewals, a sure way to cut-throat competition. Only this year has there been some signs of prices rising, and not by much.

When I talk to companies, they say that by the end of the year they will be getting rates 10% higher than at the beginning. But brokers tell me it is only 5%. The difference is in renewals which change carrier, since the broker can measure the new price against the old, but the new carrier often cannot. Insurers may be getting 10% on their own renewals, but not on those of other companies.

Low interest rates will pressure insurers to increase premiums, because they can no longer rely on investment income to subsidize their underwriting results. There is also a potential danger here, since the change from a prescribed list of investments to a prudent portfolio approach, which came into force in 1992, may encourage some companies to seek higher returns in more risky investments, particularly while their underwriting results remain poor.

Larger companies with deeper pockets can ride out underpricing and low investment returns better than smaller less well financed ones, and, as we have seen, these are generally foreign companies. This is not to suggest that their owners to-day will put up with poor results for long, but they may do so a little longer.

Catastrophe reinsurance

A storm in Europe in October 1987 ushered in what has been the most devastating period for catastrophe reinsurers ever. Since then, there have been ten other losses of over $1 billion, the most recent and largest being Hurricane Andrew last year, costing an estimated $16 billion.

Although none of these losses affected Canada—the largest Canadian loss was from a hailstorm in Calgary in 1991 at a little over $300 million—Canadian insurers rely on the international market for catastrophe protection, so must pay the prevailing international price.

As a result, Canadian catastrophe protection has doubled in price in the last three years. More dramatically, the cost of earthquake protection has increased fourfold. This is enough to cause insurers to look more closely at the coverage they are giving and there are now expert systems available to help them. The result is that they are beginning to compare the cost of putting business in certain parts of the country on their books with the premium they are collecting for it.

We recently showed a client how reducing its business in certain parts of Vancouver would cause it to lose $1.5 million in premium, but reduce its catastrophe reinsurance costs by over $2 million. As more and more companies analyze their portfolios this way, it could result in an availability problem in parts of Vancouver and possibly the St. Lawrence Valley, the other major earthquake zone in Canada.

Catastrophe prices should have their last major increase this year end and may start to come down in 1995, but they will not come down to the levels we were used to even three years ago and portfolio management will be of increasing importance to insurance companies. This is one area where size is not an issue. The control systems now available are not expensive and a small portfolio will be easier to manage than a large one. On the other hand, national companies get a break on their catastrophe reinsurance, since they can spread the cost more widely.

Nor is there any special advantage in having access to the reinsurance protection from a foreign parent, since catastrophe prices in Canada remain amongst the lowest in the world.

Ontario automobile

As I mentioned, Ontario automobile business produces 25% of the premium written by private insurers in Canada, and for several years it has been the major focus for political intervention in the industry, first by the Liberal government of the province and now by the New Democrats.

Although nationalization is not now an issue, further changes in coverage have been introduced by Bill 164 and are expected to come into force early next year. They will provide higher benefits to those injured in car accidents, in particular loss of income benefits indexed to the cost of living.

The changes will have a major effect on the cost of reinsurance, with the possibility that most of the 5% premium increase being allowed by the Ontario government will have to be paid to reinsurers.

There are discussions going on for the formation of an all-industry pool to provide reinsurance protection against catastrophe losses—those individual claimants who will recover more than $2 million or $3 million. This will ease the reinsurance burden somewhat, but the higher cost of reinsurance will still affect the smaller companies particularly. These are the same companies for which the cost of such things as rate filing represents a greater cost per policy than for the larger companies, so the changes will make it more difficult for smaller companies to remain in the market.

Indeed, there has been speculation since the days of the Liberal government that one part of the government agenda is to reduce the number of companies handling Ontario automobile to a handful. In 1992, there were only twenty-three companies with more than $50 million of direct premiums, only seven of them Canadian.

Financial services legislation

The cry that the banks are coming has been resounding through the Canadian insurance market for a few years now. Why are insurers worried about the banks? One reason was summed up by Ogden Nash—"Bankers are like anybody else, except richer". The other reason is their distribution network.

Under current legislation, banks can own insurance companies, but cannot use their distribution networks for selling insurance, even for their own subsidiaries. This may be short-lived, since the banks have shown far more interest in distributing insurance than taking the underwriting risk and can be expected to continue their push for changes the next time the Bank Act is up for review. "Branch" may need defining too. I read recently of a banker talking about a "virtual reality" branch, which does not actually exist except in the bank's computer, but does not need to, since its customers will deal with it only by telephone, computer and ATM.

Although all the major banks moved quickly into the securities field and most have trust companies in their stable, only the Royal Bank has an active Canadian insurance subsidiary, Voyageur, which gets most of its business from travel accident and sickness.

The most aggressive bank in insurance is the CIBC, which has licensed two property casualty companies and a life company, although they are not yet operating.

At first glance, it would seem that the banks' financial strength would enable them to increase the Canadian share of the market. However, their natural market is personal lines and, perhaps, small business, which is where Canadian companies are already strong. Since there is little new business, the banks can only grow by taking what there is away from someone else, as often as not another Canadian insurer. The foreign companies' hold on commercial business, meanwhile, will remain unchallenged.

Not only are the banks likely to concentrate on personal lines, but they are likely to do so by direct sales, rather than through independent agents. Two companies which have started up with this approach in the last few years are Assurances Générales des Caisses Desjardins, which sells through caisses populaires in Quebec, and Security National Insurance Company, part of the London Insurance Group, which sells by telephone and direct mail to members of groups and associations. Since 1987, their combined share of the personal lines market has gone from virtually zero to over 3%, showing the potential for direct sales.

As new entrants, banks will also be able to apply the latest data processing technology, a major problem for existing insurers because of the huge investment in non-compatible systems amongst insurers and agents. This could give the banks a significant cost advantage in a market which is highly price sensitive.

If the banks do come strongly into this market, then, they are likely to take business not only from smaller Canadian insurers, but also from the small independent agents, who rely on personal lines for their survival. So the banks will probably do major damage to Canadian involvement in the insurance market as a whole, not improve it.

Worldwide rationalization of the industry

The move to a united, albeit fractious, Europe has necessarily had an impact on Canada because of the strong presence of European insurers on the market. Although recent results have slowed the rush to merge, it will probably break out again in the next year or two, as results improve. Michael Muth, a director of the Munich office of McKinsey & Company, writing in the Wall Street Journal about both life and property casualty insurers, estimates that "of the more than 2,000 insurance groups operating in Europe to-day, less than half will survive".

American companies, on the other hand, continue to be concerned with problems at home and show little inclination to push back into the Canadian market, despite pockets of activity.

For Canadian companies, the drive for synergy through the creation of financial supermarkets has ended, but they remain vulnerable to buyers from all sides. When the Commerce Group and the Laurentian Group can fall into foreign hands, no-one but the mutuals is safe. And the mutuals have their own problems, unable until recently to organize themselves to raise capital for acquisitions to compete with the foreigners. Now that they are able to do so, they are facing a capital market which is only just beginning to find new offers attractive, and not likely to see wonderful prospects in the insurance business.

Nor are the capital markets where Canadian stock companies would go to raise money. Once the sale of Simcoe Erie to the French Groupe des Assurances Nationales is complete, there will not be a Canadian property casualty insurer quoted on a stock exchange. The closest are the London Insurance Group, where life business is the main feature, and Fairfax, which is more an investment company.

As smaller Canadian companies find the going harder, they will look for partners, but may find only foreign buyers they cannot refuse. We seem to be moving steadily towards a market of huge national writers of general insurance and a few smaller niche companies with high levels of expertise in their narrow field. The day of the small generalist may be coming to an end. And most small generalists are Canadian.

Conclusion

As you will have gathered, I think the answer to the question "Will property and casualty insurance remain the most international Canadian financial services market?" is a definite yes.

The likelihood of a Canadian reinsurer or a second Canadian reinsurance broker emerging is low and increasing direct sales of personal lines will reduce the Canadian presence in insurance broking, with little likelihood of a second Canadian insurance broker challenging the international leaders in the commercial market.

Not that this is a problem for the consumer, the ultimate target of all this activity. All sectors of the market are highly competitive and well served by the participants, be they Canadian or foreign. It may be sad for a Canadian to see an important part of the economy dominated by foreign companies, and the market is certainly influenced by what happens outside Canadian borders, but in that it is no different from many other sectors of the economy.

Canadian companies, with the addition of at least the CIBC, should hold their own in the personal lines market, even increase their share. But there is little prospect of their playing an increasing role in the commercial market, particularly for medium and large risks.

The worldwide commercial insurance market, like the reinsurance market, is becoming increasingly international as the scope and complexity of risks grow. It is disappointing that Canadians will not play a role in that market internationally, but they will still benefit from the international expertise of those foreign companies which operate here.