Mrs. Neelie Kroes
European Commissioner for Competition
DG Competition
rue Joseph II 70
B-1000 Brussels
Belgium

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Dear Commissioner Kroes,

Zurich Financial Services

Mythenquai 2
P.O. Box
8022 Zurich
Switzerland

Phone +41 (0)44 625 25 25
http://www.zurich.com

Dir. phone +41 (0)44 625 39 21
Dir. fax +41 (0)44 625 19 21
peter.buomberger
@zurich.com

We read with interest the interim report published by the Commission in January 2007 and we welcome the opportunity to respond to the findings it presented. Holding a Public Hearing and giving the industry an opportunity to respond to the Interim Report demonstrates the Commission's commitment to 'better regulation'. Zurich Financial Services and its entities in five Member States addressed by the Commission (Sweden, France, Germany, Spain and the United Kingdom) actively took part in the Commission's sector inquiry into business insurance.

As the world's second largest corporate business insurer, Zurich Financial Services is very much interested in the efforts of DG Competition to further liberalize the European insurance markets. In our view, the Lisbon Agenda is a key instrument for driving forward the single European market. Increased competition leads to more efficiency and innovation in the insurance market and ensures that both retail and wholesale consumers have access to a wider range of products and services at competitive prices.

Despite the many efforts to liberalize the European insurance market(s), there are in our experience still many obstacles to sell insurance products across national borders. In this regard, the Commission rightly points out that that the preferred method of entering a foreign market continues to be through mergers and acquisitions. Therefore, the final report should clearly state that the cross-border delivery of insurance products is frequently hindered by differences in the legal and regulatory environments which obstruct the sale of the same insurance product in different Member States. The costs for complying with these very heterogeneous standards are inevitably passed on to the end customer. Introducing the country of origin principle in customer protection regulation would boost cross-border sales.

With respect to specific comments on the interim report, you will find enclosed a more detailed analysis. In summary, we would like to encourage the Commission to review a few key issues, such as

- the financial methodology used in the inquiry (the Combined Ratio)
- the importance of long-term contracts for business customers
- the fact that the block exemption regulation is largely necessary to provide the legal certainty to ensure insurance market stability and foster useful collaboration that benefits consumers in a number of crucial areas.

Zurich Financial Services appreciates the European Commission's efforts to increase competition and modernize the regulatory environment in the European insurance market. In this regard, the work on Solvency II and on lead supervision of insurance groups is crucial to consolidate existing regulation and advance the 'better regulation' agenda.

If you and your staff would like to discuss any of the issues raised in our response, we would be more than happy to assist.

Yours sincerely,

Peter Buomberger
Group Head of Government and Industry Affairs

The European Commission's Interim Report into the Business Insurance Sector: Response from Zurich Financial Services

Financial Aspects

In terms of the financial methodology used during the Inquiry, we would question the rationale behind using the Combined Ratio across business lines to assess the degree of competition within the business insurance market. As the report says itself, this unveils drawbacks, the main one being that combined ratios are comparable only for perfectly identical books with identical risk profiles and loss experiences.

Commercial books even in the same line of business will have different combined ratios depending on the book's composition of risks. The decisive factor is the Loss Ratio and periodic variations in loss ratios are determined by factors outside the insurer's control, for example, large claims and natural catastrophes.

The second element of the combined ratio is the Expense Ratio**.** The expense ratio is partially determined by internal efficiencies but a decisive part is also determined by whether an insurer distributes its products directly or through intermediaries. For example, in some markets brokerage is paid as a fee by the customer directly and, hence, not included in the combined ratio where in most markets brokerage is part of the combined ratio. In addition, since each insurer has a different distribution mix, they will also all have different expense ratios. Consequently, the methodology used in the Inquiry would have to make adjustments for actual loss developments and distribution differences and, thus, as it stands this paints a distorted picture of the business insurance market.

Furthermore, we would add that we believe that, at a national level, insurance markets are highly competitive. All insurers find themselves under constant pressure to offer discounts or reduce prices or face the prospect that they will lose customers to the competition. These market conditions drive up standards and ensure the market continues to flourish.

Generally, the last decade has seen the development of a much greater level of sophistication amongst customers in all segments including the large corporate, SME as well as personal lines sectors. Most customers have access to and seek professional advice and the proliferation of internet-based advice and comparison services enhances this sophistication even further. As such, we would not agree with the Report's view that discrimination and a lack of buying power exists amongst SME customers and that the advice on a particular risk is of lower quality. Indeed, in certain Member States, we find competition in the SME market to be at its most fierce with a large number of market participants and many new entrants. This again leads to pressures on underwriting and price.

Again, the drawbacks of using the combined ratio as an indicator of profit is no different in the SME sector than it is for the large corporate sector. This is due to coverage, risk profiles and loss experiences being different for each sector and individual customer.

Duration of Contracts in the Business Insurance Sector

The Commission has raised concerns regarding the use of long-term contracts by insurers. However, in fact, long-term insurance contracts can often serve the legitimate needs of customers. Customers may be attracted by the substantial rebates on premium that can be offered in relation to long-term insurance contracts, as well as the stability of premium levels. Indeed, the current market conditions make it more desirable for customers and brokers to negotiate longer-term contracts and our large corporate customers often express their frustration at the inability to purchase long-term contracts.

It should also be recognised that insurance contract law also differs between Member States regarding the length of insurance policies. Further, early termination rights available to the parties do obviously also influence actual duration of insurance contracts.

Of course, as the Commission noted in the Interim Report, the duration of insurance contracts is sometimes an integral characteristic of those products needed to cover the need of the customer and therefore cannot be considered to have an adverse effect on competition. As an example, in respect of the credit and surety line of business, the period of liability for an individual bond could vary between a few weeks and several years depending on the nature and extent of the underlying contractual obligation which is being guaranteed.

In terms of your question regarding automatic renewals, from our point of view they provide a benefit to customer and insurer alike by avoiding coverage gaps and the need for negotiations on an annual basis.

Structure, Function and Remuneration of Distribution Channels

One of the key issues in the Interim Report is that disclosure of intermediaries' remuneration requires further investigation.

Zurich welcomes the debate around the transparency of intermediary remuneration as it is an issue that requires further clarity and possible improvement. In the case of brokers acting as the agent of their customer, we consider that it is the responsibility of the broker and the customer to decide how to shape their relationship but we support the general notion of industry-wide transparency.

In the case of intermediaries acting as the agent of the insurer, the situation is somewhat different as the commission is paid by the insurer in respect of the services it receives. Those agents are to be treated in this regard as if they were employees, as both these situations are the same with respect to remuneration and there is no conflict of interest. This view is also applied in other areas of the economy.

The interim report mentions that the issue of transparency will be subject to further inquiry. The Commission is not alone in wishing to carry out this analysis. Indeed, the UK Financial Services Authority recently appointed independent consultants to conduct an objective analysis of whether there is in fact a market failure in the distribution of wholesale insurance and if they find there is to do a cost-benefit analysis of mandated commission disclosure. Although only focused on the UK market, the Commission may find cooperation with the consulting firm, CRA International, to be a useful starting point for deliberations.

Horizontal Co-operation among Insurers

A number of forms of horizontal co-operation in the insurance sector are permitted by the Insurance Block Exemption Regulation. In our view, the Block Exemption provides the necessary legal certainty to ensure market stability. It also encourages the provision of insurance coverage and competition to Europe's citizens and businesses. In particular, it allows greater competition as it enables smaller and medium-sized insurers to participate in large risks as they do not have the resources to technically assess risks unaided. It is particularly vital to ensure the continued efficient running of the London subscription market.

Set out below are some examples of the benefits that might be threatened by the removal of the Block Exemption provides:

Joint Studies and Calculation of Risks
The Block Exemption covers co-operation between insurers to calculate the average cost of risk cover based on historical data. The Block Exemption also allows the joint carrying out of studies relating to the impact of external factors on the frequency and scale of claims.

In our view, such co-operation increases the efficiency of the sector. This exemption allows insurers (particularly small to medium sized insurers) access to representative data that they would not otherwise have to accurately assess risks and calculate premium levels. In this way, the Block Exemption promotes market participation and encourages new entrants into the sector.

In areas that constitute new risks and where there is no statistical information available, it is vital for the insurance industry to be able to undertake studies about the development and nature of such possible risks. It is obvious that such risks can threaten the whole industry and therefore benefit all insurers. The other alternative would be that the insurance industry does not offer such coverage at all due to lack of information.

Standard Policy Conditions
The availability of non-binding standard policy wordings for use by insurers assists new entrants to break into markets, especially niche markets, thereby fostering competition. We would expect that the advantages of using standard policy wordings is greatly felt by smaller insurers who do not have the global network of resources available to Zurich.

In our view, the availability of non-binding standard policy wordings does not in any way stifle customer choice as insurers recognise the need to differentiate and improve their products in order to win new business. Indeed, standard policy conditions also aid customers and independent insurance advisors in comparing policies offered by different insurers.

Insurance Pools
Certain risks can only be insured via participation of several insurers. Even if an insurer could, in theory, take the whole risk, the need to avoid a risk cumulation means that the insurer will take only part of the risk in accordance with its own internal underwriting guidelines. This is even more important for medium and smaller insurers.

Many insurers would simply be excluded from participation in the market if pooling arrangements were not permitted under the Block Exemption. The detriment would inevitably be felt by customers who are forced to pay excessive premiums to cover the risk, or who are not able to obtain cover at all. The UK's Pool Re and the Spanish Consorcio de Compensación de Seguros are examples where pools are essential to providing coverage that would otherwise be difficult or impossible to obtain. It should be noted, however, that it is our general view that traditional pooling models along national lines have less validity with the opening up of a global insurance market and that, where possible, insurance pools should be replaced by free market solutions.

Security Devices

Security devices are an important tool to keep claims costs down and to prevent damage (also uncovered damage) to the insured. However, security devices must be reliable in order to fulfil this role effectively and the insurer must be able to ascertain the reliability of the device in order to take this into account in connection with pricing and drafting the wording of the insurance coverage.

Establishing standards regarding the technical specifications of security devices is therefore in the interests of all insurers and this can be done most effectively and efficiently by the insurers together. Smaller insurers would not have the capacity to check security devices on their own. Conversely, competition takes place in the pricing and shaping of the wording. Reliable security devices are just a precondition for that, not a means for competition.

Claims Settlement Agreements
Zurich supports the efforts to extend the Block Exemption to certain aspects of claims handling. Collaboration between insurers and also between insurers and service providers has many advantages for the insurance industry and, as such, presents cost savings to policyholders. Some examples include the Italian direct damages (motor) recovery code, which allows for direct compensation to injured parties and which may soon be extended to personal injuries covered by other policies; the Spanish CICOS; the Irish Personal Injury Assessment Board and the UK Insurance Fraud Bureau (which is being considered by other Member States). All of these require close collaboration of insurance claims' departments. In our experience, such collaboration helps drive costs down and also allows us to provide a quicker, more customised service to the customer. Claims handling agreements would also minimise the disputes between insurers in single claims cases.

In summary, we would urge caution about the potential unintended consequences of removing the Block Exemption Regulation without simultaneously presenting a workable alternative particularly in the area of co-insurance and claims settlements agreements. It could negate such useful exercises in joint collaboration and potentially create consumer detriment.