Profile on German Insurance Market

Demographics and Trends

Germany has the largest economy in Europe and the second largest population. After Spain, it has the most growth potential for life insurance of any market in Western Europe.

With over 82 million people living in the country, 30% of Germany's population is currently 55 years and older. By 2050, it is expected that 40% will be over the age of 55. Changing demographics will have an adverse impact on the insurance industry unless current business models and distribution channels change to provide better service to the consumer. Products for the elderly, long-term care products, and immediate annuities are becoming more attractive.

The Federal Financial Supervisory Authority (BaFin) is a government agency which supervises German banks, financial services institutions, and over 700 insurance undertakings. BaFin reports that in 2006 there were 643 insurance companies operating in Germany, down from 785 in 1990. In 2006, 112 were life assurance companies, compared to 122 in 1990. In 2006, there were 53 health insurers, as compared to 57 in 1990.

A survey commissioned by IBM reveals that 41% of German insurance customers buy direct from their life and pensions provider. German consumers of insurance are seen as high risk for customer churn, with 59% opting to switch policies in five years or less.

Since the liberalization of the insurance market in 1994, foreign insurers have entered the German life insurance market, offering more equity-exposed products. They have been very successful in penetrating the market. More foreign entries are expected because of the attractive market which is powered by a fundamentally changed product environment. However, it should be noted that the products offered by foreign competitors are increasingly offered by German companies as well.

The German insurance market generated total revenues of $189.7 billion in 2004, representing a compound annual growth rate (CAGR) of 3.9% for the five-year period spanning 2000-2004. This growth was similar to that of the European market itself.

It is expected that the demand for insurance will increase in 2009 and thereafter. The impact of political reforms, intense competition, and high penetration in some markets will be determining factors.

The trend for life assurance is towards long-term contracts with pension-like payouts providing the largest share of new business. There were 3.5 million new contracts concluded in the first half of 2007, representing a decline of 13.5 percent in the number of contracts.

The performance of the market is forecast to decelerate, with an anticipated CAGR of 2.5% for the five-year period 2006-2011 expected to drive the market to a value of $233.5 billion by the end of 2011.

Leading Companies and Employees

The leading players in German insurance are large companies offering similar products. They have a wide geographical presence and strong buying power, creating great rivalry in the German market.

Some leading players in the direct sales environment include Allianz, CosmosDirekt (AMB Generali), AXA, KarstadtQuelle Versicherungen AG (ERGO Versicherungsgruppe AG and Arcandor AG), HDI Direkt Versicherung AG (Talanx), Munich Re, Zurich, HUK24 (HUK-Coburg), DA Direkt Versicherung (DA - Deutsche Allgemeine), Europa Direktversicherer, and Ontos.

CosmosDirekt and KarstadtQuell-Versicherungen are two of the biggest competitors in the direct sales arena. Arcandor AG, a joint owner of KarstadtQuell-Versicherungen with the ERGO Insurance Group, is a German mail order and department store corporation. KarstadtQuelle Financial Services is also a joint venture between ERGO (50%) and Arcandor (50%) and is a marketing and sales company for insurance and banking products. The company has access to 19 million Karstadt customers.

LEADING LIFE INSURANCE COMPANIES, 2006

	Gross written premiums	
Company	EUR Mn	USDBn
Allianz Leben	12,583.0	15,786.0
Aachenmunchener Leben	3,694.0	4,634.3
Zurich Deutschland Herold	3,667.0	4,600.4
R+V Lebensversicherung	3,376.0	4,235.4
Hamb Mannheimer LV	3,145.0	3,945.6
Debeka Leben	2,709.0	3,398.6
Volksfursorge DT LV	2,391.0	2,999.6
Victoria Leben	2,043.0	2,563.0
HDI-Gerling Leben	2,009.0	2,520.4
AXA Leben	1,994.0	2,501.6

I.I.I. International Insurance Fact Book 2008-09

In 1970 the German insurance industry employed 189 500 people. The numbers fluctuated since then with the highest number employed in 1992 (259 000). The most recent available numbers show that 225 700 people were employed in 2006. In 1970, 62 900 people were employed in the life insurance sector; health insurance employed 25 800. Ten years later, 67 200 were working in life insurance and 27 500 in health. In 1990, the numbers jumped to 77 400 working in the life insurance industry, with 31 700 in health. In 2000, the number of people working in life dropped to 72 800, while the numbers in health insurance jumped to 35 200. The numbers dropped again to 65 400 for employment in life in 2006, as compared to another increase in employment numbers for health to 43 700.

Life Insurance Penetration, Trends, and Challenges

German life insurers currently have a penetration of about 45%. When compared with other European countries, German life insurers have significant growth potential, with the number of policies per person being significantly below countries such as France or the UK.

Life insurers are the largest segment in the German insurance industry with a 48% market share and a GWP of EUR78.3bn. Life insurance contributes significantly to the market's value, with total revenues of $63.7 billion in 2004, equating to 33.6% of the market's aggregate revenues. Since 2004, German life insurers have moved away from traditional endowment policies towards unit-linked business and longer-term annuity business.

The German Insurance Association is made up of 455 member companies with a combined market volume of approximately 97%. It reports a progressive slowdown in the insurance industry over the last few years, attributed largely to a weak economy that is slowly on the upswing. Premium growth in 2007 was expected to be minimal at 0.2% as compared to 2.4 % in 2006. Premium revenue from growth in private health insurance for the same period grew by 2.5%.

The last year has seen the German life insurance industry busy reacting to changes in the legal and regulatory framework. Introduced in May 2007, the EU Insurance Mediation Directive (IMD) and the Insurance Contract Law, which came into effect in January 2008, are regulations that have increased the complexity of the life insurance business model, leading to higher expenses. Higher deferred acquisition costs and surrender values, and a change from "policy model" to an "offer-acceptance model" are two of the changes that are creating new challenges for insurers.

The German life insurance industry is still one of the least profitable in Europe, as German life insurers' business prospects remain weak overall. Preliminary results for 2007 indicate a decrease of 7.1% in total new business premiums to EUR 146.1bn and gross written premiums stagnated at EUR 74.3bn. Fitch currently believes that from 2009, new business in Riester and overall, will slow down.

Fitch is forecasting acceleration in competition from within Germany as investment funds and banks try to benefit from the changed product environment given their experience in short- and long-term savings products. Increased competition is also expected from foreign insurers.

The distribution landscape for German insurers has changed dramatically in recent years. Currently influencing German life insurers is new legislation such as the Retirement Income Act (Alters-Einkünfte-Gesetz) and the Tax-Amendment Law (Steueränderungsgesetz). Also, the EU Mediation Insurance Directive has had a significant impact on distribution. After the partial lapse of tax benefits for traditional endowment policies, the new life insurance products require a much higher degree of sales force competence, as product advantages are more complex to explain to the consumer. This may spell bad news for direct sales.

After skyrocketing sales at year-end 2004 due to the imminent partial lapse of tax benefits, German life insurers reported a significant fall in new business in 2005 (see Table 1). New business in terms of regular premiums dropped by 50.2% (without allowing for business carried over from 2004), reflecting the less attractive product features of traditional endowment policies compared with other investment products and anticipated insurance purchases in 2004. Compared with the more "normal" year of 2003, new business in regular premiums was still down by 29.6%.

Table 1: German Life Insurers: Business Growth in 2006[a]

	2003	2005	2006	2006/2005 Δ (%)
New business				
Number of policies (m)	8.6	7.3	8.0	+9.5
New business premiums (EURbn)	16.6	14.7	18.1	+22.6
- Thereof regular premiums	8.1	5.7	6.5	+15.0
- Thereof single premiums	8.5	9.0	11.6	+27.4
Sum insured (EURbn)	269.4	227.8	251.4	+10.4
Portfolio				
Number of policies (m)	91.5	94.2	94.0	-0.2
Gross written premiums (EURbn)	67.7	72.6	74.7	+2.9

[a] Excluding 'Pensionskassen' and 'Pensions Fonds' (pension funds)
Source: GDV

The following chart tracks the history of premium income in the German life insurance industry from 1975-2006.

Trend of premium income in life insurance* **25**

Year	number of reporting entities	premium income[1] total EUR m	premium income[1] change against previous year as %	Year	number of reporting entities	premium income[1] total EUR m	premium income[1] change against previous year as %
1975	107	8,218	7.7	1993	121	38,514	11.7
1980	102	13,215	8.8	1994	120	42,416	10.1
1981	102	14,294	8.2	1995	125	45,201	6.6
1982	101	15,202	6.4	1996	125	47,494	5.1
1983	102	16,633	9.4	1997[2]	125	50,500	x
1984	104	17,333	4.2	1998	122	52,505	4.0
1985	105	18,385	6.1	1999	122	58,749	11.9
1986	105	19,669	7.0	2000	118	61,225	4.2
1987	107	21,222	7.9	2001	117	62,387	1.9
1988	107	23,102	8.9	2002	111	65,018	4.2
1989	111	25,027	8.3	2003	109	67,618	4.0
1990	110	27,403	9.5	2004	104	68,399	1.2
1991	117	31,098	13.5	2005	101	72,636	6.2
1992	120	34,489	10.9	2006	97	74,714	2.9

The German Insurance Association (GDV) reported the following in its *Statistical Yearbook of German Insurance 2007*: life assurance gross premiums written in 2005 were valued at 75.24 EUR bn. In 2006, the amount increased to 78.3 EUR bn, while 2007 saw a slight drop to 78.1 EUR bn. From the same publication, private health insurance in 2005 had a value of 27.40 EUR bn; 2006, 28.5 EUR bn; and 2007, 29.2 EUR bn. Gross premiums written for accident insurance in 2005 were 6.03 EUR bn, with 2006 reporting 6.2 EUR bn, and 2007, 6.4 EUR bn.

It is interesting to note the changes in the German life assurance industry over time as product environments evolved in reaction to legal, demographic, cultural, and political realities.

Life assurance (without *Pensionskassen* and pension funds): time series of redeemed new business
Number in thousands (share as per cent)

	1980		1990		1995[3])		2000		2003		2004		2005		2006	
Individual insurances																
endowment insurances	3 084.2	59.3	4 939.8	63.6	2 768.5	41.0	1 486.5	20.3	1 592.4	18.4	2 649.2	22.4	962.4	13.1	982.8	12.2
unit-linked endowment insurances	12.2	0.2	150.6	1.9	220.1	3.2	1 281.7	17.5	538.9	6.2	1183.3	10.0	391.8	5.3	300.1	3.7
unit-linked annuity insurances									581.0	6.7	1 251.3	10.6	857.0	11.7	1 281.1	15.9
term insurances[1)]	1 271.3	24.5	1 456.5	18.7	603.9	8.9	649.4	8.9	738.0	8.6	734.8	6.2	738.7	10.1	753.9	9.4
pension and annuity insurances	65.1	1.3	170.9	2.2	727.7	10.8	961.8	13.2	1 866.0	21.6	2 969.7	25.2	1 868.7	25.5	2 224.0	27.7
occupational disability insurances			22.0	0.3	38.8	0.6	184.4	2.5	334.9	3.9	376.4	3.2	323.6	4.4	329.1	4.1
long-term care insurances			0.4	0.0	4.2	0.1	0.1	0.0	1.6	0.0	2.5	0.0	5.3	0.1	9.1	0.1
other individual insurances[2)]					6.8	0.1	6.1	0.1	30.4	0.4	29.1	0.2	73.0	0.9	89.9	1.1
Collective insurances																
endowment insurances	207.5	4.0	375.6	4.8	473.9	7.0	468.3	6.4	602.1	7.0	630.5	5.4	391.8	5.3	341.2	4.3
builder's risk insurances	525.8	10.1	603.8	7.8	585.9	8.7	544.3	7.5	411.9	4.8	368.3	3.1	290.2	4.0	269.9	3.4
residual debt insurances					1 183.7	17.5	1 481.2	20.3	1 511.7	17.5	1170.1	9.9	1103.5	15.1	1 047.8	13.1
other collective insurances	31.6	0.6	53.6	0.7	140.2	2.1	238.0	3.3	419.2	4.9	442.0	3.8	331.0	4.5	404.8	5.0
Total new business	**5 197.6**	**100.0**	**7 773.1**	**100.0**	**6 753.7**	**100.0**	**7 301.8**	**100.0**	**8 628.0**	**100.0**	**11 807.2**	**100.0**	**7 337.0**	**100.0**	**8 033.7**	**100.0**

1) until 1994 including residual debt insurances, 2) life assurances without profit sharing, tontine insurances and capitalization business, etc., 3) from 1995 change in accounting rules, comparison with previous year not possible.

Health Insurance

Healthcare insurance is mandatory in Germany, with most of the population obliged to deal with state regulated providers. In Germany, employees who gross less than the EUR 47 700 threshold for mandatory insurance must contract to the statutory health insurance scheme. Employees who earn more than EUR 47 700 can choose either statutory or private health insurance.

As a result, the private health insurance (PHI) market is significantly underdeveloped when compared to other markets in Western European. Please note: Unlike many other countries in Europe, private health insurance in Germany is not considered to be part of the non-life sector. Health insurance products are calculated using life insurance actuarial and accounting methods. In 2005, PHIs posted a significant increase in their gross profits after tax, with the majority (92%) allocated for the benefit of policyholders. The increase is due to a substantial increase of transfers to both profit-related and non-profit-related provisions for premium refunds. In total, German health insurers are more profitable than German life insurers.

Allianz Private Krankenversicherung AG, AXA Krankenversicherung AG, Central Krankenversicherung AG, DBV Winterthur Krankenversicherung AG, and DKV Deutsche Krankenversicherung AG are some of Germany's top health insurance companies.

In the *Statistical Yearbook of German Insurance 2007*, published by the German Insurance Association (GDV), it was reported that the number of people with full cover health insurance in 2006 was 8 489 100, up from 8 373 000 in 2005, and 8 259 400 in 2004. Long-term care insurance numbers beginning in 2004 were fixed at 9 117 600 and steadily increased to 9 276 800 in 2006. Bigger numbers were reported for supplementary health insurance in 2006 (18 400 500), 2005 (17 087 800), and 2004 (15 897 900).

The majority of German health insurers use a multi-channel distribution strategy to sell their products. Some employ brokers or exclusive distribution channels to market full-value health insurance products. For example, Debeka, the health insurance mutual provider, generated 108,000 new full-value health insurance contracts in 2005 using an exclusive sales force, more than any other company.

Full-value insurance direct marketing has proven to be impracticable because of product complexity and the amount of advice required for each contract sold. On the other hand, direct marketing provides an excellent cost-effective channel in which to sell supplementary insurance because of the large number of policies and the low volume of premiums. The supplementary health insurance sector has substantial growth potential since over 60 million people in Germany have not taken out a supplementary PHI policy. The market potential is there but the willingness to purchase a policy declines significantly when premiums exceed EUR 20 per month.

Reform of the health sector will have major consequences for PHIs before 2009. Full-value health insurance will continue to decline due to the introduction of a three year period of deferment. Afterwards, an increase in new entrants is expected since the deferment period expires for the first age groups.

German private health insurers are moving into new business models such as supplementary health insurance or as specialists in selling to the high-net-worth market health insurance.

Private health insurers had premiums totalling 29.2 billion EUR in 2007, which includes 27.3 billion EUR from health insurance. 8.5 million Germans had full health insurance coverage as of June 2007. The first half of 2007 saw only 37 700 new customers, as compared to new business in the first half of 2006 reaching almost 47 000. This turndown in new business for PHI for the fourth consecutive year is attributed to the raising of the compulsory insurance limit by 450 EUR a month, legislation that came into effect January 1, 2003. While full coverage business suffered, the number of people buying supplementary coverage increased again. By mid-year 2007, more than 19 million supplementary contracts were signed, which was up from the same period in 2006 (17.9 million).

Distribution Channels

Bancassurance

Germany's market share of bancassurance (% of life insurance premiums) stands at around 25%, as compared to Portugal's at 86%, Spain's at 81%, and Brazil's at 70%. Based on research by insurance regulators, insurance associations, Axco, LIMRA and Swiss Re carried out in 2007 and based on 2006 figures, bancassurance holds a 24.8% share of the life insurance market. Tied agents came in at 27.1%, brokers at 39.4%, and others (including direct sales) at 8.7%. In the mid-1980s, tied agents held almost 80% of the market for new business.

Fitch is forecasting that bancassurance will gain in market share, particularly if common branding is emphasized, more of a commitment is made to employee training, and additional focus is placed on products that are profitable. For direct distribution, Fitch sees considerable growth potential but only in products such as term insurance or for insurers with special niche customer markets. Fitch notes, however, that the quality of direct insurance, for example in terms of lapse rates, is generally high.

Most insurance purchased through banks in Germany is handled by external networks of insurance advisers who work closely with branch staff. Branch staff regularly sell straightforward products, but insurance specialists assist them in the selling of more complex products.

The leading insurance companies mostly have an exclusive bancassurance partner with a bank. Leading bancassurance partnerships in Germany are Dresdner Bank/Allianz; Volksbanken/R+V; Deutsche Bank/Zurich; and HVB/ERGO. Allianz employs 1,000 insurance specialists, one for every branch. R+V Insurance is owned by the DZ Bank and has its Volksbank as its main sales channel for R+V; one insurance specialist is employed for each branch. ERGO employs 180 insurance specialists, one for every four branches and focuses on life products.

IFAs

Since May 2007 IFAs have had to take out a professional indemnity insurance which generally ranges between EUR 800-1,200 per annum per individual. IFAs are also required to meet certain standards with respect to their qualifications and expertise, and must be registered with the local Chambers of Industry and Commerce (Industrie- und Handelskammer, IHK).

As of November 2007, 13,000 IFAs and 124,000 tied agents had registered with the IHKs. Many unqualified and part-time IFAs were forced to leave the industry. Fitch believes the new regulation could improve the reputations and credibility of IFAs. Tied agents are required to register with the IHK but are mainly spared from the new regulations.

Fitch expects these new regulations to have a negative impact on the amount of new business generated by German life insurers in the near term and could reduce IFAs’ revenues by more than 15%. Many German life insurers are beginning to compete for IFAs by increasing their commission rates and investing in service infrastructure. Other insurers have decided that looking for alternative or complementary distribution strategies is a better option. Example: AachenMünchener Lebensversicherung AG to acquire a major stake in the multi-channel distributor DVAG.

The success of new products is strongly influenced by the various forms of distribution. In 2005 there was a significant increase in new business among IFAs and independent brokers, at the expense of traditional tied agents. It is expected that tied agent networks will experience increased pressure from a number of sources, including the move from fixed-income remuneration to solely commission-based payments (section 84 of the German Commercial Code). The new product environment will also require new and different sales strategies and a deeper knowledge of the products and how they work. Historically in Germany, the structure and size of distribution channels were based on the selling of simple endowment products primarily by tied agents. That is no longer the case with the introduction of increasingly complex products and is why industry experts expect IFAs to increase their market share of new business.

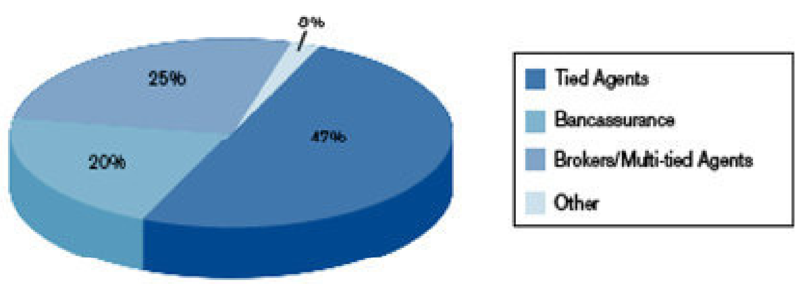
Many sole IFAs and brokers are expected to make the move to bigger agencies because of liability insurance for individual agents and stricter requirements, such as improved documentation from the IMD.

Leading financial advisor firms include DVAG (tied to AMB), AWD, MLP, and OVB.

Tied-agent Channel

The most important distribution channel for the larger insurance companies is the tied-agent channel. Similarly, the larger companies also tend to dominate in bancassurance distribution. As an example, see the distribution split of Allianz Group in Germany.

CHART 12: RELEVANCE OF DISTRIBUTION CHANNELS FOR ALLIANZ GROUP



SOURCE: ANNUAL REPORT 2006 ALLIANZ GROUP, PAGE 37

A few large companies are also major players in the broker market, but the tied-agent channel tends to be the main distribution channel for medium-sized and smaller insurance companies, which usually lack the scale or resources to build their own national tied-agent channel. Brokers and financial advisor networks are also often the main channel for new entrants in the German market. Some regional state-owned insurance companies operate via tied agents and bancassurance, but only with a local presence.

Brokers and multi-tied agents dominate in unit-linked distribution, with a share of close to 50% based on number of policies.

A small number of insurance companies are specialized direct insurers; they distribute their business mainly through call centres and via the Internet. Direct sales have a small share of the market. The biggest player in this sector is CosmosDirekt with around EURO 1 bn. of premium income in 2005. In 2006, the company announced a record year with premiums growing by 18% to more than EURO 1.1 bn.