Netherlands
Special Report

Dutch Insurance Market

Market Maturity Limits Growth Potential

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Summary

The Dutch insurance market has had a particularly difficult period since 2008, with the global financial crisis having a significant impact. Insurers also face the daunting challenge of implementing Solvency II. Nevertheless, Fitch Ratings believes the key underlying challenge remains the maturity and very competitive nature of the market, with limited growth potential.

As there is little scope for companies to simply grow their way out of the issues they face, the focus of the leading Dutch insurers is on improving operational efficiencies and cutting costs, in an effort to improve their profitability and ensure their business models remain viable and sustainable.

Underlying profitability has been poor, reflecting a number of factors:

- Lower business volumes reflect the poor macroeconomic environment and, importantly, strong competition from substitute bank products, largely as a result of the removal of tax advantages that individual life products benefited from in the past.
- Low interest rates have played an important role in depressing profitability, particularly for life products with investment guarantees.
- In recent years, there has been a strong consumerist agenda. Not only has this led to the life insurance industry having to pay significant compensation costs to customers in relation to unit-linked mis-selling, it has also put downward pressure on product pricing, ratcheting up the competitive pressures in the market.

In Q408, at a critical point in the financial crisis, most of the leading Dutch insurance groups (with the notable exception of Delta Lloyd) were compelled to seek and accept support from the Dutch state and/or their respective majority shareholders. As the financial crisis has subsided, alongside the operational challenges of cutting costs and improving profitability, the insurers are also focused on seeking to repay state support as soon as practically possible and regain their freedom to manoeuvre (such as being able to resume dividends to shareholders).

Implementation of the proposed EU Solvency II regime, effective from 1 January 2013, poses a major challenge for Dutch insurers in 2011/2012, in common with insurers in Europe as a whole. The participation rate by Dutch insurance entities in the recent fifth Quantitative Impact Study (QIS5) was 83%, compared with 68% for the EU as a whole. It was also a significant jump from the 51% participation rate in the previous exercise, QIS4.

Aggregate capital surplus for the Dutch market under QIS5 was EUR17.5bn, with available capital of EUR47.5bn and a solvency capital requirement of EUR30bn. The capital surplus is around EUR7.5bn lower than under the current regime, broadly mirroring the Europe-wide trend. Unless risk charges for non-life business are recalibrated (as expected), some non-life insurers may fall short of the solvency capital requirements. There are also some important issues specific to the Dutch market that have not yet been fully addressed, in particular treatment of the Dutch health insurance system.

Market Overview

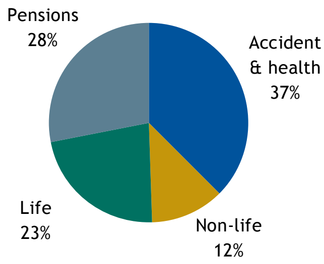
The Dutch insurance market is very mature and one of the top 10 largest in the world by gross written premiums. At 13.1% of GDP in 2008, the insurance penetration rate is a close second to the UK globally.

The market has a distinctive pension system and compulsory private health care system, with the latter constituting a large part of the overall insurance market compared with other developed countries' insurance markets. Non-life and health business account for about half the total gross written premiums, with life and pensions accounting for around a quarter each (see Figure 1).

Figure 1

Dutch Product Mix

Gross written premiums (EURbn) 2009



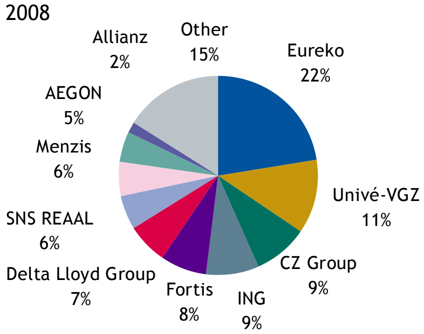
Source: De Nederlandsche Bank (DNB)

The market is very competitive and quite concentrated, with limited opportunities for growth. There are seven main players in the Dutch market and three health-focused non-profit insurers (Univé-VGZ, CZ Group and Menzis). Altogether these 10 companies represent more than 80% of the life and non-life market, as shown in Figure 2. Eureko has more than 20% market share, reflecting its dominance in the health sector. In addition to the small number of large insurance groups, there are a number of smaller insurers usually operating in niche segments.

Figure 2

Market Share by Gross Premium Income

2008



Source: Dutch association of insurers (verbond van Verzekeraars)

In 2006 the Dutch government implemented a fundamental reform of the health care system. A key feature was the introduction of mandatory health insurance through private insurers. Since then, the health market has grown significantly and been very competitive.

In recent years a number of foreign players have exited the market, selling their Dutch operations to domestic insurers (for example, AXA and Swiss Life, who both sold their Dutch businesses to SNS Reaal in 2007). Fitch expects there to be continuing consolidation and a focus on cost-cutting over the coming years, particularly in the wake of Solvency II.

2008-2009 Global Financial Crisis — State Support

The financial crisis proved challenging for Dutch insurers and exposed some weaknesses. Although insurers in most of western Europe bore the brunt of the financial crisis reasonably well, almost all the leading Dutch insurance groups were compelled to accept support from the Dutch state and/or their respective majority shareholders, with the notable exception of Delta Lloyd.

The detailed reasons for insurance groups requiring support varied from case to case, but the common thread was over-exposure to equity and credit risk, whether through related banking activities or directly in the insurance operations, particularly life insurance business.

In Q408 direct state support was received by three of the largest Dutch insurers: the ING group (received EUR10bn), AEGON (EUR3bn) and SNS REAAL (EUR750m). In addition, SNS REAAL received EUR500m from its majority owner, Stichting Beheer SNS REAAL, a self-owned foundation whose purpose is to promote the interests of its insurance group.

Eureko was forced to raise EUR1bn from its two main shareholders, Achmea Association and Rabobank, to improve its solvency position. Following the rescue and break-up of the then Belgo-Dutch Fortis banking and insurance group, its Dutch insurance operations were taken into 100% state ownership and rebranded as ASR; ASR did not need or receive any capital injections.

As the financial crisis has subsided, insurers have been seeking to repay state support as soon as practically possible. They have financed this through various means, including capital release activities, asset disposals, rights issues and retained earnings. Following AEGON's agreed sale of its Transamerica Re mortality risk reinsurance business to SCOR, it appears that later in 2011 AEGON will become the first Benelux financial services firm to fully repay the state support it received at the height of the crisis.

One notable effect of the financial crisis and resulting state intervention has been the decline of the integrated bancassurance model, of which the ING group had been a prime example. As required under its restructuring plan agreed with the EU, ING is splitting itself up into separate banking and insurance groups. Fitch believes that distribution of insurance products through banks is likely to continue to be important, but the Dutch integrated model is on its way out.

The Decline of Life

The Dutch life insurance market is dominated by the larger players. The top five insurers (ING, Eureko, AEGON, Delta Lloyd and REAAL) have over 65% market share between them (excluding pensions).

Profit margins are low, and fierce competition is causing some of the larger market leaders to suspend (perhaps only temporarily) new sales of certain products. New entrants to the market, offering very competitive rates, are putting further downward pressure on prices. As a result, the number of companies operating in the life sector is gradually reducing: a trend Fitch expects to continue.

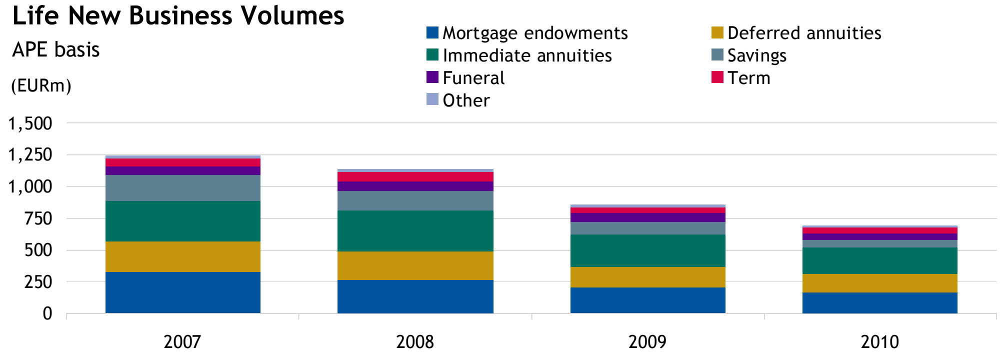
Banks Encroach on the Savings Market

The life market in the Netherlands has declined sharply since 2007 (see Figure 3).

Figure 3

Life New Business Volumes

APE basis



Source: De Nederlandsche Bank (DNB)

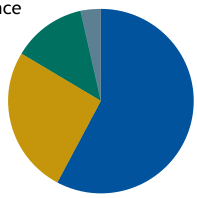
- Sharp decline in savings products, largely due to competition from banks

This decline reflects the increased use of banking products as substitutes for insurers' savings products. The introduction in January 2008 of the Wet Banksparen (Bank Mortgage and Pensions Savings Act), ended insurers' competitive advantage over banks by enabling comparable tax advantages in the banking system. Sales of new savings products fell by over 70% from 2007 to 2010, including a fall of nearly 40% from 2008 to 2009.

Figure 4

Distribution Channels for Life Products

2008



[a] Includes post offices, bike shops and car dealers

Source: Dutch Association of Insurers (Verbond van Verzekeraars)

The large falls in sales can be attributed to the two-fold effect of increased competition and the loss of distribution channel functionality as the banks are now focusing on pushing their own comparable products. Consequently, life insurers' new sales and profitability are structurally under pressure. Furthermore, increased competition within the banking sector is pushing down prices, making it even harder for the insurers to compete.

Life products are primarily distributed through intermediaries (see Figure 4). Opportunities to write business directly are increasing with technological innovation. Fitch expects the bank distribution channel to decline further as banks continue to take market share, using these channels to sell their own substitute products.

Pensions

- Pricing extremely competitive
- Established players leaving market and low-cost start-ups entering

The pensions market in the Netherlands is predominantly group contracts with employers. In recent years the market has become increasingly competitive, with many insurers priced out of the market and some leaving of their own accord, not prepared to, or unable to, lower prices drastically enough to be able to compete. Furthermore, new low-cost entrants are putting additional pressure on pricing, which established players — with their higher cost bases — are finding difficult to contend with. Price is the decisive factor in employers' purchasing decisions, making it virtually impossible for companies to compete with even small price differentials.

The vast majority of existing business is still with the large established insurers. However, some are reluctant to participate in the market until competition stabilises, at which point there could be attractive opportunities due to the size of the retirement market. Fitch considers the current level of price competition unsustainable, but it could still be some time before competition becomes more rational.

Key Concerns and Profitability Drivers

Low Interest Rates

- Prolonged low interest rates threatening insurers' ability to meet investment guarantees

Prolonged low interest rates are a major concern for insurers. As in other European countries, Dutch life products typically offer guarantees of minimum crediting rates. The regulator, DNB, has expressed concern about the impact of guarantees in a low interest-rate environment and, in August 2010, required insurers to undertake reserving valuations using these lower rates. The results indicated that Dutch insurers would be able to cope if interest rates remained at these levels in the longer term.

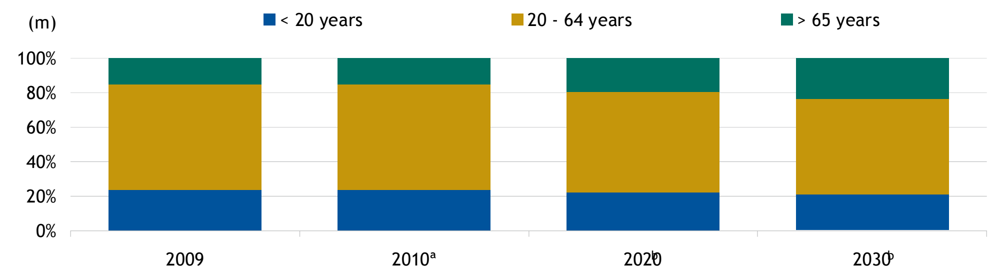
Longevity Risk

- New mortality tables meaning much larger reserves

In 2010 new mortality base tables were published in the Netherlands. Mortality has been improving at a greater rate than previously anticipated, putting pressure on insurers' assumptions and prompting further government reviews of legislation in respect of the retirement age. The ageing population (Figure 5) is likely to lead to further increases in the retirement age.

Figure 5

Population Trends



[a] Provisional figures; [b] Population forecasts
Source: Dutch Association of Insurers (Verbond van Verzekeraars)

The Dutch Actuarial Society's updated tables show significant increases in life expectancy, with men expected to live to 85.9 years on average and women to 87.6 years. For both men and women, this is more than three years longer than projected in the 2005 tables.

With life expectancies continuing to rise, insurers are likely to use the new tables when setting reserves for their insurance contracts. This resulted in increased reserves for longevity during 2010.

"Wabeke"

The Dutch market suffered financially and, perhaps more importantly, reputationally after claims of mis-selling resulted in most Dutch insurers making compensation payments to customers. These claims were related to unit-linked policies for which charges were deemed to have been too high and not sufficiently disclosed at the point of sale. Fitch believes it will take some time and considerable effort before the reputational damage suffered by the Dutch life industry is reversed. Companies individually, and collectively through the Dutch insurance association, are making efforts to engage with their customer bases and promote trust.

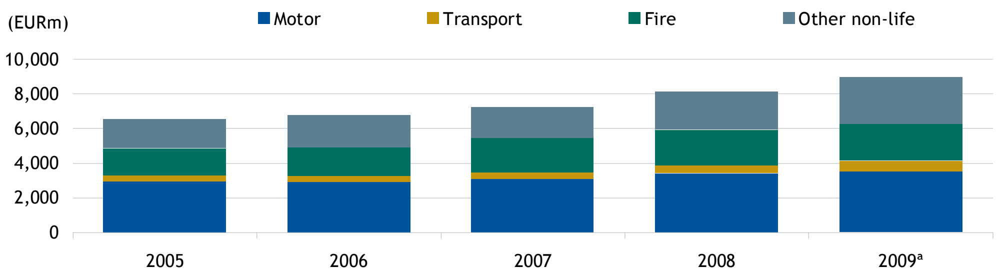
However, even if the industry's reputation improves, Fitch believes that the influential consumerist lobby will continue to exist and to exert downward pressure on pricing.

Non-Life: Limited Growth

The Dutch non-life insurance market is also dominated by the larger companies. The top six insurers (Eureko, ASR, Delta Lloyd, ING, Allianz and Amlin) have around 60% market share between them. Eureko is the market leader with 20% market share; there are three main brands under the Eureko umbrella, each focused on a different distribution channel. This enables the company to maintain its dominance in this market.

Figure 6

Non-Life Gross Written Premium by Product Line



Other non-life: liability, legal expense, travel and credit
Source: Dutch Association of Insurers (Verbond van Verzekeraars)

The non-life market in the Netherlands is focused on motor and property insurance, in line with markets elsewhere, although there are also some insurance opportunities particular to the Dutch market, for example covering greenhouses against natural events such as hailstorms. There has been modest growth in the non-life sector in recent years (see Figure 6 above).

Fitch believes growth in non-life premiums has been, and will continue to be, constrained by the poor macroeconomic environment. GDP growth was somewhat muted at 1.8% in 2010, although it was a significant improvement on the 3.9% shrinking in 2009. Fitch forecasts GDP growth of around 1.5% for 2011.

Profitability: Focus on Cost-Cutting

Insurers in the non-life sector are having to focus on cutting costs and improving efficiency to generate sufficient profit margins. Disciplined underwriting, lower expense bases (including reduced staff headcounts) and cost-effective sales platforms remain crucial success factors.

The established market participants are facing threats to their market position from increasingly popular internet-based providers. Fitch believes companies will need to address this challenge and focus on using direct channels themselves if they are to remain competitive in the market. It remains to be seen how important or dominant internet-based providers become in the Dutch market but the established players cannot afford to be complacent, if the UK market experience is any guide.

Distribution Channels

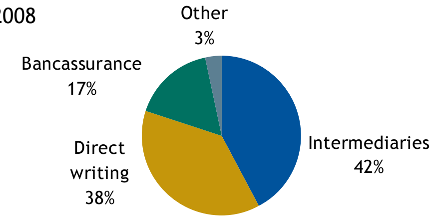
Fitch expects the percentage of premiums written through direct channels to increase over the coming years (see Figure 7), reflecting an increase in internet-based sales.

Fitch also expects the large established insurers to focus on developing web-based sales platforms. Direct selling could help with cost cutting, through lower commission charges and lower underwriting expenses, although savings might be offset by the substantial promotional spend required.

Figure 7

Distribution Channels for Non-Life Products

2008



Other channels include post offices, bike shops, car dealers

Source: Dutch association of insurers (Verbond van Verzekeraars)

Health: Low Margin but Supplementary Opportunities

The Netherlands has the largest private health insurance market in Europe, with gross written premiums of EUR40.5bn in 2009. Health reforms in 2006 transformed the industry, with the state introducing a compulsory requirement for basic health insurance provided through private insurers. Enrolment is mandatory and there is no opportunity for risk selection by insurers.

The market has high entry barriers and operates with low margins, driven by neutral underwriting. However, insurers have the opportunity to write more profitable business through the supplementary health insurance options attached to the compulsory policies. Around 90% of basic health insurance policyholders purchase some form of supplementary insurance, meaning that the market is fairly buoyant in this area.

The health market has gradually evolved. The competitive pricing conditions that prevailed when the scheme was first introduced, prompted by insurers' desire to gain market share and build scale at the outset, often led to losses on the basic policies. These conditions have since abated. The market has begun to settle, with non-price factors now playing a more important role in consumers' decisions, especially specific services offered and the amount of comparative information available.

In addition, procurement advantages offer opportunities for higher margins. This is particularly true of the market leaders, who have the economies of scale to purchase services in bulk and secure competitive deals with suppliers.

In Fitch's view, the profitability of private health care insurance is driven by:

- market presence, which is important for negotiating power - the vast majority of contracts are negotiated with employers rather than sold directly to the end consumers;
- sufficient scale to ensure bargaining power to minimise procurement costs for the health services provided;
- general economies of scale to minimise unit costs; and
- customer service, to maximise customer loyalty.

Main Players

The health market is dominated by four companies, which together have over 80% of the market share (Figure 8). It is a stable market with only small changes to insurers' market shares from year to year. However, there is an increasing level of consolidation within the industry. These large market shares typically reflect a series of smaller brands working within a single group, offering a group greater exposure in the industry. A number of brands operate as non-profit entities, including parts of UVIT, CZ Group and Menzis.

Switch rates are low — under 5% a year since 2007. Those most likely to switch are younger and healthier enrollees: those who are less concerned with non-price-related factors. Switch rates had been gradually decreasing after implementation of the reforms in 2006, reaching 3.5% in 2009. The increase, slight as it may be, to 4.3% for 2010, was partly due to increased use of price comparison websites by customers. Fitch also considers this trend indicative of increased competitiveness within the industry, with more customers considering switching during the renewal period.

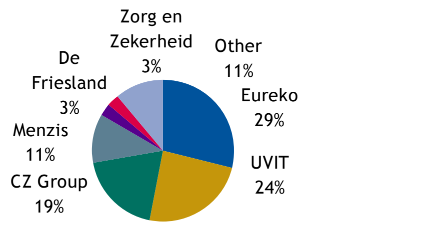
Distribution

Most health policies are sold on a group basis to employees. Under this system, insurers are able to offer discounts, making the plans more attractive to employees when they join through their workplace. Policies purchased by individuals are often bought online. The non-profit health companies and larger insurers offering health products have branded websites dedicated to the direct selling of health policies. The importance of these direct forms of distribution accounts for the dominance of this distribution channel — 83% of gross premiums come from direct writing, compared with 9% from intermediaries and only 2% from bank distribution.

Figure 8

Health Market Share

2008, Gross premium income



Note: De Friesland and Eureko are awaiting a permit to confirm a merger
Source: Dutch Association of Insurers (Verbond van Verzekeraars)

Risk Equalisation: Low Risk for Insurers

The Dutch health insurance system shields insurers from the underwriting risks normally associated with health insurance through the "risk equalisation" system operated by the state, which ultimately takes the underwriting risks. The system is financed in two parts: employees pay mandatory income-related premiums into a national risk-equalisation fund, to which the government also contributes; the employees then pay a nominal premium to their chosen insurer.

The risk system used in the Netherlands uses a relatively sophisticated model to identify the risk category of each policyholder. This classification is used to decide how funds are redistributed from the risk-equalisation fund among insurers. It has proved better able to predict use than in Switzerland, where a similar compulsory health insurance system exists.

Solvency II and the Netherlands

QIS5

Insurers in the Netherlands, as in Europe generally, are focusing resources on the implementation of Solvency II. Eighty-three percent of Dutch insurers participated in QIS5, a substantial increase from 51% for QIS4. The Netherlands' QIS5 participation rate was significantly higher than the overall European rate of 68%.

Fitch views the high participation rate as a marked sign that Dutch insurers are actively engaging with the Solvency II specifications and implementation within their own company-specific frameworks. The QIS5 results showed that only a very small proportion of Dutch insurance entities failed to meet the solvency capital requirement; in total, these insurers had not yet covered EUR0.9bn of the capital they are required to hold. Unless risk charges for non-life business are recalibrated, some non-life insurers may fall short of the solvency capital requirements. However, the QIS5 calibrations are not final and Fitch expects some changes, which are likely to be favourable for companies. Furthermore, insurers have time to attract more capital or to change their risk profile before the regime is in place.

Major Items to be Resolved

Fitch believes the most important aspects of Solvency II for Dutch insurers that have yet to be resolved are:

- third-country equivalence;
- internal models;
- risk calibrations for Dutch health insurance; and
- treatment of smaller insurers.

Equivalence

For some of the larger companies in the Dutch market, third-party equivalence will be a concern, especially for ING and AEGON, who both have large US subsidiaries. In the absence of equivalence being granted for the US solvency regime, the US entities may face higher (European) capital requirements than their US-owned peers, and might therefore become less viable under continued ownership by a European parent. Other Dutch insurers will be less affected. Fitch regards the potential transitional measures (up to five years) as beneficial with regard to equivalence.

Internal Models

Ten to twelve Dutch insurers have indicated that they may choose internal model approval. However, Fitch expects the number ultimately to be lower, with only the larger insurers (around seven) having the resources available to establish an internal model. The competitive advantages of an internal model for certain product lines will be beneficial for these market leaders, particularly for health insurance.

Fitch has concerns about the comparability of internal models among those companies that choose to have one, with early indications suggesting the use of

- Risk-mitigating characteristics of Dutch health insurance not reflected in onerous calibrations

diverse methodologies.
The volatility of results under Solvency II is causing concern, with some apprehension among market participants about this pushing up the cost of capital.

Dutch Health Insurance

The treatment of Dutch health insurance under the Solvency II standard-formula approach proved onerous in QIS5, and although calibrations were lowered to reflect the nature of the system (as described above), insurers still feel that more needs to be done to recognise the risk-mitigating characteristics of the Dutch health insurance system. Fitch expects further lobbying from insurers in this area.

Overall, the industry expects basic capital requirements for health contracts to increase. One advantage of the system in the Netherlands is that insurers are able to pass the increased costs of regulation on to consumers due to the mandatory nature of the product.

Smaller Insurers

The Netherlands has a large number of small, niche insurers. DNB is actively considering how to apply "proportionality" for these insurers through its "Solvency II Basic" scheme, which covers 75 small insurers that fall outside full risk-based regulation. However, Fitch expects additional consolidation as a result of Solvency II. Small insurers within the scope of the regime are likely to incur higher risk charges through the standard formula, compared with larger peers who have the resources to build internal models that better reflect their risks and lead to lower risk charges overall.

Other Potential Issues

- Submission of implementation plan to DNB by end-2011 to include details on disclosure

Disclosure

It is not yet clear what the public disclosure requirements will be under Solvency II. DNB has stipulated that insurers must prepare to release large volumes of information into the public domain. It is encouraging insurers to actively consider the ways they present this information with a focus on formats that are both usable and understandable. Insurers in the Netherlands must submit a "Solvency II Reporting Implementation Plan" to the regulator by end-2011.

Contract Boundaries

The Netherlands has a large volume of group pensions business. Under QIS5, the guidelines relating to contract boundaries stipulate that future premiums and benefit accruals must be disregarded and the expectation that new employees join the scheme (replacing leavers) should not be taken in to account. Companies are unconvinced by these requirements, believing that they do not accurately reflect how group pension plans actually operate, and many insurers did not adhere to the QIS5 specification for group pensions.

Similarly, these rules would imply that health policies should be considered only on a one-year basis as contracts can be cancelled after this time. However, with a switch rate of only 4.3%, some leeway might be expected for taking likely renewals into account. Fitch considers that surplus capital would have been much lower had companies adhered to the QIS5 specification more strictly.