

# HARMONISING THE CZECH INSURANCE MARKET WITH THE SINGLE EU INSURANCE MARKET – AN ANALYSIS

## Part 2

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*In a market economy insurance has a significant position with specific tasks and importance. Insurance is a special sector of the financial services of an economy, ensuring the elimination of risks ensuing from economic activity. It represents a system and rules for subjects performing their activity in this sector. The insurance industry comprises insurance institutions, insured subjects, insurance intermediaries, supervisory authority of insurance industry, associations of insurance companies and other subjects.*

*The main aim of this article is to present knowledge acquired in studying the development of indicators of the level of the insurance market both in the Czech Republic as well as in the single insurance market of the European Union. This analysis of indicators evaluating the level of insurance markets serves as an evaluation of the current degree of transformation and approximation of the Czech insurance industry in the process of harmonisation with the European insurance industry.*

### The single insurance market of the European Union

The last 30 years of the 20th century moved the multinational activities of European insurers on to a qualitatively new level through the creation of a single insurance market. This single insurance market (see [3]) in the European insurance industry has now been a legal reality for the member states of the European Community since 1 July 1994. The creation of the single insurance market came not as a sudden breakthrough, but through a process of the gradual acceptance of individual Community directives over time. At the end of this process is the single legal area, or single licence, defined by the following five principles:

• First principle (basic) – is essentially the regime of a single licence. The single licence system, or European passport, enables any insurance company incorporated or registered in one of the EU member states to sell its products via its branches or representative offices in another state, or sell them across borders directly from its seat throughout the European territory on basis of their domestic licence.

• Second principle (a direct consequence of the first) – the cancellation of the dual licensing system (licensing in the home and host state). This dual procedure has been replaced by a notification procedure, which is far simpler than the control procedure in the home country.

• Third principle – the mutual recognition of licences issued by various supervisory bodies of EU countries, and also the recognition of their systems of supervision applied by them.

• Fourth principle – means the complete cancellation of the preceding control check of insurance terms and rates, and its replacement by supervision over the insurance company's solvency by its shareholders and management.

• Fifth principle – means liberalization of rules for investing technical reserves with the goal of fulfilling another basic principle of the Treaty of Rome, regarding the free movement of capital.

With 29 national markets in the EU and EEA, where assets under administration total almost EUR 5 billion, and premium more than EUR 800 billion (data for 2001, CEA), the European insurance market is a unique example of an integrated insurance area.



Insurers can sell their products in these European markets on the basis of a licence from their home country. Every European customer can in theory choose any of the products offered by the insurance companies from various states. Even in the USA there is no similar system of a functioning insurance market. Commercial insurers operating there must apply for a licence in each state of the Union in which they wish to sell products.

The basic aim of European Union legislation in the field of the insurance industry is to achieve integration, globalisation and the functioning of a single insurance market in the EU countries. The effort is to remove all barriers existing mainly in national law preventing or limiting the creation and functioning of this single market. It also concerns the unification of rules for pursuing insurance business and the maximum protection for clients of commercial insurance companies.

A substantial motive behind the integration and gradual unification of the market is the effort of insurers to expand the range and sales of their insurance products abroad. The reasons may be commercial (market expansion and new opportunities), but neither should we forget also the insurance-technical reasons. Market expansion enables a greater diffusion of all types of risk.

#### **Pillars of the European Market in Services**

The legal norm governing the financial sector at the general level is the Treaty of Rome (hereinafter "ToR"). This Treaty constituted a new legal code – European Community law. The Treaty of Rome is the primary source of European law.

The cornerstone of the single financial market on which EU legal standards in insurance and other partial regulations are founded, are the three basic freedoms – the three pillars of the European market in services, defined and codified in the Treaty Establishing the European Communities. These are the freedom of establishment (Article 52 et seq. ToR), the freedom to provide services (Article 59 et seq. ToR) and the free movement of capital (Article 67 et seq. ToR).

- The freedom of establishment – allows a company registered in a member state to open a subsidiary or branch in another member state under the same conditions as apply for subjects in the host country (this applies in the case of an application to a company and the free movement of persons). This is then a commitment on the side of the receiving member state to provide subjects from other member states "national treatment", i.e. the same as that provided to their own subjects.

- The freedom to provide services – enables com-

panies registered in a member state to perform occasional and transitional activities in another member state where it has no operation to not be discriminated against in comparison with companies registered there. Here, too, applies the non-discrimination principle on grounds of nationality.

- The free movement of capital – enables all citizens of the EU to perform any financial transactions throughout the EU (for example opening bank accounts, loans, investments, etc.). This means for member states the obligation to liberalise financial trade together with the effective application of other freedoms. Under the Directive of 24 July 1988 member states were obliged to cancel as at 1 July 1990 all restrictions on the movement of capital between persons residing in member states. These requirements concern primarily transfers in relation to the indemnity of life assurance and credit insurance policies.

The Treaty of Rome however laid down only the basic legal framework in the field of services. The removal of partial barriers is though a matter for secondary legislation and Community directives, which operate multilaterally, that is to say they are for an unlimited number of subjects. However, even these create only a certain legal framework by which member states should proceed. The largest share of work in the field of legislation is then in hands of member states themselves.

The application of these three freedoms by individual member states remains a certain problem. The reason is more or less the different present legal regulation in the field of services, based on differing traditions or philosophies, meaning stricter, or conversely more liberal, conditions for pursuing business in these countries.

For these reasons both the creation and functioning of the single European market in services required and still does require a certain degree of harmonisation in the legislation of member states in order to introduce equality in competition. This is a basic prerequisite for the effective application of the three freedoms.

The process of harmonising national law with EU standards is not though a simple matter of transposing Community directives into national legislations. Doing so could in some specific way disrupt certain mechanisms already codified in the legal regulations of individual countries. For this reason the principle of minimal harmonisation is applied, whereby individual member states are entitled to adopt legal standards different to Community directives though only where these are stricter than those set by the respective Community directive. In this way equality of competition should be ensured, since member states



applying this principle do not have the option of creating a more liberal environment than that created by Community directives.

### Stage of Harmonisation and the Generation of Directives

When talking of the process of harmonising law it is necessary to mention the document that forms the basic framework for the implementation of EU legal regulations by associated countries. In June 1995 the meeting of the Council of Europe in Cannes approved the White Book on the preparation of the associated countries of Central and Eastern Europe for integration into the internal market of the European Union. Its purpose was to assist in preparing them for the gradual fulfilment of the requirements of the EU's single internal market. This concerned those legal regulations forming the basis of the single internal market, introduced in the European Community on 1 January 1993.

The White Book also required that the associated countries of central and eastern Europe implement the structures and conditions necessary for ensuring the effective realisation of harmonised legal regulations. This document is essentially an instruction manual for the associated countries as to how to proceed in preparing for integration into the EU's internal market and how to orient themselves in the range of single internal market regulations. Specifically, for the field of banking and finance the White Book (similarly as for other sectors) gives a differentiation of key measures, which are then broken down into several stages. This division reflects priorities ensuing from the logic of the legal regulations themselves and serves as an instruction manual for associated countries as to how most effectively divide the work in approximating legislation, and likewise for its implementation and enforcement. Negotiations on accession, begun in autumn 1998, do not in contrast to the White Book concern solely the single internal market, but relate to all applicable regulations of EC law adopted up to the time of Slovakia's entry.

From the aspect of the EU's single internal market the field of insurance is governed mainly by directives on life and non-life insurance .

In the case of the Czech Republic it was necessary to implement not only vertical directives, which concern insurance directly (the above-mentioned and some other directives, for example regarding legal protection insurance, third-party liability for vehicles, etc.), as well as horizontal directives, which are not

intended directly for insurance, but are significantly connected with this sector. This for example concerns the issue of economic competition, consumer protection, money laundering, the assignment of public procurement orders, etc. It is necessary to realize that the single market was built gradually over a relatively long time period. Back in 1961 the EEC adopted a program for the insurance industry (see [8]) the aim of which was to achieve, over several stages, the freedom to provide services, at first in the field of reinsurance, then the freedom of establishment and the freedom to provide services in the field of life and non-life insurance. On 25 February 1964 Directive No 64/225/EEC was adopted for reinsurance, cancelling barriers to the realisation of the freedom of establishment and the freedom to provide services in reinsurance and retrocession. This Directive was at the same time the first Council Directive on insurance.

Over the period 1973 to 1992 the so-called First to Third Coordination Directives were issued for the field of insurance, regarding life and non-life insurance. These directives were as follows:

#### • Non-life insurance:

- Council Directive No 73/239/EEC – 1st non-life insurance directive,
- Council Directive No 88/357/EEC – 2nd non-life insurance directive,
- Council Directive No 92/49/EEC – 3rd non-life insurance directive,

#### • Life insurance:

- Council Directive No 79/267/EEC – 1st life assurance directive,
- Council Directive No 90/619/EEC – 2nd life assurance directive,
- Council Directive No 92/96/EEC – 3rd life assurance directive.

Therefore we differentiate directives of the first to third generation, which correspond to the three stages of harmonising legal regulation. The first stage presents the freedom of establishment, the second stage the freedom to provide services and the third stage the single licence principles. For more detail, see [4].

### Conclusion

In 1997, the Czech Republic joined the group of states conducting negotiations on future membership with the European Union. In the field of insurance the main task (besides the liberalisation of the insurance market) became primarily the harmonisation of Czech insurance law with EU legislation, meaning the implementation of the respective European legal norms into Czech law. This concerned the individual

\* A complete list of EU legal regulations regarding insurance can be found at [www.cap.cz](http://www.cap.cz)



provisions and principles of the single market codified mainly in the first to third generation directives.

Despite the fact that most of the essential fields of European legislation in insurance are already governed in accordance with the liberal market principles, the concept of the single European insurance market has in practice been applied very slowly. One of the reasons has been persistent differences between national legislations (see [8]) even in fields which are already harmonised by European directives. Not all EU member states have yet completed the implementation of European legal acts into their national legislations.

A further factor influencing the relatively slow progress of the single market is the fact that the process of its gradual building, even despite the existence of three generations of directives, is not yet quite complete.

In total 72 EU legal acts govern the field of insurance. A leading role in the field of legislation and the gradual process of its enforcement is played by the White Book.

Several key provisions codified in European directives – primarily the first and second generation – have gradually began to appear also in Czech legal acts. These have been mostly edicts and amendments to partial acts. From this aspect though the year 1999 was of cardinal importance, when two legal acts were adopted – Act No 168/1999 Coll. on third-party liability for damage caused by the operation of a vehicle, and Act No 363/1999 on insurance business and the amendment to certain acts, which entered into force on 1 April 2000.

The process of approximating the insurance legislation of the Czech Republic and that of the European Union is almost at an end, given that on 1 January 2005 the following legal regulations entered into force (except certain provisions with effect from 1 May 2004):

- new legal regulation of an insurance policy, in Act No 37/2004 Coll. on insurance contract
- amendment to Act No 39/2004 Coll. on insurance ,
- Act No 38/2004 Coll. on insurance intermediaries and independent loss adjusters,
- Act No 47/2004 Coll. on third-party liability for damage caused by the operation of a vehicle,
- other regulations connected with the insurance business (on bankruptcy and settlement, tax regulations, economic competition).

All efforts were made in the legislative field so that by the end of 2003 all necessary legal regulations not yet fully corresponding with European insurance regulation had been adopted or amended. The legislative field itself is an element of the transformation

process that can be influenced relatively quickly. Conversely, the development of the insurance market as such will be a longer-term process, which will itself be generated by gradual changes not only in acts adopted, but primarily in the attitude of businesses and citizens to insurance.

The process of the gradual transformation of the Czech insurance market, which has been underway since the first half of the nineties was by far from complete with the Czech Republic's accession to the European Union – changes of a qualitative nature are more long-term.

The transformation of the insurance industry, as well as other sectors of the financial system is an irrevocable process which has not been, nor will be, without the most diverse of problems. In its objective form it should, nevertheless, bring overall prosperity not only for the financial, but also the whole economic system.

The main aim of this article has been to assess the current status and analyse the process of the Czech insurance market's harmonisation with the single insurance market of European Union countries, or respectively the insurance markets of the national associations of insurers associated in the CEA. The results of the investigation and evaluation of assessed phenomena with the help of selected indicators on the level of relevant insurance markets has allowed their analysis both from the quantitative as well as qualitative aspect. The article defines the benefits and risks of a single insurance market in the European Union and describes the basic principles on which this single insurance market has been founded. The market has been developed gradually through the application of several generations of directives governing the field of life and non-life insurance. In assessing and documenting the present degree of transformation and approximation of the Czech insurance industry, we have worked from the gradual implementation of European legal acts into national legislation. The field of insurance is governed in total by 72 EU legal acts.

The process of the Czech insurance industry's harmonisation and transformation prior to entering the EU single insurance market can be assessed as positive. Some aspects of this process are of a longer-term nature. The implementation of European Union legal regulations into Czech insurance legislation may be considered as having been conditionally completed at the moment of the latest legislative regulations entering into effect, i.e. 1 January 2005, except those provisions which entered into effect on the date of the Treaty on the Czech Republic's Accession to the European Union entering into force.

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