

LLOYD'S

PERSPECTIVES ON EMERGING EUROPE



NOVEMBER 2007

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GLOSSARY

CAGR	Compound Annual Growth Rate
CEE	Central and Eastern Europe
CIS	Commonwealth of Independent States
EU	European Union
IMF	International Monetary Fund
MAT	Marine, Aviation and Transit
MTPL	Motor Third Party Liability
OECD	Organisation for Economic Co-operation and Development
PA	Personal Accident

EXECUTIVE SUMMARY

This paper examines the business environments, insurance environments and Lloyd's business within the 11 Central and Eastern Europe (CEE) EU member states. It is argued that there are five key markets which offer Lloyd's managing agents significant potential for business development activities, namely: Austria, the Czech Republic, Hungary, Poland and Romania.

1

Business environment

Of the key markets studied in this paper; Austria, the Czech Republic, Poland and Hungary offer the most favourable business environments for Lloyd's managing agents. These countries tend to have either large or mid-sized economies, high or moderate levels of economic development, high or moderately high regulatory quality and to be either mostly or moderately economically free. The Romanian business environment is deemed to be less favourable as its level of GDP *per capita*, and thus economic development, is comparatively low.

2

Insurance environment

Of the key markets; Austria, the Czech Republic and Romania have the most favourable insurance environments for managing agents. These countries tend to have large or mid-sized non-life markets and a moderate level of broker penetration. The Polish and Hungarian insurance environments are deemed to be marginally less favourable. Indeed, the Polish insurance market has comparatively low broker penetration and the Hungarian insurance market demonstrates the least absolute and relative growth amongst the key CEE markets.

3

Lloyd's business

In terms of Lloyd's business, the five key markets that offer the most potential for Lloyd's in the region tend to be the larger and mid-sized markets and the markets demonstrating low or average premium volatility. While Lloyd's is generally authorised for services and reinsurance business in these countries, establishment business is currently not possible.

Potential of key markets

This paper suggests that the market within the CEE region, which offers by far the greatest short to medium term potential from a Lloyd's perspective, is Austria. For greater penetration into the CEE region, Poland and the Czech Republic offer significant business development opportunities over the short to medium term.

Due to the challenges existing within Romania and Hungary, these territories are deemed to offer fewer opportunities, in the short term, for Lloyd's managing agents.

NOTE OF CAUTION

This paper uses a combination of soft and hard intelligence to arrive at a high level overview of insurance markets within the CEE region.

Accordingly, the analysis contained in this paper should not be used in isolation for guiding business development activities, but part of a broader suite of work which fully considers all of the factors affecting operations within the CEE region.

AUSTRIA

Austria's strong historical, cultural and business ties within CEE mean that the country should be included in any analysis of the region. Austria, the only CEE EU member not to be part of the former Eastern Bloc, has a strong political environment and a well-developed market economy. Within the region, Austria's non-life market is the largest. It has demonstrated the largest volume of growth during the past five years and has reasonably good profitability. Moreover, Austria's non-life market is the least concentrated and the most diverse in terms of specialist classes. In respect of Lloyd's business, Austria has the largest and fastest growing (in absolute terms) CEE market. Whilst the market as a whole is relatively developed, property accounts for over half of Lloyd's Austrian business. The broker market in Austria is fairly diverse for Lloyd's.

POLAND

Poland has achieved robust economic growth since 2000, but catch-up with higher-income countries is still some way off. Indeed, Poland underperforms on all governance indicators. Within the CEE region, Poland has the second-largest economy and the second-largest non-life market, which is moderately developed and more profitable than the other key markets. Nonetheless, the market is dominated by former monopoly insurers, which represents a challenge for smaller and new entrants into the market. Poland is Lloyd's fourth-largest CEE market, but growth is comparatively low. Lloyd's Polish portfolio is dominated by property business. The broker market is very fragmented as broker penetration is amongst the lowest in the region.

CZECH R.

Of the emerging CEE democracies, the Czech Republic is amongst the most developed and politically sound. Amongst the key CEE markets, the Czech Republic has the third-largest and the second most developed non-life market, but others are growing faster. Moreover, market profitability is comparatively poor, largely due to repeated flooding events, and brokers tend not to be perceived well. The market is dominated by foreign companies and is composed almost entirely of motor, property and liability business. The Czech Republic is Lloyd's third-largest market in the region, but its growth has been somewhat erratic during the past five years. Lloyd's Czech portfolio is dominated by property business.

ROMANIA

Since 2002, the Romanian economy has grown faster (in relative terms) than its regional peers. Nonetheless, significant challenges remain and, in terms of governance indicators, Romania is lagging. Romania's non-life market has demonstrated huge growth during the past five years, but it is still the least developed amongst its peers and the least profitable. Moreover, the market is increasingly being dominated by large foreign players. The growth of Lloyd's Romanian business has been fairly erratic. Indeed, business contracted in 2002-2003 and 2004-2005, but grew by 130% in 2005-2006. Lloyd's Romanian business is dominated by MAT and the broker market is fairly concentrated for Lloyd's.

HUNGARY

Hungarian economic growth is in line with that of the Czech Republic and its economic development is in line with that of Poland. Hungary is politically sound, but the government is hindered by its huge public debts. Hungary has the fourth-largest non-life market amongst the key CEE markets, but its growth rate and profitability are comparatively poor. Whilst it is one of the less developed markets, broker penetration is fairly high. The market is dominated by a few key players who focus on motor and/or property business. Amongst the key CEE markets, Hungary produces the least amount of business for Lloyd's and the market is demonstrating the lowest rate of growth.

INTRODUCTION

Objective

This paper provides an overview of the EU member states within Central and Eastern Europe (CEE). More specifically, this paper seeks to evaluate the business environment, insurance environment and Lloyd's business within each of five key territories and to provide managing agents with an idea of the potential of these countries from a Lloyd's perspective.

Methodology

The analysis contained within this paper is largely based on a priority matrix framework, which has been devised by Lloyd's Market Intelligence team. The matrix aims to provide a rational guideline for determining business development priorities from a Lloyd's perspective.

The priority matrix is based on 18 indicators, as listed below. Further information on these indicators and how they have been derived is given in the **APPENDIX**.

BUSINESS ENVIRONMENT	INSURANCE ENVIRONMENT	LLOYD'S BUSINESS
Economic growth	Market dynamism	Premium growth
Prosperity level	Broker penetration	Premium volatility
Legal system fit	Market development	Licences
Regulatory quality	Competition	Market penetration
Economic freedom	Specialist classes	Share of insurance/reinsurance
Cultural environment fit	CAT incidence	
	Market profitability	

Whilst these 18 indicators have been used as the framework for this document, the analysis contained within also includes additional information, which it was not possible to incorporate within the matrix.

Structure

Regional overview: This first section aims to give an overview of the EU markets within the CEE region and a rationale for selecting the five key markets.

Key markets: The main section of this document discusses the business environment, insurance environment and Lloyd's business in each of the five key markets: Austria, the Czech Republic, Hungary, Poland and Romania. Whilst each section is based on the priority matrix, only the insurance environment specifically compares each indicator, to enable the inclusion of other key information.

This paper concludes by suggesting which countries within the CEE region offer the greatest potential from a Lloyd's perspective.

Further information for managing agents

The information contained within this document has been drawn from underlying briefs, which have been produced for each of the key territories: Austria, the Czech Republic, Hungary, Poland and Romania, as well as for Bulgaria. These briefs contain high-level intelligence on each country's business and insurance environment, including a brief breakdown of Lloyd's position.

Managing agents can access the suite of briefs on the CEE region via Lloyd's Market Intelligence website at: WWW.LLOYDS.COM/MARKETINTELLIGENCE

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INFORMATION FROM THE
COUNTRY BRIEFS**

REGIONAL OVERVIEW

Business environment

The business environment indicators, which Lloyd's deems to be most influential in respect of business development opportunities, are economic growth, prosperity level and legal system fit. Regulatory quality and economic freedom are also deemed to play lesser, but nonetheless, important roles in such decisions. Another more minor business environment factor is the cultural environment fit.

Economic growth

GDP size and growth have been used to estimate the economic growth of CEE EU member countries.

In terms of the size of the economies (*shown by the size of the bubble*), absolute growth (*x-axis*) and relative growth (*y-axis*) three groups can be distinguished for the region:

- **Larger economies:** with substantial absolute growth, but low relative growth (Austria and Poland)
- **Mid-sized economies:** with less absolute growth, but more relative growth (Romania, the Czech Republic and Hungary)
- **Smaller economies:** with little absolute growth (Slovakia, Estonia, Latvia, Lithuania, Bulgaria and Slovenia).

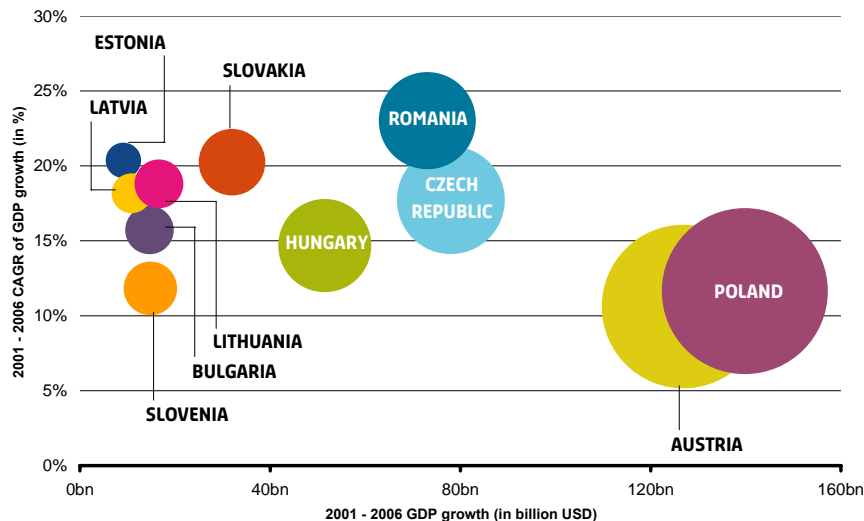
Due to their size and growth potential, the larger and mid-sized economies are deemed to offer the greater business development opportunities for Lloyd's.

CHART 1: absolute and relative economic growth (2001-2006)¹

LEGEND

Size of bubble is equivalent to 2006 GDP levels

○ ≡ USD 50bn



Prosperity level

GDP *per capita* is widely used as a reliable indicator for gauging the level of economic development of a country.

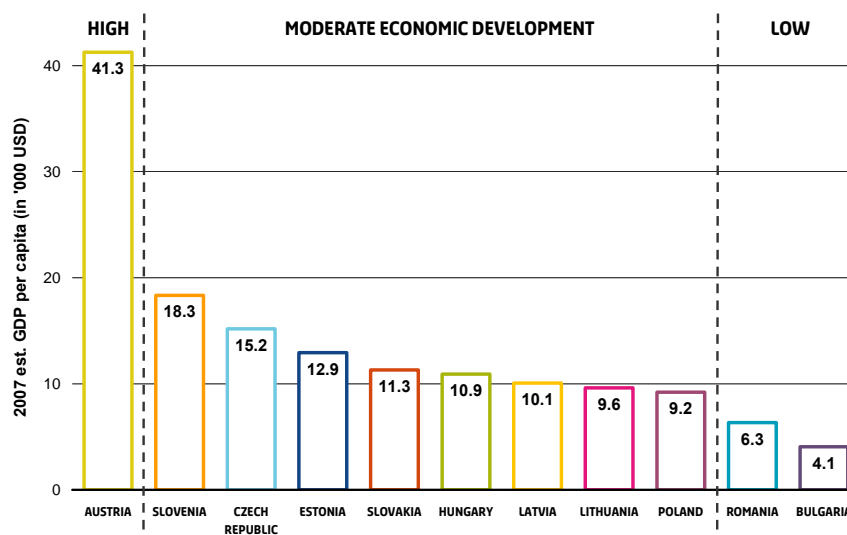
The chart overleaf highlights that, in terms of economic development, Austria is far more advanced than the other CEE EU members. Indeed, Austria's GDP *per capita* is more than twice that of Slovenia, the second most prosperous country. In contrast, the newest members of the EU exhibit significantly less economic development. Indeed, Bulgaria's GDP *per capita*

¹ International Monetary Fund (2006)

is currently ten times smaller than that of Austria. In terms of economic development, the CEE countries can thus be categorised as follows:

- *Highly developed*: with GDP *per capita* levels comparable to other countries in Western Europe (Austria)
- *Moderately developed*: with the potential to catch-up with the more prosperous countries over the medium-term (Slovenia, the Czech Republic, Estonia, Slovakia, Hungary, Latvia, Lithuania and Poland)
- *Less developed*: with low levels of GDP *per capita* (Romania and Bulgaria).

CHART 2: GDP per capita in CEE countries (2007 est.)²



Highly and moderately developed economies are deemed to have greater needs for more sophisticated asset protection solutions. As such, these economies are likely to offer greater business development opportunities to Lloyd's in the short term.

Legal system fit

The legal system fit indicator categorises legal systems* around the world to enable an understanding of compatibility with the British legal system.

Research has highlighted that there is a link between GDP *per capita* and the organisation of the legal system. As such, the legal system fit considers both the type of legal system and the GDP *per capita*. All CEE EU member countries have, however, been classified as having a civilist legal system. Thus the only differentiator on the legal system fit indicator for the CEE region is the GDP *per capita*.

The civilist legal system (based on civil law) is one of the world's key legal systems. The main difference between this system and the British system (based on common law) is that the latter draws abstract rules from specific cases, whereas civil law starts with abstract rules which judges must then apply to specific cases. The legal systems in many civilist countries are based around one or several codes of law which set out the main legal principles.

Regulatory quality

The *World Bank* publishes an annual study of governance for more than 200 countries and regulatory quality is one of the six dimensions examined within this study.³

² International Monetary Fund (2006)

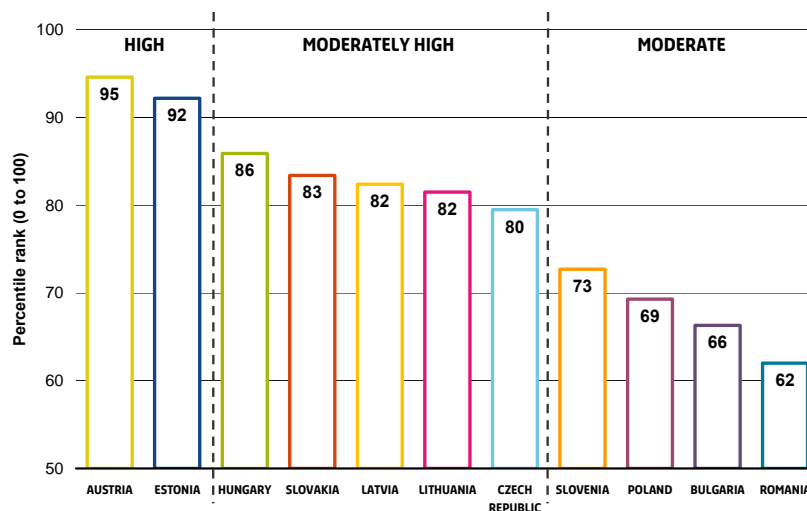
* No value is attributed to the legal system, this indicator is purely an assessment of the cultural fit with the British legal system.

In terms of regulatory quality, three groups of countries can be distinguished for the region:

- *High regulatory quality*: better than 90% of countries worldwide (Austria and Estonia)
- *Moderately high regulatory quality*: better than 75% to 89% of countries (Hungary, Slovakia, Latvia, Lithuania and the Czech Republic)
- *Moderate regulatory quality*: better than 50% to 74% of countries (Slovenia, Poland, Bulgaria and Romania).

Countries with high and moderately high regulatory quality are deemed to offer more business-friendly legal environments.

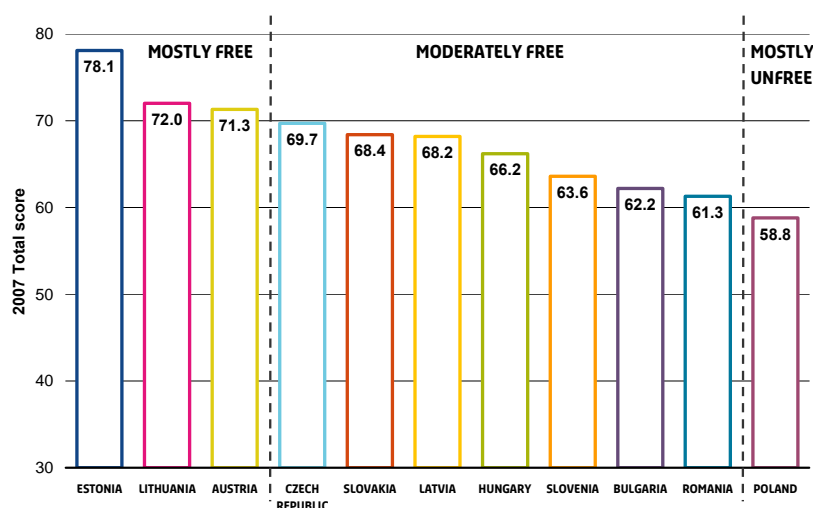
CHART 3: regulatory quality* in CEE EU member countries⁴



Economic freedom

The *Heritage Foundation* publishes an annual index of economic freedom which considers: ease of licensing, trade barriers, fiscal concerns, government intervention, inflation, investment, openness of the financial system, property rights, corruption and labour.⁵

CHART 4: economic freedom in CEE EU member countries⁶



³ World Bank (2007)

* Regulatory quality is measured on a relative scale using percentile ranks. The percentile rank indicates the percentage of countries worldwide that are below the rank of the selected country.

⁴ World Bank (2007)

⁵ Heritage Foundation (2007)

⁶ Ibid

In terms of economic freedom, three groups of countries can be distinguished for the CEE region:

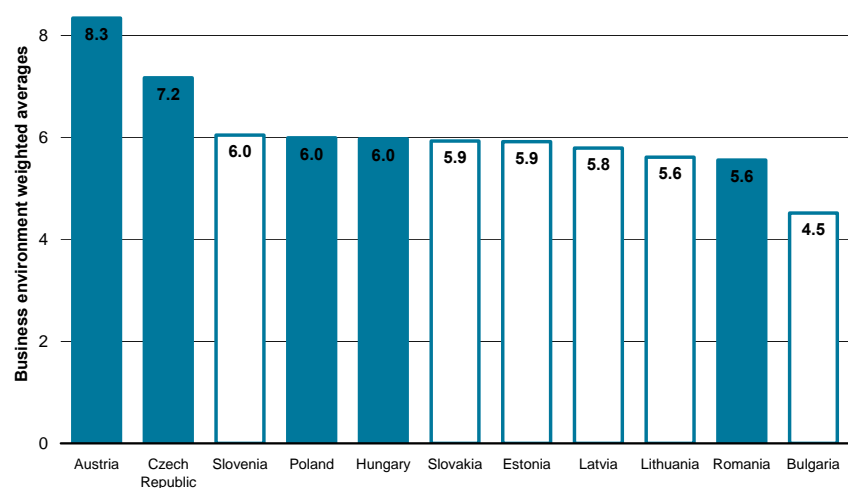
- *Mostly free*: scores of 70.0-79.9 (Estonia, Lithuania and Austria)
- *Moderately free*: scores of 60.0-69.9 (the Czech Republic, Slovakia, Latvia, Hungary, Slovenia, Bulgaria and Romania)
- *Mostly unfree*: scores of 50.0-59.9 (Poland).

The economic freedom scores (with the exception of Estonia) are spread over a small range of only 13 percentage points. As such, economic freedom for CEE EU member countries does not vary greatly.

Business environment weighted averages

The scores for each of the five key indicators discussed above (economic growth, prosperity level, legal system fit, regulatory quality and economic freedom) have been combined with the cultural environment fit indicator and weighted accordingly. (See [APPENDIX](#) for details.) This enables the business environments, which offer Lloyd's managing agents the greatest potential in the short to medium term, to be derived, as highlighted below.

CHART 5: business environment weighted averages



The solid blue bars indicate the key markets studied in this paper. Of the key markets, Austria, the Czech Republic, Poland, and Hungary have favourable business environments from a Lloyd's perspective.

The Romanian business environment is deemed to be less favourable for Lloyd's than most of the other CEE markets. The key factor driving this relatively poor performance is Romania's low GDP *per capita* and thus its relatively low level of economic development. Moreover, Romania's levels of regulatory quality and economic freedom are significantly below average.

Insurance environment

The insurance environment indicator, which Lloyd's deems to be most influential in respect of business development opportunities, is market dynamism. Broker penetration is deemed to play a lesser, but nonetheless, important role. Other more minor insurance environment factors include: market development, competition, specialist classes, natural catastrophe incidence and market profitability.

Market dynamism

Market size and growth have been used to estimate the dynamism of the non-life insurance markets of CEE EU member countries.

In terms of the size of the markets (*shown by the size of the bubble*), absolute growth (*x-axis*) and relative growth (*y-axis*) three groups can be distinguished for the region:

- **Larger markets:** these markets tend to have huge absolute growth but, due to their sizes, comparatively low relative growth (Austria and Poland)
- **Mid-sized markets:** these markets achieve a moderate level of absolute growth and variable levels of relative growth (the Czech Republic, Romania, Hungary, Slovakia and Bulgaria)
- **Smaller markets:** these markets demonstrate very little growth in absolute terms, but a moderately high level of growth in relative terms (Estonia, Latvia and Lithuania).

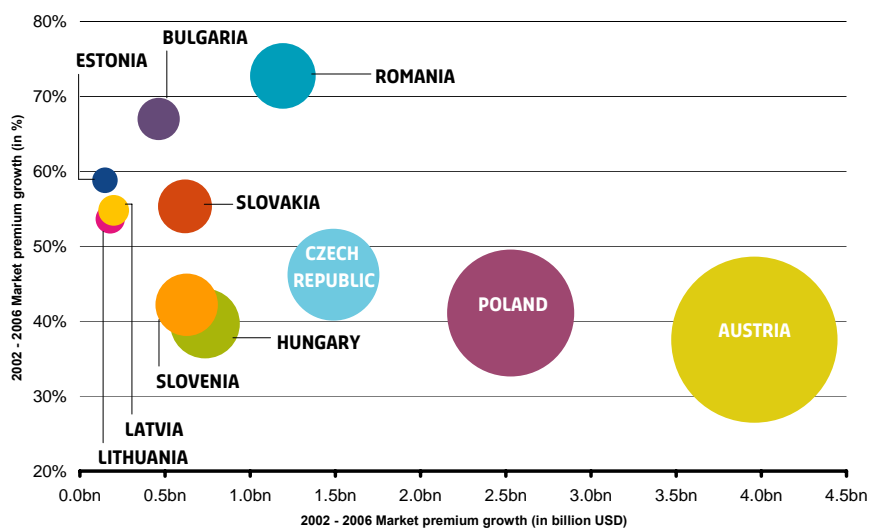
The very low levels of premium generated in the smaller markets indicate that these markets offer only limited opportunities for Lloyd's. Although the Bulgarian and Romanian markets are far smaller than the Austrian and Polish markets, their strong growth during the period 2002 to 2006 suggests that there may be opportunities arising within these markets.

CHART 6: absolute and relative growth of markets (2002-2006)⁷

LEGEND

Size of bubble is equivalent to 2006 premium levels

○ ≡ USD 1.5bn



⁷ Lloyd's Market Intelligence calculation based on Sigma (2007)

Broker penetration

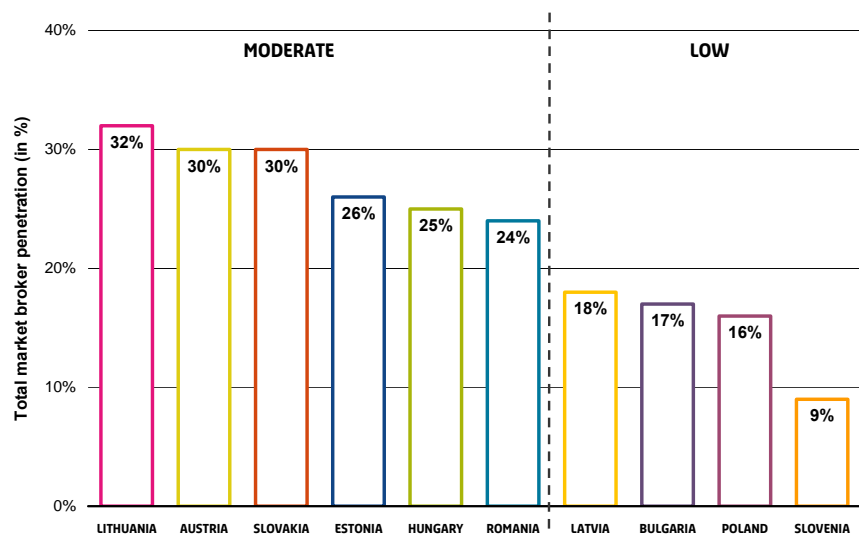
The level of business gained through the broker channel indicates the size of the potential subscription market via brokers. Broker penetration is considered to be one of the key factors for highlighting business development opportunities as the majority of Lloyd's business is transacted through brokers.

In terms of broker penetration for the whole non-life market, the CEE territories can be divided as follows:

- *Moderate broker penetration*: indicates higher business accessibility, particularly for commercial business (Lithuania, Austria, Slovakia, Estonia, Hungary and Romania)
- *Low broker penetration*: indicates limited business accessibility (Latvia, Bulgaria, Poland and Slovenia).

Where brokers have made only limited inroads into a country's insurance market, it is comparatively more difficult for Lloyd's to access business. This is the case for countries in which broker penetration is low. However, broker penetration is relatively low for the CEE region as a whole, particularly when compared to more developed markets. In the US, for example, it is estimated that brokers are involved in over three quarters of all business.

CHART 7: broker penetration in CEE* EU member countries⁸



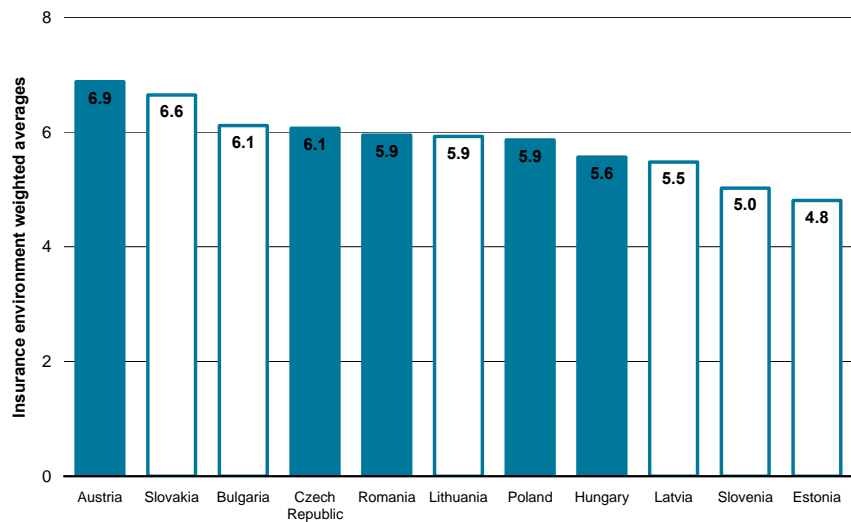
⁸ Lloyd's Market Intelligence calculation based on Axco Insurance Market Reports (2007)

* Accurate estimates are not available for the total broker market penetration for the Czech Republic.

Insurance environment weighted averages

The scores for each of the two key indicators discussed above (market dynamism and broker penetration) have been combined with indicators of: market development, competition, specialist classes, natural catastrophe incidence and market profitability, and weighted accordingly. (See [APPENDIX](#) for details.)

CHART 8: insurance environment weighted averages



The chart above shows the insurance environments within the CEE region which offer Lloyd's managing agents the greatest potential in the short to medium term. The solid blue bars indicate the key markets studied in this paper. Of the key markets, Austria, the Czech Republic and Romania have the most favourable insurance environments from a Lloyd's perspective.

Poland and Hungary are deemed to have less favourable insurance environments for Lloyd's managing agents. Indeed, the Polish insurance market has a comparatively low level of broker penetration and the Hungarian insurance market demonstrates the least absolute and relative growth amongst the five key CEE markets.

Lloyd's business

The Lloyd's business indicators, which are deemed to be most influential in respect of Lloyd's business development opportunities, are premium growth, premium volatility and licences. Other more minor Lloyd's business factors include: market penetration and share of insurance/reinsurance.

Premium growth

The premium growth indicator is based on Lloyd's gross written premiums by country of origin, which is a measure of the volume of business that Lloyd's transacts in a given territory.

In terms of the volume of Lloyd's business (*shown by the size of the bubble*), absolute growth (*x-axis*) and relative growth (*y-axis*), three groups can be distinguished for the CEE region:

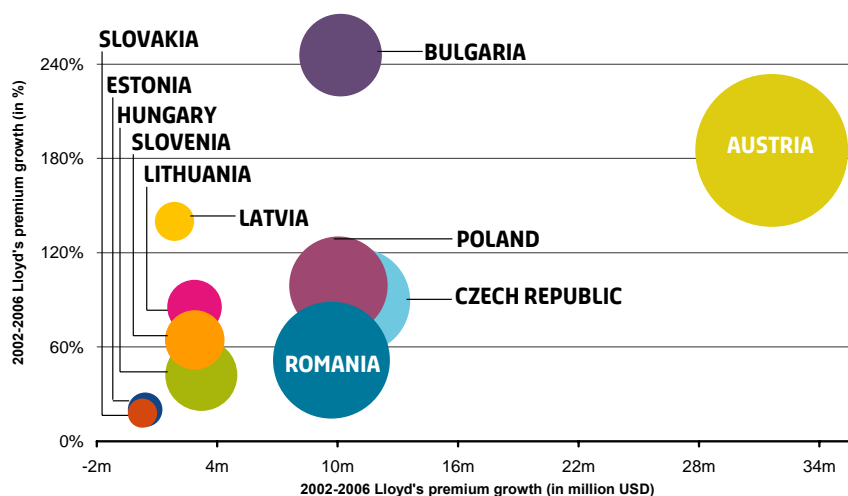
- **Larger markets:** these markets demonstrate huge absolute growth and fairly high relative growth (Austria)
- **Mid-sized markets:** these markets have achieved a moderate level of absolute growth and variable levels of relative growth (Romania, the Czech Republic, Poland and Bulgaria)
- **Smaller markets:** these markets demonstrate very little growth in absolute terms and fairly low levels of relative growth (Slovakia, Estonia, Hungary, Slovenia, Lithuania and Latvia).

CHART 9: growth of Lloyd's business (2002-2006)⁹

LEGEND

Size of bubble is equivalent to 2006 premium levels

○ ≡ USD 10m



The larger and mid-sized markets are deemed to offer the greatest business development opportunities for Lloyd's.

Premium volatility

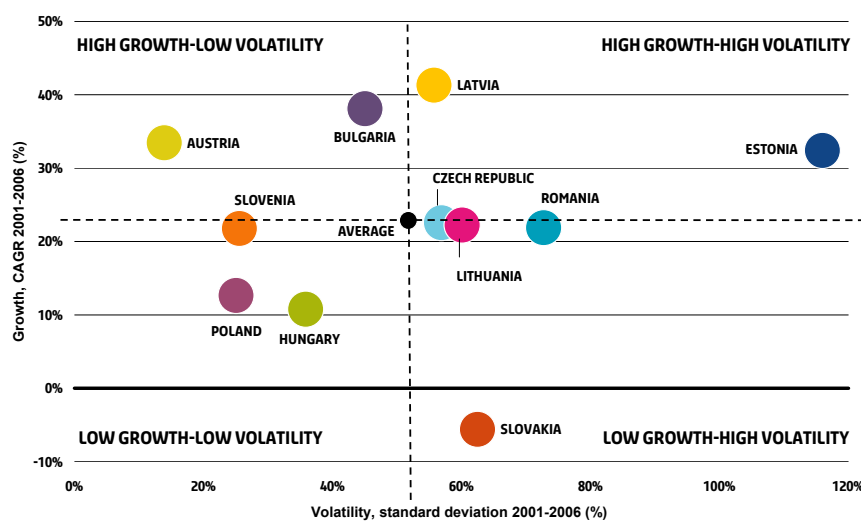
Premium volatility provides an indication of the variability of Lloyd's business generated from a particular country year-on-year. Thus it indicates the degree to which past data can be relied upon to suggest future business opportunities. As premium income in smaller markets tends to be highly affected by large accounts, this indicator favours larger markets. Volatility needs to be considered in tandem with premium growth in order that healthy, sustainable and predictable growth paths can be identified.

⁹ Xchanging (2007)

In terms of premium growth and volatility, four groups can be identified within the region:

- *High growth-low volatility*: stronger markets with reliable business growth (Austria and Bulgaria)
- *Low growth-low volatility*: weaker markets with reliable premium change, albeit at a slower pace (Slovenia, Poland and Hungary)
- *High growth-high volatility*: erratic markets typically affected by large accounts (Latvia and Estonia)
- *Low growth-high volatility*: erratic markets typically affected by large losses (the Czech Republic, Lithuania, Romania and Slovakia).

CHART 10: volatility of Lloyd's premium growth (2001-2006)¹⁰



Markets with high growth and low volatility offer the greatest sustainable business development opportunities to Lloyd's managing agents.

Licences

The licences indicator enables an understanding of Lloyd's access to global markets.

The licence position is very similar for all of the EU member states within the CEE region, as follows:

- *Services business authorisation*: Lloyd's is authorised to write all classes of business except motor third party liability (MTPL). (The only exceptions are Austria, in which Lloyd's is authorised to write all classes of business, and Slovenia, in which Lloyd's can write all classes of business except compulsory transport insurances, personal accident for motor vehicles and non-investment term life assurance.)
- *Establishment business authorisation*: Lloyd's is not authorised to write establishment business.
- *Reinsurance business authorisation*: Lloyd's is authorised to write all classes of business.

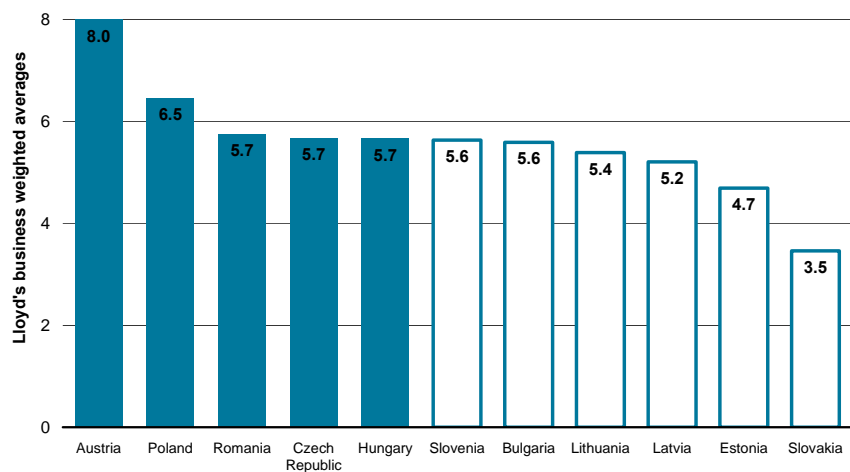
As the licensing position is so similar for the CEE EU member states, the licences indicator does not enable differentiation between countries within the region (although it does permit differentiation between countries within the CEE region and other regions).

¹⁰ Xchanging (2007)

Lloyd's business weighted averages

The scores for each of the indicators discussed above (premium growth, premium volatility and licences) have been combined with indicators on market penetration and share of insurance/reinsurance, and weighted accordingly. (See [APPENDIX](#) for details.) This enables the markets which offer greatest potential in the short to medium term to Lloyd's managing agents to be derived, as highlighted below.

CHART 11: Lloyd's business weighted averages



The solid blue bars indicate the key markets studied in this paper. All of the key markets studied are the most favourable markets from a Lloyd's perspective amongst the CEE EU member states. Given that Hungary is classified as a smaller market for Lloyd's with little absolute growth, it is not surprising that this country has the least favourable Lloyd's business conditions amongst the key markets examined in this report.

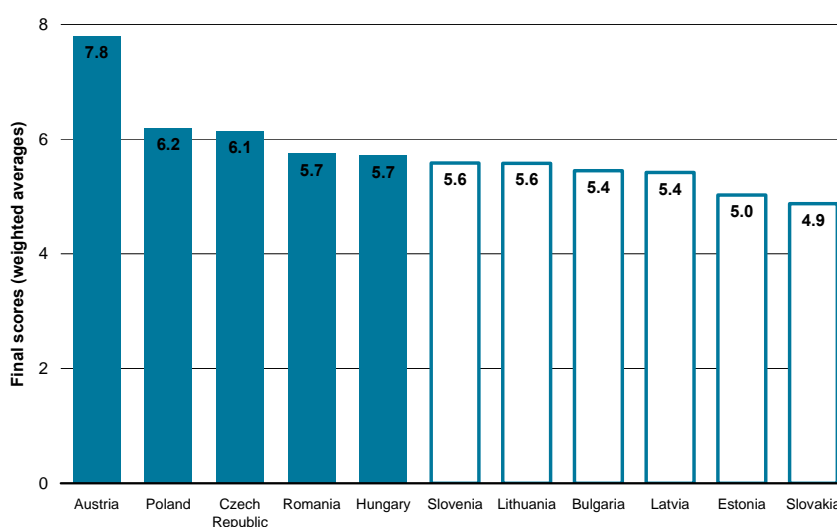
Regional priorities

Key markets

When the scores from the business environment, insurance environment and Lloyd's business are combined, the five markets with the highest scores are: Austria, the Czech Republic, Hungary, Poland and Romania.

As the Lloyd's business factors are deemed to be by far the most influential on business development opportunities, the Lloyd's business scores were given twice the weighting of the business environment and the insurance environment scores. When these weightings are taken into consideration, the five markets with the highest scores (referred to as the key markets) remain unchanged, as highlighted below.

CHART 12: key markets within the CEE region



Each of the five key markets will be discussed in more detail in the **KEY MARKETS** section of this paper.

NOTE OF CAUTION

Whilst the chart above suggests an order of potential opportunities within the CEE region from a Lloyd's perspective, this paper does not fully examine wider business factors which may affect the ease of doing business in a given territory, e.g. the ease with which a branch office can be established, tax issues and conditions within a specific segment of the market.

This paper should, therefore, not be used in isolation for guiding business development activities, but as part of a broader suite of work which fully considers all of the factors affecting operations within the CEE region.

KEY MARKETS

Austria

SWOT

STRENGTHS

BUSINESS ENVIRONMENT:

Political strengths: the ruling coalition remains stable. Austria performs marginally better than the OECD average on all governance indicators. Economic strengths: Austria has a well developed economy with high living standards. The keys to the country's economic success are its location at the gateway to Eastern Europe and its highly skilled workforce.

INSURANCE ENVIRONMENT:

Austria has the largest non-life market within the CEE region and this market has demonstrated the largest volume of absolute growth during the past five years. The Austrian market is the most developed within the region, and it compares favourably with a number of Western European markets. Brokers account for around three quarters of commercial business.

LLOYD'S:

In 2006, Austria was the largest CEE market for Lloyd's. Lloyd's Austrian premium income tends to be fairly stable.

WEAKNESSES

BUSINESS ENVIRONMENT:

Political weaknesses: tensions persist in the ruling coalition and the alliance is uneasy. The public sector suffers from a lack of efficiency and high cost service provision. Economic weaknesses: during the past six years, real GDP growth has been below the OECD average. The Austrian economy is still highly dependent on its manufacturing sector. Growth in Austria's service sector remains sluggish.

INSURANCE ENVIRONMENT:

Following significant post 9/11 growth, the non-life market softened and growth between 2004 and 2006 was much slower.

LLOYD'S:

Compared to Western European markets, Lloyd's business from Austria is fairly small. Over half of Lloyd's Austrian business is property.

OPPORTUNITIES

BUSINESS ENVIRONMENT:

Austria is pursuing its aim of greater labour and infrastructure linkages with the EU, particularly with member states located within the CEE region.

INSURANCE ENVIRONMENT:

The Austrian insurance market is becoming increasingly integrated with insurance in other countries within the CEE region. This integration is highlighted by the spread of Austrian insurance companies eastwards. Brokers are becoming increasingly important and their share of the non-life market is expected to continue to increase. Insurance profitability is believed to be reasonably good. The Austrian market is more diverse than any other within the CEE region.

LLOYD'S:

Lloyd's Austrian business has grown by 33% per year for the past five years. Just under half of Lloyd's Austrian business is concentrated in niche sub-classes, which are not readily available locally.

THREATS

BUSINESS ENVIRONMENT:

Austria is cautious to protect its own interests and on certain issues, such as university quotas, this is causing conflict with a number of EU partners. As the Austrian workforce contracts and the population ages, the burden on the Austrian economy is likely to increase. It will be difficult for Austria to maintain its current level of economic performance without tackling the efficiency and cost of service provision within the public sector.

INSURANCE ENVIRONMENT:

The Austrian non-life market is the least concentrated within the CEE region, but the top three insurers still share 62% of the market.

LLOYD'S:

The broker market within Austria is fairly diversified, but the four-largest brokers for Lloyd's focus largely or wholly on property business.



Managing agents can download the full brief at: WWW.LLOYDS.COM/MARKETINTELLIGENCE



Business environment

Economic overview¹¹

Austria differs from the other key markets examined in this report in that it was neither a centrally-planned economy nor part of the Eastern Bloc. Austria has a well-developed market economy with high standards of living. Indeed, the economic development of Austria (as measured in GDP *per capita*) is far in excess of the level of development of the other CEE economies. During the past five years, the annual average growth rate for Austria has been far below that of its regional peers, but in line with a number of the economies of Western Europe, such as Belgium or Denmark.

Key economic challenges which remain for the Austria include:

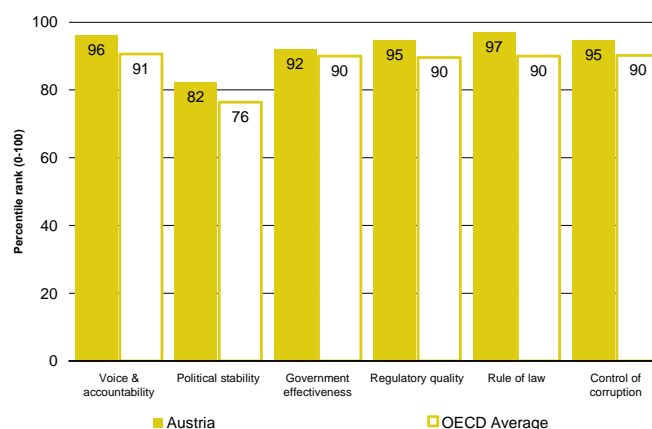
- *Slowdown in growth.* Economic growth is predicted to slow down into 2008, due to: the weaker international environment (caused by weak growth in the US), the appreciation of the Euro against the Dollar, fiscal tightening, and a weakening in domestic demand.
- *Ageing population.* Whilst Austria's population is ageing slower than the populations of its regional peers, a key challenge for the medium term will be dealing with the financial burden of ageing on the economy. In order to meet this challenge, the government needs to boost labour force participation and employment, whilst fostering productivity growth.
- *Inefficiency of the public sector.* The perceived lack of efficiency and the high cost of service provision within the public sector are most likely a result of corporatism within the Austrian economy. A key measure which could be implemented to tackle this issue is reform of the government's budgeting procedures in order to reduce the very high level of public debt which persists in Austria.

ECONOMIC INDICATORS	
GDP PER CAPITA (2007)	USD 41,266
GDP CAGR (2002-2007)	2.1%
PUBLIC DEBT (2006)	63% OF GDP
UNEMPLOYMENT (2006)	4.9%
ECONOMIC FREEDOM (2007)	MOSTLY FREE
AGEING POPULATION (2007-2050)	12.5 PP*

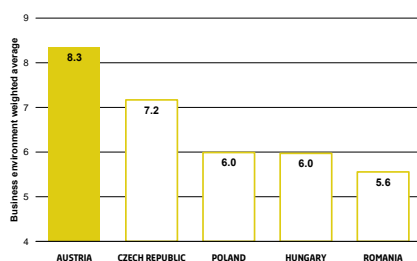
Political overview

A new grand coalition government came into power in Austria in January 2007. Whilst the coalition remains stable, the alliance is uneasy and tensions persist, particularly in relation to corruption concerns surrounding the *Eurofighter* deal. The coalition government's key policies aim to increase linkages with the new and potential EU member states within the CEE region. However, Austria is also cautious to protect its own interests and on certain issues this strategy is causing conflict with the aims of the EU. These issues aside, Austria performs far better than its regional counterparts and marginally better than the OECD average on all governance indicators. This high quality of governance is reflected in the high level of economic freedom that Austrians tend to enjoy.

CHART 13: political environment indicators for Austria (2006)¹²



BUSINESS SUMMARY



¹¹ Economic indicators are based on Heritage Foundation (2007), Central Intelligence Agency (2007) and US Census Bureau (2007). * Ageing population refers to growth in the percentage of the population aged 65 years and over, as measured in percentage points (PP).

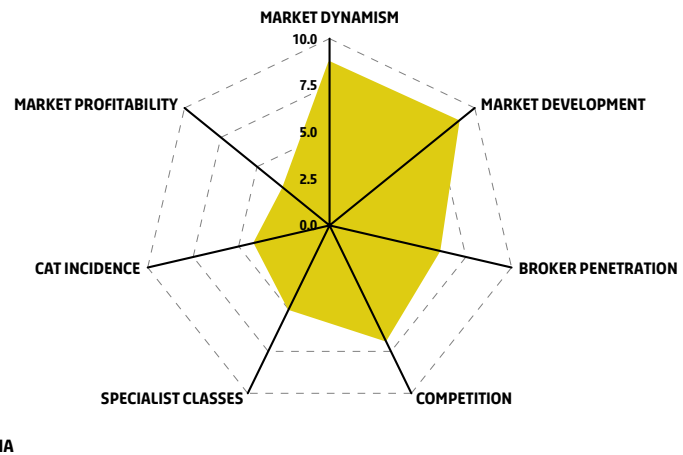
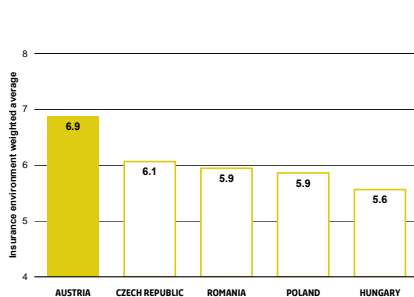
¹² World Bank (2007)

Insurance environment

The Austrian scores for the insurance environment indicators have been summarised in the chart below.

CHART 14: insurance market indicators for Austria

INSURANCE SUMMARY



Market dynamism (score 8.7)

Austria has the largest non-life market within the CEE region. Whilst it has been the slowest growing market within the region in relative terms during the past five years, it has demonstrated by far the largest volume of absolute growth. It is for this reason that Austria has achieved the second-highest score on the market dynamism indicator within the CEE region (behind Romania).

Following a period of slow decline between 1995 and 2001, the events of 9/11 and the ensuing worldwide reduction in reinsurance capacity sparked a significant growth in Austrian non-life premiums. Indeed, the average growth rate for the period 2001 to 2004 was 18%.¹³ However, in common with other European territories, the non-life market is now softening. Thus the growth in insurance premiums between 2004 and 2006 was much slower.

Market development (score 8.9)

Austria achieves the highest score on the market development indicator amongst its regional peers. Indeed, Austria has by far the highest level of insurance density within the CEE region. Furthermore, the country has the second-highest level of insurance penetration (behind Slovenia), which was above the EU 27 average of 3% in 2006.¹⁴ The level of development of the Austrian non-life market compares favourably with a number of markets in Western Europe.

Broker penetration (score 6.0)

It is estimated that in 2005, almost half of non-life business was gained through companies' own sales forces. Brokers are becoming increasingly important in the Austrian insurance market and it is expected that their market share will continue to increase as insurers seek to reduce underwriting expenses. Brokers currently account for almost one third of the non-life market and for about three quarters of commercial business. In order to provide full service to their larger Austrian clients, the larger Austrian brokers tend to operate throughout the CEE region. The Austrian brokers' association, *Verband Österreichischer Versicherungsmakler*, currently has 47 members.¹⁵ The comparatively high level of broker penetration within Austria

¹³ Lloyd's Market Intelligence calculation based on Sigma (2007)

¹⁴ Ibid

¹⁵ Verband Österreichischer Versicherungsmakler (2007)

is reflected in the country achieving the highest score on this indicator amongst the key CEE markets.

Competition (score 6.8)

Whilst the Austrian non-life market is fairly concentrated, with the top three insurers sharing approximately 62% of the market, Austria has the least concentrated non-life market amongst its regional peers.

At the end of 2006, there were 49 non-life insurance companies established in Austria, of which 18 were branches or subsidiaries of foreign companies, particularly German companies.¹⁶ In addition to established Austrian companies, a number of *European Economic Area* insurers have started to transact business in Austria under the *Freedom of Services* provisions. However, the extension of the EU has not had a major effect on the Austrian market. The key reason for this is that a number of larger Austrian insurers were previously writing business in the new member states, and are now strongly represented in the CEE region. The focus of these companies on growing their business within other CEE countries has been at the expense of domestic growth.

Specialist classes (score 4.9)

The Austrian non-life market is strongly influenced by motor, PA & healthcare and property, which together account for the majority of business. The Austrian non-life market is more diverse than any other non-life market within the CEE region, hence Austria has achieved the highest score on the specialist classes indicator. Nonetheless, the concentration on three key classes suggests that there may still be potential for growth in more sophisticated lines.

Natural catastrophe incidence (score 4.1)

9% of Austria's country area has a high or very high likelihood of flood occurrence, however, Austria does not have a strong exposure to any other natural hazards.¹⁷

Market profitability (score 3.2)

Profitability within Austrian non-life insurance has been reasonably good (when loss ratios are measured as incurred losses to written premiums). Although loss ratios have been slightly lower for MAT business, loss ratios in the other key classes have remained around 50% to 75% during the past five years. Motor and liability loss ratios have shown significant improvement during this period.

Compulsory classes

Third party liability insurance is compulsory for: motor, air carriers, carriage of passengers by land, carriage of dangerous goods, pharmaceuticals manufacture, nuclear operators, pipeline operators, attorneys, public notaries, accountants, genetic technology operators, insurance intermediaries, electronic signature certifiers and travel operators' bonds.

¹⁶ Lloyd's Market Intelligence calculation based on Austrian Financial Market Authority (2007)

¹⁷ Munich Re Geo Risks Research (2006)

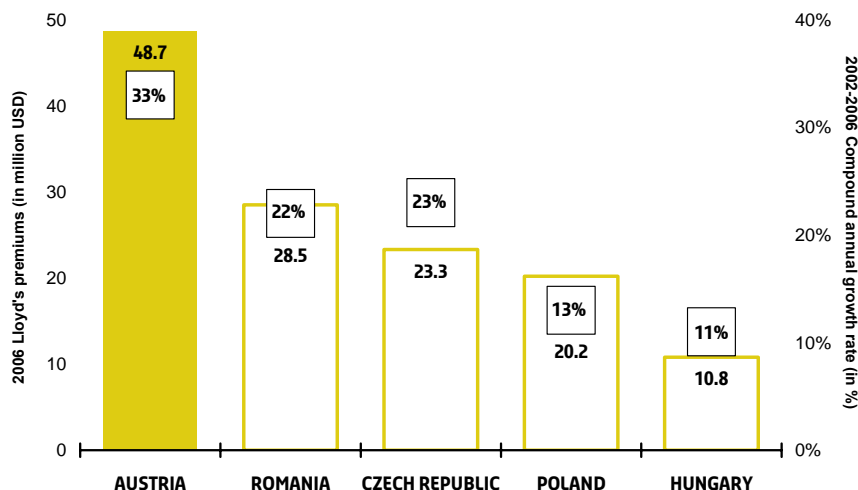
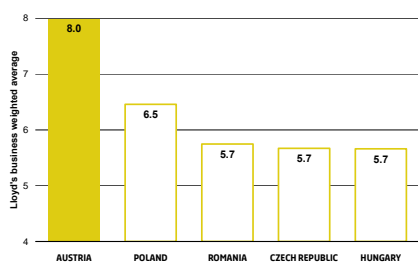
Lloyd's business

Market size

In 2006, Austria was by far Lloyd's largest CEE EU member market. During the last five years, Lloyd's Austrian business has grown at an average rate of 33% per year, which is faster than any of its regional peers. This growth has shown fairly low volatility throughout the five year period, which reflects the relatively developed and stable nature of the Austrian market.

CHART 15: Lloyd's market size and growth (2002-2006)¹⁸

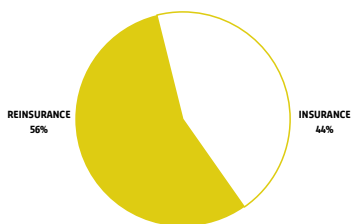
LLOYD'S SUMMARY



Lloyd's business split

The fairly even split between insurance and reinsurance business reflects the relatively developed nature of the Austrian market and the large number of classes written by Lloyd's syndicates. Nonetheless, property accounted for over half (56%) of Lloyd's Austrian business in 2006. Within the property class, the biggest segment is catastrophe excess of loss. Fine art, terrorism, engineering and property excess are also important property lines in Austria. As motor, PA & healthcare and property dominate the Austrian non-life market, just under half of Lloyd's Austrian business is concentrated into niche lines.

CHART 16: Lloyd's business split for Austria (2006)¹⁹



Lloyd's is authorised to write:

Insurance:

Services All classes
 Establishment No

Reinsurance: All classes

Broker analysis

The broker market within Austria is fairly diversified, with Lloyd's business being introduced from a range of brokers. The top four brokers focus wholly or mainly on property business.

¹⁸ Xchanging (July 2007)

¹⁹ Xchanging (July 2007) and Lloyd's (2007)

Poland

SWOT

STRENGTHS

BUSINESS ENVIRONMENT:

Political strengths: the newly-elected government is pro-European.

Economic strengths: Poland is becoming an increasingly competitive and diversified economy and has achieved robust economic growth since 2000. Strong investment and accelerating private consumption have been driving this growth.

INSURANCE ENVIRONMENT:

The Polish non-life market is the second-largest within the CEE region. The market is growing due to the increasing sophistication of clients and growing client needs for sophisticated insurance solutions. Further key factors which have encouraged growth include the collation of best insurance practices. The Polish market is the most profitable amongst the key CEE markets.

LLOYD'S:

Lloyd's business in Poland does not really reflect conditions in the market as a whole, as Lloyd's Polish business grew by 87% between 2002 and 2005. The key driver behind this dramatic growth is the property class, which accounts for the majority of Lloyd's business.

WEAKNESSES

BUSINESS ENVIRONMENT:

Political weaknesses: Poland performs poorly compared to the OECD average on all governance indicators.

Economic weaknesses: the economy suffers from costly legacies of central planning, including: high government debt, weak prospects for substantial market-oriented structural reform, weak prospects for privatisation and fiscal consolidation, and high unemployment.

INSURANCE ENVIRONMENT:

Compared to smaller CEE markets, the Polish market is growing relatively slowly. The market is dominated by two local players and the broker market has comparatively low levels of penetration.

LLOYD'S:

Lloyd's business largely stems from property reinsurance. As such, Lloyd's focuses on a niche segment of the market. A concentrated portfolio means that business tends to fluctuate according to property rates and is unlikely to reach a critical mass in the local market from which Lloyd's could grow a more diversified portfolio.

OPPORTUNITIES

BUSINESS ENVIRONMENT:

Poland has a credible and sustainable agenda of driving down fiscal deficits and debt ratios. Until recently, Poland's economic growth was chiefly driven by exports, which grew at a rate of around 20% annually. Today, the main engines of the economy are consumption and investment, both of which began to grow rapidly in 2006.

INSURANCE ENVIRONMENT:

The Polish market is one of the largest, but also one of the less developed within the CEE region. This means that there is significant scope for catch-up and high growth rates are likely for the foreseeable future.

LLOYD'S:

Poland's liability, malpractice and directors' and officers' liability business is seen as harbouring significant growth potential. The broker market for Lloyd's is fairly diversified and a large number of brokers each bring in a small volume of business.

THREATS

BUSINESS ENVIRONMENT:

Whilst Poland has benefited from being a lower cost location for assembly and production of goods close to large European markets, growing pressure for wage increases is likely to diminish this comparative advantage over the medium term. Accordingly, businesses are likely to be forced to move up the value chain in order to compete with emerging locations such as the Ukraine.

INSURANCE ENVIRONMENT:

Significant flooding losses in 2002 indicate that Poland has a high exposure to catastrophe risks. *Freedom of Services* and market entry via joint ventures or acquisitions have increased local capacity, which has translated into pressure on rates and therefore underwriting profitability.

LLOYD'S:

Lack of business sophistication and cultural and language barriers may present significant challenges to the expansion of Lloyd's business over the medium term.



Managing agents can download the full brief at: WWW.LLOYDS.COM/MARKETINTELLIGENCE

Business environment

Economic overview²⁰

Poland was the first country within the Eastern Bloc to move from central planning towards a market economy. Poland has achieved robust economic growth since 2000, which has been above that achieved by OECD countries as a whole, but catch-up with higher-income countries is still some way off. Nonetheless, Poland's average annual growth rate and economic development is in line with that of Hungary and the Czech Republic.

Key economic challenges which persist for Poland include:

- *Balance of fiscal and monetary policies.* A stable macroeconomic framework is an essential pre-requisite to healthy economic growth. However, fiscal policy is currently too relaxed, which has led to high interest rates and unnecessarily high public spending. Recent budget deficit improvements have been partly due to one-off factors.
- *Labour market performance.* With only slightly more than one in two Poles of working age employed and the highest unemployment rate in the region, getting people into productive work will be essential for maintaining economic growth. This is made even more critical by the fact that Poland's population is ageing faster than any other in the region. At present, social benefits and taxes discourage many Poles from working.
- *Levels of investment and innovation.* Poland's sluggish investment and low level of innovation activity are related to the fact that Poles have the least economic freedom amongst their regional peers. Indeed, Poland has high-levels of public ownership by regional standards and a considerable burden of bureaucracy. Investment conditions need to be improved to increase economic activity.

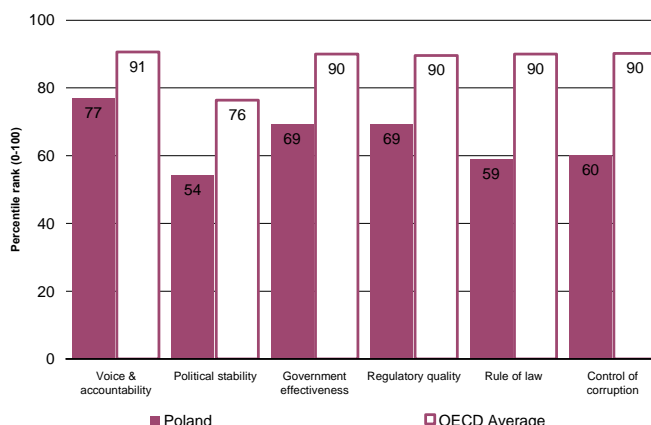


ECONOMIC INDICATORS	
GDP PER CAPITA (2007)	USD 9,214
GDP CAGR (2002-2007)	4.3%
PUBLIC DEBT (2006)	49% OF GDP
UNEMPLOYMENT (2006)	14.9%
ECONOMIC FREEDOM (2007)	MOSTLY UNFREE
AGEING POPULATION (2007-2050)	18.4 PP*

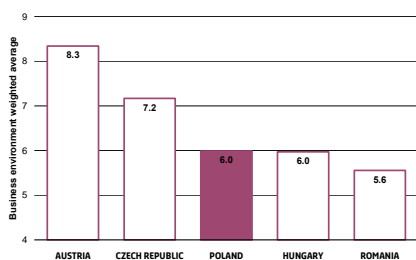
Political overview

There have been some serious concerns that the tide of liberal economic reform had turned in Poland due to the success of the populist and nationalist *Law and Justice Party* in both the parliamentary and presidential elections in 2005. However, in October 2007 the *Civic Platform*, a more moderate and pro-European party, achieved a surprise victory in the parliamentary elections. Whilst on many issues the *Law and Justice Party* and the *Civic Platform* overlap, the latter prides itself on its international credentials and competence. Poland performs substantially lower than the OECD average on all governance indicators, and lower than most CEE countries.

CHART 17: political environment indicators for Poland (2006)²¹



BUSINESS ENVIRONMENT



²⁰ Economic indicators are based on Heritage Foundation (2007), Central Intelligence Agency (2007) and US Census Bureau (2007). * Ageing population refers to growth in the percentage of the population aged 65 years and over, as measured in percentage points (PP).

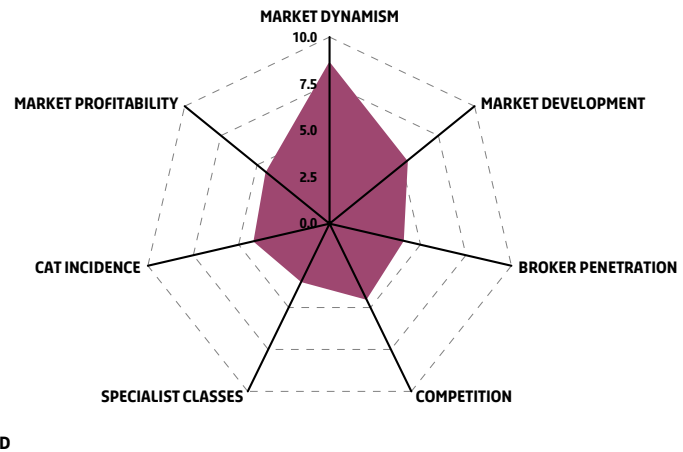
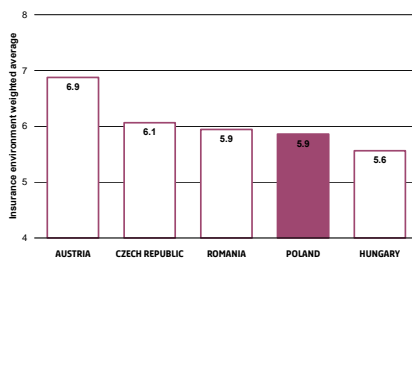
²¹ World Bank (2007)

Insurance environment

The Polish scores for the insurance environment indicators have been summarised in the chart below.

CHART 18: insurance market indicators for Poland

INSURANCE SUMMARY



Market dynamism (score 8.5)

The Polish market is the second-largest insurance market within the CEE region and demonstrated the second-largest volume of absolute growth between 2002 and 2006. Indeed, the Polish market grew in line with Austria, the Czech Republic and Hungary during this period.

Following a period of significant growth, the Polish market was relatively stagnant between 1998 and 2002. Since this time, however, non-life premiums have once again demonstrated significant growth. This growth is expected to accelerate further into 2007 and 2008 as a result of growing insurance needs of younger people and the developing middle class.

Market development (score 5.3)

Whilst the Polish market is the second-largest insurance market within the CEE region, it is only moderately developed when compared to its regional peers and thus receives a moderate score on the market development indicator. Indeed, Poland demonstrates a medium level of non-life insurance density and penetration. Nonetheless, Poland's insurance penetration was significantly below the average EU 27 penetration level in 2006. Insurance consciousness is rising in Poland as a result of expanded international trade and greater awareness of exposures, such as liability, so penetration and density levels are expected to increase correspondingly.

Broker penetration (score 4.0)

There has been a long tradition in Poland of companies having their own direct sales staff and consequently agents are still the main distribution channel for personal lines business. For industrial and commercial insurance, however, brokers play a significant role. There are about 900 registered insurance brokers in Poland. One sixth of Polish non-life insurance was handled by brokers in 2005, a slight increase on the previous few years. It is expected that broker penetration will grow during the next few years for both private and commercial clients.

Competition (score 4.4)

The Polish non-life market is dominated by the former monopoly insurers, the state-owned *PZU Group* and formerly state-owned *WARTA*. Whilst the position of these insurers is weakening, they still have a combined share of over half of the Polish non-life market. It is

thus not surprising that the Polish insurance market is a challenging environment for smaller players to operate in. Indeed, some acquisitions of smaller companies have already taken place and it seems likely that a number of others will be squeezed out in the near future.

Since 2002, foreign investment has represented more than 70% of the net equity in Polish non-life insurers. This percentage is likely to increase as more international players enter the Polish market through the *Freedom of Services* and *Freedom of Establishment* provisions. In mid-2007, the Polish non-life market was composed of 36 locally-registered companies, including nine branches and subsidiaries of foreign insurers.²²

Specialist classes (score 3.4)

The insurance market is very strongly influenced by motor, which alone accounts for almost two-thirds of business. Nonetheless, property business also plays an important role in this market and the role of this class is expected to expand as the demand for mortgages rises amongst the younger generation. Indeed, insurers are seizing this opportunity to launch new products with enhanced cover allied to service packages. However, the share of motor grew and the share of property fell in 2005, compared to 2004, partly as a result of Poland's accession to the EU.²³

Natural catastrophe incidence (score 4.1)

9% of Poland's country area has a high or very high likelihood of flood occurrence, however, Poland does not have a strong exposure to any other natural hazards.²⁴

Market profitability (score 4.3)

The Polish market is more profitable than any of the other key CEE markets (when loss ratios are measured as incurred losses to earned premiums). Loss ratios for motor and liability were fairly high in 2005. (Liability loss ratios have significantly deteriorated in recent years.) However, loss ratios for property and MAT were significantly lower in 2005.

Compulsory classes

Poland has a number of compulsory lines, including: MTPL, agricultural third party liability and professional indemnity insurance for a range of professions. Farmers' property is also a compulsory class.

²² Lloyd's Market Intelligence calculation based on Polish Financial Supervision Authority (2007)

²³ Office of the Insurance and Pension Funds Supervisory Commission (2006)

²⁴ Munich Re Geo Risks Research (2006)

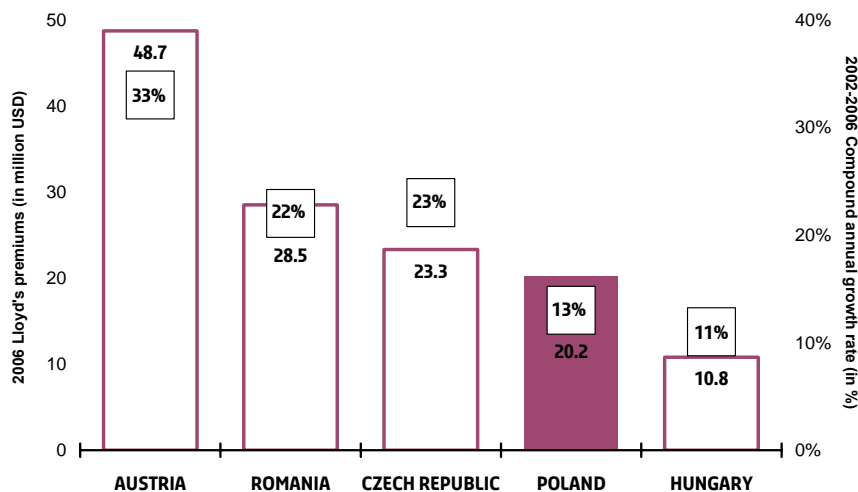
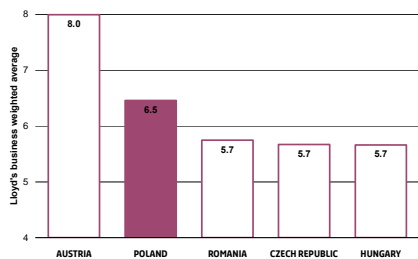
Lloyd's business

Market size

In 2006, Poland was Lloyd's fourth-largest CEE EU member market. During the last five years, Lloyd's Polish business has grown at an average rate of 13% per year, which is significantly slower than the Austrian market. The average growth rate, however, masks the slow decline in premiums, which occurred in 2001-2003 and the 45% increase in premiums between 2005 and 2006.

CHART 19: Lloyd's market size and growth (2002-2006)²⁵

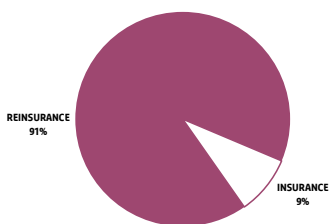
LLOYD'S SUMMARY



Lloyd's business split

With property accounting for two-thirds of Lloyd's Polish business, Lloyd's stands to benefit as the Polish economy gets richer and demand for asset protection grows. Within the property class, the biggest segment is catastrophe excess of loss. Fine art, terrorism, engineering and property excess are also important property lines in Poland.

CHART 20: Lloyd's business split for Poland (2006)²⁶



Lloyd's is authorised to write:

Insurance:

Services All classes except MTPL
 Establishment No

Reinsurance: All classes

Broker analysis

The Polish broker market is extremely fragmented with no brokers having a dominant position in terms of premiums brokered into Lloyd's. However, the top four brokers focus wholly or mainly on property business.

²⁵ Xchanging (July 2007)

²⁶ Xchanging (July 2007) and Lloyd's (2007)

Czech Republic

SWOT

STRENGTHS

BUSINESS ENVIRONMENT:

Political strengths: the ruling coalition has so far been able to withstand challenges to its stability. The current three-party coalition is unlikely to collapse in the near future, mainly because there is no real political alternative. Economic strengths: the Czech economy is currently performing well. The country shifted from having below average economic growth to above average growth between 2000 and 2006. Key segments of the economy are attracting foreign investment and driving forward growth.

INSURANCE ENVIRONMENT:

The Czech non-life market grew strongly between 2002 and 2005, particularly the motor, property and liability classes. There has been a general improvement in loss ratios across the market as a whole.

LLOYD'S:

The Czech Republic produces the third-largest volume of business for Lloyd's amongst CEE countries, which amounted to USD 23m in 2006.

WEAKNESSES

BUSINESS ENVIRONMENT:

Political weaknesses: ideological differences between coalition parties and a lack of external support from opposition parties. Economic weaknesses: catch-up with more developed economies is still some way off due to: unsustainable budget deficits, relaxed spending discipline, long term unemployment, slow progress in labour reforms, the administrative burden, weaknesses in business legislation and corruption.

INSURANCE ENVIRONMENT:

The ex-state monopoly insurer has a commanding share of the non-life market and the broker market has comparatively low levels of penetration. *Freedom of Services* provisions have increased competition between insurers.

LLOYD'S:

Lloyd's Czech portfolio is dominated by property catastrophe business. MAT is a traditional strength of Lloyd's, but it plays only a small role in the market as a whole. Lloyd's broker market in the Czech Republic is fairly concentrated.

OPPORTUNITIES

BUSINESS ENVIRONMENT:

The Czech Republic has successfully transitioned from a centrally-planned economy to one built upon market principles and has thus opened itself to foreign investment. The Czech Republic aims to join the Euro in 2010, which may increase opportunities for trade.

INSURANCE ENVIRONMENT:

With the dominance of foreign insurers within the Czech market, there is the potential for significant development of the insurance market, including increased professionalism and an increased range of products. Large accounts are being insured outside of the Czech Republic.

LLOYD'S:

The growth in compulsory liability insurances may present opportunities for Lloyd's to increase its involvement within this class of business.

THREATS

BUSINESS ENVIRONMENT:

The uncertainty regarding the Czech Republic's relationship with the EU may hinder future economic growth. Political tensions may lead to a breakdown of the ruling coalition. Without strong backing from all leading political parties, significant economic improvements are likely to prove problematic. The corruption charges against Mr Cunek may damage the reputation of the ruling coalition.

INSURANCE ENVIRONMENT:

Significant exposure to flooding (1997, 2002 and 2006) means that the Czech Republic has a high exposure to catastrophe risks and that loss ratios within property are periodically very high. The non-life market is expected to show signs of stagnation or decline in 2007.

LLOYD'S:

Lloyd's focus on property catastrophe business leaves it vulnerable to future flooding events within the Czech Republic.



Managing agents can download the full brief at: WWW.LLOYDS.COM/MARKETINTELLIGENCE



Business environment

Economic overview²⁷

Of the emerging democracies within the CEE region, the Czech Republic is amongst the most developed economies. Moreover, the Czech Republic has one of the highest economic growth rates. Past reforms and the Czech Republic’s relationship with the EU are contributing to growth, which is being driven by export-oriented manufacturing, backed by foreign direct investment. Whilst the Czech Republic is seeking to catch-up with more developed European economies, this goal is still some way off.

Key economic challenges which persist for the Czech Republic include:

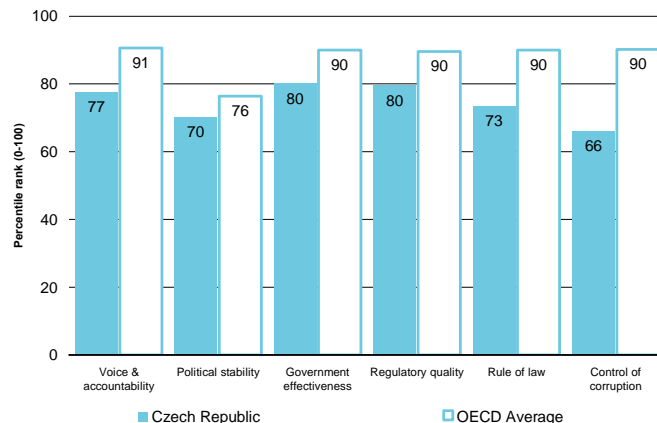
- *Maintaining progress.* The Czech Republic has one of the lowest levels of public debt in the CEE region. Nonetheless, in order to maintain its current level of economic performance, the government needs to put budget deficits on a sustainable track through reforming public spending. In particular, public spending needs to be tightened and the budgeting system is in need of improvements.
- *Improving labour market efficiency.* A relatively high level of unemployment and a rapidly ageing population are threatening the performance of the Czech economy. To tackle these threats, the government has implemented a number of measures, including making the welfare system more work-oriented and increasing the minimum wage.
- *Improving business conditions.* The Czech business environment is generally good with low inflation and borrowing costs. However, challenges remain in improving administrative processes, tightening business legislation and dealing with corruption.

ECONOMIC INDICATORS	
GDP PER CAPITA (2007)	USD 15,186
GDP CAGR (2002-2007)	4.4%
PUBLIC DEBT (2006)	22% OF GDP
UNEMPLOYMENT (2006)	8.4%
ECONOMIC FREEDOM (2007)	MODERATELY FREE
AGEING POPULATION (2007-2050)	18.3 PP*

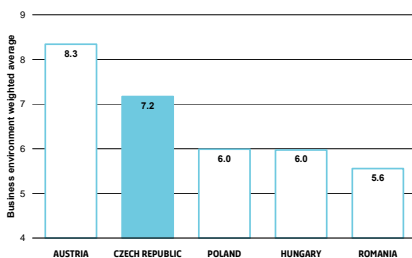
Political overview

The Czech Republic is governed by a three-party coalition. Whilst this coalition has only been formed relatively recently, cracks are already appearing due to ideological differences between the parties. In addition to these internal differences, the coalition is also struggling to gain external support on key issues from opposition parties and the president. Despite the internal and external weaknesses that the ruling coalition faces, it has thus far been able to withstand challenges to its stability, the most severe of which has been the corruption charges filed against the leader of the *Christian Democratic Union-Czechoslovak People’s Party*. Whilst control of corruption is an area of weakness for the government, the Czech Republic fares reasonably well against all other governance indicators.

CHART 21: political environment indicators for Czech Rep. (2006)²⁸



BUSINESS SUMMARY



²⁷ Economic indicators are based on Heritage Foundation (2007), Central Intelligence Agency (2007) and US Census Bureau (2007). * Ageing population refers to growth in the percentage of the population aged 65 years and over, as measured in percentage points (PP).

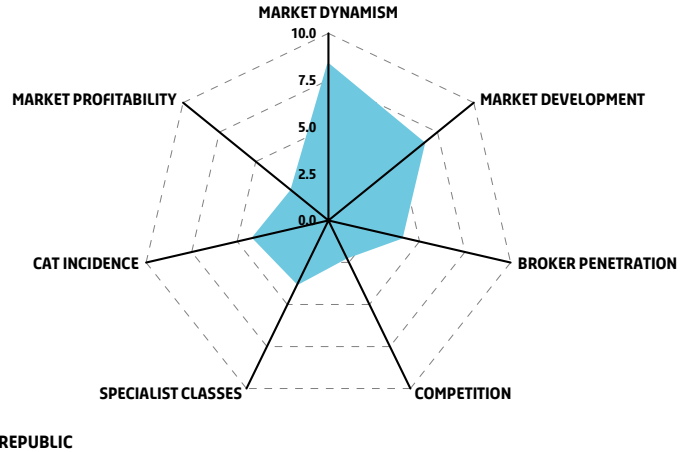
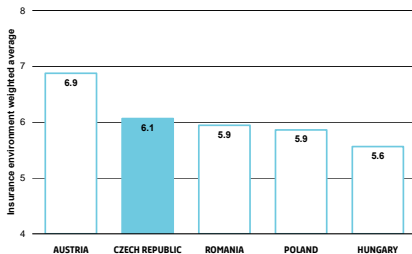
²⁸ World Bank (2007)

Insurance environment

The Czech Republic scores for the insurance environment indicators have been summarised in the chart below.

CHART 22: insurance market indicators for the Czech Republic

INSURANCE SUMMARY



Market dynamism (score 8.3)

The Czech non-life insurance market is the third-largest market amongst CEE EU members and has demonstrated the third-largest volume of absolute growth between 2002 and 2006. A number of the smaller CEE insurance markets are growing significantly faster than the Czech market, but these markets are starting from a much smaller base in terms of premium volume.

Following a period of slow premium increase between 1995 and 2001, the events of 9/11 and the ensuing worldwide reduction in reinsurance capacity sparked a significant growth in Czech non-life premiums. Indeed, the average growth rate between 2001 and 2005 was 25% per year. However, in common with other European territories, the non-life market is now softening and market growth between 2005 and 2006 slowed to 7%.²⁹

Market development (score 6.6)

Given its position as the third-largest insurance market within the region, it follows that the Czech Republic has the third most developed market of all CEE EU members. Moreover, the Czech Republic achieves the second-highest score on the market development indicator amongst the key CEE markets. The Czech Republic's level of insurance penetration was, however, significantly below that of Slovenia and the EU 27 average in 2006.

Broker penetration (score 4.0)

The Czech Republic is diversifying away from the traditional branch and agency system. Whilst branches and agents remain the leading distribution channel, bancassurance and brokers have made significant impacts on non-life insurance. The insurance broking sector has undergone rapid expansion in recent years, with the number of brokers rising by 106% between 2001 and 2006.³⁰ A key reason for this rise has been the rapid acceptance of insurance brokers by insureds and insurers alike. Indeed, most industrial and commercial accounts are now controlled by brokers.

Of the brokers that are registered in the Czech Republic (over 500), only around 100 are members of the *Association of Czech Insurance Brokers*.³¹ Brokers in the Czech Republic

²⁹ Lloyd's Market Intelligence calculation based on Sigma (2007)

³⁰ Czech Insurance Association (2006)

³¹ Ibid

tend to have a poor reputation, which is partly generated by the stiff competition between brokers.

Competition (score 2.2)

In 2005, there were 45 insurance companies engaged in the Czech insurance market, of which 40 wrote non-life business.³² Of the total number of insurers, 33 were domestic companies and the remainder were foreign branches of insurance companies from EU member states.³³ In 2005, competition increased within the Czech insurance market as 328 insurers and branches from the EU expressed interest in operating in the Czech Republic under the *Freedom of Services* provisions.³⁴

Despite the number of players in the Czech non-life market *Česká pojišťovna* has a commanding share of over one-third of the market.³⁵ Aside from *Česká pojišťovna*, Czech non-life players have a small share of the market. Indeed, almost two thirds of the market is composed of foreign subsidiaries and branches. The only state-owned insurance company is export credit insurer *Exportní garanční a pojišťovací společnost, a.s. (EGAP)*.

Specialist classes (score 3.7)

The Czech market is strongly influenced by the motor, property and liability sectors, which together account for 91% of business. The Czech market thus displays a lack of diversification, which suggests that there may still be potential for growth in sectors such as PA & healthcare and MAT. Nonetheless, the Czech Republic achieves the second-highest score on the specialist classes indicator amongst the key CEE markets.

Natural catastrophe incidence (score 4.1)

9% of the Czech Republic's country area has a high or very high likelihood of flood occurrence, however, the Czech Republic does not have a strong exposure to any other natural hazards.³⁶ Floods occur with relative frequency in the Czech Republic and significant insurance losses resulting from flooding occurred in 1997, 2002 and 2006.

Market profitability (score 2.5)

Profitability within the Czech non-life market is generally reasonably good (when loss ratios are measured as paid claims to written premiums). However, the Czech Republic compares poorly with its regional peers in respect of profitability. Loss ratios for motor, property and liability have generally been good, but property loss ratios spiked in 2002 as a result of the August 2002 floods, which amounted to the biggest natural disaster in modern Czech history. In the aftermath of the floods, industrial property policies were subject to a technical re-rating exercise, which produced excellent underwriting results and much lower loss ratios in 2004 and 2005.

Compulsory classes

The Czech Republic has a number of compulsory liability lines, including: MTPL, employer's liability, tour operators' insolvency bonds, nuclear liability, no fault liability for organisations conducting clinical trials, professional indemnity insurance for a range of professions and third party liability for a range of entities involved in transportation. Natural catastrophe and theft cover are also compulsory for the buildings and contents of agricultural storehouse operators.

³² Czech Insurance Association (2006)

³³ *Ibid*

³⁴ *Ibid*

³⁵ *Ibid*

³⁶ Munich Re Geo Risks Research (2006)

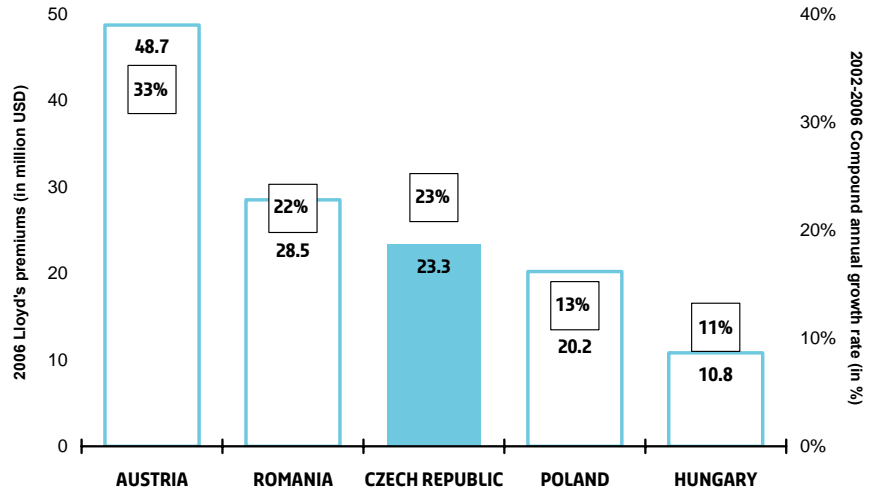
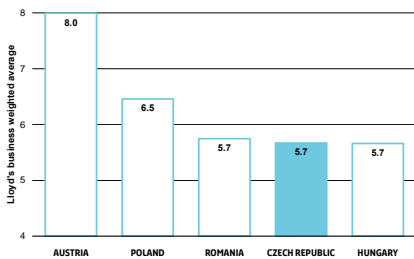
Lloyd's business

Market size

In 2006, the Czech Republic was Lloyd's third-largest CEE EU member market. During the last five years, Lloyd's Czech business has grown at an average of 23% per year, marginally faster than the growth of Lloyd's Romanian business. This annual average, however, masks the 123% increase in Lloyd's Czech business in 2002-2003, the 21% decrease in 2005-2006 and the relative stagnation for the remainder of the years. The key reason for the significant fluctuations in Lloyd's Czech business is most likely the repeated flood losses. Indeed, devastating flooding occurred in the Czech Republic in 2002 and 2006.

CHART 23: Lloyd's market size and growth (2002-2006)³⁷

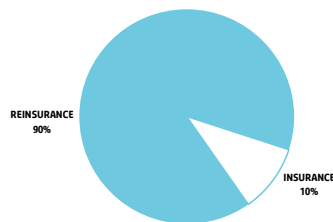
LLOYD'S SUMMARY



Lloyd's business split

The dominance of reinsurance business in Lloyd's Czech portfolio reflects the dominance of property, which alone accounts for 58% of business. Within the property class the biggest segment is catastrophe excess of loss, which explains the exposure of Lloyd's Czech business to widespread flooding claims. Lloyd's also writes a significant volume of Czech motor business, the vast majority of which is treaty reinsurance.

CHART 24: Lloyd's business split for Czech Republic (2006)³⁸



Lloyd's is authorised to write:

Insurance:

Services All classes except MTPL
 Establishment No

Reinsurance: All classes

Broker analysis

Lloyd's Czech business is dominated by two brokers, which together accounted for over half of business in 2006. This market concentration reflects the developing nature of the Czech non-life market.

³⁷ Xchanging (July 2007)

³⁸ Xchanging (July 2007) and Lloyd's (2007)

Romania

SWOT

STRENGTHS

BUSINESS ENVIRONMENT:

Political strengths: Romania has made significant progress in its integration with the rest of Europe. Romania successfully joined the EU in January 2007, after completing an impressive list of reforms. Economic strengths: economic growth is currently strong and is expected to remain so for the next few years. Economic policies have been more market-oriented since the current coalition came into power. Romania's economic growth was faster than that of any other regional peer between 2000 and 2005.

INSURANCE ENVIRONMENT:

The non-life market has shown tremendous growth since 2000. Indeed, it demonstrated the most relative growth and the fourth-largest volume of absolute growth between 2002 and 2006 within the CEE region.

LLOYD'S:

Lloyd's Romanian business grew by 130% between 2005 and 2006 albeit from a low base. Romania was the second-largest CEE market for Lloyd's business in 2006.

WEAKNESSES

BUSINESS ENVIRONMENT:

Political weaknesses: as a result of shifting alliances, the government now controls only 22% of legislative seats. President Basescu survived a vote of impeachment, but the support for the president highlighted the disconnect between the current government and the public. Romania lags behind its regional counterparts on all governance indicators. Economic weaknesses: Romania was overtaken by a number of its regional peers in terms of economic growth in 2006. The fairly large GDP share of the agricultural sector highlights the underdeveloped nature of the economy.

INSURANCE ENVIRONMENT:

The dominance of motor business reflects the developing nature of Romanian insurance. The main insurance distribution channels are direct sales and agencies.

LLOYD'S:

The broker market for Lloyd's business in Romania is fairly concentrated. Indeed, the top three brokers account for 73% of business.

OPPORTUNITIES

BUSINESS ENVIRONMENT:

Following nearly a decade of stagnation, Romania began to make reform progress in 2000. These reforms are now generating significant interest and investment from foreign companies. Future economic growth may be enhanced by EU subsidies and funding.

INSURANCE ENVIRONMENT:

The Romanian non-life market is the least developed amongst its regional peers and thus has the greatest potential for growth. Foreign-owned insurers and bancassurers have been rapidly gaining market share. These companies are likely to raise the professionalism of the industry and to increase the range of products available. The general awareness of a need for insurance is growing in Romania. The government is promoting insurance through implementing compulsory covers.

LLOYD'S:

Lloyd's is focusing on niche capacity for which there is currently little local appetite.

THREATS

BUSINESS ENVIRONMENT:

Recent political shifts have slowed down the government's reform progress. Indeed, Romania has not yet met all of the EU's acceptance levels. Romania's declining and ageing population and its labour shortages are likely to strain the government's purse and hinder business activity.

INSURANCE ENVIRONMENT:

The insurance market is on track to become dominated by just a few large insurance companies, which may lead to strong competition and reduced rates.

LLOYD'S:

A key concern for the future is the extent to which the current volume and growth rate of Lloyd's Romanian business can be maintained. Lloyd's Romanian offshore energy business, for instance, may not be sustainable as oil and natural gas productivity is declining.



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ECONOMIC INDICATORS	
GDP PER CAPITA (2007)	USD 6,338
GDP CAGR (2002-2007)	6.2%
PUBLIC DEBT (2006)	21% OF GDP
UNEMPLOYMENT (2006)	6.1%
ECONOMIC FREEDOM (2007)	MODERATELY FREE
AGEING POPULATION (2007-2050)	15.3 PP*

Business environment

Economic overview³⁹

Following the demise of communism, Romania reformed more slowly than most of its regional peers, but since 2000 the country has been growing rapidly. Indeed, between 2002 and 2006 the Romanian economy grew faster (in relative terms) than any other CEE EU member state. Nonetheless, Romania still lags behind its regional peers in terms of economic development (measured in GDP *per capita*).

Key economic challenges which remain for Romania include:

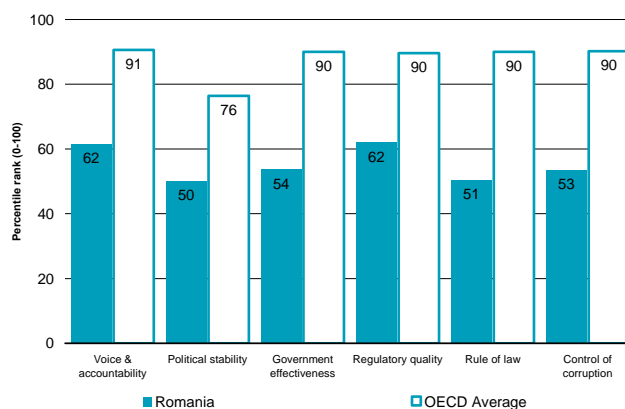
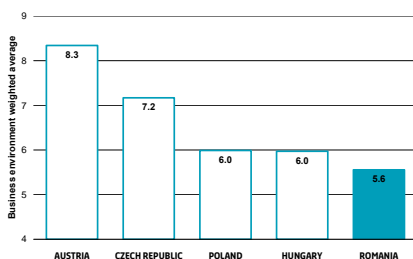
- **Demographic changes.** Romania's population is declining. The *United Nations* has projected that the population could decrease by 33% to 14.9m by 2050.⁴⁰ Romania's population is also ageing, although not as fast as the Czech and Polish populations.
- **Labour shortage.** Romania is struggling to maintain a viable labour force. Romania's average income is one of the lowest in the region, which is pushing many skilled workers to move to neighbouring countries. Unemployment is currently at a 15-year low.
- **Controversial economic policies.** The priorities of the Romanian government and the IMF have come into conflict. Indeed, the IMF believes that the government's strategies, of reducing the interest rate and not saving reserves during periods of boom, are making Romania unnecessarily vulnerable.⁴¹ The government is not, however, overly concerned as Romania's economic boom is projected to continue for the next few years and public debt is significantly lower in Romania than in some of its regional peers.

Political overview

Romania has made significant progress on its integration with the rest of Europe through its accession to the EU in January 2007. Nonetheless, the *European Commission* still has serious concerns regarding Romania's ability to achieve and maintain certain EU standards. If Romania fails to uphold EU standards then the country could face sanctions. Necessary reforms are, however, being delayed by the domestic political situation. The political situation degenerated in 2007 due to disputes between *President Basescu* and *Prime Minister Tariceanu*. This row is causing political turmoil and appears to have signalled the breakdown of the *Truth and Justice Alliance*, which dominates the ruling four-party coalition. In May 2007, Romania rejected the referendum on the impeachment of the president and the large show of support for the president highlighted the disconnect between the public and the government. Despite the substantial improvements that have been made, Romania lags behind its regional counterparts on all key governance indicators.

CHART 25: political environment indicators for Romania (2006)⁴²

BUSINESS SUMMARY



³⁹ Economic indicators are based on Heritage Foundation (2007), Central Intelligence Agency (2007) and US Census Bureau (2007). * Ageing population refers to growth in the percentage of the population aged 65 years and over, as measured in percentage points (PP).

⁴⁰ Yuxia, J (2007)

⁴¹ International Monetary Fund (2007)

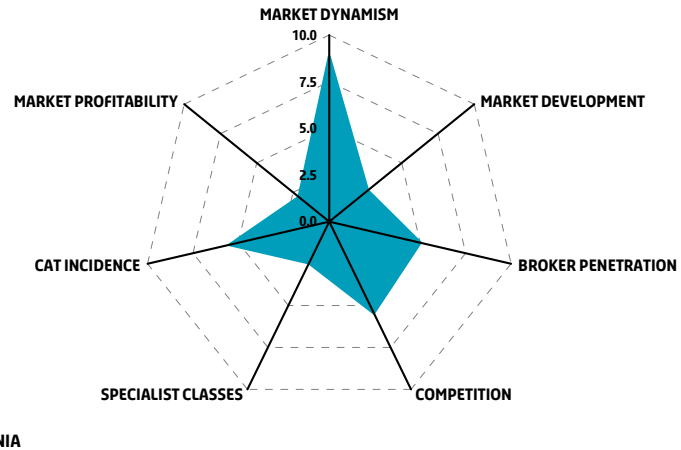
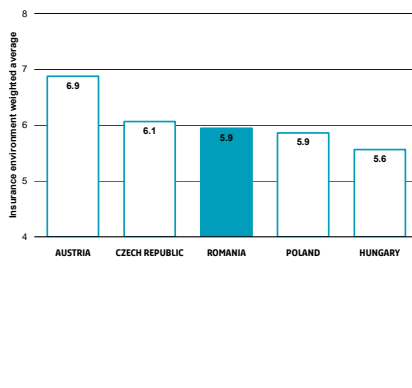
⁴² World Bank (2007)

Insurance environment

The Romanian scores for the insurance environment indicators have been summarised in the chart below.

CHART 26: insurance market indicators for Romania

INSURANCE SUMMARY



Market dynamism (score 8.8)

Following a period of very slow growth, the Romanian non-life market has shown tremendous growth since 2001. It has grown from being the seventh-largest CEE market in 2002, to being the fifth-largest in 2006 (having overtaken Slovakia and Slovenia). Indeed, not only did Romania show the most relative growth between 2002 and 2006, but it also demonstrated the fourth-largest volume of absolute growth (just slightly behind the much larger Czech market).

During the past five years, growth in this market has averaged at 22% per year. This growth can be attributed to two factors: the events of 9/11 (and the ensuing worldwide reduction in reinsurance capacity) and Romania's accession to the EU in 2007. Whereas many European non-life markets are now softening following significant post 9/11 growth, Romania's non-life market is growing very rapidly. It is thus not surprising that Romania has scored higher on the market dynamism indicator than the other key CEE markets.

Market development (score 2.6)

Whilst the Romanian non-life market has shown huge growth in recent years, this market is still the least developed amongst the CEE EU member states, both in terms of density and penetration. Indeed, Romania scores much lower than the other key CEE markets on the market development indicator. This low level of development is most likely a legacy of the communist era, during which there was little tradition of purchasing insurance and awareness of litigation was extremely low. This low level of development suggests that there is still significant potential for growth in the Romanian non-life market.

Broker penetration (score 5.0)

The dominant distribution channels for Romanian non-life insurance are: the direct sales force and agencies. Bancassurance has also become an important distribution channel. Nonetheless, Romania has a moderate level of broker penetration, comparable to penetration in Hungary. Insurance brokers were recognised for the first time by the *Law on Insurance Companies and Insurance Supervision*, which came into effect in 2001. There were over 280 licensed brokers with which almost one quarter of total non-life premiums were placed in 2005.⁴³ Brokers have become important for collateral and credit protection schemes as well

⁴³ Insurance Supervisory Commission (2006)

as for MTPL. Insurance brokers domiciled elsewhere in the EU can operate in Romania under the *Freedom of Services* or the *Freedom of Establishment* provisions.

Competition (score 5.4)

In June 2006, there were 17 companies active in the Romanian non-life market.⁴⁴ The role of the state in the non-life market has been reduced dramatically during the last decade and the two ex-state owned companies (*Asirom* and *Astra*) have been losing market share. Meanwhile, foreign-owned insurers and bancassurers have been rapidly gaining market share. The foreign entity with the greatest stake in the non-life market is the Austrian group *Wiener Städtische (Vienna Insurance Group)*. *Allianz* (Germany), *UNIQA* (Austria), *Generali* (Italy) and *AIG* (US) are also significant players within the Romanian non-life market. In total, foreign companies shared approximately 55% of the non-life market at the end of 2005.⁴⁵

Whilst the concentration of the non-life market appears to have remained fairly stable during the past five years, the stake of the *Vienna Insurance Group* has increased dramatically. Indeed, in 2007, 31% of the market was dominated by the *Vienna Insurance Group* and this share may increase as the group continues to pursue an aggressive acquisition strategy.⁴⁶ Thus, whilst the top three insurance companies accounted for half of the non-life market in 2005, almost one third of the market is actually controlled through ownership by one foreign insurance group.⁴⁷

Specialist classes (score 2.5)

The non-life market is dominated by motor, which alone accounts for more than two-thirds of all non-life premiums. The dominance of this class is a reflection of the developing nature of Romanian insurance. Indeed, Romania achieves the lowest score amongst its regional peers on the specialist classes indicator. Nonetheless, property, PA & healthcare, MAT, liability and miscellaneous classes are all written in Romania. In the next few years, as business in these classes grows, the market share of the motor portfolio is likely to decrease.

Natural catastrophe incidence (score 5.5)

10% of Romania's country area has a high likelihood of an earthquake occurring there and 9% of the territory has a high or very high likelihood of flood occurrence.⁴⁸

Market profitability (score 2.1)

Profitability within Romanian non-life insurance is the lowest amongst the key CEE markets (when loss ratios are measured as paid claims to written premiums). Between 2002 and 2004, motor loss ratios were fairly high, but they dropped significantly between 2004 and 2006. Loss ratios in property, PA & healthcare and MAT have generally remained fairly low in the last five years.

Compulsory classes

Romania has an array of compulsory liability lines, including: MTPL, aviation third party liability, nuclear liability, tour operators' bonds and professional indemnity insurance for a range of professions. Personal accident and occupational disease insurance is also compulsory for employees who belong to factory fire brigades.

⁴⁴ Insurance Supervisory Commission (2006)

⁴⁵ Lloyd's Market Intelligence calculation based on Insurance Supervisory Commission (2006)

⁴⁶ Business Standard (2007)

⁴⁷ Insurance Supervisory Commission (2006)

⁴⁸ Munich Re Geo Risks Research (2006)

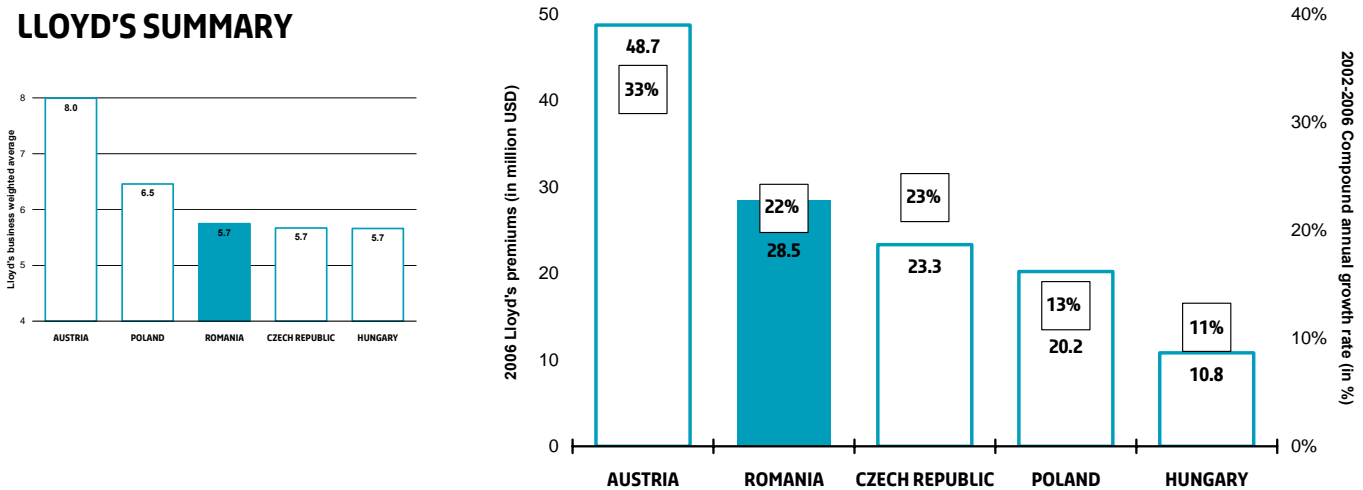
Lloyd's business

Market size

In 2006, Romania was Lloyd's second-largest CEE EU member market. During the last five years, Lloyd's Romanian business has grown at an average of 22% per year, marginally slower than the growth of Lloyd's Czech business. The growth of Lloyd's Romanian business has, however, been fairly erratic. Indeed, the business contracted in 2002-2003 and 2004-2005, but grew by 130% in 2005-2006. A key factor which is driving the current dramatic growth is Romania's accession to the EU. Thus, a key concern for the future is the extent to which the current volume and growth rate of business can be maintained.

CHART 27: Lloyd's market size and growth (2002-2006)⁴⁹

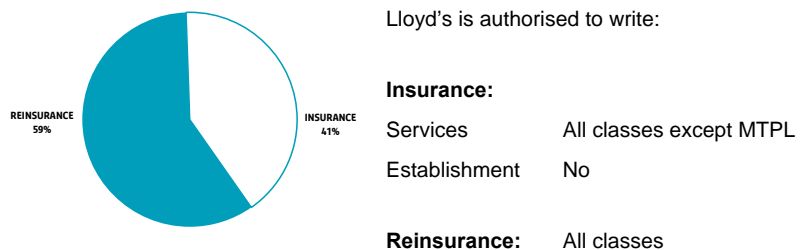
LLOYD'S SUMMARY



Lloyd's business split

The fairly even split between insurance and reinsurance business highlights the large number of classes which Lloyd's syndicates write in Romania. Nonetheless, Lloyd's Romanian business is dominated by MAT, which accounts for 74% of the portfolio. Within the MAT class, the biggest segment is offshore energy. Whilst Romania has significant reserves of oil (comparable to Denmark's reserves) and natural gas, productivity has decreased dramatically in these industries during the past three years. Thus the potential for future growth of Lloyd's business in offshore energy is questionable.

CHART 28: Lloyd's business split for Romania (2006)⁵⁰



Broker analysis

Lloyd's Romanian business is dominated by one broker, which alone brought in 41% of business in 2006. Moreover, the top three brokers accounted for 73% of Romanian business in 2006. This market concentration reflects the relatively developing nature of the Romanian non-life market.

⁴⁹ Xchanging (July 2007)

⁵⁰ Xchanging (July 2007) and Lloyd's (2007)

Hungary

SWOT

STRENGTHS

BUSINESS ENVIRONMENT:

Political strengths: Hungary is considered to have a relatively stable political environment. This stability is attributable to its membership of various international bodies.

Economic strengths: Hungary's export growth has shown a measure of robustness in spite of the recent decline in EU growth. Key segments of the economy are attracting foreign investment and driving growth forward.

INSURANCE ENVIRONMENT:

The Hungarian non-life market is the fourth-largest amongst the CEE EU member states. Brokers have been fully accepted into the market and control the majority of industrial/commercial business. Bancassurance is growing strongly as a distribution channel.

LLOYD'S:

Lloyd's Hungarian business demonstrated strong growth between 2005 and 2006.

WEAKNESSES

BUSINESS ENVIRONMENT:

Political weaknesses: rule of law and government spending and control of corruption, are areas of weakness for Hungary.

Economic weaknesses: large government debts, government overspending, the large current account deficit, and the financial burdens of an ageing population. Also, the economy is in need of structural reform. Hungary has been overtaken by a number of its regional peers in terms of economic growth.

INSURANCE ENVIRONMENT:

Following significant post 9/11 growth, the non-life market has now softened. Whilst the market is relatively poorly developed, its density and premium are in line with those of its regional peers. *Freedom of Services and Freedom of Establishment* provisions have led to intense competition, but the market is still dominated by the ex-state insurer Allianz Hungária.

LLOYD'S:

Hungary is the smallest market for Lloyd's amongst the key CEE markets. The pool of Lloyd's brokers is fairly concentrated in Hungary.

OPPORTUNITIES

BUSINESS ENVIRONMENT:

Hungary's integration with the EU appears to be fostering growth. The key source of economic growth is now perceived to be exports to EU member states, although it is expected that medium-term growth will be generated from EU-funded projects. As Hungary becomes increasingly integrated with the EU, the fortunes of Hungary will be increasingly tied to those of the other member states.

INSURANCE ENVIRONMENT:

Hungary's insurance market is on the way to becoming a developed market. Foreign insurers from EU member states can operate in the market through the *Freedom of Establishment* provisions, which decrease the barriers to entry for insurers. Opportunities for growth are emerging in a number of the smaller classes of business.

LLOYD'S:

There may be potential for Lloyd's to grow its business in more sophisticated classes, particularly in liability lines.

THREATS

BUSINESS ENVIRONMENT:

Hungarian governments have followed a pattern of massive increases in spending in the lead up to an election, followed by an austerity programme implemented in the post-election period. This pattern has contributed to the high level of government debt and threatens the quality of essential services. Moreover, this pattern has caused relatively poor GDP growth which is threatening Hungary's economic growth potential. The government is, however, unable to remedy the situation as it has already sold off its most profitable assets. In addition, the rapid development of the services sector has led to a number of stability concerns.

INSURANCE ENVIRONMENT:

The market share of middle ranking insurance companies is being squeezed. Rates are under pressure due to intense competition between insurers.

LLOYD'S:

Intense competition and comparatively low growth mean that there are a lack of opportunities for managing agents in Lloyd's traditional areas of strength, namely property and MAT.



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Business environment

Economic overview⁵¹

Following a period of privatisation, which boosted economic growth after the end of communist rule, Hungary's growth potential is now somewhat reduced. Indeed, Hungary has sold off its most profitable assets and the government is struggling to manage the country's very high level of debt. In light of the relatively poor performance of the domestic economy, the Hungarian government is pursuing a growth strategy based on greater integration with the EU. As such, the fortunes of the Hungarian economy are becoming increasingly tied in with the EU. Hungary's average annual growth rate is in line with that of the Czech Republic and its level of economic development is in line with that of Poland.

Key challenges to Hungary's economic growth include:

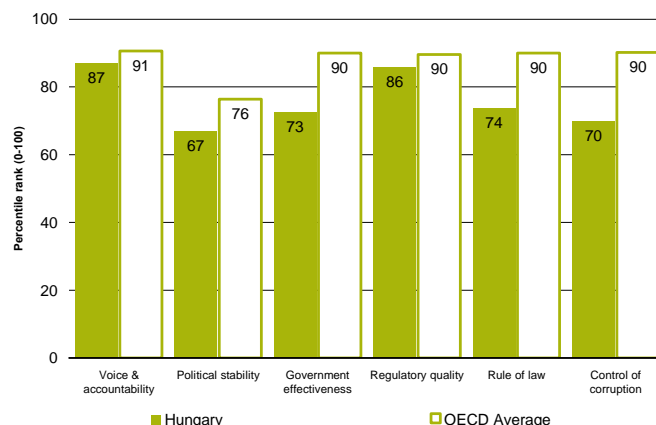
- **Government spending.** Hungary tends to follow a pattern of massive increases in government spending in the lead up to elections (which occur every four years) followed by an austerity programme in the post election period, involving spending cuts and increases in taxes. Successive governments have tried to implement reforms in order to bring about reduced public debt, stabilisation and privatisation, however, the pattern of overspending and austerity programmes has not yet been broken. Research has shown that the prosperity of the Hungarian economy has often correlated very closely with government spending. Thus government reforms could significantly improve the business environment in Hungary.
- **Ageing population.** Hungary's population is ageing, albeit at a slightly slower rate than most other CEE countries. The compound effects of the reduction in the working population and the fairly high level of unemployment (although not by regional standards) are likely to bring about a situation whereby the government has fewer resources with which to support more service-users. The increasing strain on the pension system is a real concern for the government.

ECONOMIC INDICATORS	
GDP PER CAPITA (2007)	USD 10,914
GDP CAGR (2002-2007)	4.0%
PUBLIC DEBT (2006)	69% OF GDP
UNEMPLOYMENT (2006)	7.4%
ECONOMIC FREEDOM (2007)	MODERATELY FREE
AGEING POPULATION (2007-2050)	14.1 PP*

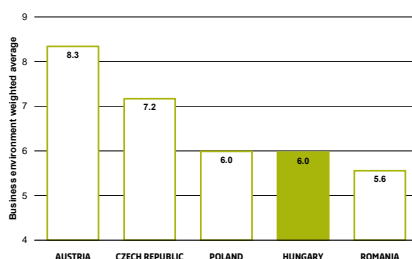
Political overview

In relation to other key CEE markets, Hungary fares well against governance indicators, only being outperformed by Austria. Nonetheless, Hungary performs substantially lower than the OECD average on all governance indicators, particularly in the area of control of corruption. This underperformance is likely to be a legacy of the change of regime since the collapse of communism.

CHART 29: political environment indicators for Hungary (2006)⁵²



BUSINESS SUMMARY



⁵¹ Economic indicators are based on Heritage Foundation (2007), Central Intelligence Agency (2007) and US Census Bureau (2007). * Ageing population refers to growth in the percentage of the population aged 65 years and over, as measured in percentage points (PP).

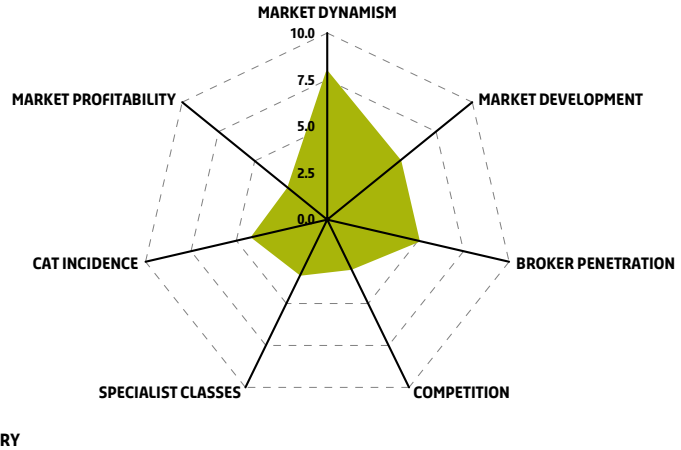
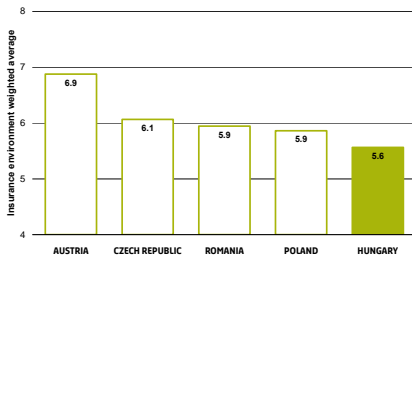
⁵² World Bank (2007)

Insurance environment

The Hungarian scores for the insurance environment indicators have been summarised in the chart below.

CHART 30: insurance market indicators for Hungary

INSURANCE SUMMARY



Market dynamism (score 7.9)

The Hungarian non-life insurance market is the fourth-largest market amongst the CEE EU member states. Whilst Hungary has the second-slowest growth rate at 40%, the non-life markets of Austria and Poland have similar growth rates, of 38% and 41% respectively. The fairly slow growth rate of the Hungarian market may be attributable to poor GDP growth and the intense competition between insurers.

Following a period of stagnation between 1995 and 2001, the events of 9/11 and the ensuing worldwide reduction in reinsurance capacity sparked a significant growth in Hungarian non-life premiums. Indeed, the average growth rate between 2001 and 2005 was 22% per year. However, in common with other European territories, the non-life market is now softening and there was a slight decrease in growth between 2005 and 2006. Moreover, business is being lost to other insurers elsewhere in the EU through the *Freedom of Services* provisions. The fairly small size of the market and poor growth rate mean that Hungary achieves the lowest score on the market dynamism indicator amongst the key CEE markets.

Market development (score 5.0)

Given its position as the fourth-largest insurance market within the CEE region, the Hungarian non-life market is comparatively poorly developed, with only Romania being less developed. Key reasons for Hungary's underdevelopment include: low natural perils exposure and intense price competition between insurers. Whilst the levels of insurance density and penetration in Hungary are largely in line with those of most of its regional peers, its penetration was significantly below the EU 27 average in 2006.

Broker penetration (score 5.0)

Tied agents are still the main distribution channel for personal lines and small commercial accounts, but tied agents are coming under increasing pressure from low-cost alternatives, particularly bancassurance. In 2006, there were over 330 authorised insurance brokers operating in Hungary, of which 115 belonged to the *Association of Independent Insurance Brokers (FBAMSZ)*.⁵³ Brokers are estimated to control the majority of the commercial/ industrial market and one quarter of the total non-life market. Brokers have been fully

⁵³ Association of Independent Insurance Brokers in Hungary (2007)

accepted by both clients and insurers. The broker market is undergoing some consolidation, which is forcing smaller brokers either to close or to focus on personal lines.

Competition (score 2.9)

In 2005, there were 18 non-life and composite insurers with supervised operations in Hungary, and the remainder were life-only insurers.⁵⁴ 24 branches have been established in Hungary by EU insurers through the *Freedom of Establishment* provisions, and there are also around 34 mutual insurance companies, which are mainly engaged in rural crop and livestock insurance.⁵⁵ Despite the number of active players, the market continues to be dominated by the ex-state insurer *Allianz Hungária*, which had a 39% market share in 2005.⁵⁶ Moreover, the top three insurers had a share of over two-thirds of the market in 2005.⁵⁷ It is for this reason that Hungary scores poorly on the competition indicator.

Hungary was the first ex-communist state to privatise its insurance industry. Every insurance company except *OTP Garancia* and *Magyar Exportitel Biztosító Rt (MEHIB)* is now majority foreign-owned. The only state-owned insurance company is *MEHIB*, which writes export credit guarantee business.

Specialist classes (score 3.2)

Hungarian insurance is strongly influenced by the motor and property sectors, which together account for 88% of the non-life market. The Hungarian market displays a lack of diversification, which suggests that there may still be significant potential for growth in sectors such as PA & healthcare, liability and MAT.

Natural catastrophe incidence (score 4.1)

9% of Hungary's country area has a high or very high likelihood of flood occurrence, however Hungary does not have a strong exposure to any other natural hazards.⁵⁸

Market profitability (score 2.7)

Profitability in the Hungarian market is quite good (when loss ratios are measured as paid claims to written premiums) although fairly low when compared to other regional peers. Loss ratios for motor are slightly higher than in other key non-life classes. Loss ratios for PA & healthcare, liability and MAT have generally remained at very low levels.

Compulsory classes

Hungary has a number of compulsory lines, including: MTPL, nuclear liability, marine and aviation liability and third party liability and/or professional indemnity insurance for a vast range of professions and activities.

⁵⁴ Association of Hungarian Insurance Companies (2006)

⁵⁵ Hungarian Financial Supervisory Authority (2007)

⁵⁶ Association of Hungarian Insurance Companies (2006)

⁵⁷ Ibid

⁵⁸ Munich Re Geo Risks Research (2006)

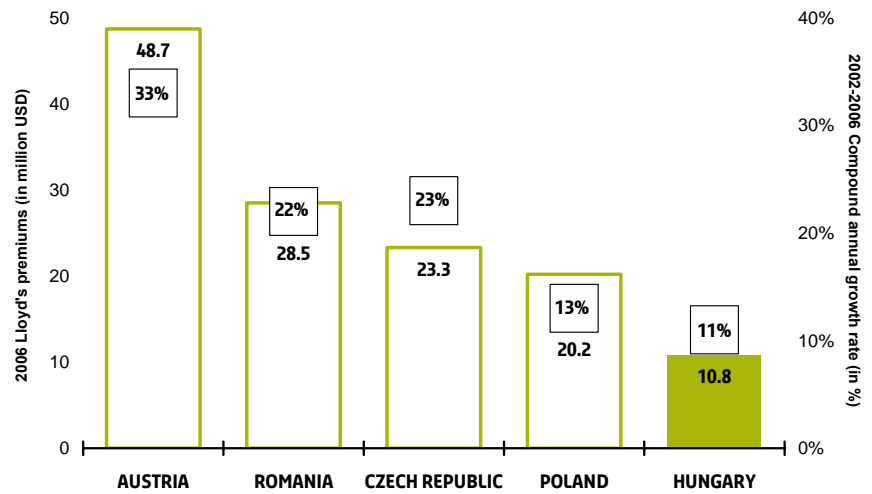
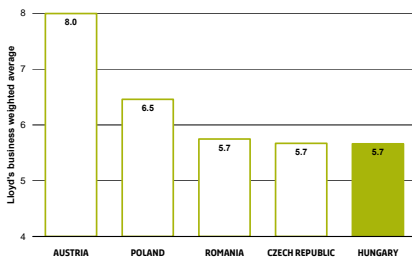
Lloyd's business

Market size

Amongst the key CEE markets, Hungary produces the smallest volume of business for Lloyd's. Moreover, during the last five years, this market has shown the least growth, with an average of 11% per year. Lloyd's Hungarian business has, however, grown somewhat erratically. Indeed, Lloyd's Hungarian business experienced slow growth (2001-2003), followed by slow contraction (2003-2006), followed by significant growth of 74% (2005-2006). The growth of Lloyd's Hungarian business is constrained by the lack of growth in the property and MAT classes within the market as a whole. The tremendous growth in the capacity of installed windfarms (438% between 2004 and 2005) is likely to be a key reason for the recent growth in Lloyd's Hungarian portfolio.⁵⁹

CHART 31: Lloyd's market size and growth (2002-2006)⁶⁰

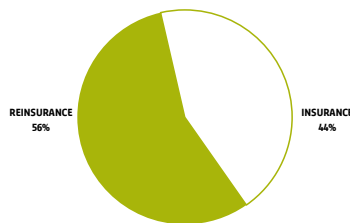
LLOYD'S SUMMARY



Lloyd's business split

The fairly even split between insurance and reinsurance business highlights the large number of classes which Lloyd's managing agents write in Hungary. Nonetheless, Lloyd's Hungarian business is dominated by property and MAT, which together accounted for 87% of business in 2006. Within the property and MAT classes the biggest segments are catastrophe excess of loss and offshore energy.

CHART 32: Lloyd's business split for Hungary (2006)⁶¹



Lloyd's is authorised to write:

Insurance:

Services All classes except MTPL
 Establishment No

Reinsurance: All classes

Broker analysis

Lloyd's Hungarian business is dominated by large international brokers, of which the top three accounted for 76% of business in 2006. This market concentration reflects the developing nature of the Hungarian non-life market.

⁵⁹ EurObserver (2006)

⁶⁰ Xchanging (July 2007)

⁶¹ Xchanging (July 2007) and Lloyd's (2007)

POTENTIAL OF KEY MARKETS

Potential from a Lloyd's perspective

Each of the key territories within the CEE region has been considered in terms of its business environment, insurance environment and Lloyd's business, and weighted according to the factors which tend to be more influential in business development opportunities. This has enabled the potential for doing business within these markets from a Lloyd's perspective to be derived, as summarised below:



From the previous sections of this paper, a number of considerations arise:

- Austria is by far the best performing CEE EU member in all three areas (business environment, insurance environment and Lloyd's business).
- Poland performs well in terms of its Lloyd's business and its business environment. Whilst, Hungary lags behind the other key markets in terms of its insurance environment, it does have the second-largest insurance market within the CEE region and future growth rates are expected to be high.
- The Czech Republic performs well in terms of its business environment and insurance environment. Whilst the performance of the Czech Republic is in line with Romania and Hungary in terms of Lloyd's business, Lloyd's Czech business is significantly more volatile than business from Poland and Austria. The key factor influencing this volatility is the occurrence of flooding events in the Czech Republic.
- In terms of its insurance environment and Lloyd's business, Romania's performance is in line with that of its regional peers. Romania's underperformance in terms of its business environment is due to its relatively low level of economic development.
- When compared to its regional peers, Hungary does not perform well in terms of its business environment or its insurance environment. Nonetheless, increasing integration with the EU is fostering export growth and political stability. Similarly, Hungary's insurance environment is on its way to becoming a developed market.

Taking the above points into account, this paper suggests that Lloyd's managing agents may wish to focus business development activities within the CEE region on Austria, as this country is deemed to offer the greatest short to medium term potential from a Lloyd's perspective. This focus would be in keeping with a number of insurance companies which are using Austria as a springboard for their operations within the CEE region.

For greater penetration into the CEE region, Poland and the Czech Republic offer significant business development opportunities over the short to medium term. A number of insurance companies have actually chosen to access these markets through their regional offices in Austria.

Due to the challenges existing within the Romanian and Hungarian business environments and/or insurance environments, these territories are deemed to only offer significant opportunities in the medium term for Lloyd's managing agents.

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APPENDIX

Indicators

Each of the 18 indicators has been scored on a scale from 0 to 10. The scores have been derived as follows:

Business environment indicators

Economic growth (weighting: 25%)

Economic growth uses macroeconomic indicators to gauge GDP size and growth, which are measures of the size of an economy.

The growth potential of the market has been evaluated by multiplying the 2006 GDP by the CAGR of the last five years. The indexation is made on a ranking basis (first country = 10, last country = 0).

Caveat: The figures have been taken straight from an International Monetary Fund (IMF) study.⁶²

Prosperity level (weighting: 25%)

GDP *per capita* is calculated using GDP on a purchasing power basis divided by the country's population. The scoring is then calculated using a 0 to 10 scale; 0 corresponds to a GDP *per capita* under USD 2,000; 10 corresponds to a GDP *per capita* over USD 35,000. The GDP *per capita* is calculated annually and IMF estimates for 2007 have been used for the prosperity level indicator. The GDP *per capita* is widely used as a reliable indicator for gauging the level of economic development of a country.

Caveat: This indicator does not take into consideration the specific income distribution of a particular territory and therefore needs to be used with caution.

Legal system fit (weighting: 25%)

The legal system fit indicator categorises legal systems around the world to enable an understanding of compatibility with the UK legal system.

Research has shown that there is a link between GDP *per capita* and the organisation of the legal system. As such, two sources of data have been used: the type of legal system (common law, civilist, customary, religious or mixed) and the GDP *per capita*.

Caveat: No value is attributed to the legal system, it is an assessment of the cultural fit with the British legal system.

Regulatory quality (weighting: 10%)

This indicator uses *World Bank* data to give an appreciation of regulatory quality in order to measure the ability of a government to formulate and implement sound policies and regulations that permit and promote private sector development.

Every year the *World Bank* publishes a study of governance in more than 200 countries worldwide. Regulatory quality is one of the six dimensions of governance. The score is given on a 0-10 scale so it fits perfectly into the matrix.

Caveat: The analysis is taken straight from a study of the World Bank.⁶³

⁶² International Monetary Fund (2006)

⁶³ World Bank (2007)

Economic freedom (weighting: 10%)

This indicator estimates the level of economic freedom in each territory to gauge structural fit and openness to the Anglo-Saxon mode of business.

The *Heritage Foundation* (2007) has ranked and scored all of the countries in the world on the following criteria: ease of licensing, trade barriers, fiscal concerns, government intervention, inflation, investment, openness of financial system, property rights, corruption and labour.

*Caveat: The analysis is taken straight from a study of the Heritage Foundation.*⁶⁴

Cultural environment fit (weighting: 5%)

This indicator gives an estimation of the cultural fit with UK, using the *Hofstede* four cultural dimensions, as national culture determines the way in which people do business in their country.

The scoring is based on a large research project into national culture differences across subsidiaries of a multinational corporation (IBM) in 64 countries. This study identified and validated four independent dimensions of national culture differences: power distance, individualism, masculinity and uncertainty avoidance. The IBM study gave a score for each country on the four dimensions. Lloyd's has scored and ranked the countries on the score difference with UK. The closer a country is to the UK the better is the score.

*Caveat: These results are entirely based on the research of Geert Hofstede and particularly his work "Cultures and Organisations".*⁶⁵

Insurance environment indicators**Market dynamism (weighting: 37%)**

This indicator estimates non-life market sizes and growth by examining direct non-life premiums and real growth.

This indicator is calculated using the volume of direct premiums in 2006 and multiplying it by the CAGR 2006/01. The scoring is made on a ranking basis (first country = 10, last one = 0).

Broker penetration (weighting: 23%)

This indicator estimates the level of business distributed through the broker channel by examining the relative size of the potential "subscription market" via brokers.

The broker penetration is based on a complete set of market estimates from *Axco*. As the figures are estimations from *Axco*, a scoring based on categories has been used. Categorization of countries follows the level of business handled by brokers, e.g. from 60% to 80% of the market, a country is given a score of 8 out of 10.

Market development (weighting: 8%)

This indicator estimates the level of market development using a combination of two indicators: density and penetration.

The countries are scored on density and on penetration and then an average of the two scores is used. The scoring is made on a ranking basis (first country = 10, last one = 0).

⁶⁴ Heritage Foundation (2007)

⁶⁵ Itim International (2004)

Competition (weighting: 8%)

This indicator estimates the level of concentration of the insurance market by examining the relative position of the three main players of each market.

Market concentration is derived from a complete set of *Axco/Sigma* data. For example, if the three main players hold 60 to 80% of the market, the country scores 4 out of 10. If the three main players hold less than 20% of the market, the country scores 10 out of 10.

Caveat: This scoring has only limited relevance as it makes the assumptions that the fragmentation of a market is correlated with its competitiveness (i.e. highly fragmented markets are competitive). However, in a number of cases, this may not be applicable.

Specialist classes (weighting: 8%)

This indicator estimates the level of specialist classes potential present in each market by examining: a negative indicator (motor – total market), and a positive indicator (MAT).

The indicator is derived using the following formula:

$$\text{"Specialist Indicator"} = [3 \cdot (1 - \text{share of motor}) + (\text{share of MAT})] / 4$$

A higher weighting has been applied to the share of non-motor business as it is the most relevant indicator of a specialist market. The score used is calculated on a ranking basis: the country with the highest indicator scores 10 and the one with the lowest indicator scores 0.

Caveat: Landlocked countries may be disadvantaged as the share of MAT business is part of the indicator. Furthermore, there is no statistical harmonisation between the countries concerning the reporting of MAT business, which makes benchmarking 'specialist classes' at best a difficult exercise.

Natural catastrophe incidence (weighting: 8%)

This indicator estimates the level of catastrophe exposure (spatially) present in each market by examining the potential level of natural hazard present in a territory.

This indicator is calculated using a combined index of geographic catastrophe exposure from a range of natural hazards (using a *MunichRe* database) and an in-house assessment of the aggregate risk exposure determined by Lloyd's Exposure Management. All the countries have received a score between 0 and 10.

Caveat: MunichRe measures the percentage of a territory exposed to natural hazards.⁶⁶ This exposition is assessed from 0 to very high. Only natural perils are assessed. The majority of countries assessed are categorised as "10" (i.e. high risk), this does not reflect the relative risk compared to other countries and does not provide any indication of the probability of the occurrence of any event.

Market profitability (weighting: 8%)

This indicator estimates the level of profitability in each market by examining the level of rates applied in a particular country and comparing the profitability of different countries.

The data is formatted into three types of loss ratio: paid claims to written premiums, incurred losses to written premiums and incurred losses to earned premiums. To homogenise the data we assume an equivalence between the different ratios: "incurred losses to earned premiums" = "incurred losses to written premiums + 10%" = "paid claims to written premiums + 25%". The countries are scored on a ranking basis, lowest loss ratio = 10 and highest = 0.

Caveat: Market profitability aggregates market figures by definition, and therefore may not be a useful guide in gauging levels of profitability for specialist classes. Furthermore, equivalence between the different types of ratio have been estimated, consequently this indicator has to be considered as only an estimation.

⁶⁶ Munich Re Geo Risks Research (2006)

Lloyd's business indicators

Premium growth (weighting: 26%)

This indicator gauges the premium growth potential of Lloyd's business on a global level.

Lloyd's growth potential has been calculated as the volume of gross written premiums in 2006 multiplied by the CAGR 2006/02. Figures have been calculated based on complete figures from Xchanging for the period 2002 to 2006. These figures have been used to calculate a score on a ranking basis.

Caveat: The amount of Lloyd's premiums is subject to cyclical movements and can vary broadly from one year to another. Lloyd's figures are based on gross written premiums based on figures processed by Xchanging by processing year and country of origin. The processing year relates to the calendar year in which the premium, additional or return premium is processed by Xchanging, irrespective of the actual underwriting year of account of the risks (which is determined by the inception date of each risk). The country of origin relates to where the Coverholder or policyholder resides, irrespective of the country to which the risk is classified for regulatory reporting purposes.

Premium volatility (weighting: 26%)

Volatility is a well-known statistical indicator which is commonly used in finance. This indicator reveals how stable a population of data points are. The premium volatility indicator thus complements the CAGR calculation used for the premium growth indicator.

To assess the volatility of Lloyd's premiums in a country, we have calculated the standard deviation of annual growth between 2001 and 2006. The lower the volatility, the more stable the Lloyd's premium development is likely to be. In other words, the country with the lowest volatility deserves a score of 10, whilst that with the highest volatility observed deserves a score of 0.

Caveat: The calculation reveals only how stable a particular growth path has been. This means that a constantly shrinking premium base would be scored in a similar fashion to a constantly increasing premium base. Accordingly, this indicator needs to be seen in conjunction with the CAGR calculation to get a fair view on premium development.

Licences (weighting: 26%)

This indicator estimates Lloyd's access to global insurance markets.

Five categories of presence have been identified and rated, from the more restrictive market to the fully licensed one. This classification enables a score to be derived according to the size of the market and for the countries to be ranked on the ratio accessibility/potentiality.

Market penetration (weighting: 11%)

This indicator estimates Lloyd's share of global insurance markets.

This indicator uses *Sigma* data (as a basis for the total market in 2006) and Lloyd's gross written premiums in order to calculate Lloyd's presence in a given territory.

Caveat: The calculation of market share includes the reinsurance premiums written by Lloyd's so it cannot be considered properly as a market share but more as an indicator of the level of Lloyd's presence.

Share of insurance/reinsurance (weighting: 11%)

This indicator estimates Lloyd's "footprint" in a given market.

This indicator uses Lloyd's gross written premiums in 2006 in order to calculate the insurance/ reinsurance split of Lloyd's business.