Vision for the future of the Dutch insurance sector

Sustainability through transformation

DeNederlandscheBank

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Summary

The insurance sector will constantly change in the years to come. A range of changes in terms of technology, society, customer behaviour and legislation will affect the sector. This requires insurers, supervisors and policymakers to make additional efforts aimed at safeguarding a sustainable, stable and efficient insurance sector that serves society in the future.

The portfolio of individual life insurance policies is expected to contract further over the years ahead. Among the causes are low interest rates, the aftermath of tax-related changes, increased competition from bank savings products and a loss of confidence throughout society due to legal disputes following the unit-linked insurance mis-selling scandal. They are forcing life insurers to scale back their capacity and cut costs, adapt their business models and consolidate where needed. Such action is needed to ensure the lasting health of the individual life insurance sector. Trends in market size are less clear for group life insurance. What is clear, however, is that group pension accumulation administered by insurers is increasingly based on defined contribution schemes, which require a different business model.

In the non-life insurance market, innovative technology may significantly depress total premium volumes. We explored three scenarios, each of which features reduced premium volumes, driven primarily by expected cost reductions and lower claims losses, both of which are caused by technological developments. We consider this to be a desirable development, viewed from the perspective of efficient service provision to society. Insurers that fail to bring their costs in line with

market levels may face lower profitability. If they continue to incur losses, they will need to look for alternatives, i.e. consider an acquisition or scale back operations.

We expect to see increased competition from new entrants to the life and non-life insurance markets, fuelled by technological developments and trends in society. Newcomers will leverage the new opportunities offered by big data and mobile communications and shifts in consumer demand. They have the potential to operate more efficiently than incumbents, which are often burdened by legacy IT systems. Furthermore, new market players are often better at meeting specific customer needs.

The Dutch non-life insurance market, in particular, is expected to face increasing competition from foreign insurers. The introduction of the European Solvency II Directive has further harmonised prudential supervision and the level playing field in Europe. For example, it allows the major international players to make investments and enjoy economies of scale. Likewise, they benefit from being able to offer the corporate market a more comprehensive range of cross-border services than smaller domestic players.

Insurers increasingly face competition from players outside the traditional insurance sector. In a number of business lines, insurers are in direct competition with banks, pension funds and other financial service providers. At the same time, insurers increasingly encroach on the territory of intermediaries or financial brokers. Service shifts such as these change the competitive landscape in various markets.

To safeguard a sustainable, stable and efficient insurance sector that serves society, we present policy recommendations to insurers, supervisors and policymakers (see Figure 1).

Figure 1 Overview of policy recommendations

Theme 1: Size of the life insurance sector

Recommendations for life insurers:

1. Anticipate contraction in the market for individual life insurance by:
   a. continuing to cut costs. Also perform sensitivity analyses for the variability of costs in relation to cost assumptions as part of the technical provisions.
   b. exploring avenues for consolidation, a potential portfolio run-off and the possibility to transfer closed portfolios to specialised parties.
2. Keep working to restore trust, and continue to put the customer's interest first. This includes looking for appropriate solutions for unit-linked insurance policies mis-sold in the past and avoiding needless complexity in new products.
3. In your capital and dividend policy, consider the impact that economic market parameters have on the development of your financial position. We will assess these policies accordingly.

Recommendations for policymakers and supervisors:

4. Put adequate instruments in place for the recovery and solution of insolvent insurers. Other European countries should also adopt this initiative.

Theme 2: Size of the non-life insurance sector

Recommendations for non-life insurers:

5. Strengthen your strategic decision-making and adaptability, allowing you to:
   a. bring your cost base and capacity in line with declining premium volumes; and
   b. be flexible in meeting the needs in society by making investments in innovation.
6. Furthermore, explore avenues for terminating operations or parts thereof or teaming up with other parties.

Recommendations for supervisors:

7. Identify the parties that stand to lose out from the envisaged changes and intervene in good time where needed to safeguard the interests of policyholders.

Recommendations for insurers, policymakers and supervisors:

8. Start a debate in society about the insurable and uninsurable risks due to innovative technology and big data analysis.

Theme 3: Competition from new market entrants

Recommendations for insurers and new market entrants:

9 Recommendations for insurers and new market entrants:

10 Proactively leverage new opportunities through innovative technology and digitisation to improve insurance service provision to consumers.

11 Ensure adequate management of the risks inherent in innovation, and use big data in a responsible and transparent manner.

Recommendations for policymakers and supervisors:

12 Facilitate responsible innovation of insurance service provision and remove unnecessary barriers.

Theme 4: Internationalisation

Recommendations for insurers:

12 Consider in your strategic decision-making the option of launching cross-border activities, weighing up potential growth and diversification benefits against additional risks and costs.

Recommendations for policymakers and supervisors:

13 Take the lead in eliminating unnecessary barriers to internationalisation.

Theme 5: Shifts in the value chain

Recommendations for insurers:

14 Communicate clearly about the risks and costs involved in pension schemes and who bears them – pension fund members individually or collectively, or the insurer.

15 Make clear strategy choices with regard to shifting to other services or neighbouring markets, for example concerning the provision of services to general pension funds (APFs). Make sure you have a unique selling proposition that sets you apart from other market players to ensure you continue to add value to customers.

Recommendations for policymakers and supervisors:

16 Remain alert to risks inherent in cross-sectoral shifts of activities and take policy and supervisory action to mitigate them where needed.

1 Introduction

We aim to safeguard a sustainable, stable and efficient insurance sector that serves society. Insurance services meet an important need in society and contribute to economic growth and prosperity in the Netherlands. Hence, it is important that the insurance sector is sustainable and stable. After all, insurers must also be able to meet their commitments in times of adversity, preferably without relying on government support. Should they fail to so do, resolution must be possible without jeopardising financial stability. At the same time, the sector must be efficient and serve society. This means that insurers must offer products that customers need and understand and that are appropriately priced in a market with healthy competition.

In this report, we analyse the impact that various developments will have on the insurance sector over the next five to ten years. Looking at technological and economic developments, trends in society, changing customer behaviour and legislative amendments, we assess their impact in terms of size of and competition in the sector.

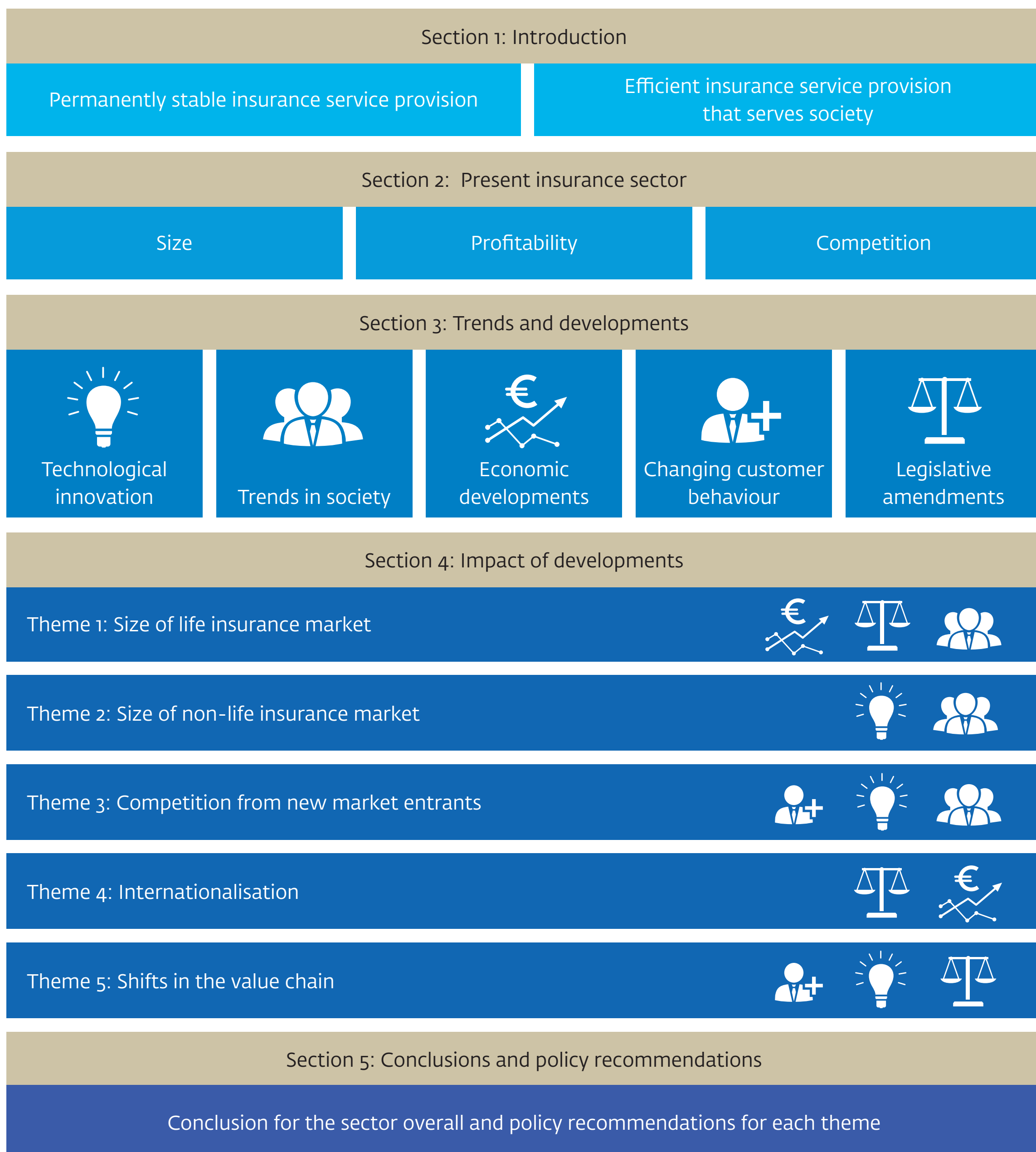
Based on our analysis, we present policy recommendations to insurers, supervisors and policymakers. In our capacity of prudential supervisor, we make these recommendations to safeguard a sustainable, stable and efficient insurance sector that serves society.

Our analysis focuses on the life and non-life insurance sectors. As the market for health insurance is very different in nature, we do not address it here, nor do we discuss the reinsurance market, for the same reason (see Boxes 9 and 10 in the Annex). We plan to specifically discuss the market for health insurance in due course.

Guide to this document

This document is structured as follows (see Figure 2). Section 2 presents an overview of the present insurance sector in the Netherlands, while section 3 provides insight into the five key trends in the sector. Section 4 discusses the impact of these trends on market size and competition and assesses them by highlighting five themes. Finally, in section 5 we present overall conclusions and policy recommendations to insurers, supervisors and policymakers.

Figure 2 Guide to this document



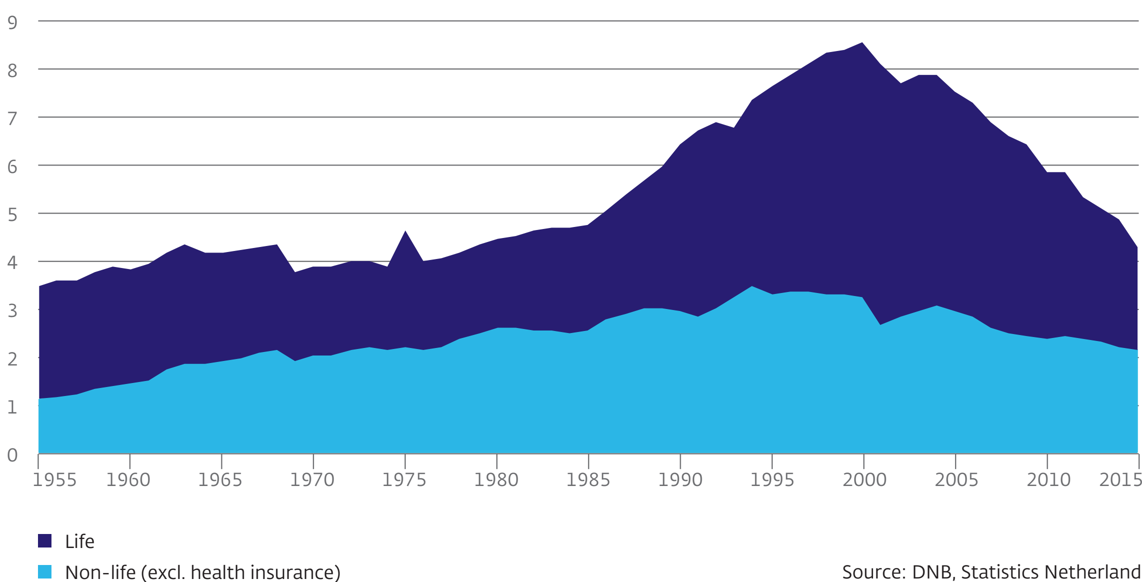
2 Overview of the Dutch insurance sector

2.1 Size of the life and non-life insurance sectors

The total volume of premiums in the Dutch life and non-life insurance sectors amounts to some EUR 29 billion a year, or around 4% of the Netherlands' gross domestic product (GDP). Individual sector volumes are similar (see Chart 1) . Compared with the balance sheet totals of banks and pension funds, the insurance sector is relatively small. Even so, at 68% of Dutch GDP, its balance sheet total is still substantial (see Chart 2), and the life insurance sector's balance sheet total is ten times that of the non-life insurance sector. This is because life insurers offer products with longer maturities, which in many cases accumulate value. Compared with other European countries, the Dutch life insurance sector is relatively small (see Chart 3), which can be largely explained by group pension accumulation, which is partly mandatory in the Netherlands,

Chart 1 Premium income of life and non-life insurers

Annual figures as a percentage of GDP



Source: DNB, Statistics Netherlands

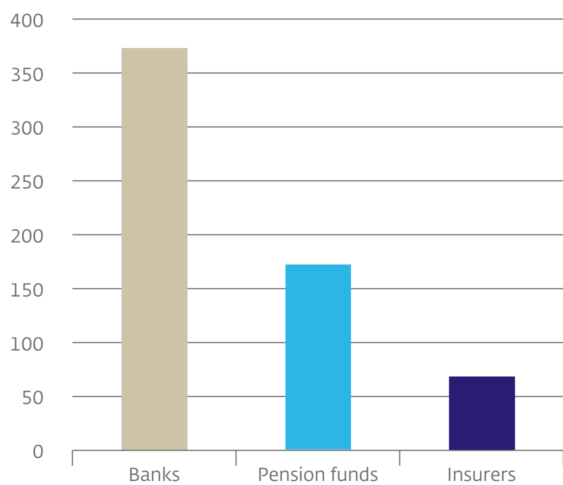
1 The figures cited in this section are only for insurers subject to our supervision and do not include those for foreign insurers operating in the Netherlands through branch offices or under a European single licence, unless expressly stated.

and which is administered by pension funds to a significant extent.

Premium volumes in the life and non-life insurance sectors have plummeted in recent years, due in particular to lower sales of new life insurance products (see Chart 1). Gross premium volumes in the life insurance sector halved between 2007 and 2015, both in absolute terms and as a percentage of GDP. Income from individual life insurance products dried up at a faster pace due to the introduction of bank saving in 2008 (see Box 1). This was offset only partly by banking activities developed within insurance groups. In the non-life insurance sector, total nominal premium volumes, expressed in euros, have remained relatively stable since 2007, thereby showing a slight relative decrease as a percentage of GDP.

Chart 2 Balance sheet total of insurers, put into perspective

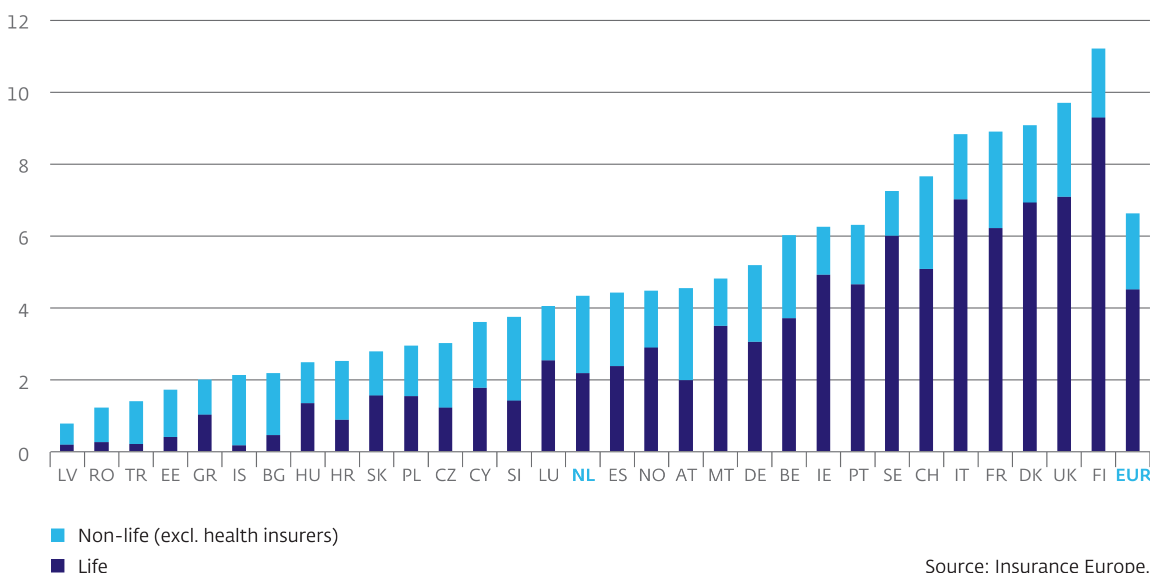
2015; as a percentage of GDP



Source: DNB, Statistics Netherlands

Chart 3 Premium income of life and non-life insurers in Europe

2015; as a percentage of GDP



Source: Insurance Europe.

Box 1 Tax relief for life insurance products scaled back

Life insurers had high sales in the nineties in particular, fuelled in part by tax relief available for capital accumulation. As the government restricted the scope for tax relief in 2002, the market for individual pension products contracted. The introduction of the Bank Saving Act in 2008 means that banks can now also offer tax-relieved capital accumulation products, and insurers lost further ground as a result. Furthermore, it was decided in 2014 that interest tax relief would only be allowed if the borrower started making mortgage loan redemptions immediately. These developments restrict tax relief for life insurance products. We welcome the scaling back of tax incentives, as they may cause market distortion and excessive growth, whereas a stable insurance sector will benefit from business models that do not depend on tax incentives.

2.2 Profitability

Life and non-life insurers have to contend with adverse market conditions and declining profitability. Over the past few years, results for their major product groups have often been negative. As a consequence, insurers are implementing cost reduction programmes. For example, the total workforce dropped by 20%, from 57,000 in 2010 to 46,000 in 2015.[2]

In the life insurance sector, profits and solvency are under pressure, due mainly to the current low interest rates. Insurers are finding it hard to maintain their profit and solvency levels. Technical results (i.e. results on underwriting risks) have fluctuated sharply over the past few years, showing both positive and negative outliers (see Chart 4). One of the most important causes for this is the risk-free term structure used to convert insurance liabilities to present value, i.e. the provision that must be maintained. If the term structure rises in a given year, this will have a positive effect on the technical result, because the provision needed is lower. Once interest rates rise, the provision must be increased, which has a negative effect on the technical result.[3] Setting the term structure therefore has a large impact on the financial position of insurers (see Box 2). In addition, current low interest rates make it difficult to deliver on return guarantees provided in the past.

The Dutch life insurers' sensitivity to changes in interest rates also became apparent in stress tests performed by the European Insurance and Occupational Pensions Authority (EIOPA). EIOPA performed stress tests among European insurers in 2014 and 2016.[4] The results show that Dutch life insurers are sensitive to declining interest rates, and particularly to a scenario of prolonged low interest rates, given that the maturities of their insurance liabilities outstrip those of the corresponding assets.

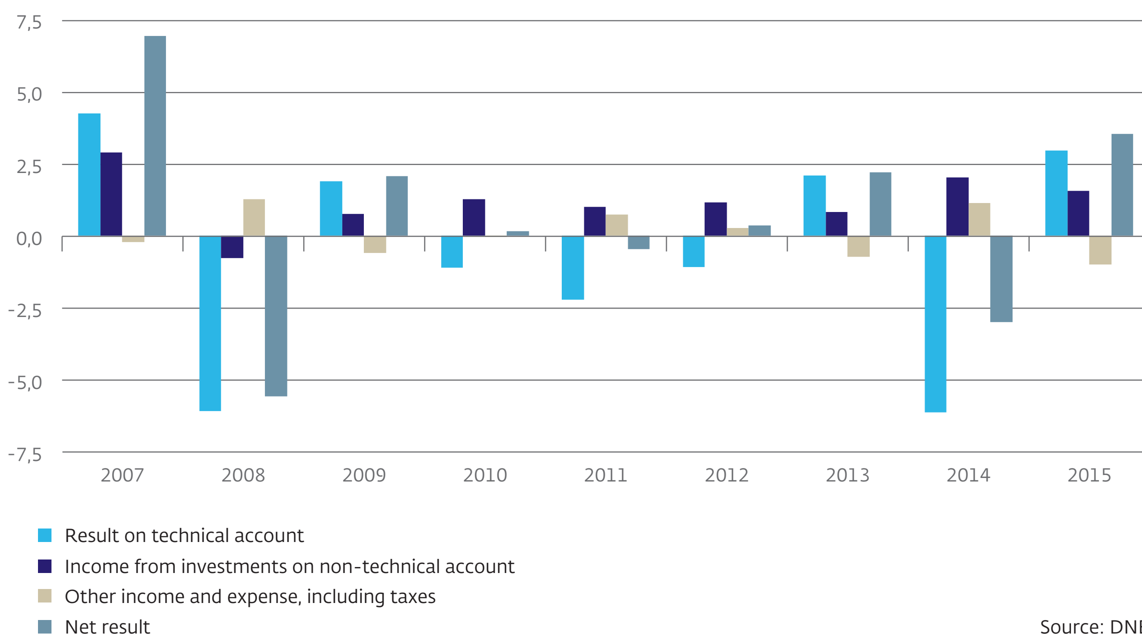
2 Source: Dutch Association of Insurers (figures include health insurers)

3 The impact of interest rate movements is not fully reflected in life insurers' profit and loss accounts. This is because movements also affect the value of investments maintained to hedge interest liabilities. Depending on an insurer's interest rate hedging strategy and accounting principles, such value changes are not always taken to the profit and loss account but taken directly to actual own funds, which are inverse to the profits or losses reported. The degree to which an insurer relies on hedging will determine whether a change in interest rates has a net positive or negative impact on its financial position.

4 https://eiopa.europa.eu/financial-stability-crisis-prevention/financial-stability/insurance-stress-test/insurance-stress-test-2014

Chart 4 Developments of results of life insurers

Result on technical account, income from investments and net results (amounts in EUR billion)



Source: DNB

Likewise, profitability is low or even negative in the non-life insurance sector. For a number of years now, the principal market segments have experienced a negative net combined ratio, which is the ratio of claims losses and costs to premium income (see Table 1). The market for motor vehicle third-party liability insurance is particularly worrying, but other market segments have also been loss-making over the past years. This means that premiums earned are not enough to cover claims and costs. To post positive results, insurers depend on sufficient investment gains, which are exceedingly difficult to achieve in the current low interest rate environment.

Table 1 Results of non-life insurers

Net combined ratio*	2007	2008	2009	2010	2011	2012	2013	2014	2015
Incapacity for work	75.7%	85.0%	90.0%	95.8%	106.4%	121.6%	107.2%	105.5%	94.1%
Fire	105.0%	100.3%	98.7%	101.8%	97.5%	97.6%	105.8%	98.2%	101.9%
Motor vehicle third-party liability	96.3%	101.5%	109.0%	104.5%	101.5%	104.6%	110.6%	120.7%	119.4%
Motor vehicle bodywork	93.8%	98.5%	96.8%	101.3%	97.4%	97.2%	93.3%	96.5%	99.6%
Third-party liability	89.3%	90.4%	86.6%	84.9%	90.6%	95.4%	103.8%	100.9%	101.6%

* Where a market segment shows a net combined ratio above 100% it is loss-making.

Source: DNB.

Box 2 Impact of setting term structure on financial position of life insurers

In the current low interest rate environment, the way in which the risk-free term structure is set is of vital importance to life insurers. This is because a notional interest rate for long-term maturities is used, known as the ultimate forward rate (UFR), to calculate the term structure used for converting long-term liabilities to present value. The UFR (currently set at 4.2% on a European level) is a level that the term structure for maturities exceeding twenty years grows towards. The difference between the current UFR and the low market rates seen over the past years has increased steadily (see charts on the next page). As a result, the current financial position of life insurers, whose liabilities are mostly of a long-term nature, does not accurately reflect their position on a more economic basis.

In spite of the long-term nature of the liabilities, this issue also arises in the short and medium term, as cash outflows scheduled twenty years from now are approaching and will need to be converted to present value in subsequent steps at prevailing market rates. This will diminish the benefit of discounting using a term structure that includes the UFR.

Chart A Market interest rates versus Solvency II curve - 31 December 2012

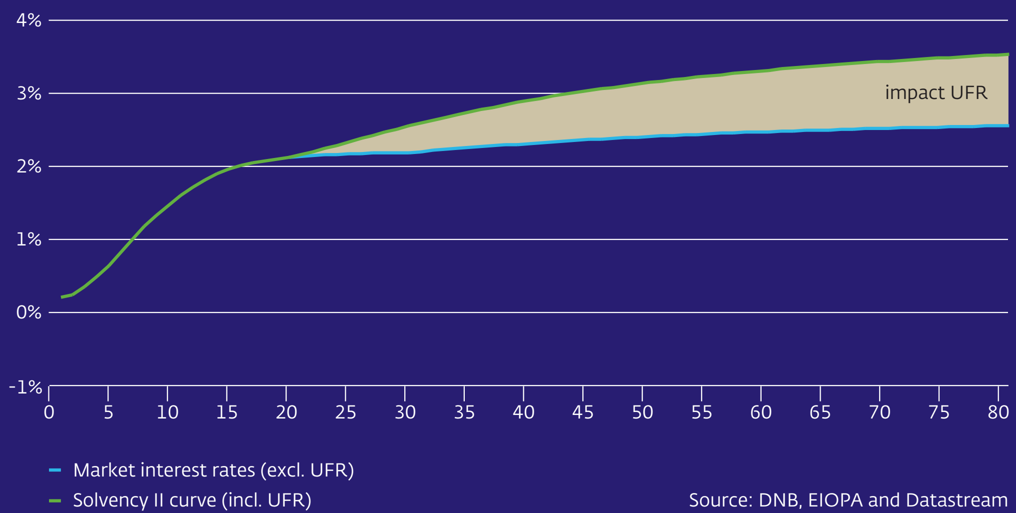
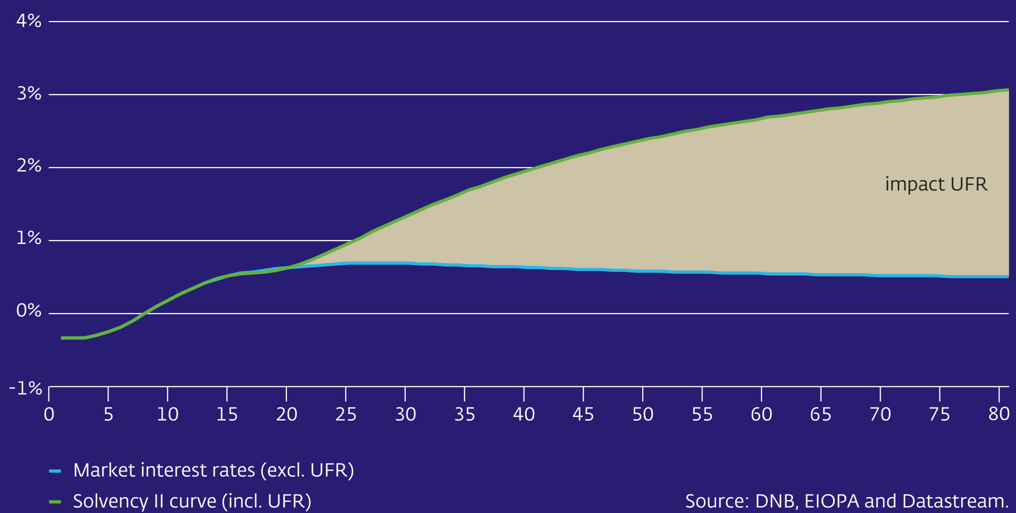


Chart B Market interest rates versus Solvency II curve - 30 September 2012



2.3 Competition

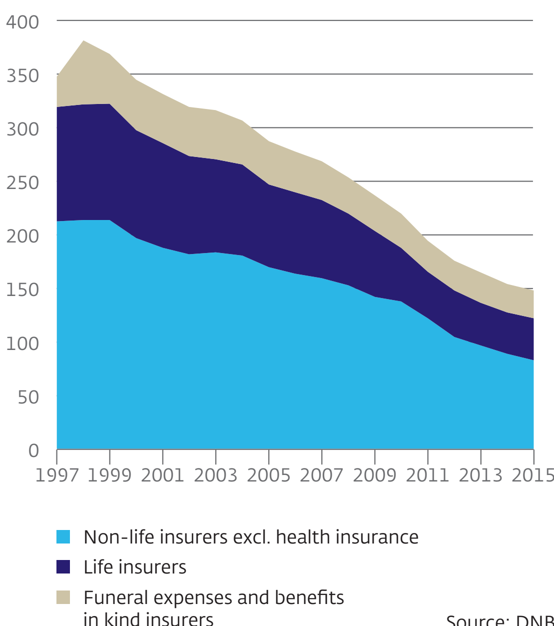
2.3.1 Concentration of the insurance sector

The Dutch insurance sector is diverse, with relatively many insurers operating in specific market segments or niche markets. Nearly half of all insurers are niche players. Their combined premium volume only represents 7% of the total Dutch insurance market. In the life insurance sector, most of these niche players are small mutual funeral services insurers. In the non-life insurance sector, niche players are more diverse, often playing a regional role and covering specific risks. Other players in the Dutch insurance market are insurance groups, financial conglomerates (FiCos) and foreign insurers (see Box 3). While their number is much smaller, they are many times larger than the niche players.

The Dutch insurance sector has seen strong consolidation over the past twenty years (see Chart 5). Many small and medium-sized insurers amalgamated into larger ones due to such factors as increased regulatory and legislative requirements, limited access to the capital market and low interest rates. A further explanation is that

Chart 5 Number of insurers in recent years

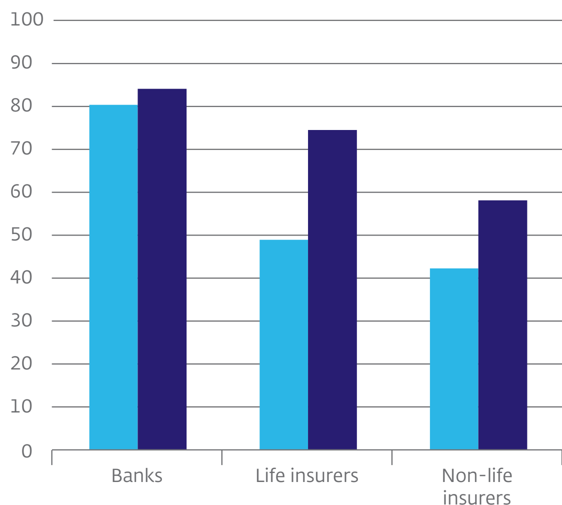
Number of authorised insurance entities



Source: DNB.

Chart 6 Concentration ratios (2015)

Concentration ratios among insurers (gross premiums) and banks (total assets)



Source: DNB.

multiple life or non-life insurers were combined for reasons of cost control and Solvency II requirements and the related capital charge (see Box 4). Despite the recent wave of consolidation, the insurance market is still less concentrated than the banking sector. The combined share of the major insurers in the Dutch insurance market is smaller than that of the major banks in the Dutch banking market (see Chart 6). The five largest life insurers have a combined market share of around 75%, while the five largest non-life insurers hold around 60% of the market in terms of gross premiums. The five largest banks serve approximately 84% of the market, in terms of total assets. FiCos have the largest market shares in premium volume terms in both the life and non-life insurance markets, holding over 70% of the life insurance market and more than 50% of the non-life insurance market.

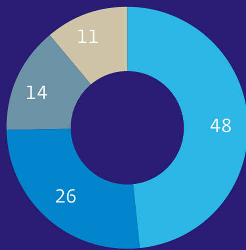
Box 3 Types of players in the Dutch insurance market

By and large, four different types of players can be distinguished in the Dutch insurance sector:

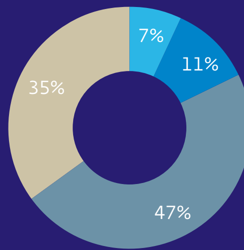
1. Niche players focusing on specific risks, customer groups or geographical regions, which typically have small market shares. Insurers.
2. IInsurers that form part of a group that specialises in insurance. These insurance groups typically offer a wide range of life and non-life insurance products.
3. Insurers that form part of a group that is also active in other areas, such as banking or asset management. These are often referred to as financial conglomerates or FiCos. In addition to being authorised to offer life and non-life insurance products, they also have entities authorised to undertake banking or asset management activities.
4. Insurers that form part of a foreign company. They are a diverse group, ranging from specific niche players for one or several types of insurance to large international insurers that offer both life and non-life insurance.

Grafiek C Market share types of players on insurance market
2015

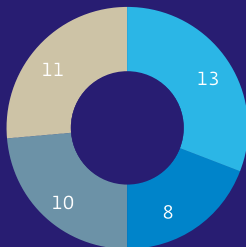
Number of non-life insurers



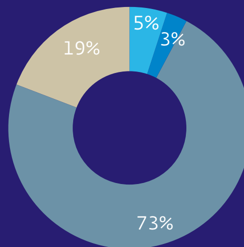
Premium volumes non-life insurers



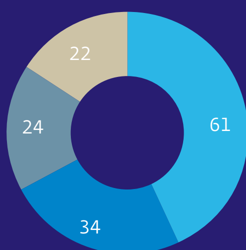
Number of life insurers



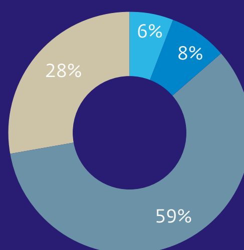
Premium volumes life insurers



Total number of life and non-life insurers



Total premium volumes



Niche players
All-round insurance group
All-round FiCos
Foreign insurers

Source: DNB.

The market share of foreign insurers has been established on the basis of premiums earned by subsidiaries, branch offices and under a European single licence in the Netherlands.

Box 4 Impact of Solvency II

Solvency II, the new statutory framework introduced in 2016, has changed supervision and the way insurers operate and make their decisions. The principal changes are in the following areas:

- Risk-based capital requirements. Under Solvency II, capital requirements are based on the risks that underlie an activity. This encourages insurers to introduce new methods and techniques to manage their risks, including the use of internal models to estimate risks. This helps improve risk management. In addition, the acknowledgement of diversification benefits may encourage mergers and reduce market fragmentation. At the same time, risk-based capital requirements may make it less attractive to offer products providing a guaranteed return, which works in favour of products providing a variable return.
- Market-based valuation of assets and liabilities. Under the new regulations, insurers' balance sheets are valued on a market basis as much as possible. This makes insurers more sensitive to market developments, which allows them to manage their business more along economic lines. A complicating factor, however is the extrapolation of the interest rate curve to the UFR (see Box 2).
- Governance and risk management. Solvency II requires strengthened governance, including key functions such as the actuarial function, and risk management. Insurers must assess their risks and expectations under various scenarios in their own risk and solvency assessment (ORSA) on a regular basis.
- External reporting. More extensive reporting increases transparency in the sector and provides a more accurate picture of the financial health and risk management of insurers. It allows analysts, investors and stakeholders to gain a better view of an insurer's financial position.
- Harmonised regulations. The introduction of Solvency II marks an important step towards further harmonisation of regulations in Europe. This may encourage insurers to undertake more cross-border activities. Discrepancies continue to exist, however, as countries have implemented transitional measures to a varying extent. For example, insurers in such countries as Germany and the United Kingdom make use of transition regimes governing the term structure and technical provisions, whereas Dutch insurers do not.

2.3.2 Third parties in the insurance sector's value chain

Various external parties play a significant role in the value chain of insurers. Insurers often use the services of brokers to sell their products, and asset managers to manage their investments. Intermediaries such as insurance brokers, estate agents, authorised agents[5] and banks have historically been important links between a policyholder and an insurer, with three out of four insurance products being sold by intermediaries (see Table 2). As a result, insurers do not maintain frequent direct contacts with policyholders. However, digital portals facilitate more direct contact between insurers and consumers.

Specialised parties offer websites to consumers for comparing and taking out insurance. This typically involves relatively simple products, such as motor vehicle, fire and contents insurance. These comparison websites increase competition and put pressure on prices. At the same time, the share of direct distribution is growing steadily (see Table 2). Specialised firms provide asset management services to smaller insurers, whereas many FiCos manage their own investments. FiCos consider asset management as an increasingly important element of their group's business model. They perform their entire asset management in-house, both managing their own assets and those of customers.

Table 2 Shares of distribution channels in insurers' turnover

	2010	2011	2012	2013	2014
Direct	23%	21%	23%	25%	27%
Through third parties	77%	79%	77%	75%	73%

Source: Dutch Association of Insurers.

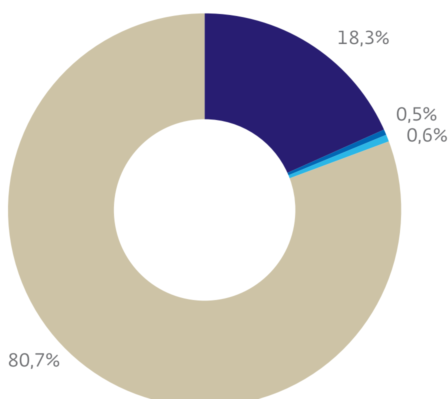
5 Authorised agents are allowed to sell insurance products to policyholders at the insurer's expense.

2.3.3 Internationalisation of the Dutch insurance market

The share of the combined Dutch life and non-life insurance markets held by foreign insurers has grown to 27% in premium volume terms. In the life insurance sector, the share held by foreign insurers went up from 6% to 19% in premium volume terms, partly driven the acquisition of VIVAT by Chinese insurer Anbang (see Chart 7). However, the Dutch life insurance market remains largely domestically oriented and tax-driven. Foreign life insurers largely operate through subsidiaries in the Netherlands. The Dutch non-life insurance sector is more international and universal in nature, with products not depending on national legislation, except loss-of-income insurance. In the Dutch non-life insurance market, foreign insurers account for 35% in terms of total premiums (see Chart 8).

Chart 7 Share of domestic and foreign life insurers in the Netherlands according to premium volumes

figures for 2015

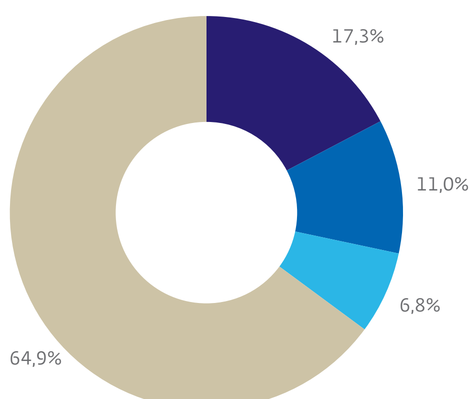


- Subsidiaries
- Branch offices
- Single-licence services
- Dutch insurers

Source: DNB

Chart 8 Share of domestic and foreign non-life insurers in the Netherlands according to premium volumes

figures for 2015



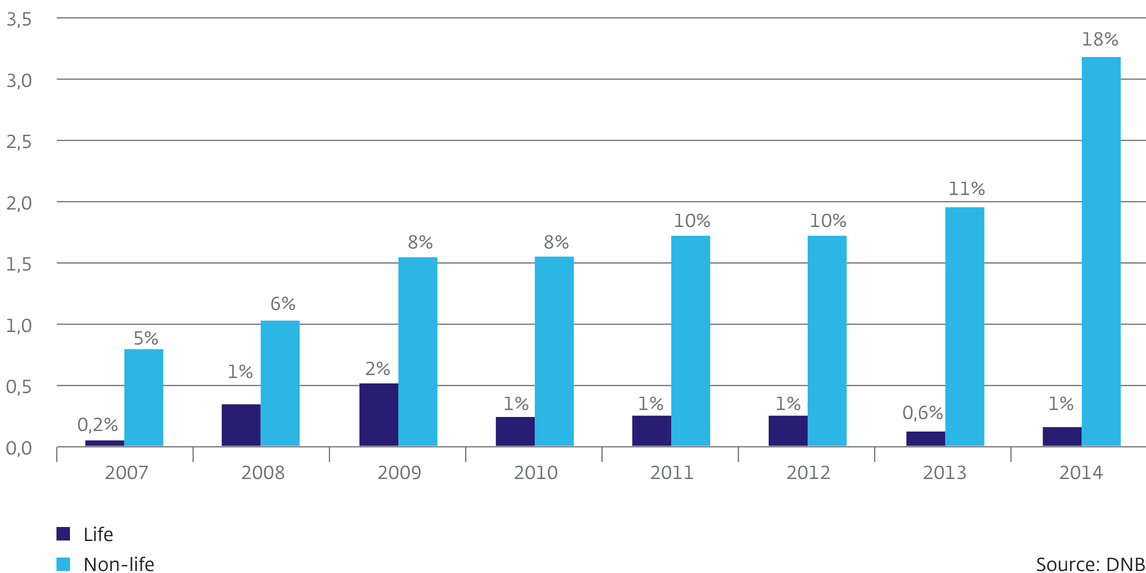
- Subsidiaries
- Branch offices
- Single-licence services
- Dutch insurers

Source: DNB

An increasing number of European insurers organise their Dutch activities into branch offices or under a European single licence. This is particularly true of the non-life insurance market (see Chart 9). European insurers can offer insurance products through branch offices in the Netherlands or operating directly from another EU Member State if they hold a European single licence, which means authorisation granted in one EU Member State is also valid in other Member States.

Chart 9 Premium development of branch offices and single licence services in the Netherlands

Amounts in EUR billion (left); market segment shares in as a percentage (right)

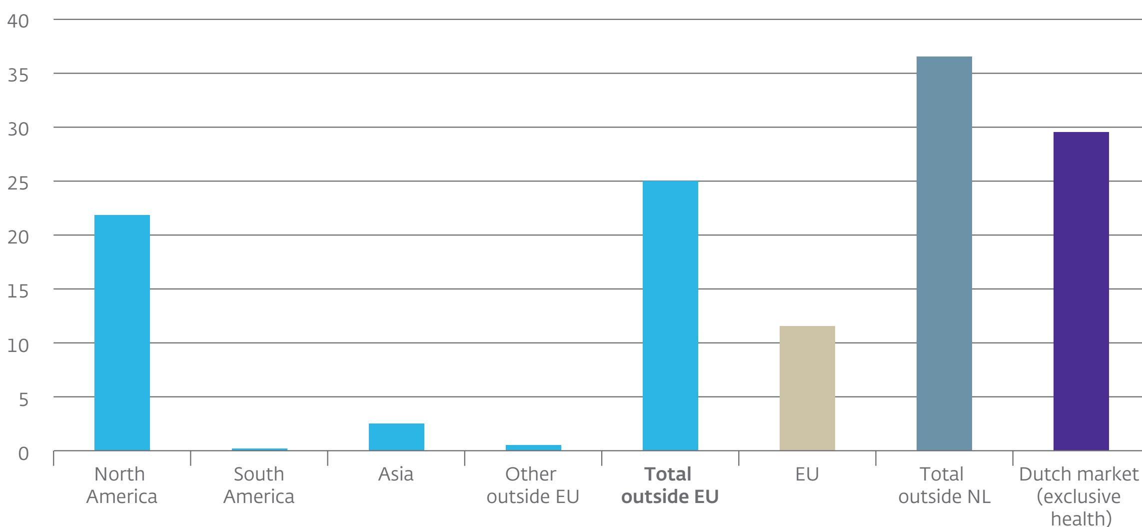


Source: DNB

Conversely, Dutch insurers also operate abroad. Together, they earn a larger volume of premiums abroad than at home. This can be ascribed to a limited number of insurers. The activities that Dutch insurers perform outside the EU are concentrated in a few insurers. In addition, premiums earned abroad are geographically concentrated in North America in particular (see Chart 10).

Chart 10 Premiums earned abroad by Dutch insurers

2015; amounts in EUR billion



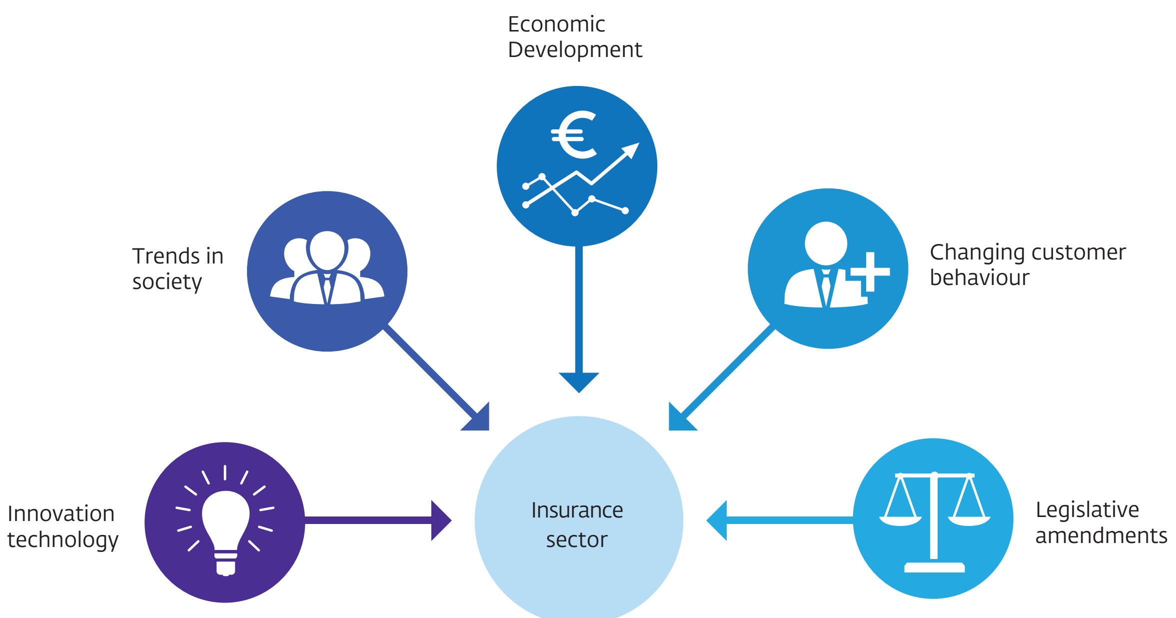
Source: DNB.

3 Developments in the Dutch insurance sector

Five developments will have a major impact on the insurance sector in the years to come: technological develop-ments, trends in society, economic developments, customer behaviour and legislative amendments. All of these bring opportunities, risks and restrictions.

1. 1. Innovative technology

A range of innovative technologies have a major impact on the size and structure of insurance service provision. Examples of such innovations include sensoring, telematics, driver assistance technology and self-driving cars, blockchain technology, open and other digital platforms and the use of big data and machine learning. For example, smart sensoring technology can help prevent or limit damage, reduce fraud and make more accurate risk assessments, thereby achieving more attractive pricing. Further examples are the use of robots to realise extensive process automation, and big data to assess risks more quickly and accurately. Innovations like these



affect the behaviour of policyholders and insurers and have a dual impact on risks – they often reduce insured risks, but sometimes create new ones, such as the risks of cybercrime or more extensive product liability.

2. 2. Trends in society

Demographic, political and legal, and social and cultural trends in society entail new risks, change insured risks, encourage the development of new products and services and influence the way insurers work. Various themes play a part, such as the emergence of the sharing economy[6], the flexibilisation of the labour market and the increase in the number of self-employed individuals, the relatively low consumer confidence in insurers and the broad-based trend in society towards transparency and individualisation.

3. Economic developments

Low interest rates make it difficult for insurers to achieve solid returns on their investments, a problem faced particularly by life insurers, but also by non-life insurers that offer loss-of-income insurance and whose portfolios typically have long maturities during which they have guaranteed a fixed payment. In other segments of the non-life insurance market, the low interest rate environment is harmful, given that insurers in some markets depend on their investment return to achieve positive results.

4. Changing customer behaviour

Consumers are increasingly demanding and have progressively high expectations of services levels. Customers demand more transparency and freedom of choice through personalised and digital platforms. At the same time, insurers gain more insight into customer behaviour and how customers make their choices, which enables them to respond more accurately to changing consumer wishes and needs.

5. Legislative amendments

Changes in laws and regulations have an impact on the playing field in which insurers operate. Take for example the tax treatment of life insurance products, the introduction of Solvency II, the Act on General Pension Funds, the Defined Contribution Scheme (Improvements) Act and potential changes to tax relief for pension accumulation (see also Box 5).

6 The sharing economy refers to various initiatives in which consumers directly exchange products or services.

Box 5 Structure of the Dutch pension system

The Dutch pension system has four pillars:

Pillar 1	Pillar 2	Pillar 3	Pillar 4
AOW (state pension benefits)	Corporate pension schemes	Voluntary private funded pensions	Other

The first pillar constitutes the non-income-related state pension benefit, or AOW, which is the Dutch acronym for the General Old Age Pensions Act. Every person living or working in the Netherlands automatically accumulates AOW entitlements. An AOW benefit provides basic income from the state pension age onwards. Its amount is linked to the statutory minimum wage.

The second pillar is the system under which employees accumulate tax-relieved savings as part of a corporate pension scheme (also referred to as group life insurance products). An employer may set up its own scheme or is covered by a compulsory industry pension scheme. The room for tax-facilitated pension accumulation is set by the government. Around 90% of the working population accumulate supplementary pensions under the second pillar, resulting in almost EUR 1,400 billion in pension savings as at mid-2016. The large majority of pension scheme members are subject to a defined benefit scheme, under which they accumulate a guaranteed nominal benefit based on career-average pay. The second pillar is dominated by pension funds.

The third pillar offers additional possibilities for voluntary pension accumulation. Most supplementary pension products target persons who accumulate insufficient pension under the second pillar or are not in employment, including the growing number of self-employed persons. In addition, consumers who wish to save up additional pension income without benefiting from tax relief may choose to purchase a product under the third pillar. This pillar is dominated by insurers, but banks and premium pension institutions (PPIs) are also active. Pension funds are not allowed to operate under the third pillar, as their field of operations is strictly limited.

The fourth pillar comprises all other types of wealth accumulation that can be used to secure pension income. It includes all other discretionary savings deposits, capital accumulated in the form of an owner-occupied home, and discretionary investments in securities.

4 Impact of developments

4.1 Size of the Dutch insurance sector

Below we analyse the impact the various developments have on the size of the life insurance sector, in section 4.1.1, and the non-life insurance sector, in section 4.1.2.

4.1.1 Size of the Dutch life insurance sector

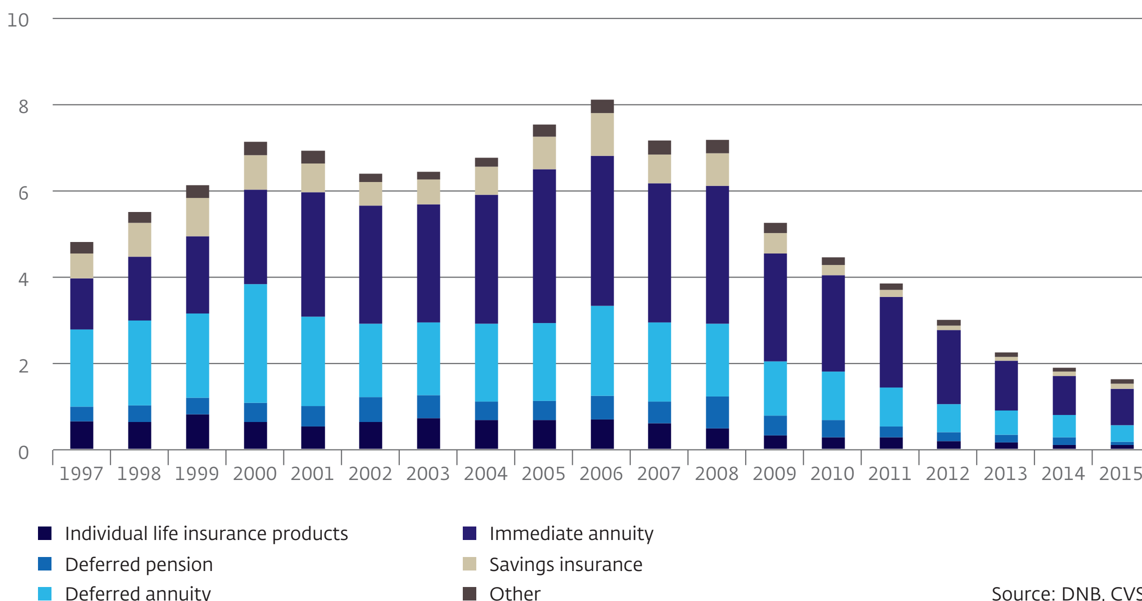
The life insurance market comprises the individual life insurance market segment, which targets individual consumers, and the group life insurance market segment, which offers pension products related to employment.

Individual life insurance products

The insurers' portfolio of individual life insurance policies is expected to contract further over the years ahead. Premium volumes have dropped significantly in recent years due to the low interest rates, the tax-related changes, increased competition from bank savings products and a loss of confidence throughout society due to legal disputes following the unit-linked insurance mis-selling scandal (see Chart 11). This contraction is set to continue in the years ahead as half of all policies will expire over the next ten years (see Chart 12), while few new policies are being sold. Outside the

Chart 11 New production of life insurance broken down by product group

Annual figures; amounts in EUR billion

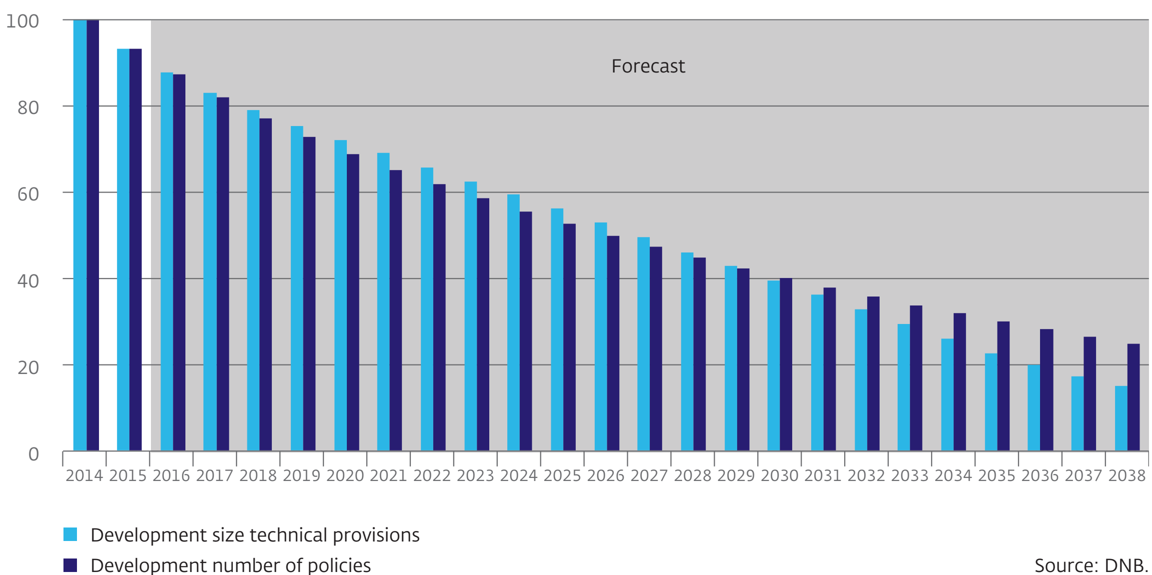


Source: DNB, CVS.

Netherlands, demand for unit-linked insurance is up[7], but the Dutch market is unlikely to recover any time soon, due to the loss of confidence in this type of product. FiCos seeking to find compensation in selling more bank saving products will see their efforts succeed only marginally (see Chart 13). In the longer run, demand for individual pension accumulation products may, however, pick up as the relevant tax framework will change, which will offer insurers opportunities to offer products under the third and fourth pillars.

With the savings-based mortgage having been phased out, insurers will play a smaller role in wealth accumulation for home buying purposes. Households accumulate a significant part of their wealth in the form of their homes. Insurers have traditionally played an important part by offering savings-based mortgages and, through their banking subsidiaries, bank saving products. With the savings-based mortgage no longer being eligible for tax relief, life insurers no longer sell such wealth accumulation products (see Chart 11; savings-based mortgages come under savings insurance).

Chart 12 Development of individual life insurance policies, closed book



Source: DNB.

7 See, for example ESRB (2016), Macroprudential Policy Issues Arising from Low Interest Rates and Structural Change in the EU Financial System.

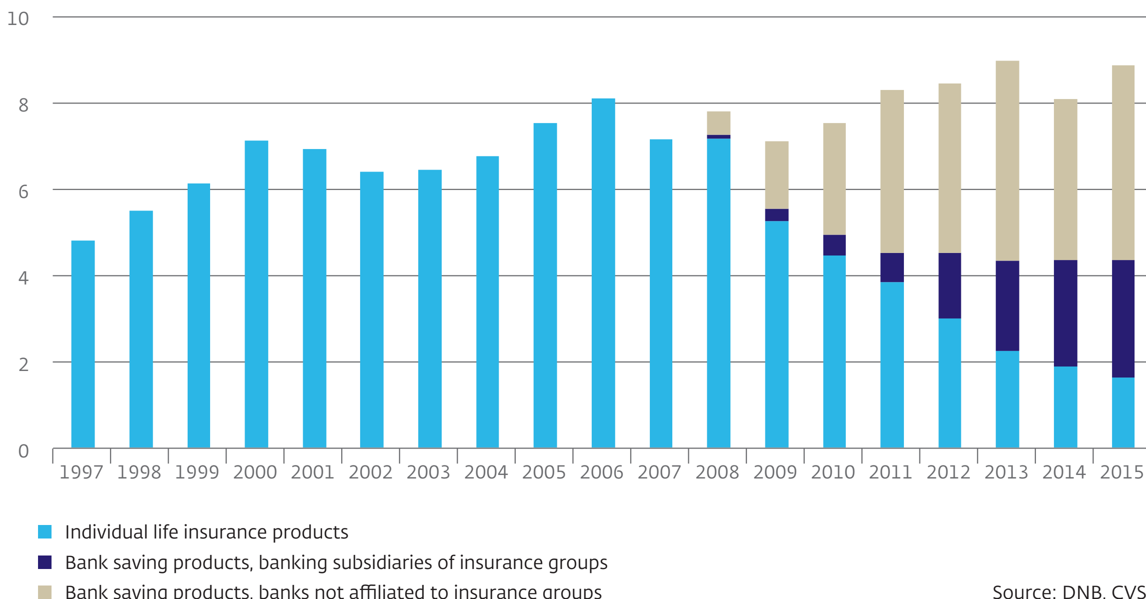
Any growth will only be from contractual payments under existing products and policyholders who change service providers. In the event of home purchase transactions, life insurers only have endowment insurance left to sell.

Group life insurance products

The role insurers play in the market for group life insurance is shifting, with new opportunities arising for administering defined contribution schemes. Insurers operate in the market for group life insurance products in different ways, both through offering directly insured schemes and through providing services to pension funds and PPIs (see also Box 6). Group pension accumulation under insured benefit schemes, with insurers bearing the pension risks, is decreasing – the number of active members fell by 12% over five years (see Chart 14). At the same time, pension accumulation under defined contribution schemes, with risks being

Chart 13 New production of individual life insurance policies and bank savings products

Jaarcijfers; bedragen in miljard EUR



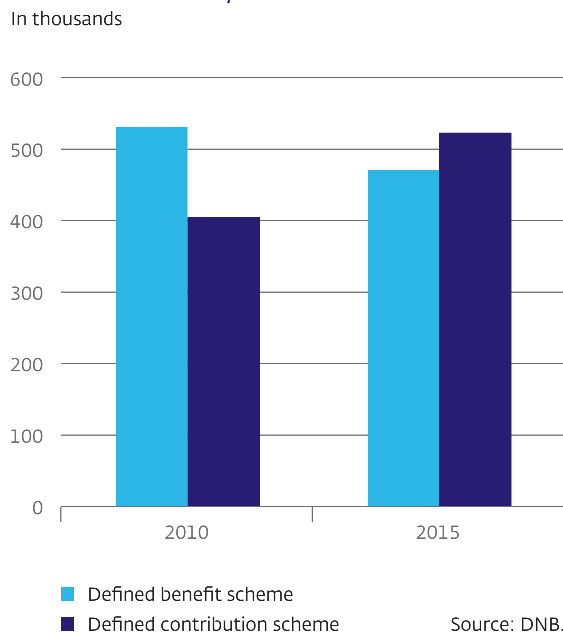
Source: DNB, CVS.

borne by the members, is on the up – more than half of all active members fall under such a defined contribution scheme. Reasons include the persistently low interest rates, which push up the cost of insured benefit schemes, the desire among employees to remove the pension liability from their balance sheets and the capital that must be maintained under Solvency II to cover the guarantees and options under defined benefit schemes. The new Defined Contribution Scheme (Improvements) Act may further encourage the shift towards defined contribution schemes. We expect the number of defined benefit schemes to drop further, also driven by the introduction of general pension funds (APFs).

The impact of long-term developments on the group life insurance market is uncertain. The trend towards group defined contribution schemes may work out favourably for insurers, given their traditional strong position in this market. The preference among consumers for having a say in their group pension scheme offers insurers opportunities, given they have experience in the area of individual pension products and may use their expertise to meet the need for more tailoring in the group pension market.

Chart 14 Number of active members of group pension schemes administered by insurers

In thousands



Source: DNB.

Box 6 Activities of insurers in the Dutch market for group pension schemes

Besides pension funds, insurers play a major role in the market for group pension schemes. The table below lists the various products and services provided by insurers and other FiCo entities based on figures at year-end 2015. The size of the provisions reflects the past inflow of contributions, whereas the number of active members indicates the current inflow. Since 2014, active members under defined contribution schemes administered by insurers has outstripped those under defined benefit schemes. In addition, other FiCo entities (i.e. non-insurance entities) perform various other roles, such as pension fund support (fund administration and asset management activities).

Tabel Box 6

Provider	Product or service	Size of provisions	Number of active members
Insurer	Directly providing defined benefit schemes	EUR 49.9 billion	470.000
	Providing reinsurance defined benefit schemes for pension funds	EUR 10.9 billion	n/a
	Directly providing defined contribution schemes	EUR 35.7 billion	523.000
Other FiCo entities	Providing defined contribution schemes through PPI subsidiary	EUR 1.6 billion	127.000
	Scheme administration through pension administration organisation	EUR 94.1 billion	716.000
	Providing asset management services through investment fund*	EUR 61.1 billion	429.000

Source: DNB

* These are pension funds 30% or more of whose assets are managed by pension administration organisations that form part of insurers. These pension funds largely overlap with pension funds to which insurers provide asset management services.

Assessment

The expected decrease in premium volumes in the individual life insurance market poses a major challenge for life insurers. The profitability of insurers is under severe pressure as existing portfolios are largely set to expire in the near future and few new life insurance products are being sold. Prospects are far from rosy, also given the negative impact of low interest rates. Insurers must therefore scale down their capacity in the very near term, cut their costs and adjust their business models. This may result in mergers, acquisitions and portfolio transfers. They must also verify that their assumed cost provision is adequate or, as part of their strategic considerations, make allowance for the possibility to transfer a closed-book portfolio to an external party or execute a portfolio run-off. Importantly, this realignment process should take place in an orderly fashion so as not to hamper the careful service provision to consumers.

The shift towards defined contribution schemes in the market for group pensions requires strategic choices to be made. This shift, away from defined benefit schemes, will also bring changes to insurers' business models and their competitive landscape. A business model for defined contribution schemes has closer parallels to fee-based activities. In addition, insurers will face non-insurance players, such as asset managers that administer defined contribution schemes through PPIs. Insurers should brace themselves for this increasing competition and its impact on their business models.

Likewise, the shift towards pension scheme administration services requires that strategic choices be made. If employers should decide to have insured pension schemes increasingly administered by APFs, insurers will gradually see their portfolios shrink. A shift towards administration services also offers opportunities to insurance groups and FiCos. They should, however, remember that services provided to an APF may be discontinued at shorter notice than under defined benefit schemes. We monitor whether potential future discontinuity of administration services in an insurance group or FiCo has a material impact on the financial position of the insurer(s) involved in the group. Naturally, it is up to the insurance groups and FiCos to analyse this risk thoroughly, for example by conducting a stress test for discontinuation of administration services and a sensitivity analysis of the degree to which they can bring down fixed costs, given that these also affect their financial position.

Adequate intervention instruments are needed to guard stability. It is imperative that DNB is able to see when a business model is no longer tenable and has adequate options for intervention. This is in the best interest of financial stability and service provision to policyholders, and it will serve to mitigate social disruption should an insurer get into difficulty. It requires strengthened instruments for recovery and resolution of insurers. We advocate making these arrangements at the European level to ensure a level playing field, in part because of the international nature of certain insurance groups.

It is equally important that life insurers consider in their capital and dividend policy the impact that economic market parameters have on the development of their financial position. This is a key aspect of a recovery and resolution scenario, as an acquisition price is based on the valuation of market parties, rather than on regulatory parameters. This applies even more in the current situation of low interest rates, with the gap between the 4.2% UFR and the low market rates having gradually widened over recent years (see also Box 2). This means the impact which the current low interest environment has on insurers is visible only in part, and their solvency position paints too rosy a picture of their true financial situation. This is why, in an international context, we are pressing for a UFR method that better reflects economic reality.

4.1.2 Size of the Dutch non-life insurance sector

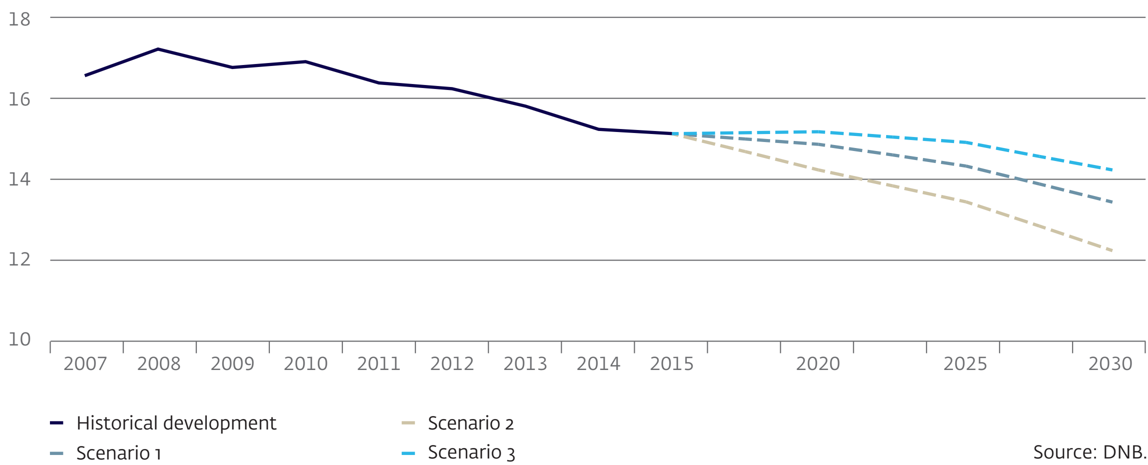
We expect premium volumes in the Dutch non-life insurance sector to decrease further in the next few years. Innovative technologies will offer opportunities for cost reductions and lower claims losses, which are expecting to push down premium volumes in significant market segments. The pace of contraction is still uncertain, which is why we have explored three scenarios (see Chart 15). They vary in terms of the pace of technological developments in the market segments for fire insurance and motor vehicle insurance, while the third scenario also incorporates the introduction of new products. The non-life insurance market is projected to contract in each of the three scenarios.

Scenario 1 (basic scenario) – Current trends continue

The gradual decrease in premium volumes will continue over the years ahead. Increasing competition – fuelled in part by the rise of comparison websites – and the use of new technologies will cause costs to drop and claims losses to fall. As consumers and insurers apply more innovations, insurance premiums will decline further. For example, insurers may offer discounts to consumers who use telematics (black boxes and USB devices) and sensors, which can help prevent damage, reduce fraud and make more accurate risk assessments, thereby achieving more attractive pricing. This type of technological development affects distribution channels, administrative processes and the size of the risks. The same effects can be seen in other market segments, for example if safety applications are used inside and around the home, in the transport sector and in manufacturing processes.

Chart 15 Development of the size of the non-life insurance market – three scenarios

Amounts in EUR billion



Source: DNB.

Assumptions for premium development in the fire insurance market segment

1 Declining premium volumes due to premium discounts granted to policyholders that use new prevention techniques and the 'internet of things".
2 Gradual increase in the number of households that use new prevention techniques.

Assumptions for premium development in the motor vehicle insurance market segment

1 Population growth for the years ahead is based on projections from Statistics Netherlands.
2 The number of cars relative to the population size will increase until 2020, stabilise until 2025 and decrease subsequently under the influence of the sharing economy.
3 Lower premiums for new car insurance policies due to pricing based on driving behaviour. First-round effect: discount for good driving; second-round effect: adjusted average driving behaviour.
4 Emergence of self-driving cars from 2025 onwards, resulting in gradual reductions in premium volumes as the car fleet is renewed.

* Figures do not include those for foreign insurers operating in the Netherlands or under a European single licence or through branch offices.

Scenario 2 – Innovative technologies cause premiums to decrease more rapidly than expected

In this scenario, innovations go further and are introduced more rapidly, enabling insurers to bring down costs and limit claims losses faster than in the basic scenario. Cars, devices and production lines will increasingly be fitted with sensors to prevent damage. In addition, the insurers' administrative processes will be automated to an increasing extent as blockchain technology, artificial intelligence and big data are used to assess risks more quickly and accurately (see Box 7). Individual insurers that are quick to leverage innovation will be in the vanguard. Once they manage to cut costs and reduce premiums, others must follow suit to maintain market share and will also start innovating and bringing down their costs. Market forces will push down premiums across the board to a certain level. Competitive pressure will increase throughout the sector, with comparison websites exerting downward price pressure. These factors will accelerate the decrease in premiums.

Scenario 3 – New product introductions partly compensate for the expected decrease in premium volumes, and price competition will ease

New developments bring new risks, including cybercrime and product liability, which offers insurers the opportunity to launch new products. At the same time, society is going through an increase in perceived unsafety and juridification. As a result, associated insurance types represent an increased share of wallet, examples including legal assistance insurance and third-party liability insurance. In addition, climate change may prompt the need for more extensive cover (see Box 8). Furthermore, insurers may enter into partnerships with large corporations to expand their consumer services. For example, a car producer may offer a comprehensive mobility package, including related insurance and product liability for self-driving cars.

Beside technological developments, political change also plays a role in the non-life insurance market, notably in the income insurance market segment. Insurers face an uncertain future in this market segment due to a number of recent changes. The income insurance market is currently in a state of flux, due in part to the new labour market flexibility legislation and the swelling numbers of self-employed. At the same time, the legislative framework is undergoing changes[8] and the Employee Insurance Administration Agency (UWV) is offering similar insurance cover. On the other hand, the trend in which the government leaves more to market forces in the area of unemployment and occupational disability benefits offers insurers fresh opportunities in the income insurance market.

8 Sickness Absence and Occupational Disability among Sickness Benefit Claimants (Restrictions) Act (Wet beperking ziekteverzuim en arbeidsongeschiktheid vangnetters).

Box 7 Big data

In recent years, the possibilities for analysing and connecting large amounts of data have increased sharply on the back of digitisation and sensoring. As a result, increasing volumes of customer and corporate data have become accessible for trend analyses and individual behaviour assessments. The phenomenon is referred to as 'big data". Its application by insurers is expected to take off in the next few years, notably in the non-life insurance market.

Many insurers are already considering how they can best use it. Smart data analysis will enable them to assess risks and quantify premiums more accurately, handle claims faster, counter insurance fraud and ensure that services better meet customer demands. For example, some insurers monitor and analyse driving behaviour using a black box fitted in cars, gather information about fire safety in homes by offering customers smart smoke detectors or allow private customers a discount if they are given access to social media profiles. Using and analysing these data allows better assessment and pricing of risks, which could result in both lower premium volumes and less volatile technical results. This means the successful application of big data may be a key differentiator in the insurance sector.

Using big data also gives rise to privacy and ethical dilemmas, however. For example, behavioural analysis based on driving behaviour, lifestyle or networks of friends and business associates may prompt sharp premium differentiation or insurance conditions aiming to influence behaviour, which may conflict with the views society holds about mutual solidarity and privacy. In extreme cases, far-reaching market segmentation may block specific groups from insurance cover at an acceptable price. It is imperative that insurers, supervisors and policymakers have a keen eye for these social aspects of the use of big data.

Assessment

Contraction in the non-life insurance market poses a challenge for insurers. Unless costs are brought down, profitability will suffer. Insurers capable of leveraging technological developments will be able to cut costs, assess risks more accurately and, hence, push down claims losses. This will increase their profitability and reinforce their competitive edge. Insurers that are well-positioned in a specific niche market will feel less pressure from technological developments.

Innovative technology may contribute to increased efficiency and a broader range of products which society requires. Insurers will have to embrace innovation to retain market share. Innovations can enable insurers to reduce costs, cut premiums and develop products that better meet consumer demands. The flip side of innovation, however, is that it may lead to higher premiums for specific individuals or objects as risks can be better quantified, potentially resulting in debates in society about the risks that can and cannot be insured.

It is important that costs are scalable and are made and kept variable and that capacity is in line with the pace at which premium volumes decline. Many insurers have recently taken initiatives to bring down costs further. However, if an insurer's premium volume permanently decreases faster than costs, its business model is no longer tenable, and consolidation may be desirable so that economies of scale can be achieved.

Innovation and cost reduction will see winners and losers. Insurers which strengthen their adaptability and innovate successfully will be able to offer their products with a competitive edge, expand their market share and increase their profitability. Those that do not will need to look for alternatives, i.e. consider an acquisition or scale back operations. In such cases, the supervisor must intervene in good time so as to safeguard policyholders' interests.

Box 8 Impact of climate change

Climate change has an impact both on insurable risks and on insurers' investments. For example, non-life insurers may be confronted with increased claims payments, unexpected or otherwise, due to climate-related damage if extreme weather conditions occur more frequently. The Dutch Association of Insurers (2015) expects damage caused by severe and extreme hailstorms to double in the long term unless measures are taken. In the most adverse climate scenario, hailstorm damage may increase by no less than 139%. Changes in extreme weather conditions will most likely require insurers to introduce new products. At the same time, certain types of risks may well turn out to be impossible to insure. In late 2015, the Bank of England warned that the risks associated with climate change faced by the UK insurance sector should not be underestimated. To gain a better understanding of these risks, we will conduct an exploratory study into the impact of climate change on the insurance sector and the potential consequences for supervision in 2017.

Climate change not only impacts insurable risks but also insurers' investments. Transition risks may emerge if current climate policies are tightened and the emergence of alternative energy sources causes traditional energy providers to be downgraded in financial markets, thereby indirectly affecting financial institutions' capital positions. We studied the impact which transition risks have on the financial sector in early 2016. We found that the exposure of insurers to the bursting of the 'carbon bubble' – the downward revaluation of financial assets due to stricter climate policies – is still limited at the moment.

4.2 Competition in the Dutch insurance sector

Three themes impact competition in the insurance sector. They are new market entrants, internationalisation and shifts in the value chain of insurers.

4.2.1 Competition from new market entrants

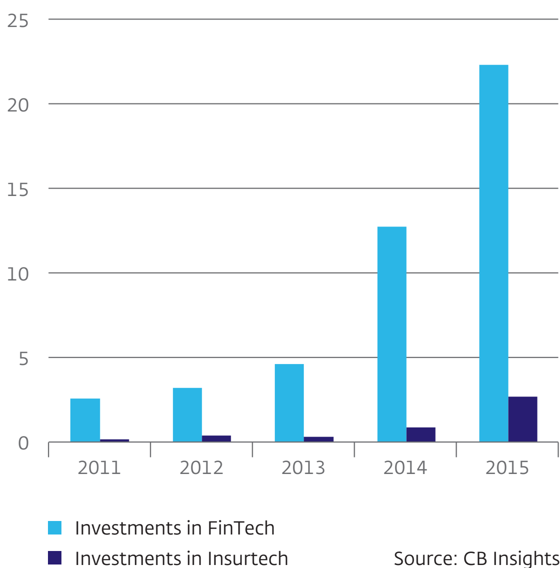
Technological developments and trends in society offer new entrants opportunities. This will boost competition in the insurance market, fuelled in part by comparison websites and direct online distribution. Furthermore, trends in society and changing customer behaviour encourage new developments, such as small-scale social networks that share risks. New entrants try to secure a position in the value chain using new innovative technologies. This gives them a potential headstart over incumbent insurers, which are typically less agile in terms of innovation. As a result, customers are more readily prepared to accept newcomers.

Innovative technology spurs competition, notably in the non-life insurance market. New sensoring and data collection technologies provide non-life insurers with vast information sources, enabling them to assess risks more accurately and prevent damage more effectively. Other parties can also develop insurance products using these data, such as car manufacturers aiming to offer insurance cover or seeking a partnership alliance with a large international insurer. This could bring disruptive change to the car insurance market and create strong competition for Dutch motor vehicle insurers. A crucial aspect in these technological developments is the ownership of the data collected and the right to use them in developing and managing insurance products, with privacy issues and ethical debates also playing a major role (see also Box 7).

FinTech start-ups are increasingly targeting the insurance market. While investments in insurance-related FinTech, also known as InsurTech, are relatively limited (see Chart 16), the number of InsurTech start-ups has steadily increased in recent years, notably in the United States, Germany and the United Kingdom. Most of them aim to secure a position in specific links in the value chain of the non-life insurance market, for example facilitating distribution or claims handling. Further emerging new concepts are on-demand insurance and fully automated insurance acceptance and portfolio management. These and other trends make open and other digital platforms more important, as they allow data from a variety of sources to be linked and compared. Although few FinTech start-ups operate in the Dutch insurance market, the application of this technology is also gaining traction in the Netherlands. A number of major insurers have commenced operations in this area. The Dutch Association of Insurers also seeks to encourage innovation in an Innovation Lab. We also expect successful non-Dutch entrants or innovations to appear in the Netherlands. The emergence of FinTech may cause incumbents to lose market share more quickly.

Chart 16 Investments in FinTech and InsurTech

Amounts in EUR billion



Source: CB Insights

The rise of the sharing economy will see the market for insurance services welcome new initiatives and potentially new players. Sharing a house, a car or a service has a variety of different impacts on the insurance sector. It raises new questions about insuring shared goods, such as 'who will be liable in the event of damage?' and 'which insurance policy covers this?' This means the sharing economy demands product and service innovation from insurers. In addition, it offers new market players the opportunity to offer insurance cover for damage.

The peer-to-peer-principle is increasingly applied directly to insurance, too. An increasing number of peer-to-peer insurance initiatives are being taken, in which participants in a small network set up a non-life insurance pool. This should reduce the likelihood of fraud. Also, they often feature a return policy – if no or few claims have been received, part of the premiums paid by participants are returned. Hence, the traditional concept of the mutual society is now making its comeback in a modern new way. The Netherlands has so far seen a few examples only[9], while the principle has been mainstreamed further in for example Germany and the United States. Given the society's interest in the sharing economy, there is room for new providers of such mutual insurance products.

9 Examples of such initiatives are broodfondsen, small-scale funds to which self-employed entrepreneurs who know each other contribute regular amounts in case one of them should become incapacitated for work or out of work for a prolonged period.

Assessment

Innovation by incumbents and new market players can make a major contribution to an efficient insurance sector that serves society. Innovations and new initiatives typically meet specific customer needs, which means they can provide fresh impetus to the sector serving society and increase diversity. New market players often enjoy higher consumer confidence and can typically work more efficiently than incumbents that are stuck with legacy systems. The emergence of new entrants in the market may squeeze margins and reduce market shares of existing insurers, thereby depressing their profitability, which also underlines how important it is for long-established parties to also innovate.

At the same time, the risks inherent in new market players and innovation must be adequately managed. Imprudent market admission or abuse of innovation, such as misuse of big data, could harm confidence. Furthermore, more far-reaching automation of processes, risk assessment and claims handling entails operational risks. Both incumbents and new market players will need to make sure they sufficiently manage such legal, operational and reputation risks.

4.2.2 Internationalisation

The European insurance market's internationalisation results in increasing competition, notably in the Dutch non-life insurance market. Foreign insurers have stepped up their activities in the Dutch market in recent years. They now hold around 35% of the Dutch non-life insurance market and 19% of the life insurance market, measured by premium volumes (see also Charts 7 and 8). Major international players benefit from economies of scale and can leverage their cross-border networks to offer a broader range of international services in the corporate market. Examples include collaborative ventures between insurers and manufacturers to provide international transport insurance or third-party liability insurance. We expect this trend to continue, which will also provide Dutch insurers with fresh opportunities, while they only recently scaled back their international portfolios, as they will now be able to put their expertise in group pensions or digital distribution to good use abroad.

At the same time, new types of insurance will increasingly be offered on an international scale. This may be conducive to the further internationalisation of the insurance market, and foreign parties may also introduce successful innovations in the Netherlands.

Harmonisation of the statutory framework and supervision will likewise encourage internationalisation of operations. The introduction of the European Solvency II Directive has further

harmonised prudential supervision of insurers in Europe. This contributes to the harmonisation of the European single market for financial services. On a global scale, too, harmonisation of various supervision frameworks is under way so as to offer policyholders across the globe comparable protection and limit any adverse impact on financial stability. For instance, the International Association of Insurance Supervisors (IAIS) is working to develop a global capital standard for insurers and additional requirements for systemically important insurers. These developments are beneficial to internationalisation of operations. At the same time, substantial differences in tax and contract law remain. As a result, product ranges in the life insurance market are still highly divergent, often tailored to specific countries or areas.

Assessment

Dependence on the national market puts pressure on sustainable and stable insurance service provision. Most Dutch insurers do not undertake any significant activities internationally, which makes them more vulnerable to changes in the national market and the arrival of foreign parties. In local non-life insurance markets, insurers may also be extra sensitive to local extreme weather conditions. Spreading geographical risks and making adequate reinsurance arrangements may mitigate this dependence.

In addition, many market segments in the Netherlands are mature and saturated. For some insurers, expanding internationally will be a valid option, either autonomously or by teaming up with foreign partners. This will enable them to broaden their market, spread risks and leverage economies of scale to maintain their competitiveness and profitability. However, they must carefully weigh up the benefits of risk spreading and diversification against the additional risks and costs involved in international operations. Going international is a valid option in particular for insurers that already have a substantial presence abroad or possess specific expertise which they can monetise abroad. Setting up an international organisation is, however, not an easy task and requires prudence and well-considered strategy choices.

Competition from foreign insurers boosts efficiency, particularly in the corporate non-life insurance market. In the longer run, the entrance onto the Dutch market of foreign market players which invest relatively heavily in innovative technology, including start-ups, may be conducive to sustainable insurance services that serve society.

The effect which internationalisation has on profitability varies from insurer to insurer.

Non-life insurers operating in the corporate market are contending with price pressures, losing ground to more efficient foreign competitors. Insurers which lack size, an international network or a clear niche market will have difficulty maintaining their profitability in the corporate non-life insurance market. Moreover, specific insurance groups and FiCos can actually drive their profitability by setting up shop abroad. They may for example wish to put specific Dutch expertise in group pensions or digital distribution to good use elsewhere.

4.2.3 Shifts in the value chain

The value chain in insurance is shifting across the board, as fee-based and support services are gaining prominence. With earnings prospects for traditional life and non-life insurance being far from rosy, insurers increasingly look to provide other types of services. Their focus is shifting from accepting underwriting risk to the fee business, providing fee-based services to consumers and professional parties. This means consultancy and prevention are becoming more important working areas. These activities are not entirely new, but used to be integrated links in the traditional value chains of insurers. They are now given a more prominent role. This is happening particularly with broadly diversified insurance groups, but not so much with smaller niche insurers.

The shift towards integrated service provision and fee-based services is fuelled by the commission ban, the rise of the direct distribution channel and changing customer behaviour. Various insurers are considering broadening their integrated personal service offerings to better meet the demands of consumers and companies. A shift can be seen from traditional insurance products geared to specific risk categories towards wider service provision. Examples include safe housing and mobility packages, as part of which insurers provide monitoring services, advice and prevention measures. Likewise, they increasingly offer integrated financial planning to consumers and small entrepreneurs, rather than separate elements like endowment or term insurance.

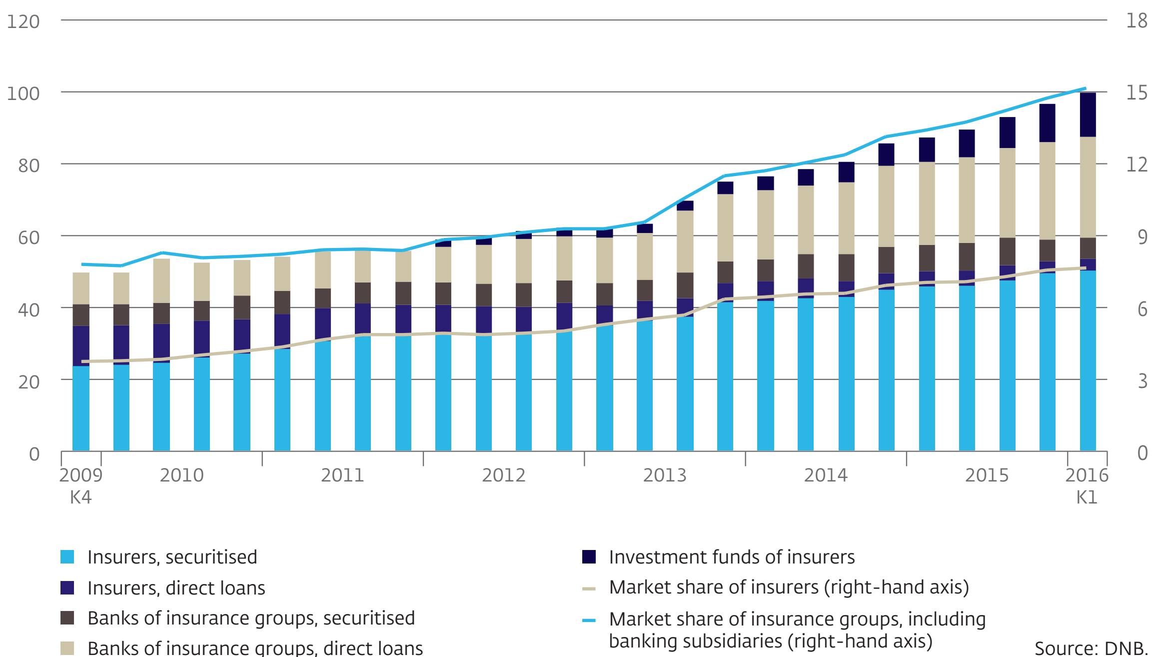
This means insurance groups and FiCos increasingly encroach on the territory of financial brokers, banks and pension funds. The shifts in services changes the competitive landscape in various markets, with boundaries between activities becoming blurred. Insurers are now in direct competition with banks, pension funds and other financial service providers in a number of areas, such as individual wealth accumulation, group life insurance and lending. With respect to individual wealth accumulation, life insurers are in competition with bank savings products. In the group pension market, insurers increasingly compete with pension funds and pension administration organisations, driven in part by the rise of PPIs and APFs.
In lending, insurance groups and FiCos also compete with banks and pension funds, having regained market share particularly in the mortgage market in recent years (see Chart 17). Insurance groups and FiCos not only provide mortgage loans to put them on their own balance sheets, but also play a role as brokers for other investors. For instance, pension funds typically do not grant mortgage loans but invest in loans granted by third parties, including through the investment institutions of insurance groups and FiCos. Furthermore, in the current low interest rate environment, insurers are scaling back their investments in sovereign and corporate bonds, preferring mortgage loans instead. This trend is set to continue, given the expected growth in the Dutch mortgage market. On top of this, the proposal for a minimum floor for risk weights of mortgage loans as proposed recently by the Basel Committee may impact the capital charge for banks and, hence,

the market share of insurance groups and FiCos with respect to mortgage loans.

Insurers are competing on two fronts in the group life insurance market, competing with pension funds and PPIs offering pension schemes and with asset managers and pension administration organisations providing asset management or administration services. The rise of new types of pension providers, such as general pension funds (APFs), the role in insurers in service provision is likely to gain prominence. A number of insurance groups and FiCos are involved in setting up APFs, for which they perform fee-based services, such as administration and asset management. The introduction of the APF has caused a shift in activities, from those of life insurers to administration services provided by other parts of the group. Expectations are that pension schemes administered by these new pension providers will show sharp growth.

Chart 17 Dutch mortgage loans in insurers' balance sheets

Left: amounts in EUR billion; right: percentages



Source: DNB.

Assessment

Tailored service provision may contribute to the restoration of trust, but only if insurers offer transparency. Consumers increasingly expect service providers to make their lives easier in a professional and comprehensive manner. Insurers can meet this need by putting the customer's interest first. To do so, they should be transparent about the certainties offered and communicate clearly about risks and costs, enabling policyholders to make well-informed choices. Transparency is even more important for an APF, given that carrying an insurance label may give consumers the impression that their pension scheme is an insurance product. That impression is incorrect, because the insurer does not guarantee the amount of a pension benefit.

Wider service provision may also contribute to a more efficient insurance sector that serves society. New opportunities in financial services provision to consumers and self-employed individuals present themselves as life expectancy rises, tax relief rules concerning pensions are changing and the labour market is shifting. Increasing competition in these markets is encouraging efficiency improvements.

The shift towards support and fee-based services changes the business model of insurers, notably of life insurers. Traditional insurance activities generate profits mainly from technical results (from claims, costs and interest), and returns on investments. A business model based on administrative and support services leaves the result on costs as the only source of profits. This reduces the earnings potential, but also makes it less volatile. Technical results have been highly volatile, notably in recent years, due to such factors as increasing life expectancy and sharply declining interest rates. As investment results are no longer at the risk and expense of insurers, they will see a source of profits disappear, but risks and concomitant capital requirements will also be lower. While insurance groups and FiCos will be able to increase their earnings generating capacity by broadening their service offerings, competition with other financial services providers will keep margins relatively narrow.

The changing competitive landscape accordingly requires from insurance groups and FiCos that they have sufficient competitive power and distinctive capacity. As their activities shift towards support services and enter neighbouring markets, broad-based insurance groups and FiCos increasingly encroach on competitive markets. There, they are challenged by such traditional players as intermediaries, investment institutions, banks, pension funds and pension administration organisations. This underlines the need for cost efficiency – if only to make costs variable – sufficient scale and clear distinctive capacity on

the part of insurers. Where other parties are more efficient or better at offering services, it could be worthwhile to consider entering into strategic partnerships. For example, the value chain could be broken up, with insurers maintaining responsibility for the entire chain but outsourcing specific links in the chain. Insurers will need to identify customer needs at an early stage and maintain contacts with customers or face the risk of losing their added value and other market players seizing opportunities they have neglected.

5 Conclusions and policy recommendations

5.1 Conclusions and policy recommendations for the sector overall

The Dutch insurance landscape is bound to undergo permanent changes. Based on the developments outlined in this report, we expect premium volumes in important market segments to slide further, while business processes will undergo drastic changes and competition will increase. This will put additional pressure on profitability, particularly of insurers which fail to respond adequately to the changing environment. This adds to the pressure already caused by low interest rates, legacy systems and fall-out from the unit-linked insurance mis-selling scandal.

In principle, it is up to the insurers to respond effectively to changes in their environment. We have noted that the Dutch insurance sector is working to develop future-proof business models, but disruptive economic and technological change demands that insurers further bolster their capabilities to respond to rapid changes and face competition internationally and at home head-on. They have important strategy choices to make – should they innovate, specialise, cut costs, go international, integrate vertically, or integrate horizontally? The most suitable solution will differ from insurer to insurer.

A changing sector also requires supervisors and policymakers to devote heightened attention to safeguarding stability. The supervisor's primary task is to protect the interests of policyholders and monitor financial stability. Once an insurer's business model is in danger of becoming untenable, closer supervision must be exercised. To do so, supervisors need adequate intervention tools, including a strengthened set of instruments for the recovery and resolution of insurers. It is desirable for this to be arranged in a European context so as to ensure a level playing field.

In addition, it is the task of policymakers and supervisors to remove barriers to innovation and internationalisation as far as possible. In themselves, market contraction and fiercer competition are not undesirable, at least viewed from the perspective of an efficient insurance sector that serves society. Policymakers and supervisors face the challenge of removing barriers to innovation and internationalisation while safeguarding a permanently stable sector.

5.2 Recommendations for each theme

Due to the expected continued contraction of the life insurance market, life insurers urgently need to scale back their capacity and safeguard policyholders' interests, also in the longer term (see paragraph 4.1.1). Life insurers will need to bring their business operations into line with shrinking portfolios. Importantly, they must integrate realistic cost assumptions into their provisions and subject them to sensitivity analyses and stress tests. If an insurer should find that its size is or will soon be insufficient, it may explore avenues for consolidation, consider to run off its portfolios or transfer closed portfolios to specialised

market operators. To safeguard the interests of policyholders in the longer term, too, it is important that insurers consider in their capital and dividend policy the impact that economic market parameters have on the development of their financial position.

In the non-life insurance market, the expected contraction and heightened competition are largely driven by innovative technology, presenting insurers with both opportunities and risks (see paragraphs 4.1.2 and 4.2.1). Innovative technology may contribute to increased efficiency and a broader range of products which society requires. Conversely, it may cause insurers which are incapable of adjusting their costs or product offering to face pressure. They will need to explore alternative options, such as an acquisition or a scale-down of their operations. Supervisors must be watchful in this regard and intervene where needed. Likewise, insurers, policymakers and supervisors must start a debate on the potential consequences of innovative technology, including about risks that can and cannot be insured and the increased vulnerability to cyberattacks.

Ongoing internationalisation is also expected to fuel competition in the insurance sector (see paragraph 4.2.2). Competition from foreign insurers may improve efficiency and provide fresh impetus to the insurance sector serving society. At the same time, Dutch insurers will see opportunities to set up shop abroad to leverage economies of scale and spread risks internationally. Going international is a valid option in particular for insurers that already have a substantial presence abroad or possess specific expertise which they can monetise abroad. Eliminating unnecessary barriers to internationalisation is key.

We are observing shifts in the insurance value chain caused by the increasing pressure on the traditional insurance sector (see paragraph 4.2.3). Wider service provision may contribute to a more efficient insurance sector that serves society. Insurers are increasingly entering markets in which they face competition from such traditional parties as intermediaries, investment institutions, banks, pension funds and pension administration organisations. It is vital that insurers are always transparent about a product and its risks for the policyholder, especially in the case of pension schemes. Supervisors must never cease to devote attention to cross-sectoral shifts in operations and take action to improve policies and supervision where necessary.

Annex

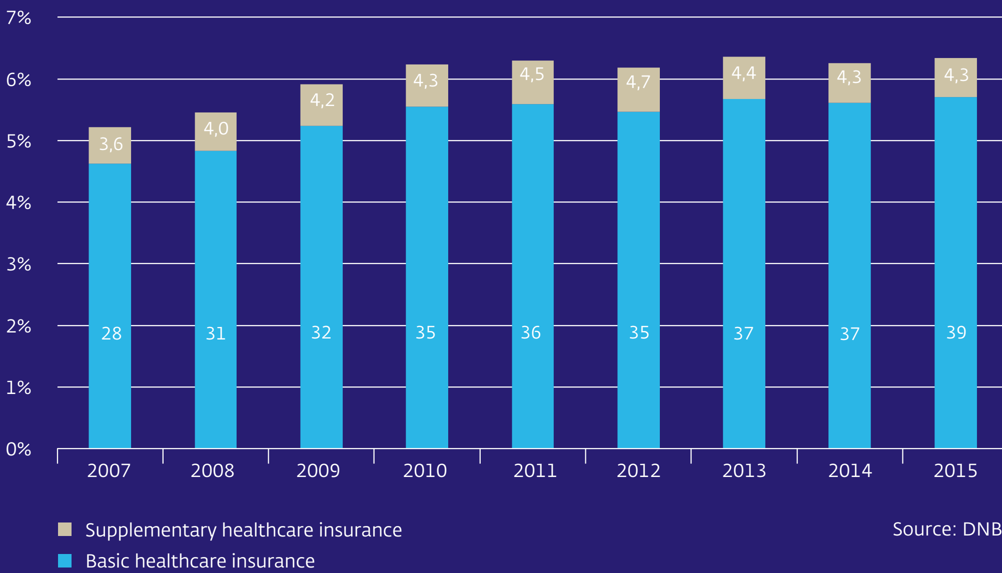
Box 9 Health insurers

Since the Health Insurance Act was introduced as part of the new healthcare system in 2006, healthcare in the Netherlands has been an area of regulated market forces. Dutch health insurers play an important coordinating role, bearing responsibility for basic and supplementary health insurance. They occupy a special position in the financial sector. While they are private parties, they provide their social basic health insurance in a tightly regulated market. Everyone living or working in the Netherlands is obliged to take out basic health insurance with a health insurer. The government determines which healthcare services are covered by a basic health insurance package. Each Dutch health insurer has an acceptance obligation for basic health insurance and may not charge different individuals different premiums: to safeguard the accessibility of basic care for all, it is obliged to accept anyone as a policyholder against the same premium, regardless of health or age. To compensate insurers for differences in policyholder populations, a risk settlement system for basic health insurance has been established. Health insurers catering for a relatively unhealthy policyholder population receive a larger contribution from the system than those serving a relatively healthy population. In addition to mandatory basic health insurance, health insurers also offer supplementary health insurance, under which they may charge different premiums, formulate their own policies and compose their own health insurance packages.

In the Netherlands, 34 insurers, which form part of nine insurance groups, offer health insurance cover. Of these insurers, 15 offer basic insurance only, nine offer supplementary insurance only, and ten offer both. The total annual premium volume is around EUR 39 billion for basic health insurance and EUR 4 billion for supplementary insurance (see Chart).

Chart D Premium volumes of health insurers

In % of GDP (left-hand axis); amounts in EUR billion (labels)



Source: DNB.

Health insurers operate in a complex playing field, with high expectations from the general public, and stakeholders ranging from policyholders and healthcare providers to politicians and supervisors. This means health insurers face their own particular challenges, which show similarities with those of other non-life insurers and of pension funds. We plan to specifically discuss the market for health insurance in due course.

Box 10 Reinsurers

A total of 9 reinsurers operate in the Netherlands. As at year-end 2015, they accounted for well over EUR 1 billion in premiums. The majority are captive reinsurers, which form part of wider insurance groups, bundling group risks and partly reinsuring them externally. As at year-end 2015, premiums paid by Dutch non-life insurers to captive and external reinsurers had dropped to just over 13% of the total premiums earned, from nearly 17% in 2008. By contrast, the Dutch life insurers' reinsurance ratio went up from 3% in 2008 to 6% in 2015.

Reinsurers are important to the Dutch insurance sector as a means to mitigate underwriting risks. In addition, both life and non-life insurers increasingly use reinsurance to manage their balance sheets in a bid to optimise the risk-return ratio of shareholders' equity. To non-life insurers, windstorm continues to be the principal underwriting risk. To date, they still cover this risk by purchasing traditional reinsurance. Life insurers mainly seek to cover longevity risk, which is their main reason for applying one or more risk-mitigating techniques. These vary from traditional types of reinsurance and financial reinsurance to using special purpose vehicles and derivatives structures.

The persistent low interest rate environment and the generally robust capital position of reinsurers currently make the reinsurance sector an attractive option for investors. Both private equity and pension funds increasingly participate in the sector as part of their investment strategy, either by setting up new reinsurers (special purpose reinsurance vehicles) or by investing in insurance-linked securities and catastrophe bonds. New market entrants are, however, putting pressure on the margins of traditional reinsurers, prompting smaller reinsurers in particular to consider their future. More mergers and acquisitions are expected in the next five years, and the reinsurance sector is likely to split in two segments, comprising mega-reinsurers focusing on super cedents on the one hand and remaining reinsurers which target local insurers on the other.

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