BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Chairman, Subcommittee On Business, Trade And Tourism, Committee On Commerce, Science And Transportation United States Senate

RELEASED

International Insurance Trade--U.S. Market Open: Impact Of Foreign Barriers Unknown

GAO reviewed foreign access to the U.S. insurance market, U.S. access to foreign markets, and Federal efforts to remove insurance trade barriers and to enhance U.S. competitiveness in world markets and found that:

--The number of foreign-owned firms in the U.S. market has increased but, because of domestic competition, these firms have achieved only a relatively small share of the U.S. market.

--Government and industry officials generally believe that foreign barriers are widespread, but the extent of new business that would be achieved if these barriers were lessened or removed is unknown.

--The administration is making efforts to reach international agreements to eliminate unfair trade practices in the service sector, but discriminatory practices in the insurance sector will be difficult to resolve.

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AUGUST 23, 1982

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INTERNATIONAL DIVISION

B-204005

The Honorable Larry Pressler, Chairman
Subcommittee on Business, Trade, and Tourism
Committee on Commerce, Science, and
Transportation
United States Senate

Dear Mr. Chairman:

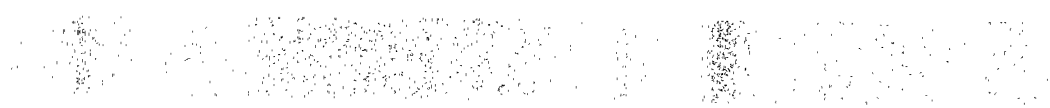
This report responds to the Subcommittee's request for a GAO study of service sector trade issues. As you know, it was agreed in subsequent discussions with your office that we would review the competitiveness of the U.S. insurance industry. Therefore, we examined (1) access of foreign-owned firms to the U.S. market, (2) access of U.S. firms to foreign insurance markets, and (3) Federal efforts to review barriers and enhance the competitivenesss of U.S. firms in world markets.

We obtained formal comments on the report from the Office of the United States Trade Representative, the Department of Commerce, and the International Insurance Advisory Council. We requested formal comments from the Insurance Departments of California, Illinois, Massachusetts, and New York but did not receive them. We received oral comments from A.M. Best Company, the insurance data firm.

As arranged with your office, we plan no further distribution of this report other than to Senator Daniel K. Inouye, until 2 days from the date it is issued. At that time, we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,

Frank C. Conahan
Director



GENERAL ACCOUNTING OFFICE
REPORT TO THE CHAIRMAN,
SUBCOMMITTEE ON BUSINESS,
TRADE AND TOURISM,
COMMITTEE ON COMMERCE, SCIENCE
AND TRANSPORTATION
UNITED STATES SENATE

INTERNATIONAL INSURANCE TRADE--U.S. MARKET OPEN; IMPACT OF FOREIGN BARRIERS UNKNOWN

D I G E S T

GAO reviewed the competitiveness of the U.S. insurance industry at the request of the Chairman, Subcommittee on Merchant Marine and Tourism (now the Subcommittee on Business, Trade and Tourism), Senate Committee on Commerce, Science and Transportation. GAO examined the (1) access of foreign-owned firms to the U.S. insurance market, (2) barriers to U.S. firms serving foreign markets, and (3) Federal efforts to remove insurance barriers in world markets.

OPERATIONS BY FOREIGN-OWNED FIRMS IN THE U.S. MARKET

GAO contracted with A.M. Best Company to provide statistical data on the operations of insurance firms in the U.S. market--the largest in the world. The data show that the number of foreign-owned firms licensed to operate in the United States has substantially increased over the past decade but that these firms have achieved only a relatively small share of the U.S. market. Representatives of foreign-owned firms believe that the limited market share is due to strong competition, not from U.S. barriers. (See pp. 8 to 10.)

GAO visited four States to determine the extent of restrictions against foreign-owned firms. Foreign-owned insurers seeking to enter and operate in the four States face a variety of State requirements which differ from those imposed on domestic insurers. However, representatives of foreign-owned companies state that experienced and financially sound companies encounter no serious obstacles to entry and operation in the U.S. market. GAO's analysis of the barriers supports this conclusion. (See pp. 5 to 8.)

U.S. INSURANCE OPERATIONS IN FOREIGN MARKETS

Officials of U.S. insurance firms that operat- outside of the United States said that barriers --such as expropriation, domestication, license delays, and restrictions on entry, branch operations, and placement of reinsurance-hamper their

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ability to compete for business on an equal basis with domestic firms in foreign countries and result in decreased earnings. (See pp. 14 to 17.)

Government and industry officials generally believe that foreign barriers are widespread, but the extent of new business that would be achieved if these barriers were lessened or removed is unknown. Opinions vary as to whether the U.S. insurance industry would obtain substantial new business. There are indications that U.S. firms are successfully overcoming barriers in some instances and some have been grandfathered in certain markets. More importantly, the elimination of barriers may not result in substantial financial benefits because of domestic competition in the developed countries and low premium volume in the less developed countries. (See pp. 18 to 21.)

U.S. EFFORTS TO REMOVE FOREIGN INSURANCE BARRIERS

The United States Trade Representative (USTR) is attempting to convince major U.S. trading partners that service sector trade is an important matter that should be discussed in multilateral trade negotiations; he recognizes that significant progress in reducing insurance and other service sector trade barriers probably will not be achieved before 1990. In the interim, companies can seek relief on a case-by-case basis by requesting assistance under section 301 of the Trade Act of 1974, as amended. (See pp. 23 to 31.)

The U.S. Government does not have unlimited leverage that can be used as a means to obtain trade concessions from foreign governments. U.S. insurers believe that the Government will have to negotiate in other trade issues to obtain concessions in insurance. Before giving priority to any individual industry's concerns, such as insurance, the United States needs to know the significance of foreign barriers and whether substantial economic benefit will be realized by the industry if the barriers are lessened or eliminated.

AGENCY COMMENTS AND OUR EVALUTATION

The Commerce Department concurs that U.S. requirements do not, in practice, constitute serious obstacles to foreign-owned insurers and that foreign-owned firms have achieved only a limited market share in the United States.

The USTR and Commerce were concerned, to varying degrees, that the report portrayed a negative impression of the potential value to be derived from the lessening or removing of foreign insurance barriers. The International Insurance Advisory Council believed that the editorial tone is such that the reader is led to infer the problems posed by discriminatory barriers are less important than the practitioners (insurance companies) know them to be and that the economic importance of barriers is not lessened by the fact that industry, government, and academic research have not put a fixed value on the barriers. Commerce also commented that it is working to improve data in service sector trade but that even with improved data, the precise impact of non-tariff barriers would be difficult to quantify.

GAO did not conclude that the insurance industry--and particularly individual firms--would or would not increase business (and potential profits) with the removal or lessening of foreign barriers. GAO does indicate that while the insurance industry cites that barriers are widespread, the significance and economic impact of barriers are unknown. The insurance firms that GAO visited provided few documents to support their statements concerning the specifics and impact of barriers. The USTR and Commerce both commented that the need exists to develop better information on the significance and economic impact of foreign insurance barriers, and GAO agrees.

Commerce concurred that the U.S. Government does not have unlimited leverage but believes there is strong interest by foreign insurers in the U.S. market, which indicates that leverage is not entirely lacking. GAO notes that, because foreign-owned insurers entering the U.S. market are mostly from developed countries, the United States has little leverage in insurance in the developing and lesser developed countries. Some insurance companies told us that these countries are the most restrictive while offering the greatest potential. Also, companies from the United Kingdom, a trading partner that GAO is told has an open market, account for about 60 percent of premiums generated by foreign-owned firms.

Contents

		Page
DIGEST		i
CHAPTER		
1	INTRODUCTION	1
	The insurance industry	1
	Objectives, scope, and methodology	2
2	THE U.S. INSURANCE MARKET: MINIMUM PENETRATION BY FOREIGN-OWNED FIRMS DESPITE THE ABSENCE OF MAJOR BARRIERS	5
	Extent of barriers applied to foreign-owned firms	5
	Extent of foreign penetration into U.S. market	8
	Captive insurers--major competitors for U.S. premiums	12
	Agency comments and our evaluation	13
3	THE IMPACT OF REMOVING FOREIGN INSURANCE BARRIERS IS UNKOWN	14
	Insurance firms report that barriers impede business abroad	14
	Federal data on insurance barriers	17
	The impact of removing foreign insurance barriers is unknown	18
	Additional comments and data on the impact of barriers	20
	Agency comments and our evaluation	21
4	EFFORTS TO REMOVE FOREIGN INSURANCE BARRIERS: A DIFFICULT TASK	23
	Problems encountered in removing barriers	23
	What is being done?	24
	Agency comments and our evaluation	31
APPENDIX		
I	Analysis of requirements that apply to foreign-owned insurance companies in California, Illinois, Massachusetts, and New York	33
II	Number of foreign-owned insurance firms licensed in the United States	37

APPENDIX		Page
III	Volume of property/casualty direct premiums in the United States	38
IV	Volume of life, accident and health direct premiums in the United States	39
V	Profitability ratios for U.S.-owned and foreign-owned companies in the U.S.--property and casualty insurance	40
VI	Letter dated July 16, 1982, from the Office of the United States Trade Representative, Executive Office of the President	41
VII	Letter dated June 28, 1982, from the United States Department of Commerce	43
VIII	Letter dated July 21, 1982, from the International Insurance Advisory Council	48

ABBREVIATIONS

GAO	U.S. General Accounting Office
GATT	General Agreement on Tariffs and Trade
OECD	Organization for Economic Cooperation and Development
USTR	United States Trade Representative

CHAPTER 1

INTRODUCTION

The Chairman, Subcommittee on Merchant Marine and Tourism (now the Subcommittee on Business, Trade and Tourism), Senate Committee on Commerce, Science, and Transportation, asked us to review the competitiveness of U.S. firms in world service markets. In subsequent discussions with our representatives, it was agreed that we would review the competitiveness of the U.S. insurance industry, including (1) access of foreign-owned firms 1/ to the U.S. insurance market, (2) U.S. access to foreign insurance markets, and (3) Federal efforts to remove insurance barriers and to enhance U.S. competitiveness in world markets.

Since World War II, service industries have provided the majority of U.S. economic and employment growth. According to the Department of Commerce, service industries account for about 65 percent of the Nation's gross national product and two out of every three jobs.

The role of service industries in international trade is very important to the United States. Although many service industries are important in the domestic market, about 15 are significant internationally--accounting, advertising, banking, communications, computer services, construction and engineering, consulting and management services, educational services, franchising, health services, legal services, motion pictures, shipping and air transport, tourism, and insurance. The United States Trade Representative (USTR), the Nation's chief trade policy spokesman, believes that service industry trade is the frontier for expansion of export sales and that aggressive cultivation of foreign markets is as critical to U.S. economic recovery as increased exports of goods.

According to Government sources, service industries are experiencing many of the same kinds of trade barriers faced by exporters of goods. A barrier is any government regulation, cultural practice, or existing condition which impedes a business from operating in the country as it would like to operate. Discriminatory barriers are measures or conditions which place a foreign firm at a competitive disadvantage with domestic firms.

THE INSURANCE INDUSTRY

Insurance can be divided into three types.

1/Foreign-owned companies are alien branches (i.e., branches of insurance companies organized under the laws of a jurisdiction outside of the United States) as well as companies organized in the United States and owned by foreign interests.

1. Property and casualty insurance--the insurance company promises to compensate the insured against financial loss resulting from an event, such as the accidental damage or destruction of insured property.

2. Life insurance--the insurance consists of a number of plans to provide financial protection for the family; accident and health policies as well as pension plans are included under life insurance.

3. Reinsurance--an insurance company shares its risks with another, paying to the sharing company a portion of the premiums it receives. Generally, the reinsurance is conducted on an international level and reinsurance firms do not deal with the general public. Insurance companies purchase reinsurance to reduce their liability on particular risks and to provide greater capacity to accept risks involving larger amounts than could otherwise be covered.

Two less common ways of providing insurance which are important in a discussion of international insurance are "nonadmitted insurers" and "captive insurance companies".

Nonadmitted insurance is provided by insurance companies not licensed to transact business within a State or country. In the United States, nonadmitted insurers are authorized to do business under limited-purpose laws known as excess or surplus lines laws. These laws are designed to permit a consumer to secure coverage for difficult or unusual risks which are not serviced by insurers admitted in the State. The placement of risk must be through a specially authorized agent or broker. A broker may place these risks only with nonadmitted insurers considered acceptable by State insurance authorities.

A captive insurance company is an insurance firm that is owned by a noninsurance parent firm or group of parent firms. An increasing amount of U.S. commercial risks are being underwritten by captives. The primary purpose of the captive is to insure or reinsure the risks of the parent company. The impetus for the creation of captives comes from the desire of noninsurance firms to self-insure, yet retain the tax advantage of paying premiums. Many captives have diversified their operations and accept insurance and reinsurance business from other than parent company firms. Although several States allow the formation of captives, most captives are located offshore, where they are free from State regulatory requirements and have tax advantages.

OBJECTIVES, SCOPE, AND METHODOLOGY

We interviewed representatives of 14 foreign-owned insurance companies to determine whether foreign insurance firms are treated the same as domestic insurance firms in the U.S. market. Among

other things, we asked the companies why they entered the U.S. market, whether they planned to expand their U.S. business, and whether States regulate foreign-owned insurers the same way as domestic insurers. To further document how foreign insurers are treated relative to domestic insurers, we reviewed insurance codes and talked to State insurance department officials in California, Illinois, Massachusetts and New York; we did not contact all State insurance departments because of time and cost constraints. The States we visited were selected because of premium volume and high level of insurance expertise and because two of them are considered major entry points for foreign-owned insurers. We also talked with representatives of the National Association of Insurance Commissioners.

We contracted with the A. M. Best Company of Oldwick, New Jersey, the major U.S. insurance data firm, for statistical data on insurance firms in the U.S. market. Best Company maintains financial and other historical data on about 1,400 life (including accident and health insurance) and 1,500 property/casualty firms operating in North America. It compiles its data from insurance firms' annual reports and financial statements. Best Company officials estimate that firms included in its data base account for about 95 percent of the life and property/casualty insurance business in the U.S. market. To determine whether foreign-owned firms control a significant and increasing share of the U.S. market, we obtained Best Company data on the nationality, premium volume, and profitability of insurance firms for 1971, 1975, and 1980. We analyzed these data to identify trends in market penetration and profitability of U.S. and foreign-owned firms operating in the U.S. market.

To assess the extent to which foreign barriers hinder U.S. insurance firms from entering foreign markets or from competing on an equal basis with foreign insurance firms in their markets, we reviewed pertinent records and studies of the USTR and the Departments of Commerce and State. We talked with various industry trade associations and 15 U.S. insurance firms, including the five major international U.S. firms. The insurance firms provided few documents to support their statements concerning the existence and impact of barriers. Although they were very willing to discuss problems encountered within various markets, they did not provide us with supporting documentation on how the barriers work, the effect on their business, or market conditions in the various countries. We were told that such information is proprietary and that many barriers involve administrative practices which are difficult to document.

We also talked with Federal and State officials concerning their efforts to remove foreign insurance barriers and reviewed records supporting the actions taken on the three industry petitions submitted under section 301 of the Trade Act of 1974 seeking relief from unfair insurance trade practices.

We did not discuss or verify reported restrictions and barriers with foreign government officials or with the overseas management staff of U.S. insurance firms.

Comments by the Office of the United States Trade Representative, Department of Commerce, and the International Insurance Advisory Council are included in the report as Appendixes VI, VII, and VIII. Our evaluation of the comments are contained within the report chapters.

We performed our review in accordance with our "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions."

CHAPTER 2

THE U.S. INSURANCE MARKET: MINIMUM PENETRATION BY FOREIGN-OWNED FIRMS DESPITE THE ABSENCE OF MAJOR BARRIERS

The U.S. insurance market is the largest in the world. The industry is regulated under the laws and regulations of the 50 States and the District of Columbia. Size, ease of entry, and other factors have attracted foreign-owned insurance firms to the United States in substantial numbers; nevertheless, A. M. Best Company data show that foreign-owned firms have accounted for only a small share of the U.S. insurance market over the last decade. Foreign-owned insurers seeking to enter and operate in the four States we visited face a variety of State requirements, some of which differ from those imposed on domestic insurers. Representatives of foreign-owned firms, however, said that their limited market share is the result of competition rather than trade barriers, and our analysis of the barriers supports this conclusion.

Foreign-owned firms continue to account for a large but decreasing role in meeting U.S. demand for property/casualty reinsurance and excess lines coverage. U.S. tax laws and other considerations have also led to the rapid growth of offshore captive insurance firms which have become major competitors for the U.S. premium dollar.

EXTENT OF BARRIERS APPLIED TO FOREIGN-OWNED FIRMS

In 1980, the United States generated $190 billion, or about 44 percent, of the world insurance premium volume. About 5,000 insurance firms operate in the U.S. market, slightly less than half of the approximately 10,600 firms worldwide. In contrast, Japan--the second largest market--accounted for $59 billion, or about 14 percent, of the world premium volume.

State insurance requirements, for the most part, vary according to the company's place of organization--not ownership. In insurance terminology, a <u>domestic company</u> is one organized under the laws of the State in which it is selling. A <u>foreign company</u> is organized under the laws of a different State, and an <u>alien company (or alien branch)</u> is organized under the laws of a jurisdiction outside of the United States. However, in determining the extent of foreign penetration, it is important to distinguish domestic firms owned by U.S. interests from those controlled by foreign interests. For ease of reference where appropriate, we will call alien branches and U.S. companies owned by foreign interests <u>foreign-owned</u> companies.

Several representatives of foreign-owned firms believe that the complex regulatory structure discourages some foreign-owned firms from seeking entry into the U.S. market. Whether acquiring an established firm, creating and capitalizing a subsidiary, or licensing a branch, a foreign-owned insurer faces a complicated regulatory system administered separately by 50 State governments and the District of Columbia. A foreign-owned firm wanting to establish a multi-State operation must comply with the insurance laws and regulations of each State where it seeks a license. U.S. domestic firms face the same problem, but the regulatory structures of 50 separate States can be confusing for a foreign-owned firm, particularly one accustomed to doing business in countries which apply uniform requirements countrywide.

Foreign-owned insurers seeking to enter and operate in the four States we visited (California, Illinois, Massachusetts, and New York) face a variety of requirements--some of which differ from requirements imposed on U.S.-owned insurers. According to A.M. Best Company, these States accounted for about 30 percent of property/casualty and about 27 percent of life insurance direct premiums written in the United States during 1980. Differing State requirements can apply to one or more of the following: (1) alien branches, (2) domestic companies owned by foreign interests, or (3) foreign companies--insurance companies organized within other States and owned by either U.S. interests or foreign interests. State requirements for foreign companies (those organized within other States) may not be considered discriminatory, because the requirements apply equally to both U.S. companies and companies owned by foreign interests seeking entry from another State. However, we have included them in our analysis because a company owned by foreign interests and organized within another State may incur different requirements compared with domestic U.S.-owned insurers organized within the State. This could be viewed as a barrier by foreign-owned firms attempting to participate in the U.S. market. Appendix I contains an analysis of requirements on foreign-owned companies. The major requirements are discussed below.

States have specific licensing and admission standards governing minimum paid-in capital and surplus funds requirements. In New York, these standards differ for alien branches and domestic firms. Alien branches are required to deposit 150 percent (200 percent for fire and marine insurance) of the minimum capital that is required of domestic and foreign firms. Data published by the Commerce Department indicate that three other States also impose higher paid-in capital and surplus requirements on alien branches.

All four States we visited require alien branches to maintain their minimum paid-in capital and/or surplus funds in trust. For two of the States, this requirement also pertains to foreign companies. The trust funds must be deposited with officials of that State or of another State or with a bank or trust company. Funds generally cannot be removed without approval of the State insurance

commissioner. Domestic insurers are not required to maintain such deposits in trust.

Two States have requirements specifying the assets or investments that can be used toward meeting certain requirements. Illinois counts only the admitted assets (assets physically located in the United States) of alien branches and foreign companies toward meeting capitalization, asset, and deposit requirements. New York requires alien branches to maintain capital and surplus requirements in specific securities allowed under State insurance law and also limits alien branches to $500,000 of investments in their home countries which can be applied toward meeting minimum capital requirements.

New York, California, and Illinois prohibit the entry of insurance companies owned or controlled in whole or part by a U.S. State or by a foreign government. According to the Department of Commerce, 28 States have statutes prohibiting government ownership.

California requires proof of successful operation before it will admit an alien branch. With some exceptions, an alien branch must show proof it has transacted business for 3 years in the classes of insurance for which it seeks admittance before a license can be granted. Such provisions could be viewed as discriminating against new and inexperienced foreign-owned firms.

We also found some instances of discrimination against foreign-owned firms after admittance. For example, all four States require alien branches to appoint a U.S. manager as a focal point for access to records and reporting requirements. A license issued to an alien branch in New York is subject to renewal each year, while a domestic company's license, although subject to revocation, runs for an indefinite period. Illinois limits the amount of dividends that can be paid by alien subsidiaries (foreign-owned companies which became domestic companies) to 10 percent of the firm's surplus without prior approval by State insurance officials. New York limits alien branches' repatriation of investment income to $50,000 each quarter of the year unless approval for more is received from the Superintendent of Insurance. State officials said that provisions limiting dividends and repatriation of investment income are established to assure solvency.

Alien branches and foreign companies (firms organized in other U.S. States and either owned by U.S. interests or foreign interests) were subject to additional taxes of 1 to 2.6 percent in New York and 2 percent in Illinois. In addition, the New York insurance law provides for a fire department tax amounting to $1.80 per $100 of premiums written by alien branches and foreign companies licensed to cover fire insurance.

A company considering the State alien branch requirements too burdensome can become licensed as a domestic company, to which those special provisions do not apply.

Foreign-owned firms do not consider U.S. restrictions as major barriers

Foreign-owned company representatives told us that State regulations do not substantially restrict the entry and operation of financially sound and experienced foreign-owned firms. They said that the differences in treatment that do exist have little effect on their ability to operate successfully in the U.S. market.

These representatives said that although foreign-owned firms can operate profitably in the United States, heavy competition from domestic firms makes building premium volume a slow process. They stated that competition, not barriers to entry and operation, account for their small share of the U.S. direct premium market.

EXTENT OF FOREIGN PENETRATION INTO U.S. MARKET

Although it is highly competitive, the U.S. insurance market's size, liberal regulatory requirements, and other factors make it an attractive market for expanding foreign-owned insurance firms. The United States generates about 44 percent of the world premium volume and that volume is growing at a faster rate than the gross national product. Analysts expect net property/casualty premiums to increase from about $72.7 billion in 1978 to about $163 billion in 1986. Also, general U.S. business conditions are favorable to foreign investment; the United States is politically stable and has a policy of not discouraging inward or outward investments.

The A.M. Best Company data shows that the number of foreign-owned firms operating in the U.S. market has increased substantially over the last decade, as shown in table 1.

Appendix II contains an analysis of this data by type of insurance.

Foreign-owned firms operating in the United States increased from a number of countries where industry officials have identified insurance barriers, such as Canada, France, Germany, Japan, and Sweden. According to a USTR inventory of problems encountered by U.S. service industries conducting business abroad, these countries restrict the entry and operations of U.S. insurance firms. (See ch. 3).

Best Company data shows that between 1971-80 the volume of property/casualty and life insurance direct premiums by foreign-owned firms also increased substantially, but the total market

Table 1

Number of Foreign-owned Companies Licensed in the United States

Country	1971	1975	1980
Canada	3	6	14
England/United Kingdom	46	45	58
Finland	0	0	4
France	1	4	12
Germany	7	9	19
Italy	2	2	6
Japan	4	6	13
Netherlands	3	5	23
Sweden	2	2	7
Switzerland	11	10	18
Other	6	10	19
Total	85	99	193

share remained relatively small. As shown in table 2, foreign-owned insurers more than doubled their premium volume in property/casualty, from $1.9 to $4.6 billion, but experienced a decrease in market share from 5.3 to 4.7 percent. Similarly, during this same period, foreign-owned insurers' premium volume in life, accident, and health increased from about $20 million to $1.4 billion, but their share of the market in 1980 was only 1.7 percent. It should be noted that companies from the United Kingdom account for about 60 percent of premiums generated by foreign-owned companies. The United Kingdom is a trading partner that, we are told, has an open insurance market in which U.S. companies do not face serious discriminatory barriers.

See appendixes III and IV for an analysis of premium volume by nationality and type of insurance.

Best Company data show that foreign-owned firms are operating profitably in the U.S. market. The data include seven ratios to measure the profitability of property/casualty firms. The total combined ratio,considered to be the best overall measure of profitability, shows the relationship between all funds paid out and those coming in. Therefore, a ratio lower than 100 is necessary for profitability, and the lower the ratio, the more profitable the operation. The combined ratio in 1980 for domestic firms, foreign-owned branches, and foreign-owned subsidiaries was similar--87.5, 88.0, and 87.9, respectively.

Table 2

Volume of Direct Premiums
Property/Casualty Insurance and
Life, Accident, and Health Insurance
1971, 1975, 1980

	1971		1975		1980	
	Amount (billions)	Percent	Amount (billions)	Percent	Amount (billions)	Percent
Property and casualty						
U.S. owned	$33.9	94.7	$48.0	95.2	$94.4	95.3
Foreign owned	1.9	5.3	2.4	4.8	4.6	4.7
Total	$35.8	100.0	$50.4	100.0	$99.0	100.0
Life, Accident and Health						
U.S. owned	$37.9	99.95	$52.2	99.8	$78.0	98.3
Foreign owned	.02	.05	.1	.2	1.4	1.7
Total	$37.9	100.00	$52.3	100.0	$79.4	100.0

Best Company officials informed us that there is no widely accepted ratio for measuring the profitability of life and accident/health insurance firms. They did, however, provide data on the total gain from operations which showed that foreign-owned firms realized a total gain from 1980 operations of about $99 million on a premium volume of $1.4 billion.

Appendix V summarizes the various profitability ratios for property/casualty insurance.

Foreign-owned firms write significant volume of reinsurance and excess lines insurance

Insurance companies reinsure to reduce their liability on particular risks and to provide greater capacity to accept new risks. Excess or surplus lines insurance is coverage for large or difficult to place risks which cannot be placed with a licensed insurer within a State. Such risks are placed with nonadmitted insurers by brokers who are approved by the State. A substantial portion of such risks are placed with Lloyds of London.

Historically, foreign-owned insurers have played a major role in meeting U.S. demands for reinsurance. Data covering 20 years ending in 1977 shows that payments for reinsurance ceded abroad

consistently exceeded payments for reinsurance assumed from abroad by U.S. insurers. The Department of Commerce reported that U.S. firms in 1980 paid alien insurance companies $2.1 billion in premiums while alien firms paid U.S. insurers $922 million.

Insurance industry representatives believe that the share of U.S. reinsurance written by foreign-owned firms is decreasing. Best Company data on property/casualty reinsurance supports this view and shows that the market share of foreign-owned firms operating within the U.S. market decreased from 18.1 percent in 1971 to 11.9 percent in 1980, as shown below

Property/Casualty Reinsurance
U.S. Business

	1971		1980	
	Amount (billions)	Percent	Amount (billions)	Percent
Within the U.S.market:				
U.S.-owned companies	$12.2	81.9	$48.7	88.1
Foreign-owned companies	2.7	18.1	6.6	11.9
Total	$14.9	100.0	$55.3	100.0
Outside U.S. market: (note a)	$ 0.6		$ 3.4	

a/Volume of insurance ceded abroad.

The data also indicate a continued U.S. reliance on world markets to reinsure property/casualty risks in keeping with the international nature of reinsurance. Comparable data are not available for life, accident, and health insurance.

Foreign-owned insurers have also played a major role in meeting U.S. demand for excess lines coverage of large and unusual risks. The National Association of Insurance Commissioners reports that in 1963 this market volume was an estimated $500 million to $600 million, at least 75 percent of which was written by foreign-owned insurers. Over the next 14 years, market positions shifted considerably, and by 1977 U.S. insurers wrote about 50 percent of total U.S. excess lines premiums of $1.6 billion. The importance of foreign-owned firms in providing excess lines coverage appears to be diminishing.

The development of State insurance exchanges, such as the New York Insurance Exchange, may further decrease the volume of reinsurance and excess lines insurance placed with foreign-owned firms and may also have the potential to attract foreign insurance premiums to the United States. Exchanges are centralized insurance

"markets" designed to keep within a State a portion of excess lines and reinsurance premiums written by foreign-owned insurers. On the trading floor, brokers can approach underwriters and insurer "syndicates" to find insurance for all or part of a risk. Officials responsible for exchange development in New York, Illinois, and Florida believe that exchanges will accomplish their goal but that building premium volume will be slow.

CAPTIVE INSURERS--MAJOR COMPETITORS FOR U.S. PREMIUMS

Offshore captive insurance firms established by U.S. noninsurance companies are major competitors for the U.S. premium dollar and may ultimately have more impact on the U.S. insurance market than foreign-owned firms writing direct insurance in the United States.

A captive is an insurance firm which is wholly owned by a noninsurance company (or group of companies) whose primary purpose is to insure or reinsure the parent company risks. However, many captives do accept insurance and reinsurance risks from firms other than their parent companies. A few States, including Colorado and Tennessee, allow the formation of captives; however, most captives have been formed offshore where they are free from State regulatory requirements and have added tax benefits. Bermuda (with about 1,200 captives), the Bahamas, and the Cayman Islands are the most popular offshore locations.

U.S. noninsurance firms established offshore captives because domestic premiums were excessive for such risks as product and professional liability coverage and in some cases coverage was not available at all. If a firm chose to self insure such risks, the self-insurance expense was not deductible under U.S. tax law. Forming an offshore captive allowed U.S. noninsurance firms to reduce insurance costs, secure needed coverage, and, under certain conditions, avoid Federal taxes on self-insurance funds. In addition, offshore captives allow noninsurance firms to diversify into insurance.

An industry representative estimated that offshore captives in Bermuda alone received $4 billion (or about 5 percent of total U.S. property/casualty premiums) during 1978 and that by 1985 this volume could reach $10 billion. Proliferation of offshore captives could have significant competitive effects on the U.S. insurance market and on insurance trade if these firms place a substantial portion of the risk with reinsurance firms located outside the United States.

Reliable data are not available on the amount of reinsurance that offshore captives place in foreign markets. Host countries, like Bermuda, require minimal reporting by captives, since captives are not allowed to sell insurance locally. However, industry representatives believe that offshore captives place a considerable

amount of reinsurance in foreign markets. They also believe that captives will continue to grow in numbers and in premium volume over the next decade. Some believe that Bermuda, because of captives, will develop into a major world insurance and reinsurance market, able to compete with the major insurance markets of New York and London.

AGENCY COMMENTS AND OUR EVALUATION

The Commerce Department concurs that, in practice, U.S. barriers to entry and operation do not constitute serious obstacles to foreign-owned insurers. This is consistent with what Commerce has heard from foreign firms and governments in international meetings and through contacts with trade associations. Commerce concurs that foreign firms have achieved limited market share in the United States but notes that the number of foreign insurance firms in the United States nearly doubled during 1975-80, that the trend seems to be continuing and that the future market share of foreign firms will probably increase. We are skeptical whether foreign insurance firms will increase their market share to any significant degree. The U.S. insurance market is very competitive, and although the number of such firms has increased substantially between 1971-80, their market share has actually declined.

The USTR and the International Insurance Advisory Council provided no comments on this chapter. We requested formal comments from the insurance departments of California, Illinois, Massachusetts and New York, but received no comments in time for final processing of the report.

CHAPTER 3

THE IMPACT OF REMOVING FOREIGN INSURANCE BARRIERS IS UNKNOWN

U.S. insurance industry officials state that barriers hamper their ability to compete for business equally with domestic companies in foreign countries. Foreign barriers include expropriation, domestication, license delays, and restrictions on entry, branch operations, and placement of reinsurance. Reportedly, the barriers result in decreased earnings for insurance firms.

Government and industry officials generally believe that foreign barriers are widespread, but opinions vary as to whether the U.S. insurance industry would obtain substantial new business if the barriers were less or removed. There are indications that U.S. firms are successfully overcoming barriers in some instances and some have been grandfathered in certain markets. More importantly, the elimination of barriers may not result in substantial financial benefits to the U.S. insurance industry because of domestic competition in the developed countries and low premium volume in the less developed countries.

INSURANCE FIRMS REPORT THAT BARRIERS IMPEDE BUSINESS ABROAD

Insurance industry representatives state that about 50 of the approximately 4,800 U.S. insurance firms participate to a significant degree in foreign markets, about 5 of them participate worldwide. To determine if barriers hamper U.S. insurers ability to compete in foreign markets, we interviewed officials from 15 insurance firms, two insurance brokerage houses, and four insurance trade associations. The firms were selected to obtain a mix of life, property/casualty, and reinsurance companies, as well as to include the major international insurers. The 15 companies we contacted had differing perspectives regarding insurance trade problems, based on such factors as their lines of insurance coverage, marketing strategies, current locations, and corporate priorities. Some U.S. firms expanded overseas to increase profits as well as to service their multinational corporate clients. It is important for U.S. insurers to service globally the insurance needs of U.S. multinational corporations; otherwise, they risk loss of the domestic accounts.

U.S. insurance officials told us that foreign barriers hamper their ability to compete in many foreign markets, thus reducing potential earnings. New insurance regulations have proliferated in the past 10 years and many of them are intended to modernize and overhaul the regulation of insurance. In the viewpoint of a U.S.-based international insurer, however, the thrust of the new laws often is to protect the market--it has the effect of limiting

or excluding foreign participation in national insurance markets. The situation varies in each country, but insurance officials believe that few countries have no restrictions at all. Many barriers relate to more than insurance--some are directed at imports in general, while others relate to investment within the country. These officials are sure that they would generate additional business in these foreign markets, but the amount could not be quantified. Opinions varied as to whether the U.S. insurance industry would substantially benefit if insurance trade barriers were relaxed or removed.

The five major U.S. international insurers told us that the developing and lesser developed countries have the most restrictive barriers, preventing entry into the market or forcing foreign insurers to leave the market. U.S. companies are interested in developing future markets by seeking business in developing countries with good economic potential, such as extensive natural resources and expanding manufacturing sectors, even though their current markets may be small.

Below are examples of barriers discussed by insurers.

1. Expropriation or nationalization--a government transfers all or part of a company from private to government ownership. In Nigeria, the government expropriated 49 percent of a U.S. company. According to company officials, the amount paid by the government to acquire the shares was well below their value; an independent appraiser said that the compensation represented about 3 to 7 percent of market value. We were subsequently advised that the government expropriated an additional 11 percent, for a total of 60 percent.

2. Domestication or localization--foreign branch or agency operations are required to convert to a local corporation and a majority of the stock must be owned by nationals. Venezuela passed legislation requiring branch operations to be replaced by subsidiary companies with majority local ownership. This forced a U.S. company to reduce its equity below 20 percent, and company representatives said this effectively put them out of business in Venezuela.

3. Restrictions on entry--insurance officials told us that Norway has licensed no domestic or foreign insurance firms for many years because the government believes that there is sufficient competition in the market. This requirement is applied equally to both domestic and foreign insurance firms, thus it appears that U.S. firms are not discriminated against. Nevertheless, they are not allowed entry into the market.

4. License delays--a company has been attempting to obtain a life insurance license in Japan for several years. Despite assurances from the Japanese Government that the company would receive priority among the numerous applicants, it was not granted a license until recently.

5. Discrimination against branch operations--insurance companies often prefer to establish branch offices rather than local subsidiary companies. Some markets permit only the establishment of subsidiary operations. Disallowing branch operations increases costs and reduces efficiency of the U.S. insurer relative to local competition. A U.S. insurer that operates in 10 Central and South American countries experienced discriminatory treatment against its branch operations in Nicaragua, whose government passed legislation in 1980 disallowing foreign branch operations from covering new risks and requiring branches to make local investments.

6. Restrictions on freedom of reinsurance--an insurance company official said that some countries require insurers to reinsure all or part of their portfolios with national or regional reinsurance companies. He said that insurance firms operating in Argentina must place 60 percent of their reinsurance premiums with the government reinsurance company, which reportedly pays foreign firms a less favorable commission than it pays to domestic insurance firms.

Discriminatory requirements for maintaining paid-in capital and surplus funds, exclusion from trade associations, discrimination in government procurement, barriers to employment of nonnationals, and discriminatory taxation are other examples that insurers cited of laws and regulations restricting the sale of insurance abroad. We were also advised that, although the laws of some nations are nondiscriminatory, administrative practices, which are often difficult to document, impede foreign insurance companies.

Industry representatives believe that the priority U.S. objective must be to prevent restrictions from becoming worse or more widespread. Rollback of existing restrictions was viewed as an important second priority to be sought through bilateral and multilateral channels over the long term. Since there appears to be few U.S. tradeoffs in insurance, U.S. insurers believe that the U.S. Government will have to negotiate on other trade issues to obtain concessions in insurance.

The insurance firms that we contacted were willing to discuss problems encountered within various markets, but they did not pro-

vide us with supporting documentation on how the barriers work or their effect on company business or on market conditions in the various countries. They told us that such information is proprietary, that they do not want their competition to know that they are complaining about barriers, and that many barriers involve administrative practices which are difficult to document. One major insurer said that the industry has not spent the time to document the economic impact of foreign barriers but that, should the U.S. Government push for market studies and economic impact data, industry would be willing to do the research.

FEDERAL DATA ON INSURANCE BARRIERS

Both the Department of Commerce and the USTR have attempted to obtain data on problems faced by U.S. insurers in foreign markets. Commerce commissioned a study in 1976 on service sector barriers (including insurance) and initiated a study of international insurance problems in 1980. The USTR has compiled an inventory of trade barriers. These efforts, discussed in more detail below, are not sufficient to assess the significance and impact of foreign insurance barriers.

In February 1976, the Secretary of Commerce and the Special Trade Representative (predecessor to the USTR) established a Federal task force to identify foreign service barriers and assess ways to deal with them. The study, "U.S. Service Industries in World Markets, Current Problems and Future Policy Development," was completed in December 1976 and concluded that (1) insurance is one of five service industries experiencing serious international problems, (2) foreign insurance barriers are extensive, with most occurring in lesser developed countries, and (3) U.S. insurers are increasing their foreign business but foreign barriers decrease their competitiveness and potential foreign earnings. The study recommended that Commerce compile and maintain an inventory of service barriers. As part of the study, a private consultant was employed to report on the effect of foreign barriers on U.S. competitiveness in international markets. The consultant's report, which relied heavily on interviews with U.S. insurance industry officials, cautioned that much of the data on foreign barriers was not susceptible to full verification and that better information needed to be developed.

In April 1980, Commerce began a study of problems faced by U.S. insurance firms attempting to operate abroad; it planned to compare foreign government treatment of U.S. insurance companies with U.S. treatment of foreign insurance companies. Commerce believed this study was badly needed because insurance information was piecemeal and fragmented. To meet the report's objectives, Commerce developed a questionnaire for State insurance departments on domestic insurance barriers, reviewed Government and private sector documents covering domestic insurance barriers and foreign penetration of the U.S. market, cabled about 20 U.S.

Embassies requesting information on discriminatory foreign practices, and obtained financial information from the U.S. insurance industry on its foreign operations. Report completion was planned for July 1981. A Commerce official told us that Commerce was having problems concluding the study; data received from some U.S. Embassies lacked specificity and the questionnaire for the State insurance commissioners was never sent out.

In July 1982, the Commerce Department informed us that the scope of the Commerce study was substantially altered to focus more on general international insurance issues for the purpose of discussions with the Organization for Economic Cooperation and Development. Country specific information, which was to comprise the bulk of the original study, will not be published. Commerce determined that further work on this aspect of the study would not be productive because a comprehensive private-sector study of insurance regulation was prepared in conjunction with the 1982 World Insurance Congress.

In 1979 the USTR compiled a computer file of problems encountered by 13 U.S. service industries conducting business abroad. The inventory has been updated and includes information on barriers by country, type, and industry affected. The inventory covering insurance was formulated from the 1976 Commerce study with input from an international insurance trade association and one insurance firm. The USTR recognizes shortcomings in the barrier document's validity, accuracy, and specificity but told us that the objective is not to develop a definitive list of barriers by country but, as a general analytical tool, to have data which summarize the types of barriers encountered by U.S. firms.

THE IMPACT OF REMOVING FOREIGN INSURANCE BARRIERS IS UNKNOWN

Government and industry officials generally believe that foreign barriers are widespread, but opinions vary as to whether the U.S. insurance industry will obtain substantial additional business if these barriers were relaxed or removed. The five major U.S. insurers already operate in most non-Communist countries and have substantial amounts of premiums, as shown in table 3. Also, there are indications that U.S. firms are successfully overcoming barriers in some instances and some have been grandfathered in other markets. More importantly, the elimination of barriers may not result in substantial benefits because of limited interest of U.S. insurers in foreign markets, domestic competition in the developed countries, and low premium volume in the less developed countries.

Table 3

Company	Countries/ jurisdictions of operation	Approximate volume of foreign premiums/revenues-1980 (millions)
1	130	$1,800
2	80	900
3	145	733
4	70	519
5 (note a)	101	114

a/1979 data.

Some U.S. insurers have been "grandfathered" into some markets that have been closed to foreign firms, meaning that their existing businesses were allowed to continue operations after passage of a law prohibiting foreign ownership of insurance firms. Representatives of two insurers that we visited told us about Mexican efforts to decrease foreign ownership of insurance firms. Beginning in 1972, foreign investment in Mexican insurance firms was prohibited, but one firm was required only to reduce its equity position to 49 percent and the second firm merged with a Mexican bank, retaining a 37 percent interest in the newly formed company. These firms are not operating in their desired manner, but they are currently operating at the lower equity levels. We were advised that, despite the grandfathered status, there is continual pressure to reduce ownership.

There are methods by which foreign barriers can be overcome to some extent. In developing countries where direct insurance is tightly regulated, multinational corporations are reluctant to contract for insurance locally because local insurers are not able to quote comparable terms and conditions available from worldwide insurers. Also, the capability of small local insurers to meet large claims is questionable. To avoid infringing on local laws, the multinational corporation arranges to have the local insurer cover the risk and then reinsure the risk with the multinational's primary insurer. This process, called fronting, enables multinational corporations to satisfy local insurance requirements without losing the coverage available from the primary insurer.

U.S. and foreign insurers can also establish international collaborative agreements. As explained, the foreign insurer writes the insurance coverage for the clients of the U.S. insurance firm physically located in the foreign country then reinsures with the U.S. insurer. In turn, the U.S. insurer writes the insurance coverage for the foreign insurer's customers in the United States and reinsures with the foreign insurer. This may not be as profitable as a direct presence in the market, but it gives both companies access to the other's market at minimal cost and without the expense of establishing a direct presence. Three domestic firms that we visited conduct business in this manner.

Insurance firms reported that discrimination against branch operations is a barrier sometimes faced by U.S. insurers. According to insurers, disallowing branch operations increases costs and reduces efficiency of the U.S. insurer relative to local competition. Also, U.S. branches are viewed as less likely to be sub-subject to regulatory action, such as expropriation. One insurance firm that we visited experienced problems with its branch operations in Guatemala. The government passed legislation in the 1960s which "closed down" foreign branches--the company could not cover new risks, although it could maintain existing life insurance accounts. To comply with this restrictive legislation, the company formed a subsidiary company in 1969 to cover new life and general insurance risks, and the subsidiary is operating today.

According to one international insurer, the effect of foreign restrictions may be lessened depending on how the company adapts to different cultures and business practices. The primary concerns of foreign governments are the solvency and commitment of proposed U.S. operations, although some control is also desired. The insurer said that accommodation to a country's culture, rules of protocol, and regulations must be made. Each market and situation must be thoroughly researched and analyzed to determine ways which will permit creative insurance sales.

ADDITIONAL COMMENTS AND DATA ON THE IMPACT OF BARRIERS

Some insurance industry representatives stated that removing or lessening barriers may not result in a significant increase in U.S. premiums because of the limited interest of many U.S. insurers in foreign markets, domestic competition in the developed countries, and low premium volume in the lesser developed countries. However, some companies individually may benefit. Below are comments made by several insurance officials.

1. Few U.S. insurers will initiate efforts to enter foreign markets because of the significant investment required and the likelihood that profits will not accrue for 5 to 7 years. Only those U.S. insurers who have participated in foreign markets for many years are likely to expand their foreign operations because they have the money, expertise, and commitment to expand foreign operations.

2. Insurance barriers do not significantly affect U.S. insurance firms because those firms that want to operate internationally find ways to overcome barriers. Further, because market shares are already well established in the developed countries due to domestic competition and because premium income is so low in the lesser developed countries, there will be no great change in market shares if barriers are removed.

3. The U.S. insurance industry will realize no great economic benefit because of competition in the developed countries and low premium volume in the lesser developed countries. Of course, those U.S. insurers presently participating in a foreign market will receive some financial benefit and possibly two to three new U.S. firms will enter the market if barriers are relaxed or removed.

4. Removing all insurance barriers will not necessarily lead to substantial new business except for those U.S. firms already doing business in foreign markets. One official doubts whether many U.S. insurers will enter developed foreign markets, but, with removal of barriers, some U.S. firms will expand their businesses to the lesser developed countries that have good economic potential.

In 1980 a private research and consulting company studied the regulatory conditions and competitive status of insurance firms in England, Japan, West Germany, and France for a large U.S. insurer anticipating expansion in foreign markets. In general, the company found that there was much competition for insurance business in those developed markets and that profitable operations would be difficult to achieve. For example, in Japan, the world's second largest market with about $49 billion in 1978 premiums, 37 foreign insurers cover only 2.9 percent of the property and casualty insurance business and 3 foreign insurers cover 0.3 percent of the life insurance business. The consulting company stated stated that "As the Japanese market becomes more saturated, competition for business will intensify. It will not be easy for Japanese firms to increase their market share let alone foreign insurers." West Germany, the third largest world insurance market, had premiums of $37.2 billion in 1978. The study concluded that competition in this market represents a strong challenge for foreign insurance firms; domestic insurers are well entrenched and foreign firms have not been successful in recent attempts to penetrate the market.

A report prepared by the U.N. Conference on Trade and Development shows that in 1977 the developing and lesser developed countries contributed about $13 billion, or about 4.3 percent, of the world's premium volume. This percentage is lower than that of the French market alone. The report pointed out that Brazil, Argentina, Venezuela, and Mexico write premiums totaling $3.6 billion, or just under 30 percent of the total premiums of all developing countries and that in these countries the average premium per capita is only about $17. Some lesser developed countries do not even average $1 per capita in insurance premiums.

AGENCY COMMENTS AND OUR EVALUATION

The USTR and Commerce Department were concerned that our report portrayed a negative impression of the potential value to be

derived from relaxing or removing foreign insurance barriers. The International Insurance Advisory Council believed that the editorial tone is such that the reader is led to infer the problems posed by discriminatory barriers are less important than the practitioners (insurance companies) know them to be, and the economic importance of barriers is not lessened by the fact that industry, government, and academic research have not put a fixed value on the barriers. The Commerce Department also commented that it is working to improve data in service sector trade but that even with improved data the precise impact of non-tariff barriers would be difficult to quantify.

We did not conclude that the insurance industry--and particularly individual firms--would or would not increase business (and potential profits) with the removal or relaxing of foreign barriers. We do indicate that, although the insurance industry cites that barriers are widespread, the significance and economic impact of barriers are unknown. The insurance firms that we visited provided us with few documents to support their statements concerning the specifics and impact of barriers. The USTR and Commerce Department both commented that better information needs to be developed on the significance and economic impact of foreign insurance barriers, and we agree.

CHAPTER 4

EFFORTS TO REMOVE FOREIGN INSURANCE BARRIERS: A DIFFICULT TASK

The Federal Government is addressing the difficult problem of removing foreign insurance barriers. The USTR is attempting to convince U.S. major trading partners that service sector trade is an important sector that should be discussed in multilateral trade negotiations. It is recognized, however, that a multilateral approach will not achieve significant progress in reducing insurance and other service sector trade barriers before 1990. In the interim, companies can seek relief from unfair or discriminatory foreign trade practices on a case-by-case basis by requesting assistance under section 301 of the Trade Act of 1974, as amended. Three such insurance cases have been processed and the USTR made considerable effort to resolve the complaints. According to industry, significant benefits have been achieved in one case.

The U.S. Government does not have unlimited leverage to use as a means to obtain trade concessions from foreign governments. U.S. insurers believe that the Government will have to negotiate in other trade issues to obtain concessions in insurance. Before giving priority to any individual industry's concerns, such as insurance, the Government needs to know the significance of foreign barriers and whether substantial economic benefit would be realized by the industry if the barriers were relaxed or eliminated.

PROBLEMS ENCOUNTERED IN REMOVING BARRIERS

Removing foreign insurance barriers requires negotiations and concessions from foreign governments that are often unwilling to remove barriers for national interest reasons. According to U.S. insurance officials, many insurance barriers are present in developing and lesser developed countries which often have strong political and economic reasons for precluding foreign insurers from operating within their markets. Specific reasons for a nation to establish insurance barriers are:

--Loss of foreign exchange. The presence of foreign insurers in a market results in an outflow of premiums which may aggrevate foreign exchange problems in less developed countries.

--Prevention of foreign domination. Because insurance plays an important role in the economy, governments want the local insurance industry to be controlled by nationals to ensure that insurance is managed in accordance with the national interest.

--Oversupply. Too many insurance firms in a market are viewed as leading to excessive competition, underwriting losses and unsound business practices.

--Infant industry argument. Because international insurers are strong and solvent, the national companies require protection until they reach a level of development where they can compete on their own.

The U.N. Conference on Trade and Development is an international forum which represents less developed countries and provides an opportunity for them to meet and debate economic issues. In July 1980, the Conference issued a position paper on the insurance situation in developing countries. A U.S. Government-industry committee rejected the position paper because its tone and direction suggested that effective development of these insurance markets "requires strong government intervention and ownership."

The United States, in setting its negotiating position, has little to concede in insurance as an enticement for foreign nations to remove barriers because the U.S. insurance industry is regulated by the State governments with only minimal Federal involvement. The States' regulatory requirements do not substantially restrict the entry and operation of foreign-owned firms in the U.S. market.

State regulation of
domestic insurance market

According to a USTR official, State governments and insurance firms are very concerned because of the potential increased Federal role in insurance regulation. The official believes the issue of the State's role in retaliation can be resolved, but is unsure at this time how to best approach it.

In the four States we visited, insurance statutes contain reciprocity provisions that could be used to counter discriminatory practices of other States and foreign governments. The reciprocity statues are sufficiently broad to cover issues ranging from discriminatory taxes and fees to denial of the right to conduct business. State officials told us that these statutes have not been used against alien companies, but they seemed willing to apply the reciprocity provisions against alien companies from countries discriminating against U.S. firms. One official said that the State would consider taking action if presented with a well-documented case of discrimination, but he did not know how effective the action would be since the State has no experience in applying the provision. Only two of four States were aware that U.S. insurers were encountering entry and operational barriers overseas.

WHAT IS BEING DONE?

In April 1981, the United States Trade Representative released the administration's work program on trade in services. He said that, in recognition of the growing importance of U.S. trade in services and the relative lack of existing mechanisms for dealing with the problems, trade issues relating to services would be given a high priority in the administration's trade program. As a part of the work program, the administration (1) gave priority to domestic and international efforts to lay the groundwork for future multilateral negotiations on trade in services and (2) commited itself to make every effort to deal with pressing trade problems through bilateral contacts with responsible foreign officials.

Relief through multilateral trade negotiations

No international framework currently exists for resolving trade problems in services, and governments generally rely on bilateral contacts to resolve such problems on a case-by-case basis. The rules on unfair trade practices covered under the General Agreement on Tariffs and Trade (GATT) 1/ do not apply to services. No criteria has been developed internationally for what constitutes unfair trade practices in services.

In November 1982, GATT members will meet to discuss an agenda for a possible next round of multilateral trade negotiations. The last meeting, the "Tokyo Round", formally began in 1973 with negotiations starting in 1975 and being substantially concluded in 1979. Agreements were reached reducing barriers to agricultural trade and reducing tariffs on industrial goods. Service sector trade was not part of the agenda. Making it part of any forthcoming negotiations is a high priority for the administration.

The Tokyo Round Agreements on nontariff barriers for trade in goods represent the type of agreement the U.S. Government will likely seek for international trade in services. A feature of the Tokyo Round Agreements is a dispute settlement procedure for encouraging development of mutually satisfactory solutions to trade disputes; if a mutually satisfactory solution is not found, a committee may authorize appropriate countermeasures.

1/A code of rules for international trade and a forum in which countries can discuss trade problems and work together to reduce trade barriers and further liberalize world trade. GATT membership consists of 85 countries that represent four-fifths of the world's trade. The GATT rules govern the trade of its member countries and the conduct of trade relations with one another.

The President may also use appropriate countermeasures to enforce the rights of the United States under the Tokyo Round, or any other trade agreement. Under the authority of the Trade Agreements Act of 1979 (19 USC 2411 et. seq.), which amends section 301 of the Trade Act of 1974, he may take "all appropriate and feasible" action.

The U.S. Government is also attempting to generate interest in the issue within the Organization for Economic Cooperation and Development (OECD), 1/ by pressing the issue of trade problems in services to help lay the groundwork for future multilateral trade negotiations in services. At the U.S. request, the OECD Trade Committee agreed to study the services trade, evaluate trade problems and issues, and identify possible negotiating goals. In June 1981, the OECD ministers issued a joint statement in which they agreed that barriers to services trade is an important issue warranting attention. According to the Assistant USTR for Policy Development, because nations are starting to view barriers to international services trade as an important issue, there is a very good prospect that a services round of multilateral trade negotiations will be undertaken. However, negotiations will not likely begin before the mid-1980s nor be completed before the end of this decade.

An OECD Insurance Committee is actively working on a number of international insurance issues, including updating the OECD Code of Liberalization of Current Invisibles Operations concerning insurance, compiling and prioritizing international insurance barriers, improving international insurance statistics, and harmonizing classification of classes of insurance.

Relief under section 301 of the Trade Act

Section 301 of the Trade Act of 1974, as amended, authorizes the President, among other things, to take action against any foreign government whose act, policy, or practice is unjustifiable, unreasonable, or discriminatory and burdens or restricts U.S. commerce. To initiate action, an injured party submits a petition to the USTR. The petition includes information on the unfair trade practice and other information required by the USTR. The USTR investigates the petition and is assisted by a section 301 committee composed of representatives of various Federal agencies. Section 301 cases are often resolved through bilateral negotiations before Presidential action is required. If no progress is made, the President is empowered to take unilateral action. The Government can also attempt to assist companies through bilateral contacts with

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1/Headquartered in Paris, the OECD constitutes the forum for developed countries to discuss trade and related matters.

foreign governments for those companies not wanting to initiate formal section 301 cases.

Despite the reported widespread existence of discriminatory insurance barriers, only three section 301 petitions have been submitted by the insurance industry. According to the USTR, Commerce Department, and insurance industry representatives, there are a number of reasons why so few cases have been submitted to date. Section 301 is relatively new, and companies are not familiar with the procedure and are unwilling to spend considerable money in legal fees on an unproven method. Many trade restricting practices occur in countries where the United States has little or no leverage. In most situations, no legal basis or criteria exists with which to measure discriminatory or unreasonable practices in services (in contrast to GATT codes for trade in goods). Also, the language in Treaties of Friendship, Commerce, and Navigation is often too ambiguous to be used as legal support in such discrimination cases. Lastly, since the section 301 process is open and a matter of record, more harm than good may result from the case--even though a company may win a section 301 case, the foreign government may initiate covert discriminatory practices against the company for initiating the case.

The USTR and its section 301 committee investigated the merits of each of the three insurance cases and worked closely and cooperatively in developing a joint position on each case. In two cases, the committee found that unfair practices existed and U.S. negotiators gained concessions from the foreign governments. In the third case, although the committee believed that discriminatory treatment existed, it did not recommend action because of certain economic and political factors. However, the foreign government did agree to attend future multilateral trade discussions aimed at liberalizing insurance barriers. The USTR expended considerable effort in processing the three insurance cases, and according to industry, substantial benefits have been achieved in one case.

The three insurance cases are summarized below.

Soviet Union - marine insurance

In November 1977, the American Institute of Marine Underwriters, a trade association representing 126 U.S. marine insurers, petitioned the USTR for relief from unfair or discriminatory foreign trade practices. The Institute alleged that the Soviet Union restricted U.S. commerce by requiring that insurance on imports and exports between the United States and the Soviet Union be placed with the Soviet state insurance monopoly, Ingosstrakh. The Institute was especially concerned that U.S. marine insurers would be precluded from participating in any future shipments of wheat to the Soviet Union--trade which would total millions in premium dollars.

The USTR initiated an investigation that included public hearings and many meetings of the section 301 committee. The committee determined that the United States should seek a settlement assuring U.S. underwriters a share of the marine insurance on U.S.-Soviet trade. In May 1978, the USTR recommended that the President (1) make a determination that the Soviet practice restricts U.S. commerce within the meaning of section 301 and (2) establish an interagency committee to focus on ways to eliminate the unreasonable practice. In June 1978, President Carter carried out both recommendations.

The Soviets requested a meeting in the fall of 1978 to discuss concrete proposals for resolving the marine insurance issue. Although the Institute had been trying to gain access to the Soviet market for years, this represented the first action initiated by the Soviets to address the problem. USTR documents indicate that the Soviets believed the United States might retaliate against their lucrative maritime business and thus wanted to quickly focus the discussions solely on marine insurance. In October 1978, U.S. and Soviet negotiators met in Vienna, and in April 1979, U.S. and Soviet officials signed a memorandum of understanding which provided that each party recognized the interest of the other in having a substantial share of the marine cargo insurance resulting from U.S.-Soviet trade. They also agreed to annually review the placement of this insurance and to exchange the necessary data to evaluate compliance with the memorandum. In July 1979, the USTR suspended its investigation pending the outcome of the first annual review.

A first year annual review of the agreement was not possible, however, because of the disruption in relations and bilateral trade following the Soviet invasion of Afghanistan.

According to industry and Maritime Administration sources, U.S. marine insurers did not obtain additional business as a result of the April 1979 agreement. Institute officials said that a survey of Institute members shows that U.S. marine underwriters did not write any U.S.-Soviet business in 1980, although there was substantial trade, including 8 million tons of wheat. In May 1980, the Maritime Administration sent a letter to the Soviet Deputy Minister of Trade pointing out that U.S. marine underwriters had not obtained a significant share of the cargo insurance on bilateral trade. During the first year of the agreement, which began in April 1979, U.S. marine insurers obtained only 1.2 percent of premiums generated to cover the $4.5 billion in trade.

The President of the American Institute of Marine Underwriters said that he doubts that U.S. marine insurers will obtain a substantial share of the marine insurance business on bilateral trade. He also doubts that the Soviet Union will honor the agreement because (1) U.S. marine insurers obtained almost no business on past shipments when the terms of the agreement should have been

applied and (2) there is no penalty clause or dispute settlement mechanism in the agreement.

Argentina - marine insurance

In May 1979, the American Institute of Marine Underwriters petitioned the USTR for relief from unfair and discriminatory trade practices by the Government of Argentina. The petition alleged that Argentina severely restricts and hinders competition in the marine market so that virtually all insurance on exports and imports must be placed with Argentine companies. Further, it alleged that these practices were inconsistent with Argentina's obligations under the Treaty of Friendship, Commerce, and Navigation and precluded U.S. marine insurers from a substantial market.

USTR initiated an investigation, held several interagency meetings and public hearings, and contacted Argentine officials. Information developed by the section 301 committee showed that:

--There were no specific violations of the Treaty, which contains no provisions mandating national treatment for services. Although the Treaty pertains to freedom of commerce, it specifically deals with trade in goods.

--Estimated premiums and profits were overstated.

--Normal commercial practices call for importers to purchase insurance locally.

--Argentina suffers a negative balance of payments in bilateral trade with the United States.

--Argentina is only one of many developing countries that have the same restrictive marine insurance barriers.

Although the committee believed that Argentina did discriminate against U.S. marine insurers, it did not recommend that the President make a determination that Argentina's marine insurance requirements burden and restrict U.S. commerce. Rather, the committee recommended that the United States request that Argentina, together with other countries with similar restrictions, attend future multilateral trade negotiations aimed at seeking agreement for applying national treatment to foreign insurance firms. The committee recommended this course of action after considering several economic and foreign policy issues.

Subsequently, U.S. negotiators received a commitment from Argentina to participate in a multilateral negotiation concerning the elimination of restrictive insurance practices. In July 1980,

the section 301 case was suspended pending the outcome of these negotiations. To date, the USTR has not initiated negotiations.

USTR officials advised us that the United States has little leverage to force Argentina into concessions on insurance. Also, the possibility of negotiating concessions was limited because of the absence of international agreements or rules governing services and insurance trade.

Institute officials are unhappy with the outcome of this case because member insurance firms have not obtained any marine insurance business.

Korea - marine, fire, and reinsurance

In November 1979, the American Home Assurance Company, an American subsidiary of the American International Group with a branch in Korea, petitioned the USTR for relief under section 301. The Company had been attempting to get the Republic of Korea to broaden its insurance license for several years. Following the Korean war, the Company was licensed to insure non-Koreans under policies written in U.S. dollars for all lines of insurance except life insurance. Although the Republic assured the Company that an extended license eventually would be issued, attempts to obtain the extended license failed. In March 1977, the Company initiated steps to file a section 301 petition but decided against this action when the Republic of Korea agreed in April to grant an expanded license to conduct business with Koreans in Korean currency. The agreement was not honored, and the Company resubmitted its section 301 petition in November 1979.

The section 301 petition alleged that the Republic of Korea:

--Failed to expand the Company's license to write marine insurance in Korea.

--Disallowed the Company from joining the fire pool or writing most forms of joint venture fire insurance. The fire pool is an association of domestic insurance companies established by government statute to jointly underwrite substantial risks.

--Granted retrocessions from the Korean Reinsurance Corporation to the Company of about 10 percent the amount granted to Korean insurance companies. Insurance firms in Korea must cede a portion of every risk to the Korean Reinsurance Corporation, a quasi-governmental entity. In turn, the corporation retrocedes a portion to insurance firms according to a predetermined formula.

The Company believed that the treatment accorded by the Republic of Korea was discriminatory and in violation of the standard of equal national treatment provided for in the bilateral Treaty of Friendship, Commerce, and Navigation.

The section 301 Committee investigated the petition and found that the Republic of Korea did discriminate against the Company, thereby negatively affecting U.S. commerce, and recommended that the United States enter into bilateral discussions with the Republic of Korea and seek a commitment for national treatment.

Beginning in June 1980, negotiators from both countries held several rounds of consultations. Because of the slow progress, the committee, in November 1980, considered the following four alternatives as areas of possible retaliation.

1. Deny Korean vessels owned by shipping companies related to Korean insurance firms the right to enter U.S. ports.

2. Impose substantial entry fees on Korean vessels owned and operated by entities related to Korean insurance companies.

3. Disqualify Korean construction companies related to Korean insurance companies from bidding on U.S. Government contracts, except contracts related to the support of U.S. forces in Korea.

4. Proclaim appropriate duty increases on selected imported products manufactured by affiliates of Korean insurance companies.

The committee subsequently considered (1) requesting the States to use their reciprocity statutes against Korean insurers, (2) requesting the National Association of Insurance Commissioners to remove the names of Korean insurers from the approved list of alien surplus lines insurers, and (3) withdrawing the right of Korean insurers to write workmen's compensation insurance in Guam. For various reasons, only alternative 4 above remained under consideration as a possible form of U.S. retaliation. The committee recognized that States regulate the domestic insurance industry and that, because Korean insurers have very limited operations in the United States, retaliation would have little impact.

In December 1980, USTR officials traveled to Korea and conducted four days of negotiations, which resulted in the Republic of Korea agreeing to

--grant the Company a full and complete marine insurance license;

--gradually remove restrictions on the Company's opportunity to compete for a significant share of the fire insurance market; and

--eliminate the discriminatory nature of the Korean retrocession system.

Company representatives told us that the Company is now realizing significant benefits as the result of the section 301 case. According to a Company official, the section 301 efforts were successful because the Koreans gave them a complete marine license and are releasing certain types of risks from the fire pool. However, the Company did not obtain all that it wanted because it is excluded from writing commercial business in many of Korea's larger cities.

AGENCY COMMENTS AND OUR EVALUATION

The Commerce Department commented that an effort will be made to extend some important general trade principles to services as a whole, with the need for specific sectoral issues to be explored later. Commerce concurred with us that the U.S. Government does not have unlimited leverage in the insurance area, but it believes that foreign insurers have a strong interest in the U.S. market which indicates that leverage is not entirely lacking. While State regulation of the industry complicates the exercise of this leverage, Commerce is confident that the problem can be largely overcome through close contact and cooperation with the National Association of Insurance Commissioners.

We believe that, because foreign-owned insurers entering the U.S. market are mostly from developed countries, the United States has little leverage in insurance in the developing and less developed countries. Some insurance companies tell us these countries are the most restrictive while offering the greatest potential. Also, companies from the United Kingdom, a trading partner which we are told has an open market, account for about 60 percent of premiums generated by foreign-owned firms.

ANALYSIS OF REQUIREMENTS THAT APPLY TO FOREIGN-OWNED INSURANCE COMPANIES IN CALIFORNIA, ILLINOIS, MASSACHUSETTS, AND NEW YORK

State requirements for companies owned by foreign interests can apply to one or more of the following: (1) alien companies or branches only (companies organized under the laws of a jurisdiction outside the United States), (2) domestic companies owned by foreign interests, or (3) foreign companies (companies organized within other States and either owned by U.S. interests or foreign interests). Information on the types of provisions and the States in which they exist are shown below. A summary of individual State requirements is contained on the following pages.

Requirements

Category	States			
	Calif.	Ill.	Mass.	N.Y.
Capitalization, asset, and deposit amount				X
Trust deposits	X	X	X	X
Proof of successful operations	X			
Government ownership	X	X		X
Assets or investments		X		X
Taxes and fees		X		X
U.S. managers	X	X	X	X
Profit repatriation		X		X
Lines of insurance		X		
Licensing periods				X

Individual State Requirements

State	Requirements	Applied to
California	Trust deposits Deposits for minimum paid-in capital must be placed with specified officials of the State, another State, or otherwise held in trust.	Alien branches
	Proof of successful operations With some exceptions, no certificates of authority (licenses) can be granted to companies which have not transacted business for 3 years in the lines of insurance for which they seek admittance.	Alien branches and foreign companies
	Government-owned or controlled firms No certificates of authority (license) should be issued to any insurers owned, operated, or controlled directly or indirectly by any other State or province, district, territory, nation, or governmental subdivision or agency.	Alien branches, domestic companies owned by foreign interests, and foreign companies
	U.S. manager Companies must appoint U.S. managers.	Alien branches
Illinois	Trust deposits Deposits for minimum paid-in capital must be placed with specified officials of the State or another U.S. State.	Alien branches and foreign companies
	Government ownership Companies owned or controlled by another U.S. State, foreign government, or political subdivision are prohibited from operating in the State.	Alien branches, domestic companies owned by foreign interests, and foreign companies

State	Requirements	Applied to
Illinois	Asset or investments Only assets physically located in the United States are recognized toward meeting capitalization, assets and deposit requirements set by the State.	Alien branches and foreign companies
	Taxes and fees Companies must pay an annual 2-percent tax on net taxable premium income when their principal offices are located outside Illinois.	Alien branches and foreign companies
	U.S. manager Companies must appoint U.S. managers.	Alien branches
	Profit repatriation Companies cannot remit more than 10 percent of surplus in dividends without prior approval.	Alien branches, domestic companies owned by foreign interests, and foreign companies owned by foreign interests
	Prohibited insurance lines Companies cannot write mortgage guarantee insurance or operate mutual benefit societies or burial societies.	Alien branches
Massachuestts	Trust deposits Deposits of minimum paid-in capital must be made with the State, another State, or otherwise held in trust.	Alien branches and foreign companies
	U.S. Manager Firms must appoint U.S. managers.	Alien branches
New York	Capitilization, assets, deposit amounts Companies must deposit 150 percent of minimum capital required of domestic firms (and 200 percent for fire and marine insurance)	Alien branches

State	Requirements	Application
New York	Trust deposits Companies must maintain deposits to meet minimum capital requirements in trust with State officials, officials of another State, or otherwise in trust.	Alien branches
	Government-owned or controlled firms No license can be issued to any company financially controlled by any U.S. State, foreign government, or their political subdivisions—unless so owned and authorized to do business prior to 1956.	Alien branches, domestic companies owned by foreign interests, and foreign companies
	Assets or investments Companies must maintain capital and surplus requirements in specific securities allowed under the law. Only $500,000 of their minimum capital can be invested in their home countries.	Alien branches
	Taxes and fees Companies are assessed an additional 1 to 2.6 percent in taxes, based on premium volume, depending on type of insurance and whether they are alien branches or foreign companies. Fire insurance companies are subject to a fire department tax amounting to $1.80 per $100 of premiums.	Alien branches and foreign companies
	U.S. manager Companies must appoint U.S. managers.	Alien branches
	Profit repatriation Alien branches can remit investment income only up to $50,000 for each quarter year without approval of Superintendent of Insurance.	Alien branches
	Licensing Companies subject to annual license renewals.	Alien branches and foreign companies

NUMBER OF FOREIGN-OWNED INSURANCE FIRMS

LICENSED IN THE UNITED STATES

Nationality	1971 P/C (note a)	1971 L/A&H (note b)	1971 Total	1975 P/C	1975 L/A&H	1975 Total	1980 P/C	1980 L/A&H	1980 Total
Canada	2	1	3	4	2	6	9	5	14
England/United Kingdom	43	3	46	41	4	45	53	5	58
Finland	-	-	-	-	-	-	4	-	4
France	1	-	1	3	1	4	7	5	12
Germany	4	3	7	5	4	9	11	8	19
Italy	2	-	2	2	-	2	6	-	6
Japan	4	-	4	6	-	6	12	1	13
Netherlands	3	-	3	3	2	5	6	17	23
Sweden	2	-	2	2	-	2	7	-	7
Switzerland	8	3	11	7	3	10	14	4	18
Other (note c)	6	-	6	9	1	10	19	-	19
Total (note d)	75	10	85	82	17	99	148	45	193

a/Property and casualty

b/Life/accident and health

c/Includes firms from New Zealand, Spain, Norway, Brazil, Bermuda, the Philippines, Denmark, Ireland, Belgium, Mexico, and several Scandinavian and European consortiums (no more than three firms in any year are from any one country or consortium).

d/Although licensed to do business, many of the firms had no direct premiums in property/casualty or life insurance. A. M. Best Company data showed the following number of licensed companies with no direct premiums--25 of 85 companies in 1971, 25 of 99 companies in 1975, and 60 of 193 companies in 1980. About 85 percent of these firms, however, did have reinsurance premiums in the U.S. market during these years.

VOLUME OF PROPERTY/CASUALTY DIRECT PREMIUMS IN THE UNITED STATES

Nationality	1971		1975		1980	
	Amount (millions)	Percent	Amount (millions)	Percent	Amount (millions)	Percent
United States	$33,940.0	94.65	$47,959.5	95.20	$94,443.6	95.33
Foreign-owned						
Canada	20.6	0.06	35.0	0.07	118.9	0.12
England/United Kingdom	1,672.2	4.66	2,029.1	4.03	3,298.4	3.33
Finland	-	-	-	-	55.0	0.06
France	-	-	-	-	0.1	-
Germany	19.5	0.05	25.3	0.05	133.1	0.13
Italy	12.6	0.04	19.7	0.04	35.1	0.04
Japan	4.4	0.01	12.6	0.03	118.3	0.12
Netherlands	0.4	-	67.3	0.13	233.1	0.24
Sweden	-	-	-	-	0.03	-
Switzerland	180.6	0.51	210.8	0.42	559.1	0.56
Other	7.5	0.02	17.1	0.03	73.4	0.07
	1,917.8	5.35	2,416.9	4.80	4,624.5	4.67
Total	$35,857.8	100.00	$50,376.4	100.00	$99,068.1	100.00

VOLUME OF LIFE, ACCIDENT, AND HEALTH

DIRECT PREMIUMS IN THE UNITED STATES

Nationality	1971		1975		1980	
	Amount (millions)	Percent	Amount (millions)	Percent	Amount (millions)	Percent
United States	$37,897.2	99.95	$52,222.7	99.84	$78,055.2	98.3
Foreign-owned						
Canada			8.0		43.8	
England/United Kingdom	17.0		17.3		251.5	
Finland	-		-		-	
France	-		3.5		35.5	
Germany	-		1.1		335.3	
Italy	-		-		-	
Japan	-		-		17.0	
Netherlands	-		32.1		656.1	
Sweden	-		-		-	
Switzerland	3.0		4.8		12.1	
Other	-		19.4		-	
	20.0	0.05	86.2	0.16	1,351.3	1.7
Total	$37,917.2	100.00	$52,308.9	100.0	$79,406.5	100.0

PROFITABILITY RATIOS FOR U.S.-OWNED AND
FOREIGN-OWNED COMPANIES IN THE UNITED STATES
PROPERTY AND CASUALTY INSURANCE

Ratios	1980		
		Foreign-owned (note a)	
	U.S.-owned	Branches	Subsidiaries
Loss ratio (note b)	75.2	73.1	69.8
Expense ratio (note c)	26.1	32.9	33.8
Combined underwriting ratio (note d)	101.2	106.0	103.6
Policyholders dividend ratio (note e)	1.8	0.7	0.7
Investment ratio (note f)	12.4	15.8	14.0
Stockholders dividend ratio (note g)	-3.2	-2.9	-2.4
Total combined ratio (note h)	87.5	88.0	87.9

a/Includes alien branches as well as domestic U.S. companies owned by foreign interests (subsidiaries).

b/Losses and adjustment expenses related to net earned premiums.

c/Underwriting expenses related to net written premiums.

d/Sum of loss ratio and expense ratio.

e/Policyholder's dividends related to net earned premiums.

f/Net investment income related to net earned premiums.

g/Stockholder's dividends related to net earned premiums.

h/Sum of the loss, expense, policyholder's dividend, and stockholder's dividend ratios less investment ratio.

OFFICE OF THE UNITED STATES
TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON
20506

July 16, 1982

Mr. Frank C. Conahan
Director
International Division
United States General Accounting
Office
Washington, D.C. 20548

Dear Mr. Conahan:

This is in response to your invitation to Ambassador Brock to comment on the GAO report, International Insurance Trade Barriers: Reportedly Widespread, But Impact Unknown. In general, we find the report well done. However, we have a few brief comments about the general thrust of the report.

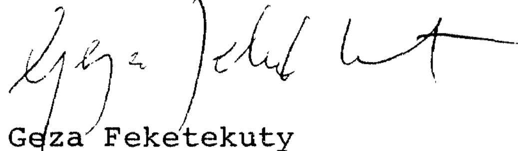
First, in the Cover Summary of the report, it states that ". . . though the number of foreign-owned firms in the U.S. market has increased, these firms have achieved only a relatively small share of the U.S. markets." Later in the report itself this finding is expanded, and it is pointed out that the principal reason for this is the competitive strength of U.S. firms. Representatives of foreign-owned firms are reported as saying that ". . . competition -- not barriers to entry and operation -- account for their small share of the U.S. direct premium market." We believe that this additional explanation is important because it makes it clear that the relatively small share of the U.S. market held by foreign-owned firms is not due to any barriers to the U.S. market. The Cover Summary, which may well be more widely read than the more detailed text, should be changed to reflect this explanation.

A second, perhaps more important, comment has to do with the report's comments on the potential value to U.S. insurance firms of reducing foreign insurance barriers. We believe that U.S. insurance firms are strong innovative competitors and would likely receive benefit from any reduction in foreign insurance barriers which might be achieved. We are still in the early stages of preparation for any possible future negotiations on services, and we need to

develop more information regarding possible benefits that might accrue to the U.S. insurance industry. We should not prejudge what these benefits might be, however, and the report is somewhat more negative in tone on this issue than we believe appropriate at this stage.

I hope you find these comments helpful. We appreciate the opportunity to share our thoughts with you.

Sincerely,



Geza Feketekuty
Assistant U.S. Trade
Representative for Services
and Policy Development

UNITED STATES DEPARTMENT OF COMMERCE
The Under Secretary for International Trade
Washington, D.C. 20230

JUN 28 1982

Mr. Henry Eschwege
Director
Community and Economic Development Division
United States General Accounting Office

Dear Mr. Eschwege:

Thank you for the opportunity to review the GAO draft report "International Insurance Trade Barriers: Reportedly Widespread, But Impact Unknown."

The data you have developed reflects the competitiveness of the U.S. insurance industry domestically and abroad. This degree of competitiveness worldwide is not unique to the insurance industry but is characteristic of the situation in many U.S. service sectors. Your proposed report raises a number of important questions at a time when the U.S. is considering how best to preserve its international competitiveness in the services area. It highlights the amount of work which still needs to be done before international negotiations should be initiated. The Administration has made the development of necessary data an important element of the five-point work program on services.

Our detailed comments on the proposed report are attached. We would be pleased to provide any further information you may need.

Sincerely,

Lionel H. Olmer

Enclosure

COMMENTS ON DRAFT GAO REPORT "INTERNATIONAL INSURANCE TRADE BARRIERS: REPORTEDLY WIDESPREAD, BUT IMPACT UNKNOWN"

The following comments are divided into two parts: (1) general comments on the GAO's findings with respect to the three major issues examined; (2) comments, with page references, on specific points in the body of the report.

General Comments

Alien Operations in the U.S. We concur with the GAO finding that U.S. barriers to entry and operation do not, in practice, constitute serious obstacles to foreign-owned insurers seeking to enter the U.S. market. This is consistent with what we have heard from foreign firms and foreign governments in international meetings we have attended and through contacts with trade associations. We are also aware that foreign firms have achieved limited market share in the U.S. We believe it is significant, however, that the number of foreign insurance firms in the U.S. nearly doubled in the 1975-1980 period. This trend seems to be continuing and points to a likely increase in the future market share of foreign firms. Because of the nature of the service, the insurance purchasing decision tends to be a conservative one. New firms in the market, whether domestic or foreign cannot expect to rapidly attain a large share of the market. Perhaps more importantly, the increasing establishment of foreign insurers in the U.S. indicates what we perceive as an internationalization of the insurance market.

U.S. Insurance Operations in Foreign Markets. GAO found, as we have, that many foreign barriers are difficult to identify, because they are often subtle, or obscured by lack of transparency in foreign regulations. The extent to which U.S. firms would attain economic benefits as a result of reduction of nontariff barriers will be difficult to measure empirically. (This is true for other service industries and trade in goods, too.) However, we believe the GAO report understates the potential growth of international insurance markets and U.S. participation in them, for the following reasons:

o It has not given sufficient recognition to the general trend toward internationalization of the insurance industry. This trend is exemplified by: a) increased establishment of foreign branches and subsidiaries throughout the world; b) the recent transformation of the insurance brokerage industry from a local and national into a largely multinational enterprise; c) recent development in the United States of insurance exchanges capable of becoming alternative international marketplaces to Lloyds of London; d) a strong trend, particularly among U.S. multinationals, toward development of worldwide risk management programs; e) the recent establishment of international committees in a number of important insurance trade associations.

o We do not believe that the existence of strong domestic competition in a foreign market presupposes the failure of a potential new supplier in the insurance sector, any more than it

does in any other good or service industry. On the contrary, protectionism which is endemic in many national insurance markets often results in lack of innovation and competitiveness. For example, an executive of a large U.S. life insurer licensed in Japan in 1979 recently said that the Japanese life insurance industry is "old fashioned" lacking sophistication and efficiency.

o In developing countries, GAO correctly observes that insurance premiums are relatively low. However, the growth rate of premiums in many of those countries is relatively high. Insurance is income elastic, especially as an economy becomes industrialized. In OECD countries, insurance premiums accounted for 5.38 percent of GNP in 1979, whereas, premiums accounted for only 1.53 percent of GNP in non-OECD countries. This gap will narrow, and non-OECD countries will account for a larger share of world insurance premiums as they industrialize. From 1950 through 1979, non OECD countries' share of world insurance premiums rose from 2.9 percent to 5 percent. It is generally accepted within the industry that the developing country markets are the growth markets of the future, if restrictions are minimized.

o A recent study by the office of New York State Senate Minority Leader Manfred Orenstein estimated the growth of international premiums attributable to U.S. based enterprises as follows: 1975 - $3.2 billion, 1980 - $6.5 billion, 1985 - $11.5 billion. The report concluded that the primary factor inhibiting greater growth is the restrictive policies of foreign governments affecting direct writing of foreign risks.

o GAO indicates that some U.S. firms have been able to overcome barriers through various forms of accommodation and through being "grandfathered" in certain markets. It should be pointed out that the former entails unquantifiable direct and opportunity costs, while the latter assumes denial of new market entrants.

U.S. Efforts to Remove Foreign Insurance Barriers - Plans for service sector negotiations are in an early stage. It is expected that an effort will be made to extend some important general trade principles to services as a whole with the need for specific sectoral issues to be explored later. It has never been the Administration's intention to negotiate insurance issues in a vacuum.

It is clear that the U.S. Government does not have unlimited leverage in the insurance area. However, the strong interest exhibited in recent years by foreign insurers in the U.S. market indicates that leverage is not entirely lacking. While state regulation complicates the exercise of this leverage, we are confident that the problem can be largely overcome through close contact and cooperation with the National Association of Insurance Commissioners (NAIC) -- and that process has begun. The NAIC has established a liaison with the Commerce Department, through its Task Force on Discrimination Against U.S. Insurers in Foreign Countries.

The Administration is fully aware of the need to develop more information on the significance and economic impact of foreign insurance barriers. An important aspect of this is the need for improvement of statistical data. The International Trade Administration is working with the Bureaus of the Census and Economic Analysis to enhance international data in insurance and other service sectors. This work draws upon studies contracted by Commerce and other agencies to assess current data availability and recommend methods of data improvement. We are also working through the OECD Insurance Committee to develop internationally comparable insurance data. Even with improved data, the precise impact of nontariff barriers would be difficult to quantify. This is inherent to analysis of nontariff barriers. It has not precluded successful nontariff barriers negotiations in goods, nor should it in services.

Specific Comments

- P. 2 — Marine insurance is often considered a separate branch of the insurance sector.

- P. 7 (now p. 5) — It should be noted that the District of Columbia also has an insurance department.

- P. 7-8 (now p. 5) — In 1980, the U.S. accounted for $190 billion or about 44 percent of the world's premium volume. Japan accounted for about $59 billion or 14 percent of world premium volume.

- P. 18 (now p. 11) — In 1980, U.S. reinsurance payments were $2.1 billion; U.S. reinsurance receipts were $922 million. Data for 1981 will be available about August 1, 1982.

- P. 19 (now p. 11) — Exchanges also have the potential to attract foreign insurance premiums to the U.S. This would result in an additional positive impact on the U.S. balance of payments.

- P. 29 (now p. 17) — The scope of the Commerce study was substantially altered to focus more on general international insurance issues for the purpose of OECD dicussions. (Copy attached).[1] Country specific information, which was to comprise the bulk of the original study will not be published. We have determined that further work on this aspect of the study would not be productive because a comprehensive private sector study of insurance regulation and markets in 91 countries was prepared in conjunction with the 1982 World Insurance Congress in Philadelphia and published in April, 1982.

- P. 34-36 (now pp. 20 and 21) — The generally negative comments of insurance officials regarding the potential effect of a lessening of barriers cannot be definitively confirmed or refuted by existing data. However, certain trends seem to belie these statements. The example of Japan is cited

[1]Not included in report because it is an OECD discussion paper, not the Commerce study discussed in this report.

(now p. 21)

on p.35. Since the 1978 study cited in the report, three (soon to be four) new property/casualty insurers and two new life insurers have entered the market. All are U.S.- based firms. They are apparently not discouraged by the relatively small share of the market now held by foreign firms in Japan. In addition, it is a mistake to conclude that, although some companies have found ways to work around the barriers to entry or operation, that such barriers do not have "any great effect" on U.S. insurance firms. It can be concluded just as accurately that being forced to make such adjustments results in added costs and inefficiencies which affect their competitive position in those and third markets.

39 (now p. 24)

State insurance commissioners have recently demonstrated increased interest in foreign barriers. The National Association of Insurance Commissioners has formed a Task Force on Discrimination Against U.S. Insurers in Foreign Countries.

42 (now p. 26)

Discussion of the OECD should note the work of the OECD Insurance Committee. This committee is actively working on a number of international insurance issues including updating the OECD Code of Liberalization of Current Invisibles Operations concerning insurance, compiling and prioritizing international insurance barriers, improving international insurance statistics and harmonizing classification of classes of insurance.

43 (now p. 26)

The report states that "despite the reported widespread existence of insurance barriers, only three Section 301 petitions have been submitted by the insurance industry." It should be noted that in the context of the overall experience with Section 301, three cases in one industry is a relatively high concentration. Furthermore, the applicability of Section 301 to discrimination affecting foreign establishments (especially important in the insurance industry) was in doubt prior to the AIG case.

International Insurance Advisory Council

INTERNATIONAL DIVISION
CHAMBER OF COMMERCE OF THE UNITED STATES
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Tel (202) 659-6114

July 21, 1982

Mr. Frank C. Conahan
Director
International Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Conahan:

Thank you for your earlier letter and for review copies of your proposed report to the Congress "International Insurance Trade Barriers: Reportedly Widespread, But Impact Unknown." This material has been shared with members of the Executive Committee of the International Insurance Advisory Council.

In general, the report should make a useful contribution to the literature on the subject of insurance trade barriers.

However, at points the editorial tone used dilutes the objectivity which generally characterizes the study. Particularly in addressing the presence and impact of barriers to insurance trade, principally in Chapter III (and in the report's title), the reader is led to infer the problems posed by discriminatory barriers to U.S. international insurers and reinsurers abroad are less important than the practitioners know them to be.

From the perspective of the International Insurance Advisory Council, whose membership includes U.S. companies producing the greater part of the international premium volume garnered by U.S. insurers and reinsurers, this inference is troublesome. Through its members the Council has identified hundreds of discriminatory practices facing U.S. insurers in dozens of countries. Some of these are major barriers which deny or severely constrict access to local markets and so eliminate or severely injure foreign competition which is dependent upon fair trading conditions. Such barriers have frequently forced U.S. companies into second, third or fourth best modes of operation when they have not been so severe as to exclude U.S. insurance and reinsurance firms altogether.

Other barriers identified by industry have less dramatic trade impact and some are largely irritants. The Council, speaking for the U.S. international industry, has long recognized ambiguities result because to date methodologies have not been designed which can attach a

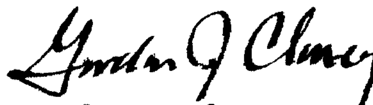
dollar value to individual insurance trade barriers. Hence, establishing priorities among major impact and minor impact barriers is, at the margin, difficult.

The economic importance of widespread protectionist nontariff barriers that impact upon the doing of an international insurance business, is not lessened by the equally objective fact that neither industry, government or academic research has yet put a fixed value or "price tag" on these barriers. By the same token, while some forms of discrimination are relatively minor irritants, this should not cast doubt upon the fact that there are also other major barriers which must be subject to international trade discipline, including enforcement procedures, directed toward their elimination.

Such distinctions are long recognized by industry practitioners and the GAO report is not unaware of them. However, to the extent resulting ambiguities are at points addressed through editorial skepticism, a disservice is done to the balanced orientation the report otherwise gives.

We appreciate the opportunity to provide these observations and commend the GAO for the obvious effort that has gone into the study.

Sincerely,



Gordon J. Cloney
Executive Secretary

cc: Mr. J. M. Campbell, Chairman, IIAC
Mr. Charles Bowsher, Comptroller General

(483300)

GPO 891-195

AN EQUAL OPPORTUNITY EMPLOYER

UNITED STATES
GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

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