

# PVK STUDIES 13

## INSURANCE COMPANY OWNERSHIP IN THE NETHERLANDS: IMPLICATIONS FOR CORPORATE GOVERNANCE AND COMPETITION

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# Insurance Company Ownership in the Netherlands: Implications for Corporate Governance and Competition

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# 1 Introduction: Formulation of the Problem and Outline

## Corporate Governance<sup>1</sup>

- 1.1 It is fashionable to discuss and consider Corporate Governance (= CG)! This was the call by Sir Colin Marshall (CEO of British Airways) at the beginning of 1996 on the occasion of the first annual meeting of the ICGN (International Corporate Governance Network) for a world-wide code of conduct (no laws!) in this area for investors and companies. In part, CG is possibly a hype. Nevertheless at the same time it is a permanent and important topic. It is a new approach to the discussion on the way the market economy works. It is a debate in essence about the direction which should be given to the Western economic order. It is therefore of great structural importance.

This paper will discuss CG within a certain context. In doing so, it is important to mention the following limitations: (i) it deals with the insurance industry in the Netherlands, and (ii) viewed from the perspective – not of the interested citizen, ex-politician or former professor of economics – but of the legal supervisor of insurance companies and pension funds<sup>2</sup>.

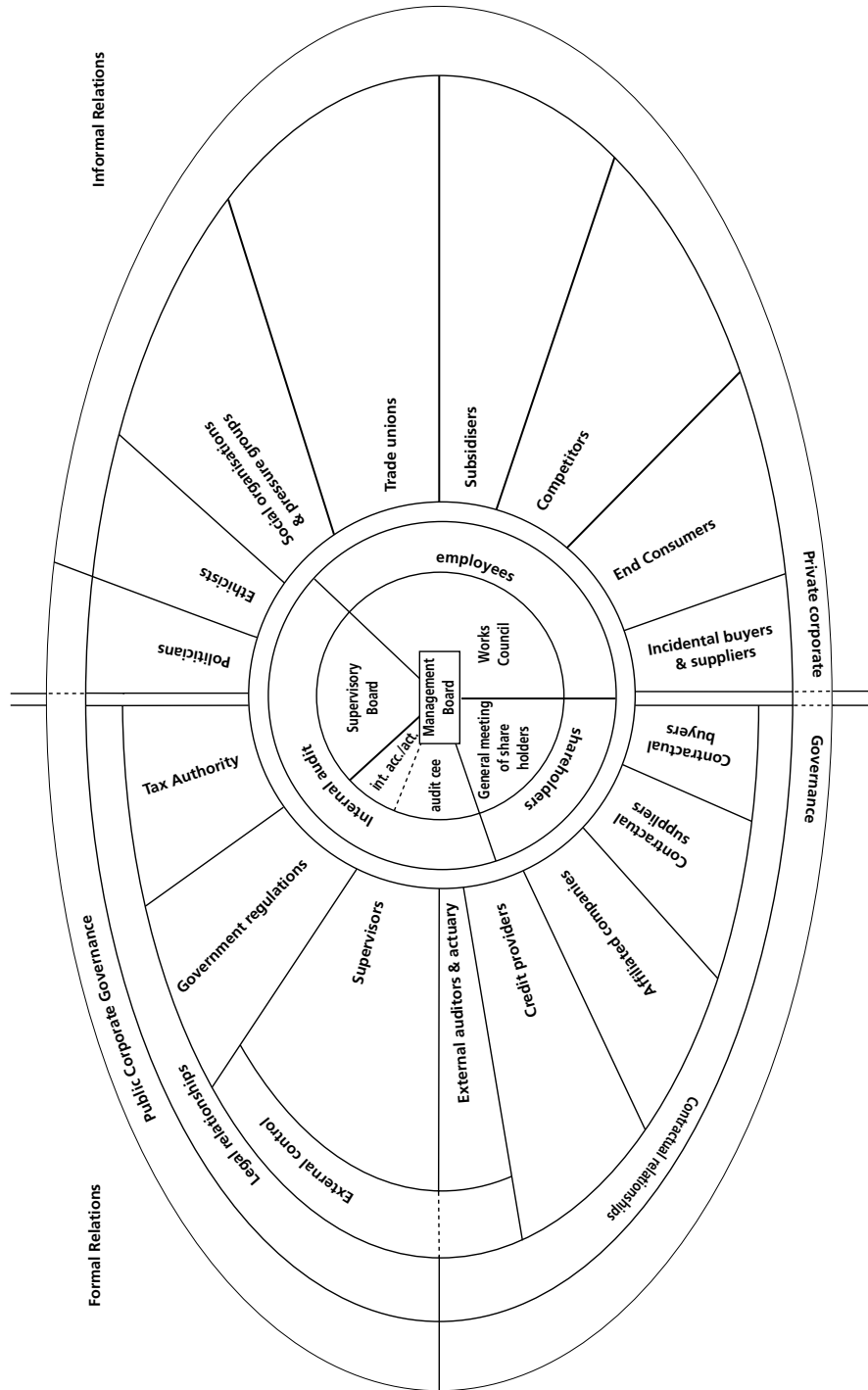
- 1.2 What do I understand by CG? CG relates to the disciplining of the management of a company —to a greater or lesser degree— by the parties involved.

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<sup>1</sup> A well-known definition is: "Corporate Governance can be defined as the whole system of rights, processes and controls established internally and externally over the management of a business entity with the objective of protecting the interests of all stakeholders." (CEPS 1995 p. 5). In Dutch persistent use is made of the English term CG. This points to the origin of such discussions in the seventies in the USA and later in the UK. With Moerland (FD 16 March 1996) I prefer 'ondernehmensdisciplineren' (disciplining of companies) as the equivalent Dutch term.

<sup>2</sup> In the Netherlands a normative retrospective system of supervision has existed for a long time which has as its main focus the monitoring of solvency (of more broadly, solidity). The Dutch Insurance Supervisory Board (which has been a foundation established under Civil Law since 1992) is responsible for legal supervision and operates as a so-called 'independent public authority'. For a general introduction see Vermaat/Oosenbrug (1994).

Diagram: A topology of Corporate Governance  
 (based on an idea by Wallage, 1995, p.274)



It relates mainly to larger companies, usually characterised as companies with share capital. Since Berle & Means (1932) the distinction between capital provider/owner as opposed to the management has resulted in the principal agent theory. In the broader sense, CG does not relate to discipline imposed by shareholders (or alternatively the providers of loan capital) only but to the entire group of stakeholders directly or indirectly involved with the company. The diagram on page 6 provides an overview of this.

The diagram is largely self-explanatory. I wish to make a number of additional comments, however, for the sake of clarity. A distinction is made between CG with an internal character (i.e. within the circle in the centre of the diagram) and CG with an external guise. A further distinction is made with regard to the latter, namely, between (a) (on the left) the formal relationships with the company in question as opposed to (b) (on the right) the informal relationships. Within the formal relationships a further dichotomy is appropriate, namely, that between (a.1) legal relationships (or their equivalents) and (a.2) contractual relationships. The external supervisors are to be found where both components meet. As the legal prudential supervisor of insurance companies, the Dutch Insurance Supervisory Board also falls within this group.

I have summarised the segment of relationships with the company which function on the basis of legal regulations by the term 'public corporate governance'. The remaining segments are collectively referred to as 'private corporate governance'. I wish to reserve the umbrella term CG for the entire group. This deviates from some of the existing literature. Gelauff & Den Broeder (1996), for instance, use the following three terms: Corporate Governance (for influence of finance providers), (ii) Contractual Governance (for inter-firm relationships), and (iii) Work Governance (for the labour factor). In itself it is understandable that these three important parts of CG are referred to by a separate term. I propose adopting this on the understanding that the influence of finance providers (in other words, both equity and loan capital; in this respect suppliers and customers may also be included!) is denoted by the term 'Financial Governance'. Furthermore, the terms 'Public CG' and 'Informal CG' may be used for the other CG forces.

Since the term 'stakeholders' is often used in discussions of CG, I would also like to make a distinction between the direct stakeholders (namely, shareholders, employees and contractual relationships) as opposed to indirect stakeholders (in other words, all other parties involved). Finally, it should be noted that in addition to laws and contracts, also codes, customs, social and ethic norms of behaviour et cetera exert a considerable influence. In fact, the way in which CG operates is embedded in the entire framework comprising the socio-economic order. It is no longer possible to limit this even to the national economy. The influence of treaties, internationalisation and globalization are now far too intense for this!

## **A variant of the Rhineland model**

- 1.3** My discussion in this paper will relate to the Dutch insurance industry. This implies that the context is that of the Dutch economy. In general, this discussion will therefore focus on a specific variant of the so-called Rhineland or German model. An extensive description and analysis of, amongst others, this Dutch variant can be found in Gelauff & Den Broeder (1996). I will limit myself here to two points, namely (i) a brief outline of the major characteristics, for the foreign reader, and (ii) a comment on the present dynamics in the Dutch economic order.

Firstly, a number of characteristics:

- a relatively small country with a very open economy;
- a fairly centralistic structure (in other words, a free market supplemented by agreements between umbrella organisations and the government);
- a labour union committed to consensus (supported by legally regulated influence at the company level through works councils or, alternatively, the phenomenon that the provisions of collective labour agreements are declared to be generally applicable);
- the unique so-called structure regime for large companies in which a dominant role is given to the supervisory board<sup>3</sup>;
- considerable influence from constructions which provide protection against hostile takeovers;
- a wide distribution of the ownership of the shares, without dominant blocs of shareholders;
- little ownership of shares by the management of the company;

- limited CG role on the part of banks or institutional investors, and
- a high degree of funded (as opposed to pay-as-you-go) pension arrangements.

The above is a sketch of the situation in recent years (the period of, say, 1970-1990). Certain clear trends in the changes that are occurring are discernible. A number of these are:

- further opening of the Dutch economy (both internationally through GATT, GATS etc., but mainly through the creation of the EU market);
- participation in the internationalisation of money and capital markets;
- a growing discussion on the relative merits of the Dutch welfare state (as a specific variant of the Rhineland model) in comparison with the more Anglo-Saxon models<sup>4</sup>.
- social trends in favour of liberalisation and individualisation.

In a cultural climate such as this, it is logical that the discussion of whether the special arrangements in the Netherlands in the area of CG are useful and whether they can be retained is gaining momentum. With regard to whether these can be retained it should be said that this is not determined only by political ideas and legal regulations, but also and no less by the power of the markets. In any event, the discussion on the most desirable

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<sup>3</sup> The so-called 'structure regime' has been applicable since 1971 to companies which meet the following criteria: (1) a subscribed capital of at least 25 million guilders, (2) at least 100 employees employed in the Netherlands, and (3) the presence of a works council in the company. Under the structure regime, the supervisory board is given strong powers, namely (i) it appoints its own members by co-option (with a right of nomination and a right of veto – which may be annulled by a Court ruling – for the general meeting of shareholders and the works council), (ii) it appoints and dismisses the members of the management board and ratifies the annual statements of accounts and (iii) it has to give its approval for important decisions taken by the company. There are two important exceptions. Subsidiaries of a holding company in the Netherlands, of which the latter is subject to the structure regime, are themselves exempted from it. In the case of international holding companies in the Netherlands, where at least 50% of the shares are in foreign ownership, a milder regime applies in which more powers are given to the general meeting of shareholders.

<sup>4</sup> It has by no means been established that the Anglo-Saxon model for companies is superior to the Rhineland or German model. De Jong (1996), for instance, argues on the basis of long-term empirical results, that the Anglo-Saxon model in the long run is characterised by (on average) lower labour productivity, lower growth of the total added value and lower employment. The higher pressure exerted by the capital market – resulting in a relatively higher dividend – appears to be counterproductive from a perspective of society as a whole. According to Scholtens (1996) the differences between the USA, UK, Germany and Japan with regard to their financial systems are, in fact, much less fundamental so that the influence of such systemic differences on the way in which CG operates in these countries cannot be very significant. Other factors would then have to have a greater effect!

forms of CG in the Netherlands is very lively. The report, Corporate Governance in the Netherlands, by the Peters Committee (October 1996)<sup>5</sup> has acted as a catalyst. It is not my task, however, to give an analysis of this discussion, but to discuss CG within/by the insurance industry. It was necessary, however, to refer to the above (very briefly) as a (dynamic) environmental framework.

## Problem Formulation

- 1.4** The following problem formulation will apply to the rest of my paper. Given the Dutch context, what can be said of the practice or developments with regard CG in relation to the insurance industry? This relates to two perspectives, namely both (a) CG exercised in relation to insurance companies, and (b) CG exercised by these institutions (even more broadly, including the pension funds). In the first instance, the emphasis is on Financial Governance, in other words, the influence exerted by the providers of capital and credit. In the second instance, the focus is widened to include the aspect of competition and the perspective of the prudential legal supervisor. This is, after all, my daily task.

## Outline

- 1.5** In the next paragraph a sketch is given of the Dutch insurance industry. Attention is also given to competitive relationships. In paragraph 3 a discussion follows of the possible specific characteristics of CG of insurance companies. The role of insurance and pension funds in CG of other companies is also discussed. In paragraph 4 the related aspects of policy with regard to competition in the insurance sector and supervision in relation to the CG phenomenon are dealt with. Finally, the last paragraph contains a brief summary and conclusions.

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<sup>5</sup> Corporate Governance in Nederland. This is a Dutch echo of such well-known reports as the Treadway Committee (USA 1987), the Cadbury Committee (UK 1992), CEPS (EU 1995) and the ICMG report (International 1995).

## 2 Sketch of the Dutch Insurance Industry

### Data

#### 2.1 Firstly a table with data on the number of insurers in the Netherlands.

**Table 1** *Number of insurers in the Netherlands as at 31 December 1996\**)

	Life	Non-Life	Total
<b>With a licence:</b>			
- registered offices in the Netherlands	96	266	362
- branch office in the Netherlands	3	22	25
<b>Through a notification procedure</b>			
- branch office in the Netherlands	3	113	116
- services provided in the Netherlands	98	328	426
	200	729	929

\*)Number of active small mutual non-life insurance companies exempt from supervision: 251

Source: Dutch Insurance Supervisory Board

Since the Netherlands is a member of the EU, the legal licensing system applies in accordance with the various European Directives. Our country has traditionally had a very liberal policy with regard to establishing businesses, also for foreign companies. This is partly the reason for the higher density of insurers in the Netherlands, as is illustrated in Table 2.

**Table 2** *Density of insurers in a number of countries as at 31 December 1995 defined as the number of insurance licences per 1 million inhabitants*

	Life	Non-Life	Composite	Total
The Netherlands	6.4	25.5	-	31.9
Germany	1.5	4.1	-	5.7
France	2.2	3.4	-	5.7
United Kingdom	2.7	10.2	0.9	13.9

Source: Dutch Central Bureau of Statistics and annual reports of supervisors

#### 2.2 For the positioning of the (life) insurance industry in the Netherlands mention must be made of the pension funds. Although an employer (or, alternatively, via the negotiations regarding the collective labour

agreement) is free to promise a pension to employees, or not to do so, approximately 85% of employees has such a promise of a pension. This may be implemented through a life insurer (both by means of a group contract and through individual policies) or by means of a pension fund. Various types of pension funds are important in this regard. The following table contains some relevant data.

**Table 3** *Pension funds in the Netherlands*

	Number of funds as at 31 December 1994	Balance-sheet total as at 31 December 1994 (x NLG 1 million)
Industry-wide pension funds	82	178,662
Company pension funds	1,003	147,598
Pension funds for the professions	11	15,290
Savings funds	6	708
Abp (civil servants)	1	194,044
	1,103	536,302

*Source: Dutch Insurance Supervisory Board*

In order to complete the above table, it should be mentioned that as at 31 December 1995 life insurance contracts for pension purposes had been entered into with life insurance companies for more than one million people, for a total insured amount of NLG 45 billion. For further data, see *Pensioenmonitor, PVK-studies, No. 9 (1996; pp. 38-47)*.

Together with the various mutual funds or unit trusts, insurance companies and pension funds are the most important institutional investors. As an indication of their importance in quantitative terms, the combined balance-sheet total of the insurance companies plus the pension funds as at 31 December 1996 is estimated to be approximately NLG 864 billion, in other words, 130% of GNP of the Netherlands in 1996.

For discussions of CG the fact that adjustments have been made to the investment policy during the past ten years is of considerable importance. Previously the favourites were (government)bonds, private loans, mortgages and direct real estate. At present equities, indirect real estate holdings and financial derivatives are given greater emphasis. In the case of insurers, this is related to the increasing role of unit-linked insurance policies (with no investment risk for the insurer).

In the case of pension funds the aim of indexing accrued pension rights plays a central role. At year-end 1996 the proportion of 'real assets' (equities and real estate) in the portfolios of the abovementioned group of institutional investors was estimated to be 35.2%, as opposed to approximately 16.1% in 1985.

## Competitive Relationships

- 2.3 Table 2 showed a high density of insurers in the Netherlands. This is sometimes explained as a sign of limited competition (see, for instance, Drabbe, 1994). The reasoning behind this is that as a result of a well-developed system of self regulation in the industry (in other words, cartel-like agreements!) the premiums and profits are kept so high that a limited market share – albeit in a steadily growing market – results in a sufficient net return on capital. This seems to be a strongly distorted historical picture which urgently needs to be updated.

Due to the easy access, relatively many foreign insurers have been active on the Dutch market since the sixties. Later this was also a strategic choice in order to gain access to Fortress Europe. Furthermore these foreign insurers often did not participate in the process of self regulation. The access was not only de jure, but also de facto. In this regard the role of the independent insurance brokers' network is of crucial importance, so that it is relatively easy to build up a market position. The emergence and growth of direct writers was also an additional stimulus to competition, resulting in a reduction in the value of distribution channels through salaried agents.

Already in 1988 the well-known Cecchini report pointed out that premium levels in the Netherlands (and the UK) were relatively low. Since then competition has increased. Forms of price leadership in market segments have almost entirely disappeared. Self regulation to the extent to which it occurred has been almost abolished since 1992 (exceptions are very general group exemptions in recommended policy conditions, data collecting and advertising codes). Even in recent years, in which even the non-life insurers reported splendid profit growth, the net return on capital may be characterised as relatively meagre in this subsector.

Studies of the development of the degree of concentration also support the

above argument (see also Vermaat, 1992, p. 16 and Nijenhuis, Potjes & Schilder, 1994).

With regard to the life insurance business increasing competition is coming from the pension funds. In addition, pension funds are setting up life and non-life insurance subsidiaries. This should, however, be seen in perspective. A significant number of insurers are, after all, part of an insurance group or even of a financial conglomerate.

Despite the fact that within such groups competition occurs between sister companies (aimed, in particular, at the various distribution channels), this reduces the number of 'genuinely' independent market players. Table 4 therefore puts Table 1 in perspective:

**Table 4** *Number of insurers in the Netherlands (corrected for insurance groups) as at 31 December 1995*

	Life	Non-Life	Total
	59	198	257

## 3 Insurance Company Ownership and Corporate Governance

### Further Data

- 3.1** In this paragraph CG of or by insurers (and pension funds) will be discussed. From the discussion it will emerge that the Financial Governance variant is the most important, and exercised in both directions. In addition to the general influence of Dutch legislation (such as that regarding the structure regime), Informal Governance (not discussed further here) and the role of solvency supervision and the competition policy (see also paragraph 4) are also of importance. In order to provide a sketch of Financial Governance within the Dutch insurance industry, the relationships of ownership are, of course, of great importance. For this reason we have provided a number of additional tables in this section. In the following table, a further categorisation of the types of insurers is given.

**Table 5** *Types of insurers by ownership characteristics as at 31 December 1995*

	Life	Non-Life	Total
Public limited liability companies	79	149	228
Mutuals (including class 3 exempted mutual guarantee companies)	13	128	141
Non EU/European Economic Area	4	23	27
	96	300	396
Dutch shareholders	72	245	317
Foreign shareholders	24	55	79
Listed	23	30	53
Non-listed	73	270	343

Contractual Governance is relatively unimportant for the insurance industry (for pension funds this is more complicated). Although insurers are also active on the capital markets on the demand side (with a view to optimising their capital structures) they occupy a relatively strong position. Due to the nature of their very long-term liabilities, insurers and pension funds have better matching than, for instance, banks. The relationship with suppliers/customers is rather unique. They are, after all, the same policyholders in two different roles. Although large group contracts play a role, this influence is

reflected more in the conditions of contracts and less on the governance side. After all, contract renegotiations occur regularly so that a 'hold up' problem does not exist in this respect. Credit providers play a role of little importance. It is for this reason that Financial Governance mainly relates to the role of shareholders. Below some data are given with regard to the distribution of shareholdings in insurance companies<sup>6</sup>. The legal provision that a stake of 10% or more in a licensed insurer requires a declaration of no objection from the supervisor is also important in this regard. In addition, listed companies are subject to the Disclosure of Major Holdings in Listed Companies Act.

**Table 6** *Some data on the distribution of shareholdings in insurance companies*

A) Distribution of Dutch listed shares (in %)<sup>7</sup>

	1990	1995
Banks	0,7	0,8
Institutional investors <sup>8</sup>	19,0	19,1
Non-Domestic	44,0	39,3
Investment funds	1,5	1,3
Others	34,8	39,4

B) Percentage of equities in total assets (31-12-1995)

	Total assets (Dfl bn)	Equities %
Life assurance companies	300,9	19,3%
Non-life insurance companies	38,9	21,9%
Pension funds	536,0	22,8%

C) Classification of life assurance companies established in the Netherlands as at 31 December 1996<sup>9</sup>

Mutuals	Stock companies controlled by:			Others <sup>10</sup>	Total
	Majority holdings by so-called 'administration offices'	Foreign ownership	Other Stock companies		
27	19	13	23	14	96

<sup>6</sup> Pension funds almost exclusively have the legal form of a foundation under Civil Law. See also section 11 of this paragraph.

<sup>7</sup> Total value of listed shares as a percentage of Gross Domestic Product: 72,2%.

<sup>8</sup> Insurance companies and Pension funds.

D) Mutual holdings<sup>11</sup> between Dutch financial conglomerates<sup>12</sup> (direct and indirect)  
(31-12-1996)

in:	ING	ABN AMRO	Aegon	Fortis	Stad Rotterdam
by:					
ING	-	16,6	5,3	8,9	19,9
ABN AMRO	0	-	0	0	0
Aegon	6,3	12,9	-	0	0
Fortis	6,2	5,7	0	-	19,7
Stad Rotterdam	0	0	0	0	-

Finally, I wish to discuss a few characteristics of the distribution of shares held by insurance companies and pension funds in other companies.

It is not possible at this moment to provide an analogous table for the distribution of shares held by insurance companies and pension funds in other companies. In general the shareholdings of insurance companies and pension funds have the same characteristics as those of any investor. Leaving aside less frequently occurring strategic participations aimed at acquiring control (or defensive participations) the aim is to achieve direct or indirect revenues from the investment. Tax considerations are mainly the reason for at least a 5% holding by insurance companies, that is, in the fiscal entity. In the case of pension funds this tax incentive does not play a role. Exceptional cases aside, the participations are well diversified.

## Financial Governance on Insurers

- 3.2** On the basis of the above and from the point of view of Financial Governance, the question of whether shareholders manage to attract a larger portion of the net added value is of considerable importance. Given the degree of competition on the insurance market, the conflict is between the shareholders and the interests of those who wish to keep capital growth within the company (management and policyholders: security and profit sharing). In a (brief) study on the basis of data held by the Dutch Insurance

<sup>9</sup> Directly or indirectly listed on the Amsterdam Stock Exchange: 22.

<sup>10</sup> For example: Pension funds, Foundations or Family ownership.

<sup>11</sup> In the Netherlands these participations usually are so called certificated shares, i.e. without direct voting power.

<sup>12</sup> As regards the other important insurance groups: the Achmea Group is in essence a mutual group, Delta Lloyd Group is a 100% subsidiary of Commercial Union(UK), Interpolis Group is a 100% subsidiary of the (Mutual) Rabo Bank Group.

Supervisory Board, Bakker (1996) came up with the following results for non-life insurers (see Table 7).

**Table 7** *FDSE-quotient for Non-Life Insurers, 1990-1994 (The FDSE-quotient is the freely distributable shareholders' equity divided by the size of the required solvency margin)\*)*

<b>Non-Life Insurers</b>	<b>1990</b>	<b>1992</b>	<b>1994</b>
<i>Market total</i>	2.4 (2.7)	2.7 (2.8)	2.5 (2.8)
<i>Part of a group</i>			
Yes	2.3 (2.6)	2.5 (2.6)	2.4 (2.7)
No	2.8 (3.6)	3.8 (5.1)	3.4 (4.4)
<i>Origin of shareholders</i>			
The Netherlands	2.6 (2.8)	2.9 (2.7)	2.7 (2.7)
Foreign	2.0 (2.4)	2.1 (3.0)	1.8 (2.9)
<i>Size**)</i>			
Large	1.7 (2.2)	2.1 (2.5)	1.9 (2.4)
Small	3.5 (3.9)	3.7 (3.4)	3.8 (4.1)

\*)The corresponding data for non-life insurers which make regular dividend payouts are given in brackets.

\*\*\*)Criterion: NLG 100 million in annual premium income.

On the basis of the above results, Bakker (1996, p. 59/60) draws the following conclusions.

- 1) Despite the cyclical character of the market for non-life insurers the FDSE-quotient is fairly stable during the period under review. (The FDSE-quotient may be regarded as a good indication of the degree of solidity of an insurance company.)
  - 2) On average insurance companies which pay out a dividend have a higher FDSE-quotient, particularly if they are foreign companies or are not part of a group.
  - 3) The level of the FDSE-quotient within the group of foreign insurers diverges strongly. This may be due to differences between their respective countries of origin, but also to relative maturity and the market position they have achieved.
  - 4) Insurers which are part of a group have a lower FDSE-quotient. This can be explained by their risk management (or growth strategy) at group level, but also by more active CG by shareholders at this level!
- Personally, on the basis of the above, I draw the more general conclusion that since 1990 CG has still had little discernible influence on non-life insurers in the Netherlands. Only weak indications of a movement in this

direction can be observed. Possibly this is not only due to the relatively weak or weakly concentrated position of shareholders in the Dutch non-life insurance industry, but also to the moderate returns and the unfavourable tax treatment of dividend payouts. A parallel study was recently carried out in relation to life insurers (see Table 8).

**Table 8** *FDSE-quotient for Life Insurers, 1991-1995 (The FDSE-quotient is the freely distributable shareholders' equity divided by the size of the required solvency margin)\*)*

Life Insurers	1991	1993	1995	Average dividend (%) 1991-1995
Market total	1.0 (1.1)	1.7 (1.8)	1.9 (2.1)	8.50% (10.21%)
Origin of shareholders				
The Netherlands	1.1 (1.1)	1.9 (2.0)	2.1 (2.2)	8.93% (9.89%)
Foreign	0.8 (0.7)	0.9 (0.7)	1.3 (1.2)	5.92% (14.81%)
Size**)				
Large	1.0 (1.1)	1.7 (1.8)	2.0 (2.1)	8.69% (9.29%)
Small	1.2 (1.2)	1.7 (1.2)	1.7 (1.6)	4.54% (10.29%)

\*)The corresponding data for life insurers which make regular dividend payouts are given in brackets.

\*\*\*)Criterion: NLG 100 million in annual premium income.

The latter data gives rise to the following additional conclusions.

- 1) Life assurance companies show steady growth in their FDSE-quotients. This reflects the achieved results.
- 2) Life insurers in foreign hands have a slightly lower FDSE-quotient.
- 3) Other differences are not very relevant, with the exception of the fact that the smaller foreign life assurance companies, in particular, pay out an above average dividend to their parent companies.

Finally, I conclude that with regard to CG – despite the less cyclical market position – little difference (as yet) exists between non-life and life insurers.

## Financial Governance on Pension Funds

- 3.3** Leaving aside legal prudential supervision, pension funds are usually characterised by internal or internalised discipline. The latter is the result of the composition of the management of pension funds which is (mostly) based on equal representation of employers and employees. This has resulted in combined influence by employers and employees (trade unions). Where previously there was little interest in the investment activities of a

fund (in fact their main activity!), this has definitely changed in recent years (cf. Goslings, 1996). Sponsoring companies set higher norms for investment returns, while active members and pensioners show greater interest. Added to this the more intense discussion on the desired competition with life insurers and the increasing opportunities to take out additional insurance with pension funds, the above implies stronger Financial Governance pressure on pension funds. This will become more explicit in the coming years. The following are a number of predictable developments in relation to this:

- stricter performance measurement and norms for returns on investment;
- an emphasis on the importance of the quality of managers;
- heterogeneous financial groups, with pension funds as parts of these;
- the emergence of the trust phenomenon as a legal form for a pension fund;
- demands for a greater say for those with pension rights and/or profit sharing arrangements a reaction to the need for further independence for funds in relation to the sponsors.

To what extent the last phenomenon will actually have a substantial effect in relation to CG is open to discussion. The interests of the various groups are often opposed, so that the creation and effectuation of influence are weakened. Also, in a more general sense, the influence of large constituencies (such as members meetings and shareholders' meetings) without further organisational and accepted concentrations is usually insignificant. Such negative experiences with attempts to democratise pension funds will also stimulate the emergence of the trust phenomenon.

## **Financial Governance by Insurers and Pension Funds**

- 3.4** This does not relate to internal group relationships in which, for instance, a subsidiary is directed to a greater or sometimes indeed a lesser extent by controlling top holding companies or sub-holding companies. The influence on strategic (controlling) participations entered into for commercial motives will not be discussed neither. For the rest, Financial Governance by insurers and pension funds may be regarded as cautious.

The dominant factor is the aim of the long-term investment<sup>13</sup>. (Idem Gelauff & Den Broeder, 1996 p. 77).

However, in recent years there have been noticeable signs that especially the large insurers and pension funds are intending to give more attention to Financial Governance. This is related to several trends indicated earlier. Internationalisation of the capital markets, convergence due to EU and EMU, more competition, more interest – from both sides – for investor relations<sup>14</sup> and the public debate in relation to CG are all contributing to this. In addition, the expansion of investment in equities by institutional investors makes that ‘voting with their feet’ (alias the ‘Wall Street walk!’) is less opportune for a relatively small country as the Netherlands.

In the Netherlands there is also no ‘market for corporate control’. Due to the many practised forms of protection (such as preference shares, priority shares, depositary receipts, binding nomination or voting caps) hostile take-overs hardly ever occur. All of these factors imply that the larger investors (have to) seek ways of better protecting their long-term interests in the companies and groups in which they participate (Frijns et al, 1995).

I therefore expect a strong influence in the national CG debate in the coming years from this quarter. This will result in adjustments to Dutch company law in which a new socially acceptable and fruitful balance will be achieved between the various stakeholders, in particular management/ shareholders/labour. Furthermore, the increasingly far-reaching and convergent embedding of Dutch company law in EU company law is of crucial importance in this respect.

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<sup>13</sup> This applies less to partial portfolios for which independent (external) fund managers are given responsibility. In such cases, investment behaviour usually is so active that CG pressure is less efficient.

<sup>14</sup> Idem De Man (1996).

# 4 Corporate Governance, Competition and Prudential Supervision

## Trends in CG in the Netherlands

- 4.1** Actually putting CG, or other variants of this, into effect assumes that this is possible. If the so-called model of perfect competition applies to a certain market, this would not be possible. After all, the 'entrepreneur' is in that case only a price taker and a pure volume adjuster. Although theoretically oriented economics and legislation lawyers are rather impressed (and apparently normatively enamoured) with this abstract model, this form seldom occurs in practice. In by far the largest number of cases, a given market (which is usually broader than the 'national' domain) is characterised by the monopolistic competition model (actually a confusing name!). This has a number of degrees of freedom for the market behaviour of companies, so that all sorts of dynamics can occur<sup>15</sup>. Furthermore the company also has moments at which it can make choices which are not directly subject to market confrontations (in particular, in relation to intra-company issues). In a general sense, there is therefore room to influence the company by means of CG and therefore also for influence of and by insurance companies and pension funds.
- 4.2** Given the external forces already sketched earlier, CG in the Netherlands is undergoing major changes. For instance, the globalization and internationalisation of markets for goods and services – and, in particular, the capital markets – as well as the creation of the EU and EMU provide strong stimuli. The social compromise reached in the seventies in the Netherlands between 'capital' and 'labour' – for instance, through the structure regime for large companies and the role of the works councils – is under pressure. This is partly the result of the reduction in the power of the unions on the labour market as a result of the relative labour surplus. The demands of shareholders with regard to profitability carry more weight since the restructuring of companies in the eighties and nineties when it became

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<sup>15</sup> And that's a good thing too! After all, from a theoretical point of view, in a pure market form of perfect competition without any exogenous intervention by an 'auctioneer', to use Walras's term, no new equilibrium would arise of its own accord.

apparent that sufficient shareholder's equity was necessary as a buffer. The same empirical experiences have increased the desired level of returns on shareholders' equity – partly because of the unfavourable tax treatment of dividend payouts and certainly now that long-term interest rates have not adequately reflected decreased inflation expectations – and, in doing so, have added to the importance of the capital factor. In line with this, the resistance of groups of investors to protective barriers, which in their view are too high, is understandable. Developments of this sort need time. (Itself another illustration of the fact that markets do not work as perfectly as the textbooks assume!) The trends still have to take shape in a context which is constantly changing. Business cycle and economic structure interfere. Movements involving social pressure groups and the resulting legislation – fortunately – need time. The international dimension sometimes accelerates this and sometimes slows it down.

- 4.3** In recent years in the Netherlands the struggle for a greater role for shareholders has flared up. It is not possible to summarize this discussion adequately here. I wish to give only three examples as an illustration of this. Considerable discussion was generated by a proposal to make it compulsory to submit protective clauses for review by a panel of experts (with the possibility of lodging an appeal with the Commercial Chamber of the Amsterdam Court, which may only conduct a limited judicial review) if a shareholder or group of shareholders has acquired a certain percentage of the shares or depository receipts.

The report of the Peters Committee (1996), Corporate Governance in the Netherlands, has raised even more dust. This committee made forty recommendations aimed at increasing the degree of CG. The focus was primarily on the soundness and transparency of the role of the supervisory board of the company and, in the second instance, on the possibilities for shareholders to obtain more information. Also, the proxy solicitation instrument was recommended in addition to opening a legal possibility for majority shareholders to claim the remaining shares subject to realistic conditions.

The opinions on this are still very divided. Some regard all of this as an undesirable increase in the influence of the capital factor, although a few union leaders do wish to increase the influence of certain (large)

shareholders – in particular, the influence of the pension funds. Others believe that these proposals do not go far enough by any means because, in fact, nothing really changes. In this regard, the opinion that the essence of the discussion on CG in the Netherlands should be the revision of the structure regime is very interesting. In this regard, Boot (1995) has suggested that the right to appoint members on the supervisory board of a company should be given to a special appointment committee – which, in accordance with the articles of association, should consist of (representatives of) shareholders, employees and other interested parties – possibly, for instance, in the ratio of 60% members of the supervisory board and 40% additionally co-opted members, in order to guarantee the role of the independent experts.

An alternative solution would be to hold a vote of confidence in the sitting supervisory board periodically (for instance, every seven years) and/or at request of a qualified majority of shareholders in the general meeting of shareholders. The above is intended to illustrate the proposition that the outcome of the CG debate is still far from clear. In my personal assessment, the new 'solutions' will be determined by (i) the impact of the EU and other international forces, and (ii) the degree to which a shift occurs in the economic influence of labour as opposed to capital. It seems that the importance – and therefore the influence – of the providers of shareholders' equity will increase, both de facto and de jure. Whether this tendency will continue in the decades to come depends on the race between the decrease in the size of the potential working population due to aging, on the one hand, and the degree of participation of women and the elderly, migration from the South and East, the nature and speed of technological development, the impact of environmental demands and the development of the savings ratio, on the other. From a short-term perspective, however, the influence of shareholders within Dutch management models for companies will increase substantially.

## **Trends in Competition and Competition Policy**

- 4.4** In paragraph 2 an indication was given that the insurance market in the Netherlands is characterised, in general, by strong competition. Despite the emergence of concentration phenomena, which has also occurred in other countries, through mergers and takeovers or the creation of insurance

groups and financial conglomerates, the degree of concentration has decreased rather than increased (Vermaat, 1992). This result can be explained by influences such as the strong growth in the turnover of small and medium-sized insurers, in particular, the impact of direct writers, entry by new foreign players (with the backing of financially strong parent companies) and the erosion of self-regulatory agreements and forms of oligopolistic price leadership. The above development will certainly continue in the coming years. A number of factors play an important role in this. A case in point is the increasing competition between pension funds and insurers, which increasingly are being allowed to enter into each other's traditional areas. This is further intensified by the actual lowering of thresholds to competition through the gradual creation of a genuinely convergent European insurance market through the harmonisation of legislation, cultural convergence, the increasing importance of cross-border service provision (aimed particularly at companies) et cetera. No less important in this regard is the competition policy of 'Brussels' and 'The Hague'. EU competition policy has resulted in notification and termination of the traditionally important self-regulatory agreements (in so far as these had not already perished in the face of market forces). The group exemptions which have been granted do not serve as an obstacle to competition. The Dutch own national competition policy has also been considerably tightened up in line with that of 'Brussels'. The new Competition Act goes a step further.

The emphasis here is placed on prohibiting all mutual agreements between companies unless it can be shown in advance that such agreements will be advantageous to the consumer. This modernisation and tightening up of Dutch policy on competition in line with the EU is characterised by its juridical flavour. The action taken by Mr Kok's government towards the deregulation of legislation supports the above. An important example in this regard is the intended abolition of the legal provisions in relation to the commission system for insurance intermediaries. In short, the simple conclusion from the above is not only that the Dutch market is characterised by strong competition, but also that a substantial increase in competition may be expected in the future. This will be all the more so if a downward movement occurs in the business cycle or the typical cycle of the non-life industry. As a supervisor, I am concerned about these future developments<sup>16</sup>.

**4.5** Together with other parts of the financial sector, the insurance sector plays an essential part in the economy. Confidence is a keyword. This not only includes confidence in the financial system as such – with regard to both the short and the long-term: liabilities over periods of more than thirty years! – but also confidence no less in the individual companies. Long ago the legislator therefore decreed that there should be a prudential supervisor which would supervise solvency and solidity, in particular<sup>17</sup>. In the light of recent experiences, society is absolutely unwilling anymore to accept bankruptcies. For this reason, a prudential supervisor *must* be concerned when the balance between market forces, competition policy and supervisory policy is in danger of being disturbed.

My criticism of modern competition policy is twofold. Firstly, the tacit norm of perfect competition is erroneous. In the context of technological growth and dynamic markets, if efficient competition is to be achieved, a form of monopolistic competition is preferable to a legally defined form of so-called perfect competition. Furthermore, the fiduciary character of the financial sector does not benefit from excessive competition with a significant chance of bankruptcies. Without an acceptable level of self-regulatory agreement which can be verified by the government, supervision will be compelled to take on the form of material supervision. This results inevitably in limitations on entrepreneurial behaviour (which competition policy attempts to prohibit by different means).

Instead of normative supervision which only imposes general conditions on the behaviour of the insurer (through, for instance, the solvency requirement), a network of restrictions will be created in relation to products and groups of products. Furthermore, this 'degeneration' of the supervisory system aside, a renewed wave of concentration will sooner occur in the insurance market which will probably also include the insurance brokers. Ultimately, on balance, the consequences of such a J-curve effect will be less genuine competition and therefore higher consumer prices<sup>18</sup>.

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<sup>16</sup> This is dealt with extensively in Vermaat and Bakker (1994).

<sup>17</sup> In the Netherlands – as in the United Kingdom, and currently in all EU countries – a normative system of retrospective supervision has been applied since 1923, in which insurers are free to adjust the way they run their companies, their products and their premium tariffs to market conditions. This promotes very innovative and competitive markets!

## Trends in Corporate Governance and the Role of the Prudential Supervisor

**4.6** In the previous section it was explained that the task of the prudential supervisor has been increased considerably as a result of both public feeling and the nature of competition policy. The development of CG methods will have a parallel influence. In my opinion, the trends in CG in the Netherlands described earlier in this paragraph support this assumption. Whatever institutional form this takes, this will result in more and more direct influence on the part of the providers of capital. It goes without saying that a more Anglo-Saxon CG culture will be a strong stimulus for the importance of short-term performance benchmarks and the emphasising of quantities such as shareholders' value. Such a development will be further stimulated by the growing role of rewards in the form of bonuses and options for management and senior personnel. Insurance companies will also not be able to distance themselves from this. In principle, the mutual insurers may well be able to do so, but in general they have the problem of raising the equity necessary for expansion. Pension funds will also increasingly experience the same pressure to perform; not, it is true, from shareholders, but from sponsors, members and outsiders (for example, politicians, analysts and journalists).

In itself stricter financial checks on institutions need not be disastrous<sup>18</sup>. The matter becomes more serious if insufficient attention is given to such aspects as the neglect of the special nature of pension and insurance business, fixation on short-term effects and the link between the nature of the liabilities and investments.

An example of such an aberration is the intention (of a commercial institution in the Netherlands) to publish monthly performance indicators with regard to the investment policies of institutional investors. Such nonsense can do damage to a healthy industry. Nevertheless, if the

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<sup>18</sup> Another example which typifies the adverse effect of an approach to competition law which is too legalistic is the following. The new Act will impose a variety of far-reaching limitations on voluntary chains in relation to the use of shop formulas. A large retail business is not subject to this (after all, it is one company!). On balance, the consequence will be a weakening of the independent retailer and, in time, a reduction in competition.

<sup>19</sup> This paper does not include a comparative discussion whether the achievements for society of the Anglo-Saxon and Rhineland models (see footnote 4). Neither is an answer given to the question whether the net returns required by shareholders at present are not too high from the perspective of society as a whole.

expectations regarding CG trends in the Netherlands which have been outlined – and in line with these, in the other EU member states – come to fruition this will present prudential supervision with a new challenge. Demands will also be made on other external controllers, such as the external auditor and the actuary.

Since, in my opinion, a more material type of insurance supervision is not desirable from a society perspective (because this would put the economic cart before the horse) other solutions have to be found such as an increase in the required solvency margins and a more prospective definition of normative supervision (through, for instance, profit testing, embedded value calculations and scenario studies).

A stronger emphasis on the long-term importance of supervision is important as a countervailing power and as a reaction to increasing manifestations of Anglo-Saxon CG. After all, the prudential supervisor has long been one of the most important CG players! In addition, the assessment of shareholders of insurance companies and perhaps the assessment of the expertise and reliability of the management and supervisory directors are important instruments.

- 4.7** From the prudential point of view, the same key, namely a greater emphasis on the long-term perspective, is an eye-opener with regard to the desired model for Financial Governance by insurers and pension funds on other companies (in other words, their investments and participations). In general, the investor role must be and must remain paramount. However, this certainly does not exclude a more active role in Financial Governance<sup>20</sup>. This will perhaps not occur with such activism as, for instance, CALPERS (Crist, 1995), but certainly more actively than at present.

For a responsible exercising of their roles, institutional investors in the Netherlands will have to be given more opportunities for effective Financial Governance. In this respect, I foresee both the reduction and the removal of existing protective constructions and, in time, an amendment to company law but, in the shorter term, I foresee the creation of a special right of access for major shareholders to both strategic information relating to the company

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<sup>20</sup> The question with regard to so-called Chinese walls will again come forcefully to the fore and not only in relation to financial conglomerates!

and consultation with management. Such intensified communication between these special parties – possibly through special shareholder committees but, if necessary, directly – should serve to shore up confidence in the long-term direction of the company. In this regard, not every shareholder is the same. A further recommendation by the Peters Committee is important in this respect, namely, that sector and company analyses should be stimulated so that more objective information is available for evaluation by institutional investors. It is, after all, a colossal task for an investor to generate such insights himself.

A development such as this in Financial Governance by insurers and pension funds is not only a positive way of disciplining the companies involved, but also has a positive effect on investment behaviour (and the external assessment of this) by the institutions themselves. In time this gives support to the work of prudential supervision.

## 5 Summary and Conclusions

- 5.1** In this paper the importance and the developments in the Netherlands in the area of Corporate Governance, in particular on and by insurance companies (and pension funds), were discussed. The element of Financial Governance – in other words, influence by the company’s group of capital providers – is of particular importance in this regard. Following a brief sketch of CG within the Dutch economic order (as a variant of the Rhineland model) and the structure of the insurance market in the Netherlands, the degree to which insurers (and pension funds) actually show signs of CG was discussed. In this respect, it was noted that until now there was relatively little substantial CG on or by insurers and pension funds. At the same time, signs have been observed which indicate that a considerable increase in Financial Governance in the Netherlands is likely. These developmental trends were then discussed in more detail. In addition, an analogous influence from the domain of European and national competition policy was considered. Both developmental trends were then evaluated from the specific perspective of (legal) prudential supervision.
- 5.2** On the basis of the above discussion, I draw the following conclusions:
- 1) Discussions on CG certainly have a substantial significance in addition to their fashionable facets.
  - 2) The CG arrangements in the Netherlands cannot be extricated from the European and other international forces and developments.
  - 3) There is a very real chance that CG of a more Anglo-Saxon guise will become dominant in Europe.
  - 4) CG exercised by insurers and other institutional investors (such as pension funds) – in particular the Financial Governance variant – will manifest itself substantially in due time. This applies primarily to CG within the Netherlands. In so far as institutional investors make use of international (external) investment managers, this effect will be relatively much weaker.
  - 5) In doing so, an emphasis on the long-term investment perspective will be a countervailing force against an undesirable emphasis on short-term benchmarks.
  - 6) An increase in CG of insurers (and perhaps of pension funds) may be

accompanied by very undesirable risks. This is all the more so since competition policy in the European Union and, in particular, in the Netherlands is becoming stricter and is defined primarily in legal terms.

- 7) A considerable effort will therefore be required of prudential supervisors – and of those who play a role in this, such as external accountants and actuaries – with the danger of slipping into systems of supervision which are inferior from the perspective of society as a whole.

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