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Trade and development aspects of insurance services and regulatory frameworks

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Foreword

As one of the key pillars of the financial services sector the insurance sector is a central element of the trade and development matrix. As both an infrastructural and commercial service, a well-functioning insurance sector plays a crucial role in economic development not just at a macro economic level but also in terms of the activities of individuals and businesses.

The world insurance market is dominated by industrialized countries which in 2004 generated about 88 per cent of world life insurance premiums and accounted for 90 per cent of the world non-life market. However figures for real growth rate and insurance density, i.e premium per capita, indicate the potential for substantial growth within the insurance sectors of emerging markets. The overall real growth rate of emerging markets for 2004 stood at 7.5 per cent as compared with 1.7 per cent in industrialized countries. Figures for insurance density also indicate substantial differences between industrialized countries ($2,966) and emerging markets ($687).

Given the importance of the insurance sector, its potential for growth, rapidly emerging trends within the sector including the trend towards liberalization of insurance services, it is essential to clearly understand the challenges and opportunities that arise from both the development of the insurance sector as well as its liberalization for developing countries. It was with this objective in mind that UNCTAD, at the behest of its member States and in accordance to its mandate pursuant to the ninth session of the Commission on Trade in Goods and Services, and Commodities, held in Geneva from 14 to 18 March 2005, held an ad hoc expert meeting on insurance services on 24 November 2005.

The discussions indicated that while insurance service liberalization and globalization can be beneficial, they have different impacts on developed and developing countries. Country experiences seemed to indicate that liberalization of insurance services needs to be accompanied by a strategic and clearly defined national policy on the financial services sector in general and the insurance sector in particular (taking into account each country's specific national development objectives), as well as the development of efficient and effective regulatory and supervisory frameworks, in line with international initiatives. This recognition that liberalization alone might be insufficient may be one of the reasons for the hesitation of some countries in the context of the liberalization of insurance services.

Other areas that pose a challenge for developing countries include the potential impact of the operations of insurance companies on the activities of policyholders and the economy as a whole, the impact of emerging trends in the global insurance market, the need to overcome supply-side constraints, the need to raise public awareness about the benefits of insurance coverage, the need to build human capacity and how to take advantage of changes arising from liberalization and globalization within the insurance sector to develop export opportunities. The role of regional/South-South cooperation and that of government as a facilitator, regulator and provider of insurance services also require due consideration. The challenge would ultimately lie in reconciling efficiency and social considerations, particularly for lower-income and marginal sections of the population.

The UNCTAD ad hoc expert meeting on insurance services drew heavily on the experiences of the insurance sector in India, China, Africa and Guatemala to identify to the widest extent possible the problems faced by developing countries. This was complemented by deliberations and interventions made by representatives from the private sector, regulators, trade negotiators, international organizations (including the international association of insurance supervisors), academics and government representatives from both developed and developing countries, thereby enabling not just a sharing of views, but concrete and varied suggestions on the way forward.

As the focal point of the United Nations for the integrated treatment of trade and development and interrelated issues, UNCTAD will continue its work on insurance services and its trade, development and regulatory implications.

Mr. Supachai Panitchpakdi
Secretary-General of UNCTAD

Acknowledgements

The volume contains papers, presentations and submissions delivered at the UNCTAD ad hoc expert meeting on insurance services held on 24 November 2005 at the Palais des Nations, Geneva, organized under the supervision of Lakshmi Puri, director of the Division on International Trade in Goods and Services, and Commodities, by a team led by Mina Mashayekhi, head of the Trade Negotiations and Commercial Diplomacy Branch. The volume also draws on the ongoing substantive work of UNCTAD.

The volume was edited and prepared by Mina Mashayekhi and Deepali Fernandes.

The major contributors are the authors of the individual papers. Substantive contributions of the participants in the above forum were also significant, particularly those from Yoshihiro Kawai, Secretary-General, IAIS; Yoseph Aseffa, former Secretary-General, African Insurance Organization; John Cooke, chairman, Financial Leaders Working Group; Israel Kamuzora, Commissioner of Insurance, United Republic of Tanzania; Jurgen Huppenbauer, Udaibir Das, Ahmed Zinoun, executive manager, Societe Centrale de Reassurance Casablanca, Morocco; Wei Zheng, Secretary-General, China Center for Insurance and Social Security Research; and Nigel Easton, UNCTAD.

A full list of participants is contained in annex I to this volume.

We would like to thank all our experts who took part and contributed to the meeting, and UNCTAD members and donors for their interest in and follow-through on the meeting.

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I. Introduction to the trade and development aspects of insurance services and regulatory frameworks

Lakshmi Puri[1]

Global picture of insurance services

We are all aware of the essential role that insurance services play as a commercial and infrastructural service. From an infrastructural perspective it promotes financial and social stability, mobilizes and channel savings, supports trade, commerce and entrepreneurial activity and improves the quality of the lives of individuals. In a fast-globalizing world economy, Governments the world over are faced with challenges relating to the regulatory environment, emerging global trends in the insurance sector, technological innovations and liberalization of the insurance sector. The impact of these trends is perhaps more pronounced in the case of developing countries, who stand to benefit from liberalization of the insurance sector provided due consideration is paid to putting in place an efficient and well-functioning institutional and regulatory framework, tailored national policies and well-planned sequential commitments on insurance liberalization.

One finds that there is a positive correlation between a country's level of development and insurance coverage. Developed countries tend to have better developed and well-functioning insurance services sectors both domestically and in terms of insurance exports, as compared to developing countries. This is perhaps most evident when one compares the share of industrialized countries in the world insurance markets, which in 2004 stood at 88.5 per cent as compared with 11.4 per cent for emerging markets, the majority of which are developing countries. Another good indication of insurance penetration is the premium volume generated as a percentage of gross domestic product (GDP). For developed countries this figure stood at 9.02 per cent in 2004, whereas for developing countries it stood at 3.94 per cent. What is interesting to note here, however, is that emerging markets have a far higher overall real growth rate, at 7.5 per cent, than industrialized countries, where it is 1.7 per cent, indicating the existence of substantial potential within emerging markets.

Challenges for developing countries

Developing country challenges in relation to insurance services sector arise essentially from five areas.

First is the impact of insurance liberalization on developing countries. While liberalization and privatization is likely to lead to the admission of foreign insurers with substantial financial strength, technological and industry know how and good risk management and asset liability management skills vis-à-vis global markets, it also raises

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areas of concern for developing countries. One of the principle areas is the security and stability of the insurance sector, which in turn is linked to setting up and ensuring a well-functioning insurance supervisory and regulatory authority. Other concerns include the possibility of anti-competitive practices, selective marketing to high value client's, possible loss of employment in the case of privatization, selective sectors of operation, protection of nascent insurance operations and perhaps the most important of all the need to set in place strong and adaptable regulatory systems within the insurance sector.

A second area is the importance of building supply side capacity. Given the capital intensive nature of the insurance sector this is a not a simple task, but nonetheless one which is achievable, primarily by building on existing insurance strengths. This could involve raising public awareness, training of insurance professionals, identifying sectors of strength or niche areas where strength can be developed. In this regard, Developing countries can avail of inherent advantages such as existing distribution networks, local knowledge, identifying niche areas of operation including in the context of Mode 4, insurance intermediation, software and outsourcing services among others. Further South-South and regional cooperation and exchanges particularly relating to human resource-building, financial and information pooling and regulatory practices could be extremely valuable in addressing supply side constraints.

A third area is the role of regulation frameworks. The importance of setting in place efficient regulatory structures as a prerequisite to the efficient operation of the insurance sector and particularly in the context of insurance liberalization and an evolving global insurance sector is essential. Emerging trends in the global insurance market particularly those relating to technology, newer financial products and corporate failures have underscored the value of regulation in the insurance sector. There exist differences, sometimes large ones in the regulatory and supervisory structures of developed and developing countries. In respect of regulation most Governments are faced with three challenges. One as pointed out earlier is the need to set up efficient regulatory structures, the second is harmonization of prudential and regulatory structures across countries and the third is an examination of the implications of accessions to international standards in general and vis-à-vis the General Agreement on Trade in Services (GATS). Also relevant in this context is an examination of provisions within the GATS such as those relating to domestic regulation and the prudential carve-out and its implications for developing countries. This last area specifically has raised much discussion within WTO and is considered in more detail later on in this book.

A fourth area, relates to the current negotiations on insurance services within the GATS. One part of this relates to proposals made and discussions on issues such as classification of insurance services, transparency, and the scope of the prudential carve out, the exemption for services supplied in the exercise of governmental authorities, among other things. The other part relates to specific commitments made and those that are being requested of developing countries. For instance it is estimated that approximately 30 of the total 69 offers made in the current Doha round of negotiations relate to insurance and insurance related services.

A fifth area for consideration relates to the role of the Government as a provider of insurance services and the extent of its role as a provider of insurance services. This is particularly relevant for developing countries and to the interests of the lower income sections within these populaces. In the past where the Governments in these countries

have been the sole if not the only supplier of insurance services, this has offset the provision of insurance services in non-profitable areas such as agricultural or credit insurance against the supply of insurance services in more profitable areas. This raises two questions for the Government, what are the areas where it might be important for the Government to provide some manner of insurance intervention from a social and development perspective and second how is this likely to be financed.

Policymaking and implementation as an effective solution

In summary, many of the issues raised can be addressed through effective policymaking in these five areas, overcoming supply side constraints, establishing and implementing effective financial and supervisory machinery to ensure smooth functioning of the insurance sector and its stakeholders, identifying areas where the Government has a role as a provider of insurance services and last appropriate sequencing of privatization and liberalization of insurance services, while identifying areas of export interest present or potential for developing countries. All this presupposes necessary technical cooperation and capacity-building support.

UNCTAD's role

Some of the issues just outlined are issues that have been constructively considered in the course of this book. UNCTAD has been involved in the area of insurance since its inception in 1964. More recently with the twin focus on the insurance sector being in the area of regulation and trade negotiation in the sector, we have at the request of our member States tried to look at arising development implications so as to provide an overview. As a focal point in the United Nations system for the integrated treatment of trade and development and related issues, UNCTAD has unique and comprehensive mandate to support international trade negotiations and regulatory efforts through international consensus-building, research and technical cooperation and capacity-building at both the multilateral and regional level.

In this vein UNCTADs contribution will continue to focus on: the benefits and challenges arising from international trade in insurance services, regulatory challenges arising from domestic implementation as well as in relation to the GATS, measures to overcome supply side constraints and build domestic capacity in the insurance sector, the role of the Government both as a regulator and a provider of insurance services, likely impacts of emerging global and technological trends in the insurance sector and in relation to the GATS assisting developing countries in their ongoing and evolving negotiations on insurance services and larger issues which could impact on insurance services negotiations.

This publication is a first step towards institutionalizing the rich sharing of experiences which emerged as an outcome of the UNCTAD ad hoc expert meeting on insurance services held on 24 November 2005. It was put together as a result of numerous requests made to the UNCTAD secretariat.

This publication consists of six parts. The first part is intended to provide readers with an overview of the insurance sector from the perspective of developing countries. It considers developing country shares in the global insurance market, regulatory and trade liberalization issues that developing countries are faced with as well as suggestions as to how developing countries can identify areas of competence within the insurance services sector. It includes a paper by UNCTAD staff members Mina Mashayekhi, Elizabeth Tuerk and Deepali Fernandes which sets out ithe importance and role of insurance services, tying it in with regulatory frameworks and as well as with the trade and development aspects of insurance services and regulatory frameworks.

The second part of the book is focused on developments in the global insurance market. It essentially considers global market trends in the insurance sector in terms of the challenges posed by market trends, regulatory convergence and changes in the technological and corporate landscape. It benefits from submissions made by John Cooke, Chairman of the Financial Leaders Working Group, Chris Gentle Global Director (Research), Financial Services, Deloitte & Touche, Patrizia Baur of Swiss Re and J.F. Outreville of UNCTAD.

The third part considers issues relating to regulation, its importance, what kind of regulatory and supervisory principles are key to an effective regulatory framework as well as the challenges faced by developing countries in setting up effective regulatory and supervisory frameworks. This section draws on observations by Israel Kamuzora, Commissioner of Insurance, on the regulatory experience of the United Republic of Tanzania, as well as on the experience of China.

The fourth part deals with country experiences in the insurance sector specifically the experiences of China and Africa based on two case studies undertaken specifically for the meeting. It also focuses on the experiences of insurance providers from developing countries such as Guatemala, India and South Africa. The experiences of Indian insurance provider JB Boda in terms of its operations and the challenges the company faces as well as that of Basil Reekie, chief executive officer, QED, and chairman, African Life Committee, are very illuminating in this regard. The fifth part considers the challenges faced by developing countries in a globalizing insurance market. It includes submissions made by Bakary Kamara, chief executive officer of Africa Reinsurance, on his vision for the future, Udaibir Das of the IMF and Julian Arkell. A paper by the World Federation of Insurance Intermediaries looks at the role of insurance intermediaries and Craig Churchill's piece on the role of microinsurance in creating inclusive markets looks at specific schemes that may help in the development process.

The sixth and last part of the book, considers developments at the international level within the context of the World Trade Organization (WTO). It sets out the current state-of-play within WTO and alternate modalities for scheduling WTO commitments within the insurance sector, and ends with the chairman's summary of the meeting which encapsulates discussions in all areas but focuses on the impact of insurance liberalization on developing countries.

It is hoped that this publication will flag key issues and areas of considerations for developing countries wishing to strengthen their insurance markets and foster a deeper understanding of the development implications of this central pillar of a country's economy.

II. Trade and development aspects of insurance services and regulatory frameworks

Mina Mashayekhi, Elisabeth Tuerk and Deepali Fernandes[2]

Introduction

This paper gives an overview of the global insurance market and emerging trends; the importance of the insurance sector for economic development; the significance and elements of an effective regulatory framework; development issues arising from insurance services liberalization; the importance of insurance as a public good; and the implications of GATS negotiations for the insurance sector and areas of potential export interest for developing countries.

Under appropriately designed financial-policy, regulatory and institutional frameworks, insurance services and trade in them will significantly affect an economy's productivity (including through their impact on the volume of savings). This makes the insurance sector a key element in the trade and development matrix.

Insurance services and development

Insurance services and their contribution to development

The insurance sector is an infrastructural pillar of the financial services sector and the economy as a whole. It plays a key role in economic development. Several empirical studies suggest a strong correlation between the development of financial intermediaries and economic growth. According to Patrick (1966)[3] there are two, possibly coexisting, relationships between the financial sector and economic growth. The first is the case where the financial sector has a supply-leading relationship with growth, and where economic growth can be induced through the supply of financial services. The second is a demand-following relationship where the demand for financial services can induce growth of financial institutions and their assets. Developing countries have supply-leading patterns of causality of development and have considered locally incorporated insurance institutions or State-owned monopolies an essential element of economic development.[4]

Recently, the economic importance of the insurance sector has been increasing in most developed countries and some developing ones. Insurance companies form a growing part of the domestic financial sector. They have also become significant players in the international capital markets. During the 1990s, the total assets of insurance companies in

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[2] UNCTAD, Division on International Trade in Goods and Services, and Commodities, Trade Negotiations and Commercial Diplomacy Branch.

[3] Patrick (1966), Financial Development and Economic Growth in Underdeveloped Countries, Economic Development and Cultural Change, Vol. 14 (2), pp. 174–189.

[4] The stream of literature on the interrelationship between economic growth and the financial services sector also includes Levine Ross, Financial Development and Economic Growth: Views and Agenda , October 1996.

developed countries grew faster than the assets of banks, mainly through M&As. Other reasons for the sector's increasing importance are the liberalization of financial systems (including privatization), financial consolidation, the increasing use of contractual savings products and market-seeking approaches.

The insurance sector is closely linked with macroeconomic factors (e.g. inflation, currency controls and the national income of a country), regulation and supervision, and the achievement of national development objectives, as well as the international trade regime. Given its dual infrastructural and commercial role, the sector has attracted great interest in the context of privatization and liberalization. There are several ways in which insurance services contribute to economic development:[5]

- ***Insurance promotes financial stability for both households and firms.*** Insurance services transfer and pool risks, thereby encouraging individuals and firms to specialize, create wealth and undertake beneficial projects they would not otherwise consider.

- ***Life insurance companies mobilize and channel savings***. They mobilize savings from the household sector and channel them to the corporate and public sectors. As the maturity of life insurance liabilities is generally longer than the maturity of bank liabilities, life insurers can play a large role in the equity and bond markets. In addition, their portfolios are less prone to liquidity crises. Countries with higher savings rates tend to show faster growth.

- ***Strong insurance can relieve pressure on the government budget.*** Because life insurance can play an important role in personal retirement planning and health insurance programmes, and to the extent that private insurance reduces demands on government social security and health programmes, it can relieve pressure on the government budget.

- ***Insurance supports trade, commerce and entrepreneurial activity.*** Given the heavy reliance of all economic activities (e.g. manufacturing, shipping, aviation, medical, legal, accounting and banking services) on risk transfer, insurance services play a key supporting role. More broadly, insurance can give investors the financial confidence to make investments, since they know they will be able to recover their investment.

- ***Insurance may lower the total risk faced by the economy.*** This risk reduction arises from the portfolio diversification and incentives to better measure and manage the risks to which they are exposed, as well as to promote risk mitigation activities.

- ***Insurance improves individuals' quality of life and increases social stability.*** It does this through, for example, individual health and life insurance, pension funds and workers' compensation.

[5] Das, Davies and Podpiera (2003), Insurance and issues in financial soundness, IMF Working Paper WP/03/138.

The insurance industry is quite heterogeneous and the structure of the sector varies according to the prevailing level of economic development.[6] In fact, developed countries' insurance sectors usually include life insurers, non-life insurers and reinsurers. These companies may be stand-alone enterprises or parts of groups or conglomerates, and they may conduct business internationally. Developing countries' insurance providers, in turn, are smaller and generally do not engage in major international activities. There can also be differences between insurance institutions in a particular country or market segment. (For example, because of the wide range of risks to which they can be exposed, companies may differ in their risk profile.)

The Government plays an important role in ensuring that insurance services can generate benefits. In developed countries, the Government's key role is to act as a regulator to ensure security and stability in the sector. In developing countries, it also has the role of providing insurance services as a public good.

Developing countries seek to establish efficient domestic regulatory frameworks as a prerequisite for insurance service privatization and liberalization. By making the regulatory environment transparent, effective, flexible and simplified, and by pursuing national policy objectives, Governments can help maximize the contribution of insurance services to development. The benefits of insurance liberalization can be captured through effective policymaking pertaining to, among other areas:

- Building domestic capacity and overcoming supply-side constraints;
- Establishing and implementing effective regulation and supervision;
- The role of government as an insurance service provider;
- Appropriate pacing and sequencing of privatization and liberalization of insurance services;
- Consumer protection.

Developing countries' markets depend extensively (technically and financially) on international services. Reasons for this include (among others) structural, financial and technical constraints, including the small size of markets, under-capitalization of insurance companies and insufficient experience and know-how. Usually, insurance industries there also have a shortage of skilled personnel. There is also a dependence on foreign reinsurance, which has implications for the contribution of the insurance industry to national development, in particular with respect to savings promotion and mobilization.[7] Given that these constraints can significantly affect the shortage of insurance services, more research needs to be done on the supply side (including analysing the managerial issues) and on the nature of appropriate regulatory frameworks.[8] Prioritizing the strengthening of human capital is an important source of comparative advantage for insurance services and their export.

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[6] Ibid.
[7] See Vittas (2003), The Insurance Industry in Mauritius, World Bank Policy Research Paper 3034.
[8] See Outreville (1996), Life insurance markets in developing countries, Journal of Risk and Insurance.

Box 1. African insurance markets

Insurance markets in Africa are at varying stages of development. Their share of the total premium generated on the continent closely correlates with the level of economic development in their respective countries. African countries have some 650 insurance and reinsurance companies, which generate a gross premium income of $38 billion. South Africa has the most developed economy and insurance industry on the continent and produces around $30 billion, or 79 per cent, of the continent's total insurance output. Ten African countries (Morocco, Egypt, Tunisia, Kenya, Mauritius, Namibia, Nigeria, Algeria, Côte d'Ivoire and Cameroon) generate 15 per cent of Africa's insurance and reinsurance premium, totalling $5.7 billion. The rest of the continent has a share of 9 per cent, or $3.4 billion. There is substantial potential for growth and development in the insurance sector of the vast majority of African countries, but there are also serious difficulties and challenges. The performance of African insurance supervisory authorities does not always correspond to the pattern of economic development and the premium distribution. South Africa has an independent financial services supervisory authority that is highly complex and functional by international standards. CIMA, the subregional insurance supervisory authority of the 12 French-speaking sub-Saharan countries, is well organized and autonomous. In order to cope with the challenges posed by the GATS and their services commitments in WTO, a number of countries have revised their insurance legislations, created autonomous supervisory authorities and taken measures to establish and operate insurance markets based on sound principles. Mutually beneficial and successful liberalization in the sector requires appropriate preconditions, including efficient regulation and supervision. African Governments have expressed the urgent need for international support to strengthen their markets, their supply capacities and their regulatory and supervisory authorities.

For further data on the African insurance market see the case study on the African insurance market in Chapter XI of this publication

Factors to consider in striving to realize export opportunities for developing countries include the following:

- ***Outsourcing and offshoring*** (of insurance claims, call centre work related to insurance queries, marketing and claim settlements), provision of insurance advisory services through Mode 1 (e.g. the cross-border supply of auxiliary services, such as actuarial and risk assessment services, which require specialized knowledge) and development of offshore insurance centres. It is estimated that by 2010 more than 20 per cent of the financial services industry's global cost base will have shifted offshore.[9] To capture this potential, developing countries need to build language skills; understand the culture of the target market; comply with standards (e.g. privacy requirements); and develop the necessary infrastructure.

[9] Deloitte (2005), Top ten issues, Global Insurance Industry Outlook 2005.

Box 2. Development of China's insurance industry

In the past decade, China's insurance market has been one of the most dynamic markets in the Asia-Pacific region and in the world. The premium volume rose from RMB 0.46 billion in 1980 to RMB 431.81 billion in 2004. In 2004, although the total insurance premium volume attributable to China was $52.171 billion, with 1.61 per cent of the world market and eleventh in the world, China's insurance density (per capita insurance premium) was $40.2, far less than the world average of $502.1, putting it seventy-second in the world. The development of China's insurance industry in the past 25 years can be divided into three stages consistent with the gradual progression of China's economic system reform. The first is resumption and restoration (1980 to 1985), the second is market-oriented reform (1986 to 1991) and the third is opening up and rapid growth (1992 to the present). Here is an overview of insurance operators in China at the end of 2004.[10]

<table>
<tr><th>Type of company</th><th colspan="2">Total no. of operators</th><th>No. of domestic companies</th></tr>
<tr><td>Insurance group (holding)</td><td colspan="2">5</td><td></td></tr>
<tr><td>Life insurance</td><td colspan="2">29</td><td>9</td></tr>
<tr><td>Property insurance</td><td colspan="2">29</td><td>16</td></tr>
<tr><td>Reinsurance</td><td colspan="2">5</td><td>2</td></tr>
<tr><td rowspan="3">Insurance intermediary</td><td rowspan="3">1,297</td><td>Agencies: 920</td><td rowspan="3"></td></tr>
<tr><td>Brokerage: 197</td></tr>
<tr><td>Insurance adjustment: 180</td></tr>
</table>

November 1998 saw the creation of a new insurance regulatory body, the China Insurance Regulatory Commission. The Insurance Law of the People's Republic of China, which was amended in 2002, regulates the insurance industry in China. China's insurance industry has gradually opened up to the outside world. In the 1980s, the Government allowed several foreign insurance companies to set up representative offices in China. In 1992, the State Council chose Shanghai to be the first experimental city for opening up. More cities followed suit thereafter. The current stage is characterized by overall opening and by insurance services commitments under GATS, which is viewed as a more predictable legal framework.

For further data on the Chinese insurance market see the case study on the Chinese insurance market in chapter X of this publication.

[10] Furthermore, by the end of 2004, there were more than 120,000 affiliated insurance agency companies (mostly commercial banks and postal offices) and about 1,490,000 individual insurance agents.

- ***Provision of insurance services through Mode 4*** (e.g. movement of local insurance specialists to other countries) ***and through Mode 3*** (e.g. Mode 3 establishment of firms from developing countries, particularly in neighboring countries and South-South investment flows).

- ***Distribution of insurance services and insurance intermediation.*** Distribution of insurance services is extremely vital for successful insurance penetration. Effective and efficient access to existing channels for insurance distribution is important. Insurance intermediation is a sector where developing countries can benefit by providing local knowledge of domestic markets to foreign suppliers and international knowledge of foreign markets to domestic suppliers.

- ***Local knowledge.*** Since the marketing of insurance products requires a thorough understanding of the domestic market, including consumers' lifestyles and consumption patterns. Acquiring such knowledge requires partnerships with local firms in developing countries. Such firms could also offer distribution channels, effective marketing strategies and niche areas of operation.

- ***Portability of insurance.*** As developing countries can build up niche areas of services exports, (such as health services) and insurance services linked to them could be promoted domestically.

- ***Development of software services related to the insurance sector.*** Developing insurance-friendly software systems for use domestically, in other developing countries and globally. Certain insurance activities such as claim settlements, actuarial services and risk assessment could benefit from the use of enhanced software. Website development for insurance marketing and promotion is another area of potential export interest.

The Government's role in providing insurance services as a public good

In many developing countries the Government continues to play a role in the provision of insurance services. One possible area of operation is services, that are not immediately profitable and where there is a perceived need, but that the private sector may not be interested in providing. For example, agricultural insurance can help to address challenges arising from the fact that in developing countries, a majority of the population is employed in agrarian activities, which can be risky and impacted by many variables. As far as microcredit insurance is concerned, good precedents have been set in microfinance and micro-industry through programmes such as GrameenBank and GrameenPhone in Bangladesh, and it might be possible to use similar models in micro-insurance and other areas. Traditionally, in a State-owned insurance company these non-profitable insurance services are counterbalanced by government insurance activities in more profitable areas such as commercial insurance.

Another possible area of operation for Governments is public services such as social security plans and social programmes. Most developing-country Governments liberalizing their insurance markets need to know which insurance subsectors of social importance

they should supply and how they can ensure that the interests of lower-income segments are taken into account.[11]

While government intervention in providing insurance services to the poorer segments of a population is important, Governments also need to establish supporting mechanisms. First, they must create consumer awareness and interest. Second, they must create a favourable regulatory environment with incentives to insurance services suppliers to supply services to the poor, and with adequate enforcement mechanisms. Third, they could provide some level of subsidies, at least in the initial phase, for activities in areas such as risk assessment, data collection and actuarial modeling. Fourth, they need to explore alternative insurance schemes, such as community-based schemes for rural populations, as well as alternative distribution channels or mechanisms (e.g. bank account holders receive insurance instead of interest on their deposits). The latter mechanism could be used to distribute health or life insurance, and it would encourage both banking and insurance. A means of subsidizing or capitalizing socially beneficial insurance schemes is a fund through which compulsory contributions of a specified percentage of insurance profits generated by public and private operators are channeled into providing insurance coverage in sectors like rural insurance or microcredit. Finally, the Government may choose to act as a reinsurer in order to encourage private-sector operations in non-profitable but socially important insurance sectors.

Global trends

Market overview[12]

There is a positive correlation between a country's level of development and insurance coverage. This is reflected both in the premium volume generated as a percentage of GDP (insurance penetration) and in the premium per capita (insurance density). Developed countries have a market share of about 88.53 per cent and developing countries have a small share.

World insurance premiums rose from approximately $2.959 trillion in 2003 to $3.244 trillion in 2004,[13] indicating an overall real growth rate of 2.3 per cent.[14] Industrialized countries generate about 88 per cent of world life insurance premiums and account for 90 per cent of the world non-life market. While the collective premiums of industrialized countries[15] were higher than those of emerging markets,[16] the overall real growth rate of the emerging markets for 2004 stood higher, at 7.5 per cent as opposed to 1.7 per cent in industrialized countries, indicating the existence of great potential in emerging markets.

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[11] Sectors where Governments have operated as insurance service providers include social insurance schemes, programmemes relating to unemployment, retirement, disability and survivor benefits, and especially sectors that benefit the rural and lower-income segments of society.

[12] Figures and approximations taken from SIGMA edition No.2/2005, World Insurance in 2004: growing premiums and stronger balance sheets.

[13] Insurance can be divided into life and non-life insurance. World premium volume stood at $1,849 for the life insurance sector and $1,395 for the non-life sector.

[14] The most commonly used indicator of insurance market size is gross direct written premiums.

[15] North America, Western Europe, Japan and Oceania (i.e. New Zealand and Australia).

[16] Latin America, Central and Eastern Europe, South and East Asia, Middle East and Central Asia, Africa.

Insurance penetration for industrialized countries stood at 9.02 per cent, whereas for emerging markets the figure was 3.94 per cent. In both developed and developing countries there are differences in insurance penetration. For example, the figure was 7.40 per cent for South and East Asia, 4.89 per cent for Africa,[17] 2.47 per cent for Latin America and 1.65 per cent for the Middle East and Central Asia. In terms of insurance density, the world average for premium per capita was $602. There is a big difference between the insurance density of industrialized countries ($2,966) and that of emerging markets ($687). Differences can also be observed within emerging markets. For instance, insurance density for South and East Asia was $67.8, for the Middle East and Central Asia it was $48.4, for Latin America it was $90.9 and for Africa it was $43.4. The top 10 global insurance companies are from developed countries.

Table 1. The world's 10 largest insurance TNCs, 2003

(ranked by foreign insurance income, in millions of dollars, and number of employees)

Rank	TNC	Home country	Insurance income		Employment		TNI	Number
			Foreign	Total	Foreign	Total	(%)	of host countries
1	Allianz	Germany	75,230	107,180	90,350	173,750	61.1	62
2	AXA	France	65,120	84,800	85,490	117,113	74.9	46
3	ING	Netherlands	47,990	57,350	80,407	114,344	77.0	58
4	Zurich Financial Services	Switzerland	44,520	48,920	n.a.	58,667	91.0	46
5	Ass. Generali	Italy	38,155	62,500	49,671	60,638	71.5	42
6	AIG	United States	32,718	70,319	n.a.	86,000	46.5	92
7	Munich Re	Germany	27,900	50,900	11,060	41,430	40.7	36
8	Aviva	United Kingdom	26,180	53,480	23,555	56,000	43.8	32
9	Swiss Re	Switzerland	25,540	26,940	n.a.	7,949	94.8	28
10	Winterthur	Switzerland	19,680	27,060	13,865	20,281	66.7	16

Source: J. François Outreville, "Players and Driving Forces in World Insurance Services: Locations and Governance, Paper delivered during the *2005World Risk and Insurance Economics Congress*, 7–11 August 2005, Salt Lake City, Utah, United States of America.

Note: The transnationality index is calculated as the average of two ratios: foreign income to total income and foreign employment to total employment. When employment is not available, only one ratio has been calculated.

Emerging markets, which include developing countries, differ in size, culture, insurance regulation and GDP, which leads to differences in growth rates for both life and non-life insurance. For example, in the life insurance sector, the emerging markets as a whole achieved a real growth rate of 10.5 per cent in 2003. However, within this group, the real

[17] Trends in the African insurance market are largely linked to the dominant S. African insurance market.

growth rate for 2004 was over 25 per cent for Argentina and Hong Kong (China) and only 3.5 per cent for China, Hungary and Israel.

Table 2. Global and regional share of world insurance market, insurance penetration and insurance density[18]

Country/region	Premium volume (2004)[19]	Share of world market (%)	Growth rate in real terms for 2004 (%)	Indication of insurance penetration[20] or premium as percentage of GDP	Indication of insurance density for 2004 (in US$) or premiums per capita
Total					
World	324 3906	100	2.3	7.99	602
Industrialized countries[21]	2 871 690	88.53	1.7	9.02	2 966
Emerging markets[22]	372 215	11.47	7.5	3.94	687
America	1 216 900	37.51	1.8	8.27	1 404.3
North America	1 167 576	35.99	1.4	9.17	3 601.1
Latin America	49 323	1.52	10.5	2.47	90.9
Europe	1 198 184	36.94	3.2	7.89	1 427.9
Western Europe	1 156 511	35.65	3.1	8.41	2 359.5
Central/Eastern Europe	41 673	1.28	5.6	2.97	125.2
Asia	736 036	22.69	2.1	7.40	194.3
Japan	492 425	15.18	–0.9	10.51	3 874.8
South and East Asia	229 558	7.08	9.0	5.19	67.8
Middle East / Central Asia	14 052	0.43	2.6	1.65	484
Oceania	55 177	1.70	3.2	7.65	1 736.9
Africa	37 609	1.16	–1.3	4.89	43.4

Source: Swiss Re.

[18] Figures taken from SIGMA edition No. 2/2005, World Insurance in 2004: growing premiums and stronger balance sheets.
[19] In millions of US$.
[20] Figures for insurance penetration and density is in this section exclude cross-border transactions.
[21] North America, Western Europe, Japan and Oceania (i.e. New Zealand and Australia).
[22] Latin America, Central and Eastern Europe, South and East Asia, the Middle East and Central Asia, and Africa.

Foreign insurers look towards emerging markets for potential markets, new opportunities for risk diversification and demand by foreign investors operating in emerging markets. Developing-country markets hold potential in two ways. First, insurance premiums (and therefore investment funds) are growing in emerging markets driven by large populations and rising standards of living. Second, these are attractive markets for investment. Emerging markets in China, South-East Asia, Brazil and India present attractive potential insurance markets and investment opportunities. The poor performance and the reform process of social security systems in many developed countries, coupled with increased life expectancy and minimal birth rates, have led some developed-country Governments, consumers and shareholders to look to the private sector to maximize returns on their pension plans and shares. Foreign insurance and investment companies in turn may look for attractive markets where their investment turnover is likely to be maximized. Emerging markets may provide such an opportunity.

Recent developments in the insurance services sector

In recent decades, the insurance services sector has undergone a series of changes in both the developed and developing world. Changes in the market structure showed two distinct trends. The first was the gradual move towards privatization and liberalization – either autonomously by countries, through bilateral and regional agreements, or as a result of commitments undertaken in the GATS. The second trend, consolidation of insurance operations, is most pronounced in the global life insurance sector. The reason for this trend is essentially economic efficiency through economies of scale and consolidation of capital and human resources. As markets gradually become deregulated and admit competition, the financial services sector in general is seeing a natural process of mergers and acquisitions. In a competitive market only companies that have a large enough capital base to meet regulatory requirements and still make a profit are likely to survive. Consolidation is taking place across insurance subsectors[23] and within the financial services sector (for example, in the banking and insurance sectors).

Other trends include the following:

Technology and the Internet: Technological developments have brought gains in cost, time and efficiency, which have led to new financial products and easy access to information on insurance companies and their products. Besides serving as a marketing tool, the Internet can be a useful and cheap global distribution channel for insurance products. However, the products sold online appear to be limited to personal insurance products. Larger insurance coverage, such as commercial insurance continues to rely on agents and brokers for advisory inputs. Technology use also makes possible the creation of customer databases and the integration of financial information, especially in risk assessment and monitoring activities.

Break-up of the service being supplied: In the goods and services sector, this trend has been fairly obvious. In the insurance services sector, it could mean the fragmentation of distribution, underwriting, administration and fund management into distinct functions

[23] For example, an insurance operator providing services in MAT and property insurance may choose to consolidate its operatons in property insurance, where it has a comparative advantage, thus achieving consolidation of resources and greater market share.

provided by different entities.[24] This disaggregation could be useful for developing countries, which could then invest in capturing specific markets such as policies administration, marketing, claim settlement/processing and (depending on the level of skills and harmonization of qualifications acquired) fund management, accounting and underwriting.

Closer ties between insurers and banks: Ties between insurers and banks have increased, either through *bancassurance* (a combination of banks and insurers) or conglomerates (broader financial groups). In the past five years, many banks and insurers have joined forces, motivated by expected synergies, economies of scale and higher revenues from cross-selling each other's products, especially in Europe. While the extent of actual synergies remains to be seen, both *bancassurance* and financial conglomerates pose new challenges for regulators. Not only have insurers recently diversified into banking and asset management products, but new, often complex and sophisticated risk management products have been created. These new products create challenges for regulation and supervision in terms of understanding them, identifying their precise impact and deciding on the most appropriate supervisory approach.

Offshore centres: Offshoring centres aim to attract international insurance business by providing an attractive legislative environment, good infrastructural facilities, tax concessions and liberal incorporation requirements.[25] Between 2003 and 2004, the number of financial institutions with offshore operations grew 39 per cent globally.[26] This trend is being replicated, though cautiously, in the insurance services sector.

Still other trends include the shifting focus of regulation from what is being sold to how it is being sold, newer insurance challenges for Governments and investors (such as coverage for terrorist and catastrophe risks) and, given the proliferation of liability cases (particularly in the United States), the emergence and growth of liability insurance.[27]

Benefits and challenges for developing countries from the presence of foreign insurers

The advantages of foreign insurers include substantial financial strength, which enables them to take on risks (especially commercial insurance risks) which domestic insurance companies are unable or unwilling to take on; market credibility globally, which makes international investors more willing to invest; technological and industry know-how; and risk management and asset liability management in the context of international/global markets.

Developing countries, however, have some concerns about the liberalization of the insurance sector. These relate to issues such as the following:

- ***Integrity of the sector:*** Given the importance of the insurance sector in mobilizing savings and investment funds, there are concerns related to

[24] Fragmentation occurs when the chain of events leading up to the delivery of a final product is broken up into various components and these are produced or provided by different business entities.
[25] Malaysia's offshore insurance centre in Labuan is an example.
[26] Deloitte (2005), "Top Ten Issues", Global Insurance Industry Outlook, 2005.
[27] Liability insurance includes employer's liability, product liability, public liability (which covers businesses) and professional liability (which covers professionals such as lawyers, doctors and accountants).

insolvencies, mismanagement of insurance funds and newer financial products, among others.

- ***Anti-competitive practices:*** Admission of large insurers could result in anti-competitive practices, including predatory pricing of insurance products and replacement of government monopolies with dominant insurance firms' products as a result of, among other reasons, privatization. All of this may negatively impact domestic insurance suppliers.

- ***Selective marketing to high-value clients*** (individuals or companies) while lower-value clients and sectors are ignored

- ***The need to promote domestic insurance suppliers and nascent industry***

- ***Potential loss of employment*** in the case of privatization of publicly-owned insurance companies

- ***Weak insurance supervisory and regulatory authorities***

Finally, foreign insurers in emerging markets face difficulties. These include market access barriers, discriminatory insurance regulations, lack of transparency, cultural differences, political risks, alignment of insurance products and services with needs in emerging markets, insufficient insurance expertise and lack of adequately trained insurance professionals, as well as regulatory differences.

Scope and importance of insurance services

Definition of insurance services

Following the Financial Stability Forum,[28] one can classify insurance into three major categories: life insurance, non-life insurance and reinsurance. The WTO W/120 Sectoral Classification List[29] breaks down financial services into (a) all insurance and insurance-related services and (b) banking and other financial services. The former is further broken down into life, accident and health insurance services; non-life insurance services; reinsurance and retrocession; insurance intermediation; and services auxiliary to insurance. The Annex on Financial Services ("the Annex") defines financial services as

[28] The Financial Stability Forum (FSF) brings together senior representatives of national financial authorities, international financial institutions, international regulatory and supervisory groupings (including sector specific ones), committees of central bank experts and the European Central Bank. It was convened in April 1999 to promote international financial stability through information exchange and international cooperation in financial supervision and surveillance. The FSF seeks to coordinate the efforts of these various bodies in order to promote international financial stability, improve the functioning of markets, and reduce systemic risk. See http://www.fsforum.org.

[29] Note that the W/120 differs from the CPC in the following ways (among others): (a) accident and health insurance are included in "life" insurance instead of "non-life" insurance, as in the CPC; (b) reinsurance and retrocession, which were not specifically mentioned in the CPC and were part of a residual category "other insurance services n.e.c.", have been separated out; (c) pension fund management services are set apart from life insurance services and included in asset management services under "banking and other financial services"; and (d) "insurance brokering and agency services" and other services auxiliary to insurance have been regrouped together as a subsector of insurance services. As regards the GATS Annex on Financial Services it goes a step further in the disaggregation of "services auxiliary to insurance" in W/120 by separating "intermediation such as brokerage and agency" from auxiliary services and by specifying explicitly some of those auxiliary services; namely consultancy actuarial, risk assessment and claim settlement services.

any services of a financial nature offered by a financial services supplier. It specifies the inclusion of insurance and insurance-related products. The Annex goes on to list insurance and insurance-related products as:

- Direct insurance, both life and non-life;
- Reinsurance and retrocession;
- Insurance intermediation, such as brokerage and agency services;
- Services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services.

This broad listing of insurance products, coupled with technological developments and the creation of newer hybrid products, has in the current round of negotiations raised issues of classification.[30] Essentially there are three types of stakeholders in the insurance process: the insured (the consumer), the insurer (the provider of a service) and the regulator (generally the Government or an independent authority). Other stakeholders in the sector include actuaries and auditors.

Some sectoral features and trends and their implications

Each insurance subsector has its own peculiarities and implications for developing countries. The following are some features of subsectors that fall into the life and non-life categories.

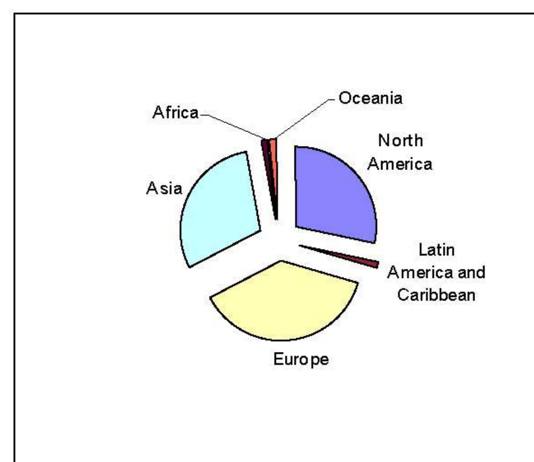
Life insurance

Life insurance (e.g. pension, savings and health insurance) presupposes the existence of a large capital base, good distribution networks and direct selling and marketing. Life insurance has the most potential to benefit lower-income sections of the population. Industrial countries have the largest share of the life insurance market. In terms of insurance penetration or premiums as a percentage of GDP, Japan has the highest (8.26 per cent), followed by Western Europe (5.1 per cent) and North America (4.12 per cent). Among emerging markets, South and East Asian economies lead at 3.77 per cent, followed by Africa, which includes South Africa (3.41 per cent); Latin America and the Caribbean (1.01 per cent); and the Middle Eastern and Central Asian economies (0.47 per cent).[31]

[30] Examples of hybrid products encompassing different financial services include bancassurance and insurance-linked derivates.
[31] SIGMA edition No. 2/2005, World Insurance in 2004: Growing Premiums and Stronger Balance Sheets.

Table 3. Life insurance regional trends for 2004

Region	Premium volume in US$ for 2004	Premiums as percentage of GDP
North America	524 327	4.12
Latin America and Caribbean	19 357	1.01
Europe (includes Central and Eastern Europe)	694 563	4.68
Asia (including Japan)	556 321	5.61
Africa	26 241	3.41
Oceania	27 034	3.75
World	1 848 688	



Source: Swiss Re, SIGMA edition No. 2/2005, *World Insurance in 2004: Growing Premiums and Stronger Balance Sheets.*

Non-life insurance

The non-life sector includes motor insurance, marine aviation and other transport insurance (maritime, aviation and transport (MAT) insurance), fire and property insurance, insurance in international contracts. In terms of insurance penetration or premiums as a percentage of GDP for 2004, North America has the highest at 5.05 per cent followed by Oceania (3.9 per cent), Western Europe (3.2 per cent) and Japan (2.25 per cent). Among emerging markets Africa lead at 1.48 per cent, followed by Latin America and the Caribbean (1.46 per cent), South and East Asian economies (1.42 per cent) and the Middle East/Central Asian economies (1.18 per cent).[32]

For developing countries which are disaster prone, catastrophe insurance is also important as it could help cover heavy damages. Catastrophe insurance maybe difficult to provide for within a local market and hence catastrophe insurers rely on reinsurance companies. Mutual cooperation between Governments and catastrophe insurers to insure a sufficient level of coverage in case of the occurrence of a catastrophe could take the form of tax breaks on catastrophe insurance coverage, sharing of information between the Government and catastrophe insurers, deduction of insurance claims settled by private insurers from claims made on the government relief fund.

[32] Ibid.

Reinsurance[33]

Developing countries often find themselves in the position of being buyers of reinsurance. One of the limiting factors in the reinsurance sector is risk assessment, which presupposes a high level of sophistication and technical know-how. Developing countries could develop an advantage in training of qualified risk assessment experts not only as far as domestic risk assessment is concerned but also to act as reinsurance brokers, where risk has to be placed in the global reinsurance market.

Table 4. Non-life insurance regional trends for 2004

Region	Premium volume in US$ for 2004	Share of world market in 2004 (%)
North America	643 249	46.10
Latin America and Caribbean	29 121	2.09
Europe	503 621	36.10
Asia	179 715	12.88
Africa	11 368	0.81
Oceania	28 144	2.02
World	*1 395 218*	

Source: Swiss Re, SIGMA edition No. 2/2005, *World Insurance in 2004: Growing Premiums and Stronger Balance Sheets.*

Insurance services and regulatory frameworks

Regulation, its importance and elements to consider

Broadly speaking, the role of the regulator in the insurance sector is to ensure the viability, integrity and stability of the financial system, as well to ensure that public confidence in the institutional financial structure of the economy as a whole is maintained. Given that the insurance sector is rather heterogenic and increasingly complex, its regulation and supervision are considerably complicated.[34] In addition, during the last two decades, the rapid development of the insurance sector has made it difficult for regulators to keep up with the changes in the structure of the industry. Finally, the fact that financial conglomerates are frequently subject to multiple regulatory agencies creates coordination problems between regulators, possibly even leading to problems of regulatory arbitrage.

In developing countries, regulatory infrastructure is often minimal or inadequate leading to a gap between insurance regulatory frameworks in developing and developed countries. However, even developed countries have been faced with failures. Examples include Australia's experience with HiH, the country's second largest non-life insurer (the

[33] Broadly, this covers insurance for insurance companies.
[34] Based on Das, Davies and Podpiera, Insurance and Issues in Financial Soundness, July 2003, IMF Working Paper WP/03/138.

company's failure led to the halting of construction projects and bankruptcy of small businesses), or Japan's experience with the accelerated financial deregulation after the late 1980s (which led to a collapse of eight mid-sized life insurers during 1997–2001), as well as the Republic of Korea's experience after the 1997 financial and currency crisis (which resulted in massive nonperforming loans, including both banks and insurance companies).

Across countries, the regulation and supervision of the insurance industry is far from consistent. This is despite recent efforts of the International Association of Insurance Supervisors (IAIS). For example, even among developed countries there are great differences with regard to capital adequacy and reinsurance supervision (where supervisory practices vary considerably even within the European Union). Given the high mobility of capital, these inconsistencies create the danger of leaving regulators and supervisors ill-equipped to monitor the financial strength and risk profiles of insurers and reinsurers. This in turn, can have negative implications for financial stability as such.

A review of several episodes of the failure of life insurance suggests that the main factors placing an important role include: (a) financial deregulation and liberalization, which allowed insurers to assimilate banking-type activities; (b) large macroeconomic fluctuations both in output and price levels; and (c) close business linkages between banks and insurers.

A well-functioning and efficient insurance services sector requires legislation which provides for the role, functions and powers of an independent supervisory authority. Developing countries face the added challenge of having to deal with quickly evolving domestic insurance markets that are affected by global trends in the insurance sector. Based on the focus of regulation, insurance regulation can be looked at from different perspectives, including market-impacting regulation and the regulation of market conduct, prudential regulation and transparency/information regulation.

Market-impacting regulation or the regulation of market conduct

The first area Governments seek to regulate are entry requirements to ensure that financially weak or non-credible insurance companies are not admitted into the domestic market. These restrictions can take the form of licensing requirements, specified organizational requirements, ownership restrictions, restrictions on operating in areas other than insurance such as banking or securities and separation of activities in different insurance subsectors. Well-functioning financial reporting and monitoring ensures compliance and timely intervention in case of mismanagement/non-compliance thereby minimizing the risk of insolvency. Corporate governance requirements presuppose the existence of efficient internal control by management of procedures and policies followed in the insurance company. It includes the use and supervision of qualified accountants and actuaries, who play an important role in providing an accurate picture to the supervisor, consumer and shareholder of the financial health of the company.

Prudential regulation

Prudential regulations are measures the compliance of which allows an insurer to continue its operations within a given market. Prudential laws and regulations cover a broad range of aspects related to the operations of insurers ranging from consumer protection to establishment of reasonable solvency standards. The objective of prudential

regulation is to ensure the security and solvency of the market and protect policyholders even if insurers fail. In that context, the prudential regulation also ensures the integrity and stability of the financial system. Prudential regulations set by the regulator that insurance companies are required to comply with include the following:

- Adequate entry requirements, capital adequacy and solvency margins, which insurance companies are required to maintain as a hedge against unexpected changes, as well as asset quality, requirements for business operating plans and estimates, and requirements for actuarial and auditing;

- A system to monitor operations (effective reporting and accounting practices; continuous monitoring of capital adequacy, solvency, reserves and investment);

- Technical provisions, which serve the purpose of meeting arising liabilities – an inaccurate estimation may lead to financial difficulties, insolvency or loss of credibility;

- Regulations pertaining to the investments of insurance companies, which are generally focused on the investment of premium money and the need to ensure reasonable rates of return on investments made.

To complement prudential regulations for consumer protection also other measures, such as public complaints processing, consumer education and information and adequate policyholder protection solutions are worth to be considered.

Indicators for the insurer's financial soundness can help. The following indicators have been identified,[35] most of which are relevant for both life and non-life insurance: capital adequacy, assets quality, reinsurance and actuarial issues, management soundness, earnings and profitability, liquidity, market-based indicators, group exposures.

The extent of government regulation of investment funds is an important question, which, in fact, is further complicated by the changing nature of financial products (e.g. high return/high risk) and their markets. While proponents of liberal investment rules suggest allowing insurers to maximize returns as they deem fit (including by investing in foreign markets), there is also an important role for regulators, in terms of setting out investment regulations[36] to avoid the collapse of insurance companies. An added objective for the regulator has been the reliance on the insurance sectors for investment into the economies infrastructural development and related sectors often through the purchase of specified instruments such as government bonds, real estate, secured loans, investment in local stock markets, etc.

Information-gathering is a valuable tool in the hands of the regulatory authority. Information could be transmitted through reporting requirements or at the behest of the regulators. The regulator could conduct on-the-spot checks, employ constant vigilance to determine unusual behaviour and hold regular meetings with the private sector and insurance associations. While insurance professionals such as agents/brokers and actuaries can play an important role, their role may also be misused leading to fraud and

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[35] See above.

[36] For example stipulations that investment of insurance premium income is in a diversified basket of investments.

other exploitative practices. Regulation relating to insurance professionals could include registration, requirements regarding years of experience and specific knowledge of insurance products, a code of professional conduct, limits on the commission percentage that can be demanded by intermediaries, and bank guarantee. The insurance supervisors also look into cases of non-conformity, insolvency and anti-competitive practices. In cases of non-conformity with insurance legislation or regulation, the insurance supervisor may provide for a consumer redressal forum. In the case of insolvencies and mergers/acquisition, the question arises as to who would take on the insurance claims of the insolvent/acquired insurance company. Certain countries have set up a safety net in the form of guarantee funds.[37] Finally, the insurance supervisor can play an important role in controlling and preventing abuse of dominant position, ensuring competition in the fixing of insurance rates and thereby the price of the insurance product, and preventing the formation of cartels.

Regulation and its interlinkages with international standards

In an increasingly globalizing world, government regulatory activities encounter challenges arising from the linkages between the national and international levels. Two of these potential linkages are of particular interest for developing countries and their participation in international trade in insurance services: (a) trends towards the harmonization of prudential measures as well as the development of international standards for insurance services more broadly; and (b) the fact that the GATS refers to international standards and, in the Annex on Financial Services, sets out a carve-out for prudential measures.

Harmonization of prudential measures and the need for international standards

Linkages between different countries' financial services sectors are increasing. For example, the effects of the financial crises of the 1990s were not confined to those countries where the crises originally arose, and regulatory responses may need to reflect the greater connectedness between markets and economies. International standards in insurance services, can contribute to the important goal of preventing and correcting financial sector instability.

From a business perspective, harmonization can also help create favourable conditions and a level playing field for investors, thereby facilitating easy operation of foreign insurance service suppliers. There is currently a move towards international standards in the insurance services sector. There are efforts to define those measures which may be resorted to for prudential reasons. Relevant international standards and guidelines for the insurance sector include primarily those formulated by the International Association of Insurance Supervisors (IAIS), the General Accepted Accounting Principles (GAAP), the International Financial Reporting Standards (IFRS),[38] the Basel Committee and the

[37] Guarantee funds are used in the United States of America (State of New York), the United Kingdom, the European Union and Canada, they are generally administered by the Government but may also be administered by the insurance industry. Thailand set up the Insurance Stabilization Fund to handle insolvency cases.

[38] Twenty insurance guidelines issued by the OECD (decision of the OECD Council on the exchange of information between reinsurers and the OECD guidelines for insurers governance, April 2005) and the OECD Code of Liberalization of Current Invisible Operations (this includes insurance and stipulates that member States must deal with the authorization of a current invisible transaction in the most liberal and non-discriminatory manner).

International Organization of Securities Commission (IOSCO), and those originating from the OECD.

Together with other OECD bodies, the OECD Insurance Committee works to promote liberalization of investment and other cross-border operations of insurers. This work includes the development of principles and standards related to insurance market liberalization; work to revise the OECD Codes; insurance guidelines for emerging economies; and other activities (e.g. development of guidelines for the governance of insurance companies and pension funds). Some of the OECD's work (such as work to promote regulatory awareness) extends to non-OECD member countries.

Box 3. The work of the International Association of Insurance Supervisors

The International Association of Insurance Supervisors (IAIS), a private-law-based international organization open to insurance authorities from all over the world (currently with 160 members and 70 observers, including individuals), promotes cooperation between insurance regulators and supervisors. To achieve this goal, the IAIS develops various principles and standards (through consensus), including the *Insurance Core Principles* (on capital adequacy and solvency standards, reinsurances, disclosure and cross-border business transactions); the *Supervisory Standards on Capital Adequacy and Solvency* (on prudential regulation and supervision of, among others, policy liabilities, assets, and capitals); the *Supervisory Standard on Reinsurance Companies* (covering how reinsurers should be supervised); the *Disclosure Standard (*on public disclosure requirements by insurers); and *Standards on Cross-Border Business Transactions* (insurance concordat on best practices for cooperation between supervisors dealing with international operations). With their Financial Sector Assessment Programme, the IMF and the World Bank assess the extent of implementation by authorities. The IAIS also encourages identification of weaknesses in the supervisory system (e.g. through assessment of observance) and addressing the weaknesses (e.g. by incorporating the principles and standards into national legislation). Work towards this goal includes self-assessment programmes, learning material for supervisors, regional seminars and technical assistance.

At the same time, harmonization of insurance sector regulation gives rise to a series of questions. One relates to the fact that each country may need to design its prudential and other regulatory measures according to the specificities of its economic and developmental situation (which leads to differences in the types of measures implemented). Particularly for developing countries, this may require a gradual approach to the adoption of global standards, keeping in mind individual policy objectives and resources.

Another relates to the fact that standard-setting bodies could be used to assess countries' prudential regimes. It has been suggested that the joint IMF/World Bank Financial Sector Appraisal Programme (FSAP) be used for this purpose.[39] While regulatory assessments can improve the understanding of best practices followed by other countries, differences in national insurance regulation as well as in the economic and institutional underpinnings

[39] The FSAP programme is aimed at identifying a countries weakness in the FS sector and identifying priority areas, based on internationally agreed standards.

of countries' financial services sectors suggest that any such best practices cannot be rigorously applied across the board. Technical assistance, including for the development of local expertise and appropriate institutional structures, as well as flexibility in the design and implementation of regulatory systems in accordance with national insurance policy objectives are likely to be key.

A third question relates to the fact that developing countries frequently lack the necessary resources to effectively participate in international standard-setting processes. In 2004, Antigua and Barbuda, on behalf of several other small and vulnerable economies, raised this issue in the WTO Committee on Financial Services. More specifically, Antigua flagged the need to ensure that international regulation of financial services becomes an inclusive process for small developing-country members.

These questions are even more important in light of the fact that the GATS refers to both, international standards as well as measures for prudential reasons.[40]

Article VI:5 (b) of the GATS, for example, sets out that a determination of a member's conformity with certain GATS obligations shall take into account international standards of relevant international organizations applied by that member.[41] Thus, international standards may play an important role. Interestingly, the GATS explicitly refers to international standards applied by a member, as opposed to international standards as such. Possibly, this is a response to the fact that in the area of "services", international standards are much/to date less developed than in the area of "goods".

Besides article VII of GATS (which addresses recognition, including by encouraging the acceptance of multilaterally agreed criteria and the development of criteria for mutual recognition (para. 5)), paragraph 3 of the Annex on Financial Services deals with recognition. In fact, paragraph 3 specifically addresses prudential measures and, in lit. (a) states that "a Member may recognize prudential measures of any other country in determining how the Member's measures relating to financial services shall be applied". It further states that recognition may be achieved through harmonization or otherwise, including on an autonomous basis. Subsequently, in lit. (b), it requires members who are part to such an agreement to grant other members adequate opportunity to accede to or to negotiate comparable agreements, as well as procedures for information sharing. In 1997, WTO members adopted the Guidelines on Mutual Recognition in the Accountancy Sector. These guidelines are voluntary and nonbinding and are aimed at facilitating the negotiations of mutual recognition agreements (MRAs) in the accountancy sector as well as accession of third parties to existing ones. The Guidelines cover both the negotiating process and the substance of the agreements.

The prudential carve-out

Article VI of the GATS covers domestic regulation. For sectors where a member has undertaken specific commitments, it requires the reasonable, objective and impartial administration of regulations pertaining to services trade. Article VI also aims to ensure that domestic regulations do not constitute unnecessary barriers to trade in services, and do so, amongst others, by providing a negotiating mandate for any necessary disciplines

[40] Paragraph 2 (a) of the Annex on FS also addresses prudential measures.

[41] "Relevant international organization" is described as an international body whose membership is open relevant bodies of at least all members of the WTO.

to that effect.[42] Over time, there have been concerns about the extent to which article VI, and any future disciplines developed under it, could constrain domestic regulatory prerogatives. The challenge in current negotiations of future disciplines is to navigate between establishing specific and effective disciplines to secure market access (including in sectors and modes of export interest to developing countries) and preserving domestic policy flexibility and the right to regulate.

Also the Annex on Financial Services contains a provision on "domestic regulation". Paragraph 2 of the Annex sets out the "prudential carve-out", stating that, "notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons…." This provision raises a series of important questions, including about what exactly, are "measures for prudential reasons". According to the Annex, these include measures "for the protection of investors, depositors, policyholders or persons to whom a fiduciary duty is owned by a financial services supplier, or to ensure the integrity and stability of the financial system". This language suggests that the list is indicative, identifying some but not all prudential measures. The exact nature of such measures, including their nature in the context of insurance, as opposed to other financial services remains to be clarified.

Given the leeway the above language might entail, some members have suggested that there is a need to clarify what is covered by the prudential carve-out. Some developed countries (having moved towards international cooperation in the banking and insurance sectors) view a clear definition of prudential regulation to be useful. It would help increase transparency, including for foreign insurance suppliers (e.g. EC, Canada, Australia, Switzerland and the United States). The EC and Switzerland have also suggested for domestic regulatory reform to reflect international standards developed by competent international organizations/international forums outside WTO.

Others, however, are more cautious. Developing countries refer to the complexity of issues involved and to the fact that prudential measures are essential for the integrity and stability of the financial system. A too narrow interpretation of the prudential carve-out may weaken the right to regulate which is central to the GATS. In sum, the challenge is to understand prudential measures in a manner broad enough for prudential objective, but also not too broad so as to undermine the purpose of GATS regarding security, predictability and liberalization of services trade.

Additional complexities arise from language stating that prudential measures can be taken "notwithstanding any other provisions of the agreement" and that "where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member's commitments or obligations under the Agreement."

These questions are significant, not only because of the sensitivities surrounding the insurance sector or the fundamental role the sector plays in a country's economic development, but also because they can be subject to WTO dispute settlement. Interestingly, paragraph 4 of the Annex requires that dispute settlement panels on prudential issues "shall have the necessary expertise".

[42] More specifically, article VI.4 also states that "[s]uch disciplines shall aim to ensure that such requirements are, inter alia: (a) based on objective and transparent criteria, such as competition and the ability to supply the service; (b) not more burdensome than necessary to ensure the quality of the service; (c) in the case of licensing procedures, not in themselves a restriction on the supply of the service."

Insurance services in the GATS and developing countries

GATS and insurance services

Provisions relevant to insurance services are included in: the GATS Agreement, the Annex on Financial Services, the Understanding on Commitments in Financial Services and individual members' schedules of specific commitments. Through its objectives and principles of progressive liberalization and positive listing of specific commitments, the GATS allows WTO members to carefully determine the extent of liberalization they wish to commit to. Along these lines, a member may choose to (a) select sectors and modes of supply; (b) schedule market access restrictions such as numerical limitations on insurance licences or foreign equity caps on insurance subsectors; (c) limit access to foreign suppliers by scheduling national treatment limitations such as residency requirements for senior management; (d) take additional commitments, with respect to measures which are not subject to scheduling under articles XVI and XVII, including those regarding qualifications, standards or licensing matters.

The Understanding on Financial Services provides an alternative mechanism for scheduling deeper commitments. As a voluntary tool, to date, the Understanding applies mostly to developed countries (apart from Nigeria and Sri Lanka). However, in current negotiations, developing countries are requested to subscribe to some, if not all, of the provisions of the Understanding. While the Understanding sets out rather detailed rules, even if WTO members agree to make commitments according to the Understanding, they retain some flexibility in so far as they can add conditions and limitations to their commitments. Members using the Understanding do so on an MFN basis.

The Understanding gives details about the sectoral scope and substantive nature of financial services commitments. For Modes 1 and 2, it lists the specific insurance services that would be covered (e.g. insurance of risks relating to, amongst others, maritime shipping, commercial aviation; goods in international transit; insurance and retrocession; provision and transfer of financial information, financial data processing and advisory and other auxiliary services). For Modes 3 and 4, however, the sectoral coverage is open-ended to all financial services. The Understanding also specifies the nature of the commitments (e.g. for Mode 1 to permit non-resident suppliers of financial services to supply, as a principal, through an intermediary or as an intermediary, and under terms and conditions that accord national treatment; for Mode 3, the right to establish or expand within the member's territory, including through the acquisition of existing enterprises, a commercial presence[43]). Finally, the Understanding contains provisions on: standstill; government procurement; new financial services (requirement to permit suppliers established in its territory to offer in this territory any new financial service); transfer and processing of information; best endeavour commitments to remove certain non-discriminatory measures; additional definitions (e.g. for "commercial presence") and clarifications (on national treatment).

[43] Note that for Mode 3, the Understanding also adds that, under certain conditions, "[a] Member may impose terms, conditions and procedures for authorization of the establishment and expansion of a commercial presence".

In article XIX, the GATS mandates WTO members to conduct successive rounds of negotiations, with a view to progressively liberalizing trade in service. Having started in 2000, these built-in negotiations were subsequently folded into the Doha work programme which places the needs and interests of developing countries at its heart. The work programme reaffirms the Guidelines and Procedures for the Negotiations adopted by the Council for Trade in Services on 28 March 2001 as the basis for continuing the negotiations, with a view to achieving the objectives of the GATS, as stipulated in the preamble, article IV and article XIX of that Agreement. The deadline for submitting initial request for specific commitments was set for 30 June 2002, and initial offers for 31 March 2003. In 2004, the 1 August WTO General Council Decision provided for a new timeline for the tabling of revised offers (May 2005) and called for high quality of offers, particularly in sectors and modes of supply of export interest to developing countries, particularly in Mode 4. Request and offers in insurance services, GATS Rules (Subsidies, Emergency Safeguards Mechanisms and Government Procurement) as well as future disciplines on domestic regulation are part of these negotiations.

Classification

The Annex on Financial Services broadly sets out definitions of what amounts to insurance and insurance-related services.[44] Given that this classification differs from the United Nations Central Product Classification (CPC), there are potential for conflict and lack of consistency or adequate coverage in definitions. This is also reflected in the scheduling of commitments.

Several members endorsed the use of the Annex as a basis, since it is more comprehensive and disaggregated than the W/120 and this will also improve clarity. Some found that broad Annex definitions provide enough flexibility for emerging services and different regulatory approaches (based either on the content of services provided or the nature of the institution). Others found that the Annex is not comprehensive enough to include new products such as electronic merchanting systems or other activities such as venture capital, electronic bill presentment and securitization.

However, it has also been pointed out that broad definitions can lead to conflicting interpretations and leave central questions to dispute settlement. The evolving nature of the global insurance sector further exacerbates this situation. A WTO background note[45] explains that the GATS classification is well adapted to new products, as it is based on the content of services supplied. Some members face difficulties translating their domestic laws formulated on the basis of financial institutions into their GATS commitments.

Switzerland proposed reviewing the entire classification system for financial services so as to take into account (a) differences in domestic regulatory structures, (b) new financial products that may be classified in more than one sector, and (c) emerging trends (e.g. bancassurance) that make existing distinctions obsolete.[46] Specifically regarding insurance, Norway suggested new definitions of marine and energy insurance and

[44] Section 5 of the Annex on Financial Services, defines insurance services as: (i) direct insurance to include life and non-life insurance; (ii) reinsurance and retrocession; (iii) insurance intermediation including brokerage and agency services; and (iv) auxiliary services such as claim settlement, consultancy services, actuarial risk assessment, etc.

[45] Background note on financial services, WTO secretariat, 2 December 1998, S/C/W/72.

[46] Communication from Switzerland to the Council for Trade in Services Special Session, S/CSS/W/71, 4 May, 2001.

suggested broadening the definition used in the Understanding to include insurance services with regard to passenger transport and larger fishing vessels. On energy insurance, the proposal suggests insurance of the commercial upstream or "offshore" segment of the market such as exploration, development, production activities and properties of petroleum sector, both onshore and offshore.

Services supplied in the exercise of governmental authority

Setting out the scope of the GATS, article I:3 (b) specifically excludes "services supplied in the exercise of governmental authority" from the coverage of the agreement. In paragraph 3(c), the provision clarifies that services excluded are those which are not supplied on a commercial basis or in competition with one or more service suppliers. This provision has given rise to an intense debate about what sort of services, exactly, would be covered by this carve-out.

The Annex provides some clarification on this issue as regards financial services. First, it states that the above-mentioned paragraph 3(c) definition "services supplied in governmental authority" shall not apply to financial services covered by the Annex. Second, it lists three types of services which are considered "services in governmental authority" and are therefore excluded from the Annex: (a) activities conducted by a central bank or monetary authority or by any other public entity in pursuit of monetary or exchange rate policies; (b) activities forming part of a statutory system of social security or public retirement plans; and (c) other activities conducted by a public entity for the account or with the guarantee or using the financial resources of the Government). Third, it specifies that any of the activities listed under (b) or (c) above will, if they are provided by financial service suppliers in competition with a public entity or a financial service supplier, no longer be considered a "service supplied in governmental authority" and will therefore no longer be excluded from the coverage of the Annex.

Uruguay Round commitments

Among the 11 services sectors covered by W/120, the financial services sector ranks second in terms of numbers of commitments (with tourism registering the highest). As of March 2005, 81 per cent of members had committed to at least one of the subsectors falling under financial services. Country participation was highest in Eastern Europe, where all seven countries made commitments. Among African countries, only 13 out of 41 WTO members made commitments. In Latin America, 18 out of 32 members have commitments, while in Asia, 17 out of 25 have commitments. Regarding the extent of bindings, there are considerable differences, with four small countries, Bahrain, Gambia, Guyana and Solomon Islands committing fully to Modes 1, 2 and 3. Mode 3 is the mode where members demonstrate relative willingness to guarantee unrestricted entry, with Eastern Europe representing potentially the most liberal market for foreign service suppliers. Among the conditions countries maintain are limitations on the types of legal entity, the number of suppliers, foreign equity participation and investment across financial institutions, along with certain nationality and residency, authorization and licensing requirements. Some have also included the application of economic needs tests and reciprocity conditions for entry.[47]

[47] Aaditya Mattoo, "Financial Services and the WTO: Liberalization in the Developing and Transition Economies," 16 March 1998, WTO staff working paper.

Current status of GATS negotiations on insurance services

Market access and national treatment proposals

The following are selected aspects of current proposals relating to market access and national treatment:

- ***Identifying sectors for further liberalization*** (e.g. intermediation and auxiliary services including, actuarial, risk assessment and claims settlement services; life insurance; reinsurance and retrocession; transport services and reinsurance; marine aviation and transport)

- ***Identifying the nature of commitments/the removal of limitations*** (removal of mandatory cessation requirements; dismantling of State-run monopoly insurance companies)

- ***Identifying modes for further liberalization*** (developed countries have asked for Mode 4 commitments in terms of temporary entry of natural persons, including the temporary movement of intra-corporate transferees and contractual service suppliers, nationality and residency requirements for executives and employees, and the reduction of limits on the number of foreign employees)

- ***Identifying cross-cutting issues*** (most proposals underlined transparency issues as important for reducing trade effects of post establishment regulatory barriers and some propose to schedule commitments according to the Understanding)

Modes 1 and 2

Developing countries have expressed concerns regarding Mode 1 and 2 liberalization given the sensitivity and importance of the financial services sector and weaknesses of their supervisory and regulatory frameworks.[48] It has been pointed out that any liberalization should take into account the financial, monetary and exchange policies of the countries concerned. Mode 1 specific concerns relate to volatile capital movements, which is further exacerbated by technological changes and the blurring distinction between Mode 1 and 2. Switzerland has recommended reassessing commitments in Modes 1 and 2 highlighting the need for greater homogenization and perhaps the possibility of merging the two modes in financial services. For developing countries, it could be useful to look at specific insurance subsectors which could benefit from liberalization in Modes 1 and 2 and which cannot be provided domestically as they may require a large capital base and technical know how.

Initial and revised offers

Those developing countries which consider it necessary to preserve some local presence in the financial services sector use a series of limitations, including: domestic equity participation, local content and technology transfer requirements or quotas for local personnel. Restrictions on commercial presence, quotas, including restrictions on the geographical expansion of foreign banks and ENTs are also used.

[48] Specifically in sectors like reinsurance and marine, aviation and transport insurance.

Developed countries, which are key players in financial services-related activities, request for further liberalization in this sector, for example, by addressing caps on foreign equity participation. Other barriers to trade in insurance services include: restrictions on the type of legal entity (e.g. joint venture requirements), limitations on real estate purchase or rental, discriminatory tax and subsidy measures, nationality requirements, unspecified licensing and authorization requirements, ENTs, quotas, existence of monopolies, mandatory cession requirements, limitations of economic activity through geographical restrictions, minimum capital requirements, nationality and residency requirements for high-ranking personnel and/or board of directors.

Besides requests for reducing barriers to trade and classification issues (see above)[49] also regulatory issues have figured prominently in the current round of service negotiations. Members agree that an appropriate regulatory framework is a prerequisite for opening financial markets. Accordingly, members expressed their views about where to continue discussions on improving transparency: either sectorally (i.e. in the Committee on Trade in Financial Services) or in the Working Party on Domestic Regulation. The latter has received more support than the former. Countries also acknowledged the need to consider the relationship between any future disciplines on domestic regulation and the "prudential carve-out." Some developing countries expressed concern about the prescriptiveness of current proposals on transparency and their possible impacts on a member's right to regulate and to pursue national policy objectives.

Based on a recent summary of discussions,[50] some members have mentioned their interest to see the following elements in future offers: (a) the use of the Annex for scheduling commitments; (b) more Mode 3 commitments, preferably full binding or at least the right to establish new and acquire existing companies in the form of wholly-owned subsidiaries, joint ventures or branches; (c) commitments on Modes 1 and 2 in appropriate subsectors; (d) elimination of national treatment and market access limitations including discriminatory application of certain laws and regulations and non-discriminatory limitations such as monopolies, numerical quotas, or economic needs tests; and (e) transparency in the development and application of laws and regulations, and speedy and transparent licensing procedures.

As regards offers, 32 (out of 68) offers have been made with respect to insurance and insurance-related services. The main features of offers across country groups are: *Developed countries*: while there has been a reduction or elimination on restrictions relating to the geographical application of existing limitations, limitations relating to establishment, types of transactions and nationality requirements for Board of Directors, horizontal restrictions on investments (including limitations on type of legal entity and limitations on foreign equity participation, taxation, subsidies and purchase of real estate and on Mode 4) remain. Along these lines, limitations maintained include limitations on the provision of insurance activities (e.g. only through incorporation under provincial statutes, reciprocal insurance exchanges). *Developing countries*: some improvements regarding their insurance and insurance-related offers:, including the removal or improvement of foreign equity limitations, limitations on the type of legal entity, ENTs, or asset requirements. The phasing-in of commitments resulted in the expansion of

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[49] On scheduling, issues raised include: (i) the adoption of the Understanding on Commitments in Financial Services ("Understanding") in scheduling commitments; (ii) the discussion of the distinction between modes 1 and 2 and to (possibly) arrive at a common understanding of the matter.

[50] "Sectoral and modal objectives as expressed by members", Job(05)/237/Rev.1, 26 October 2005.

geographic coverage of the commitment as well as the expansion of the type of activities the provision of which is permitted. Some members also made new commitments.

Box 4. Transparency proposals

Transparency (for financial services in general and insurance in particular) has been the subject of proposals and discussions in current WTO negotiations. Main elements of the proposed transparency framework on financial services include: (I) *for new regulations or amendments*: (a) prior comment; (b) publication of the final text (and as appropriate addressing substantive comments received); (c) a mechanism to respond to public inquiries; (II) *for the application of regulations*: (a) public availability of all laws, regulations, procedures and administrative or judicial decisions of general application; (b) reasonable advance notice before requiring compliance with new/amended regulations; (c) listing activities requiring authorization or licence to supply a service (plus respective procedures/criteria); (d) information about reasons possibly justifying denial; (e) information on types of conduct, practices, and activities, the violation of which could result in disciplinary actions (plus information on respective procedures); (III) *other principles*: (a) independence of the regulator; (b) acknowledging receipt of an application and informing the applicant of licensing and authorization decision within reasonable period of time; (c) upon request – giving reasons for denial of authorization or licence and allowing for resubmission of an application; (d) procedures for review/appeal of administrative decisions, and for the service supplier to submit its views; (e) reasonableness of administrative requirements (e.g. fees). More specifically as regards the insurance sector, it was mentioned for WTO members to: (1) not limit the ability of insurance service suppliers to provide information on their credit worthiness to the public; (2) make financial reporting information available to the public; (3) make regulations governing identification and handling of financially-troubled institutions available to the public; (4) mechanisms to accelerate the offering of insurance products by licensed suppliers; (5) avoiding certain requirements for product filing or approval; (6) allow the introduction of new products which will be deemed to be approved if no action is taken to disapprove them within a reasonable period of time; (7) avoid limits on the number/frequency of new product introductions.

Other approaches to liberalization

While the main method of negotiations is the request/offer method, some have suggested "complementary approaches". Proposals differ in details, but concur in using simple and artificially-set cross-sectoral, formula-type approaches, establishing quantitative and qualitative criteria to which individual offers should correspond. Some proposals suggest complementing multilateral baselines with more ambitious plurilateral initiatives, and ultimately a continuation of the bilateral request/offer process.

One of the proposals (by Japan) also offers specific ideas for complementary approaches in financial services. For example, it suggests undertaking commitments in all subsectors; commitments in Modes 1 and 2 in accordance with the "Understanding"; or a focus on Mode 3 (elimination of: limitations on foreign equity participation; on types of legal entity and on the total number of suppliers). Given the importance of Governments' regulatory activities, it may be useful to carefully consider the potential implications of

such proposals. Many developing countries are of the view that complementary approaches would reverse the logic and spirit of the GATS and the Negotiating Guidelines, and that this could lead to a substantial loss of current, built-in flexibilities. In addition, complementary approaches could not fully take into account the complexity of services sectors and their regulatory frameworks. Issues to be considered are: possible challenges of complementary approaches as regards insurance services; reduction of regulatory flexibility; changes in legal regimes, which are based on historical, social and developmental considerations; assigning negative scores to limitations (e.g. those referring to legal or institutional forms or those reflecting societal differences).

A model schedule for future commitments in insurance services has also been proposed,[51] with the objective of addressing effective market access for insurance providers. The model schedule would have two parts: one for commitments in the market access and national treatment columns (both for new as well as improved commitments), and one taking the form of additional commitments, covering domestic regulation type of measures (in the form of best practices). While the first part would be upon individual members to adopt, the second part would be uniformly adopted by a critical mass of countries.

Conclusions

Some areas at which developing countries may wish to look from a broader perspective include:

- ***Building supply capacity:*** Creating domestic capacity either locally or in cooperation with other emerging markets and regional counterparts can be achieved through: (a) an exchange of technical and managerial skills and human resources; (b) financial cooperation by encouraging South-South insurance trade while putting in place effective capitalization and regulatory requirements; (c) information pooling which can include exchange of databases and access to information.

- ***Training insurance professionals:*** There is a need to develop homegrown talent to staff the private sector, the public sector and the insurance regulator. Given the technical nature of the insurance sector in terms of calculating premiums, rate setting, underwriting etc. and given the fact that these components get more complex within specific subsectors, in specialized areas (like actuarial services, accountants, brokers/agents) and newly emerging areas training is essential. This could be achieved by setting up specialized schools for the training of insurance professionals, through the exchange of insurance professionals within the private sector domestically and internationally, through private-public partnerships exchanges or through intergovernmental exchanges for supervisors from developing countries.

- ***Regulatory frameworks:*** The regulator performs a key role in terms of ensuring the viability, integrity and stability of the financial system and that public confidence in the financial structure of an economy is maintained. However, the heterogenic and increasingly complex nature of the insurance sector (including

[51] The Financial Leaders Group, to which associations from developed countries have subscribed.

because of the fact that financial conglomerates are frequently subject to multiple regulatory agencies) makes the regulation and supervision of the insurance sector considerably complicated. Additional challenges arise from the rapid changes in the insurance sector over the last decades, which have made it difficult for regulators, to keep up with developments of the industry. While also developed countries have experienced failures, challenges are bigger for developing countries, whose regulatory infrastructure frequently remains minimal or inadequate.

- ***Public awareness:*** Enhancing consumer information as to insurers' prices, products and financial strength is essential to a well performing market, especially regarding to small value customers in areas like life insurance.

Other areas for consideration include:

- ***Technology:*** Besides facilitating cost cutting, distribution and information sharing, technology can also prevent fraudulent practices. For example for the supervisor an online system of regulation, which individual insurance companies are required to constantly update could be a useful tool in the prevention of insolvencies.

- ***Need for exchange of information and views between all stakeholders:*** This could include the private sector, supervisors, professional insurance associations and consumer associations.

- ***Foreign exchange regulations:*** As in most financial services, the insurance services sector is susceptible to volatile and large cross-border transfers of capital potentially in sectors such as reinsurance and MAT. On the one hand, resort to international reinsurers and MAT may be a necessity; on the other hand, it may entail large outflows of capital either in terms of premium payment or in terms of claims made where a domestic insurance company is providing either reinsurance or MAT coverage to a foreign consumer or a local consumer resident abroad.

In view of its longstanding work on insurance, UNCTAD can make an important contribution in assisting developing countries in the field of insurance. Some issues for further consideration and research include:

- What is the contribution of the insurance sector to economic and human development? What measures can Governments/regulators put in place to maximize benefits and minimize challenges arising from international trade (and investment) in insurance services? What are the regulatory challenges arising from the global/international nature of such trade, including in terms of cooperation, monitoring and enforcement? What are possible responses at the national and international levels?

- What are the impacts of liberalization, privatization, and increasing investment in the insurance sector? Do impacts differ across countries? What are the trends and similarities?

- What are the measures, which Governments/regulators can take to improve domestic efficiency and to address supply capacity constraints in developing

countries insurance markets? More broadly, what is the role of Governments, both as a regulator and as a provider of insurance services?

- What effects can economic and financial crises have on the growth of the insurance services sector, on employment and on economic development? What can governments/regulators do to minimize the potential of such crises?

- What possible impacts would the consolidation and restructuring of financial sectors have on financial services trade? Will they enhance competition and consumer welfare?

- What are the implications of technological innovations on the structure of financial services industries and markets?

- What are the implications of the international nature of insurance services transactions? What regulatory challenges may arise? What are possible responses both at the national and international levels?

- Is there a general trend towards the privatization of State-owned financial institutions in countries? If so, what effect has it had on the structure of the financial industries and markets, and what regulatory challenges do these changes bring about?

- How can the GATS and ongoing negotiations to liberalize services, including on domestic regulation, trade reflect the current realities in the insurance sector and respond to development challenges in the sector? What are the potential impacts of recent suggestions on complementary and other approaches?

- What technical challenges do WTO members face? Have they encountered any problems in interpreting the scope of prudential measures as defined in the GATS Annex on Financial Services?

- What are the key technical assistance and capacity-building needs of developing countries as regards international trade in insurance services?

Annex 1

The world's leading insurance countries, 2004 (direct premiums written, US$ billion)

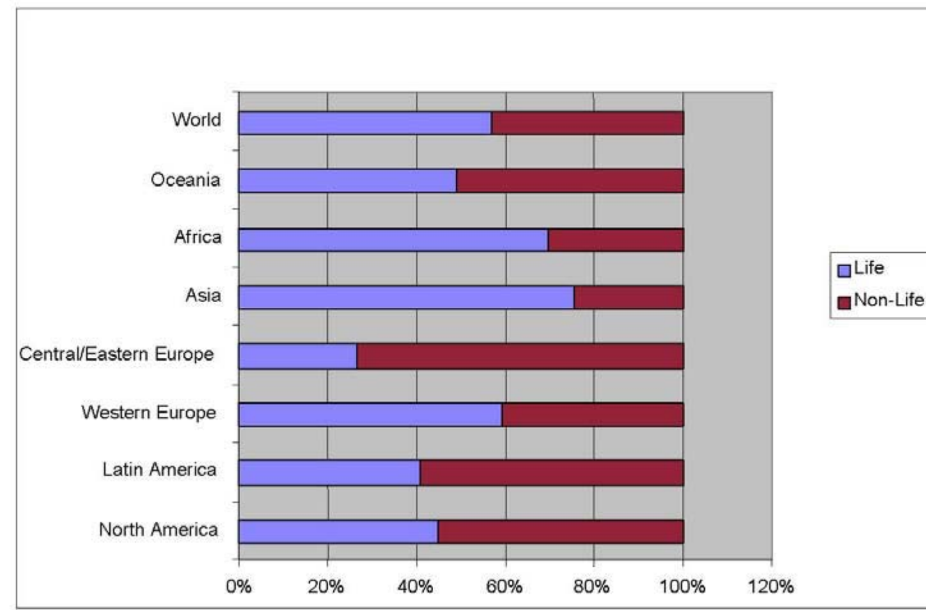
Rank	**Country**	**Non-life premiums**[52]	**Life premiums**	**Total amount**	**Percentage of total world premiums**
1	United States[53]	603,018	494,818	1,097,836	33.84
2	Japan	105,587	386,839	492,425	15.18
3	United Kingdom	105,241	189,591	294,831	9.09
4	France	65,811	128,813	194,624	6.00
5	Germany	106,261	84,535	190,797	5.88
6	Italy	46,728	84,535	128,811	3.97
7	Canada[54]	40,232	29,509	69,741	2.15
8	Rep. of Korea	19,944	48,680	68,623	2.12
9	Netherlands[55]	27,064	31,512	58,577	1.81
10	Spain	32,311	23,592	55,903	1.72

Source: Swiss Re, *Sigma*, No. 2/2005.

[52] Includes accident and health insurance.
[53] Non-life premiums include state funds, life premiums include an estimate of group pension business.
[54] Life business expressed in net premiums.
[55] Life business expressed in net premiums.

Annex 2

Life and non-life premium portions worldwide, 2004



Source: Swiss Re, Sigma No 2/2005.

III. Insurance: global market trends

John Cooke[56]

Introduction

This paper draws on presentations and background contributions from the UNCTAD ad hoc expert meeting on insurance services on 24 November 2005. Much has happened since the expert meeting, including the WTO Hong Kong ministerial meeting and (in the insurance field) the subsequent negotiations on financial services in a plurilateral framework. The author is therefore grateful for the opportunity to revise and update his earlier presentations and contributions.

The paper examines global market trends in insurance services, in terms of key drivers of market trends, the scope for growth in insurance markets, the role of insurance in economic development, and the link between market trends and the case for liberalization.

Global market trends in insurance services

Insurance plays a crucial role in economic development: a well-functioning insurance sector is a vital piece of national infrastructure. Insurance liberalization, successfully managed, will help to attract foreign direct investment and drive development in financial services, in turn spurring overall economic development, financial security and levels of prosperity.

Some key drivers of market trends

Some key drivers affect global insurance market trends and will continue to do so. The first is the role of the State as an insurance provider. In any emerging markets, there has traditionally been a high degree of State (or State-owned) provision of insurance, rather than private sector provision. This is now giving way to increasing diversification, as the requirements of commercial risk-management, or the realistic expectations of certain social groups, have resulted in change. In the main, where this change has taken place it has been successful: few markets that have turned to private sector insurance providers would wish to reverse the process.

But the change has nor been identical across all emerging markets, and has differentiated some from others. The main drivers of differentiation are the extent of the ongoing role of the State (e.g. in social security or the provision of “pillar one” basic pensions) and the opportunities accorded to the private sector (e.g. as insurance supplier for increasingly complex commercial risks, life/investment products, pension products). And the process of differentiation has thrown up some contested areas (e.g. compulsory motor, employer liability, group life, reinsurance) where the demarcation between the role of the State (or State-owned) providers and of the private sector is not yet settled. But the trend in most

[56] Chairman, Liberalization of Trade in Services (LOTIS) Committee, International Financial Services, London (IFSL).

markets is reasonably clear. Future drivers of change are likely to be economic advance, the exigencies of commercial risk management, the demographics of ageing societies and the inability of finite State tax revenue to provide for them. Finally, as growth and wealth increase in certain markets, personal savings will rise and can be harnessed for investment via insurance products, provided that the law and regulatory environment set the supervisory framework for insurance providers and offer insurance consumers the fiduciary guarantees and safeguards that need to be present in any insurance market.

Scope for growth in insurance markets

In many markets there is great potential for further growth in insurance. There are two broad yardsticks to support this proposition. First, a measure of the degree of maturity of various insurance markets can be gained by analysis of insurance densities (total premium income per person in a country's population) in different markets, in comparison to those of the most intensely developed markets. The world's largest three insurance markets (United States of America, Japan and the United Kingdom) have insurance densities of $3,755, $3,874 and $4,508 respectively. Insurance density over the OECD countries as a whole is $2,517, and in ASEAN countries is $54.[57] This huge difference in densities gives some idea of the potential which different markets have for growth.

Such figures point towards the other approach to appreciating the scope for growth in the insurance sector in emerging markets. It has long been a well recognized global trend that insurance markets grow faster than national income; and this in turn has helped facilitate structural change in insurance markets. For emerging insurance markets, there has often been a multiple of three or four times faster growth in insurance markets than in the economy as a whole. For more mature insurance markets, the multiple comes down, but even so growth has generally been faster than the expansion of national income.

The role of insurance in economic development

Such trends are important. They underline the message that a vibrant insurance industry is one of the keys to wider economic advance. This is scarcely surprising. Insurance aids economic development through its financial intermediation function in at least five ways:

Insurance facilitates business. Modern economies rely on specialization and improvements in productivity, including productivity in financial services. Trade and commercial specialization demand, in turn, financial specialization and flexibility. Unless there is a wide choice of financial products – and this includes insurance products – with corresponding levels of innovation, developments in trade and commerce can be held back.

Insurers provide risk management services. In their widest sense, these services cover risk pricing, risk transformation, and risk reduction. They are all essential services for a competitive market. Businesses and individuals need to transform their risk exposures in property, liability, loss of income and many other fields to achieve an optimum "fit" to their own needs. Again, life insurers enable individuals to manage their savings to match the liquidity, security and other risk profiles desired.

[57] All figures are for 2004 (latest available). *Source:* Swiss Re, sigma No. 2/2005.

Insurers offer risk management through risk pooling. This is the essence of insurance, taking underwriting and investment together. Pooling reduces volatility. If volatility is reduced, there is a smaller "risk premium" to be faced by insureds and borrowers. And, through risk management, insurers can bring to bear economic incentives for reducing business risk exposures.

Insurance mobilizes personal savings: In general, countries with high savings rates are those showing fastest growth. An IMF study in 1995 indicated that of the world's 20 fastest-growing economies over the previous 10 years, 14 had savings rates greater than 25 per cent of GDP, and none had a saving rate of less than 18 per cent. But 14 of the 20 slowest growing countries had savings rates below 15 per cent. Insurers have a key role in enhancing savings rates and in channelling domestic savings into domestic investment; and, through long-run investments, matched to risks and generally located in the host economy in which they operate, insurers are key holders of equity and bond portfolios.

Insurers play a key role in fostering efficient allocation of capital and economic resources: In assessing risks, they engage in an information function which requires them to evaluate firms, projects and managers. And they do so both in deciding whether to offer insurance and in their role as lenders and investors. In these ways, a vibrant insurance sector can act as a catalyst to economic growth.

Link between market trends and the case for liberalization

All these trends and indicators should be pointers to the value of liberalization and foreign direct investment in insurance markets. Historically however, Governments have often leant towards the view that a critical sector such as insurance, with its key role in wider economic development, should be reserved, wholly or partly, to national economic operators, enjoying a degree of protection. And Governments are sometimes swayed towards protection, for a number of reasons. First, strategic reasons are implied: they may feel that there needs to be a strong domestic insurance industry, with strong local regulatory systems. Second, other development-related reasons: given insurance companies' key role in mobilizing savings for financial investments, Governments may wish to ensure that the insurance industry's investments closely match their own investment priorities. Third, social reasons: given the role of insurance in maintaining financial security and quality of life, it is argued that there needs to be a strong State-controlled or State-dominated domestic insurance industry. Finally, there is the "infant industry" argument, often closely associated with the suggestion that liberalizing the insurance market would have adverse effects on a country's balance of payments.

All these arguments can be – and are – brought forward. In different countries they have been used to justify measures taking a variety of forms, for example:

- Restrictions on entry to the market for foreign insurers
- Where access is allowed, a requrement that foreign insurers operate only through joint ventures with local companies or are subjected to other restrictions on corporate form
- Discriminatory levels of taxation on foreign companies and their agents

- A requirement that reinsurance be ceded to a specified national reinsurer
- Restrictions on the nature of assets in which an insurer can hold funds
- Limitations on the amount of insurance and reinsurance business which can be placed abroad
- Restrictions on the level of remittances to overseas parent companies

These arguments for restricted markets, and the measures that go with them, are historically familiar. Yet the commercial case for liberalization, and for opening markets to direct investment from abroad, is far stronger. First, economic analysis points strongly to liberalization being the right route. A report by the British Trade Policy Research Centre showed that infant industry protection of the insurance industry in emerging markets raised the price of insurance and lowered the quality of cover, while at the same time failing to achieve the principal policy goal of improving the balance of payments. And, at a more pragmatic level, economic growth gives rise to strong pressures for liberalization. With rising levels of economic development, the number of large risks being faced has risen dramatically. These risks tend to be capital intensive investments, with each project worth hundreds of millions of dollars. In addition, many countries have been investing in advanced telecommunications systems and improving infrastructure. Much of this technology is directly transferred from the United States, Japan and Europe, but without the corresponding transfer of methods of risk control protection available in technology-exporting countries. In many cases, domestic insurance industries have faced difficulties in keeping pace with the changing and increasingly complex risks to be covered. There is a real requirement for broader-based, external expertise and capital to help develop a deeper and more innovative insurance market to cover these risks.

There are similar pressures on the personal insurance side. Increased levels of individual wealth in many countries have led to fast-growing personal lines insurance markets, with growing demand for both protection and investment products. But product ranges offered by domestic insurance industries can remain limited in scope, and sold through traditional distribution networks, with little attention paid to innovation in insurance product marketing. In some countries this lack of innovation may hold back development of personal insurance markets.

And the requirements of personal insurance markets raise the whole question of the reform of welfare provision, as an important global trend. No country is free from this trend, which is acting – the world over – as a catalyst for new developments in the insurance and pensions sector, and as a pressure for enhanced insurance capacity and product innovation. As people live longer, insurance and pensions expectations have risen, and are rising still further. But the economic cost of insurance cover and pensions is high. Many countries are already actively involved in changing the balance of provision from the State to the private sector, often on the basis of one or more "pillars". This is hardly surprising, taking just one statistic: the percentage of the population over 60 years old today and what this is projected to be by the year 2050. On average, for OECD countries, 18.4 per cent of the population were 60 years old or over in 2000; but by the year 2050 the percentage is expected to be about 34 per cent (almost doubling the proportion of the population aged 60 or over). Clearly, this presents the challenge of a major funding requirement. For Asian countries, the challenge is even greater: in 2000 on average

6.8 per cent of the population were aged 60 or over, but by the year 2050 this percentage is expected to rise to about 21.9 per cent – more than trebling the proportion aged 60 or over. These challenges are recognized in every country of the world, and are international in scope.

The solutions – whatever form they take – will require huge reserves of funding, which unless met by the State (through taxation) will need to be borne by private individuals. In an increasing number of countries, solutions involving an element of private funding are under discussion; and in these countries it is an insurance-based solution that is most frequently considered. In turn, the liberalization of insurance offers a path towards facilitating that solution, bringing with it international standards, technical, managerial and technological expertise, and high standards of regulatory compliance as well as extra capital for local investment, a transfer of experience, and an enhanced level of know-how throughout the industry as long-standing providers (including wholly domestically-owned insurers) alter their business practices to compete effectively with the new entrants.

For these advantages to be realized through more competitive, insurance markets some key prerequisites need to be in place. At a domestic level, and irrespective of whether foreign investment in a country's insurance industry is to be attracted, there needs to be a system of insurance supervision that is transparent and convergent with the standards and guidelines recommended by the International Association of Insurance Supervisors. From the supervisory point of view, it is prudent also to avoid requirements that effectively compel insurers to cross-subsidize lines of business on an uneconomic basis (e.g. setting ceilings for motor-insurance premiums, on the assumption that this line of business will be subsidized by other lines).

If foreign inward investment is to be attracted, some further prerequisites are also desirable. These include adequate protection for foreign direct investment (FDI), realistic permitted foreign capital levels, freedom for investing policyholder funds (within prudential limits) and freedom to reinsure. Taken together, these are the keystones to matching market trends with the appropriate liberalizing approach, sequenced as necessary.

Conclusion

This paper has given no more than a general overview of global market trends in insurance services, some of the key drivers affecting them and the scope for growth in insurance markets. It has pointed to the role of insurance in economic development and the types of link that exist between market trends and the case for liberalization. It goes without saying that such a brief overview cannot do full justice to the topic, or take account of the degree of diversity that characterizes the market as a whole and the opportunities, challenges and difficulties affecting different countries and regions. Many of these matters – and particularly the case for liberalization – are examined in greater detail later in this publication.

IV. 2010: hallmarks for success in insurance

Chris Gentle[58]

Helping ensure an insurance company has all the hallmarks for success in 2010 necessitates the building of a more global outlook into their business – the journey needs to start today

The world of financial services is evolving rapidly. Looking ahead to the end of the decade the shifting centres of gravity in financial markets are likely to have a profound impact on the evolution of the financial services industry. Building a business with strong foundations in mature markets allied with a fit-for-purpose emerging markets operating model is likely to distinguish leaders from followers. The race to be successful by the end of the decade is not a crystal-ball gazing exercise for corporate planners locked in darkened rooms, however. Rather it needs to be high on the corporate agenda, with actions and priorities set now to ensure the hallmarks for success will be in place by 2010.

We expect rapid evolutionary progress for the industry. The financial services industry is unlikely to see revolutionary change over the next four or five years, only because it is highly regulated and has high barriers to entry. Further, the regulatory (re-)enforcements in the early part of this decade, such as Sarbanes Oxley, Solvency II, International Financial Reporting Standards amongst many, are likely to have further raised the barriers to entry.

Nonetheless, the shifting centres of economic and financial gravity will precipitate some highly significant changes both in the markets that major financial institutions operate and in the challenges management will face over the medium term.

A look back to 1995 shows just how far the industry has progressed. For instance, the United States retirement market has seen a doubling of assets from $6 billion to over $13 billion between 1995 and 2005.[59] To be sure, the environment going forward will be shaped by two major forces of operational efficiency and attention switching to global markets. Witness the 2005 results of a major financial services group showing modest profit growth in Europe and North America of between 10 and 13 per cent, but in Asia and Latin America growth rates of 30–50 per cent.[60]

Last year, 15 major financial groups had more than half their assets abroad. Although a United States organization takes top spot, seven of the top ten places are taken by European organizations.[61] It is clear from the battle for international dominance will be played out between the top tier of institutions, each of which knows there will only be a handful of winners. The last five years have seen both grow rapidly in both asset and market value terms. European financial institutions have their fate in their own hands, accounting, for instance, for nearly two thirds of global banking assets. The rise of China

[58] Global Director, Financial Services, Deloitte & Touche LLP UK.
[59] Merrill Lynch (2004) The Outlook for the Defined Contribution and IRA Markets. Deloitte Analysis.
[60] Financial Times, 7 March 2006.
[61] Financial Times 9 March 2006.

is still to come and its trajectory will be determined by the opening up of the market in 2007 under WTO.

Secondly, operational efficiency will play an increasingly important role. The need to streamline processes, eradicate paper, reduce headcounts and manage related operational risk will affect all parts of the financial services industry. The march to reduce the cost base is already taking hold. In the banking sector the cost to income ratio has fallen from the high 60s to the low 60s over the last five years.

Helping ensure a financial institution has the hallmarks for success in 2010 means building a more global outlook into their business – the journey needs to start today by identifying the key market and operational drivers. Going forward, we expect leading financial institutions in 2010 to exhibit the following six hallmarks of success.

Global markets and a business model to match

The financial services industry will become increasingly global as firms in mature markets seek new sources of growth in emerging economies beyond their domestic home market. Success will hinge on creating an exportable, low-cost business model specifically designed to serve these new types of customers (low income, high volume), rather than trying to force-fit the model currently used to serve more affluent customers in existing western markets. The need to scale up will be driven by three factors. First, the need to have a significant balance sheet will be critical in supporting the major corporate clients and in funding future activities. Second, many financial products will become commoditized meaning margins will become thinner and economies of scale more important. Third, the ability to have a multinational market portfolio can only be sustained by major organizations.

Mass efficiency with focused premium service

Shrinking margins will drive an overall trend toward commoditization. Operational improvements will primarily focus on efficiency, self-service and economies of scale. Yet there will also be opportunities to reinvest some of those back-office cost savings into premium services for high value market segments – including “mass affluent” segments that may be underserved today. In the back office this will further drive the move to offshore non-customer-facing activities. Beyond 2010, the emergence of industry utilities will become dominant from investment banking to insurance.

Consolidation with a purpose

Merger and acquisition volume will remain high, both at the national and regional levels. For example, we expect 700 European banks essentially to disappear through mergers over the next three years. A number of deals are also expected between west and east, and vice versa, specifically to capitalize on increasing globalization.[62] The Asia Pacific market is also likely to see a rise in both transaction volumes and values between now and the end of the decade – with major capital flows into both China and India. Finally, North America will also see an up-tick in deals although these are likely to be centreed around mid-tier consolidation. However, acquisitions should not be the only club in the bag in

[62] A new playing field: Creating global champions – the emergence of pan-European retail banks through cross-border M&A. Deloitte Research, January 2006.

creating the hallmarks for success. Savvy divestments allied with smart redeployment of capital, can be equally important in creating competitive advantage, although they do not always make the front page. Further, we expect to see both strategies being augmented by organic market entry strategies. Business models leveraging direct distribution, can be highly effective, profitable and efficient – if, critically, the right proposition can be formulated.

Winning the struggle for growth through stronger customer relationships

Financial institutions of every shape and size will face a continuing challenge to grow their top line – even after large acquisitions. Financial markets reward financial institutions achieving the best revenue growth and superior risk adjusted returns on invested capital. For instance, our analysis shows on a worldwide basis the five banks with the fastest revenue growth saw their stock price soar by an average of 91 per cent over a four year period – over four times better than the industry average.[63] Going forward, there will be reduced headroom for growth in most mature western economies; the game will be to solidify existing customer relationships, steal market share and increase share of wallet by relearning the growth habit through innovative practices.

Financial institutions need to rethink their growth strategies, eschewing product innovation in favour of process and service improvements. The latter are much harder for competitors to replicate, thus providing a more enduring advantage both in terms of better customer relationships and revenue growth. Process and service innovations also tend to reduce complexity and cost, creating a virtuous circle of top-line growth and bottom-line profitability.

Successful financial institutions are likely to embed innovation into the very fabric of the organization – from strategy and processes, to people, systems and business partners – actively developing good ideas into enduring commercial success.

Transparency and compliance as a performance springboard

Regulators and capital markets are demanding greater transparency in all aspects of governance. But top-performing firms by 2010 will go beyond the minimum requirements, using transparency and compliance as a way to win the hearts and minds of investors, and leveraging their efforts to improve decision-making, cost efficiency, and service quality. This is a significant mindset shift for most financial institutions. Since behavioural shifts are often the most challenging to attain – expect many financial institutions not to develop this capability for a performance springboard.

Cracking the IT value code

By 2010 leading financial institutions will be some of the most sophisticated users of technology on the planet. Today the top 25 financial institutions in the world spend in excess of $50 billion on technology in a single year. Clearly, financial institutions will need to get improved productivity; enhanced revenue growth and better profitability from

[63] Glittering prize: how financial institutions can drive growth through process and service innovations. Deloitte, Global Financial Services, June 2005.

this level of spend in the future. The challenge going forward for financial institutions will be twofold: digitization of business and effective IT governance.

Firstly, the differentiator between success and failure is likely not to be the absolute amount spent rather on the governance of technology within the business. Recent decades have seen large gaps open up within financial firms between the board and technology departments. To remedy this problem, it is important financial institutions have a chief information officer with a seat at the top table. This will only be granted to those individuals who are "bilingual" in the languages of technology and business – acquiring such an individual should be among the top items on every chief executive officer's agenda.

Secondly, financial institutions are incredibly complex businesses. Over the next five years technology should be applied to reducing this degree of complexity by the eradication of paper-based processes. For instance, trading of many asset classes is now done on electronic exchanges. By contrast, back office clearing and settlement is often stuck in paper-based world driving up complexity, risk and reducing the efficiency of markets.

By 2010, technology will be almost invisible yet pervasive throughout leading financial institutions. This simplicity will drive new business models and will be integral to forging each of the hallmarks of success identified in this report.

The trends and challenges identified here are likely to affect the vast majority financial services firms. But only the best will profit from them. Big is likely to become beautiful but in itself will be no guarantee of success. Financial institutions that start building these qualities into their corporate DNA today are the ones most likely to come out on top in 2010.

V. Players and driving forces in world insurance services: locations and governance

J. François Outreville[64]

Abstract

This paper has two objectives. The first is to document the relative importance of the largest insurance or reinsurance companies in the world and changes that may have occurred in the past 15 years. The second is to identify some of the factors that may explain the increased internationalization and most-favoured locations of insurance groups.

The results of this study have two important implications. First, they indicate that a location-specific advantage, such as size, human capital and cultural distance do provide an explication of the internationalization of insurance firms. Second, they show that good governance has a significant impact on the choice of countries by insurance firms.

This paper was presented at the 2005 World Risk and Insurance Economics Congress in Salt Lake City. The opinions expressed in this paper do not necessarily reflect the official views of UNCTAD.

Introduction

Recent years have seen a rapid growth in global trade, foreign direct investment (FDI) and portfolio investment in the services sector. All services industries that, until recently, were largely national are becoming transnational. All countries are affected by the rise of foreign direct investment (FDI) in services and the broad-based growth of transnational corporations (TNCs), and European Union (EU) TNCs are taking the lead (UNCTAD 2004).[65] The insurance industry has also succumbed to the general trend towards global markets and risks (SwissRe 2000)

Fifteen years ago, a United Nations study revealed that the United States was the single most important home country for service TNCs.[66] In the second half of the 1990s, EU source TNCs, having acquired experience within Europe, expanded into over countries in pursuit of the more ambitious goal of having a global presence.

The United States TNCs still have a strong presence in many services, but they are less dominant than 15 years ago, and in some industries they no longer occupy leading positions. In insurance, the home country composition of the largest TNCs has changed

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[64] Division on Investment, Technology and Enterprise Development, UNCTAD.

[65] We use the term *transnational* in preference to *multinational* because our measures are based on the number of countries (home and host) in which companies operate. The term *multinational* implies some degree of globalization of activities in some key locations.

[66] United Nations Centre on Transnational Corporations (UNCTC) 1989. *Foreign Direct Investment and Transnational Corporations in Services* (New York: United Nations).

dramatically. European TNCs have taken over the lead from the United States and Japanese firms. The rise to prominence of European TNCs has occurred in parallel with their increasing participation in cross-border mergers and acquisitions (M&As) (SwissRe 2001).

Market-seeking motivations and strategies dominate TNCs activities in services. A large group of new TNCs has emerged in service industries that are new for FDI – notably telecommunications, electricity, water and postal services. Many of the top players in these services are former State-owned monopolies from Europe as in the case of the telecom industry. In the insurance sector, Moshirian (1999) concluded that premium growth, strategic diversification and the national income of the host countries was the main motivation of insurers to seek transnational activities. The deregulation of insurance markets and the liberalization of FDI policies have created opportunities for increased participation of international competitors in emerging economies.

This paper has two objectives. The first is the documentation of the relative importance of the largest insurance or reinsurance companies in the world and changes that may have occurred in the past 15 years. The second objective is to identify some of the factors that may explain the increased internationalization and location of insurance groups.

In the next section the data used for the largest insurance companies in the world is described. In the following section, the transnational power of companies and the analysis of the internationalization of these companies are presented.

The world's largest insurance and reinsurance companies[67]

In 1989, according to the data on revenues published by the review *Fortune* in July 1990, the largest United States insurance company (Prudential of America) did not rank among the top 50 of the world's biggest corporations. In 2003, according to the same source, the world's largest financial services company from Germany (Allianz) ranked 12th, and seven insurance companies from the Triad (United States, EU and Japan) were listed in the top 50 corporations in the world in terms of revenues.[68]

Obtaining comparable data for all companies around the world is a difficult task because of different reporting procedures. The list of the largest insurance and reinsurance companies in the world has been compiled using company websites and the information published in the business literature.[69]

The listing of the 45 largest companies (appendix 1) provides information on global insurance income, total assets and total number of employees worldwide. The list

[67] In this paper, large is defined in relation to insurance income (excluding investment related income). There is a significant correlation between income and assets (0.83) and between income and employment (0.81).
[68] Fortune, 26 July 2004, pp. F1–F10.
[69] The list has been compiled using company names published in Fortune 500, Business Week Global 1000 and with the help of the French Federation of Insurers which provided its own list. Because reporting procedures are not similar across countries and net premiums written or earned are not available in several countries, the concept of gross premiums has been used as far as possible.

includes 15 companies from the Unites States, 18 from the European Union, 7 from Japan, 4 from Switzerland and one from the Republic of Korea. This list is compared with the list of the world's largest insurance companies in 1986 published by UNCTC (1989) (appendix 2).

If only the top 20 companies are considered, in 1986 they were 8 companies from the United States, 6 from Japan and 6 from European countries, compared with 2003 with only 3 companies from the United States, 5 from Japan and 12 from European countries. The relative decline in the leadership of financial firms from Japan and the United States has been well documented in the literature on banking (Rhoades, 1983; Goldberg and Hanweck, 1991; and Edwards and Mishkin, 1995), insurance (Puleo and Butler, 1997) and in reinsurance (Outreville, 1998).

The size and concentration patterns of the largest 30 companies is examined and compared between 1986 and 2003 using the information available (table 1).[70] The most widely used indexes are the k-firms concentration ratio and the Herfindhal-Hirschman index (H= the sum of the shares of all n firms weighted by themselves). This later measure makes it possible to calculate a "number equivalent" of companies (N* = 1/H) where N* is the potential number of companies of the same size which could exist for a given degree of concentration.

Another static measure is Kwoka's (1977) "dominance index", which emphasizes the gap between successive firms when they are ranked by size. The values of this measure range from 1 to 0, with the former value indicating a monopolistic market. Conversely, the closer to zero the measure is, the lower is the power of any single company.

Casual observation reveals that the market shares of the largest companies have remained stable over time. The value of the Herfindahl index is almost the same and the dominance index has slightly increased between 1986 and 2003, confirming a larger spread among the top 10 companies and others than before.

Table 1: Measures of Size and Concentration of the 30 Largest Insurance Companies, 2003, 1986, 1980

Measure	2003	1986	1980
Total insurance income			
Percentage share of the first 5	33.8	34.6	33.6
Percentage share of the first 10	60.5	58.1	57.1
Herfindahl index	0.0446	0.0427	0.0451
Number equivalent	22	23	22
Dominance index	0.00089	0.00043	0.00048
Relative size of insurance business			
Assets/Income (total 30)	7.32	3.67	
Assets/Income (first 10)	7.8	3.52	
Assets/Income (first 5)	9.8	3.86	
Income/Employment (total 30)	715.6	295.7	
Income/Employment (first 10)	738.1	340.8	
Income/Employment (first 5)	789.4	371.2	

[70] Data for 1980 are incomplete in the UNCTC (1989) study and only part of the analysis is reported.

Grossack (1965) suggested, for determining whether a change in concentration is statistically significant or not, to regress the market shares from one period to the other. If the slope coefficient is significantly greater than 1, then concentration as measured by the Herfindahl-Hirschman index has increased. Similarly, if it is less than 1, concentration has decreased. The result of the regression of market shares of 2003 over market shares of 1986 gives a value of 0.848 (0.218), which is lower than 1.0, but not significantly different.

Table 1 also reports some measures of performance. The ratio of assets over income generated has doubled from 1986 to 2003 and today, this ratio is significantly higher for the 5 largest companies (this was not the case in 1986). The ratio of income over employment (the dollar amount of premiums generated on average by one staff) has more than doubled during the same period but this figure is largely affected by inflation and exchange rates fluctuations. In constant United States dollars the amount of premiums written has been multiplied by 1.4 on average but only by 1.25 for the 5 largest companies.

International presence of the largest insurance TNCs

The degree of international involvement of a firm can be analysed from a number of perspectives: their operations, stakeholders and the spatial organization of management. Given the range of perspectives and dimensions that can be considered for each, the degree of transnationality of a TNC cannot be fully captured by a single synthetic measure. In this paper, transnationality is defined as a function of the extent to which a firm's activities are located abroad.

The index of transnationalization (TNI) used here is a composite of two ratios – foreign income over total income and foreign employment over total employment.[71] The conceptual framework underlying this index helps to assess the degree to which the activities and interests of companies are embedded in their home country activities or in economies abroad. A high value of this index may raise questions about a home country's locational advantages (a small market for example) or indicate strong international competitiveness on the part of the home country firms. A drawback of this index is that it does not take into account the size of the home country and does not distinguish between companies whose activities are concentrated in a few foreign countries, and companies whose activities are spread across numerous host countries.

An approach that measures this dimension of transnationality is captured in the number of host countries in which a company is established. This measure may indicate high levels of ownership advantages as well as high knowledge of market conditions in many countries. However, it does not take into account the magnitude of a company's activity in a given host country.

A correlation analysis of these two measures usually gives a low value (UNCTAD, 2004). This underlines the fact that companies can transnationalize their activities without having

[71] A transnationality index can be compiled by choosing a single key variable (like assets) or by combining several variables. Since information on foreign assets is almost never available, the second approach is used in this paper.

to spread their foreign assets. Table 2 below presents the list of the largest insurance TNCs based on the amount of foreign business, foreign employment, the TNI index and the number of host countries.

Table 2: The World's 30 largest insurance TNCs, 2003

(ranked by foreign insurance income)

(million of dollars and number of employees)

Rank	TNC	Home country	Insurance income		Employment		TNI	Number
			Foreign	Total	Foreign	Total	(%)	of host countries
1	Allianz	Germany	75,230	107,180	90,350	173,750	61.1	62
2	AXA	France	65,120	84,800	85,490	117,113	74.9	46
3	ING	Netherlands	47,990	57,350	80,407	114,344	77.0	58
4	Zurich Financial Services	Switzerland	44,520	48,920	n.a.	58,667	91.0	46
5	Ass. Generali	Italy	38,155	62,500	49,671	60,638	71.5	42
6	AIG	United States	32,718	70,319	n.a.	86,000	46.5	92
7	Munich Re	Germany	27,900	50,900	11,060	41,430	40.7	36
8	Aviva	United Kingdom	26,180	53,480	23,555	56,000	43.8	32
9	Swiss Re	Switzerland	25,540	26,940	n.a.	7,949	94.8	28
10	Winterthur	Switzerland	19,680	27,060	13,865	20,281	66.7	16
11	Aegon	Netherlands	19,650	24,530	21674	27708	79.2	12
12	Prudential (a)	United Kingdom	12,980	24,480	9,540	21,000	49.2	18
13	Fortis	Belgium/Netherland:	12,940	26,230	15,268	25,785	54.2	48
14	Hannover Re	Germany	12,000	14,290	1,183	1,972	72.0	22
15	Royal and Sun Alliance	United Kingdom	10,600	19,800	18,935	31,980	56.4	30
16	Swiss Life	Switzerland	8,944	15,160	n.a.	10,015	59.0	6
17	Skandia	Sweden	8,650	10,035	4,245	5,936	78.8	20
18	Prudential Financial	United States	5,655	13,233	n.a.	39,400	42.7	18
19	Berkshire Hathaway	United States	5,484	22,454	n.a.	25,395	24.4	21
20	GE-Employers Re	United States	4,071	9,729	n.a.	3,300	41.8	22
21	Standard Life	United Kingdom	4,058	16,910	3,244	14,586	23.1	8
22	Ergo	Germany	3,800	20,330	7,263	31,470	20.9	21
23	Liberty Mutual	United States	3,671	18,319	6,000	38,000	18.0	11
24	Groupama	France	2,780	13,010	2683	10806	23.1	11
25	Mapfre	Spain	2,010	9,475	8,541	18,605	33.5	36
26	Chubb	United States	1,975	11,338	n.a.	12,300	17.4	16
27	Metlife	United States	1,950	23,170	49,030	84,810	33.1	11
28	Millea Holdings	Japan	1,302	23,736	4,400	32,900	9.4	48
29	Legal and General	United Kingdom	1,196	9,965	603	8,547	9.5	4
30	CNP Assurances	France	1,005	24,520	1,010	3,580	16.2	5

Source: Based on company's websites.
(a) For Prudential, foreign figures means other than U.K. and European business.
n.a. = not available. All companies were contacted by e-mail but only a few answered to the request for information.

Note: The transnationality index is calculated as the average of two ratios: foreign income to total income and foreign employment to total employment. When employment is not available only one ratio has been calculated.
The number of potential countries is equal to the number of countries where at least one foreign company has a branch/Office = 128
Japanese companies are missing from this list for lack of information on foreign activities. Life companies usually report only 4 to 6 host countries.

In the ranking by total insurance business written abroad, European insurance companies from five different countries dominate the top five. If we rank the TNCs by their TNI index, then the top company is a Swiss reinsurer and the small countries (Switzerland, Sweden and the Netherlands) are present in the top five. Looking at the number of host countries (or economies) also confirms the importance of a brand name (AIG, Allianz and ING form the top three).[72]

[72] Internationalization is affected by the size and volume of resources of the organization (Javalgi et al. 2003).

The network-spread index (NSI) is calculated as the ratio of the number of host countries over the number of potential host countries. It is more likely than a TNC reaches significant market shares in a few foreign countries than it expands in many countries and therefore, the NSI value is usually small compared to the TNI value.

The average NSI is 21 for the world's 25 largest non-financial TNCs reported in UNCTAD (2004), compared to an average TNI of 59. Considering that the number of potential host countries is equal to the number of countries where at least one foreign insurance company from the list has a branch/office (128 countries or economies), the network spread index (NSI) calculated for the 25 largest insurance TNCs is equal to 24 compared to an average TNI of 54. It is important to note that the internationalization of the 10 largest insurance companies, measured in terms of TNI or NSI, is significantly higher than the average top 25. This is not the case for non-financial corporations, as reported in table 3.

Table 3: Internationalization of the Largest Insurance TNCs

Measure	TNI	NSI
Largest insurance TNCs		
Average value of the first 10	66.8	36.9
Average value of the first 25	53.8	24.1
Largest non-financial TNCs		
Average value of the first 10	58.0	24.8
Average value of the first 25	59.1	20.7

Geographic and cultural distances have received a great deal of attention in the international business literature and have been identified as a key factor in explaining foreign market attractiveness (Kogut and Singh, 1998).[73] Johansson and Vahlne (1977, 1990) argued that TNCs expand first in geographically proximate markets and as experiential learning is built up, firms venture into more distant markets. Companies from the United States have a dominant presence in Latin America and the Caribbean (LAC) as well as Spain (Mapfre) which has a network of branches or offices in almost all LAC countries for obvious ethnic and cultural ties reasons. European companies have expanded mainly in Europe and in Asia. From a company point of view, AXA (France) and Fortis (Belgium), again for cultural reasons, are dominant in Africa. It is interesting to note that Allianz (Germany), which acquired the French company AGF, is represented in more French speaking countries of Africa than any other company. The involvement of German companies in Central and Eastern Europe (CEE) is noteworthy.[74]

Developing countries from Eastern and South-Eastern Asia have become considerably more important as host countries for insurance TNCs than countries from any other

[73] Cultural distance is different from geographical distance. Empirical evidence suggests the importance of geography in determining international economic interactions and in shaping the structure of production across space (Overman et al. 2001). Ghemawat (2001) suggested that four dimensions of distance namely cultural, administrative, geographic and economic, influence companies considering global expansion.
[74] Eight of these countries have joined the European Union in 2004.

developing region. This is in line with the overall trends in foreign direct investments in the developing world (UNCTAD 2004).

Table 4: Geographical Repartition of the Insurance TNCs
(based on the number of companies for which geographical breakdown is available)

Home Country	**Host Region**					
	Europe	CEE	Africa	LAC	Asia&Pacific	West Asia
United States (5)	24.8	10.3	4.1	25.6	28.3	6.9
United Kingdom (4)	37.7	6.5	1.3	7.8	40.2	6.5
France (3)	43.4	1.5	5.9	17.1	28.4	3.7
Germany (3)	34.1	20.6	12.1	9.5	21.1	2.6
Netherlands (3)	38.1	15.5	10.4	7.8	24.9	3.2
Switzerland (3)	36.8	12.3	8.7	5.5	31.8	4.8
Spain (1)	25.0	5.5	2.8	55.6	8.3	2.8
Italy (1)	35.9	17.9	2.6	23.1	12.8	7.7

LAC = Latin America nd the Caribbean
CEE= Central and Eastern Europe
West Asia is the new terminology for Middle East
In (.) is the number of companies in the calculated average value.

Determinants of international presence

Conventional internalization theory suggests that international sales rise because firms possess firm-specific advantages, which can be exploited profitably across national borders. Further, and especially in the context of market-seeking investment, internalization advantages and country-specific advantages are important to the explanation of foreign direct investment and the establishment of foreign subsidiaries (Rugman and Verbeke, 2004).

The concept of eclectic or OLI paradigm explained by Dunning (1977) and updated in later work (Dunning 1988, 1995) was put forward to identify and evaluate the significance of factors explaining the activities of Transnational Corporations (TNCs) outside their national boundaries.[75]

The paradigm asserts that international activities are dependent on the value of and interaction between three main variables, which are not necessarily independent of each other:

1. ***Ownership-specific advantages (O)*** such as technological, managerial and marketing advantages of TNCs vis-à-vis indigenous firms in the host country. The ability to create a successful brand name and image by offering services from multiple locations is central to the competitive advantage of TNCs. Insurance relies on information and technical knowledge and, the ability to spread risks confer a sizeable advantage to some companies;

[75] The argument is that the classical Heckscher-Ohlin-Samuelson theory of trade fails to take into account positive transaction costs, which may explain the internationalization of production.

2. ***Location-specific advantages of host countries (L)*** such as geographic and cultural distance (cultural differences), level of infrastructure (education, telecommunications, legal) and the potential size of the market. The reduction (or elimination) of barriers to trade in insurance services has been a major factor in the expansion of insurance TNCs abroad;

3. ***Market internalization (I)*** such as the exploitation of resources to participate in global activities or the need for sharing risks (reinsurance).

In recent years there has been a strong increase in the demand for insurance in emerging markets. The average annual growth rate has been twice has high as in industrialized countries in both life and non-life business (SwissRe 2000). Faced with limited local opportunities and encouraged by trends in financial deregulation and globalization, North American and European insurers have been looking to stake out new territories. These new opportunities based on expectations of potential market size and rapid expansion of the economy also came with many challenges – technical risk, cultural environment, country risk assessment – and were supported by recent developments in information technology.

At the same time, FDI in the financial sector of emerging economies surged in the 1990s as some countries were eager to attract a number of FDI-based activities by insurance TNCs – greenfield projects, mergers and acquisitions, partnership and alliances and the like. This new situation also may help understand some of the factors that are contributing to international expansion of insurance activities.

A number of studies have investigated issues related to the determinants of FDI in various countries and industries, but only recently papers by Moshirian (1999) and Ma and Pope (2003) have examined the determinants of international insurers' participation in foreign markets. Moshirian concluded that insurance premiums and the national income of host countries contribute to the expansion of insurance TNCs. Ma and Pope found that countries with higher GDP tend to attract more international insurers participation.[76] A more recent paper by Cole et al. (2005) provides a comprehensive approach to the decision process of United States reinsurers to assume from foreign insurers based on the OLI paradigm. The results of the study provide support to firm-specific factors and location-specific advantages.

The importance of good governance

In recent years there has been a surge of interest in the consequences of governance and misgovernance for development and how a country risk could have an impact on global investment strategies by transnational corporations.[77] Corruption is commonly defined as the abuse of public office for private gain.[78] Governance is a much broader notion, which is defined as the traditions, and institutions that determine how authority is exercised in a particular country. This includes: (i) the process by which Governments are selected, held accountable, monitored and replaced; (ii) the capacity of Governments to manage

[76] These studies are limited to insurance markets of the industrialized countries of the OECD.
[77] Knack and Keefer (1997) found that the institutional environment for economies activity generally determines the ability of emerging economies to catch up to industrial country standards.
[78] See Habib and Zurawicki (2004) for a survey of the literature.

resources efficiently and formulate, implement and enforce sound policies and regulations; and (iii) the respect of citizens and the State for the institutions that govern economic and social interactions among them (Kaufmann et al., 2000).

Much recent studies of governance and corruption, based on simple empirical observations, using available worldwide indices, have shown that, on average, per capita income and the quality of governance are also strongly positively correlated across countries.[79] Simple deduction reasoning would imply that good governance is also a relevant factor explaining the most favoured locations by TNCs to set up foreign affiliates.

The importance of good governance in the financial sector (both public and corporate) has been highlighted by recent high profile crisis in some countries. Despite this, there has been little effort devoted in evaluating its empirical impact on the choice of locations by financial firms and to our knowledge this variable is ignored in the banking and insurance literature.[80]

Data and empirical analysis

A wide variety of cross-country indicators are produced by a range of organizations (government agencies, commercial-risk-rating agencies, international organizations, think tanks, and other non-governmental organizations) and cover various dimensions of governance. Macroeconomic factors played a crucial role in the past in attracting FDI, but the dynamics of FDI require an analysis beyond such macroeconomic variables and a simple review of the recent data suggests a much higher correlation between FDI and governance (both from the public and private sector) than between FDI and macroeconomic variables. Other factors are diverse, ranging from the business climate (WEF, 2005), the presence of natural resources (Easterly and Levine, 2002), infrastructure, skills and technologies.

The ranking of developing countries in terms of the frequency of host country for insurance TNCs is compared with several indicators of governance and economic and political stability. OECD countries are excluded to avoid biases due to the perceived relationship between riches countries and good governance.[81] Spearman rank correlation values are calculated between the ranking of the most frequent host countries and the ranking of the following governance indices for the same 2002–2003 period:

[79] Recent work has been carried out by Galan and Gonzales-Benito (2001), Habib and Zurawicki (2002), Javalgi et al. (2003), La Porta et al. (1999, 2000); Kaufmann, D. and A. Kraay (2002); Kaufmann, D. (2003); Rodrick et al. (2002); among others.

[80] Although Forbes and Lynn (2004) have identified 193 sources of studies in governance research in 51 journals (mainly international business and public choice literature), none is reported in the banking and finance literature.

[81] The causality link between income and governance is far from being explained: (1) better governance exerts a powerful effect on per capita income; (2) higher incomes lead to improvements in governance; and (3) there are other factors to be considered. In a recent paper Kaufmann and Kraay (2002) discussed the surprising finding of negative feedback from incomes to governance attributed, at least partly, to a consequence of state capture by largest institutions (private or public).

- The ***Euromoney Global Political Risk Map*** gives a measure of country financial risk on the basis of political risk, economic performance, debt indicators, credit rating and access to finance and capital markets.[82]

- The ***Economist Intelligence Unit (EIU)*** country risk index is calculated using two distinct perspectives: (1) broad risk, i.e. political and economic; (2) specific risk, i.e. currency, banking sector risk and sovereign risk.[83]

- The ***Corruption Perception Index (CPI),*** compiled at the University of Passau (Germany), is based on the aggregation of multiple surveys.[84]

- ***Government effectiveness,*** published by the World Bank Institute, combines perception of the quality of public service provision, the quality of bureaucracy, the competence of civil servants, the independence of the civil service from political pressures, and the credibility of the Government's commitment to policies. It is one of the six indices published by WBI on governance.[85]

To verify the effect of size, Spearman rank correlations are also calculated with GDP per capita for 2002, the size of the population (POP), the penetration rank (premiums/GDP) and the density rank (premiums/population).

The human resources base is generally measured by educational enrolments and literacy rates. The Human Capital Index (HCI) used in this study is a weighted average of the literacy rate and enrolment ratios (secondary school and tertiary education).

Data are available for 45 countries for which at least two insurance TNCs have an office (branch and/or affiliate). The most popular locations are China and Hong Kong (China), followed by Brazil, Mexico, Argentina, India and Singapore in that order. The breakdown by region is as follows: Latin and Central America (15 countries), Asia (14), Africa (9) and the Middle East (West Asia) (7).

Results of Spearman rank correlations (table 5) show that the highest correlation is with the size of the country as measured by GDP. Other size measures are also significantly correlated. As expected, the Human Capital Index is significantly correlated and gives support to the hypothesis of location-specific advantages of some host countries. Governance measures such as country risk and government effectiveness are also significantly correlated.

The findings are consistent with the arguments presented in the literature and suggest that location-specific factors including good governance are important determinants in the choice of a location. They highlight the important role of governance in the supply for insurance and the need to include such a variable in further empirical work in cross-country analysis of insurance demand and supply.

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[82] The methodology is available at www.euromoney.com.
[83] See www.eiuresources.com.
[84] Information on data and methodology are available at www.tranparency.org.
[85] Available at www.worldbank.org/wbi/governance. This variable has been selected to differentiate government governance from political, financial or corruption risk.

Table 5: Spearman rank order correlation coefficient

Explanatory variables for Governance	Rs	t
Euromoney risk 2002	0.476	3.55
Government effectiveness	0.465	3.44
Corruption perception index	0.345	2.41
EIU country risk	0.331	2.38
Explanatory variables for Size		
GDP 2002	0.742	7.50
Population size	0.377	2.76
Penetration rank	0.316	2.26
Density rank	0.353	2.56
Human Capital Index (2001)	0.453	3.45

Conclusion

The opening up of the insurance markets in developing countries to foreign competition has long been a contentious issue. Numerous arguments, including the unfavourable balance-of-payments effect and the need to protect infant industries, have been advanced to justify measures to limit foreign investments. Today, most policymakers have concluded that liberalizing financial intermediation would strengthen financial markets and would be more conducive to sustainable economic growth.[86]

The results of this study have two important implications. First, the results indicate that location-specific advantages such as size, education and cultural distance, does provide an explication of the internationalization of insurance firms. Second, they show that, as hypothesized, good governance, measured by corruption and government effectiveness has a strong impact on the choice of countries by insurance firms.

Provided that liberalization is promoted against the backdrop of a solid set of prudent supervision – the recent shift towards solvency-based supervision in many emerging markets is in this line of approach – consumer protection, competition, as well as proper disclosure of information, the opening up of the insurance markets should bring long-term benefits to the countries. The privatization of the social security system and excellent growth perspectives will open new opportunities for foreign insurers.

[86] See a survey paper by Skipper (1997) on these issues.

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Appendix 1: The World's largest insurance companies, 2003

ranked by world insurance income (million of dollars and number of employees)

Rank	Company	Home country	Insurance Income	Total Assets	Employees
1	Allianz	Germany	107,180	1178,750 (b)	173,750 (b)
2	AXA	France	84,800	566,000	117,113
3	AIG	United States	70,320	678,350	86,000
4	Ass. Generali	Italy	62,500	289,700	60,638
5	ING	Netherlands	57,350	981,200 (b)	114,344 (b)
6	Aviva (CGNU)	United Kingdom	53,480	370,650	60,740
7	Zenkyoren (Agricultural Coop)	Japan	53,050	398,720	6,433
8	Munich Re	Germany	50,900	263,830	41,430
9	Zurich Financial Services	Switzerland	48,920	317,900	58,667
10	State Farm	United States	48,900	139,410	76,000
11	Nissay (Nippon Life)	Japan	48,260	424,700	72,784
12	Dai-Ichi Mutual	Japan	31,360	277,440	55,134
13	Meiji-Yasuda Life	Japan	31,100	239,600	49,412
14	Winterthur	Switzerland	30,230	129,910	20,281
15	Swiss Re	Switzerland	26,940	137,140	7,949
16	Fortis	Belgium/Netherland	26,230	133,520	25,785
17	Sumitomo Life	Japan	25,830	200,610	53,000
18	Allstate	United States	25,187	134,200	39,630
19	Aegon	Netherlands	24,530	295,500	27,708
20	CNP Assurances	France	24,520	210,800	3,580
21	Prudential	United Kingdom	24,480	287,250	21,930
22	Millea Holdings (Tokio Marine)	Japan	23,736	104,137	32,900
23	Metlife	United States	23,170	326,840	84,810
24	Berkshire Hathaway	United States	22,454	180,559	25,395
25	Ergo	Germany	20,330	141,000	31,470
26	Royal & Sun Alliance	United Kingdom	19,800	94,500	31,980
27	Liberty Mutual	United States	16,949	64,422	38,000
28	Standard Life	United Kingdom	16,910	156,910	14,586
29	Cigna	United States	15,440 (a)	90,953	32,700 (c)
30	Swiss Life	Switzerland	15,160	131,305	10,015
31	Travelers Corporation	United States	14,976	64,872	21,300
32	Hartford Financial Services	United States	14,910	225,853	30,000
33	Aetna	United States	14,900 (a)	40,950	27,600 (c)
34	Hannover Re	Germany	14,290	41,550	1,972
35	Samsung Life	Korea (Rep. Of)	13,765	70,000	6,300
36	Massachussetts Mutual Life	United States	13,508	96,779	18,500
37	Predica (Crédit Agricole)	France	13,500	125,550	284 (d)
37	Prudential Financial	United States	13,233	321,274	39,400 (c)
39	Groupama	France	13,010	78,270	10,806
40	Mitsui-Sumitomo	Japan	12,140	69,245	13,675
41	CNA Financial (Loews)	United States	11,716	68,503	11,000
42	Chubb	United States	11,338	38,360	12,300
43	Northwestern Life	United States	10,300	113,822	7,900
44	Skandia	Sweden	10,035	47,340	5,936
45	Legal and General	United Kingdom	9,965	223,137	8547

Source: Based on company's websites. Figures are in US$ converted as of 31 Dec. 2003 except for Japanese firms (31 March 2004).
(a) Health insurance business (b) Figures are for global activities.
(c) Information is provided for 2002. (d) Sales through 7260 bank agencies and 35,000 bank representatives.

Note: Insurance income is gross premiums written (when available) because net premiums are not reported in most european and japanese companies.
On April 28, 2004, Manulife (Canada) acquired John Hancock Financial (USA). Consolidated insurance income for 2003 would amount to $12,256.
On April 1, 2004, St Paul Travelers was formed by the combination of Travelers Corporation and the St. Paul Companies.
Consolidated insurance income for 2003 would amount to more than $22,000 and the company would have been ranked in the top 25.
Two Japanese companies may be missing in the list for lack of recent information (Mitsui Mutual Life which became a stock company in early 2004 and Asahi Mutual Life which posponed plans to be fully integrated into Millea Holdings).
China Life is missing in this list for lack of information on the exact insurance income. TIAA-CREF is excluded from the list.

Appendix 2

The World's largest insurance companies, 1986
ranked by world insurance income
(million of dollars and number of employees)

Rank	Company	Home country	Total revenue	Total Assets	Employment
1	Prudential of America	United States	23,602	103,317	62,400
2	Nippon Life	Japan	21,777	70,171	90,496
3	Metropolitan Life	United States	18,855	81,581	35,900
4	Cigna	United States	17,064	50,016	50,100
5	Zenkyoren	Japan	14,004	62,443	7,900
6	Aetna Life	United States	13,637	42,957	25,700
7	Dai-Ichi Mutual	Japan	12,791	46,483	68,082
8	Sumitomo Life	Japan	11,211	38,910	71,821
9	American International Group	United States	9,704	21,023	28,000
10	Allianz	Germany	8,850	n.a.	28,300
11	Equitable Life	United States	8,234	48,578	25,000
12	Meiji Mutual Life	Japan	7,461	25,424	46,532
13	Trans-America Corporation	United States	7,120	16,182	14,800
14	Zurich Insurance Group	Switzerland	6,704	17,156	23,800
15	Prudential Corporation	United Kingdom	6,516	38,023	29,900
16	Assicurazioni Generali	Italy	6,435	16,688	18,500
17	Nationale Netherlanden	Netherland	6,423	31,877	22,500
18	Travelers Life	United States	6,396	27,210	40,900
19	Union des Assurances de Paris	France	6,371	15,673	16,700
20	Asahi Mutual Life	Japan	6,229	22,775	41,570
21	Royal Insurance	United Kingdom	6,146	17,253	22,000
22	Continental Corporation	United States	6,002	13,623	17,000
23	Lincoln National	United States	5,999	16,244	14,000
24	New York Life	United States	5,890	29,794	18,300
25	John Hancock Mutual Life	United States	5,580	27,213	18,300
26	TIAA/CREF	United States	5,433	27,887	2,800
27	Mitsui Mutual Life	Japan	4,942	17,072	31,024
28	Winterthur Group	Switzerland	4,545	15,337	13,200
29	Assurances Générales de France	France	4,533	11,979	12,200
30	Principal Mutual Life	United States	4,504	16,994	9,700

Source: UNCTC (1989, p. 184-186).

VI. Insurance services, regulatory frameworks in Africa and international regulatory standards

Israel Kamuzora[87]

Regulatory capacity in Africa

With the exception of South Africa, all insurance regulatory bodies in Africa are experiencing problems which have to do with the following factors:

- A lack of techniques to deal with risk analysis and measurement: these techniques depend upon models handled by actuaries but since in the whole of Africa the number of actuaries is estimated at 300 with more than 80 per cent of them in South Africa, the rest of the continent is yet to benefit from the two techniques
- The regulator's lack of autonomy
- Small training budgets
- A lack of clear goals and strategies
- Political intervention in the decisions of the regulator
- A lack of historical data on insurance regulation in Africa
- Inadequate application of information and communication technologies in insurance supervision activities
- Low levels of insurance awareness, resulting in low levels of insurance penetration
- Delay by some Governments' in liberalizing the pensions industry to allow individual annuities and pension schemes to be sold by life insurance companies
- Premium rate undercutting in the market due to non-application of actuarial techniques in determination of premiums payable
- Products and services which are obsolete when compared with those in the developed markets or in other sectors of business
- The fact that the continent is mainly a non-life insurance market

[87] Commissioner of Insurance, United Republic of Tanzania, member of the Executive Committee Association of African Insurance supervisory Authorities.

- The industry's failure to be sufficiently innovative, with the result that insurance is not perceived as a service for the masses, unlike, say, the cellphone industry, which only recently came into Africa but has now identified itself with both the urban and rural population

Are there solutions to African regulatory problems?

We should keep our laws in tune with market developments, which will require integration of the IAIS Insurance Core Principles. We also need to adopt international accounting standards in order to enhance the quality of financial reporting.

We must give independence to our supervisory organs to enable them to acquire the necessary capacity for the identification and analysis of risks: risk-based supervision needs to be adoptied.

In each block where the insurance supervisory organ falls, such as COMESA, EAC, ECOWAS, SADC, etc, we must start now planning for the transposition of the existing regulatory framework, i.e laying the foundation for building up an effective and efficient regional supervisory structure. In other words, we need to harmonize our insurance laws within the region.

Can Africa harmonize its laws and practices?

Africa is always perceived as a continent of divisions, both culturally and politically. However, in the history of insurance development in Africa, we have had examples of the East Africa insurance Fire Tariff and the CIMA Code. It will be recalled that during the former East African Community arrangement, the three countries of East Africa (Kenya, Uganda and the United Republic of Tanzania), used to have a single tariff for motor, fire and other property risks.

Is it possible for Africa to adopt international standards?

There is a wide gap in terms of knowledge between regulators in developed markets and those in Africa. What we should do, is to call upon our Governments to play a more parenting role to our young industry to help it attain standards required for insurance regulation.

We need to make capacity-building part of the agenda in economic recovery programmes currently led in Africa by partners like the World Bank and IMF.

It is the reputation of our countries for high standards of insurance practice which will enable African players take the full benefit of globalization and set high standards for the market conduct and prudential requirements.

Insurance regulators in Africa, are the holders of the keys for the gates that will lead African insurance players into the global marketplace.

Access to WTO

Over 41 African countries are members of WTO. However, at present, Africa does not have a common strategy; nor does it have a negotiating forum. We need to create such a

forum for two reasons: (i) to promote internal liberalization – WTO conditions will make the less adaptive markets/Governments in Africa do so inorder to trade under WTO rules; and (ii) to negotiate with others as a block. United States and European insurance companies have been working to produce a single negotiating position. We also need to have one.

Conclusion

With the exception of South Africa, insurance practice in the rest of Africa is yet to catch up with the pace of development in the rest of the world and this calls for a coherent and comprehensive approach by all African regulators who together with the support of development partners such as UNCTAD and the World Bank, will ensure that a programme is in place to accelerate the transposition of our existing regulatory framework into the required level of international practice.

Africa cannot ask for its own set of rules and regulations simply because it has no capacity to apply international standards. It must run when others are walking if it is to catch up and keep up with the pace of change in the globalized world.

VII. Guidance on insurance regulation and supervision for emerging market economies[88]

International Association of Insurance Supervisors

Introduction

This paper was prepared by the Emerging Markets Issues Committee of the International Association of Insurance Supervisors (IAIS) with a view to promoting the establishment, adoption and implementation of regulatory and supervisory guidance for insurance markets in emerging economies. The guidance describes the unique challenges specific to emerging market economies and specifies the measures to be taken in order to move from the current regulatory regimes to ones meeting the level of supervision described in the IAIS Insurance Standards, which are being prepared by the technical committee.

The paper consists of three main parts, dealing with: the roots of the problems in insurance markets in emerging economies (general characteristics of insurance markets in emerging economies); measures to solve problems (guidance for sound insurance systems); and action plans (plans for implementing essential measures for insurance markets in emerging markets).

Some parts of the paper refer to the concepts and terminology used in the report of the G-10 working party on financial stability in emerging market economies; the 20 insurance guidelines for economies in transition adopted at the Second East-West OECD Conference on Insurance, which was organized in cooperation with the Polish Government in Warsaw in April 1997, and their related notes.

Background

This guidance was prepared on the basis of the discussion and conclusion in the Emerging Market Issues Committee held in February and May in 1997. As discussed in the meetings, insurance markets in emerging market economies have faced unique challenges as have other financial sectors in the economies. Instability of financial markets, including the insurance sector in emerging market economies could have an impact on global financial markets. Indeed, lack of clear guidance to foster sound insurance markets for the emerging market economies has slowed the reform of the insurance sector and aggravated their problems. Thus the Emerging Market Issues Committee and Education Committee of the IAIS, because of their unique role in the international insurance supervisors' society, decided to prepare guidance on insurance regulation and supervision for emerging market economies.

[88] Report from IAIS Emerging Market Issues Committee, September 1997.

Aim and main contents

The aim of this paper is to promote the establishment, adoption and implementation of regulatory and supervisory guidance for insurance markets in emerging economies that will assist in establishing a sound and reliable insurance system. The guidance is intended for insurance supervisors of emerging market economies.

Draft guidelines on insurance supervision applicable to all insurance markets (the IAIS Insurance Standards) are presently being discussed by the Technical Committee of the IAIS. The guidance presented here describes the unique challenges specific to emerging market economies and specifies the general measures that can be taken in order to move from the current regulatory regimes to others that are settled in the IAIS Insurance Standards and that can improve their actual situation. In other words, the guidance is intended to confirm the principles of basic regulatory and supervisory issues and to indicate clearly a route for reaching the level of supervision of IAIS Insurance Standards, covering crucial issues for the stability of insurance markets in emerging market economies.

Without specific action, establishing principles and preparing guidance do not have any impact on the real market. Thus, the paper proposes at the end a strategy (action plan) to promote the development and implementation of the described measures in emerging market economies.

Premises

In order to achieve its aim, this report has been guided by the fundamental premises set out below:

1. Sound macroeconomic and structural policies are essential for insurance system stability in order to prevent or at least limit the emergence of serious market distortions. Without the stability of the economy as a whole and sound development of basic financial and legal infrastructure such as the banking, credit and tax systems, the sound development of the insurance industry will not be achieved. There must also be sufficient political and social consensus supporting the measures needed to establish and maintain sound insurance markets.

2. Ultimate responsibility for the policies chosen to strengthen insurance systems must lie with the national supervisors or regulators who have a strong interest in developing sound arrangements for these systems.

3. Insurance sector stability is only achieved when prudential standards are met and when markets operate competitively, professionally and transparently in an international environment, according to sound principles and practices that generate the relevant information and appropriate incentives.

4. The strengthening of the regulation and supervision framework in parallel with the slow and cautious introduction of liberalization measures is essential for improving the efficiency of the insurance market. Liberalization without attendant prudential regulations and supervisory measures merely fosters chaotic market situations. Emerging

market economies need special consideration in this regard due to their particular economic and financial situations.

5. Although reforms are in many cases urgently required, it must be realized that insurance markets in emerging market economies differ widely from one another. It is indispensable that insurance system reform take into account the particular character of each country and be appropriately adapted. In addition, regulatory and supervisory frameworks have to be adapted on a regular basis in order to match changing conditions, perceptions and economic needs.

General characteristics of insurance markets in emerging economies

The instability of the insurance sector in emerging market economies can be attributed to a wide range of microeconomic and institutional failings. However, it is almost invariably in an unstable macroeconomic environment such as a high inflation rate, in the wake of major structural transformations or as a result of serious distortions in the real economy, that these failings give way to more critical problems.

In general, problems begin with lax management within insurance companies. Poor internal controls and moral hazard, where owners lack the proper incentives to act prudently and to supervise managers, often cause institutional failures. A particular case in this regard may be that of State-owned companies, where managers may be guided by objectives that are not compatible with sound financial practices, while at the same time they are shielded from any external discipline. Weaknesses in the legal framework compound the problems of lax management and weak corporate governance.

The market can play a crucial role in disciplining bad performers, but this function may not be performed satisfactorily in the presence of inadequate information or distorted incentives. Some of the Governments in emerging market economies also tend to be very cautious to expose the insurance sector to market discipline.

Basic infrastructure shortcomings for establishment and maintenance of a sound insurance system (accounting systems, financial markets as well as a legislative framework) can aggravate matters by failing to identify problems and preventing them from being addressed in a comprehensive and timely manner.

Strong regulatory and supervisory arrangements (insurance supervisory authorities, prudential regulations) that complement and support the operation of market discipline are indispensable to the stability of insurance markets. However, in the absence of effective market discipline, the entire burden of external control falls on insurance supervisors who may not have the requisite capacity.

The crucial issue for a robust insurance system is the development of a capable, professional cadre of insurers and supervisors. However, basic manuals for this purpose, particularly for training manuals for supervisors, have not yet been properly developed and training programmes are often not systematically arranged.

Guidance for sound insurance systems in emerging market economies

Creation of the essential infrastructure for effective market functioning

Legislation

Insurance legislation is essential to establish a sound and robust insurance system. Other legislation indispensable to the insurance sector such as commercial code, civil code, company law, tax law, banking law, should also be established at the same time. A legal environment should be fostered in any case. High quality insurance regulations and standards assure market participants that sound practices are being applied, thereby increasing market transparency and confidence. Although all economies should periodically revise and update legislation to meet new market realities, emerging market economies face a particular challenge in developing a legal system suitable to a market environment, given the rapidly changing economic conditions and in some cases, the heritage of extensive State involvement in economic decisions. Frameworks based on industrial country models have proved useful but must still be adapted to the particular environment of emerging market economies and altered as those systems evolve.

A comprehensive set of prudential regulations and standards is indispensable if insurance supervisory authorities are to exercise their powers and responsibilities in a coherent fashion. The regulations and standards should be objective, internally consistent, transparent and clearly understood by those to whom they are applied.

Accounting principles and the role of actuaries and auditors

Accouting systems are central to the provision of the information needed by investors, consumers, managers, supervisors and other interested parties with an actual or potential stake in an enterprise so that they can make reasonable assessments of the effectiveness of the enterprise's operations and assess its future prospects. High quality accounting systems, taking into account the particular nature of the insurance sector, provide authorities with the practical means to perform proper audits, while at the same time are a vital resource for the management of companies and other interested parties. Indeed, insurance legislation can only play its intended role where effective information exists for its enforcement. Ensuring that the supervisory authorities have regular access to reliable information about insurance companies is a crucial issue for emerging markets since a lack of this mechanism have often delayed the discovery of financial problems in insurance companies and has therefore failed to prevent many of them going bankrupt.

Accounting methods should provide a real picture of economic gains and losses. The accounting system should establish rules that are to be applied uniformly to all insurance companies and are compatible with internationally accepted accounting standards. Not only should each accounting item be clearly defined but also the precise evaluation method should be stated in the regulations so that the financial condition of a company can be disclosed without any ambiguity. The information provided should be accurate, relevant and transparent. The information should also be comprehensive, timely and provided to the relevant parties on a regular basis.

Auditing provided by chartered accountants, independent, officially recognized and with a deontology code is vital to ensuring that accounting norms for insurance businesses are effectively applied and maintained, and to monitor the quality of internal control procedures. Internal auditing is vital to monitor the quality of internal control procedures. An actuarial system might be established that covers at a minimum, valuation of the liabilities of life insurance businesses, valuation of the assets corresponding to liabilities and the amount of the required solvency margin of life insurance businesses. Both internal and external audits are necessary and these constitute important complements to the assessment of insurance companies by the insurance supervisor.

Reliable database

Availability of reliable basic data is also essential for effective market discipline. In particular, insurance premiums are calculated on the basis of the law of large numbers. For this reason, establishment of reliable policy data such as loss frequency and loss severity is indispensable in calculating correct insurance premiums and the technical provisions that are crucial for maintaining the solvency of insurance companies and for establishing the stability of insurance markets. Reliable mortality tables are also essential for life insurance products. In many cases of emerging market economies, an insurance company does not have enough past insurance policies to create a reliable data basis or a data collecting system itself has not yet been properly established. Thus the collection of claims data through cooperation of insurers should be encouraged. The insurance supervisory authorities should also establish a reliable claims database that will help insurers and supervisors confirm the right price for various categories of products.

Creation of the insurance supervisory authority

Insurance legislation and reliable information can play their proper role only if an enforcement body, that is, an insurance supervisory body is established and functions effectively.

Therefore, the insurance supervisory authority should:

- Have the power to license insurance companies, apply prudential regulations, conduct consolidated supervision, obtain and independently verify relevant information, engage in remedial action and execute portfolio transfer, and apply sanctions against insurance companies which do not follow the recommendations and injunctions of the supervisory authorities (i.e. restrict the business activities of a company, direct a company to stop practices that are unsafe or unsound or take action to remedy an unsafe or unsound business practice with the option to invoke other sanctions on a company or any business operation);

- Be independent of both political authorities and controlled companies in the daily execution of supervisory tasks and be accountable in the use of its powers and resources to pursue clearly defined objectives;

- Have broad and ample knowledge and experience ranging from actuarial science to contract law drawn from wide experience;

- Have a reliable and stable source of funding to safeguard its independence and effectiveness;
- Have the powers and sufficient resources to cooperate and exchange information with other authorities both at home and abroad thereby supporting consolidated supervision;
- Establish an employment system to hire, train and maintain a professionally qualified staff.

At the same time, the insurance supervisory authority must be bound to strict professional secrecy and the legislation must exclude any arbitrary intervention of the administration. Except the cases stipulated in law, the insurance supervisor may under no circumstances interfere in the management of insurance companies: the company's management being the only party liable for the decision it makes within the framework of the mandate conferred upon it by the owners of the company.

The supervisory authority should establish good cooperation and coordination schemes with other related government bodies or insurance institutions, such as ministries, tax offices or insurance guaranteed funds so that the given tasks are properly carried out.

Private market arrangements

The insurance industry should be encouraged to set up private mechanisms and institutions for the application of business guidelines and a code of conduct to limit detrimental practices. Self-regulatory principles and organizations, including professional bodies can be a useful complement to the public supervisory structure. However, supervisory authorities need to scrutinize such arrangements in order to ensure that they promote effective market functioning.

Promotion of the market mechanism

Information disclosure

It is important to improve the quality, timeliness and relevance of standards for disclosure of key information needed for credit and investment decisions in the interest of stakeholders (interested parties). Ensuring information disclosure is also essential for consumers to be able to select appropriate insurance products from the right insurance company. The most important information concerns the financial condition of an insurance company, the nature of its insurance products and the character of an insurance intermediary.

Foundations for good institutional governance

The foundation for good institutional governance is sound business strategy along with competent and responsible management. Insurance companies should be encouraged to develop an ownership structure that fosters stakeholder oversight. Private ownership of insurance companies is essential for strengthening the monitoring of management performance and reducing distortions in incentives and avoiding political interference in management. Privatized insurance companies should be established on a sound financial basis and with diverse ownership.

Good institutional governance of insurance companies requires comprehensive internal control procedures and policies that are implemented by skilled personnel and carefully monitored by management. Even capable management is liable to commit errors in fulfilment of its duties. Thus effective risk management of insurance companies is crucial. Insurance companies should have effective means to measure, monitor and control the various risks they face.

Promotion of competitiveness that is subject to essential prudential safeguards

Reforms leading to a market economy, particularly competition and liberalization measures, are expected to promote entrepreneurial freedom, responsibility and accountability, optimize allocation of resources, increase efficiency and bring a better match between supply and demand and ultimately better quality services at reasonable prices. Subject to prudential regulations and supervision being met, competition in the insurance sector should be fostered by removing unnecessary restrictions and allowing participation of sound insurance companies in the insurance market. In particular, establishment of foreign insurance companies should be based on prudential but non-discriminatory rules.

Prudential supervisory and regulatory measures

Due to the high risk (insurance risk, investment risk, credit risk) environments in emerging market economies combined with limited experience and expertise, prudential regulations should be given particular emphasis.

Licensing and changes in control

Starting an insurance business requires a considerable amount of capital, special expertise, reliable management and an elaborate business strategy. For this reason, in most jurisdictions, it is a legislative requirement that those companies wishing to transact business in the domestic insurance market be licensed. In effect, licensing control is the main supervisory means by which unsound insurance companies are prevented from entering the market. This means that supervisory authorities can concentrate more on preventive measures against any financial difficulties rather than spend considerable energy and time dealing with insurance companies that are in trouble.

In emerging market economies, lax licensing control often allows undercapitalized and poorly managed insurance companies to enter the market and subsequently suffer from financial problems. Therefore, sufficiently strict licensing criteria should in particular govern the establishment of insurance companies. Examination of the nature and adequacy of the financial resources of insurance companies through analysis of business plans and the requirement for a relevant minimum level of capital deserves particular consideration. The supervisor should also consider the suitability of owners, directors and/or senior management. The insurance supervisor should also review changes in the control of companies and establish clear requirements to be met when a change in control occurs. These may be the same as or similar to the requirements which apply in granting a licence.

The underwriting of insurance risks should be restricted to insurance companies which may transact insurance operations only. Life and non-life insurance operations should be

separated, so that one activity cannot be required to support the other. Reinsurance companies and direct insurance companies should also be separated at the initial stage in emerging market economies.

Ongoing supervision

(a) Practice with regard to supervision, in particular on-site inspection

Insurance supervision should be exercised over the entire operations of the insurance company undergoing control and should involve various aspects, such as moral, legal, technical and financial. The insurance supervisor should in particular ensure that insurance companies are observing the regulations applicable to insurance. More specifically, the insurance supervisor should ensure that insurance companies:

- Meet the contractual commitments made toward the insured (legal control);
- Are at all times in a sound financial position so as to meet their commitments (solvency control).

In order to achieve this, the insurance supervisor should examine not only the financial position of an insurance company at a given moment but also its operating conditions that determine its future financial position. Indeed the aim of insurance supervision is not to check whether a company was solvent at the date of its last financial report but to assess its ability to meet its commitments in the future.

In order to conduct the preventive control, regular contact with insurance management and thorough understanding of the insurer's operations are essential. There must be a means for independently and reliably verifying information reported or disclosed, in particular, the adequacy of technical provisions and asset valuations. On-site inspections are particularly important in allowing a supervisory authority to evaluate a management's effectiveness and its compliance with supervisory standards in those markets where weaknesses in accounting or reporting systems impair the effectiveness of off-site inspections. On-site inspection and off-site inspection of the same company should in principle be performed by the same person or group so as to ensure rational use of the information provided and supervisory powers. On-site inspections should cover all the factors which may sooner or later have an impact on the performance of the insurance company and thus on its financial position, i.e. control over the sales network, rating system policy, follow-up of claims and of results, risk selection, administrative organization, financial management, efficiency of reinsurance, internal control, etc. These observations are essential in the assessment both of the skills and efficiency of the managers of an insurance company and of its capital requirements. A certain reliance could be placed on external auditors or actuaries only if a well developed auditing and actuarial profession exists and where auditors and actuaries are fully accountable.

(b) Liabilities

The setting aside of liability, particularly technical (mathematical) provisions in an amount sufficient to meet at all times the company's commitments vis-à-vis the insured is at the very core of insurance business. However, calculating the proper level of technical provisions is indeed a challenge both for the insurance companies and for the insurance

supervisor in emerging market economies. Inadequacy of technical provisions often cause financial difficulties or insolvency of insurance companies.

Inadequacy of technical provisions may be due to several factors: lack of legislative and practical measures on technical provisions, lack of historical data, uncertain economic conditions particularly a high inflation rate, an inadequate premium rate and a lack of professionals such as actuaries and auditors.

Introduction of appropriate legislation and monitoring measures is the first step to be taken. Insurance supervisors should establish standards with respect to the liabilities of companies. In developing the standards, the insurance supervisor should consider the following:

- What is to be included as a liability of the company, e.g. claims incurred but not paid, claims incurred but not reported, amounts owed to others, amounts owed that are in dispute and premiums received in advance, as well as the provision for policy liabilities or technical provisions that may be set by an actuary;

- The standards for establishing policy liabilities or technical provisions;

- The amount of credit allowed to reduce liabilities for amounts recoverable under reinsurance arrangements, making provision for the ultimate collectability.

In addition, the accumulation of expertise both in supervisory authorities and in insurance companies should be encouraged. Data should be established that help evaluate sufficiency of technical provisions. The technical interest rate should be regulated in proportion to the general economic situation. The supervisor should monitor premium levels in order to avoid underpriced products. Professionals such as actuaries and auditors should be encouraged to be developed.

(c) Assets

Technical provisions must at all times be backed up by equivalent assets that belong in full to the insurance company and are set aside to guarantee its commitments. Policyholders should have a preferential claim on the assets of the insurer in case of liquidation. In order to ensure the safety , profitability and liquidity of its investments, the insurance company must ensure that its investments are sufficiently diversified and dispersed.

Emerging market economies often suffer from limited investment opportunities, highly volatile capital markets, limited investment management and unadapted evaluation measures. Information on the financial markets is often not transparent. In addition, where stakeholder discipline mechanisms are poorly developed, competition is limited or historical circumstances have retarded the development of strong risk management as an institutional governance priority, the regulatory framework needs to pay special attention to insurance companies' procedures for assessing and managing all risks including credit risk (exposure to loss as a result of default on an instrument) and market risk (exposure to price change).

Prudential investment rules should be implemented that take into account the reality of markets. Insurance supervisors should establish standards with respect to the assets of insurance companies. These standards should address:

- Diversification by type;
- Any limits or restrictions on the amount that may be invested in financial instruments, property and receivables;
- The basis for valuing assets which are included in the financial reports;
- The manner in which those assets are held, such as self-keeping assets;
- Appropriate matching and liquidity.

In addition, admissibility of the value placed on assets for the backing up of technical provisions by equivalent assets, or solvency margin requirements may be stated in regulations. It would also be appropriate for the value of unlisted assets and real estate to be certified by independent professionals.

Investment regulations on insurance should be coordinated with the regulations in other financial sectors so that they do not unbalance competition and hold back the sound development of the whole financial sector.

Emerging market economies tend to adopt highly restrictive rules on investment abroad. This is understandable for countries which have severe foreign currency reserve constraints. Also it is appropriate to follow the principle of currency matching in order to ensure protection from exchange rate risks. On the other hand, investments abroad can provide access to a healthy diversified portfolio and long-term investments tool, which are sometimes difficult to find in emerging market economies. Since fostering national investments also helps to finance the national economy, and on the other hand, investments abroad may reduce the risk linked to the inflation rate, then the investment policy abroad should be gradually liberalized at the same time as prudential regulations are introduced.

(d) Capital adequacy

Both in the licensing process and in ongoing supervision, the insurance supervisor needs to pay particular attention to capital adequacy. The capital base (solvency margin) means the financial sources (margin) that work as a buffer against the possible adverse development of liabilities and other adverse circumstances such as changes in the litigation system, unexpected expense overruns, etc. Thus it provides information on the financial standing of the company and alerts supervisors to take any necessary action to protect policyholders. The requirements regarding the capital to be maintained by insurance companies should be clearly defined and should address the following:

- Minimum levels of capital or the levels of deposits (these levels concern only local branches of foreign insurers) that should be maintained: capital adequacy requirements should reflect the size and business risks of the insurance company;

- The process for valuing capital, which should reflect the requirements for valuing both assets and liabilities.

The capital base is only an instrument for measuring and monitoring solvency. It should not be deemed by the management or the supervisor to be the end result of asset liability management or a fail-safe index of the financial soundness of the company concerned. Adequate tarification and technical provisions covered by sufficient assets remain the main pillars of solvency.

(e) Reinsurance

Adequate and effective reinsurance enables insurance companies to share risks with others, and to maintain stable underwriting results by spreading risks. In emerging markets, many insurance companies are still struggling to increase their capital base in order to establish sound financial conditions. A reinsurer's strong capital base can assist the business development of such insurers. High quality reinsurers also provide direct insurers with essential technical knowledge on insurance and reinsurance. At the same time however, in emerging market economies, reinsurance is a new activity for insurance companies which often suffer unsuitable reinsurance contracts or transactions with financially unstable reinsurers. In some cases, insurance companies use reinsurance contracts only as a means of cash transfer abroad.

For this reason, reinsurance transactions, in emerging markets in particular, should be closely monitored. The supervisor must be able to review reinsurance arrangements to assess the degree of reliance placed on these arrangements and to determine the appropriateness of such reliance. Insurance companies would be expected to assess the financial positions of their reinsurers in determining an appropriate level of exposure to them. A method for the collection and monitoring of information relating to reinsurance companies should be established. International cooperation is particularly important in obtaining accurate information and this should be developed.

At the same time regulatory intervention of reinsurance placement should not be abused. Only through liberal access to the wider international reinsurance market can both the ceding and accepting companies be assured of providing and obtaining the best product and service at a competitive price. Compulsory cession of risks to local reinsurers, domestic market or discriminatory tax regimes against foreign reinsurance placement should therefore be avoided.

(f) Control of products and tariffs

Rates of insurance products should be adequate, not excessive and not discriminatory. In emerging market economies however, the lack of experience in insurance management, combined with the shortage of basic statistical data such as the frequency and severity of losses, make it difficult to set appropriate rates based on actual risk exposure. A considerable number of policyholders have suffered due to bankruptcies of insurance companies which were often caused by underpricing. Information asymmetry between insurers and consumers is even greater in emerging markets due to insufficient disclosure of information on products and companies. It is difficult for prudent companies to compete against others that charge prices lower than cost in order to gain market share.

Thus, initially at least, it may be appropriate for emerging market economies to request submission of premium rates to insurance supervisory authorities for prior approval.

Similarly, it may be preferable that the insurance products offered for sale be examined by the supervisory authority so that those seeking insurance will not be harmed by inappropriate policy conditions.

Supervision of tariffs and products should however be adapted to the particular situation of each country and reassessed at a later stage according to the development and progress of the market.

(g) Intermediaries

Intermediary systems play a key role in consumers benefiting from a market oriented economy and thus choosing the best suitable products from a wide product range. The importance of properly controlled insurance intermediaries may be particularly relevant in emerging market economies where abuses in the distribution network are often observed that cause considerable problems for policyholders. Normally, insurance legislation distinguishes between brokers who represent the buyer and generally work with several companies to provide the best coverage for their clients, from agents or direct sales who represent the seller(s). Regulations on intermediaries should clearly state the scope of business and rights and responsibilities of intermediaries.

Supervision of intermediaries could take a variety of alternative or complementary forms. It can be carried out under the insurance supervisory authorities or through an independent body or industry organization.

Insurance intermediaries should be registered or be required to obtain authorization prior to commencing their operations. Insurance intermediaries should possess professional qualifications that prove general, commercial and professional knowledge and ability to ensure that consumers are protected. Insurance brokers are liable to their clients and thus should possess either financial guarantees or professional liability insurance or both, for the purpose of policyholder protection and of maintaining a sound intermediary system. Insurance intermediaries should disclose to their clients their status and provide extensive information on and comprehensive explanations of insurance products to policyholders.

(h) Compulsory insurance

Compulsory insurance may be justified in respect of certain forms of social protection and might be considered in other areas where the risks covered are particularly serious and are not covered on a non-compulsory basis. Premium payments should be divided on an equitable basis among the policyholder group under consideration. Compulsory insurance is particularly recommended for automobile third party liability. Some emerging market economies do not have functioning compulsory third party automobile insurance, even though automobile accidents are frequent and victims are often not sufficiently compensated.

In order to establish a properly functioning compulsory insurance system, a suitable monitoring system is crucial for ensuring that all relevant parties have insurance contract. For this purpose, a penalty system for those who breach obligations could be set up. A guarantee funds system could be created to compensate victims in cases where there is no

insurance cover. Tariffs for compulsory insurance should also be based on statistical data. Underwriting compulsory insurance should not be limited to particular companies such as (former) State monopolies.

Remedial correction of problems

(a) Remedial procedures

Even in well-controlled insurance markets, it may happen that a company confronts financial difficulties that lead to insolvency. For this reason, there should be well formulated policies for achieving corrective action and in cases where an institution is not viable as a going concern, orderly exit policies are essential to effectively exercise insurance supervision. Of particular importance in this context are remedial (going from preventive recovery measures up to sanctions) to deal with the financial problems of individual insurance companies. Clear instructions on this matter should be defined in legislation, covering matters connected with the management of troubled companies including: the standards applied in monitoring insolvency, the basis for being able to do a reorganization by restoring solvency, available recovery measures, the revocation of licences, conditions under which the portfolio of insurance policies may be transferred to a sound company, the role of the liquidator and the ranking of creditors' claims. Because long delay can magnify the cost of resolving a crisis, it is of great benefit to have available concrete procedures for prompt corrective actions. Permanent supervision focused on preventive control through on-site and off-site inspection will play a key role for this purpose. Corrective procedures based on rules can help to reduce political pressures for undue forbearance.

At the same time however, authorities need to retain sufficient discretion to be able to deal flexibly with problems that arise and be able to adapt the means for dealing with problem insurance companies to market circumstances.

(b) Design and application of safety-net arrangements

Protection of policyholders and the high cost of a possible collapse of the insurance system are principal reasons why in certain countries, the supervisor provides a safety net (guarantee funds). Under certain conditions and particularly if the domestic market comprises a sufficient number of potential contributors with a broad spread of risks, creation of a safety net could be considered. However, such an arrangement inevitably creates moral hazards because it holds the prospect that stakeholders will be at least partially indemnified from losses caused by failing institutions. In order to minimize the moral hazard, it is essential to design and apply safety-net arrangements in which the incentives of stakeholders to exercise oversight and to act prudently are not undermined.

Developing essential measures for insurance markets in emerging economies

The IAIS, in particular, the Emerging Market Issues Committee and the Education Committee will play a key role in promoting and fostering the principles and measures mentioned above.

Developing guidance on regulation and supervision of emerging market economies

Currently there is no comprehensive practical and concrete text which describes measures on legislation and supervision in detail for assisting in fostering a sound insurance system in emerging market economies, although it is indispensable during the process of introducing a new insurance system or of amending the current regulations or insurance supervisory system.

Thus the Emerging Market Issues Committee of the IAIS will develop a practical and concrete text for insurance legislation and supervision in order to help those economies to implement the principles and best practice established (or going to be established) by the Technical Committee. Such an exercise will provide other aspects on insurance supervision and would eventually contribute to the activities of the Technical Committee.

This exercise will take the following steps:

- Collect relevant materials from member countries and international organizations such as the Basel Committee, IOSCO, OECD and UNCTAD on the practical measures for implementing sound supervision; close cooperation with the Laws and Regulations Committee would be useful

- Determine priorities on supervisory issues for emerging market economies

- Draft concrete analysis on the issues which require priority

- Prepare guidance, to be drafted by a small task force made up of members of the Emerging Market Issues Committee and the Educational Committee for discussion by both committees

Implementing sound principles and standards in emerging market economies

Training and seminars

The effectiveness of a supervisory body depends mainly on the human resources at its disposal. Taking into account the shortage of qualified staff and proper resource development strategies, well organized training schemes for supervisors are crucial to the emerging market economies. Training for supervisors should consist of both theoretical and practical aspects and of both legislative and supervisory aspects. It should not be a single event but should be conducted continuously and be based on well arranged programmes. However, at the moment, training courses, materials and methods for supervisory staff are not arranged systematically in many cases.

Within this process, an active role of the recipient countries should be particularly encouraged so as to ensure that training addresses their needs.

The training programmes for insurance supervisors in emerging market economies drafted by Mr. Bellando, Chairman of the IAIS Education Committee, will provide supervisory training by geographical area (Africa, Central and South America, Asia, East

European countries), with a total of four training programmes in two years (one for each geographical area). The themes of the training programmes will be determined on the basis of both the results of the survey made by the Emerging Markets Committee and the main sections of the Manual (licensing, control and supervision, investments, solvency). Each organizer will contact the countries in his/her zone and the competent regional organizations, settle the plan, duration, language and location of the training and report back to the Education Committee. Funding will be determined by the Education Committee in consultation with the Emerging Market Issues Committee. Some training could be organized in cooperation with the national or international organizations.

As suggested by Mr. Molgaard (Denmark), the Committee should also consider organizing missions to emerging market economies in order to:

- Implement the mandate of the Emerging Market Issues Committee and contribute to raising the level of both the insurance industry and the insurance market;
- Recruit more IAIS members;
- Create a prototype for insurance industry supervision;
- Develop know-how on technical assistance on the same lines as the extensive technical and financial support for the banking system;
- Establish a base for channelling technical assistance and financing from the industrial countries to the emerging market economies.

Coordination

The IAIS will also play a key role in coordinating technical assistance on insurance issues in emerging markets. Due to its large membership (in both industrial and emerging market economies) and its unique international role on insurance supervision, the IAIS is in an ideal position to be a central intermediary between organizations which provide technical assistance and users of technical assistance. Furthermore, the IAIS will also play a coordinating role in ensuring that technical assistance provided by various institutions is complementary. At present, the European Union, OECD, UNCTAD and the World Bank as well as other international organizations, certain Governments, academic societies and private sector bodies, etc., all organize their own technical assistance programmes, training, seminars with limited coordination between them.

Therefore, the Emerging Market Issues Committee and the Education Committee will:

- Further develop the results of the research prepared by Mr. Butterworth, former chairman of the Education Committee, concerning training requests and organizations which provided training;
- Prepare and send a questionnaire on those providing technical assistance and requests for technical assistance to all IAIS member countries, non-IAIS member countries and international organizations under the initiative of Mr. Bellando, chairman of the Education Committee; a questionnaire will cover questions on concrete assistance programmes, the possibility of financial assistance, name and address of the contact persons (organizations which provide training) and on

results of using technical assistance including training courses, future needs for training and other technical assistance and suggested topics, etc. (training requirements);

- Analyse the collected answers and assess the needs for assistance and possible organizations which provide assistance;
- Nominate a person from the Education Committee to strengthen coordination between organizations which provide assistance and requests for assistance, between the IAIS and other organizations which provide technical assistance on insurance supervision: he/she will take the initiative in exchanging information and coordinating seminars or training programmes and will foster bilateral exchange visits and studies for supervisors;
- Nominate a key person from each region to coordinate technical assistance programmes in that region.

Further development of guidance for insurance regulation for emerging market economies and their training programmes

The activities of the Emerging Market Issues Committee and the Education Committee is not static, but evolve and develop through experience. The experience and information obtained by seminars, training and missions will be utilized to further develop a practical text and measures for supervisors. The interaction between the text and training will be mutually beneficial, leading to the higher level of expertise in both fields.

VIII. Insurance Core Principles and Methodology[89]

International Association of Insurance Supervisors

The Insurance Core Principles and Methodology consist of:

- Essential principles that need to be in place for a supervisory system to be effective;
- Explanatory notes that set out the rationale underlying each principle;
- Criteria to facilitate comprehensive and consistent assessments.

This paper should serve as a benchmark for insurance supervisors in all jurisdictions. It can be used when establishing a supervisory regime or identifying areas in existing regimes that need to be improved. Public authorities concerned with issues of financial stability are urged to provide the necessary support to the supervisory authority so that it can meet the principles and the criteria set out herein.

Introduction

To contribute to economic growth, efficiently allocate resources, manage risk, and mobilize long-term savings, the insurance sector must operate on a financially sound basis. A well-developed insurance sector also helps enhance overall efficiency of the financial system by reducing transaction costs, creating liquidity, and facilitating economies of scale in investment. A sound regulatory and supervisory system is necessary for maintaining efficient, safe, fair and stable insurance markets and for promoting growth and competition in the sector. Such markets benefit and protect policyholders.[90] Sound macroeconomic policies are also essential for the effective performance of insurance supervisory regimes.

The insurance industry, like other components of the financial system, is changing in response to a wide range of social and economic forces. In particular, insurance and insurance-linked financial activities are increasingly crossing national and sectoral boundaries. Technological advances are facilitating innovation. Insurance supervisory systems and practices must be continually upgraded to cope with these developments. Furthermore insurance and other financial sector supervisors and regulators should understand and address financial and systemic stability concerns arising from the insurance sector as they emerge.

The nature of insurance activity – covering risks for the economy, financial and corporate undertakings and households – has both differences and similarities when compared to

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[89] This document was prepared by the IAIS Task Force on the Revisions to the Insurance Core Principles in consultation with members and observers. October 2003.

[90] In this document, the term "policyholder" includes beneficiaries.

the other financial sectors. Insurance, unlike most financial products, is characterized by the reversal of the production cycle insofar as premiums are collected when the contract is entered into and claims and costs arise only if a specified event occurs. Insurers intermediate risks directly. They manage these risks through diversification and the law of large numbers enhanced by a range of other techniques.

Aside from the direct business risks, significant risks to insurers are generated on the liability side of the balance sheet. These risks are referred to as technical risks and relate to the actuarial or statistical calculations used in estimating liabilities. On the asset side of the balance sheet, insurers incur market, credit, and liquidity risk from their investments and financial operations, as well as risks arising from asset-liability mismatches. Life insurers also offer products of life cover with a savings content and pension products that are usually managed with a long-term perspective. The supervisory framework must address all these aspects.

Finally, the supervisory framework needs to reflect the increasing presence in the market of financial conglomerates and groups, as well as financial convergence. The importance of the insurance sector for financial stability has been increasing. This trend has implications for insurance supervision as it requires more focus on a broader set of risks. Supervisory authorities at a national and international level must collaborate to ensure that these entities are effectively supervised so that business and individual policyholders are protected and financial markets remain stable; to avoid contagious risks being transferred from one sector or jurisdiction to another; and to avoid supervisory duplication.

Scope and coverage of the Insurance Core Principles

The Insurance Core Principles provide a globally-accepted framework for the regulation and supervision of the insurance sector. The International Association of Insurance Supervisors (IAIS) principles, standards and guidance papers expand on various aspects. They provide the basis for evaluating insurance legislation, and supervisory systems and procedures.

The principles apply to the supervision of insurers and reinsurers, whether private or government-controlled insurers that compete with private enterprises, wherever their business is conducted, including through e-commerce. The term insurer refers to both insurers and reinsurers. Where the principles do not apply to reinsurers (such as, consumer protection), this is indicated in the text. Conversely, the core principles do not normally apply to the supervision of intermediaries, however, where they do this is specifically indicated.

Insurance supervision within an individual jurisdiction may be the responsibility of more than one authority. For example, the body that sets out the legal framework for insurance supervision may be different from the body that implements it. In this document, the expectation is that the core principles are applied within the jurisdiction rather than necessarily by one supervisory authority. It is, however, essential that in situations where multiple authorities exist, coordination arrangements be established to ensure the implementation of the core principles within an accountable framework.

The supervisory authority must operate in a transparent and accountable manner. It needs legal authority to perform its tasks. It should be noted, however, that the possession of authority is not enough to demonstrate observance with a principle. The supervisory authority should exercise its authority in practice. Similarly it is not enough for the supervisory authority to set requirements; it should also ensure that these requirements are implemented. Having the necessary resources and capacity is essential for the supervisory authority to effectively implement the requirements.

The supervisor must recognize that transparency and accountability in all its functions contribute to its legitimacy and credibility, and the efficiency and stability of the market. A critical element of transparency is for supervisors to provide the opportunity for meaningful public consultation on the development of supervisory policies, and in the establishment of new and amended rules and regulations. To further ensure the proper and efficient operation of the market, supervisors should establish clear timelines for public consultation and action, where appropriate.

Implementation and assessment

The Insurance Core Principles can be used to establish or enhance a jurisdiction's supervisory framework. They can also serve as the basis for assessing the existing supervisory framework and in so doing may identify weaknesses, some of which could affect policyholder protection and market stability. In order to ensure that the core principles are interpreted and implemented in a consistent manner by insurance supervisory authorities, each principle is followed by an explanatory note and criteria. Annex 1 contains a list of IAIS principles, standards and guidance documents, as well as selected codes, that expand on some of the core principles. This list will be updated as new principles, standards and guidance are developed. Annex 2 sets out factors that should be considered when using or implementing these principles and describes how observance should be evaluated.

The criteria, which must be implemented both in form and in practice, consist of two distinct groupings:

1. ***Essential criteria,*** or those components that are intrinsic to the implementation of the core principle. All the essential elements should be met for a supervisory authority to demonstrate "observed" status for each principle.

2. ***Advanced criteria,*** or those components that are considered to improve on the essential criteria and thus enhance the supervisory regime. Advanced criteria are not used for assessing observance with a principle, rather they are used when commenting on a jurisdiction's supervisory framework and making recommendations.[91]

While implementing the criteria in a jurisdiction, and when carrying out the assessment, it is important to take into account the domestic context, industry, structure and stage of development of the financial system and overall macroeconomic conditions. The ways and means of implementation will vary across jurisdictions, and while good implementation practices should be kept in mind, there is no mandated method of

[91] Recommendations may also arise from comments made about the observation of the essential criteria.

implementation. For example, in some jurisdictions the supervisory authority may, within clear limits and following a consultative process, be able to issue guidelines or establish regulations that insurers must follow, whereas in other jurisdictions these powers may reside with the legislature.[92]

For a core principle to be regarded as being "observed" the essential criteria must be met without any significant shortcomings although there may be instances, where one can demonstrate that the principles have been observed through different means other than those identified in the criteria. Conversely, owing to the specific conditions in individual jurisdictions, the criteria identified in this document may not always be sufficient to achieve the objective of the specific principle and therefore additional elements may have to be taken into account.

Conditions for effective insurance supervision

ICP 1 Conditions for effective insurance supervision

Insurance supervision relies upon

- a policy, institutional and legal framework for financial sector supervision
- a well developed and effective financial market infrastructure
- efficient financial markets.

Explanatory note

1.1. Implementation of the principle depends upon the existence of a sound financial policy and institutional environment, as well as a properly functioning financial sector and legal infrastructure.

1.2. This is essential for the supervisory authority to perform its functions and meet its supervisory objectives effectively. The lack of any, or a combination of, essential conditions could affect the quality and efficacy of insurance supervision.

1.3. This principle identifies elements of the economic, legal and financial sector environment and the supporting market infrastructure that need to be present. In most jurisdictions these elements are not defined or controlled by the supervisory authority and are also required for the effective functioning of other sectors as well.

1.4. The existence of an effective financial sector policy and an appropriate institutional and legal framework is necessary to ensure the stable and efficient operation of the financial system. It also facilitates formal and closer coordination among the relevant

[92] In this document, "law" requires full legislative consent; "legislation" refers to either laws or other forms of regulatory rules (e.g. regulations, decrees, ordinance).

supervisory authorities and with the Government, and enhances stakeholders' confidence in the supervisory regime. Good laws alone are not enough. The legal system must provide support in honouring and enforcing insurance contracts.

1.5. Another essential condit ion for effective supervision is for the supervisor to establish credibility and respect in the market vis-à-vis stakeholders, especially insurers and intermediaries. Credibility and respect are a function of many factors including relevant laws and rules, consultation with the industry, and the quality of supervision and supervisory staff.

1.6. Similarly, insurance supervision can be severely constrained by inadequacies in the financial sector infrastructure, such as weaknesses in the national accounting standards or the lack of actuarial skills and insurance expertise. Accurate financial data requires qualified experts including accountants, auditors and financial analysts and access to reliable and comparable economic and social statistics for the proper evaluation of risks. In order to conduct asset liability management a broad-based, liquid and well-functioning money and securities markets are also essential.

1.7. Where the conditions for effective insurance supervision are not yet sufficient, the insurance supervisor could have additional powers to put in place rules and procedures and prudential rules to address the weaknesses.

Financial sector policy framework

Essential criteria

a. The Government establishes and publicly discloses a policy statement aimed at ensuring financial stability, including the provision of effective financial sector supervision covering the insurance and other financial sectors.

b. An institutional and legal framework – comprising public institutions, laws and regulations – exists for financial sector issues, including those pertaining to insurance, to address system-wide issues. This framework is well defined and publicly disclosed.

Financial market infrastructure

Essential criteria

c. There is a reliable, effective, efficient and fair legal and court system (a body of ethical, professional and trained lawyers and judges) whose decisions are enforceable. Alternative dispute mechanisms operate within an appropriate legal framework.

d. Accounting, actuarial and auditing standards are comprehensive, documented, transparent and consistent with international standards. Accounting and actuarial standards are applied and disclosed in a manner that allows current and prospective policyholders, investors, intermediaries, creditors and

supervisors to properly evaluate the financial condition of insurers.

e. Accountants, actuaries and auditors are competent and experienced and comply with technical and ethical standards to ensure the accuracy and reliability of financial data and its interpretation. Auditors are independent from the insurer.

f. Professional bodies set and enforce technical and ethical standards. These standards are accessible to the public.

g. Basic economic, financial and social statistics are available to the supervisory authority, the industry and the public.

Advanced criteria

h. Laws and regulations are updated, as necessary, to reflect current best practices and industry conditions.

Efficient financial markets

Essential criteria

i. Well-functioning money and securities markets exist to support the availability of both long-term and short-term investment opportunities.

The supervisory system

ICP 2 Supervisory objectives

The principal objectives of insurance supervision are clearly defined.

Explanatory note

2.1. The insurance law should include a clear statement of the mandate and responsibilities of the supervisory authority. This gives prominence to the authority's role. Publicly defined objectives also foster transparency. With this basis the public, the Government, the legislature and other interested bodies can form expectations about insurance supervision and assess how well the authority is achieving its mandate and fulfilling its responsibilities legislation.

2.2. Being entrenched in law also ensures that the mandate and functions of the supervisory authority cannot be changed on an *ad hoc* basis. The process of periodically altering the governing laws can promote transparency by way of public discussions on relevant issues; however, if done too frequently stakeholders may form the impression

that the policymaking process is unstable. Therefore it would be prudent to avoid being overly specific. Instead the law could be supplemented as needed with updated regulations, for example.

2.3. The law should also set forth the institutional framework or the basic conceptual structure governing the institutions involved in the design and implementation of insurance supervisory policies, identifying, wherever appropriate, the broader set of relevant financial agencies and the nature of the relationships among them.

2.4. Often the supervisory authority's mandate includes several objectives. As financial markets evolve and depending on current financial conditions, the emphasis a supervisory authority places on a particular objective may change and, where requested, this should be explained.

Essential criteria

a. Legislation or regulation clearly defines the objectives of insurance supervision .

b. The key objectives of supervision promote the maintenance of efficient, fair, safe and stable insurance markets for the benefit and protection of policyholders.

c. In the event that the law mandates or specifies multiple objectives for insurance supervision, the supervisory authority discloses and explains how each objective will be applied.

d. The supervisory authority gives reasons for and explains any deviations from its objectives.

e. Where objectives are contradictory, the supervisory authority initiates or proposes correction in law or regulation.

ICP 3 Supervisory authority

The supervisory authority:

- has adequate powers, legal protection and financial resources to exercise its functions and powers
- is operationally independent and accountable in the exercise of its functions and powers
- hires, trains and maintains sufficient staff with high professional standards
- treats confidential information appropriately.

Explanatory note

3.1. The supervisory authority must be fully empowered to achieve its objectives. The principle therefore covers the following essential elements relating to a supervisory authority: its legal basis, independence and accountability, powers, financial resources, human resources, legal protection and confidentiality.

3.2. Independence, accountability, transparency and integrity interact and reinforce each other. Transparency is a vehicle for safeguarding independence, ensuring accountability, and establishing and safeguarding integrity.

3.3. To support the independence and integrity of the supervisors, there should be provisions for the legal protection of staff, as well as clear rules for appointment and removal of the head of the supervisory authority. These should be publicly disclosed. The supervisory authority should be operationally independent from external political and commercial interference in the exercise of its functions and powers. Independence enhances the credibility and effectiveness of the supervisory process. The existence of an appeals mechanism through the courts helps ensure that regulatory and supervisory decisions are made within the law consistently and are well reasoned.

3.4. It is important to define the relationship between the supervisory authority and the executive and judicial branches, including processes for sharing information, consultation or approval with the relevant ministry and the manner in which the supervisory authority could be subject to judicial review. This might include establishing what information should be provided, how each entity should consult on matters of mutual interest and when approval from relevant ministries is necessary.

Legal framework

Essential criteria

a.	The legislation identifies the authority (or authorities) responsible for the supervision of insurance entities.
b.	The legislation gives the supervisory authorities the power to issue and enforce rules by administrative means (refer to ICP 4EC a).
c.	The legislation grants sufficient powers for the effective discharge of supervisory responsibilities.

Independence and accountability

Essential criteria

d.	The governance structure of the supervisory authority is clearly defined. Internal governance procedures necessary to ensure the integrity of supervisory operations, including internal audit arrangements, are in place.

e.	There are explicit procedures regarding the appointment and dismissal of the head and members of the governing body. When the head of an authority or the governing body is removed from office, the reasons are publicly disclosed.
f.	The institutional relationships between the supervisory authority and executive and the judiciary branches are clearly defined and transparent. Circumstances where executive overrides are allowed are specified.
g.	The supervisory authority and its staff are free from undue political, governmental and industry interference in the performance of supervisory responsibilities.
h.	The supervisory authority is financed in a manner that does not undermine its independence from political, governmental or industry bodies.
i.	The supervisory authority has discretion to allocate its resources in accordance with its mandate and objectives and the risks it perceives.
j.	The supervisory authority has transparent processes and procedures for making supervisory decisions. Supervisory decisions are demonstrably consistent.
k.	All material changes to the insurance legislation and supervisory practices are normally subject to prior consultations with market participants.

Advanced criteria

l..	Representatives of the supervisory authority publicly explain their policy objectives, and report on their activities and performance in pursuing their objectives.
m.	Subject to confidentiality considerations, information is provided publicly about problem or failed insurers, including information on official actions taken.

Powers

Essential criteria

n.	When necessary, the supervisory authority has the power to take immediate action to achieve its objectives, especially to protect policyholders' interests (refer to ICP 4 EC e).

Financial resources

Essential criteria

o.	The supervisory authority has its own budget sufficient to enable it to conduct effective supervision. The supervisory authority is able to attract and retain highly skilled staff, hire outside experts as necessary, provide training, and rely upon an adequate supervisory infrastructure and tools.
p.	The supervisory authority publishes audited financial statements on a regular basis.

Human resources and legal protection

Essential criteria

q.	The supervisory authority and its staff – observe the highest professional standards – have the appropriate levels of skills and experience have the necessary legal protection to protect them against lawsuits for actions taken in good faith while discharging their duties, provided they have not acted illegally – are adequately protected against the costs of defending their actions while discharging their duties – act with integrity. Supervisory staff are subject to conflict of interest rules, such as prohibition on dealing in shares and investing in the companies they supervise. The supervisory authority establishes and enforces a code of conduct that applies to all staff members.
r.	The supervisory authority has the authority to hire, contract or retain the services of external specialists through contracts or outsourcing arrangements if necessary.
s.	Where supervisory functions are outsourced to third parties, the supervisory authority is able to assess their competence, monitor their performance, and ensure their independence from the insurer or any other related party.

Confidentiality

Essential criteria

t.	The supervisory authority maintains appropriate safeguards for the protection of confidential information in its possession. Other than when required by law, or when requested by another supervisor who has a legitimate supervisory interest and the ability to uphold the confidentiality of the requested

information, the supervisory authority denies requests for confidential information in its possession (refer to ICP 5).

u. External specialists hired by the supervisory authority are subject to the same confidentiality and code of conduct requirements as the staff of the supervisory authority.

ICP 4 Supervisory process

The supervisory authority conducts its functions in a transparent and accountable manner.

Explanatory note

4.1. The public's knowledge of and appropriate consultation on the supervisory process is important to the effectiveness and credibility of the supervisor. Accordingly, the supervisor should make available to the public written information about its organization and activities.

4.2. The supervisory authority should make available to the public the text of proposed and existing regulations. This would include not only substantive rules of general applicability but also policies and interpretations that are not confidential but that may affect a member of the public. The supervisory authority's public information should include information about how the public can interact with its officials. It would be appropriate also to describe the manner in which and on what timetable the supervisory authority intends to respond.

4.3. The supervisory authority must be accountable for the actions it takes in fulf illing its mandate to those who delegated the responsibility – the Government or the legislature – as well as to those it supervises and the public at large. It should provide the rationale for decisions taken.

4.4. In general, proper accountability requires a complex combination of approaches, such as legislative and executive oversight, strict procedural requirements, and disclosure. In addition the supervisory authority establishes internal processes for ensuring it is meeting its objectives and complying with legislation.

Essential criteria

a. The supervisory authority adopts clear, transparent and consistent regulatory and supervisory processes. The rules and procedures of the supervisory authority are published and updated regularly.

b. The supervisory authority applies all regulations and administrative procedures consistently and equitably, taking into account the different risk profiles of insurers.

c. The administrative decisions of the supervisory authority can be subject to substantive judicial review. However, such action must not unduly impede the ability of the supervisory authority to make timely interventions in order to protect policyholders' interests.

d. The supervisory authority makes information on its role publicly available.

e. The decision-making lines of the supervisory authority are so structured that action can be taken immediately in the case of an emergency situation (refer to ICP 3 EC n and ICP 15).

f. The process to appeal supervisory decisions is specified and balanced to preserve supervisory independence and effectiveness.

g. The supervisory authority publishes a regular report – at least annually and in a timely manner – on the conduct of its policy, explaining its objectives and describing its performance in pursuing its objectives.

h. The supervisory authority provides and publishes information about the financial situation of the insurance industry and observations on major developments in the insurance or financial market.

Advanced criteria

ICP 5 Supervisory cooperation and information sharing

The supervisory authority cooperates and shares information with other relevant supervisors subject to confidentiality requirements.

Explanatory note

5.1. Efficient and timely exchange of information among supervisory bodies, both within the insurance sector and across the financial services sector, is critical to the effective supervision particularly in the case of internationally active insurers, insurance groups and financial conglomerates. This is also essential in the context of the effective supervision of the financial system as a whole.

5.2. Information sharing arrangements should facilitate prompt and appropriate action in situations where material supervisory issues need to be addressed. Increasingly supervisors need to share information on matters relating to fraud, anti-money laundering and the combating of financing of terrorism.

5.3. The supervisory authority maintains the confidentiality of the supervisory information it receives from another supervisor. Without adequate safeguards on confidentiality, supervisors will find that their access to confidential information is denied or delayed and their ability to carry out supervisory responsibilities severely diminished.

Essential criteria

a. The existence of a formal agreement with another supervisor is not a prerequisite for information sharing.

b. The supervisory authority, at its discretion, can enter into agreements or understandings with any other financial sector supervisor ("another supervisor") to share relevant supervisory information or to otherwise work together.

c. When reasonably requested and with appropriate safeguards, the supervisory authority is able to exchange with another supervisor (refer to ICP 7 EC e) the following:

- relevant supervisory information, including specific information requested and gathered from a supervised entity
- relevant financial data
- objective information on individuals holding positions of responsibility in such entities.

d. Information sharing, whether carried out under formal or informal arrangements, allows for a two-way flow of information without requiring strict reciprocity in terms of the level, format and detailed characteristics of the information exchanged.

e. The home supervisory authority provides relevant information to the host supervisor.

f. The supervisory authority is required to take reasonable steps to ensure that any information released to another supervisor will be treated as confidential by the receiving supervisor and will be used only for supervisory purposes.

g. The supervisory authority consults with another supervisor if it proposes to take action on the evidence of the information received from that supervisor.

h. The home supervisory authority informs relevant host supervisors of any material changes in supervision that may have a significant bearing on the operations of foreign establishments operating in their jurisdictions.

i. Where possible, the home supervisory authority informs the host supervisor in advance of taking any action that will affect the foreign establishment in the host supervisor's jurisdiction.

j. Where possible, the host supervisory authority informs the home supervisor in advance of taking any action that will affect the parent company or headquarters in the home supervisor's jurisdiction.

The supervised entity

ICP 6 Licensing

An insurer must be licensed before it can operate within a jurisdiction. The requirements for licensing are clear, objective and public.

Explanatory note

6.1. To protect the interest of policyholders a jurisdiction must be able to determine which insurers are allowed to carry out insurance activities within its area. Licensing refers to the formal authority given to an insurer to carry on insurance business under the domestic insurance legislation. It does not refer to any approval granted in terms of the general domestic company or business legislation.

6.2. When the licensing procedure meets internationally accepted standards and is effective and impartial, confidence in the supervisory system will grow and may facilitate mutual recognition of supervisory systems and thus the further liberalization of market access for foreign insurers. Licensing procedures and conditions are in place for supervisory purposes; they should not in themselves act as a barrier to market access.

Essential criteria

a. The insurance legislation:

- includes a definition of insurers
- requires licensing of insurers, and prohibits unauthorized insurance activities
- defines the permissible legal forms of insurers
- allocates the responsibility for issuing licences.

b. Clear, objective and public licensing criteria require:

- the applicant's board members, senior management, auditor and actuary both individually and collectively to be suitable, as specified in ICP 7
- the applicant's significant owners (refer to ICP 8 EC a) to be suitable, as specified in ICP 7
- the applicant to hold the required capital
- the applicant's risk management systems including reinsurance arrangements, internal control systems, information technology systems, policies and procedures to be adequate for the nature and scale

of the business in question

- information on the applicant's business plan projected out for a minimum of three years. The business plan must reflect the business lines and risk profile, and give details of projected setting-up costs, capital requirements, projected development of business, solvency margins and reinsurance arrangements. The business plan must present information regarding primary insurance and inward reinsurance separately
- information on the products to be offered by the insurer
- information on contracts with affiliates and outsourcing arrangements
- information on the applicant's reporting arrangements, both internally to its own management and externally to the supervisory authority
- input from the applicant's home supervisory authority when the insurer or its owners are not domestic and a home supervisory authority exists (refer to ICP 5).

c. The supervisory authority requires that no domestic or foreign insurance establishment escape supervision.

d. All insurance establishments of international insurance groups and international insurers are subject to effective supervision. The creation of a cross-border establishment should be subject to consultation between the host and home supervisor.

e. The insurance legislation determines the method by which a foreign insurer can carry on business in the jurisdiction. This may be by way of a local branch or subsidiary that must be licensed, or on a services basis only.

f. If a foreign insurer is allowed to carry on business in the jurisdiction the supervisory authority must be provided with the following data:

- confirmation from the home supervisory authority that the insurer is authorized to carry on the types of insurance business proposed
- information from the home supervisory authority that the insurer is solvent and meets all the regulatory requirements in the home jurisdiction
- in the case of a branch office: the name and address of the branch
- the name of the authorized agent in the local jurisdiction in the case of insurance offered on a services basis (i.e. where a local branch or subsidiary is not established)
- the information and documentation normally required to be licensed in

the local jurisdiction, when appropriate

These information requirements might be waived if insurance is offered on a services basis only.

g. An insurer licensed to underwrite life insurance business must not also be licensed to underwrite non-life insurance business, and vice versa, unless the supervisory authority is satisfied that the insurer has satisfactory processes requiring that risks be handled separately on both a going concern and a winding-up basis.

h. The supervisory authority imposes additional requirements, conditions or restrictions on an applicant where the supervisory authority considers this appropriate. This might include restrictions on non-insurance activities.

i. The supervisory authority assesses the application and makes a decision within a reasonable time. No licence is issued without its approval. The applicant must be informed of the decision without delay and, if the licence is denied or conditional, be provided with an explanation.

j. The supervisory authority refuses to issue a licence where it considers the applicant not to have sufficient resources to maintain the insurer's solvency on an ongoing basis, where the organizational (or group) structure hinders effective supervision, or where the application is not in accordance with the licensing criteria.

k. As necessary, after an insurer has been licensed, the supervisory authority evaluates and monitors the degree to which the insurer satisfies the relevant licensing principles and requirements of the jurisdiction.

ICP 7 Suitability of persons

The significant owners, board members, senior management, auditors and actuaries of an insurer are fit and proper to fulfil their roles. This requires that they possess the appropriate integrity, competency, experience and qualifications.

Explanatory note

7.1. An important element of the supervision of insurers is the initial and ongoing assessment of the fitness and propriety of an insurer's significant owners and key functionaries such as board members, senior management, auditors and actuaries. In the case of significant owners, fit and proper requirements relate to the persons and their financial soundness. A significant owner is defined as a person (legal or natural) that directly or indirectly, alone or with an associate, exercises control over the insurer (refer to ICP 8 EC a). The main responsibility for assessment of the fitness and propriety of key functionaries lies with the insurers themselves.

7.2. The supervisory authority should be satisfied that significant owners and key functionaries have the level of competence for their roles, and should ascertain whether they have the appropriate ability and integrity to conduct insurance business, taking account of potential conflicts of interests. Appropriate ability can generally be judged from the level of a person's professional or formal qualifications or relevant experience within the insurance and financial industries or other related businesses.

Essential criteria

a.	Legislation identifies which key functionaries must meet fit and proper requirements. The key functionaries identified may differ depending on the legal form and governance structure of the insurer.
b.	In cases where significant owners no longer meet fit and proper requirements, the supervisory authority must be able to take appropriate action, including requiring that the owners dispose of their interests.
c.	The supervisory authority disqualifies the appointment of key functionaries including auditors and actuaries of insurers that do not comply with fit and proper requirements
d.	The insurer should be required to demonstrate to the supervisory authority the fitness and propriety of key functionaries by submitting documentation illustrating their knowledge, experience, skills and integrity upon request, or where there are changes in key functionaries. The knowledge and experience required depends on the position and responsibility of the functionary within the insurer.
e.	The supervisory authority exchanges information with other authorities inside and outside its jurisdiction where necessary to check the suitability of persons. The supervisory authority uses this information as an additional tool to effectively assess the fitness and propriety of, or to obtain information on, a key functionary of an insurer (refer to ICP 5).
f.	The supervisory authority disallows actuaries, auditors, directors and senior managers, from simultaneously holding two positions in an insurer where this could result in a material conflict.
g.	Where the insurer becomes aware of circumstances that may be relevant to the fitness and propriety of its key functionaries, it is required to notify the supervisory authority as soon as possible.

Advanced criteria

h.	Criteria to assess the fitness and propriety of auditors' and actuaries' include qualifications, professional proficiency, appropriate practical experience and updated knowledge on developments within their profession and membership of professional bodies.

i. In the case of auditors and actuaries, the supervisory authority may give regard to or rely on professional bodies that set and enforce standards of professional conduct.

ICP 8 Changes in control and portfolio transfers

The supervisory authority approves or rejects proposals to acquire significant ownership or any other interest in an insurer that results in that person, directly or indirectly, alone or with an associate, exercising control over the insurer.

The supervisory authority approves the portfolio transfer or merger of insurance business.

Explanatory note

8.1. The supervisory authority must be able to grant or deny approval to a person (legal or natural) that wants to acquire significant ownership or a controlling interest in an insurer, whether directly or indirectly, alone or with an associate. The concepts of significant ownership or control should be defined in legislation.

8.2. Notification should be required for changes in ownership or control according to the percentages of an insurer's issued shares. These established percentages typically range between 5 and 10 per cent. Where supervisory approval is required in addition to notification, specific thresholds (equal to or higher than those for notification) should be set.

8.3. The supervisory authority must require that the proposed owners have the resources to provide the minimum capital required as well as the ability to provide further capital or other support for the insurer when needed.

8.4. Owners should not expose the insurer to undue risks or hinder effective supervision. The supervisory authority should be satisfied about what constitutes an insurance group or conglomerate and which entities are considered to be part of such a group. The structure and risk profile of the group to which the insurer belongs should not damage the insurer's stability and solvency (refer to ICP 17).

8.5. Changes in control have an indirect effect on the contractual arrangements between insurer and policyholder, whereas a portfolio transfer will have a direct effect on this relationship. For this reason supervisory authorities should closely monitor portfolio transfers.

8.6. Insurance policies are legal contracts between an insurer and its policyholders. An insurer should not be able to unilaterally alter the terms of a contract by merging with another insurer, mutualizing or demutualizing or transferring some of its policy liabilities to another insurer. In order to protect the interests of policyholders, legislation should restrict the ability of insurers to transfer their policy liabilities. The supervisory authority must ensure that policyholders' reasonable benefit expectations and existing policy values will not normally be lessened as a result of liability transfer. This should apply whether the transfer involves a single policy or a portfolio or the transaction is considered a part of

normal business, a merger or part of a winding-up procedure in a situation where the insurer is no longer financially viable or is insolvent (refer to ICP 16).

Changes in control

Essential criteria

a. The term "control" over an insurer is defined in legislation and it addresses:

- holding of a defined number or percentage of issued shares or specified financial instruments (such as compulsory convertible debentures) above a designated threshold in an insurer or its intermediate or ultimate beneficial owner
- voting rights attached to the aforementioned shares or financial instruments
- power to appoint or remove directors to the board and other executive committees.

b. The supervisory authority requires that the potential controlling owners apply for approval for the acquisition, or change in control, of the insurers. The insurer must inform the supervisory authority of any acquisitions or changes in control.

c. The supervisory authority approves any significant increase in shareholdings above the predetermined control levels in an insurer by legal or natural persons, whether obtained individually or in association with others. This also applies to any other interest in that insurer or its intermediate or ultimate beneficial owners.

d. The requirements in criteria b and c above also refer to the acquisition or change of control where the intermediate or ultimate beneficial owner(s) of an insurer is (are) outside the jurisdiction where the insurer is incorporated. Supervision of changes in control may require coordination with supervisors in other jurisdictions (refer to ICP 5).

e. The supervisory authority must be satisfied that those seeking control meet the criteria applied during the licensing process. The requirements in ICP 7 – Suitability of persons – will apply to the prospective owners in control of insurers.

f. The supervisory authority requires that the structures of the financial groups containing potential controlling owners of insurers be sufficiently transparent so that supervision of the insurance group will not be hindered (refer to ICP 17).

g. The supervisory authority rejects applications of proposed owners to control insurers if facts exist from which it can be deduced that their ownership will be unduly prejudicial to policyholders. The supervisory authority should know

who is the intended beneficial owner.

h. To assess applications for proposed acquisitions or changes in control of insurers the supervisory authority establishes requirements for financial and non-financial resources.

Advanced criteria

i. Upon request insurers provide the supervisory authority with information on their shareholders and any other person directly or indirectly exercising control. The supervisory authority determines the content and format of this information.

Portfolio transfer

Essential criteria

j. The supervisory authority requires that insurers get approval from the authority before they transfer all or any part of their insurance business.

k. The supervisory authority establishes requirements to assess insurers' applications to transfer all or any part of their insurance business.

l. The supervisory authority requires that the interests of the policyholders of both the transferee and transferor be protected when insurance business is transferred (refer to ICP 15 EC c).

ICP 9 Corporate governance

The corporate governance framework recognizes and protects rights of all interested parties. The supervisory authority requires compliance with all applicable corporate governance standards.

Explanatory note

9.1. Insurers must be managed prudently. Corporate governance refers to the manner in which boards of directors and senior management oversee the insurer's business. It encompasses the means by which members of the board and senior management are held accountable and responsible for their actions. Corporate governance includes corporate discipline, transparency, independence, accountability, responsibility, fairness and social responsibility. Timely and accurate disclosure on all material matters regarding the insurer, including the financial situation, performance, ownership and governance arrangements, is part of a corporate governance framework. Corporate governance also includes compliance with legal and regulatory requirements.

9.2. The board is the focal point of the corporate governance system. It is ultimately accountable and responsible for the performance and conduct of the insurer. Delegating authority to board committees or management does not in any way mitigate or dissipate the discharge by the board of directors of its duties and responsibilities. In the case of a policy established by the board, the board would need to be satisfied that the policy has been implemented and that compliance has been monitored. Similarly the board needs to be satisfied that applicable laws and regulations have been complied with. The responsibilities of the governing body must be consistent with the rules on governance structure established in the jurisdiction. Where the posts of chairman and chief executive are combined in one person, the supervisory authority will verify that appropriate controls are in place to ensure that management is sufficiently accountable to the board of directors.

9.3. In most jurisdictions corporate governance rules exist for general purpose corporations; these likely also apply to insurers. Often, however, it is necessary to establish additional requirements, through the insurance legislation, that deal with the matters of specific concern and importance to insurance supervisors. These matters are described in the criteria below. As the supervisory authority may not have the power to specify the details of general corporate governance rules or to enforce compliance, several criteria under this principle refer to the responsibility of the board of directors rather than requirements from the supervisory authority.

Essential criteria

a. The supervisory authority requires and verifies that the insurer complies with applicable corporate governance principles.

b. The board of directors:

– sets out its responsibilities in accepting and committing to the specific corporate governance principles for its undertaking. Regulations on corporate governance should be covered in general company law and/or insurance law. These regulations should take account of the size, nature and complexity of the insurer.

– establishes policies and strategies, the means of attaining them, and procedures for monitoring and evaluating the progress toward them. Adherence to the policies and strategies are reviewed regularly, and at least annually.

– satisfies itself that the insurer is organized in a way that promotes the effective and prudent management of the institution and the board’s oversight of that management. The board of directors has in place and monitors independent risk management functions that monitor the risks related to the type of business undertaken. The board of directors establishes audit functions, actuarial functions, strong internal controls and applicable checks and balances.

– distinguishes between the responsibilities, decision-making, interaction and cooperation of the board of directors, chairman, chief executive and senior management. The board of directors delegates its responsibilities and establishes decision-making processes. The insurer establishes a division of

responsibilities that will ensure a balance of power and authority, so that no one individual has unfettered powers of decision.

– establishes standards of business conduct and ethical behaviour for directors, senior management and other personnel. These include policies on private transactions, self-dealing, preferential treatment of favoured internal and external entities, covering trading losses and other inordinate trade practices of a non-arm's length nature. The insurer has an ongoing, appropriate and effective process of ensuring adherence to those standards.

– appoints and dismisses senior management. It establishes a remuneration policy that is reviewed periodically. This policy is made available to the supervisory authority.

– collectively ensures that the insurer complies with all relevant laws, regulations and any established codes of conduct (refer to EC f).

– has thorough knowledge, skills, experience and commitment to oversee the insurer effectively (refer to ICP 7).

– is not subject to undue influence from management or other parties. The board of directors has access to information about the insurer, and asks and receives additional information and analyses that the board sees fit.

– communicates with the supervisory authority as required and meets with the supervisory authority when requested.

– sets out policies that address conflicts of interest, fair treatment of customers and information sharing with stakeholders, and reviews these policies regularly (refer to ICP 25).

c. – overseeing the operations of the insurer and providing direction to it on a day-to-day basis, subject to the objectives and policies set out by the board of directors, as well as to legislation.

– providing the board of directors with recommendations, for its review and approval, on objectives, strategy, business plans and major policies that govern the operation of the insurer.

– providing the board with comprehensive, relevant and timely information that will enable it to review business objectives, business strategy and policies, and to hold senior management accountable for its performance.

Advanced criteria

d. The board of directors may establish committees with specific responsibilities like a compensation committee, audit committee or risk management committee.

e. The remuneration policy for directors and senior management has regard to the performance of the person as well as that of the insurer. The remuneration policy should not include incentives that would encourage imprudent behaviour.

f. The board of directors identifies an officer or officers with responsibility for ensuring compliance with relevant legislation and required standards of business conduct and who reports to the board of directors at regular intervals (refer to EC b).

g. When a "responsible actuary" is part of the supervisory process, the actuary has direct access to the board of directors or a committee of the board. The actuary reports relevant matters to the board of directors on a timely basis.

ICP 10 Internal control

The supervisory authority requires insurers to have in place internal controls that are adequate for the nature and scale of the business. The oversight and reporting systems allow the board and management to monitor and control the operations.

Explanatory note

10.1. The purpose of internal control is to verify that:

- the business of an insurer is conducted in a prudent manner in accordance with policies and strategies established by the board of directors (refer to ICP 9)
- transactions are only entered into with appropriate authority
- assets are safeguarded (refer to ICP 21)
- accounting and other records provide complete, accurate, verifiable and timely information
- management is able to identify, assess, manage and control the risks of the business and hold sufficient capital for these risks (refer to ICP 18 and 23)

10.2. A system of internal control is critical to effective risk management and a foundation for the safe and sound operation of an insurer. It provides a systematic and disciplined approach to evaluating and improving the effectiveness of the operation and assuring compliance with laws and regulations. It is the responsibility of the board of directors to develop a strong internal control culture within its organization, a central feature of which is the establishment of systems for adequate communication of information between levels of management.

10.3. It is an essential element of an internal control system that the board of directors receive regular reporting on the effectiveness of the internal control. Any identified

weakness should be reported to the board of directors as soon as possible so appropriate action can be taken.

Essential criteria

a. The supervisory authority reviews the internal controls and checks their adequacy to the nature and the scale of the business and requires strengthening of these controls where necessary. The board of directors is ultimately responsible for establishing and maintaining an effective internal control system.

b. The framework for internal controls within the insurer includes arrangements for delegating authority and responsibility, and the segregation of duties. The internal controls address checks and balances; e.g. cross-checking, dual control of assets, double signatures (refer to ICP 9 EC b).

c. The internal and external audit, actuarial and compliance functions are part of the framework for internal control, and must test adherence to the internal controls as well as to applicable laws and regulations.

d. The board of directors must provide suitable prudential oversight and establish a risk management system that includes setting and monitoring policies so that all major risks are identified, measured, monitored and controlled on an ongoing basis. The risk management systems, strategies and policies are approved and periodically reviewed by the board of directors (refer to ICP 18).

e. The board of directors provides suitable oversight of market conduct activities.

f. The board of directors should receive regular reporting on the effectiveness of the internal controls. Internal control deficiencies, either identified by management, staff, internal audit or other control personnel, are reported in a timely manner and addressed promptly.

g. The supervisory authority requires that internal controls address accounting procedures, reconciliation of accounts, control lists and information for management.

h. The supervisory authority requires oversight and clear accountability for all outsourced functions as if these functions were performed internally and subject to the normal standards of internal controls.

i. The supervisory authority requires the insurer to have an ongoing internal audit function of a nature and scope appropriate to the business. This includes ensuring compliance with all applicable policies and procedures and reviewing whether the insurer’s policies, practices and controls remain sufficient and appropriate for its business.

j. The supervisory authority requires that an internal audit function:

- has unfettered access to all the insurer's business lines and support departments
- assesses outsourced functions
- has appropriate independence, including reporting lines to the board of directors
- has status within the insurer to ensure that senior management reacts to and acts upon its recommendations
- has sufficient resources and staff that are suitably trained and have relevant experience to understand and evaluate the business they are auditing

employs a methodology that identifies the key risks run by the institution and allocates its resources accordingly (refer to ICP 18).

k. The supervisory authority has access to reports of the internal audit function.

l. Where the appointment of an actuary is called for by applicable legislation or by the nature of the insurer's operations, the supervisory authority requires that actuarial reports be made to the board and to management.

Ongoing supervision

ICP 11 Market analysis

Making use of all available sources, the supervisory authority monitors and analyses all factors that may have an impact on insurers and insurance markets. It draws conclusions and takes action as appropriate.

Explanatory note

11.1. In order to achieve its objectives, the supervisory authority supervises the financial soundness of individual insurers and contributes to financial stability of the insurance market. Both require an analysis of individual insurers and insurance groups as well as the market and the environment in which they operate.

11.2. In today's globalized financial markets and rapidly integrating financial systems, economic developments and policy decisions of one jurisdiction may affect many other jurisdictions. Similarly, developments in the economy as a whole, or in one part of the financial sector, may impact the business operations and financial stability of the insurance market. To enable an assessment of financial data, it will be necessary to have an understanding of the basis of financial reporting in relevant jurisdictions.

11.3. In-depth market analysis helps identify risks and vulnerabilities, supports prompt supervisory intervention as referred in ICP 14 and strengthens the supervisory framework with a view to reducing the likelihood or severity of future problems. It is recognized that in-depth market analysis requires skilled resources.

11.4. A quantitative analysis of the market could include, for example, developments in the financial markets generally; the number of insurers and reinsurers subdivided by ownership structure whether a branch, domestic or foreign; the number of insurers and reinsurers entering and exiting the market; market indicators such as premiums, balance sheet totals and profitability; investment structure; new product developments and market share; distribution channels; and use of reinsurance.

11.5. A qualitative analysis could include, for example, reporting on general developments which may impact insurance markets, companies and clients; new or forthcoming financial sector and other relevant legislation; developments in supervisory practices and approaches; and reasons for market exits.

Essential criteria

a.	The supervisory authority conducts regular analysis of market conditions.
b.	The market analysis not only includes past developments and the present situation, but also aims to identify trends and possible future scenarios and issues, so that the supervisory authority is well prepared to take action at an early stage, if required.
c.	The market analysis is both quantitative and qualitative and makes use of both public and confidentia l sources of information.
d.	The supervisory authority or others, such as the insurance industry, publish aggregated market data that is readily and publicly available to the insurance industry and other interested parties.
e.	The supervisory authority requires market-wide systematic reporting to analyse and monitor particular market-wide events of importance for the financial stability of insurance markets.

Advanced criteria

f.	Insofar as international relationships affect internal insurance and financial markets, the analysis is not limited to the home market, but also includes developments elsewhere.
g.	The supervisory authority monitors trends that may have an impact on the financial stability of insurance markets. It assesses whether macroeconomic risks and vulnerabilities are adversely impinging on prudential safeguards, financial stability or consumer interests.

ICP 12 Reporting to supervisors and off-site monitoring

The supervisory authority receives necessary information to conduct effective off-site monitoring and to evaluate the condition of each insurer as well as the insurance market.

Explanatory note

12.1. It is essential for the supervisory authority to receive information necessary to conduct effective off-site monitoring which can often identify potential problems, particularly in the interval between on-site inspections, thereby providing early detection and prompting corrective action before problems become more serious.

12.2. The supervisory authority decides what information it requires, in what form, from whom, and with what frequency. The reporting requirements are a reflection of the supervisory needs, and will thus vary according to overall market structure and situation. They also reflect the situation at individual insurers and the way they control their risks (e.g. asset/liability management, reinsurance policy.). Information should be both current and prospective in nature. In setting the requirements the supervisory authority should strike a balance between the need for information for supervisory purposes and the administrative burden it puts on insurers.

12.3. Reporting requirements should apply to all insurers licensed in a jurisdiction and form the general basis for off-site analysis. The reporting requirements should be reviewed periodically. Additional information may be requested from specific insurers on a case-by-case basis. New developments may require the supervisory authority to carry out market-wide off-site analyses, which will require having insurers to submit information on an ad hoc basis.

12.4. In setting the requirements, the supervisory authority may make a distinction between the standards applied to reports prepared for disclosure to policyholders and investors, and those applied for the supervisory authority.

12.5. In setting the requirements, the supervisory authority may make a distinction between the financial reports and calculations prepared for companies incorporated in its jurisdiction, and branch operations in its jurisdiction of companies incorporated in another jurisdiction.

Essential criteria

a. The supervisory authority:

- sets the requirements for the submission of regular and systematic financial and statistical information, actuarial reports and other information from all insurers licensed in the jurisdiction
- defines the scope and frequency of those reports and information, including any requirement that reports and information be audited
- requires, as a minimum, an audit opinion should be provided annually (refer to ICP 1 EC e)

- requests more frequent and more detailed additional information whenever there is a need.

b. If making a distinction between the financial reports and requirements of companies incorporated in the jurisdiction and branches, or between private entities and government-sponsored insurers that compete with private enterprises, the supervisory authority should not distort the market in favour of or against any particular form of enterprise.

c. The supervisory authority:

- requires insurers to submit information about their financial condition and performance on both a solo and a group-wide basis. It may request and obtain financial information on any subsidiary of the supervised entity.
- sets out the principles and norms regarding accounting and consolidation techniques to be used. The valuation of assets and liabilities should be consistent, realistic, and prudent (refer to ICP 21 EC b).
- requires insurers to report any off-balance sheet exposures.
- requires insurers to report on their outsourced functions.
- requires that the appropriate level of an insurer's senior management is responsible for the timing and accuracy of these returns.
- requires that inaccurate information be corrected and has the authority to impose sanctions for deliberate misreporting.
- based on this information, maintains a framework for ongoing monitoring of the financial condition and performance of the insurers.

Advanced criteria

d. From time to time, the supervisory authority reviews its regular and systematic reporting requirements to ensure they still serve their intended aims and are carried out in an efficient and effective manner.

e. The supervisory authority requires insurers to report promptly material changes that affect the evaluation of their condition.

ICP 13 On-site inspection

The supervisory authority carries out on-site inspections to examine the business of an insurer and its compliance with legislation and supervisory requirements.

Explanatory note

13.1. Whether performed by the staff of the supervisory authority or other suitably qualif ied specialists, on-site inspection is an important part of the supervisory process, closely related to the off-site monitoring process. It provides information that supplements the analysis of the reporting to supervisory authorities sent by the insurer. On-site inspection, however, also needs the support of market information and statistics derived from the analysis of the annual accounts and returns.

13.2. Through on-site inspections the supervisory authority is able to verify or capture reliable data and information to assess and analyse an insurer's current and prospective solvency. On-site inspection enables the supervisor to obtain information and detect problems that cannot be easily obtained or detected through ongoing monitoring. In particular, on-site inspections allow the supervisor to identify problems or irregularities in a range of areas, including asset quality, accounting and actuarial practices, internal controls (including those dealing with information technology and outsourcing), quality of underwriting (both the prudence of the underwriting policy and the effectiveness of its implementation in practice), valuation of technical provisions,[93] strategic and operational direction, reinsurance, and risk management.

13.3. On-site inspections enhance the supervisor's ability to assess the competence of the managers of insurers. It is also an effective way for supervisors to assess the management's decision-making processes and internal controls. It provides supervisors the opportunity to analyse the impact of specific regulations and, more generally, to gather information for benchmarking.

13.4. The criteria envisage that on-site inspection may be carried out in a manner that is either "full scale" or "on a focused basis." Both forms of inspection need to be conducted by skilled staff that can evaluate and analyse the information that they obtain during the inspection. Usually the supervisory authority provides guidance on the scope and procedures for on-site inspections. However, staff performing inspections should use their investigative and technical skills when forming views about the information they obtain.

13.5. On-site inspection can assist in assessing the risks to which a firm is exposed. A full-scale on-site inspection includes, at a minimum, the following activities:

- evaluation of the management and internal control system
- analysis of the nature of the insurer's activities, e.g. the type of business written

[93] The term "technical provisions" is used throughout this document. Some jurisdictions use the term "policy liabilities" instead. The meaning is the same, i.e., amount set aside on the balance sheet to meet liabilities arising out of insurance contracts, including claims provision "whether reported or not", provision for unearned premiums, provision for unexpired risks, life assurance provision and other liabilities related to life insurance contracts (e.g. premium deposits, savings accumulated over the term of with-profit policies) (*source:* IAIS Glossary of Terms).

- evaluation of the technical conduct of insurance business or an evaluation of the organization and the management of the insurer, the commercial policy and the reinsurance cover and its security
- analysis of the relationships with external entities, such as through outsourcing or with respect to other companies in the same group
- assessment of the insurer's financial strength, notably the technical provisions
- evaluation of compliance with corporate governance requirements

13.6. A full-scale on-site inspection of market conduct issues includes, at a minimum, the following activities:

- checking the sufficiency and adequacy of the information given to consumers
- reviewing the timing of payments
- reviewing the frequency and nature of litigation
- assessing observance of the market conduct standards and consumer regulations (refer to ICP 25 and 26)

13.7. Effective inspections may need to include access to outsourced service providers or other parties to ensure that the inspection adequately addresses insurers who transfer functions and information outside the company. Where another authority supervises the outsourced service provider supervisory actions should be coordinated (refer to ICP 5).

13.8. The frequency of on-site inspections will take account of the risk profile of the insurer as it appears from previous on-site inspections and off-site monitoring; an additional factor may be the relative importance of the insurer in the market.

Essential criteria

a. By law, the supervisory authority has wide-ranging powers to conduct on-site inspections and gather information deemed necessary to perform its duties.

b. The supervisory authority, external auditors or other suitably qualified parties verify information in regulatory returns periodically through on-site inspections. Where parties other than the supervisory authority verify information, then arrangements for communication with the supervisory authority should be established.

c. The supervisory authority may conduct on-site inspections on either a full scale, or a focused basis investigating areas of specific concern.

d. The supervisory authority promptly discusses findings and any need for corrective action with the insurer and obtains appropriate feedback from the insurer.

e. The supervisory authority follows up with the insurer to ensure that any

required action has been taken.

f. The supervisory authority can extend on-site inspections to obtain information from intermediaries and companies that have accepted functions outsourced by the supervised insurer.

ICP 14 Preventive and corrective measures

The supervisory authority takes preventive and corrective measures that are timely, suitable and necessary to achieve the objectives of insurance supervision.

Explanatory note

14.1. Where insurers fail to meet supervisory requirements or where their continued solvency comes into question, the supervisory authority must intervene to protect policyholders. To do so, the supervisor authority needs to have the legal and operational capacity to bring about timely corrective action. Depending on the nature of the problem detected, a graduated response may be required. In instances where the detected problem is relatively minor, informal action such as an oral or written communication to management may be sufficient. In other instances, more formal action may be necessary.

Essential criteria

a. The supervisory authority has available and makes use of adequate instruments to enable timely preventive and corrective measures if an insurer fails to operate in a manner that is consistent with sound business practices or regulatory requirements.

b. There should be a progressive escalation of action or remedial measures if the problems become worse or if management of the insurer ignores more informal requests from the supervisory authority to take corrective action.

c. The supervisory authority has the capacity and standing to communicate with insurers, and insurers comply with such communications, to ensure that relatively minor preventive or corrective measures are taken.

d. If necessary the supervisory authority requires the insurer to develop an acceptable plan for correction of problems. Corrective plans include agreed and acceptable steps to be taken to resolve the issues raised and an acceptable timetable.

e. The supervisory authority initiates measures designed to prevent a breach of the legislation from occurring, and promptly and effectively deals with non-compliance with regulations that could put policyholders at risk or impinge on any other of the authority's objectives.

ICP 15 Enforcement or sanctions

The supervisory authority enforces corrective action and, where needed, imposes sanctions based on clear and objective criteria that are publicly disclosed.

Explanatory note

15.1. The supervisory authority must have the power to take remedial action in a timely manner where problems involving licensed insurers are identified. The decision-making lines of the supervisory authority should be structured so that action can be taken immediately in the case of an emergency situation (refer to ICP 4 EC e).

15.2. The supervisory authority must have a range of actions available in order to apply appropriate enforcement or sanctions where problems are encountered. Powers should be set out in legislation and may include:

- restricting business activities
- stopping the writing of new business
- withholding approval for new activities or acquisitions
- directing the insurer to stop practices that are unsafe or unsound
- putting assets of the insurer in trust or restricting disposal of those assets
- revoking the licence of an insurer
- removing directors and managers
- barring individuals from the business of insurance

15.3. In some cases it may be appropriate to apply punitive sanctions against insurers or individuals. Provided that the policyholders are not put at greater risk, provisions would normally apply to such situations that would permit a right of appeal of decisions. For actions taken in good faith while discharging their duties the law provides legal protection to the supervisory authority and its staff against lawsuits (refer to ICP 3).

15.4. This principle is directed at the overall protection of policyholders and the observance of requirements. Matters involving individual customers are subject to ICP 25.

Essential criteria

a. The supervisory authority can issue formal directions to companies to take particular actions or to desist from taking particular actions. Failure to comply with a formal direction issued by the supervisory authority has serious consequences for those that take such a step.

b. The supervisory authority has the power to prevent the insurer issuing new policies.

c. The supervisory authority can arrange for compulsory transfer of the obligations under the policies from a failing insurer to another insurer that accepts this transfer (refer to ICP 8 EC l).

d. The supervisory authority can require capital levels to be increased, restrict or suspend dividend or other payments to shareholders, restrict asset transfers and restrict an insurer's purchase of its own shares. It can also initiate action to restrict the ownership or activities of a subsidiary where, in its opinion, such activities jeopardize the financial situation of the insurer.

e. The supervisory authority has effective means to address management problems, including the power to have controlling owners, directors, and managers replaced or their powers restricted. More generally the supervisory authority in extreme cases, imposes conservatorship over an insurer that is failing to meet prudential or other requirements. The supervisory authority has the power to take control of the insurer, or to appoint other specified officials or receivers for the task, and to make such arrangements for the benefit of the policyholders as are necessary.

f. Once action has been taken or remedial measures have been imposed, the supervisory authority periodically checks to determine that the insurer is complying with the measures.

g. The insurance legislation provides for sanctions by way of fines against individuals and insurers where the provisions of the legislation are breached.

h. The insurance legislation provides for sanctions against individuals who withhold information from the supervisory authority, provide information that is intended to mislead the supervisory authority or fail to provide information to the supervisory authority in a timely fashion.

i. Individuals can be barred from acting in responsible capacities in the future.

j. The process of applying sanctions should not delay necessary preventive and corrective measures and enforcement.

k. The supervisory authority takes action to withdraw the licence of an insurer where appropriate.

l. The supervisory authority has the powers to protect one or more insurers within its jurisdiction that belong to a group from the financial difficulties in other parts of the group.

m. The supervisory authority, or another responsible body in the jurisdiction, takes action to enforce all the sanctions noted above.

n. The supervisory authority ensures consistency in the way insurers are sanctioned, so that similar violations and weaknesses attract similar preventive and corrective measures.

o. The supervisory authority or other authority takes action against those individuals or entities that are operating an insurance business without a licence.

ICP 16 Winding-up and exit from the market

The legal and regulatory framework defines a range of options for the orderly exit of insurers from the marketplace. It defines insolvency and establishes the criteria and procedure for dealing with insolvency. In the event of winding-up proceedings, the legal framework gives priority to the protection of policyholders.

Explanatory note

16.1. An insurer may no longer be financially viable or may be insolvent. In such cases, the supervisory authority can be involved in resolutions that require a takeover by or merger with a healthier institution. When all other measures fail, the supervisory authority should have the ability to close or assist in the closure of the troubled insurer.

16.2. The legislation should establish the priority that policyholders receive in winding up an insurer. However, it is also common in many jurisdictions that priority is given to other stakeholders, such as employees or the fiscal authorities. In some jurisdictions, a policyholder protection fund provides additional or alternative protection. Some jurisdictions may decide that protection provided through a policyholder protection fund is not necessary for commercial policyholders.

Essential criteria

a. The legal and regulatory framework provides for the determination of the point at which it is no longer permissible for an insurer to continue its business.

b. The procedures for dealing with insolvency and the winding-up of the insurer are clearly set forth in the law.

c. A high legal priority is given to the protection of the rights and entitlements of policyholders and other policy beneficiaries in the event of an insurer becoming insolvent and winding up. This priority ensures that, as far as is practical, there is limited disruption to the provision of benefits to policyholders.

ICP 17 Group-wide supervision

The supervisory authority supervises its insurers on a solo and a group-wide basis.

Explanatory note

17.1. Supervision of insurers, who are part of a wider insurance group or conglomerate, whether domestic or international, should not be limited to the solo supervision of that insurer. The operations of other group companies, including any holding companies if

applicable, are taken into account in assessing the totality of the risk exposures of the insurers, insurance groups and conglomerates. The fact that such an insurer is part of a group generally alters, often considerably, its risk profile, its financial position, the role of its management, and its business strategy. As a consequence, there should be legal provisions and effective supervision that adequately meet the changed profile of the insurer, ensuring adequate group wide assessment and supervisory action as appropriate.

17.2. As a first step, there should be legal certainty for all parties involved about what constitutes an insurance group or conglomerate. For entities that are considered to be part of such a group, a group mapping exercise should be undertaken that delineates the group structure, and identifies the supervisory authorities involved. Supervisory tasks for the group and the constituent parts should be agreed upon by the supervisors involved or may be set out in legislation. This may call for further cooperation agreements between the various supervisory authorities often including supervisory authorities from different jurisdictions and financial sectors.

17.3. Group-wide assessment and supervision should not be limited to financial indicators such as capital adequacy and risk concentration, but also the management structure, fit and proper testing, and legal issues. The groups should have information systems in place not only to serve their internal information needs, but also to provide all information that the supervisory authority may require in an adequate and timely manner.

17.4. The effective supervision of groups may require effort to ensure that the necessary supervisory tools such as information collection and on-site inspections are able to address group-wide issues effectively.

Essential criteria

a. What constitutes an insurance group and financial conglomerate is clearly defined so that supervisors and insurers can determine:

- which groups are considered to be insurance groups or financial conglomerates
- which group or groups an insurer belongs to
- the scope of the supervision.

b. The supervisory authority ensures effective and efficient group-wide supervision. The supervisory authorities cooperate to avoid unnecessary duplication.

c. Where different supervisory authorities are responsible for different parts of a group or conglomerate appropriate cooperation and coordination exists. The supervisory responsibilities of each authority are well defined and leave no supervisory gaps.

d. At a minimum, group-wide supervision of insurers which are part of insurance groups or financial conglomerates includes, as a supplement to solo supervision, at a group level, and intermediate level as appropriate, adequate

policies on and supervisory oversight of:

- group structure and interrelationships, including ownership and management structure
- capital adequacy
- reinsurance and risk concentration
- intra-group transactions and exposures, including intra-group guarantees and possible legal liabilities
- internal control mechanisms and risk management processes, including reporting lines and fit and proper testing of senior management.

e. Host supervisory authorities avoid uncooperative behaviour with home supervisory authorities so as not to hinder effective supervision of groups and conglomerates (refer to ICP 5 EC i).

f. The supervisory authority requires that insurance groups and financial conglomerates have reporting systems in place that adequately meet the supervisory information demands.

g. The supervisory authority may deny or withdraw the licence when the organizational (or group) structure hinders effective supervision (refer to ICP 6 and ICP 15).

Prudential requirements

This section sets out six principles addressing prudential requirements. Their common goal is to ensure that insurers have the ability under all reasonably foreseeable circumstances to fulfil their obligations as they fall due.

ICP 18 Risk assessment and management

The supervisory authority requires insurers to recognize the range of risks that they face and to assess and manage them effectively.

Explanatory note

18.1. An insurer should identify, understand, and manage the significant risks that it faces. Effective and prudent risk management systems appropriate to the complexity, size and nature of the insurer's business should identify and measure against risk tolerance limits the risk exposure of the insurer on an ongoing basis in order to indicate potential risks as early as possible. This may include looking at risks by territory or by line of business.

18.2. Some risks are specific to the insurance sector, such as underwriting risks and risks related to the evaluation of technical provisions. Other risks are similar to those of other financial institutions, for example market (including interest rate), operational, legal,

organizational and conglomerate risks (including contagion, correlation and counterparty risks).

18.3. Supervisors play a critical role in the risk management process by reviewing the monitoring and controls exercised by the insurer. The supervisory authority develops prudential regulations and requirements to contain these risks. While the supervisor puts such requirements in place with the intention of ensuring enhanced practices by insurers, the ultimate responsibility for the development of best practices and the proper operation of the insurer must always rest with the board of directors.

Essential criteria

a. The supervisory authority requires and checks that insurers have in place comprehensive risk management policies and systems capable of promptly identifying, measuring, assessing, reporting and controlling their risks (refer to ICP 10 EC d).

b. The risk management policies and risk control systems are appropriate to the complexity, size and nature of the insurer's business. The insurer establishes an appropriate tolerance level or risk limit for material sources of risk.

c. The risk management system monitors and controls all material risks.

d. Insurers regularly review the market environment in which they operate, draw appropriate conclusions as to the risks posed and take appropriate actions to manage adverse impacts of the environment on the insurer's business.

e. Larger insurers establish a risk management function and a risk management committee.

ICP 19 Insurance activity

Since insurance is a risk taking activity, the supervisory authority requires insurers to evaluate and manage the risks that they underwrite, in particular through reinsurance, and to have the tools to establish an adequate level of premiums.

Explanatory note

19.1. Insurers take on risks and manage them through a range of techniques including pooling and diversification. Every insurer should have an underwriting policy that is approved and monitored by the board of directors.

19.2. Insurers use actuarial, statistical, or financial methods for estimating liabilities and determining premiums. If these amounts are materially understated, the consequences for the insurer can be significant and in some cases fatal. In particular, premiums charged could be inadequate to cover the risk and costs, insurers may pursue lines of business that are not profitable, and liabilities may be understated, masking the true financial state of the insurer. There is a need to ensure that embedded options have been identified, properly priced and an appropriate reserve has been established.

19.3. Insurers use a number of tools to mitigate and diversify the risks they assume. The most important tool to transfer risk is reinsurance. An insurer should have a reinsurance strategy, approved by its board, that is appropriate to its overall risk profile and its capital. The reinsurance strategy will be part of the insurer's overall underwriting strategy.

Essential criteria

a. The supervisory authority requires insurers to have in place strategic underwriting and pricing policies approved and reviewed regularly by the board of directors.

b. The supervisory authority checks that insurers evaluate the risks that they underwrite and establish and maintain an adequate level of premiums. For this purpose, insurers should have systems in place to control their expenses related to premiums and claims, including claims handling and administration expenses. These expenses should be monitored by management on an ongoing basis.

c. The supervisory authority is able to review the methodology used by the insurer to set premiums to determine that they are established on reasonable assumptions to enable the insurer to meet its commitments.

d. The supervisory authority requires that the insurer has a clear strategy to mitigate and diversify risks by defining limits on the amount of risk retained and taking out appropriate reinsurance cover or using other risk transfer arrangements consistent with its capital position. This strategy is an integral part of the insurer's underwriting policy and must be approved and regularly monitored and reviewed by the board of directors.

e. The supervisory authority reviews reinsurance arrangements to check that they are adequate and that the claims held by insurers on their reinsurers are recoverable. This includes that:

- the reinsurance programme provides coverage appropriate to the level of capital of the insurer (taking into account the real transfer of risk) and the profile of the risks it underwrites
- the reinsurer's protection is secure. This might be addressed through different means, such as relying on a system of direct supervision of reinsurers or obtaining collateral (including trusts, letters of credit or funds withheld).

f. The supervisory authority checks that risk transfer instruments are properly accounted for in order to give a true and fair view of the insurer's risk exposure.

ICP 20 Liabilities

The supervisory authority requires insurers to comply with standards for establishing adequate technical provisions and other liabilities, and making allowance for reinsurance recoverables. The supervisory authority has both the authority and the ability to assess the adequacy of the technical provisions and to require that these provisions be increased, if necessary.

Explanatory note

20.1. An insurer must identify and quantify its existing and anticipated obligations. The establishment of sufficient technical provisions, that is the amount set aside on the balance sheet to meet obligations arising out of insurance contracts (including any related administration expenses, embedded options, policyholder dividends or bonuses and taxes) is a cornerstone of a sound capital adequacy and solvency regime.

20.2. Standards should be defined to be followed by the insurers in setting up their liabilities and, in particular, their technical provisions. These standards should address what is to be included as liabilities; for example, claims provisions – including provisions for claims incurred but not reported, provisions for unearned premiums, provisions for unexpired risks, life insurance provisions and any other liabilities or technical provisions. These standards should also be consistent with other components of the solvency regime. The standards should ensure that the technical provisions are sufficient to cover all expected and some unexpected claims and expenses, make use of reliable and objective methods, and allow a comparison across insurers. The supervisors must have both the power and the ability to check the adequacy of the technical provisions vis-à-vis the established standards and to require the provisions to be increased if, in the supervisor’s opinion, these are not sufficient. This part of the supervisory process requires the use of appropriate actuarial skills.

Essential criteria

a. Legal provisions are in place for establishing adequate technical provisions and other liabilities based on sound accounting and actuarial principles.

b. The supervisory authority prescribes or agrees to standards for establishing technical provisions and other liabilities.

c. The supervisory authority in developing the standards considers:

- what is to be included as a liability
- the procedure and the internal control system that are in place to ensure reliable data (refer to ICP 10)
- the methods and assumptions for assessing, on a reliable, objective, transparent and prudent basis, technical provisions to cover all expected and some unexpected claims and expenses.

d. The supervisory authority reviews the sufficiency of the technical provisions through off-site monitoring and on-site inspection (refer to ICPs 12 and 13).

e. The supervisory authority requires the technical provisions to be increased if they are not sufficient.

f. The supervisory authority ensures that standards stipulate:

- general limits for the valuation of the amounts recoverable under reinsurance arrangements with a given reinsurer for solvency purposes, taking into account the ultimate collectability and the real transfer of risk
- sound accounting principles for the booking of the amounts recoverable under reinsurance arrangements
- the credit for technical provisions for amounts recoverable under reinsurance arrangements. In that case, the amount recoverable is disclosed in the financial statement of the insurer by reporting the respective gross and net figures in the accounts.

Advanced criteria

g. The supervisory authority requires that insurers undertake regular stress testing for a range of adverse scenarios in order to assess the adequacy of capital resources in case technical provisions have to be increased (refer to ICP 21 AC k and ICP 23 AC j).

ICP 21 Investments

The supervisory authority requires insurers to comply with standards on investment activities. These standards include requirements on investment policy, asset mix, valuation, diversification, asset-liability matching, and risk management.

Explanatory note

21.1. Insurers must manage their investments in a sound and prudent manner. An investment portfolio carries a range of investment-related risks that might affect the coverage of technical provisions and the solvency margin. Insurers need to identify, measure, report and control the main risks.

21.2. For insurers in many jurisdictions concentration risk arising from the limited availability of suitable domestic investment vehicles is a real problem. By contrast, international insurers' investment strategies are potentially complex because often they need to manage and match assets and liabilities in a number of currencies and different markets. In addition, the need for liquidity resulting from potential large-scale payments may further complicate an insurer's investment strategy.

21.3. The supervisory authority ensures that standards are established for insurers in managing their investment portfolios and inherent risks. The supervisory authority needs to have both the authority and ability to assess these risks and their potential impact on technical provisions and solvency. However, the detailed formulation of an insurer's investment management policy and internal risk control methodology is the responsibility of the board of directors.

Essential criteria

a. Requirements regarding the management of investments are in place, either in the law or in supervisory rules. These requirements address, but may not be limited to, the following:

- the mixture and diversification by type
- limits or restrictions on the amount that may be held in particular types of financial instruments, property, and receivables
- the safekeeping of assets
- the appropriate matching of assets and liabilities
- the level of liquidity.

b. Investments are valued according to a method prescribed by or acceptable to the supervisory authority.

c. The supervisory authority requires insurers to have in place an overall strategic investment policy, approved and reviewed annually by the board of directors, that addresses the following main elements:

- the risk profile of the insurer
- the determination of the strategic asset allocation, that is, the long-term asset mix over the main investment categories
- the establishment of limits for the allocation of assets by geographical area, markets, sectors, counterparties and currency
- the extent to which the holding of some types of assets is restricted or disallowed, for example illiquid or volatile assets or derivatives
- the conditions under which the insurer can pledge or lend assets
- an overall policy on the use of financial derivatives and structured products that have the economic effect of derivatives (refer to ICP 22)
- clear accountability for all asset transactions and associated risks.

d. The risk management systems must cover the risks associated with investment activities that might affect the coverage of technical provisions and/or solvency

margins (capital). The main risks include:

market risk

credit risk

liquidity risk

failure in safe keeping of assets (including the risk of inadequate custodial agreements).

e. The supervisory authority checks that insurers have in place adequate internal controls to ensure that assets are managed in accordance with the overall investment policy, as well as in compliance with legal, accounting, and regulatory requirements. These controls should ensure that investment procedures are documented and properly overseen. Normally the functions responsible for measuring, monitoring, settling and controlling asset transactions are separate from the front office functions (refer to ICP 10).

f. The supervisory authority requires that oversight of, and clear management accountability for, an insurer's investment policies and procedures remain ultimately with the board of directors, regardless of the extent to which associated activities and functions are delegated or outsourced.

g. The supervisory authority requires that key staff involved with investment activities have the appropriate levels of skills, experience and integrity.

h. The supervisory authority requires that insurers have in place rigorous audit procedures that include full coverage of their investment activities to ensure the timely identification of internal control weaknesses and operating system deficiencies. If the audit is performed internally it should be independent of the function being reviewed.

i. The supervisory authority requires that insurers have in place effective procedures for monitoring and managing their asset/liability position to ensure that their investment activities and asset positions are appropriate to their liability and risk profiles.

j. The supervisory authority requires that insurers have in place contingency plans to mitigate the effects of deteriorating conditions.

Advanced criteria

k. The supervisory authority requires that insurers undertake regular stress testing for a range of market scenarios and changing investment and operating conditions in order to assess the appropriateness of asset allocation limits (refer to ICP 20 AC g and ICP 23 AC j).

ICP 22 Derivatives and similar commitments

The supervisory authority requires insurers to comply with standards on the use of derivatives and similar commitments. These standards address restrictions in their use and disclosure requirements, as well as internal controls and monitoring of the related positions.

Explanatory note

22.1. A derivative is a financial asset or liability whose value depends on (or is derived from) other assets, liabilities or indices (the "underlying asset"). Derivatives are financial contracts and include a wide assortment of instruments, such as forwards, futures, options, warrants, and swaps. These features can be embedded in hybrid instruments (e.g. a bond whose maturity value is tied to an equity index is a hybrid instrument that contains a derivative). Insurers choosing to engage in derivative activities should clearly define their objectives, ensuring that these are consistent with any legislative restrictions.

22.2. Given the nature of insurance operations, derivatives should be used preferably as a risk mitigation mechanism. Supervisory authorities may restrict the use of derivatives to the reduction of investment risk or efficient portfolio management. Derivatives should be considered in the context of a prudent overall asset/liability management strategy.

22.3. This principle also applies to financial instruments that have the economic effect of derivatives and could apply to commodity derivatives, where insurers are permitted to engage in these transactions. Where a jurisdiction completely prohibits the use of derivatives and similar commitments then the assessment criteria clearly do not apply. The prohibition of the use of derivatives is particularly appropriate where a jurisdiction does not fully observe the conditions for effective supervision (refer to ICP 1).

22.4. The criteria of transparent and structured decision-making procedures of policy-setting, execution, monitoring, reporting and control apply equally to similar commitments that are not derivatives transactions but which may be included in some jurisdictions as "off-balance sheet" items. Equivalent requirements and controls should be in place for commitments transacted through special purpose vehicles.

22.5. Derivatives, used appropriately, can be useful tools in the reduction of portfolio risk of insurers. In monitoring the activities of insurers involved in derivatives, the supervisory authority must satisfy itself that insurers have the ability to recognize, measure, and prudently manage the risks associated with their use. The supervisory authority should obtain sufficient information on insurers' policies and procedures on the use of derivatives and may request information on the purpose for which particular derivatives are to be used and the rationale for undertaking particular transactions.

Essential criteria

a. Requirements regarding the use of derivatives are in place, either in the law or in supervisory rules. The requirements consider the risks in the use of derivatives and similar commitments.

b. The supervisory authority establishes disclosure requirements for derivatives and similar commitments.

c. The supervisory authority requires the board of directors to satisfy itself that collectively the board has sufficient expertise to understand the important issues related to the use of derivatives, and that all individuals conducting and monitoring derivatives activities are suitably qualified and competent.

d. The supervisory authority requires insurers using derivatives to have in place an appropriate policy for their use that must be approved and reviewed annually by the board of directors. This policy should be consistent with the insurer's activities, its overall strategic investment policy and asset/liability management strategy, and its risk tolerance. It addresses at least the following elements:

- the purposes for which derivatives can be used
- the establishment of appropriately structured exposure limits for derivatives taking into account the purpose of their use and the uncertainty caused by market, credit, liquidity, operations and legal risk
- the extent to which the holding of some types of derivatives is restricted or not authorized; for example, where the potential exposure cannot be reliably measured, the closing out or disposal of the derivative could be difficult due to its lack of marketability (as may be the case with over-the-counter instruments) or the illiquidity of the market, or where independent (i.e. external) verification of pricing is not available
- the delineation of lines of responsibility and a framework of accountability for derivatives transactions.

e. The supervisory authority requires that insurers have in place risk management systems, covering the risks from derivatives activities to ensure that the risks arising from all derivatives transactions undertaken by the insurer can be:

- analysed and monitored individually and in aggregate
- monitored and managed in an integrated manner with similar risks arising from nonderivatives activities so that exposures can be regularly assessed on a consolidated basis.

f. The supervisory authority requires that insurers have in place adequate internal controls to ensure that derivatives activities are properly overseen and that transactions have been entered into only in accordance with the insurer's approved policies and procedures, and legal and regulatory requirements. These controls ensure appropriate segregation between those who measure, monitor, settle and control derivatives and those who initiate transactions (refer to ICP 10).

g. The supervisory authority requires that insurers have in place personnel with appropriate skills to vet models used by the front office and to price the instruments used, and that pricing follows market convention. These functions should also be separate from the front office.

h. The supervisory authority requires that the board of directors ensure that the insurer has the appropriate capability to verify pricing independently where the use of "over-the-counter" derivatives is permitted under the insurer's policy.

i. The supervisory authority requires that insurers have in place rigorous audit procedures that include coverage of their derivatives activities to ensure the timely identification of internal control weaknesses and operating system deficiencies. If the audit is performed internally it should be independent of the function being reviewed.

ICP 23 Capital adequacy and solvency

The supervisory authority requires insurers to comply with the prescribed solvency regime. This regime includes capital adequacy requirements and requires suitable forms of capital that enable the insurer to absorb significant unforeseen losses.

Explanatory note

23.1. A sound solvency regime is essential to the supervision of insurance companies and the protection of policyholders. Capital adequacy requirements are part of a solvency regime. A solvency regime should take into account not only the sufficiency of technical provisions to cover all expected and some unexpected claims and expenses but also the sufficiency of capital to absorb significant unexpected losses – to the extent not covered by the technical provisions – on the risks for which capital is explicitly required. It should also require additional capital to absorb losses from risks not explicitly identified.

23.2. In order to protect policyholders from undue loss, it is necessary that a solvency regime establishes not only minimum capital adequacy requirements, but also a solvency control level, or series of control levels, which act as indicators or triggers for early supervisory action, before problems become serious threats to an insurer's solvency. The form of the solvency control level may be based on capital levels or other financial measures related to the solvency regime of the jurisdiction.

23.3. Any allowance for reinsurance in a capital adequacy and solvency regime should consider the effectiveness of the risk transfer and make allowance for the likely security of the reinsurance counterparty.

Essential criteria

a. The solvency regime addresses in a consistent manner:

- valuation of liabilities, including technical provisions and the margins contained therein

- quality, liquidity and valuation of assets
- matching of assets and liabilities
- suitable forms of capital
- capital adequacy requirements.

b. Any allowance for risk mitigation or transfer considers both its effectiveness and the security of any counterparty.

c. Suitable forms of capital are defined.

d. Capital adequacy requirements are sensitive to the size, complexity and risks of an insurer's operations, as well as the accounting requirements that apply to the insurer.

e. The minimum capital adequacy requirements should be set at a sufficiently prudent level to give reasonable assurance that policyholder interests will be protected.

f. Capital adequacy requirements are established at a level such that an insurer having assets equal to the total of liabilities and required capital will be able to absorb significant unforeseen losses.

g. Solvency control levels are established. Where the solvency position reaches or falls below one or more control levels, the supervisory authority intervenes and requires corrective action by the insurer or imposes restrictions on the insurer. The control level is set so that corrective action can be taken in a timely manner (refer to ICP 14).

h. Inflation of capital – through double or multiple gearing, intra-group transactions, or other financing techniques available as a result of the insurer's membership in a corporate group – is addressed in the capital adequacy and solvency calculation (refer to ICP 17).

i. The solvency regime addresses the requirements placed upon an insurer operating through a branch.

Advanced criteria

j. The solvency regime provides for periodic, forward-looking analysis (e.g. dynamic solvency/ stress testing) of an insurer's ability to meet its obligations under various conditions (refer to ICP 20 AC g and ICP 21 AC k).

k. The supervisory authority assesses the structure of its solvency regime against structures of a peer group of jurisdictions and works towards achieving consistency.

Markets and consumers

The following principles address issues of market conduct that are an essential area of the supervision in the insurance sector, and may have a reputation risk or prudential impact on insurers.

ICP 24 Intermediaries

The supervisory authority sets requirements, directly or through the supervision of insurers, for the conduct of intermediaries.

Explanatory note

24.1. In many insurance markets, intermediaries serve as important distribution channels of insurance. They provide the interface between consumers and the insurer. Their good conduct is essential to protect consumers and promote confidence in insurance markets. For this reason, intermediaries should be directly or indirectly supervised. Where intermediaries are supervised directly, then the supervisory authority should be able to conduct on-site inspection when needed (refer to ICP 13 EC f).

24.2. Intermediaries include all those who are engaged in insurance intermediation activities.

Essential criteria

a. The supervisory authority requires intermediaries to be licensed or registered.

b. The supervisory authority requires intermediaries to have adequate general commercial and professional knowledge and ability as well as having a good reputation.

c. If necessary, the supervisory authority takes corrective action, including applying sanctions, directly or through insurers, and cancelling the intermediary's licence or registration, when appropriate.

d. The supervisory authority requires an intermediary who handles client's money to have sufficient safeguards in place to protect these funds.

e. The supervisory authority requires intermediaries to give customers information on their status, specifically whether they are independent or associated with particular insurance companies and whether they are authorized to conclude insurance contracts on behalf of an insurer or not.

f. The supervisory authority or other authority must have powers to take action against those individuals or entities that are carrying on insurance intermediation activity without licence or registration.

ICP 25 Consumer protection

The supervisory authority sets minimum requirements for insurers and intermediaries in dealing with consumers in its jurisdiction, including foreign insurers selling products on a cross-border basis. The requirements include provision of timely, complete and relevant information to consumers both before a contract is entered into through to the point at which all obligations under a contract have been satisfied.

Explanatory note

25.1. Requirements for the conduct of insurance business help to strengthen consumer confidence in the insurance market.

25.2. The supervisory authority requires insurers and intermediaries to treat their customers fairly, paying attention to their information needs. With respect to consumers in their own jurisdiction, the supervisory authority should set requirements with which insurers and intermediaries must comply. The requirements applicable to cross-border sales should also be clear.

25.3. A good claim resolution process is essential for the fair treatment of consumers. For this purpose, some jurisdictions have established extra judicial claim resolution mechanisms, such as independent panels or arbitrators.

25.4. For a large number of consumers, insurance products are difficult to understand and evaluate. Insurers and intermediaries have a greater knowledge of insurance issues than the consumers. Arrangements should therefore exist for potential policyholders:

- to have access to information needed to make an informed decision before entering into a contract
- to be informed about their rights and obligations for the duration of the contract

25.5. These requirements should distinguish between particular types of customers. In particular, detailed conduct of business rules may not be appropriate for reinsurance transactions or in respect of professional customers. Nonetheless this does not relieve reinsurers of their duty to provide complete and accurate information to the insurers with whom they deal.

Essential criteria

a. The supervisory authority requires insurers and intermediaries to act with due skill, care and diligence in their dealing with consumers.

b. The supervisory authority requires insurers and intermediaries to have policies on how to treat consumers fairly and to have systems and provide training to ensure compliance with those policies by their employees and other sales collaborators.

c. The supervisory authority requires insurers and intermediaries to seek the information from their consumers that is appropriate in order to assess their insurance needs, before giving advice or concluding a contract.

d. The supervisory authority sets requirements for insurers and intermediaries with regard to the content and timing of provision of information:

- on the product, including the associated risks, benefits, obligations, and charges
- on other matters related to the sale, including possible conflict of interest to existing or potential policyholders.

e. The supervisory authority requires insurers and intermediaries to deal with claims and complaints effectively and fairly through a simple, easily accessible and equitable process.

Advanced criteria

f. The supervisory authority requires insurers and intermediaries to set rules on the handling of customer information paying due regard to the protection of private information of customers.

g. The supervisory authority gives information to the public about whether and how local legislation applies to the cross-border offering of insurance, such as e-commerce. The supervisor issues warning notices to consumers when necessary in order to avoid transactions with unsupervised entities.

h. The supervisory authority promotes the consumers' understanding of the insurance contracts.

ICP 26 Information, disclosure & transparency towards the market

The supervisory authority requires insurers to disclose relevant information on a timely basis in order to give stakeholders a clear view of their business activities and financial position and to facilitate the understanding of the risks to which they are exposed.

Explanatory note

26.1. Public disclosure of reliable and timely information facilitates the understanding by prospective and existing stakeholders of the financial position of insurers and the risks to which they are subject, regardless of whether they are publicly traded or not.

26.2. Supervisory authorities are concerned with maintaining efficient, fair, safe and stable insurance markets for the benefit and protection of policyholders. When provided with appropriate information markets can act efficiently, rewarding those insurers that

operate effectively and penalizing those that do not. This aspect of market discipline serves as an adjunct to supervision.

26.3. Regular disclosure can facilitate the smooth functioning of the insurance markets. For example, when timely public disclosure exists market participants are less likely to overreact to negative information about an insurer.

26.4. Greater disclosure entails increased costs, which may be direct or indirect. For example, companies may experience a competitive disadvantage from increased disclosure of proprietary information. These costs must be weighed against the potential benefit of increased disclosure required by any standards.

26.5. The supervisory authority takes action, if necessary in coordination with other relevant bodies, to ensure effective and relevant disclosure.

Essential criteria

a. Insurers are required to disclose information on their financial position and the risks to which they are subject. Specifically, information disclosed should be:

- relevant to decisions taken by market participants
- timely so as to be available and up to date at the time those decisions are made
- accessible without undue expense or delay by the market participants
- comprehensive and meaningful so as to enable market participants to form a well-rounded view of the insurer
- reliable as a basis upon which to make decisions
- comparable between different insurers
- consistent over time so as to enable relevant trends to be discerned.

b. Information includes quantitative and qualitative information on:

- financial position
- financial performance

and a description of:

- the basis, methods and assumptions upon which information is prepared (and comments on the impact of any changes)
- risks exposures and how they are managed
- management and corporate governance.

c. Insurers are required to produce, at least annually, audited financial statements and make them available to stakeholders.

d. The supervisory authority monitors the information disclosed by insurers and takes the necessary actions to ensure the compliance with disclosure requirements.

Advanced criteria

e. Information includes quantitative information of relevant risk exposures.

ICP 27 Fraud

The supervisory authority requires that insurers and intermediaries take the necessary measures to prevent, detect and remedy insurance fraud.

Explanatory note

27.1. The supervisory authority has an important role to play in combating fraud in insurance in its jurisdiction. It communicates with other supervisors in addressing such fraud across jurisdictions.

27.2. Fraud can be perpetrated by any party involved in insurance, e.g. insurers, insurers' managers and staff, intermediaries, accountants, auditors, consultants, claims adjusters as well as policyholders.

27.3. Most jurisdictions have legal provisions against fraud in insurance. In many jurisdictions, instances of fraud are criminal acts.

27.4. Fraud in insurance results in reputational as well as financial damage and social and economic costs. That is why the supervisory authority requires that insurers and intermediaries address it effectively.

Essential criteria

a. The supervisory authority has the powers and resources to establish and enforce regulations and to communicate as appropriate with enforcement authorities, as well as with other supervisors, to deter, detect, record, report and remedy fraud in insurance.

b. Legislation addresses insurer fraud.

c. Claims fraud is a punishable offence.

d. The supervisory authority requires insurers and intermediaries to ensure high standards of integrity of their business.

e.	The supervisory authority requires that insurers and intermediaries allocate appropriate resources and implement effective procedures and controls to deter, detect, record and, as required, promptly report fraud to appropriate authorities. This function is under the responsibility of senior staff of the insurer and intermediary.
f.	As required, the supervisory authority ascertains that insurers take effective measures to prevent fraud, including providing counter-fraud training to management and staff. The supervisory authority promotes the exchange of information between insurers with respect to fraud and those committing fraud including, as appropriate, through the use of databases.
g.	The supervisory authority cooperates with other supervisory authorities including, as appropriate, in other jurisdictions in countering fraud.

Anti-money laundering: combating the financing of terrorism

ICP 28 Anti-money laundering, combating the financing of terrorism (AML/CFT)

The supervisory authority requires insurers and intermediaries, at a minimum those insurers and intermediaries offering life insurance products or other investment related insurance, to take effective measures to deter, detect and report money laundering and the financing of terrorism consistent with the Recommendations of the Financial Action Task Force on Money Laundering (FATF).

Explanatory note

28.1. In most IAIS member jurisdictions, money laundering and financing of terrorism are criminal acts under the law. Money laundering is the processing of criminal proceeds to disguise their illegal origin. The financing of terrorism involves the direct or indirect provision of funds, whether lawfully or unlawfully obtained, for terrorist acts or to terrorist organizations.

28.2. Insurers and intermediaries, in particular those insurers and intermediaries offering life insurance or other investment related insurance could be involved, knowingly or unknowingly, in money laundering and financing of terrorism. This exposes them to legal, operational and reputational risks. Supervisory authorities, in conjunction with law enforcement authorities and in cooperation with other supervisors, must adequately supervise insurers and intermediaries for AML/CFT purposes to prevent and counter such activities.

Essential criteria

a. The measures required under the AML/CFT legislation and the activities of the supervisors should meet the criteria under those FATF Recommendations applicable to the insurance sector[94].

b. The supervisory authority has adequate powers of supervision, enforcement and sanction in order to monitor and ensure compliance with AML/CFT requirements. Furthermore, the supervisory authority has the authority to take the necessary supervisory measures to prevent criminals or their associates from holding or being the beneficial owner of a significant or controlling interest or holding a management function in an insurer or an intermediary.

c. The supervisory authority has appropriate authority to cooperate effectively with the domestic Financial Intelligence Unit (FIU) and domestic enforcement authorities, as well as with other supervisors both domestic and foreign, for AML/CFT purposes.

d. The supervisory authority devotes adequate resources – financial, human and technical – to AML/CFT supervisory activities.

e. The supervisory authority requires insurers and intermediaries, at a minimum those insurers and intermediaries offering life insurance products or other investment related insurance, to comply with AML/CFT requirements, which are consistent with the FATF Recommendations applicable to the insurance sector, including:

- performing the necessary customer due diligence (CDD) on customers, beneficial owners and beneficiaries
- taking enhanced measures with respect to higher risk customers
- maintaining full business and transaction records, including CDD data, for at least 5 years
- monitoring for complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose
- reporting suspicious transactions to the FIU
- developing internal programmes (including training), procedures, controls and audit functions to combat money laundering and terrorist financing
- ensuring that their foreign branches and subsidiaries observe appropriate AML/CFT measures consistent with the home jurisdiction requirements.

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[94] See FATF recommendations 4–6, 8–11, 13–15, 17, 21–23, 25, 29–32 and 40 as well as Special Recommendations IV, V and the AML/CFT Methodology for a description of the complete set of AML/CFT measures that are required.

Annex 1

References[95]

Conditions for effective supervision

ICP 1	Conditions for effective insurance supervision

The supervisory system

ICP 2	Supervisory objectives
ICP 3	Supervisory authority
ICP 4	Supervisory process
ICP 5	Supervisory cooperation and information sharing

References

Principles No. 2. Principles Applicable to the Supervision of International Insurers and Insurance Groups and their Cross-Border Business Operations *(approved December 1999)*

Principles No. 6. Principles on Minimum Requirements for Supervision of Reinsurers *(approved October 2002)*

Supervisory Standard No. 6. Supervisory Standard on the Exchange of Information *(approved January 2002)*

Supervisory Standard No. 8. Standard on supervision of reinsurers *(approved October 2003)*

Guidance Paper No. 2. A Model Memorandum of Understanding (to facilitate the exchange of information between financial supervisors) *(approved September 1997)*

IMF Code of Good Practices on Transparency in Monetary and Financial Policies: Declaration of Principles *(September 1999 and July 2000)*

The supervised entity

ICP 6	Licensing
ICP 7	Suitability of persons
ICP 8	Changes in control and portfolio transfers

[95] Papers that are still in draft but whose adoption is anticipated at the October 2003 General Meeting are listed in bold. Annual updating of this part of the document will be necessary.

ICP 9	Corporate governance
ICP 10	Internal control

References

Principles No. 2. Principles Applicable to the Supervision of International Insurers and Insurance Groups and their Cross-Border Business Operations *(approved December 1999)*

Principles No. 6. Principles on Minimum Requirements for Supervision of Reinsurers *(approved October 2002)*

Supervisory Standard No. 1. Supervisory Standard on Licensing *(approved October 1998)*

Supervisory Standard No.3. Supervisory Standard on Derivatives *(approved October 1998)*

Supervisory Standard No.4. Supervisory Standard on Asset Management by Insurance Companies *(approved December 1999)*

Supervisory Standard No.7. Supervisory Standard on the Evaluation of the Reinsurance Cover *(approved January 2002)*

Supervisory Standard No. 8. Standard on supervision of reinsurers *(approved October 2003)*

Guidance Paper No 1. Guidance on Insurance Regulation and Supervision for Emerging Market Economies *(approved September 1997)*

Guidance Paper No. 2. A Model Memorandum of Understanding (to facilitate the exchange of information between financial supervisors) *(approved September 1997)*

Guidance Paper No. 3. Guidance Paper for Fit And Proper Principles and their Application *(approved October 2000)*

Guidance Paper No. 7: The Use of actuaries as part of a supervisory model *(approved October 2003)*

Ongoing supervision

ICP 11	Market analysis
ICP 12	Reporting to supervisors and off-site monitoring
ICP 13	On-site inspection
ICP 14	Preventive and corrective measures

ICP 15	Enforcement or sanctions
ICP 16	Winding-up and exit from the market
ICP 17	Group-wide supervision

References

Principles No. 6. Principles on Minimum Requirements for Supervision of Reinsurers *(approved October 2002)*

Supervisory Standard No. 2. Supervisory Standard on On-Site Inspections *(approved October 1998)*

Supervisory Standard No. 5. Supervisory Standard on Group Coordination *(approved October 2000)*

Supervisory Standard No. 7. Supervisory Standard on the Evaluation of the Reinsurance Cover *(approved January 2002)*

Guidance Paper No. 6: Solvency control levels *(approved October 2003)*

Joint Forum papers pertaining to: ˜ coordination ˜ supervisory information sharing ˜ capital adequacy ˜ fit and proper tests ˜ intra-group transactions and exposures ˜ risk concentrations

Prudential requirements

ICP 18	Risk assessment and management
ICP 19	Insurance activity
ICP 20	Liabilities
ICP 21	Investments
ICP 22	Derivatives and similar commitments
ICP 23	Capital adequacy and solvency

References

Principles No. 5. Principles on Capital Adequacy and Solvency *(approved January 2002)*

Principles No. 6. Principles on Minimum Requirements for Supervision of Reinsurers *(approved October 2002)*

Supervisory Standard No. 3. Supervisory Standard on Derivatives *(approved October 1998)*

Supervisory Standard No. 4. Supervisory Standard on Asset Management by Insurance Companies *(approved December 1999)*

Supervisory Standard No. 7. Supervisory Standard on the Evaluation of the Reinsurance Cover *(approved January 2002)*

Supervisory Standard No. 8. Standard on supervision of reinsurers *(approved October 2003)*

Guidance Paper No. 7: The Use of actuaries as part of a supervisory model *(approved October 2003)*

Guidance Paper No. 6: Solvency control levels *(approved October 2003)*

Guidance Paper No. 8: Stress testing *(approved October 2003)*

Discussion Paper Quantifying and Assessing Insurance Liabilities *(January 2003)*

Markets and consumers

ICP 24	Intermediaries
ICP 25	Consumer protection
ICP 26	Information, disclosure & transparency towards the market
ICP 27	Fraud

References

Principles No. 3. Principles for the Conduct of Insurance Business *(approved December 1999)*

Principles No. 4. Principles on the Supervision of Insurance Activities on the Internet *(approved October 2000)*

Guidance Paper No. 4. Guidance Paper on Public Disclosure by Insurers *(approved January 2002)*

Anti-money laundering / combating the financing of terrorism

ICP 28	Anti-money laundering / Combating the Financing of Terrorism

References

Guidance Paper No. 5. Anti-Money Laundering Guidance Notes for Insurance Supervisors and Insurance Entities *(approved January 2002)*

Methodology for Assessing Compliance with Anti-Money Laundering and Combating the Financing of Terrorism Standards *(prepared IMF, World Bank, Financial Action Task Force and approved by at an FATF plenary meeting October 2002)*

Annex 2

Assessment methodology

This annex sets out factors that should be considered when carrying out an assessment of a jurisdiction or authority's observance of the Insurance Core Principles and criteria.

The IAIS strongly encourages implementation of the framework for effective supervision described by the Insurance Core Principles. Assessments can facilitate implementation by identifying the extent and nature of any weaknesses in a jurisdiction's supervisory framework – especially those aspects that could affect policyholder protection and market stability – as well as recommending possible remedies.

The framework described by the Insurance Core Principles is general. Supervisors have flexibility in adapting it to the domestic context (e.g. depending on the market structure and stage of development). The explanatory notes and criteria provide more guidance on what is expected in order to implement each principle. They also facilitate assessments that are comprehensive, precise and consistent. While the results of the assessments may not always be made public, it is still important for their credibility that they are conducted in a broadly uniform manner from jurisdiction to jurisdiction.

Scope

Assessments against the Insurance Core Principles can be conducted in a number of contexts, including:

- Self-assessments performed by insurance supervisors themselves, sometimes with the assistance of other experts;
- Reviews conducted by third parties and, in particular, those conducted in the context of the IMF and World Bank Financial Sector Assessment Programme (FSAP).

Assessments can be limited to the responsibilities of a particular insurance supervisory authority or relate to the jurisdiction as a whole. Whatever the case, this should be clearly understood by all parties concerned. FSAP reviews are always done with respect to the jurisdiction as a whole. Where more than one authority is involved in the supervisory process then the interaction of supervisory roles should be clearly described in the assessment.

Conduct of independent assessments – assessment by experts

The process of assessing each principle requires a judgmental weighing of numerous elements that only qualified assessors with practical and relevant experience can provide. Normally an independent assessment would be conducted by at least one expert. Assessors not familiar with the insurance sector, while possibly providing a fresh perspective, could come to incorrect or misleading conclusions due to their lack of sector specific knowledge.

Conduct of independent assessments – access to information

When conducting an independent assessment, prior consent from the relevant local authorities is required so that assessors can have access to a range of information and people. The required information may include not only published information such as the laws, regulations and administrative policies but also non-published information, such as self-assessments, operational guidelines for insurance supervisors, and the like. The information should be provided as long as it does not violate confidentiality requirements. The assessor will need to meet with various individuals and organizations, including the insurance supervisor or supervisors, other domestic supervisory authorities, any relevant government ministries, insurance companies and insurance industry associations, actuaries, auditors, and other financial sector participants.

Assessment categories

Assessment of essential criteria

In making the assessment, each of the essential criteria has to be considered. The criteria should be assessed using five categories: observed, largely observed, partly observed, not observed, and not applicable .

For a criterion to be considered *observed***,** it is usually necessary that the authority has the legal authority to perform its tasks and that it exercises this authority to a satisfactory standard. Where the supervisory authority sets requirements it should also ensure that these requirements are implemented. Having the necessary resources is essential for the supervisory authority to effectively implement the requirements. Just to accept the power in the law is insufficient for full observance to be recorded against a criterion except where the criterion is specifically limited in this respect. In the event that the supervisor has a history of using a practice for which it has no explicit legal authority, the assessment may be considered as observed if the practice is clearly substantiated as common and undisputed.

Normally, but not always, the Insurance Core Principles should be equally applicable to both life and non-life sectors in order for an overall rating to be assigned. Similarly, it is possible that certain specialized parts of the insurance sector would have observance with the Insurance Core Principles differing from the other insurance business in the jurisdiction. Where the legal or practical position is materially different between life and non-life insurance or with respect to specialized parts of the insurance business in the jurisdiction such that it would give rise to a different rating had the assessments been carried out separately, it is open to the assessor to consider assigning a level of observance separately for the two parts of the insurance sector for that particular principle. In such cases, the distinction should be clearly identified in the report.

Assessments are based solely on the laws, regulations and other supervisory requirements or practices that are in place at the time. Proposed improvements can be noted in the assessment report by way of additional comments so as to give credit for efforts that are important but at the time the assessment is made, have yet to be fully implemented. Similarly, laws that do not meet with a satisfactory level of observance in practice cannot be recorded as “observed”. As a result, it is important to recognize when the assessment is conducted and to record this in the report.

For a criterion to be considered as *largely observed,* it is necessary that only minor shortcomings exist which do not raise any concerns about the authority's ability to achieve full observance with the criterion. A criterion will be considered *partly observed* whenever, despite progress, the shortcomings are sufficient to raise doubts about the authority's ability to achieve observance. A criterion will be considered *not observed* whenever no substantive progress toward observance has been achieved.

A criterion would be considered *not applicable* whenever:

- The criterion does not apply given the structural, legal and institutional features of a jurisdiction;[96]

- An assessment is conducted in the context of the individual supervisory authority and the criterion is the responsibility of other authorities in the jurisdiction (for example for ICP 1): in this instance, the relevant authority should be clearly identified in the assessment report.

In the assessment of ICP 1 the assessor may refer to recent assessments or studies on these matters by public international institutions where available.

Assessment of advanced criteria

With respect to the advanced criteria set forth in this document, these may or may not be assessed depending on the objectives and views of those sponsoring the exercise. Even when they are included, however, the results will not be a factor in coming to an overall view on observance with a principle. Instead, the assessment of the advanced criteria is recorded in the description and informs the comments and recommendations as appropriate. For consistency only essential criteria are taken into account in the assessment of the overall core principle.

Assessment of principles

As noted above, the level of observance for each principle reflects the assessments of the essential criteria. A principle will be considered *observed* whenever all the essential criteria are considered to be observed or when all the essential criteria are observed except for a number that are considered not applicable. A principle will be considered to be *not applicable* when the essential criteria are considered to be not applicable.

With respect to an assessment of the principle that is other than observed or not applicable, similar guidance is to be used as applies to the criteria themselves. So, for a principle to be considered *largely observed,* it is necessary that only minor shortcomings exist which do not raise any concerns about the authority's ability to achieve full observance with the principle. A principle will be considered *partly observed* whenever, despite progress, the shortcomings are sufficient to raise doubts about the authority's ability to achieve observance. A principle will be considered *not observed* whenever no substantive progress toward observance has been achieved.

[96] An example of this situation is if a jurisdiction prohibits the use of derivatives and similar commitments. In such a case, most, if not all, of the criteria under ICP 22 would be noted as not applicable.

While it is generally expected that full observance of a principle would be achieved through the observance of the essential criteria, there may be instances, where a jurisdiction can demonstrate that observance with a principle has been achieved through different means. Conversely, due to specific conditions in a jurisdiction, meeting the essential criteria may not be sufficient to achieve observance of the objective of a principle. In these cases, additional measures are needed in order for observance of the particular principle to be considered effective.

Reporting

The IAIS does not prescribe the precise format or content of reports that result from an assessment against the Insurance Core Principles. It does, however, consider that the report should:

- Be in writing;
- Include both the assessment of observance itself and any additional information referred to in this section;
- Identify the scope and timing of the assessment;
- Identify the assessors;
- In the case of an external assessment, refer to the information reviewed and meetings conducted, and note when any of the necessary information was not provided and the impact that this may have had on the accuracy of the assessment;
- In the case of an external assessment, include prioritized recommendations for achieving improved observance of the Insurance Core Principles recognizing that the assessment should not be considered as an end in itself;
- In the case of an external assessment, include the formal comments provided by the authorities in response to the assessment;

The question of publication of the results of an assessment is a matter for the local authorities.

IX. A new framework for insurance supervision: towards a common structure and common standards for the assessment of insurer solvency[97]

International Association of Insurance Supervisors

Introduction

The International Association of Insurance Supervisors (IAIS) was established in 1994. Its objectivesare to:[98]

- Cooperate to ensure improved supervision of the insurance industry on a domestic as well as on an international level in order to maintain efficient, fair, safe and stable insurance markets for the benefit and protection of policyholders;

- Promote the development of well-regulated insurance markets;

- Contribute to global financial stability.

Since its inception, the IAIS has developed a range of Principles, Standards and Guidance Papers in pursuit of these objectives. The IAIS Insurance Core Principles and Methodology ("the Insurance Core Principles") address a wide range of issues of relevance to insurance and insurance supervision. These papers have undoubtedly contributed to a convergence of both industry and supervisory principles and practices over the last decade.

Insurer solvency takes a central position in risk management by insurers and in insurance supervision. To date the IAIS has developed a number of papers addressing aspects of insurer solvency, based on the Insurance Core Principles and the Principles on capital adequacy and solvency.[99] However, the IAIS has not yet articulated a globally acceptable and applicable approach to the financial components of insurance supervision, and in particular to the assessment of insurer solvency.

The IAIS has a wide membership covering most jurisdictions of the world. Some insurance lines of business are offered on a global basis and some insurance groups serve a global client base. Other insurance products have a more local flavour, reflecting local markets and conditions, and are offered by more locally operating insurers. Even so, insurance products, markets and companies have many characteristics in common, enabling, and indeed calling for a common, globally acceptable and applicable structure

[97] This document was prepared by the Solvency and Actualrial Issues Subcommittee in consultation with members and observers. October 2005.
[98] See IAIS By-laws (2004).
[99] Available on the IAIS website: www.iais.org.

for the assessment of insurer solvency. This common structure must be sufficiently flexible to take into account both the local and the global aspects of insurance.

The purpose of this paper is to outline the IAIS framework for insurance supervision, and to show where the financial components of insurance supervision (which include the assessment of insurer solvency) fit within this framework. A significant current focus for the IAIS is the development, as part of the framework, of a common structure and common standards for the assessment of insurer solvency.

A common structure and common standards for the assessment of insurer solvency will address the IAIS's first objective of improving supervision of the insurance industry for the benefit and protection of policyholders by:

- Assisting both industry and the insurance supervisory community in the determination and assessment of the risk and solvency position of insurers, reinsurers and financial groups;
- Serving to enhance the transparency and comparability of insurers worldwide, to the benefit of consumers, the industry, investors and other interested parties;
- Strengthening insurance market stability;
- Supporting a level playing field;
- Offering further opportunities for international cooperation;
- Reducing opportunities for unwanted regulatory arbitrage;
- Increasing public confidence in the insurance sector;
- Enabling a more effective use of resources by industry and the supervisory community.

The remainder of this paper presents the structure of the IAIS framework for insurance supervision.

The IAIS also refers the reader to the related paper "Towards a common structure and common standards for the assessment of insurer solvency: Cornerstones for the formulation of regulatory financial requirements" (also approved in October 2005), which provides further direction to the development of a common structure and common standards for the assessment of insurer solvency.

Framework for insurance supervision

As indicated above, the envisaged common structure and common standards for the assessment of insurer solvency will not be developed in isolation but will be embedded in, and be part of, an overarching framework for insurance supervision that is also globally acceptable and applicable. This framework serves to clarify and enhance the interrelationship between the solvency standards and the other IAIS principles, standards and guidance papers agreed so far, and also the interdependencies with other ongoing

IAIS work. The framework brings together the substantial amount of work that the IAIS has already undertaken, and provides structure in identifying priority areas for future IAIS work.

In developing a common structure and common standards for the assessment of insurer solvency and formalizing an overarching framework for insurance supervision, the IAIS has taken note, and will continue to take note, of relevant work on insurer solvency undertaken in a number of jurisdictions. The IAIS will also closely follow and carefully consider developments within global forums such as the Bank for International Settlements (BIS), the Basel Committee on Banking Supervision (BCBS), the International Accounting Standards Board (IASB), the International Actuarial Association (IAA), the International Federation of Accountants (IFAC), the International Monetary Fund (IMF), the International Organization of Securities Commissions (IOSCO), the Organization for Economic Cooperation and Development (OECD) and the World Bank.

A considerable number of large financial groups are active across various financial sectors, and supervisors are now focusing more on specific types of risk, some of which are common to the different financial sectors in which they occur, whereas others are more sector-specific. This means that:

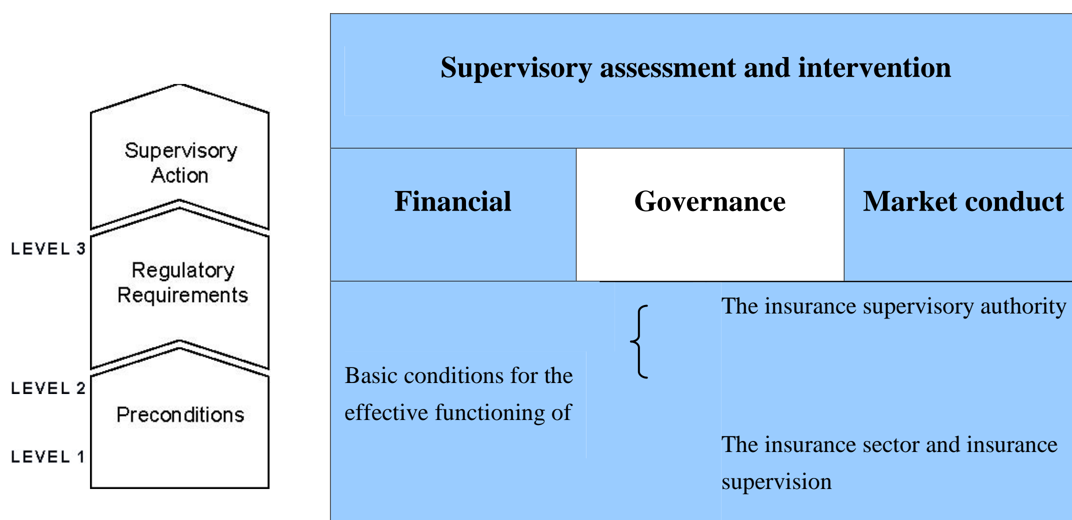
- Particular attention needs to be paid to risk-based, supervisory developments in other financial sectors such as "Basel II";[100] and that

- The proposed common structure and standards for the assessment of insurer solvency, and the framework for insurance supervision, need to reflect the particular nature of insurance, and the specific risks associated with it.

The wide range of aspects already identified and elaborated to some extent in the Insurance Core Principles suggests that the framework for insurance supervision consists of three groups of issues: financial issues, governance issues and market conduct issues. It also encapsulates three levels or aspects in relation to these issues, reflecting three different responsibilities: preconditions for effective insurance supervision, regulatory requirements, and supervisory action.

[100] *International Convergence of Capital Measurement and Capital Standards: a Revised Framework*, Basel Committee on Banking Supervision (June 2004).This is the new capital adequacy framework commonly known as Basel II developed by the Basel Committee on Banking Supervision and approved by the central bank governors and bank supervisory authorities in the Group of Ten (G10) countries in June 2004.

Figure 1. Outline of the framework for insurance supervision



Preconditions for effective insurance supervision

The framework for insurance supervision recognizes that two sets of basic conditions need to be in place before an effective framework can function.

Firstly, effective insurance supervision can only exist within an environment which has:

- A policy, and an institutional and legal framework, for the financial sector and its supervision;
- A well developed and effective financial market infrastructure;
- Efficient financial markets with relevant information available.

In many respects the general, basic conditions for effective insurance supervision are also basic conditions for the effective functioning of an insurance industry in a jurisdiction. Such basic conditions are to a large extent outside the direct control or influence of an insurance supervisor or insurer.

Secondly, effective insurance supervision can only be implemented if there is a set of clearly defined principal, supervisory objectives, and the existence of a supervisory authority (or authorities) that:

- Has adequate powers, legal protection and financial resources to exercise its functions and powers;
- Is operationally independent, notably from political authorities and from insurers;
- Is accountable and transparent in the exercise of its functions and powers;
- Hires, trains and maintains sufficient staff with high professional standards;

- Treats confidential information appropriately.

This set of basic conditions builds on the more fundamental prerequisites outlined above, and pertains more specifically to the responsibilities, means and functioning of the insurance supervisory authority.

Regulatory requirements

Supported by these preconditions, the framework consists of three broadly defined categories or "blocks" of issues, which relate to:

- The financial aspects of an insurer's operations;
- How an insurer is governed;
- How an insurer conducts its business and presents itself in the market.

Each of these blocks may be viewed from two main standpoints or aspects:

- Regulatory requirements, which are addressed to the operations of the insurer
- Supervisory action, which has regard to the responsibilities and activities of the supervisory authority

It is the responsibility of insurers to meet regulatory requirements, both qualitative and quantitative, in pursuing their insurance activities. Such requirements may be enshrined in law or regulations, or be imposed by the supervisory authority, but need to be broad enough to deal with the full range of insurers in the market. The three blocks are:

- The ***financial block*** – this pertains to the field of solvency and capital adequacy; valuation and adequacy of technical provisions; forms of capital; investments; and financial reporting and disclosure.
- The ***governance block*** – this refers to governance processes and controls in areas such as the Board, directors, senior management and other organizational aspects, fit and proper testing of directors and management; administrative, organization and internal controls, including risk management; compliance with legislative requirements; shareholder relationships; and the governance risks posed by group structures.
- The ***market conduct block*** – this includes areas such as dealing with customers in the selling and handling of insurance policies, and also the integrity of conduct by an insurer as an institutional investor: it also includes disclosure of relevant information both to the market and to policyholders.

Supervisory action

Adherence by insurers to all such requirements needs to be subject to supervisory review. Assessment of an insurer's risk profile, controls and available support are also integral to supervisory reviews. Supervisors must assess individual insurers, taking into account the specific circumstances of each insurer. More specifically, the supervisor will need to

tailor its review, and any remedial action taken, to the risk profile and specificities of each insurer, with due regard to the principles of legal certainty and equal treatment. The supervisory action "level" in the framework thus illustrates the field of responsibility of the supervisory authority, and its responsibility to take appropriate action when this is called for.

Framework solidity

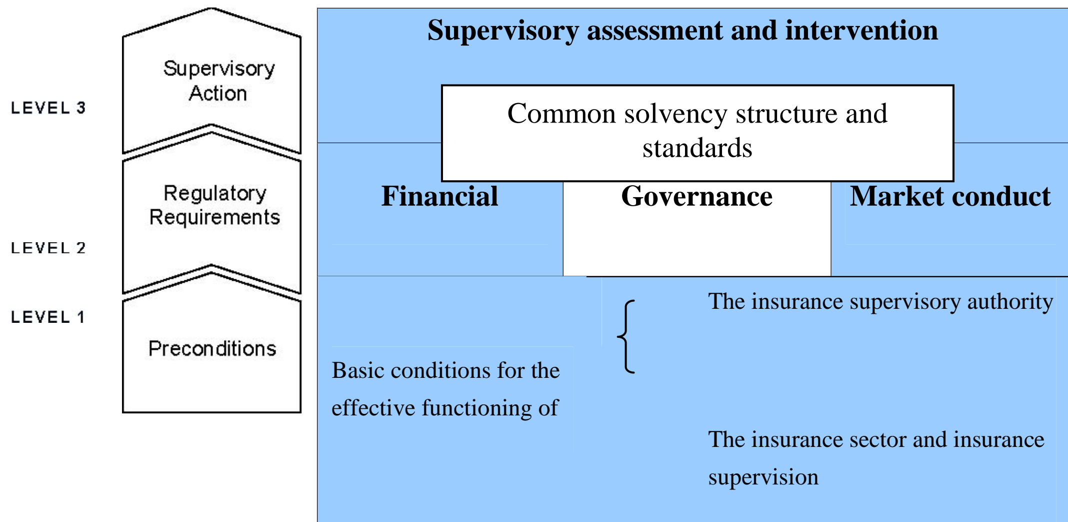
The contents of each of the elements of the framework are interdependent; to keep the framework stable and effective, less stringent requirements in one element imply a need for stronger measures in the others. However, a minimum level of coverage of each framework element needs to be determined at a sufficiently exacting and granular level and agreed upon as an internationally acceptable standard. This combination of minimum coverage with compensating interdependence provides a solid overall framework.

The framework for insurance supervision encompasses the overall spectrum of insurance and insurance supervision. It is also compatible with the approach of ´Basel II´. Both address regulatory requirements, supervisory review and market discipline through disclosure, although they are structured differently. For example, in the framework for insurance supervision, all regulatory requirements, including those addressing public disclosure, appear at the same ´level´. Such disclosure requirements may pertain to each of the three blocks: financial, governance or market conduct. Adherence to these disclosure requirements would form part of the supervisory assessment. However, the effectiveness of public disclosure would be seen as the responsibility of the market, under the presumption that insurers meet their disclosure requirements. The framework is based on the view that insurance supervision has a role in assessing whether insurers meet their disclosure requirements both to the market and to policyholders, but that it cannot ensure that market forces play their envisaged beneficial preventative and corrective role.

A common structure and common standards for the assessment of insurer solvency

The common structure and standards for the assessment of insurer solvency that are to be developed are an important part of the ´financial block´ in the framework. However they will also address components of the governance and market conduct blocks. The structure and standards will firstly address level 2 (regulatory requirements) and then be expanded into level 3 (supervisory actions). As illustrated, the effectiveness of such solvency standards will be dependent upon the other elements of the framework. The position of the common structure and standards within the framework is illustrated as follows.

Figure 2. The common solvency structure and standards within the framework for insurance supervision



The IAIS formulates in the "Cornerstones" paper mentioned above a more precise view on a number of key elements or "cornerstones" of the common structure and common standards for the assessment of insurer solvency.

The cornerstones, in turn, will be elaborated upon in further work. A road-map paper outlining further steps in this project is currently under development. The IAIS envisages circulating the road-map paper for comments and suggestions later this year.

X. China's insurance industry:reform, opening and development

Wei Zheng[101]

1. Introduction

China today is one of the fastest-growing economies in the world. In the insurance sector the total premium volume attributable to China in 2004 was $52,171 million,[102] capturing 1.61 per cent of the world market in 2004 and ranking it eleventh in the world in terms of premium volume.[103]

The purpose of this case study is to analyse the insurance services sector in China from an economic, regulatory and trade negotiations perspective so as to ascertain the benefits and challenges posed by insurance services liberalization.

Before focusing on China's insurance industry, the paper presents an overview of the Chinese economy. Table 1.1 shows the ranking of main indicators of China in the world. Although China ranks high in GDP and total value of imports and exports, the ranking of per capita GNI is still very low. Table 1.2 shows the per capita GNI of major countries and regions, which indicates that China falls between low-income and medium-income countries. Table 1.3 shows China's 10 biggest trade partners in 2004; it can be seen that the European Union, the United States of America and Japan are very important trading partners of China.

Table 1.1. Ranking of main indicators of China in the world

Item	1978	1990	2000	2002	2003	2004
GDP	10	11	6	6	7	7
Per capita GNI[a]	175 (188)	178 (200)	141 (207)	136 (207)	133 (206)	
Total value of imports and exports	27	16	8	5	4	3

Source: United Nations Database, "Industrial Commodity Statistics Yearbook"; FAO Database
[a] The number in parentheses indicates the number of countries or territories the order is based on.

[101] Wei Zheng is Associate Professor and Vice-Chair, Department of Risk Management and Insurance, School of Economics, Peking University, Beijing, China. He is also Secretary General of the China Center for Insurance and Social Security Research (CCISSR), Peking University, Beijing, China. This case study specifically prepared for the UNCTAD secretariat draws on an earlier working paper, "China's Insurance Industry: Developments and Prospects" by Qixiang Sun, Lingyan Suo and Wei Zheng.
[102] Data in this report do not deal with the insurance industry in Hong Kong, China; Macao, China; or Taiwan Province of China.
[103] Database provided by the Swiss Reinsurance Company, 2005.

Table 1.2. Per capita gross national income of major countries and regions (US$)

Countries/regions	2002	2003
World	*5 080*	*5,500*
Low-income countries	*430*	*450*
Medium-income countries	*1 840*	*1,920*
High-income countries	*26 310*	*28 550*
United States of America	35 060	37 610
Japan	33 550	34 510
United Kingdom	25 250	28 350
Netherlands	23 960	26 310
Germany	22 670	25 250
France	22 010	24 770
Canada	22 300	23 930
Australia	19 740	21 650
Italy	18 960	21 560
Singapore	20 690	21 230
Spain	14 430	16 990
Republic of Korea	9 930	12 020
Mexico	5 910	6 230
Malaysia	3 540	3 780
Argentina	4 060	3 650
South Africa	2 600	2 780
Brazil	2 850	2 710
Russian Federation	2 140	2 610
Egypt	1 470	1 390
China	940	1 100

Philippines	1 020	1 080
India	480	530
Pakistan	410	470
Nigeria	290	320
Thailand	1 980	190

Source: World Bank Database.

Table 1.3. China's 10 biggest trade partners in 2004 (in billions of US$)

Ranking	Countries/regions	Trade amount	Share (%)
1	European Union	1 772.9	15.4
2	United States of America	1 696.3	14.7
3	Japan	1 678.9	14.5
4	Hong Kong	1 126.8	9.8
5	ASEAN	1 058.8	9.2
6	Rep. of Korea	900.7	7.8
7	Taiwan	783.2	6.8
8	Russian Federation	212.3	1.8
9	Australia	203.9	1.8
10	Canada	155.2	1.3
	Others	1 958.9	16.9
	Total	*11 547.9*	*100*

Source: China Custom.

This paper has eight sections: section 1 is the introduction; section 2 presents a historical overview of China's insurance industry; section 3 does an international comparison for major insurance markets; section 4 describes the current situation of China's insurance industry; section 5 discusses the insurance regulation in China; section 6 analyses the impact that insurance services liberalization has on China's insurance industry and its economy as a whole; section 7 forecasts the future of China's insurance industry, including the key drivers for future development, main obstacles and trend expectation; and section 8 is the conclusion.

2. Historical overview of China's insurance industry

On 20 October 1949, the People's Insurance Company of China (PICC), the first State-owned insurance company in China's history, was established. PICC developed a mission to "protect State assets, ensure industry safety, promote materials flow, provide stability," and, more importantly, "collect surplus funds and enriching State assets." However, the waning necessity for commercial insurance in a centralized planning economy finally led to the closure of the domestic insurance industry in 1959. Only a small amount of foreign currency and export related insurance was left. It was not until the third plenary session of the eleventh meeting of the Chinese Communist Party (CPC) Central Committee led by Deng Xiaoping at the end of 1978 that economic system reform and economic construction became the main theme of China's development. The financial system governed by the People's Bank of China (PBOC) came into being.. Concurrently, the insurance industry was restored and developed rapidly in the ensuing years. To explore the development of the insurance industry in China, this section is divided into three stages consistent with the gradual development of China's economic system reform: (1) resumption and restoration, (2) market-oriented reform, and (3) opening up and rapid growth. The basic information about insurance premium volume from the year 1980 to 2004 is shown in table 2.1 and figure 2.1.[104]

Table 2.1. Insurance premiums in China, 1980–2004

Stage	Year	Total insurance premiums (RMB 100m)	Change (%)	Life insurance premiums (RMB 100m)	Share of life insurance (%)	Non-life insurance premiums (RMB 100m)	Share of non-life insurance (%)
1	1980	4.6	-	-	-	4.6	-
	1981	7.8	69.6	-	-	7.8	-
	1982	10.3	32.1	0.02	0.2	10.3	99.8
	1983	13.2	28.2	0.1	0.8	13.1	99.2
	1984	20.0	51.5	0.7	3.5	19.3	96.5
2	1985	33.1	65.5	4.4	13.3	28.7	86.7
	1986	45.8	38.4	11.3	24.7	34.5	75.3
	1987	71.0	55.1	25.0	35.2	46.1	64.9
	1988	110.4	55.4	37.5	34.0	72.9	66.0
	1989	97.6	(11.6)	19.6	20.1	78.1	80.0

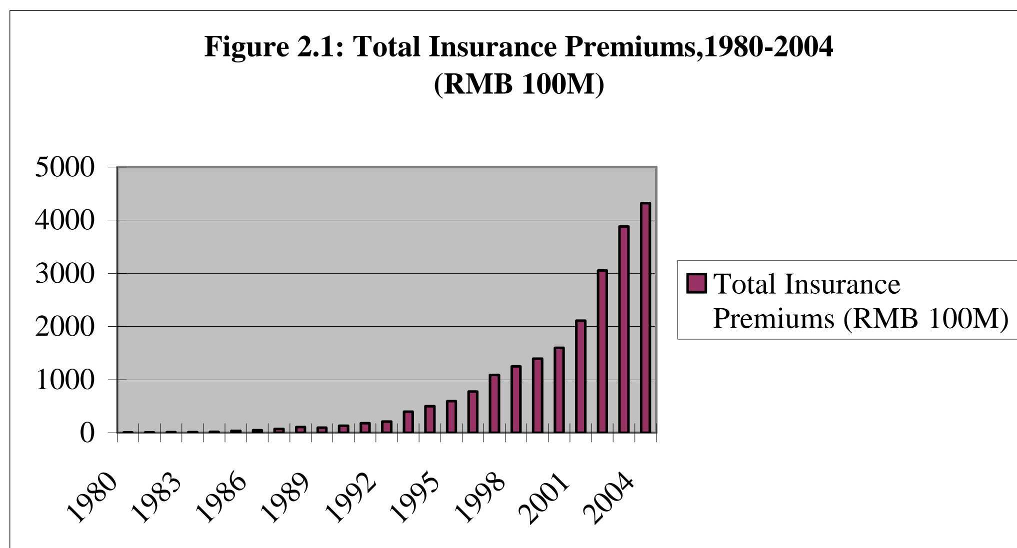
[104] RMB stands for "renminbi", the Chinese currency (also called the yuan).

3

1990	135.2	38.5	28.4	21.0	106.8	79.0
1991	178.2	31.9	41.4	23.2	136.8	76.8
1992	211.7	18.8	64.3	30.4	147.4	69.6
1993	395.5	86.8	144.1	36.4	251.4	63.6
1994	500.4	26.5	163.5	32.7	336.9	67.3
1995	594.9	18.9	204.2	34.3	390.7	65.7
1996	777.1	30.6	324.6	41.8	452.5	58.2
1997	1087.9	40.0	607.2	55.8	480.7	44.2
1998	1247.6	14.7	748.0	60.0	499.6	40.0
1999	1393.2	11.7	872.1	62.6	521.1	37.4
2000	1595.9	14.6	997.5	62.5	598.4	37.5
2001	2109.4	32.2	1424.0	67.5	685.4	32.5
2002	3053.2	44.7	2274.9	74.5	778.3	25.5
2003	3880.4	27.1	3011.0	77.6	869.4	22.4
2004	4,318.1	11.3	3228.2	74.8	1089.9	25.2

Source: China Insurance Regulatory Commission; *China Statistical Yearbook 2005*.

Figure 2.1: Total Insurance Premiums,1980-2004 (RMB 100M)



2.1 Period I (1980–1985): resumption and restoration

At the initial stage of economic system reform, the control of firms' operations was gradually transferred from the State to firms. The resulting gradual changes in risk

sharing system led firms to seek economic compensation in the market and thus the demand for insurance was created. To meet this new demand, and more importantly, for better management of the financial surplus accumulated in private sector, the Government initiated reforms in 1980 aimed at developing the commercial insurance system and encouraging the domestic insurance business. These reforms came 21 years after the closure of the insurance industry.

At this stage, all insurance business was monopolized by PICC, which was directly controlled by the central Government. Insurance regulation was carried out by the PBOC, China's central bank. The terms and rates of policies were set and/or approved by the "regulator." As a result, the insurance product portfolio lacked variety, there was narrow use of complex actuarial science in pricing, and the price structure was simplistic. Additionally, the distribution channels were limited. Products were distributed primarily through sales staff and insurance agencies located throughout China (except Tibet and Taiwan), which were established by PICC and specialized in insurance distribution. Also, insurance assets were simply deposited in banks without consideration to an investment policy of diversification between bonds, equities, or real estate.

In 1980, the total gross premium volume of RMB 460 million was solely attributable to non-life insurance. In 1982, gross life insurance premiums totaled only RMB 1.6 million (CIRC). From this very small base, both the non-life and life insurance businesses grew significantly with annual growth rates exceeding GDP growth rates. The nominal growth rate of life insurance once exceeded 500 per cent. In 1985, total premiums reached RMB 3.31 billion (CIRC). As table 1 indicates, during this period, the life insurance business was insignificant relative to non-life insurance market. At this stage, enterprise property insurance and transportation equipment insurance (insurance coverage on motor vehicles, keel boats, and fishing boats) dominated the market. In 1985, these two types of non-life insurance had approximately 30 percent and 27 percent of China's insurance market respectively (*China Statistical Yearbook 1996*, sect. 17.14).

2.2 Period II (1986–1991): beginning of market-oriented reform

In March 1985, the State Council of China enacted the Interim Regulations on the Administration of Insurance Enterprises, setting out the requirements for the establishment of insurance companies. The Farming Insurance Company of Xinjiang Production and Construction Group (FICX) was then established on 15 July 1986. Although this company specialized in farming and animal husbandry insurance and was a captive insurer within the Group, it effectively ended the monopoly of PICC. The number of players in the market started to climb initially with Ping An and Pacific insurance companies established as shareholding multi-line insurers in 1988 and 1991 respectively.

At this stage, PBOC's direct administration of the insurance industry began to give way to supervision as the market-oriented reforms progressed. In 1995, PBOC established the Division of Insurance Supervision under its Department of Non-Banking Financial Institutions Supervision, which took over the responsibility of insurance supervision.

During this period, the limit on insurance investment channels and risk control mechanisms were relaxed. This resulted in extensive investment in real estate, securities, and trusts, which led to substantial investment in non-performing assets. However, there were no visible changes in the distribution system and insurance product portfolio. As

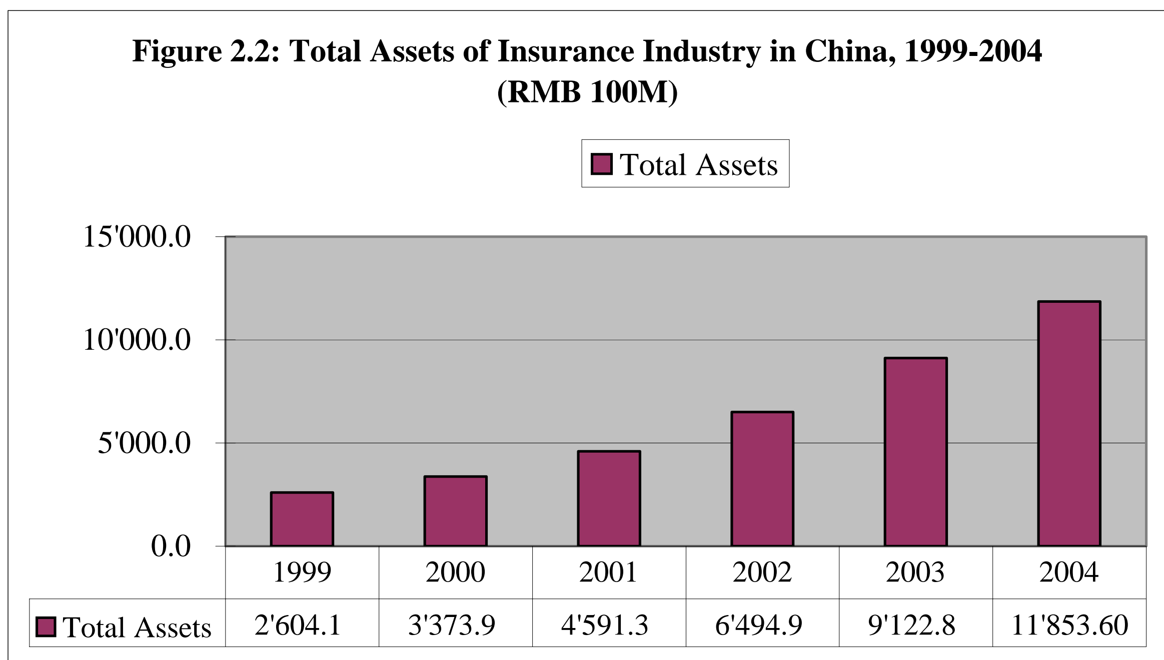
table 2 shows, while the volume of life insurance premiums was lower than that of non-life insurance, the fast growth of insurance premiums remained higher than GDP growth.

2.3 Period III (1992 to present): opening up and rapid growth

In 1992, at its third plenary session, the Fourteenth National Congress of the CPC confirmed China's irreversible commitment to market-oriented reforms. Individuals and enterprises lost their traditional economic safeguard and were responsible for assuming financial risks. As a result, many factors contributed to the rapid growth of the insurance industry, including the fast growing economy, rising personal income, accelerating industrialization and urbanization, social security system reform, and insurance market opening.

From 1992 to 2004, the average annual growth rate of gross premiums remained at over 30 per cent. China's total insurance premium reached RMB 431.81 billion in the year of 2004. It can be seen that the volume of life insurance premiums surpassed that of non-life insurance for the first time in 1997 and remained higher in the subsequent years. The rapid growth of premium income and an expanded capital base explain the substantive increase in the total assets of the industry. Figure 1 shows that the total assets in the insurance industry increased 3.6 times from 1999 to 2004 and reached RMB 1,111.65 billion by the end of 2004. In contrast, aggregate total assets were less than RMB 400 million when the insurance industry had just resumed.

Figure 2.2: Total Assets of Insurance Industry in China, 1999-2004 (RMB 100M)



	1999	2000	2001	2002	2003	2004
Total Assets	2'604.1	3'373.9	4'591.3	6'494.9	9'122.8	11'853.60

3. Recent developments in China's insurance industry and its current situation

China's insurance industry has changed a lot in the past few years. In this section, we would like to make a description on the recent development and the current situation of

China's insurance industry. Our description will be made from seven aspects: operating structure, suppliers of insurance, competitive market structure, geographic distribution, product portfolio, distribution channels and investment management. The newest data for China's insurance industry in the year of 2004 will be shown in the last part of this section.

3.1 Operating structure

The first Insurance Law of China was enacted in 1995. It developed a segregated insurance market structure between the life and non-life insurance businesses by prohibiting the same insurer from engaging in both life and non-life insurance. It was possible, however, for an insurance group to have both life and non-life subsidiaries. As a result, the former four multi-line insurers, including PICC, FICX, Pacific and Ping An, underwent organizational reform. FICX (Farming Insurance Company of Xinjiang Production and Construction Group) cast off its life insurance business and turned itself into Property Insurance Company of Xinjiang Production and Construction Group. The other three companies followed the pattern of setting up a holding group with life and non-life insurance subsidiaries. In 1996, PICC was restructured into the PICC Group, which controlled the newly established PICC Property and Casualty Insurance Company, PICC Life Insurance Company, and PICC Reinsurance Company. In October 1998, the three subsidiaries were divested and renamed the People's Insurance Company of China (it inherited the original abbreviation, i.e. PICC), the China Life Insurance Company, and the China Reinsurance Company.

The financial sectors, including the banking, securities, and insurance businesses, are still operating independently in China. According to the Banking Law of China effective on 1 February 2004, China's commercial banks can not invest in non-bank financial institutions except that such investment is allowed by other regulations or State provisions. Additionally, insurance companies are prohibited from establishing securities firms and other enterprises except insurance institutions according to the Insurance Law. In a word, banking, securities, and insurance services can only be provided by separate firms; banks cannot own insurance companies and vice versa.[105] Industrial groups, however, are not prohibited from owning both bank subsidiaries and insurance companies. There are several historical exceptions to this law. For example, the China Ping An Insurance (Group) Company does offer insurance, banking and securities through its different subsidiaries.

3.2 Suppliers of insurance

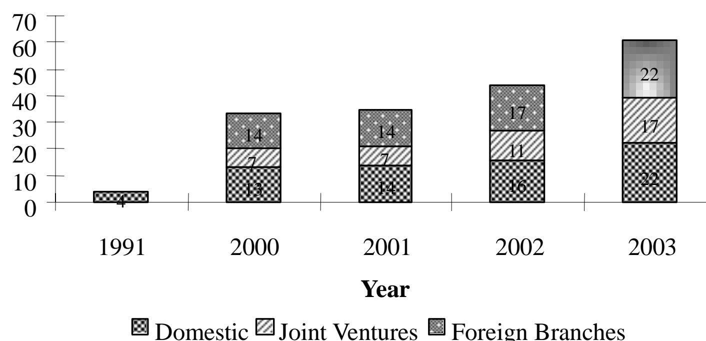
On the supply side, China's insurance market is characterized by two things: an increase in the number of insurers, and the organizational restructuring of shareholders of State-owned insurers. In 1992, China began to open its insurance market by using Shanghai as an experimental city. According to the Temporary Measures for Administration of Foreign-Funded Insurance Institutions in Shanghai enacted by the PBOC in September 1992, foreign insurers applying to establish branches or joint ventures shall satisfy the prudential requirements stipulated by the insurance regulator to get licences including the

[105] At the present time, there is no legislation on financial holding companies, although many researchers deem the pattern as a good approach to achieve financial convergence. The only "financial holding company," CITIC International Financial Holdings Limited (CIFH), was approved to establish as a "holding company" in 2002 by the State Council and it operates outside of mainland China.

"533" requirements meaning that the applicant's total assets should be more than $5 billion at the end of the year before application, the applicant should have established its representative office(s) three years before application, and have had over three decades of experience in the insurance business. In September of the same year, American International Assurance Company (AIA) and American International Underwriters, Ltd. (AIU), subsidiaries of the American International Group (AIG), were the first to be approved to establish affiliates in Shanghai and thus opened the gate for foreign capital to flow into China's insurance industry.

Since then the number of insurers, both domestic and foreign, has kept rising. After China's entry into World Trade Organization (WTO) in 2001, the State Council enacted The Regulations on Administration of Foreign-Funded Insurance Companies, which became effective on 1 February 2002. Many restrictions to foreign insurers to obtain licences in China were relaxed in a sense, such as the "533" requirements were changed to the "523," allowing foreign insurers who have just established representative offices in China two years before to submit an application.[106] Actually, the requirements to get licences could easily be satisfied by many foreign insurers and as figure 3.1 shows, a number of famous foreign insurers obtained licences to establish branches or joint ventures in China. Most significantly, Munich Re, Swiss Re, and General Cologne Re were approved to set up branches in China in 2003, and this effectively ended the role of the State-owned China Reinsurance Company (China Re) as the only reinsurer in China. At the end of 2003, there were 61 insurance companies, six insurance holding groups, and two insurance asset management companies in China. Of the 61 insurers, 26 are non-life insurers, 30 life insurers and 5 reinsurers (CIRC).

Figure 3.1
The Number of Insurers in China in Selected Years



Source: China Insurance Regulatory Commission; *China Statistical Yearbook 2003*, p. 709; *China Statistical Yearbook 2002,* 19.16.§

China's corporate governance system reform started first in the insurance industry. In 2003, the People's Insurance Company of China (PICC), China Life Insurance Company, and China Reinsurance Company, the three purely State-owned insurance companies, successfully underwent shareholder organizational restructuring.

[106] The qualified foreign applicant can apply to set up a company in China and will be given one year to finish preparation work once the application is approved by CIRC. Once the preparation work has been completed, CIRC will conduct a review and make a decision as whether to grant a licence or not in 30 days after they receive the entire set of formal application materials.

On 19 July 2003, PICC incorporated PICC Property and Casualty Company Limited (PICC P&C). PICC was then renamed and re-registered as PICC Holding Company, which injected all of its commercial insurance operations, together with related assets, liabilities, and subsidiaries into PICC P&C. The initial public offering (IPO) of PICC P&C on the Hong Kong Stock Exchange in November 2003, which was proved to be a great success, raised $693 million (CIRC).

China Life Insurance Company incorporated China Life Insurance Company Limited (China Life) on 30 June 2003 and transferred its well-performing policies and related assets and liabilities to the latter. China Life Insurance Company was then restructured to China Life Insurance (Group) Company in July 2003. The IPO of China Life on New York Stock Exchange (NYSE) and the Hong Kong Stock Exchange on 17 and 18 December 2003 respectively was the world’s largest that year and raised about $3.5 billion (CIRC).

China Re was renamed China Reinsurance (Group) Company in August 2003, and began to incorporate China Property and Casualty Reinsurance Company, China Life Reinsurance Company, and China Dadi Property and Casualty Insurance Company. Unlike PICC and China Life, China Re did not begin its IPO efforts right after the restructuring, but committed itself to improve its internal management first.

3.3 Competitive market structure

China’s insurance market has become more competitive as the number of insurers has increased. On the non-life insurance side, the market share of the leading insurer, PICC, was 96 per cent in 1992 and dropped to 70 per cent in 2003 (CIRC). However, the top three non-life insurers, including PICC P&C, Pacific P&C, and Ping An P&C, still accounted for more than 90 per cent of China’s gross premiums in 2003 (CIRC). As table 2.2 shows, the non-life insurance market could be characterized as a typical oligopoly market. The situation on the life insurance side is a little bit better, but is still highly concentrated as well. Table 3.1 indicates that the market share of the top three life insurers in 2003 was as high as 87 per cent (Chen 2004, p. 59). Tables 3.2 and 3.3 list the top five life insurers and top five non-life insurers in 2003.

Table 3.1. Concentration of China’s insurance market in selected years (%)

Market share by premium volume	1992		1996		2001		2002		2003	
	Life	Non-life	Life	Non-life	Life	Non-life	Life	Non-life	Life	Non-life
Top 1 Insurer	N/A	96.0	N/A	77.3	57.1	73.9	56.6	70.9	54.0	69.8
Top 2 Insurer	N/A	N/A	N/A	89.6	85.2	86.3	80.1	84.1	73.9	82.1
Top 3 Insurer	N/A	N/A	N/A	96.9	95.3	96.1	91.1	94.8	86.6	91.7

Source: China Insurance Regulatory Commission; Jiang (2004), p. 22; Chen (2004), p. 59.

N/A = not available.

Table 3.2. Overview of the top five life insurers in China, 2003

Rank	**Name**	**Premium volume (RMB 100m)**	**Organizational form**	**Principal distribution system (market share)[a]**	**Ownership type**	**Country of ultimate owner**
1	China Life	1,625.33	Stock	Exclusive agency (66.83%)	Insurance holding company	China
2	Ping An Life	598.58	Stock	Exclusive agency (63.84%)	Insurance holding company	China
3	Pacific Life	382.40	Stock	Bancassurance (39.52%)	Insurance holding company	China
4	New China Life	174.33	Stock	Bancassurance (56.43%)	Industrial firm	China
5	Taikang Life	135.19	Stock	Bancassurance (53.72%)	Industrial firm	China

Source: Chen (2004), pp. 59 and 164.

[a] Market share is the ratio of premium income collected through the distribution channel to the overall premium income of the company.

Table 3.3. Overview of the top five non-life insurers in China, 2003

Rank	Name	Premium volume (RMB 100m)	Organizational form	Ownership type	Country of ultimate owner
1	PICC P&C	606.80	Stock	Insurance holding company	China
2	Pacific P&C	106.90	Stock	Insurance holding company	China
3	Ping An	83.50	Stock	Insurance	China

	P&C			Holding company	
4	Tian An P&C	21.00	Stock	Industrial firm	China
5	China United P&C [a]	18.70	State-owned	State-owned	China

Source: 2004 Yearbook of China's Insurance (2004).
Note: The principal distribution system is not available for non-life companies.
[a] China United P&C was formerly the Property Insurance Company of Xinjiang Production and Construction Group. It was in the process of switching to stock at the time of writing.

3.4 Geographic distribution

Table 3.4 shows that geographic distribution of China's insurance industry is highly imbalanced. In 2003, the top 6 provinces, autonomous regions, or centrally controlled municipalities collected 46 per cent of China's gross premiums while the last 10 only constitute about 10 per cent.[107] (*2004 Yearbook of China's Insurance* (2004))**.** This situation is principally a result of uneven economic development in different regions.

Table 3.4
The Distribution of China's Economy and Insurance Industry by Region, 2003

			Distribution of the Economy by Reg			Distribution of Insurance Pren			
Region	Distribution of GDP (%)	Distribution of Population (%)	Primary Sectors (%)	Secondary Sectors (%)	Tertiary Sectors (%)	Non-Life (%)	Life (%)	Total (%)	Premium per Capita for Each Region (RMB)
The East Coast	58.5	37.9	42.5	64.7	60.4	53.9	61.8	59.8	473.2
The Southeast Coast*	34.7	19.5	21.6	39.3	35.8	33.1	35.6	35.0	537.0
The Middle	24.6	33.4	31.6	25.5	22.9	16.7	23.3	21.7	194.6
The West	16.9	28.7	25.9	9.8	16.7	29.5	14.9	18.5	192.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	304.6

Source: *China Statistical Yearbook 2004* (year), §4.3, §3.11; 2004 Yearbook of China's Insurance.
Notes: * The Southeast coast is a subset of the East Coast. 1.) It is generally accepted that the east coast region includes Beijing, Tianjin, Hebei, Liaoning, Shanghai, Jiangsu, Zhejiang, Fujian, Shandong, Guangdong, and Hainan. The middle region include

Because of the structural differences in location and resource endowment of different regions, the geographic deployment of China's industrialization was uneven after the reform and opening up began. Benefiting from this strategy, the southeast coastal regions soon surpassed the middle and west regions in economic development and attracted insurers' efforts with their favourable demand. Most of the newly established insurers are located in the east coastal area and the number of insurers in the middle and the west market has not increased much. As a result, the competition in the eastern market is much

[107] The top six provinces, autonomous regions, or centrally controlled municipalities are as follows: Jiangsu, Guangdong, Shanghai, Shandong, Beijing and Zhejiang (*2004 Yearbook of China's Insurance* (2004)).

more intensive. For example, in 2003, the market share of the top 4 life insurers in Shanghai was about 64 per cent, indicating a healthy competition. However, in some west provinces, China Life still holds a monopoly position (CIRC).

3.5 Product portfolio

Different kinds of insurance products have been continually introduced to the market as the industry has developed. On the life insurance side, the product portfolio before June 1999 consisted of traditional policies, whose premiums, benefits, and assumed interest rate were hard to adjust after selling, such as ordinary life insurance and endowments. PBOC reduced the interest rates seven times in succession from May 1996 to June 1999, and the nominal interest rate of a one-year certificate of deposit decreased from 10.98 per cent to 9.19 per cent after 1 May 1996 and then to 2.25 per cent after 10 June 1999. While the interest rates dropped dramatically, the assumed interest rates of China's life insurance policies were not lowered and thus the policies became very attractive to consumers. Some insurance companies did not realize the seriousness of implied losses and failed to adopt effective measures to prevent agents from selling more of the old polices. The large demand and loss of control on supply side contributed to tremendous losses from interest rate discrepancies to China's insurance companies.[108] CIRC then required the life insurers to lower the assumed interest rates of newly issued policies in June 1999 and encouraged the companies to develop innovative products, which transfer some or all of the investment risk to policyholders.

Ping An Life Insurance Company first introduced variable life insurance policies to the market in October 1999 and collected RMB 1.23 billion of premium income in the following 14 months. (CIRC) This kind of product received favourable responses in big cities due to its high potential returns in the then bull market. Therefore, other insurers began to follow suit. In 2001, the premium income from variable life products in Beijing alone accounted for 21 per cent of its total life insurance premium income. (CIRC) However, the rapid growth of variable life products was impeded by the crash of China's stock market which began in late June 2001. The Composite Index of Shanghai dropped from its highest point of 2,245.44 on 14 June 2001 to its lowest of 1,514.86 on 22 October 2001 and closed at 1,645.97 at the end of the year (Shanghai Stock Exchange, 2002). The crash is largely attributable to the withdrawal of capital, the reduction in State-owned stock, and the loss of investors' faith due to disclosure of inside trading (Li 2002).

Participating, universal life, and other innovative products with lower investment risk, increased flexibility, and higher returns relative to bank deposits began to appear and became popular in the market thereafter. In 2003, premium income from innovative products accounted for 58 per cent of gross life insurance premiums (Guoyuan Center for Securities Research and Development, 2002). Furthermore, as table 3.5 indicates, there was a notable increasing trend in health insurance premiums as health related risk became a major focus of the public's attention and health insurance became an important supplement to the medical coverage provided by the reformed social security system.

[108] Because the loss from investment earning is not realized at once and the return on investment keeps changing, an accurate estimate of the loss is not feasible. In 2002, CIRC declared the volume of the loss at about RMB 50 billion (Ning, Yu (2003)). According to Goldman Sachs (2003), the volume was about RMB 32–72 billion.

Table 3.5
Market Share by Lines of Life Insurance Business (%), 1998-2003

	1998	1999	2000	2001	2002	2003
Life Insurance*	89.12	87.62	89.09	90.45	91.20	88.66
Traditional	89.12	N/A	N/A	60.99	37.30	30.19
Variable	0.00	N/A	N/A	7.48	3.00	2.43
Universal	0.00	N/A	N/A	2.83	1.50	0.56
Participating	0.00	0.00	N/A	19.15	49.30	55.48
Health Insurance	3.75	4.72	2.83	4.28	5.32	8.03
Accidental Insurance	7.13	7.66	8.08	5.27	3.47	3.31
Total	100.00	100.00	100.00	100.00	99.89	100.00

Source: China Insurance Regulatory Commission (2004); Intranet Business Express of China Economic Information Center (2004) Jiang (2004), p. 16.

Notes: * Including pension insurance. The market share of pension insurance was 16.79% and 14.34% in 2002 and 2003, respectively. Owing to lack of data, we cannot get accurate information on pension insurance in other years.

Table 3.6. Market share by lines of non-life insurance business, 1998–2003 (%)

	1998	**1999**	**2000**	**2001**	**2002**	**2003**
Automobile insurance	55.56	58.12	61.35	61.61	60.51	62.14
Enterprise property insurance	22.27	21.43	19.41	17.66	15.77	14.38
Freight transport insurance	7.63	6.69	5.92	5.99	5.38	4.72
Liability insurance	2.78	3.19	3.45	4.09	4.74	4.03
Household property insurance	2.41	2.32	2.14	2.77	3.08	2.19
Hull and cargo insurance	2.37	2.10	1.81	1.75	1.67	1.73
Construction and installation projects insurance and related liability insurance	1.19	1.07	0.99	0.88	1.03	1.38
Export credit insurance	0.59	0.45	0.49	0.44	0.90	0.92
Agriculture insurance	1.41	1.20	0.66	0.44	0.64	0.58
Guarantee insurance	0.22	0.27	0.33	0.58	1.15	0.23
Satellite and nuclear energy insurance	0.43	0.29	0.49	0.73	0.77	0.12
Other	3.14	2.86	2.96	3.07	4.36	7.59
Total	*100.00*	*100.00*	*100.00*	*100.00*	*100.00*	*100.00*

Source: Intranet Business Express of China Economic Information Center.

As for the non-life insurance sector, table 3.6 shows the market share of the various lines of non-life insurance. The proportion of each line in terms of premium income has been relatively stable these years, although automobile insurance has played the leading role. The market share of enterprise property insurance has decreased due to the fact that many State-owned enterprises (SOEs), the major clients of the insurers, performed poorly and had to cut expenses on insurance as the way to reduce the costs. At the same time, the newly established private enterprises often lack insurance awareness.

3.6 Distribution channels

As figure 3.2 indicates, a diversified distribution system, including direct marketing, insurance intermediaries, and direct response has already taken shape. Direct response refers to the marketing channel through which the insurance companies sell products directly to consumers. Typically, direct selling does not involve face-to-face contact during the sales process. In the past, direct marketing, where the salaried staff of insurers deals directly with customers, was the most important distribution channel.

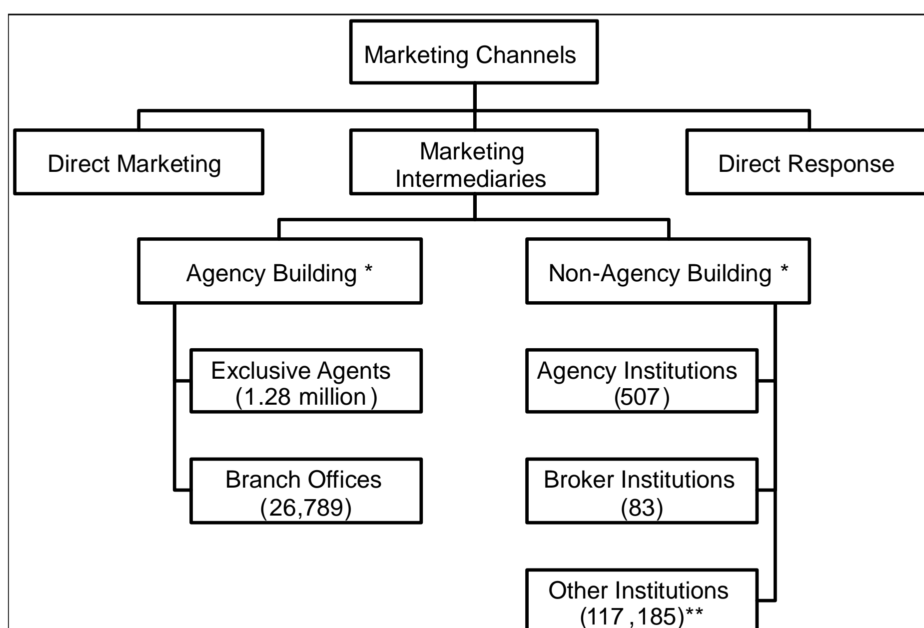
Direct marketing lost its dominant position to individual agents in the individual life insurance market in 1994 when AIA introduced the commission-based exclusive agency system in Shanghai. Within a few years, all domestic life insurance companies in China introduced the same system. An exclusive agent is an individual that can represent only one insurance company. They typically do not have an exclusive territory. Insurance agency institutions, as legal entities, can sell products of different insurers. The usual commissions to agents are based on the business volume and vary between 20 per cent and 40 per cent of premium income collected. Different companies have adopted different commission schedules.

Figure 3.3 shows that the market share of the exclusive agency system in the life insurance market climbed to 73.9 per cent in 2000 and direct marketing only accounted for 25.5 per cent of the market share instead of 100 per cent in 1992 (Chen 2004, p. 102). The Provisional Measures for Insurance Agents Administration promulgated in 1996 recognized the role of agents by setting standards for the professional practice of agents and requiring agents to pass the Insurance Agents Qualifying Examination organized by CIRC. The number of agents greatly increased and contributed significantly to the high growth of life insurance premium volume. In addition, brokers came into being with foreign enterprises and foreign insurers operating in China. In 1998, PBOC promulgated the Provisional Measures for Insurance Brokers Administration. CIRC organized the first Insurance Brokers Qualifying Examination in May 1999 and 162 people out of about 4,800 received the qualification (Wu 2004, p. 172). Individuals who had a criminal record in the past five years, or have ever received a penalty due to unfaithful behaviours in the past three years, were prohibited from being an agent or broker by the financial regulators.

In 2001, CIRC enacted the Measures for Insurance Agencies Administration and the Measures for Insurance Broker Companies Administration and then amended them at the end of 2004. The Measures for Insurance Broker Companies Administration were renewed as the Measures for Insurance Broker Institutions Administration. Under the new regulation, insurance agency institutions and broker institutions in China could only take the form of partnership, limited liability company, or limited stock company and each of them had to deposit 20 per cent of its registered capital as a guaranty fund or buy required professional liability insurance.

Institutions other than agency companies and broker companies (referred to as other institutions later), such as commercial banks, auto dealers, and post saving offices, can also act as insurers' agents to distribute insurance products after they get licences from the CIRC and come to an agreement with insurance companies.[109] Bancassurance started in 1996 in China and gained popularity on the life insurance side after Ping An Life Insurance Company developed "Century Dividend" in the year 2000. "Century Dividend" was specially designed for sales via commercial banks. The employees of banks' branch offices recommended the insurance products to their customers while doing banking business with them over the counter or used various direct reponse techniques to sell insurance policies to their existing customers. This distribution channel proved to be cost-effective and a great success. For example, 75 per cent of the life insurance premium income for Taiping Life Insurance Company in 2003 came from bancassurance (Chen 2004, p. 104). As figure 3.2 shows, direct response, such as marketing through telephone and the Internet, has also arisen lately, but the market shares are trivial by comparison.

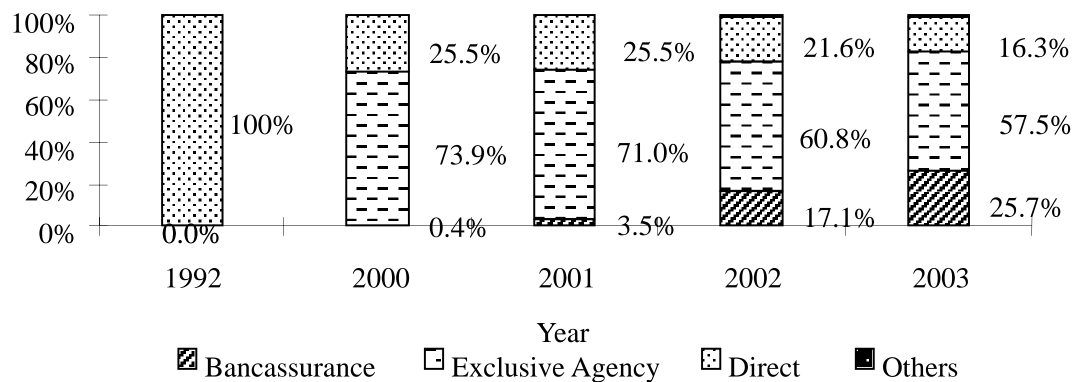
Figure 3.2
An Overview of China's Insurance Distribution System, 2003



Source: China Insurance Regulatory Commission (2004);
Notes: * We divide marketing intermediaries into two classes depending on whether the insurer is attempting to build its own agency sales force. Thus, insurers following an agency building distribution strategy recruit, train, finance, house, and supervise their agents. The non-agency building strategy means that the insurers rely only on established agents for their sales (Black and Skipper 2000, p. 603).
** Including 48,489 in non-life insurance business and 68,696 in the life insurance business, which takes insurance marketing as part of their business, similar to commercial

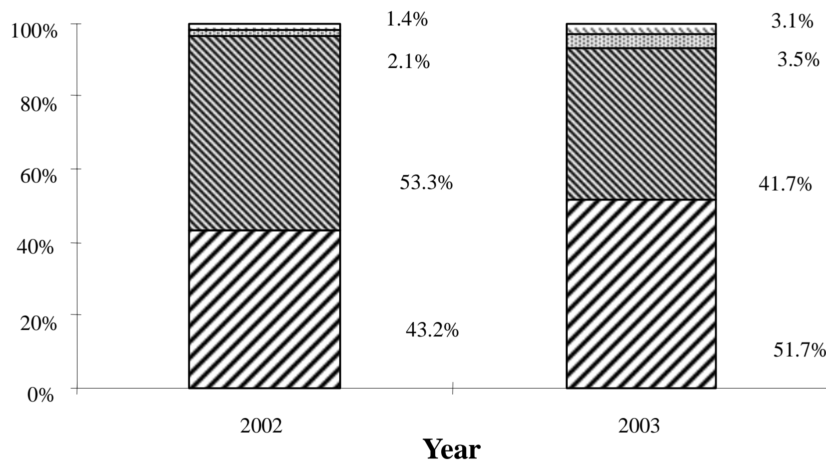
[109] In China, only China Post, a government-run postal enterprise, could provide all kinds of postal service. Other enterprises, including foreign companies could conduct only certain express delivery service and logistics service. China Post also conducts savings and remittance businesses. Every post saving office of China Post could sell insurance after it received a licence from the CIRC.

Figure 3.3
Market Share by Distribution Channel for Life Insurance in Selected Years



Source: Chen (2004), p. 64, pp. 100-102.

Figure 3.4
Market Share by Distribution Channel for Non-Life Insurance, 2002-03



Source: Tang (2004), p. 122.

As we can see in figure 3.2, by the end of 2003, there were 507 insurance agency companies operating in China and 207 were preparing to start operation; and there were 83 insurance brokerages in operation while another 82 were preparing to start operation. Other institutions engaged in insurance sales totalled 117,185 with 48,489 for non-life insurance and 68,696 for life insurance. Nationwide there were 26,789 insurance branch offices and 1.28 million exclusive agents. These intermediaries played an important role in insurance sales. Figure 3.3 shows the relative importance of all kinds of distribution channels for life insurance in recent years with figure 3.4 for non-life insurance side.

3.7 Investment management

At the beginning of this period, investment channels were wide open, but due to the lack of investment expertise and management experience, more than RMB 10 billion of non-performing assets were engendered from 1992 to 1993 (Wu 2004, p. 187). The *Insurance Law* enacted in 1995 thus put strict requirements on insurance investments in order to ensure the solvency of the insurance companies, specifying that insurance funds can only be invested in the form of bank deposits, government bonds, financial bonds, and other investments as approved by the State Council (and these requirements were not changed in the 2002 amendment).[110] Subsequently, China's insurers were gradually allowed to widen their investment channels, as the financial market developed. They were allowed to invest in corporate bonds rated AA+ issued by the central government-controlled SOEs (July 1998), government securities repurchased (August 1998), negotiated bank deposits (October 1999), mutual funds (October 1999), corporate bonds rated AA (June 2003), central bank notes (July 2003), and stocks (October 2004). The proportion of each kind of investment to the total investible fund, however, had to comply with the prescription of the regulator.[111]

Table 3.7 provides an overview of insurance investment in China for 2002–03. It is worth noticing that bank deposits, despite the low return, have always been the most important investment channel for insurance funds, and government bonds took second place. Conservative investment strategies resulted in a low rate of return, which was only 2.68 per cent in 2003 (Wu 2004, p. 189). Insurance asset management companies, which specialize in fund management for insurance companies, have become the latest trend in insurance investment. PICC Asset Management Company and China Life Asset Management Company, established in 2003 and 2004 respectively, were the first two asset management companies in China.

Table 3.7. Overview of insurance investment in China, 2002–2003

	2002 volume (RMB 100m)	Percentage of total	2003 volume (RMB 100m)	Percentage of total
Bank deposits	3,026.3	54.7	4,549.7	52.1
Government bonds	1,107.9	20.0	1,406.9	16.1

[110] Financial bonds refer to securities issued by financial institutions in China's inter-bank bonds market requiring repayment of interest and principal within a given period. Until now, financial bonds were just issued by state policy-related banks.

[111] There are no upper limits on bank deposits, government bonds, financial bonds issued by state policy-related banks, and central bank notes. One negotiated bank deposit, which is a kind of long-term deposit by non-bank financial institutions and the terms of which are set by bilateral negotiation, should exceed RMB 30 million and last more than five years. The proportion of corporate bonds investment should not exceed 20 per cent of the insurer's assets at the end of last month and the investment in one corporate bond should not exceed the minimum of 15 per cent of the circulation and 2 per cent of the insurer's assets at the end of last month. The proportion of mutual funds investment should not exceed 15 per cent of the insurer's assets at the end of last month, while the proportion of funds in separate accounts of variable life insurance is 100 per cent and for universal life insurance is 80 per cent. As to stocks, the stocks of one listed company held by one insurance institutional investor shall not reach 30 per cent of the RMB common stocks of the listed company and the specific proportion of stock investment of an insurance institution investor shall be separately specified by CIRC. The limits may be changed when necessary according to the actual situation observed by CIRC.

Financial bonds	404.8	7.3	828.7	9.5
Corporate bonds	84.6	1.5	389.0	4.5
Mutual funds	307.8	5.6	456.6	5.2
Others	599.2	10.8	1,108.1	12.7
Total	5,530.6	100.0	8,739.0	100.0
Rate of Return	3.1%		2.7%	

Source: Wu (2004), pp. 188–189; Jiang (2004), p. 54.

3.8 China's insurance industry in 2004

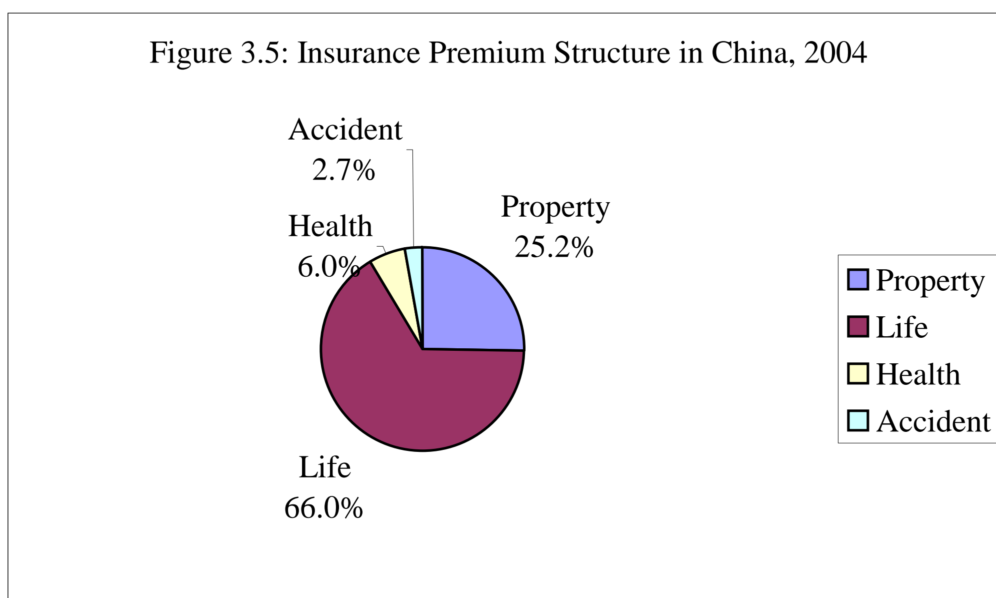
According to the updated information, we would like to present a picture of China's insurance industry in 2004, including the number of insurance companies, insurance premium volume, insurance assets and investment, insurance market share, foreign-funded insurance companies, etc.

By the end of 2004, the number of insurance companies in China increased to 68. There are 5 insurance group (holding) companies, 29 life insurance companies (including pension companies), 29 property insurance companies, and 5 reinsurance companies. Among the 29 life insurance companies, there were 9 Chinese domestic companies. Among the 29 property insurance companies, there were 16 Chinese domestic companies. Among the 5 reinsurance companies, there were 2 Chinese domestic companies.

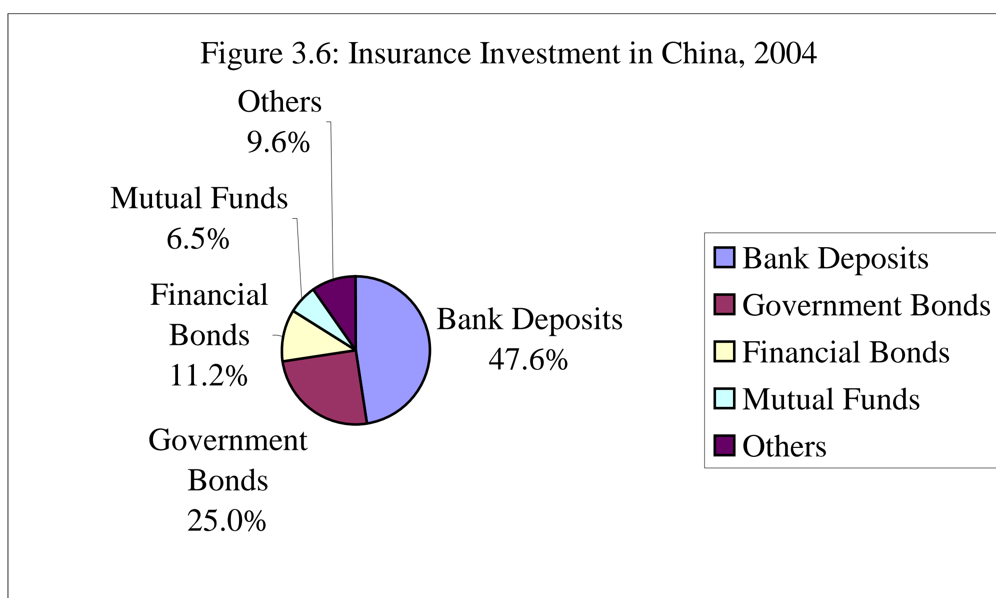
By the end of 2004, there were 24 new companies under construction: 2 insurance group companies and 22 insurance companies. Three of the 22 insurance companies under construction were foreign insurance companies.

By the end of 2004, there were 1297 insurance intermediary companies. Among them, there were 920 insurance agency companies, 197 insurance brokerage companies and 180 insurance adjustment companies. Furthermore, there were more than 120,000 affiliated insurance agency companies, most of whom were commercial banks and postal offices and there were about 1,490,000 individual insurance agents by the end of 2004.

In 2004, the total insurance premium of China was RMB 431.81 billion. For property insurance, the premium volume was RMB 108.99 billion; for life insurance, the premium volume was RMB 285.13 billion; for health insurance, the premium volume was RMB 25.99 billion; for accident insurance, the premium volume was RMB 11.71 billion (see fig. 3.5).

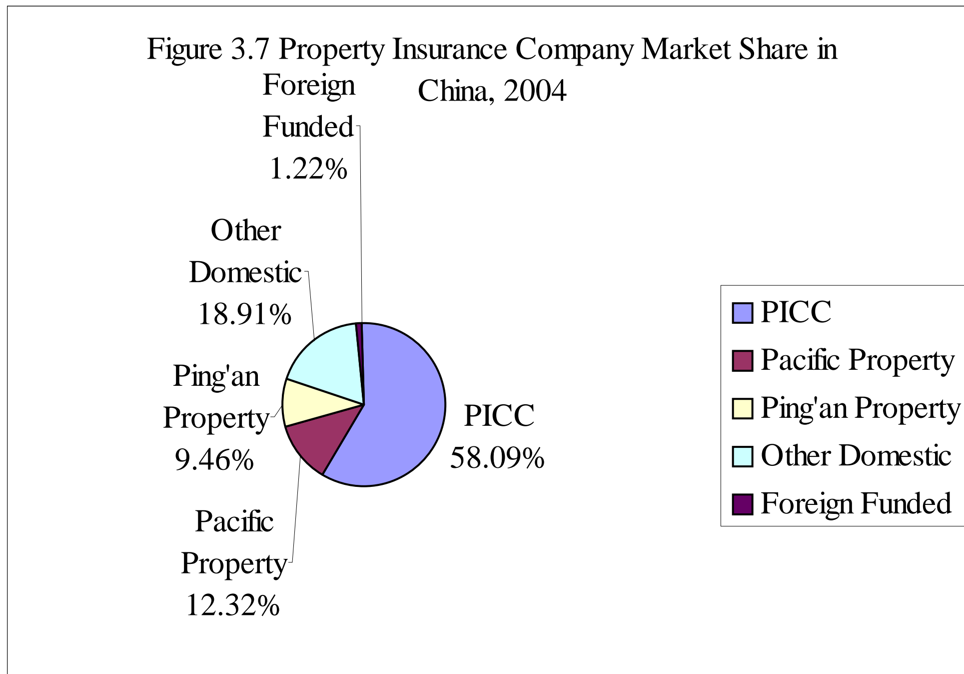


By the end of 2004, the total assets of insurance companies in China amounted to RMB 1195.37 billion. The amount of total usable funds in China's insurance industry were RMB 1124.98 billion. The amount of actual used funds in China's insurance industry were RMB 1038.98 billion. Among them, there were RMB 491.62 billion in bank deposits, RMB 258.79 billion in government bonds, RMB 116.28 billion in financial bonds, RMB 67.32 billion in mutual funds, RMB 99.75 billion in others (see fig. 3.6).

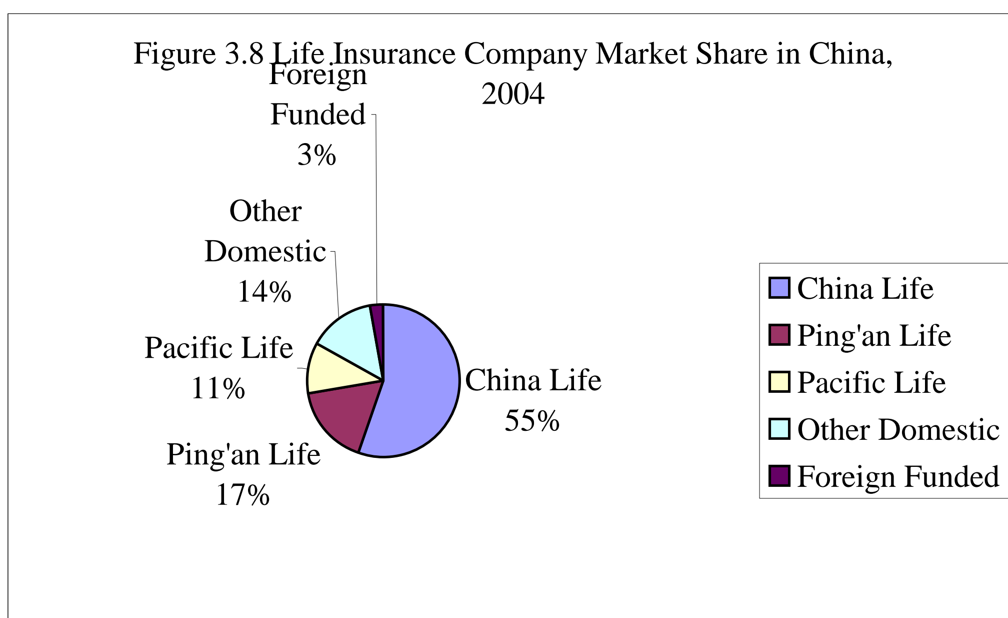


In 2004, the insurance premiums collected by property insurance companies amounted to RMB 112.46 billion. Among them, PICC collected RMB 65.33 billion, accounting for a market share of 58.09 per cent; Pacific Property collected RMB 13.85 billion, accounting for a market share of 12.32 per cent; Ping'an Property collected RMB 10.64 billion, accounting for 9.46 per cent; other property insurance companies collected RMB 22.64 billion, accounting for 20.13 per cent. Among the total RMB 112.46 billion in premiums collected by property insurance companies, Chinese domestic property insurance companies collected RMB 111.08 billion, accounting for 98.78 per cent; foreign-funded

property insurance companies collected RMB 1.37 billion, accounting for 1.22 per cent (see fig. 3.7).



In 2004, insurance premium collected by life insurance companies were RMB 319.36 billion. Among them, China Life collected RMB 176.18 billion, accounting for the market share of 55.17 per cent; Ping'an Life collected RMB 54.88 billion, accounting for 17.18 per cent; Pacific Life collected RMB 34.49 billion, accounting for the market share of 10.8 per cent; New China Life collected RMB 18.75 billion, accounting for 5.87 per cent; Taikang Life collected RMB 17.69 billion, accounting for the market share of 5.54 per cent; other life insurance companies collected RMB 17.38 billion, accounting for 5.44 per cent. Among the total RMB 319.36 billion premium collected by life insurance



companies, Chinese domestic life insurance companies collected RMB 310.93 billion, accounting for 97.36 per cent; foreign-funded life insurance companies collected RMB 8.43 billion, accounting for 2.64 per cent (see fig. 3.8).

In 2004, by province, the top 5 insurance markets were Jiangsu, Guangdong, Shandong, Shanghai and Zhejiang, with insurance premiums of RMB 41.97, 34.37, 31.83, 30.33 and 29.03 billion respectively. The sum of the insurance premium of these five provincial markets amounted to RMB 167.52 billion, accounting for the market share of 38.79 per cent of the whole country.[112]

By the end of 2004, there were 37 foreign-funded insurance companies, among which there were 13 property insurance companies, 21 life insurance companies and 3 reinsurance companies. Most of the foreign-funded insurance companies are with very high quality. For example, the magazine *Fortune* announced the world 500 biggest and strongest enterprises in 2003, among which there were 46 insurance companies. Among the 46 insurance companies, there were 27 insurance companies establishing the business institutions in China. The business development of the foreign-funded insurance companies is fast. In 2004, the premiums collected by foreign-funded insurance companies were RMB 9.8 billion, an increase of 45.7 per cent over 2003. It accounted for 2.3 per cent of the total premium incomes of the insurance industry, a rise of 0.6 per cent over 2003. In Shanghai and Guangzhou that were open early to the world, the market shares of foreign-funded insurance companies were 15.3 per cent and 8.2 per cent respectively.

4. China's insurance regulation

4.1 Legislative environment for insurance regulation

Progress in market-oriented reform and in remoulding the role of government brought forward the need for efficient mechanisms to coordinate the industry and led to great efforts in developing insurance legislation and the regulatory system. The Insurance Law of China enacted in 1995, its amendment in 2002, the Regulation for the Administration of Insurance Companies enacted in 2004, the Regulation for the Administration of Foreign-Funded Insurance Companies enacted in 2001, and other regulations and measures compose the current framework of China's legislative system for insurance. The 1995 Insurance Law consisted of insurance contract law and insurance professional law, governing different aspects of the insurance industry such as the insurance contract, insurance business, market access, and insurance regulation.

Since its promulgation in 1995, the Insurance Law of China has played an important role in the development of the insurance industry. Over the years, however, significant changes had taken place inside and outside of the insurance industry. In terms of the external environment, the reform of the financial system has been deepened and the role of market mechanisms has been strengthened. In particular, since its accession to WTO, China has further stepped up its opening to the outside world and its compliance with international practice. In terms of the internal structure, the size of the market has increased greatly, and the scale of business has grown quickly, with the variety of

[112] There are 31 provinces in mainland China.

insurance products becoming ever larger. The swift growth of new types of insurance products has set a higher demand on the use of insurance funds. At the same time, the process of allowing the market to determine rate levels has accelerated, the standard of insurance company management is constantly improving and industry self-regulatory organizations have gradually been brought into play. Since the establishment of the China Insurance Regulatory Commission, supervision of the insurance industry has clearly been strengthened. These changes have caused some of the shortcomings of the Insurance Law to become gradually apparent. For example, there are inconsistencies between individual provisions and China's commitments in connection with its accession to WTO. Some provisions are no longer appropriate to the strengthening of insurance supervision and administration. That's why the Standing Committee of the People's Congress of China decided to amend it in October, 2002.

On 28 October 2002, the China's National People's Congress promulgated the new Insurance Law effective from 1 January 2003. The new law makes several important adjustments to China's insurance sector, and enables market-based solutions to certain issues. The new law addresses government regulation of the insurance sector, as opposed to regulating insurance contract clauses. The new law shifts to more market-oriented and policy-based regulations. For example, the CIRC will carefully monitor the solvency capability of insurance companies according to specially formulated benchmarking standards. The amended law partially lifts restrictions against insurance enterprises and their business operations. The new law makes clear that administration of the insurance industry is vested solely in the CIRC. Under prior law, regulators set insurance clauses and insurance premium rates for most insurance products. The amended law stipulates that only clauses and premiums for policy-mandated insurance and new types of life insurance products need prior approval from insurance regulatory authorities. Clauses and rates for other types of insurance products are to be reported to the CIRC for filing on the record. The new law abolished mandatory reinsurance. The new law also allows property insurance companies to engage in cross-class operations in short-term health insurance and accidental injury insurance businesses, subject to regulatory approval. The new law places no restrictions on the number of insurance companies that an incorporated agency may serve. The amended Insurance Law stipulates that insurance funds shall not be used to establish securities business organizations or to establish enterprises beyond the realm of insurance. The State Council may stipulate appropriate investment vehicles for insurance funds. There are some unclear areas in the new Insurance Law, and the CIRC is expected to engage in rulemaking on penalty provisions, administrative regulations for insurance companies, and application of insurance guarantee funds.

4.2 Current situation of China's insurance regulation

The establishment of the CIRC on 18 November 1998 was a milestone in China's history of insurance regulation. It ended PBOC's function of administrating the insurance industry in China, which had continued for quite a long time. At present, CIRC is still the superintendent and regulator of the industry, but its direct involvement in administration of the industry is gradually decreasing as reform progresses. One important aspect of reform is to put more emphasis on solvency regulation, while loosening the former strict restrictions on insurers' market behaviour.

In March 2003, CIRC enacted the Regulation on the Solvency of Insurers and Regulation Indicators based upon the actual situation in China and experiences from the European

Union. According to this regulation, insurance companies in China are required to ensure that their actual solvency margin (i.e. the difference between the admitted assets and liabilities) is larger than the minimum, which is calculated based on the methods prescribed in the regulation. The minimum solvency for P&C insurance companies is the maximum of (1) 18 per cent of retention of gross premium in last fiscal year (excluding sales taxes and associate charges) below RMB 100 million plus 16 per cent of the part above RMB 100 million or (2) 26 per cent of average combined loss payment (the sum of loss payment, difference between reserve drew in current year, and reserve carried over, and reinsurance loss payment minus reinsurance loss repayment and income of loss payment recovered) below RMB 70 million and 23 per cent of the part above RMB 70 million.[113] The minimum for life insurance companies is the sum of minimum solvency of long-term business (carrying an insurance period more than one year) and short-term business. The minimum solvency of long-term business is the sum of (1) 1 per cent of mandatory minimum reserve of investment-linked products and 4 per cent of other products and (2) 0.1 per cent of amount at risk for term life products carrying an insurance period less than three years, 0.15 per cent for term life products carrying an insurance period more than three years but less than five years, and 0.3 per cent for other life products. The calculation of minimum solvency of short-term business is the same as that of P&C insurance companies.

In addition, CIRC has loosened the former strict limitations on market access, regions of operation, rates, and policy forms. For the non-life insurance side, reform which began in 2003, focuses on automobile insurance. Insurers no longer need to use the rates and forms set by CIRC and can develop their own polices and use them after getting approval from CIRC. For the life insurance side, insurers are permitted to develop their own policy forms and rates and just need to file related materials (including terms and rate schedules, cash value illustration, and legal statements) with CIRC within seven days after sale of the products. However, they must get approval prior to launching certain products according to the Administrative Measures on Examination, Approval, and Filing of Life Insurance Products.[114]

All these measures, in return, have inspired many innovations in the industry, e.g. the introduction of automobile premium rate based on insured’s personal information such as driving record and sex, the Bonus-Malus system, and the electronic loss assessing system.[115]

4.3 Five lines of defence for risk prevention proposed by CIRC

The China Insurance Regulatory Commission looked upon risk prevention as a systematic project, and tried hard to set up the five lines of defence for risk prevention in the

[113] The minimum for insurance companies, which have been in the business no more than three fiscal years, is what prescribed in (1).

[114] Include mandatory insurance products, products recognized to be related to public interest by CIRC, and life insurance carrying death protection recognized as new type by CIRC. For more information, refer to *Notice on Several Issues about Administration Measures on Life Insurance Products Approval and Filing* (2004).

[115] The Bonus-Malus system is a kind of no-claims discount strategy that can be chosen by the insurer to eliminate the moral hazard problem. No-claims bonus schemes are an important feature of some insurance contracts, most notably those for car insurance. A particularly simple Bonus-Malus scheme is the so-called “one up / one down” scheme. It rewards individuals for each claim-free period by a reduction in premium to the next lowest category and, each claim generates an increase in premium to the next highest category. Some schemes are defined as “two up / one down”.

insurance industry, namely, insisting on the base as the inner control, on the core as solvency regulation, on the importance of on-site inspections, on the key sector as the regulation for the fund application and on the barrier as the insurance protection funds (Wu, 2005).

Firstly, enforcing the inner management. CIRC guided the insurance companies to strengthen the applications of the information technology in the risk management and in the inner controls, boosted the business and the financial data to be gathered together in the country, reduced the management layers and standardized the inner operation. CIRC worked out the “Checking and Accepting Guidelines of the Information Construction When Insurance Companies Open Their Business” and made requirements for the information construction of the insurance companies. CIRC also drew up the “Temporary Stipulations of the Insurance Statistics Management”, started China’s insurance statistics information system and realized the net connection between the regulatory administration and the insurance companies.

Secondly, enforcing the regulation of the solvency. CIRC drew up the “Management Method about Non-Life Business Reserve of the Insurance Companies (try out)” and carried out the careful and standard drawing criterion of the liability reserve. CIRC worked out five “editing rules for the report about solvency of the insurance companies”, enhanced the scientology and the accuracy for the assessment on the solvency of the insurance companies, set up the quarterly report system about the solvency of the insurance companies and the financial analysis system. CIRC sent out the regulatory opinion letters to the companies that haven’t got sufficient solvency, requiring them to rectify with the stipulated time. The binding power of the regulation about solvency has been enforced obviously so that the overall solvency of the insurance industry has been enhanced greatly.

Thirdly, reinforcing the on-site inspections. Last year, CIRC punished 285 insurance institutions and insurance intermediary institutions that have violated the rules and regulations, disposed of 93 people who were liable and eliminated some risk factor that may affect the stability of the insurance market. CIRC hit against strictly the “underground insurance policies” which were mainly from the special administrative regions of Hong Kong and Macao, carried out the propaganda and education widely in Guangdong and other districts, making the public to realize the danger of the “underground insurance policies”. CIRC enforced the cooperation with the insurance regulatory administration of Hong Kong and Macao, took measures with the Public Security Ministry and effectively controlled the overspread of the “underground insurance policies”. CIRC standardized the business of motor-buying loan insurance, set up the term report system, urging insurance companies to strengthen the collection of the premiums and dissolving the risk about motor-buying loan insurance.

Fourthly, enforcing the regulation about the insurance investment. Aiming at the possible risks that might arise from the restriction lifting on insurance investment, CIRC reinforced the system construction, issued “the Temporary Stipulation about the Management of the Insurance Assets Management Companies” and “the Risk Controlling Guidelines in the Insurance Investment”, guiding all of the insurance companies to set up the risk control system for the insurance investment, introducing the trust system for the funds and enhancing the safety in the insurance investment. Aiming at the hidden risk in

the insurance investment, CIRC organized special inspections and make risk instructions for the investment of the insurance companies.

Fifthly, setting up and perfecting the system of the insurance protection funds. CIRC drew up the "Management Method for the Insurance Protection Funds", intensified the unifying management of the insurance protection funds, setting up the self-saving mechanism gradually for the insurance industry and enforced the power of preventing and dissolving the risks by the industry's own power.

5. Impact of opening up on China's insurance market

5.1 Stages of opening up and China's WTO commitments

China's insurance industry began to open up to the outside world step by step at its initial stage of restoration. The central Government first allowed several foreign insurance companies to set up representative offices in China in the early 1980s which started the first stage of opening up. 1992 was the start of the pilot stage as the State Council chose Shanghai to be the first experimental city for opening up. More cities followed the suit thereafter. Upon China's accession to WTO in 2001, the Government made certain commitments with respect to the insurance sector and thus led China's insurance industry to a completely new stage. The current stage is characterized by an overall opening instead of a limited and restricted opening and it is viewed as more predictable, based on a legal framework, with mutual openings among WTO member States.

The Chinese Government's WTO commitments concerning the insurance sector can be summed up in the following four aspects: corporate forms, regional restrictions, business restrictions, and mandatory insurance.

5.1.1 Corporate forms

The Chinese Government promised that upon WTO accession, foreign non-life insurance companies would be allowed to establish branches or joint ventures with a maximum ownership stake of 51 per cent; and 100 per cent owned subsidiaries would be allowed two years after WTO accession. Foreign life insurance companies would be allowed to freely choose Chinese partners and establish joint ventures with maximum ownership of 50 per cent upon WTO accession. Foreign insurance brokerages may set up joint ventures with maximum ownership of 50 per cent upon accession, 51 per cent within three years of accession, and 100 per cent owned subsidiaries within five years of accession. Foreign reinsurance companies would be allowed to set up branches, joint ventures, or fully-owned subsidiaries to provide life and non-life reinsurance without regional restrictions or numerical restrictions on operating licences. The new establishments are subject to licences approved by China's insurance regulator.

5.1.2 Regional restrictions

Upon WTO accession, foreign life insurance, and non-life insurance companies were allowed to operate in Shanghai, Guangzhou, Dalian, Shenzhen, and Fuoshan. Within two years of WTO accession, they were further allowed to operate in 10 more cities: Beijing, Chengdu, Chongqing, Fuzhou, Suzhou, Xiamen, Ningbo, Shenyang, Wuhan, and Tianjin. All regional restrictions were removed at the end of 2004, three years after accession.

5.1.3 Business restrictions

Upon WTO accession, foreign non-life insurance companies were allowed to engage in the sale of "master policies," which cover the insured's properties and liabilities located in different places without regional restrictions and were also allowed to underwrite large commercial risks. Foreign non-life insurance companies were allowed to provide property coverage, related liability, and credit insurance for subsidiaries of foreign companies operating in China. Within two years of accession, these companies were allowed to provide the whole range of non-life insurance products to both Chinese and foreign clients. Foreign life insurance companies were allowed to provide individual (non-group) life insurance to both Chinese and foreign citizens. Within three years of WTO accession, these companies were allowed to provide health, group, and retirement/annuity products to both Chinese and foreign citizens.

5.1.4 Mandatory insurance

China Re, the former national reinsurance company, was granted a 20 per cent mandatory reinsurance from domestic companies before WTO entry. This percentage was reduced by 5 per cent each year after WTO accession and zeroed out four years later. However, foreign companies were still excluded from mandatory insurance for automobile third-party liability, public transportation vehicle liability, and commercial vehicle driver/contract mover liabilities.[116]

Overall, the intense efforts by the developed-country members of WTO on negotiation involving the insurance sector have proven to be effective and China's insurance industry has opened to a greater extent than other emerging insurance markets in the world.

5.2 Status quo of the opening up of China's insurance industry

By the end of 2004, 17 foreign insurers (including thirteen P&C insurers, one life insurer, and three reinsurers) from 8 countries /regions set up their branches and/or subsidiaries in China and another 20 life insurers from 12 countries/regions accessed Chinese insurance market by setting up joint ventures in China.[117] The foreign insurers had about 1.2 per cent of the non-life insurance market and 2.6 per cent of the life insurance market in 2004. With the huge potential of China's insurance market, there are still quite a few foreign insurers waiting for licences. As of the end of 2004, there were 188 representative offices established by 124 foreign insurance institutions from 18 countries/regions in China.

As noted above, China, following its WTO commitments, has allowed foreign insurers to operate in extensive areas of the country and provide many types of insurance. However, the foreign insurers already in business have actually focused on the relatively developed

[116] Automobile liability insurance is mandatory in China. The compensation to the injured third party in traffic accidents is based on a tort liability system according to the Road Traffic Safety Law of the People's Republic of China effective on 1 May 2004. CIRC was preparing the Regulations on Mandatory Automobile Liability Insurance when we finished this case study and details concerning the mandatory insurance, such as the minimum insurance required, are not known yet.

[117] According to China's schedule of commitments in the insurance industry, foreign life companies can only operate in China through the establishment of joint ventures. As a result, foreign life insurers established after WTO accession are all joint ventures. The existing foreign life branches are affiliated to AIA, which received its licences in China before China's WTO entry. Furthermore, since foreign non-life insurance companies are allowed to establish branches, no joint ventures engaging in the non-life insurance business have been established.

cities, such as Shanghai, Guangzhou, and Shenzhen. These cities offer better infrastructure, high per capita incomes, and the benefits of the cluster effect. Shanghai, the first experimental city to open, was the home of over 45 per cent of the foreign insurers (by number) operating in China by the end of 2004.

As the insurance market opens up further, the number and the business volume of foreign firms in China continue to increase. The total assets of foreign insurers reached RMB 29.4 billion at the end of 2004, 2.5 per cent of that of China's insurance industry. The market share of foreign companies in the overall industry was 1.7 per cent in 2003 and increased to 2.3 per cent in 2004. In some regional markets with more foreign players such as Shanghai, Guangzhou, and Shenzhen, the market share of foreign insurers, especially life insurers, far exceeds the national average. For instance, in Shanghai alone, the market share of foreign companies reached 15 per cent (Shanghai Insurance Regulatory Agency, 2005). It is safe to say that foreign insurance companies tend to grow very fast and show a strong momentum.[118]

In addition, it is notable that foreign insurers tend to choose non-insurance firms, especially large industrial enterprises, as their joint venture partners. Observations on the 18 joint ventures already in business before August 2004 show that only 4 of them took on domestic insurers as their Chinese partners and the other Chinese partners include large industrial firms, such as Haier Group, Beijing Capital International Airport, China National Cereals, Oils and Foodstuffs Corp., and China Minmetals Corp. This fact reveals the market-oriented nature of foreign insurers. Foreign companies, if they invest together with domestic insurers, will not only have to spend a lot of efforts to integrate different corporate cultures, variant mindsets, and modes of operation and management, but also face the possibility of conflicts of interest between the joint venture and the domestic insurer. In contrast, if foreign insurers work with large non-insurance firms who are financially strong, have favourable goodwill, and enjoy the status of SOEs, they will enhance the likelihood of seeing positive returns sooner rather than later by avoiding the aforementioned risks and benefiting from securing customers, building a good image in the market, and influencing the market direction. Generali China Life Insurance Company Limited can serve as a convincing example. On 31 March 2005, this company, a joint venture of Assicurazioni Generali S.p.A. (Generali) and China National Petroleum Corporation (CNPC), sold a "Generali China Sunlight Group Pension" policy to CNPC and collected RMB 20 billion premium. This policy raised the rank of Generali China Life from number 14 in 2004 to 4 in 2005 with respect to market concentration in China.[119]

[118] Foreign insurance companies collected 19.42 per cent of the premium of newly issued individual life policies in Shanghai in 2003, while in 2002 it was 31.55 per cent. This decline might prove the relative advantage of domestic insurers in competition, yet it is hard to conclude that the competence of domestic insurance companies has been improved materially without further evidence (Chen 2004, p. 289).

[119] Some may think that the reason that foreign insurance companies search for partners outside China's insurance sector is that domestic companies do not want to partner with foreign firms. However, this is not the case. In fact, China's domestic insurers do desire foreign insurers as partners in order to enhance their skills in management, product development, and marketing. Furthermore, almost every domestic insurer that has a large market share, either has foreign insurers as strategic investors, or is searching for foreign investors, e.g. PICC P&C has AIG as a strategic investor.

5.3 Evaluation of insurance opening-up

5.3.1 Opportunities

In general, extensive opening up to the outside world has undoubtedly brought valuable opportunities to China's insurance industry and has proven to be a success in view of its effects on the development and reform of the industry.

First, opening up has helped to improve the quality of development, i.e. the industry has seen product and service innovation in addition to sales growth. Foreign insurance companies' access to China's insurance industry through various channels has brought not only substantive needed capital, but also many resources necessary for effective improvement in the quality and productivity of assets. These include experienced talent, advanced technologies and experience, abilities in research and development (R&D), superior management, and the capacity for understanding customers' demand. Actually, China's domestic insurance companies have made great progress profiting from foreign rivals' new ideas and advanced knowledge in actuarial science, product development, management, marketing, and service. What is more, foreign insurers often engage in R&D, with domestic research institutions or organizations, which provide positive spillover benefits to domestic insurers. For example, Swiss Re has completed, together with Beijing Normal University, *The China Natural Catastrophe Maps*, which include geographic and meteorological data related to major natural catastrophes in the recent 500 years and provides the insurers with a reliable basis to evaluate risks.

Second, opening to the outside has compelled China's domestic insurance industry to reform at a faster pace. Foreign insurance companies have become models for domestic insurers. Thus, fierce competition has erupted in China's insurance market. This will be intensified as foreign insurers further penetrate China. The strengthened competition will also compel domestic insurers to reform their ownership structure and build modern governance, management systems, and operating rules, and fully adopt the market economy mindsets. Furthermore, opening up has accelerated the formation of market-oriented legislation and a regulation system with the characteristics of transparency, equity, and effectiveness.

However, it is, without doubt, apparent that severe challenges to domestic insurers came with these opportunities. In a historical view, China's domestic insurers, who came into being just after the restoration of China's insurance industry, were quite young compared to their foreign rivals, who came from developed markets and were already mature themselves. Early opening has been difficult for domestic insurers, since they are at a disadvantage with regard to many aspects, such as financial strength, administration, governance, management, accumulated knowledge, and expertise.

5.3.2 Challenges

At the same time, problems resulting from the activities of the domestic insurers themselves, after WTO entry, also magnified the challenges to a great extent.

First, domestic insurers adopted mostly a "volume expansion" strategy that focused on short-term sales volume while ignoring product differentiation and core competencies. In the face of intensifying competition, domestic insurers only concentrated on customers

and lines which could be easily reached through their available and identical marketing channels, engendering an overcrowded market and identical product portfolios along with considerable unmet demands.

Second, domestic insurers generally placed an emphasis on learning and mimicking foreign experience and technologies while neglecting the enhancement of their abilities to innovate.

Third, domestic insurers gave most of their attention to learn foreign knowledge in marketing and product development and little to service. The extensive use of exclusive agents became the norm after AIA introduced the exclusive agent channel in 1994. The domestic insurers, especially life insurers, immediately began to heavily employ individual exclusive agents. This action proved to be extremely successful since more than half of the life insurance premiums were collected through exclusive agents over the past several years. However, domestic insurers interpreted “marketing via individual exclusive agents” as simply employing a quantity of salespersons and utilizing them to sell products. This partial understanding led to large numbers of insurance agents trained to compete for market share and premium volume only. The agents often attached little importance to service and made little effort to recommend insurance products that were best suitable for the consumers. While the agents sold new policies to customers in this underdeveloped market, the performance along with the growth and development of the industry were affected negatively in the long run since the creditability of the insurance industry was doubted by the consumers.

Generally speaking, China’s domestic insurers have many things to learn from their foreign competitors to improve their competence.

5.3.3 Debates on gradualism and radicalism

Gradualism and radicalism are two opposite ideas underlying any reform. In the past decade, “big bang” reforms were undertaken in the Russian Federation and some eastern European countries, while “step by step” reforms were taken in China. So far, no convincing evidence shows that one is clearly better than the other. “Big bang” reform is speedy, but the process is painful and some sort of social instability seems unavoidable. “Step by step” reform is typically less painful, but may take a very long time.

Generally speaking, gradualism has been preferred in China’s reform and market opening in the past two decades. There is a Chinese proverb expressing this idea which says, “Go across the river by fumbling for stones”. To take reforms is like crossing a river: you don’t know the exact path beforehand, and you don’t know which way is the most feasible one, so in order to get to the other side, you find one stone at a time, and after taking that step you fumble until you find the next stone. In this way you ensure that you make it safely across the river.

In the insurance situation, gradualism mainly means that further market opening should await certain reforms. If the reforms are not in place, adverse consequences will arise. Three frequently mentioned reforms are insurance legal reform, insurance regulatory reform and State-owned insurance enterprise reform.

The gradualism concept is correct for China, but there might exist a big problem. Waiting for those reforms could be an excuse for vested interest groups and policymakers to postpone insurance market opening again and again. What is good now is that China's joining WTO will provide a very good way to solve this problem. Without the pressure arising from WTO accession, it might take China much longer time to open its insurance market to such an extent. In essence, the timetable of the opening of China's insurance market is not only a compromise between the Chinese Government and other WTO member States, but also between the "radical" and "gradual" reformers in China.

6. International comparisons with major insurance markets

6.1 Introduction

Before starting our comparison between China's insurance market and other typical insurance markets in the world, we would like to provide some concise introduction on comparative markets, items and periods.

For comparative markets, we select seven markets for comparison, the United States, Japan, the European Union,[120] India, the Russian Federation, Brazil and the world market. Among these, the United States, Japanese and European Union markets are developed ones while the the Indian, Russian and Brazilian markets belong to developing ones, and the last "global" market stands for the overall or the worldwide average level. The object selecting process is progressed under principles referring to "large markets" and "involving both developed and developing markets". The United States, Japan and the European Union are the three largest insurance markets in the world, which represent typical developed markets, and India, the Russian Federation and Brazil are representatives of developing markets, since they possess the largest land areas and populations in Asia (except China), Europe and Latin America, respectively.[121] Thus, these markets could basically satisfy our requirements for explanation and analysis.

For comparative items, we choose three criteria: insurance premium, insurance density, and insurance penetration, which show some fundamental market characteristics from three different standpoints. "Insurance premium" is an aggregate index concerning the overall size of a certain insurance market; "insurance density" is a per capita index referring to the average insurance premium; "insurance penetration" is a correlative index reflecting the relationship between insurance industry and the economy (GDP) of a certain country.

For comparative periods, we turn to three years, 1982, 1992, and 2004. Except that 2004 is the year in which the newest data for each market is available, the other two years are milestones in the institutional change in China's insurance industry. In 1982, the China

[120] The European Union here refers to the following 15 countries: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the United Kingdom.

[121] We chose these large countries because China is a typical large country and, from the economic view, there are many essential differences between large and small countries.

insurance industry (both of property and life insurance) were officially revived[122]; in 1992, the industry commenced opening up formally to the outside world.

6.2 Comparison of insurance premiums

"Insurance premium" is an aggregate index concerning the overall size of a certain insurance market. Table 6.1 shows us the comparison on insurance premium between the China market and some other major markets.

Table 6.1. Comparison of insurance premiums (US$ million）

Market	1982		1992		2004	
	Premium	Share (%)	Premium	Share (%)	Premium	Share (%)
China	344	0.07	6,194	0.37	52,171	1.61
United States of America	225,160	45.58	533,005	31.95	1,097,836	33.84
Japan	79,856	16.17	444,782	26.66	492,425	15.18
European Union 15	127,558	25.82	486,450	29.16	1,095,316	33.76
India	2,048	0.41	4,550	0.27	21,249	0.65
Russian Federation	-	-	504	0.03	16,352	0.50
Brazil	2,368	0.48	5,502	0.33	18,042	0.56
World	*493,945*	*100.00*	*1,668,270*	*100.00*	*3,244,559*	*100.00*

Source: Swiss Reinsurance Database (calculated by author).

In 1982, the beginning year of the revival period, the insurance premium income of China was $340 million, or just 0.07 per cent of the worldwide income. In contrast, at the same time the premium income in the United States held 45.58 per cent of the global market, which possessed an absolutely leading position; the European 15 countries represented 25.82 per cent ranking the second largest market; and Japan was the third one taking up 16.17 per cent. Although the proportions of India and Brazil markets were both less than 0.5 per cent, a small absolute value, they were as much as 5 to 6 times of the reviving insurance market of China.

From 1982 to 1992, after 10 years of development, China's insurance industry had just grown up from an embryo. In 1992, the insurance premium income was $6.19 billion, or

[122] China resumed its property insurance business in 1980, and life insurance business in 1982.

0.37 per cent of the world total premium income. Plus it was the first time that China's premium income exceeded that of India and Brazil by 0.1 per cent and 0.04 per cent respectively, from the aspect of the share in the global market. In addition, the United States, Europe and Japan were still the top three markets, although some fluctuations in their worldwide proportions had taken place. For Japan, the premium income increased significantly, taking up 26.66 per cent of the world market, which grew by about 10 per cent from 1982; for the European Union, it held a 29.16 per cent proportion of the world market, increased by about 3 per cent from 1982; for the United States, the absolute volume of premium income also increased dramatically but its proportion in the world market decreased by about 14 per cent to 31.95 per cent. In 1992, premium income of the Russian Federation accounted for 0.03 per cent of the world market.

From 1992 to 2004, during another 10 years of rapid development, China's insurance industry kept lifting its status in the global market. The 2004 yearly premium income of China was $52,171 million, or 1.61 per cent of the worldwide market, which exceeded India, Brazil and the Russian Federation respectively by a factor of 1 to 2. In 2004, the top three markets ranking were unchanged (the United States, the European Union and Japan). The absolute volume of the 2004 yearly premium income of Japan was nearly the same as the number of 1992, but the proportion in the world market decreased to 15.18 per cent, roughly equaling the level in 1982. Meanwhile, the Russian insurance industry was growing dramatically fast, from 0.03 per cent of the world market in 1992 to 0.50 per cent in 2004.

6.3 Comparison of insurance density

"Insurance density" is a per capita index referring to the average insurance premium. Table 6.2 compares insurance density between China's market and some other major markets.

Table 6.2. Comparison of insurance density (per capita insurance premium, US$)

Market	1982	1992	2004
China	0.3	5.3	40.2
United States of America	971.9	2,086.4	3,755.1
Japan	674.2	3,582.1	3,874.8
European Union 15	338.1	1,260.2	2,729.2
India	2.9	5.2	19.7
Russian Federation	—	3.4	114.4
Brazil	18.6	36.1	101.1

World average	*106.9*	*304.0*	*502.1*

Source: Swiss Reinsurance database.

In 1982, the insurance density in China was merely $0.3, and it was much lower than the United States, Japan, the European Union, and the worldwide average level $106.9, and was also lower than Brazil and India with insurance densities of $18.6 and $2.9. In this year, insurance density in the United States, Japan and the European Union differed remarkably from each other, and the ratio among the three was about 3:2:1.

In 1992, the insurance density in China ascended to $5.3, which was still far below the level for the United States, Japanese and European markets, and was also lower than the Brazilian market and the world average level, but it exceeded the Indian market, which had an insurance density of $5.2. At the same time, insurance densities in top three markets, the United States, Japan and Europe, altered significantly: the figure for Japan reached $3,582.1 after 10 years of development from 1982 to 1992, far exceeding the United States insurance density level. Meanwhile, insurance density in the Russian Federation was $3.4, closing up on the Chinese $5.3, though still not very high.

Until 2004, the insurance density of China's market was growing to $40.2, much more than that of India and the previous data of China itself 10 or 20 years ago. Nevertheless, it should be notified that a large gap still exists between China and the world average level or other major insurance markets. In 2004, the worldwide average insurance density was $502.1, or more than 10 times the figure for China; the figures for the United States and Japan both exceeded $3,700, or over 90 times the figure for China; and the insurance density in Brazil remained higher than that in China; the Russian Federation, previously a laggard in this respect, surprisingly surpassed China.

6.4 Comparison of insurance penetration

"Insurance penetration" is a correlative index reflecting the relationship between the insurance industry and the economy of a certain country. Insurance penetration is a relatively special index that its value does not necessarily imply the degree of development of an insurance market, but it does reflect to some extent the industry penetration into an economy, saturation and developing potential of insurance industry. Table 6.3 shows a comparison of insurance penetration between China's market and some other major markets.

Table 6.3. Comparison of insurance penetration (insurance premium/GDP)

Market	**1982**	**1992**	**2004**
China	0.12%	1.28%	3.26%
United States of America	6.91%	8.41%	9.36%
Japan	7.25%	11.48%	10.51%
European Union	4.06%	5.94%	8.57%

15			
India	1.11%	1.61%	3.37%
Russian Federation	-	0.58%	2.83%
Brazil	0.87%	1.41%	2.98%
World average	*2.26%*	*6.78%*	*7.85%*

Source: Swiss Reinsurance database.

In 1982, the insurance penetration in China was 0.12 per cent, much lower than that in the United States, Japan and Europe, and also India, Brazil and the worldwide average level. Thereafter, the penetration of the Chinese insurance industry in 1992 increased by about 1 per cent from 1982, and in 2004 the number rose up by another 2 per cent from 1992. However, both in 1992 and 2004, the insurance penetration in China remained far below the United States, Japan, Europe and the world average level, and also a little bit less than the Indian number.

Time serial data indicate that the insurance penetration of these markets (including developed, developing markets and the worldwide average level) except Japan, increased significantly as time went on, not only the developing markets, but also the developed ones and the world average level. From the aspect of world average insurance penetration, it grew up from 2.26 per cent in 1982 to 7.85 per cent in 2004, which proves that the worldwide insurance penetration into economy has experienced an obvious growth in the past twenty years. It also suggests that during the last twenty years, the increase of China insurance's penetration is not an outstanding exception but in line with the global trend, and the data implies a subsequent enormous growth potential for the insurance industry penetrating into China's economy.

6.5 Implications of the comparison

The above comparison between China's insurance industry and some other major insurance markets and the world average level has illustrated the following three points. First, the relative position of China's insurance industry in the world market has ascended to some extent, and the insurance industry in China is developing very fast. Second, the insurance premium per capita in China is still very low. Third, there is a large potential for insurance penetration into China's economy. In sum, we can conclude that the current China's insurance industry is at a stage where it can be described as "fast growing, low level, large potential".

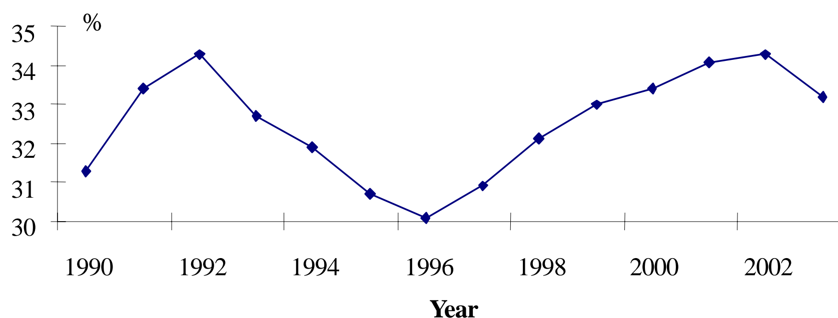
7. Future of China's insurance industry

The accelerated economic globalization is netting more and more national and regional economies into the worldwide market. However, as a process full of conflicts, globalization not only has positive effects, but also inevitably brings a series of problems. China's insurance industry must confront these challenges and make the most of the opportunities offered by globalization.

7.1 Great potential of a developing market

With the deepening industrialization in China, various service industries have been established and the framework of the service sector has been completed.[123] However, the development of the tertiary sector does not lend itself to an optimistic evaluation.[124] As figure 6 shows, the ratio of output from the tertiary sector to GDP first decreased and then increased somewhat from 1992 to 2003 with the highest level of 34 per cent in 2002 and the lowest of 30 per cent in 1996. These figures suggest that the tertiary sector of China falls behind not only that of developed countries, but also behind that of developing countries at a similar stage of economic development. For example, the ratio of output from the tertiary sector to GDP of India was 36 per cent in 1980 and kept on rising thereafter (Guo and Wang 1999, p. 7). Moreover, as figure 7 indicates, the share that China's financial service sector contributes to the output of the service sector is quite low in comparison with that of developed countries. Furthermore, the share has been decreasing in recent years despite the increase in the volume of the financial sector output. Along with the progress in China's economic development and economic system reform, many sectors such as information technology, education, and entertainment grew faster than the financial sector grew. As figure 8 shows, the ratio of output from financial sector to that of the whole service sector decreased from 20 per cent in 1996 to 17 per cent in 2002, while in the United States the ratio reached 22 per cent in 1970 and kept increasing at a decreasing pace. These data suggest that the financial service sector in China is still underdeveloped and has plenty of room to expand. China's insurance industry, as the "developing industry in a developing market," undoubtedly has tremendous potential. It is anticipated that China's insurance industry will soon take a unique role on the world stage and become the key focus of insurers from developed countries.

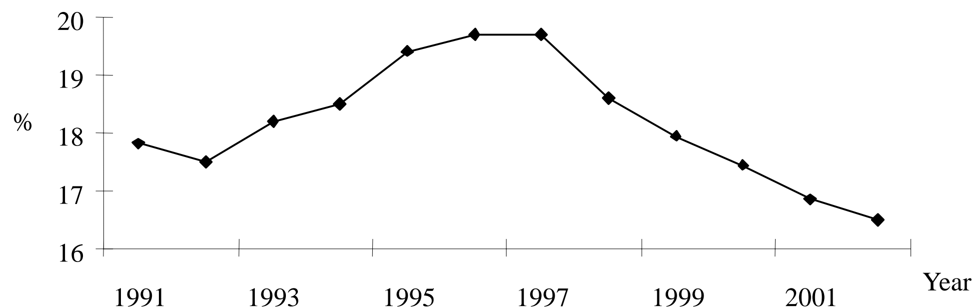
Figure 7.1
The Ratio of Output from the Tertiary Sectors to GDP,



Source: *China Statistical Yearbook 2004* , §3.2;
Notes: * There is a crash in the tertiary sectors' output to GDP in 1996. One explanation this is that although the output from the tertiary sectors of China has kept rising, secondary sectors grew much faster while the ratio of output from the primary sectors to GDP decreased slowly during the period from 1992 to 1996.

[123] The ratio of output from the primary sector to GDP decreased from 28.1 per cent in 1978 to 14.6 per cent in 2003. The employees in the primary sector accounted for 49.1 per cent of the entire workforce in 2003 vs. a 70.5 per cent in 1978 (*China Statistical Yearbook 2004* (2004), §3.2, §5.2).
[124] The tertiary sector refers to all other economic activities not included in the primary or secondary sectors. The primary sector refers to agriculture, forestry, animal husbandry, and fishery. The secondary sector refers to mining and quarrying, manufacturing, production and supply of electricity, water and gas, and construction.

Figure 7.2
The Ratio of Output from the Financial Services Sector to the Tertiary Sectors, 1991-2002



Source: China Statistical Yearbook 2004,§3.6.

7.2 Key drivers of future growth of China's insurance industry

7.2.1 Excellent economic prospects

Experts predict that China's economy is expected to continue its robust growth for at least a few years with annual real growth rates of higher than 7 per cent (Li et al., 2003). Increased national income will surely have positive impacts on people's purchasing power. The increase of all types of uncertainties accompanying accelerated industrialization and urbanization will cause individuals to adjust their risk expectation upward and thus raise their willingness to purchase insurance. The combination of strengthening purchasing power and willingness will certainly drive the robust growth of insurance demand. It is in the traditional culture of the Chinese for individuals to be strongly motivated to prepare against possible economic losses. Thus, one could reasonably assume that increases in income levels will boost insurance demand, other things being equal.

7.2.2 Economic system reform

As mentioned above, market-oriented reform has fueled insurance demand and created the current insurance market in China. We predict that further progress in the reform and opening up will continue to fuel the insurance industry on the supply side. Furthermore, forthcoming reform policies will underlie sustained growth of insurance demand in China. Two of these reform policies are focused upon here.

The first is investment system reform. The State Council of China enacted the Resolution on the Reform of the Investment System in July 2004, which abolished old administrative measures on the investment activities of firms. The old measures required that every investment must get ex ante approval from the local or State Government according to its size. Now, most investment decisions are in the hands of firms themselves. The exclusions are those projects that might have negative impacts on public interest. Consequently, the economic power of the firms has increased greatly, while the Government's involvement in the economy has decreased as a part of the gradual institutional change in China. We can foresee that the investment enthusiasm will be inspired considerably and the exposure to greater investment risks will surely increase the

firms' demand for insurance, especially for non-life insurance, since the Government will no longer be responsible for a firm's investment risk.

The second reform is related to the social security system. China's efforts to establish the social security system (previously called the labour insurance system), which began shortly after the People's Republic of China was founded, were held back during the Culture Revolution. In February 1969, the Ministry of Finance promulgated the Opinions on the Reform of Several State-Owned Enterprises' Financial Systems, which required that State-owned enterprises stop collecting social insurance funds, and instead treat reimbursements for payments of labour insurance as a non-operating expense. Thus, labour insurance was actually changed into a pay-as-you-go system running within an enterprise. This old system later proved to be a huge obstacle to China's economic system reform. The third plenary session of the fourteenth meeting of the CPC Central Committee held in 1993 formed the Decisions on Several Issues about the Establishment of Socialist Market Economic System. They decided to establish a multi-pillar social security system suitable not only to China's economic development stage, but also appropriate to the financial strength of the Government, firms, and individuals. The current social security system in China thus focuses on providing the most basic economic security to labourers. Reform has led to a widening gap between the economic security provided by the social security system and individuals' actual needs. Consequently, there exists a high demand for commercial life and health insurance.[125]

7.2.3 Demographic change

China's population was 1.3 billion at the end of 2004, about 1/5 of the world population, and is still increasing. It is expected to reach 1.32 billion by the end of 2005, according to the Population Division of United Nations (2004). The Chinese aging population will continue to grow due to the family planning policy. It is expected that the percentage of people aged 65 and above will increase from 7.50 per cent at the end of 2003 to 13.40 per cent by 2025 (National Population and Family Planning Commission of China (NPFPC) 2003). The average family size (person/household) has decreased from 4.41 in 1982 to 3.38 in 2003 (*China Statistical Yearbook 2004,* sects. 4.4 and 4.7). China's large population and demographic mix will drive the solid growth of China's insurance industry, especially in life insurance, health insurance, and pension insurance.

7.3 Factors that might have negative impacts on China's insurance industry

While we are optimistic about the future of China's insurance industry and believe that the growth trend will not be reversed, we have to concede that some factors may impede the fast pace of the development of the industry.

[125] For example, based on the current basic pension system, the target monthly old-age benefit for each retiree is about 58.5 per cent of the average wage of the society then (Ministry of Labour and Social Security of China, 1998, p. 5). If we take the life-cycle approach, many retirees' income right before retirement would be higher than the social average level, to whom the target replacement ratio of China's basic pension system is much lower than 58.5 per cent.

7.3.1 Immature capital market

The history of the world insurance industry has made it clear that investment management will be more and more important to insurers' survival and development as the insurance industry expands and matures. Presently, China's insurers are allowed to invest in domestic capital markets and the available investment channels have materially increased in 2004. However, China's capital market has not yet reached a desirable condition and is currently flooded with speculation. The average turnover rate of Shanghai Stock Exchange and Shenzhen Stock Exchange in 2003 was 251 per cent and 214 per cent respectively (*China Statistical Yearbook 2004*, sect. 20.16), much higher than that of mature capital markets.[126] If insurers invest heavily in these markets, their financial strength may be threatened. In fact, China's insurers are now still reluctant to invest much in the stock market when they were authorized to do so in October 2004.

7.3.2 Shortage of professional personnel

Over the past approximately twenty years companies were directed by the central Government to pursue volume expansion strategies because the Government viewed insurance premiums as a form of revenue generation and an approach to collect financial surplus. This strategy impelled companies to focus on short-term growth of sales volume, while profitability, management efficiency and long-term development were neglected in the long term. The domestic insurers competed fiercely for the low hanging fruit and did little research and development. To make things worse, the problem was masked by the high growth rate which was attributable only to the high potential of China's insurance market. This strategy not only led to low productivity and high operating costs, but also resulted in a lack of insurance education and career training. Lack of professional personnel, especially the lack of high quality managers, has proven to be a severe bottleneck for the development of China's insurance industry in the long run.

7.3.3 Unfavourable image of the industry

The image of China's insurance industry, especially that of domestic insurers, is not a good one, and immediate action is needed to improve it. Many consumers believe it is difficult to obtain the promised insurance indemnity and that the procedure of claims filing is inefficient. Some agents and sales staff of insurance companies are perceived as low quality, not acting in good faith and with professional behaviour. Some of them concealed important clauses in insurance contracts and even misguided consumers in their insurance purchase decisions. Others refused to meet their contractual obligations. Still, some insurers have acted against regulations and used exorbitant commissions, rebates, and/or insufficient premium rates to stimulate sales. The situation mentioned above has been worsened by the fact that the public knows little about insurance. According to a survey conducted in 2002 by the Development and Research Center of the State Council of China (DRC) in 50 big cities, 36 per cent of the interviewees said that they were ignorant about insurance on the whole (Market Economy Institute of DRC, 2002). Even in Shanghai, the most developed insurance market in China, 73 per cent interviewees said they knew just a little about insurance and only 2.4 per cent said they were acquainted with insurance (Horizon Group, 2004). Thus, it is not surprising that the mistakes made

[126] The average turnover rate in year t, TO_{t}, is defined as: $TO_t = V_t / N_t \times 100\%$ in which V_t represents the volume of transacted shares in year t in the stock exchange, and N_t represents the number of negotiable shares in the exchange during the same time period.

by some individual insurers can be easily spread out quickly and erode the public's trust in some insurers and even in the whole insurance industry.

7.3.4 Lack of public good faith

It is very important to the development of the insurance industry that consumers act on good faith. However, the situation in China at present is unsatisfactory and the development of many product lines, especially credit insurance and guarantee insurance, is restricted. For example, PICC P&C and some other P&C companies were forced to exit the auto loan insurance market temporarily because of the high default risk. Some 30 per cent of personal auto loans were in default and 10 per cent were bad debt resulting in massive losses for the insurers. One can see from the claims practice that the insureds were often concentrated within certain areas or groups and sometimes with the clear intention to cheat (Wu 2003). Additionally, according to a conservative estimate by non-life insurance companies in Beijing, about 20 per cent of the automobile insurance payments were frauds, including intentional damage, exaggerated claim amount, and claims of automobiles stolen that are false (Li 2004).

7.4 Future trends for China's insurance industry

We forecast that China's insurance industry will maintain a double-digit growth rate in the coming eight to ten years and the growth rate will be descending over time. As to the development of the industry itself, the market system will keep up with international standards gradually and the following trends will be the most prominent features in an environment characterized by globalization, financial integration, aging population, and dynamic information technologies.

7.4.1 Growing competition in the insurance market

China's insurance market will be more competitive as more foreign capital flows in and the number of insurers increases. The Herfindahl Index of the life insurance market and non-life insurance market was 2,750 and 3,682 respectively and the respective market share of the top 3 insurers in these two markets has decreased to 75 per cent and 80 per cent in 2004 (based on data from CIRC 2005).[127] The competitiveness of the insurance industry is growing at an accelerating pace. We anticipate that in the next 3 years both of the respective market shares of the top 5 insurers in the life and non-life insurance sectors will fall to about 65 per cent and 70 per cent respectively and that the largest life insurer will hold about 40 per cent of the market while the largest non-life insurer will hold about 45 per cent. At the same time, the fierce competition will drive the insurers to pay a great deal of attention to the quality of service and the functions of insurance products. However, on the whole, China's insurance market will still be characterized as a concentrated oligopoly in the medium term.

7.4.2 Deepening cooperation with other financial institutions, especially banks

Since October 2004, China's insurers are allowed to invest in domestic stock market, after a long time of tradeoff between the possible risks and return, indicating an even closer relationship between the insurance industry and the securities sector. But as China's

[127] The Herfindahl Index is an index of market concentration calculated by adding the squared value of the individual market shares of all firms in the industry.

capital market is still immature, insurers will be very prudent in investing in the stock market due to the potential risk of loss. So the insurers' investment in the stock market will not increase on a large scale in the short term and the prospective role of insurers in the capital market will depend on the maturing progress of the latter.

The cooperation between insurers and banks will be strengthened greatly. Bancassurance has been a success in China, because banks have advantages over insurers in customer resources and marketing. People in China are acquainted with and have steadfast trust in banks and therefore, bank services can be easily accepted. Bancassurance can be expected to continue to be one of the major distribution channels for life insurance. Besides strengthening strategic cooperation between the two industries, there will be more and more holding companies controlling both banks and insurance companies.

Finally, with a view to the coming financial integration, various innovative measures for the controlling of systematic financial risks, such as insurance securitization, will become popular, but not in the near term. The development of insurance securitization is a complex project and is demanding for both the insurance market and the securities market. Presently, the preconditions for insurance securitization do not exist in China, including theoretical research, the training of professional personnel, and the establishment of required infrastructure (e.g. legislation system). However, alternative risk transfer mechanisms will surely be important means for risk management by China's insurance industry.

7.4.3 Optimization of the product portfolio

With respect to China's life insurance sector, the demand for health and pension insurance will increase rapidly and steadily along with the aging population and the deepening of social security reform. On the health insurance side, while currently the Government provides a large portion of health care in urban areas, this portion is declining. Consequently, the role of private health insurance is rising. Note, however, that there is hardly any private health insurance in rural areas of China. However, it is worth indicating that severe adverse selection and moral hazard exist, and domestic insurers lack experience in risk control. Therefore, China's insurers need to improve their health plans and intensify their cooperation with hospitals in order to control the medical costs and reduce adverse selection and moral hazard. Managed care plans will be introduced in China and will likely become the major operation pattern of health insurance in the next five to eight years. As for pension insurance, the insurance industry is faced with great opportunities and foreign insurance companies specializing in pension will play an important role in the market.

With regard to China's non-life insurance sector, motor vehicle property insurance and motor vehicle liability insurance will continue to dominate the non-life insurance market. These types of insurance should account for 50 per cent of the premium income generated by the non-life industry in the next five years, primarily due to the increasing number of motor vehicles (especially private automobiles) and legal requirements for carrying liability insurance. There is likely to be solid growth of liability insurance, construction and installation projects insurance, enterprise property insurance, family property insurance, and credit insurance owing to the gradual clarification of the concept of private property rights, large-scale infrastructure construction, fast growth in home ownership, family wealth and increased public awareness of the value and need for insurance.

7.4.4 Diversification of distribution channels with agents and brokers still playing important roles

Innovative distribution channels, including bancassurance, postal insurance, Internet, and direct response have already emerged in China and their market share will certainly increase over time. The insurance distribution channels in China will become more diversified. Agents and brokers will remain important and irreplaceable since the applicability of innovative distribution channels will depend on consumers' need for advisory services and the traditional distribution channels are much more effective for complicated policies with long insurance periods and large face amounts. As a result, there will still be a need for agents and brokers to serve consumers face to face frequently. In addition, rising wealth levels will drive the demand for comprehensive risk management and financial planning services rather than simple advisory services on insurance purchase decisions. The requirements for well-trained agents and brokers will consequentially be much higher.

8. Conclusions

Through the course of the insurance market opening, we have further realized the implication of the opening. Firstly, increasing the energy for the development of the insurance industry continually through the means of opening to the world. The entrance of the foreign-capital insurance companies boosted the market competition, brought the advanced technology and management experience, played the good demonstrative role in the aspects of stable operation and excellent service and improved the overall level for the development of the national insurance industry. Secondly, combining with the international insurance market gradually. In the environment of the opening market, we should learn how to handle affairs according to the international rules, thus our national insurance industry will not go to the crooked road in the process of the development and shorten the difference of the international insurance industry as soon as possible. Thirdly, planning as a whole the national development and the opening to the world. We shall combine the international advanced experience with the actual development of China's insurance industry. We must use the international advanced experience for reference actively, yet cannot copy it blindly, boosting the coordinated development between the national insurance markets and opening to the world.

A highly respected Chinese leader once said that it does not matter whether the cat is white or black: as long as it can catch a mouse, it is a good cat. Similarly, it does not matter much whether the insurer is a locally-owned one or a foreign insurer: as long as it can contribute to China's insurance market, it is a good corporate citizen. Being a member of WTO helps China's reformers to welcome qualified "cats", whether they are black or white.

China is just one example of the emerging insurance markets in the world. A comparative study of different developing countries is one in need of further research. From this study and future research, we hope to develop some more meaningful implications that can benefit the practice of market opening not only for China but also for other developing countries as well as the rest of the world.

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XI. Insurance services liberalization and capacity-building: the case of Africa

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Introduction

Africa, excluding South Africa, has the lowest regional insurance penetration in the world, averaging below $15 per capita, both for life and non-life insurance. The main reasons for this low penetration include the late introduction of insurance to the continent, monopolistic/closed markets in many countries until the latter part of the 1990s, the low personal and disposable incomes of African populations, lack of functional financial markets in the majority of countries, unhelpful legislation and tax regimes, limited awareness of the benefits of insurance by the general population and outdated products and services in a number of countries.

Insurance markets in Africa are at varying stages of development, and their share of the total premium generated in the continent closely correlates with the level of economic development in their respective countries. Fifty-one African countries have some 650 insurance and reinsurance companies generating a gross premium income of $38 billion. South Africa has the most developed economy and insurance industry in the continent and produces around $30 billion or 79 per cent of the continent's total insurance output. Ten African countries (Algeria, Cameroon, Côte d'Ivoire, Egypt, Kenya, Mauritius, Morocco, Namibia, Nigeria and Tunisia) generate 15 per cent of Africa's insurance and reinsurance premium, amounting to $5.7 billon. The rest of the continent, comprising 40 African countries, has a share of 9 per cent, or $3.4 billion. There is substantial potential for growth and development in the insurance sector of the vast majority of African countries, but there are serious difficulties and challenges.

The performance of African insurance supervisory authorities does not always follow the pattern of economic development and the premium distribution stated above. South Africa has an independent financial services supervisory authority that is highly complex and functional by international standards; CIMA, the subregional insurance supervisory authority of the 12 French-speaking countries south of the Sahara, is well organized and autonomous. The insurance supervisory authorities in Namibia and Mauritius are fairly independent and functional. Five other countries have set up relatively independent insurance supervisory authorities. In the rest of the continent (more than 20 countries), insurance supervision tasks are assigned to ministries or central banks.

Insurance development followed a similar pattern as the general economic development of African countries. Post-independence African countries can be classified into three groups. The first group of countries had adopted socialist economic policies whereby the State nationalized and operated insurance services. This group had the lowest growth rate for the national economy and insurance, and started to denationalize insurance and allow

[128] Former Secretary-General, African Insurance Organization. This case study was specially prepared for the UNCTAD secretariat.

privately-owned companies to operate in the 1980s and 1990s. The second group of countries allowed private sector companies to operate side by side with State-owned companies, the State-owned companies in some cases having advantages in getting the business of government and public enterprises. Here again, the Government has moved out of insurance business in some countries and still maintains partial or full ownership in others. This group had better growth and penetration compared to the first group of countries. The third group of countries left insurance business entirely to the private sector. Insurance growth in these countries was as good as the second group of countries, and in some cases, even better. In countries that allowed private insurance companies to operate, the number of insurance companies was directly related to the level of capitalization required. Countries that prescribed substantial minimum capital, a limited number of companies were set up and they were able to acquire critical mass. Countries that did not require substantial minimum capital ended up with a very large number of small companies. In the past 10 years, many African countries started reducing their involvement in the insurance industry, and a number of State-owned companies have been privatized.

Domestic reinsurance companies are a recent addition to the insurance industry in Africa. Many were created in the 1970s mainly by Governments of countries where the private sector has a big share of the national insurance business. The State reinsurers were given legal rights to participate in the direct business of the insurance industry and to have compulsory cessions of outgoing reinsurance. Some regional and subregional reinsurance companies have also been established, and are performing satisfactorily. Five countries have privately-owned reinsurance companies.

Almost all African countries are now members of WTO, and many countries have made specific commitments for liberalizing their insurance sector. WTO membership requires countries to create equal opportunities for all insurers and strong regulation to enforce the healthy functioning of the sector. Entry to WTO does not dictate the speed and extent of liberalization. African countries have been given time to define their economic development strategy, review their legislation and establish appropriate regulatory and supervisory mechanisms. The majority of African countries do not have independent and well-equipped insurance supervisory authorities. In addition, domestic insurance companies are being encouraged to strengthen their capital base and human resources and prepare themselves for survival and growth in a competitive business environment in the event that international insurers and reinsurers decide to enter their markets.

Many African countries and markets face critical problems as their countries strive to implement their commitments for liberalization under their WTO membership. Firstly, Insurance legislation in many African countries is outdated, some going back to the 1970s. A number of countries do not have the expertise in insurance and related subjects to undertake a full legislative review, although they are required to bring their insurance legislations up-to-date with international standards and their commitments. Secondly, the vast majority of African countries do not have independent supervisory bodies. Many are departments within the ministries of finance or commerce, and some are under the supervision of central banks. Well-performing markets and regulators require a high knowledge base and expertise in their professions. Some 18 African insurance institutes provide insurance training for industry and supervisory staff, while 15 institutes are behind their counterparts in developed countries.

In addition to the challenges countries and markets face due to their WTO commitments, there are two major areas of concern to African countries. One is the lack of strategy, capacity and expertise to deal with catastrophe risks to which the continent is exposed. Long before the tsunami catastrophe that hit South-East Asia, African countries have been concerned about such dangers to their economy and societies and held a major conference in Morocco. The conference concluded by underlining Africa's inability to identify potential risks and prepare a plan of action to minimize the effects of such an event. The continent has taken steps to set up a centre to study catastrophe exposures of African countries and serve as a research and support centre, and asked for international assistance. One of the concrete outputs of the centre will be risk mapping of the economic zones of African countries and evaluate potential damages that natural catastrophes could cause, and provide expert advice to countries in their planning efforts to make sure major population settlements an industrial expansions avoid such catastrophe zones as much as possible. Another area where the continent lags behind other regions is in the development of mortality tables for the general population and insured lives. Proper planning for life, pensions, and other population data-based services require accurate mortality statistics currently non-existent in the continent, except for South Africa. All other countries are using mortality experiences of developed countries. This is critical for national economic planning as well as for encouraging viable life and pensions schemes.

Historical development

The non-life insurance industry

Insurance in Africa is a phenomenon of the twentieth century. At the time of independence in the 1950s and 1960s there were a number of branch offices of foreign companies and a few independent insurance companies, mainly foreign-owned. Locally owned private insurance companies began to emerge after independence, and many have remained small as the main players were either public or foreign-owned.

Insurance was introduced into English-speaking African countries a couple of decades before introduction into French-speaking countries. South Africa has a longer insurance history in the English-speaking countries of Africa, followed by Egypt. In French-speaking Africa, the countries of North Africa (Algeria, Morocco and Tunisia) have a longer history than French-speaking countries in the rest of the continent.

The operation of insurance companies followed the economic pattern established by post-independence Governments. There were three general categories of economic structures in the newly independent countries. The first group of countries opted for a free market economy. The second group followed a mixed economy where the private sector operated along with State-owned corporations. The third group of countries chose a State-controlled economy.

In countries that adopted free market economic policies, the insurance companies that existed before independence continued to do business as branch offices of their parent companies or registered as independent companies with total or majority shareholding by foreigners. A few indigenous insurance companies also began to appear in almost all the countries, their main characteristics being that they were generally undercapitalized and under resourced compared to their foreign-owned counterparts. In these countries there

was little political involvement or influence in the operation of insurance companies. The determining factor was the ownership spread and performance of the local economy on which the companies relied for business. The foreign-owned companies had better access to business as most of the insurable interests in the key industries and trading houses were foreign-owned and remained their clients. Another factor was experienced management. The foreign companies had a better spread as they continued largely with their key staff. Staff who left the foreign companies to set up indigenous companies mainly managed the local companies, but they were not in a position to attract a number of experienced staff because of their inability to offer higher pay.

In the second category of African countries that adopted a mixed economy, the foreign-owned companies continued to operate as before; and a number of local owned companies were established. In some countries, the foreign-owned companies were required to sell part or a majority of their ownership to indigenous persons or companies. In addition, the Governments established State-owned companies to compete with both the foreign and local companies. In a number of countries, these State-owned companies were given preferential competitive advantages through sole rights to insure government interests and other government-owned corporations. The privately owned companies, both local and foreign, were managed more prudently, focusing on control of operating costs and aggressive marketing. The State-controlled companies were managed more politically, chief executive officers were appointed in some instances on political merit. Generally, this resulted in bureaucratic management making these companies less competitive and under performing. The only thing that kept them in business was their access to business of the State and other State-owned companies. This state of affairs continued until the late 1980s and 1990s when the political outlook of a number of the countries started shifting towards establishing more competitive economy partly due to interaction with the World Bank institutions and bilateral contacts with western countries that extended to them economic support. Gradually, Governments removed the preferential treatment of State companies and told them to perform or else close down.

The third category of countries nationalized their financial services including insurance and merged the nationalized companies into one State-owned company. Nationalization and establishment of State-owned monopolies took place on the pretext of localizing and providing affordable and efficient insurance services to the people and mobilizing vast sums for social and economic development. However, this has not happened. The State monopolies were often burdened with political options unrelated to their business interests in investment decisions, employment and other areas. This led to acquisition of non-performing assets such as buildings and funding of projects with very little investment returns. Management appointment was often a political decision rather than business. State monopolies were the depository for unwanted people who have no place elsewhere. Their loyalty was for the political system rather than the business interest of the company. In view of the single shareholder, the Government, there was little accountability and test of profitability. Supervisory measures that would have been in place in a competitive market were non-existent and thus not applied to State-owned companies. All this created a situation of non-performance. As in the case of State-owned companies in mixed economies mentioned above, Governments were pressurized in the mid 1980s and 1990s to change their ways. Many did and allowed the establishment of private sector led insurance companies, and in some instances the State-owned companies were commercialized or privatized and told to operate on equal footing with private companies.

The African continent presently has some 650 companies, many of them small and medium-sized enterprises. Governments are taking measures to increase the capitalization of their insurance companies, the solvency and management, the quality of their reinsurance operations, etc. As regulators implement strong capital requirements and Governments liberalize markets, it is likely that the total number of insurance operators in Africa will substantially reduce due to consolidation through mergers and outright liquidation in some cases.

The life assurance industry

The development of life assurance is linked to disposable income of the population, the level of development of the industry, quality of products and marketing offered by insurers, the impact of legislation and taxation, as well as social and religious values of the society.

As African countries are at varying levels of development and natural resources of the countries differ, African countries have varying disposable income and potential for development of life assurance. As a result, the ability of the citizens of different countries to pay for life assurance is dependent on the country where they live and whether their level of personal income affords them any savings after meeting their living expenses. Generally, the level of life assurance penetration follows availability of disposable income. However, this is not always the case, and a number of issues come into play.

The development of the insurance market determines the quality and variety of Life insurance products offered by companies. In the more developed and sophisticated economies such as South Africa, Tunisia and Morocco, there is a wider variety of life insurance products and services. In addition, Life insurers in these markets have better organized financial markets where they can invest their life funds. All these add up to influence the amount of life assurance purchased in any country.

The social and political impact on life assurance development is indeed significant. Countries that have stable financial markets coupled with reasonable tax laws on Life funds and benefits attract more investment in life assurance. Social and religious values also make a significant impact. Life insurance prospers and thrives only in countries where there is a reasonable level of disposable income, good tax laws and investment opportunities.

Therefore, it is no surprise to see that South Africa, which has the most developed economy and financial market in the continent, with the right mix of products and tax regimes accounts for some 80 per cent of the life assurance business generated in the continent.

Reinsurance

National reinsurance companies

The establishment of local reinsurance companies in Africa is a more recent phenomenon and is related to the development of insurance after independence. The reason for establishing reinsurance companies by most developing countries in the 1970s and 1980s was to conserve profitable reinsurance premiums ceded out of their countries and to

indirectly control the operations of the direct companies in their markets most of whom were either foreign or privately owned. The countries that opted for a monopolistic insurance market did not bother to set up reinsurance companies as they were the sole insurers of all risks in their country, and their monopoly reinsurers dealt directly with the leading international reinsurers to place their excess risks in the international marketplace. However, with the belief that there was substantial net outflow of resources for the purchase of reinsurance, the countries that opted for free and mixed market economies started setting up national reinsurance companies with the hope of generating profit from their reinsurance operations as well as reducing the outflow of premiums for reinsurance. Many of the reinsurance companies that were set up by Governments were profitable. Their success was further enhanced by obligatory cessions and right of first refusal granted to them by government decrees that established them. However, as they were monopolistic companies, they had the potentials for government interference and many were in the political lime light, sometimes their chief executives and senior managers appointed for political reasons. Despite the political influence on some of them, a number of reinsurance companies did an excellent job in conserving resources, reducing outgoing reinsurance premiums and at difficult times providing reinsurance cover to small local companies that would have been in difficulty to get adequate and affordable reinsurance cover internationally. They also amassed relatively large financial resources and assets. As time passed, some Governments required their national reinsurance companies to prepare for competitive operations and many have gradually reduced or abolished the obligatory cessions requirements. This has in fact helped the State reinsurance companies to perform better as their survival and growth depended on their ability to write business, both domestic and foreign, on the strength of their security, service and competence. Thus, at present, we have a number of performing national reinsurance companies fully or majority government-owned. These include the national reinsurance companies in Egypt, Morocco and Kenya.

In addition to these State-owned reinsurance companies, a number of privately-owned reinsurance companies have been established to provide additional reinsurance capacity within a few medium size insurance markets in Africa. However, their performance and growth has been hampered by a number of factors including lack of adequate capitalization and confidence in their security by the majority of insurance companies that they try to serve, both within and outside of their countries. Despite this, it is worth noting that all of the privately-owned reinsurance companies are still in business, operating with a small profit margin. However, the future will be more challenging for them as they need to provide cover for totally changing risk patterns and compete with highly capitalized companies with better organized staff. Their ultimate survival strategy includes greater capitalization and mergers at national and subregional levels.

Subregional and continental reinsurers

In addition to the establishment of national reinsurance companies, a few successful multinational reinsurance companies were set up in the 1970s and 1980s. The main push for the establishment of these companies was economic integration and cooperation initiatives at various subregional levels in Africa. For example, with the establishment of the Preferential Trade Area in East and Southern Africa (later renamed COMESA), the countries in the subregion established PTA RE with its headquarters in Nairobi, Kenya, with compulsory cessions from the countries participating. However, as participation in the company through share purchases was not obligatory, not all countries and companies

of the subregion were obliged to invest in the company or cede business. However, those that invested in the company were subsequently required to make compulsory cessions to PTA RE. Currently, there are some 20 countries in the COMESA zone, and the company is in a stable financial position, doing business successfully and operating mainly within its member States but also beyond in other African countries.

The 12 countries in the French-speaking West and Central African subregion have established economic cooperation programmes for over 30 years, and they operate a highly successful and enviable economic integration programme that includes common banking and Insurance regulatory bodies. The central insurance regulatory body, CIMA, has initiated the creation of a common reinsurance company, CICA RE, covering all the 12 countries in francophone West and Central Africa. The company has its head office in Lome, Togo. This company also enjoys obligatory cessions and operates successfully both within its member States and the rest of Africa. Again, the challenge for it is to operate commercially, and to be able to continue to get business on the strength of its security and service in the event that obligatory cessions are abolished as its member countries implement their WTO membership commitments, under which they have signed up to liberalize insurance and reinsurance activities.

At the continental level, 37 African countries have joined hands to create the African Reinsurance Corporation with headquarters in Lagos, Nigeria, and six offices in the different parts of Africa. Africa Re is the most successful economic institution set up by African Governments in the insurance sector. Presently, its shareholders include African Governments, public and private insurance companies from its member States, the African Development Bank and the International Finance Corporation (IFC). It has grown from a modest beginning with a paid up capital of under $5 million to a true competitive reinsurer with shareholders’ equity in excess of $100 million and over $200 million gross written premium as at the end of 2004. On the operational side, this company has been marketing itself successfully, and despite its 5 per cent obligatory cessions some 80 per cent of its written premium comes from voluntary business relationships. Even if legal cessions were withdrawn by member countries, it is sure that its ceding insurers will continue to do business with it in view of its established security and performance.

The South African insurance industry

South Africa has a highly developed and sophisticated economy with an advanced insurance culture. As a result, although it accounts for around 6.5 per cent of the continent’s population, it produces some 75 per cent of the non-life insurance premium as well as more than 80 per cent of the life insurance premium of the continent. A number of South African insurers and brokers have local presence in many African countries, and reinsurance companies based in South Africa are the dominant reinsurers for sub-Saharan African countries. South Africa is also home for a number of leading reinsurance companies and brokerage firms in the world. Because of the level of its development, it has very sophisticated financial services supervisory standards at par with any in developed markets. The rest of the continent has indeed a lot to learn from South Africa. In any effort to update the national insurance acts or in setting up viable supervisory mechanisms, South Africa will be an excellent model for a number of African markets in view of the similarities of development potentials and economic linkages currently existing between South Africa and a number of African countries, especially those in the southern African region.

The insurance industry today

Private sector insurance development

The role of the State in the ownership of insurance companies is gradually fading away as more and more private sector companies come into operation, many of them small but effective in providing niche products and services. Many State-owned companies are also being partially or fully privatized and/or commercialized. As African countries liberalize their economies, it is expected that many more State-owned companies would be privatized. The remaining State-owned companies, whether national or regional, will be those that meet high standards of capitalization, solvency and management that would enable them to compete and grow favourably in any international trading environment. The successful national, subregional and regional reinsurance companies, many of whom have partial or full government ownership are likely to remain in business even if Governments decide to dispose off their shares. For the survival and growth of existing private insurers, there is need for effective supervision and regulation, existence and stability of a functional financial market and introduction of adequate capital criteria based on the economic realities of each country and equal playing field among insurers.

Domestic small and medium-sized enterprises

Around 70 per cent of the insurers operating in Africa today are domestic private sector companies. Many are indeed very small by developed countries' standards, in terms of capitalization; but they have been performing very satisfactorily in their own environment. While a number of companies in developed countries are making very little underwriting margins and relying mostly on their investment income, the African companies usually do make a good profit in their underwriting operations. On the other hand, insurance companies in developing countries have a better operating financial sector; they have access to fairly stable and developed capital markets, functional stock exchanges and other investment opportunities. In the case of Africa, out of some 50 plus countries, only less than five have functional financial markets. Despite this enormous difficulty, companies continue to do business and play their due role as providers of security to their clients. Because of their small size, the major constraints they face include access to affordable IT resources, training of insurance specialist staff and ability to undertake research and development tasks relating to products and services in their markets. Their continued existence and growth is indeed essential for the functioning of a sound insurance market and serving the needs of the small households and businesses, especially the informal sector that the big national and multinational insurance companies will not be interested to insure in view of the high cost of marketing per unit of premiums produced. For this reason, international assistance in implementing capacity-building projects that would afford equal playing field to small insurers vis-à-vis their large domestic and international competitors would be essential.

Foreign companies

Many foreign companies operate in countries that have allowed the operation of foreign companies either as branch offices or fully licensed companies owned by foreign multinationals. They are found in almost all the French-speaking countries with the exception of Algeria that nationalized all foreign-owned companies. Despite their limited

number in each country, their market share is indeed significant and in a number of countries, they have a dominant position.

In South Africa, the key large insurers are locally incorporated companies, some having their roots in foreign countries. They are adequately provided both in capital and human resources, and some have their branch offices or subsidiary companies in other African countries. In English-speaking countries outside of South Africa, there are very few foreign companies with the exception of East Africa, mainly Kenya, where subsidiaries of foreign companies are significant. Many of the foreign-owned companies in Africa have had a long history before the current round of liberalization came about. To date, there have been very few foreign companies set up following the liberalization decision of countries that joined WTO, but this is expected to be significant in the years ahead as liberalization commitments are implemented. The main reasons for the small number of foreign companies present in English-speaking African countries have been the protective policies of the Governments concerned. Even if a number of countries were to adopt a more liberal attitude, foreign companies are likely to consider stability of the financial market, quality of regulation and supervision, as well as growth potentials before deciding to invest in African countries.

Subsidiaries of African companies

An important development in inter-African cooperation in insurance is the creation of subsidiary companies on a regional basis within Africa whereby African Insurance companies that are licensed in one country are setting up insurance operations in other neighboring countries. Previously, it was customary for multinationals with their head offices in developed countries to set up companies in different African countries. We now have African insurance and reinsurance companies establishing a number of subsidiary companies in different countries of the continent. This is indeed a welcome development, as it would enable these companies to experience the challenges of cross-border operation and thereby prepare themselves to do business as markets are further liberalized in the continent.

Supply-side constraints

The past 10 years have seen a change in the insurance marketplace. African Governments seem to genuinely aim at creating free and competitive economies. They have started to believe in large numbers that their countries cannot function in isolation and they need to acquire foreign investment and expertise for greater growth and economic development. However, their economic policies and existing legal environment are not very attractive to encourage foreign investment. Many African countries are WTO members, and this will give them an opportunity to review their economic policies in light of developments in other countries and undertake the needed changes to make their countries attractive destinations for foreign investors.

In a number of African countries, the main constraints facing the insurance sector are the absence of functional financial markets and outdated insurance legislation.

Investment opportunities for life insurers have been quite limited. There are very few countries with domestic stock markets, and some of these stock markets offer very limited trading and there is little secondary trading in debt securities. The largest asset items on

the balance sheets of insurance companies are investments in land and buildings and accounts receivable, especially overdue premiums. Government debt securities with medium and long-term durations will be very attractive to institutional investors. With growth comes increased volume of assets, and the legal and economic environment for the existence of alternative investment channels should be given priority by Governments to promote further growth and confidence in the financial markets.

Many countries in Africa need to review their legislation to enable the smooth functioning of companies, both domestic and foreign, in an environment that is in harmony with international practice and to set up regulatory and supervisory instruments and structures that can effectively regulate the insurance marketplace.

Profile of African insurance markets

The following is a brief profile of African insurance markets in terms of ownership and market liberalization.

Algeria

The insurance industry has moved from a totally State-controlled sector to a mixed market where the State-owned companies continue to dominate but privately-owned insurance companies have appeared. The State companies were originally set up as specialized operators providing cover for specific types of insurance, but they are now competing freely for business. There is only one State-owned reinsurer with a monopoly on outgoing reinsurance. Foreign insurance companies do not operate in Algeria at present. Government assets are still insured by State-owned insurance companies. Insurance supervision is a department within the Ministry of Finance.

Outstanding tasks: Creation of equal playing field in the domestic market, legislative review and establishment of an independent insurance supervisory body.

Angola

The State continues to maintain ownership of its former State monopoly insurer; but at present privately-owned insurance companies have been licensed. Foreign companies are not allowed at present. Insurance supervision is a department within the Ministry of Finance.

Outstanding tasks: Creation of equal playing field in the domestic market, legislative review and establishment of an independent insurance supervisory body.

Benin

The former State-owned company has been privatized and all insurers are privately owned. There is no local reinsurer in the country. Foreign insurance companies are allowed to operate. The country is part of the CIMA zone, where markets have been substantially liberalized and there exists an independent subregional supervisory body.

Burkina Faso

There is one insurer where the State has share ownership, and a couple of companies that are privately owned. There is no local reinsurer in the country. There is no local reinsurer in the country. Foreign insurance companies are allowed to operate. The country is part of the CIMA zone, where markets have been substantially liberalized and there exists an independent subregional supervisory body.

Burundi

The industry has moved from a totally State-controlled insurance sector to a mixed market where the State-owned company is still dominant. The privately owned companies are gradually increasing their market share. Foreign insurance companies are allowed to operate. Insurance supervision is a department within the Ministry of Finance.

Outstanding tasks: Legislative review and establishment of an independent insurance supervisory body.

Cameroon

In the past, this was a mixed market with both State and privately-owned insurers. The State insurance company has been privatized and the insurance industry is fully privately-owned. In addition, a State-owned reinsurance company has been closed down. Branch offices of African reinsurance companies have been set up in the country. Foreign companies operate in the country and are presently the leading insurers.

The country is part of the CIMA zone, where markets have been substantially liberalized and there exists an independent subregional supervisory body.

Chad

There is a State-owned dominant insurer and some privately-owned insurers.

The country is part of the CIMA zone, where markets have been substantially liberalized and there exists an independent subregional supervisory body.

Congo

The insurance industry was a State monopoly in the past. At present, the market has a State insurer, but a privately-owned company is the dominant insurer.

The country is part of the CIMA zone, where markets have been substantially liberalized and there exists an independent subregional supervisory body.

Côte d'Ivoire

The insurance industry has always been privately-owned and very competitive. A regional office of an African reinsurer has been set up in the country. Foreign companies operate in the country and are presently the leading insurers.

The country is part of the CIMA zone, where markets have been substantially liberalized and there exists an independent subregional supervisory body.

Democratic Republic of the Congo

There is a State-owned monopoly insurer. Insurance supervision functions are the responsibility of the Ministry of Finance.

Outstanding tasks: Liberalizing the domestic market, legislative review and establishment of an independent insurance supervisory body.

Egypt

After having had a State-controlled industry for many hears, Egypt has begun licensing privately-owned companies that are successfully competing with the State-owned companies. State-owned companies dominate the market. There is a strong State-owned reinsurance company; and branch offices of foreign and regional reinsurance companies also operate in the market. Egypt has set up a free zone where some foreign companies operate. There is an independent insurance supervisory authority.

Eritrea

Until a year ago, one State monopoly insurer has now been partially privatized with the State still holding a controlling interest. Other privately-owned companies have not yet been licensed to operate. Foreign companies are not allowed at present. Insurance supervision is the responsibility of the Central Bank.

Outstanding tasks: Creation of equal playing field in the domestic market, legislative review and establishment of an independent insurance supervisory body.

Ethiopia

The State still maintains full ownership of a former monopoly insurer that is still the biggest company in the country. A number of privately-owned companies have been established and steadily increasing their market share. Foreign companies are not allowed at present. The central bank is responsible for the supervision of insurance.

Outstanding tasks: Creation of equal playing field in the domestic market, legislative review and establishment of an independent insurance supervisory body.

Gabon

The State-owned insurer has been closed down. The market is fully controlled by privately-owned companies and foreign-owned companies dominate.

The country is part of the CIMA zone, where markets have been substantially liberalized and there exists an independent subregional supervisory body.

Gambia

The market is fully private-sector-owned. No foreign-owned companies yet. The central bank is responsible for the supervision of insurance.

Outstanding tasks: Legislative review and establishment of an independent insurance supervisory body.

Ghana

This is a mixed market with one State-owned insurer and a number of privately-owned insurers, all competing for business on equal level. There is also a State-owned reinsurer. Foreign companies are not allowed at present.

Outstanding tasks: Legislative review to allow foreign companies. An independent insurance supervisory authority has been set up, and requires assistance to strengthen it.

Guinea

The industry was formerly a State monopoly. Private and foreign companies dominate the market. The central bank is responsible for the supervision of insurance.

Outstanding tasks: Legislative review and establishment of an independent insurance supervisory body.

Kenya

A State-owned insurer has been closed down. The insurance industry is 100 per cent privately-owned, some foreign-owned. There is a State-owned reinsurer; foreign, regional and subregional reinsurers also operate in the country. An independent insurance supervisory authority has been set up, and requires assistance to strengthen it.

Lesotho

The State participates in the dominant insurance company operating in the country. The central bank is responsible for the supervision of insurance.

Outstanding tasks: Legislative review and establishment of an independent insurance supervisory body.

Libyan Arab Jamahiriya

This was formerly a State monopoly market; presently the State-owned company has a dominant role and there are two fast growing privately-owned companies. Foreign companies are not allowed at present. The Ministry of Finance is responsible for the supervision of insurance.

Outstanding tasks: Creation of equal playing field in the domestic market, legislative review and establishment of an independent insurance supervisory body.

Madagascar

Two State-owned companies control the market. Foreign companies are not allowed at present. The Ministry of Finance is responsible for the supervision of insurance.

Outstanding tasks: Legislative review to allow private insurers to operate in the domestic market and establishment of an independent insurance supervisory body.

Malawi

The State-owned company has been privatized; and all the insurers in the market are privately-owned. The central bank is responsible for the supervision of insurance.

Outstanding tasks: Legislative review and establishment of an independent insurance supervisory body.

Mali

The State-owned company has been privatized; and there are a number of other privately-owned companies, some foreign-owned.

The country is part of the CIMA zone, where markets have been substantially liberalized and there exists an independent subregional supervisory body.

Mauritius

The insurance industry is largely controlled by the private sector. A number of international reinsurance companies have been incorporated locally.

Mauritius has set up a free zone where some foreign companies operate. There is an independent insurance supervisory authority.

Morocco

The insurance industry is privately-owned, both domestic and foreign. There is a State-owned reinsurer, and a branch office of a regional reinsurer has been established in the country. Insurance supervision is the responsibility of the Department of Insurance Supervision in the Ministry of Finance. The department maintains a very high standard of performance in the supervision of the insurance industry.

Outstanding tasks: Legislative review and establishment of an independent insurance supervisory body.

Mozambique

The State-owned monopoly has been privatized and other private domestic and foreign insurance companies operate in the market. Insurance supervision is the responsibility of the Ministry of Finance.

Outstanding tasks: Legislative review and establishment of an independent insurance supervisory body.

Namibia

The insurance industry is privately-owned, both local and foreign. A State-owned reinsurance company has been established.

The Namibia Financial Services Authority (Namfisa) supervises the financial sector, including the insurance sector.

Nigeria

There is mixed ownership of insurance companies in Nigeria. The government-owned insurance company is still a major player. Over 100 privately-owned insurers, many of them, dominate the market very small. This is expected to change in the near future due to the increased minimum capital requirement recently introduced. The State-owned reinsurer has been partially privatized. Foreign companies are not allowed to operate. There are three privately-owned reinsurance companies and one continental reinsurer.

Outstanding tasks: Legislative review. An independent insurance supervisory authority has been set up, and requires assistance to strengthen it.

Rwanda

There is a State-owned insurance company operating along with privately-owned insurance companies.

Outstanding tasks: Legislative review and assistance to the independent insurance supervisory authority that has been established recently.

Senegal

The insurance industry is privately-owned, and there is a State-owned reinsurance company.

The country is part of the CIMA zone, where markets have been substantially liberalized and there exists an independent subregional supervisory body.

Seychelles

There is a State-owned insurance company that previously operated as a monopoly. Privately-owned companies have also been licensed in the past few years. Insurance supervision is the responsibility of the Ministry of Finance.

Outstanding tasks: Legislative review and establishment of an independent insurance supervisory body.

Sierra Leone

There is a State-owned insurer; and a number of privately-owned insurers. Insurance supervision is the responsibility of the Ministry of Finance.

Outstanding tasks: Legislative review and establishment of an independent insurance supervisory body.

South Africa

The private sector controls the insurance industry that is dominated by a few well-established companies both in the life and non-life insurance sector. There are a large number of small companies participating in personal lines and life business, but their share of the total market is very small. Companies place reinsurance with locally incorporated companies, except for Lloyds of London that has an exemption from local

incorporation requirements. There are some specialized companies providing agricultural insurance, export credit insurance and catastrophe cover.

The Financial Services Board (FSB) supervises the financial sector including insurance.

Sudan

The insurance industry started with privately-owned companies and a State-owned reinsurer that is still an active player. Some years ago, the Government set up a State-owned insurer that is presently very dominant.

Outstanding tasks: Legislative review. An independent insurance supervisory authority has been set up, and requires assistance to strengthen it.

Swaziland

The State participates in the dominant insurance company operating in the country. The central bank is responsible for the supervision of insurance.

Outstanding tasks: Legislative review and establishment of an independent insurance supervisory body.

Togo

The State-owned insurer has been privatized; and there are other privately-owned insurance companies. A subregional reinsurance company is based in Togo.

The country is part of the CIMA zone, where markets have been substantially liberalized and there exists an independent subregional supervisory body.

Tunisia

There is a State-owned insurance company; and there are a number of privately-owned insurance companies. The Government has a minority share in the national reinsurance company. Some international and regional insurers also have branch offices in Tunisia. The Director of Insurance in the Ministry of Finance is responsible for the supervision of insurance. The department maintains a very high standard of performance in the supervision of the insurance industry.

Outstanding tasks: Legislative review and establishment of an independent insurance supervisory body.

Uganda

This is a mixed market with one State-owned insurer and other privately-owned insurers, both domestic and foreign. The State-owned company has been partially privatized.

Outstanding tasks: Legislative review. An independent insurance supervisory authority has been set up, and requires assistance to strengthen it.

United Republic of Tanzania

The State still maintains full ownership of a former monopoly insurer. In addition, a number of privately-owned insurance companies operate in the market with substantial market share. A State-owned reinsurance company has been set up recently.

Outstanding tasks: Legislative review. An independent insurance supervisory authority has been set up, and requires assistance to strengthen it.

Zambia

This was formerly a State-owned monopoly market. A number of privately-owned insurance companies, both domestic and foreign, have been established. The State-owned company competes with the private sector companies that dominate the market.

Outstanding tasks: Legislative review. An independent insurance supervisory authority has been set up, and requires assistance to strengthen it.

Zimbabwe

The insurance industry is dominated by privately-owned companies. There is a State-owned reinsurance company that controls a couple of insurance companies in which it has substantial ownership interest. The commissioner of insurance in the Ministry of Finance is responsible for the supervision of insurance.

Outstanding tasks: Legislative review and establishment of an independent insurance supervisory body.

Development of the African insurance services sector

The insurance industry plays an important role in the economy of all African countries. The Insurance sector employs a large number of people, mobilizes resources for development and further economic activities, and supports the smooth operation of business in every country. While the significance of the insurance industry is clearly seen at the local level, due to its important share of economic activity, its share of the global insurance market is indeed insignificant similar to the share of Africa in the global economy. This is directly related to the level of economic development of the continent. One exception is South Africa where the general economic development is fairly at a higher gear. South Africa contributes around 80 per cent of the total insurance turn over of the continent. This is comparable to South Africa's share of the rest of the economic activities of the continent excluding oil related industries. The rest of the continent is indeed very insignificant. However, it has shown remarkable growth in the past 10 years, with real premium incoming growing faster than the rest of the economy, with the exception of the banking sector. The reason for the poor performance of the insurance sector in the continent can be attributed to a number of causes.

Products

Less than 10 countries in Africa have insurance products and services comparable to those in developed countries. Many African markets trade in insurance products that have been in the market since the 1960s. Products for both life and non-life insurance and

services continue to evolve substantially in the developed countries based on the changing needs and demands of business and personal consumers; and very little innovation is taking place in Africa. There is need to research the insurance products best adapted to the needs of African businesses and societies.

Spread

At present, the focus of insurance companies is well-established businesses in the urban areas. Because of the low level of economic development in many African countries, formal urban businesses contribute less than 30 per cent of economic activity in many countries. There is very little effort by African insurers to cover individual households and the informal sector in the urban areas. These sectors have a very significant share of the national economic activity. Furthermore, a significant portion of the African population is rural based, and there is very little insurance coverage in the rural areas. If insurance in developing countries has to make an impact on the livelihood of the total population, insurance schemes designed to meet the needs of the rural population should be designed and implemented. Agricultural insurance covering crops and livestock, agricultural implements, farmer's credits and micro banking risks need to be introduced across the continent. The private sector may not want to be involved in providing insurance to some of these sectors, as they may not be profitable in the short run. Therefore, there is need for Governments to be involved directly or in collaboration with the private sector. Ultimately, the future growth of insurance services and activities would depend on its ability to penetrate economic and social activities that have not yet been covered. Where Governments are not able to provide services, they should devise ways and means of motivating the private sector to invest in insurance of the urban informal sector and the rural economy, mainly through agricultural insurance and micro finance insurance schemes. These sectors are realities in the African economic scene and essential elements for mobilizing resources for development. The private sector is attracted by financial returns in the short and medium term; and development of the new insurance sectors mentioned above will not interest investors in the private sector without government incentives.

The insurance regulatory framework

Independent and adequately funded supervisory authorities are undoubtedly effective in carrying out their responsibilities. African countries have set up their supervisory bodies in many different forms. In the past, almost all of them were departments in ministries of finance or central banks. They were limited in their operating budget and independence of action. Over the past 20 years, some have evolved as independent entities with varying levels of independence.

As African countries join WTO, their main preoccupation will be how to prepare their markets to meet the requirements of the GATS and WTO rules. In this regard, they have two main challenges. One challenge is to review and update their insurance laws, and the other is to set up adequately functional supervisory structures to regulate their insurance industry. Their insurance laws and supervisory performance will have to conform to agreed international standards.

Many African countries still operate with outdated insurance legislation, some as old as the 1970s and 1980s. Others have revised their insurance acts in the 1990s. Outside of South Africa, Namibia and Mauritius, very few countries have insurance laws that have been updated in line with their WTO commitments or current international practices. Therefore, largely, there is substantial work to be done by African countries. Even without GATS/WTO considerations, the insurance laws in place in many African countries need to be reviewed to ensure that the industry functions on a sound economic basis and that the interest of policyholders is adequately protected.

Some African countries are members of the International Association of Insurance Supervisors (IAIS) and benefit from its guidelines and training. The Insurance Core Principles of the IAIS are indeed indispensable to any regulator. The vast majority of African supervisory authorities that are departments within government ministries and central banks do not have the independence and budget to join the IAIS. For any insurance regulator the cost of joining the IAIS is very negligible when compared to the benefits of membership.

As advocated by the IAIS, strong supervision and regulation of the financial sector enhances stability and creates investor and consumer confidence. As one of the key components of any country's financial system, the insurance industry contributes significantly to economic growth by managing risks and mobilizing savings. In order to achieve this objective, it should be operated on a financially sound basis. A well-developed insurance sector enhances efficiency of the financial system by minimizing transaction costs, creating liquidity and facilitating investment. To maintain efficient, safe, stable and fair insurance markets, Governments need to maintain a sound regulatory and supervisory system. The interest of policyholders is best protected with a sound insurance market and adequate supervision. African supervisory authorities understand the importance of sound insurance markets and the need for regulation and supervision, but many countries have limitations.

The insurance industry is changing in response to a wide range of social and economic forces. Insurance is increasing national boundaries. Technology is facilitating innovation, and insurance supervision must be updated continually to cope with such developments. Supervisory authorities are also responsible for understanding and addressing financial and systemic stability issues affecting the insurance industry as they emerge. In a liberalized economy, insurance supervisory authorities are also required to supervise the activities of conglomerates and financial convergence. The importance of the insurance sector for financial stability has been increasing. Supervisory authorities at national and international levels need to collaborate to ensure that these entities are effectively supervised to ensure the protection of policyholders and the stability of financial markets.

The International Association of Insurance Supervisors (IAIS) provides invaluable leadership and support to national insurance supervisory authorities in various ways. One of these is the development of the Insurance Core Principles, which is a globally accepted framework for the regulation and supervision of the insurance industry. The IAIS core principles cover a number of key issues covering conditions for effective insurance supervision, the supervisory system, the supervised entities, ongoing supervision, prudential requirements and markets and consumers. In order to ascertain that their insurance supervisors are meeting internationally established standards, African countries need to review their insurance laws and assess compliance with these core principles.

While a number of African countries have reasonably well organized insurance supervisory authorities, others are far behind. In the 1990s UNCTAD was instrumental through training workshops in assisting African countries. However, this has been discontinued since the end of the 1990s. In addition to these training workshops, there is need for assistance in reviewing legislation, assessing each country's commitments for liberalization and establishing adequately functional supervisory authorities. The development assistance needed by African countries will be discussed later.

Insurance laws and regulations

Out of some 50 African countries, less than 10 countries have recently updated insurance laws that meet international standards. African insurance laws are generally found to be inadequate in the following areas:

Minimum capital requirements

Strong insurers lead to stable insurance markets and increase national retention capacity. Some African legislations provide a systematic procedure for strengthening the capital base of a company by defining continuing minimum capital and by applying part of the annual net profit after taxes to a capital reserve account. When many insurance laws in Africa were promulgated in the 1970s and earlier, minimum capital requirements were set at levels that were appropriate at the time. However, with inflation and devaluation of most currencies in the continent, capital requirements have not been revised to bring them to a level that reflects the current values of the national currency and the size of the risks handled by insurers at present. Valuation of assets and liabilities, solvency issues and outstanding premiums, are not usually contained in a number of outdated legislations; and satisfactory directives have not been issued to supplement these deficiencies.

As a result, a number of countries require very little capital to engage in insurance activities. This has resulted in the establishment of too many companies in some markets where their value to the industry has become questionable as they engage in unacceptable business practices. To remedy this situation, one country has passed legislation that increased the capital requirement by nearly100 times the previous capital requirement. This extreme action could drive more than 90 per cent of the companies in the market out of business. This would defeat the economic objectives of the insurance industry.

Lack of adequate capital limits the retention capacity of the insurance industry; and this, in turn, results in extensive reliance on foreign reinsurance capacity.

Consumer protection

The protection of policyholders is the hallmark of any modern insurance act or legislation. In older legislations that are in effect in a number of countries, these have not been spelt out satisfactorily; and many countries do not have consumer protection agencies or bodies set up under their insurance acts for this purpose.

Corporate governance

The majority of African insurance legislations are silent on this issue as these legislations have been in place long before the concept of corporate governance became a prominent tool for the prudent management of the insurance industry and bodies related to it. There

is need to state explicitly the qualifications and role of the board of an insurance company and the board of supervisory authorities. Insurance Core Principle No. 9 of the IAIS provides excellent explanatory notes and criteria on Corporate Governance whose implementation is indispensable in achieving satisfactory market conduct.

Internal controls

Many African insurance legislations do not oblige the board of insurance companies to monitor a system of internal controls. Some board of directors and external auditors review and demand an adequate internal control system from insurance companies. Some supervisory authorities review internal control systems as part of their on site supervision. However, in the absence of effective provisions in the insurance acts and regulations, the board of insurance companies is not implementing adequate internal control systems.

Insurance supervisory structures

Independence

Out of some 45 insurance supervisory authorities surveyed for this paper, only 17 countries have set up insurance supervisory authorities that are independently operating to varying degrees. Supervisors in 28 countries are departments within the ministries of finance and commerce or part of the central bank. Only South Africa, Namibia, Mauritius, and the 12 CIMA zone countries have given reasonably adequate authority to their insurance supervisors to discharge their duties independently and to report to a supervisory board rather than to ministers or central bank officials. It is worth noting that some supervisory authorities that function as departments within ministries or central banks have performance records above some newly established independent supervisory authorities that are at present under staffed and under resourced. Nonetheless, following international practice and the IAIS recommendations, insurance supervisors that are independent from any government arm and with adequate budget would be the norm into which many developing countries supervisors would fall into in the years ahead. In order to enhance the independence of insurance regulators, some countries have created an independent supervisory board to oversee the activities of the supervisor, including the appointment of the chief executive. While this is quite important, what are often missing are internal regulations and good governance guidelines for the supervisor and the various boards and committees established to oversee its activities.

Financing

In developed countries, it is not common to find supervisory authorities that are funded by the governmental budget. Instead, a number of supervisory authorities generate funds through levy on the insurance industry and services they render. As their primary source of funding is not from the Government, they are mare likely to behave independently from government influence. The African countries that have set up insurance supervisory authorities as commissions have already legislated that the supervisor's budget would be financed by levy, in some cases with some government funding, as the size of its insurance market is underdeveloped and unable to absorb the full costs of supervision. As the majority of African insurance supervisors are presently departments of government ministries, they have very limited funds to enable them to implement a supervisory structure that meets international standards. In most cases, the supervisory authority staff

are struggling with their knowledge of the 1980s and have very little update on GATS and WTO developments, and they are exposed to very little on the job training. Many supervisors that are part of government ministries do not have the budget and/or the authorization to join the IAIS that would have been the best source of supervisory resources and training.

Supervisory directives and manuals

Assuming that a supervisory authority is set up independently and empowered through a budget that would enable it to recruit, equip and maintain an optimum number of professionals, it would need to develop directives, manuals and TOR that would make its service transparent and effective. These tools should be supported by the laws in place and by understandings among the different interest groups, i.e. the consumers, the insurers and public interest groups. The development of these supervisory tools requires a thorough understanding of the law and mastery of the marketplace. Some key areas in this regard are best practices in corporate governance, IAIS core principles, risk based supervision, reinsurance, policyholder protection, insurance industry self regulation and code of conduct, content and analysis of statutory returns, regulation of insurance products, etc. National and subregional training workshops and close association with the IAIS could be of great help to supervisors in setting standard and developing these supervisory tools.

Information systems

Many supervisory authorities have difficulty in compiling national insurance statistics that provide accurate and up to date information on the state of their industry. Often, the information they gather is not relevant for purpose of national economic planning. They need to review the contents of supervisory reports in other countries and redefine the report forms for statutory returns. Assuming they are able to get the required information, they need to have access to information systems that would enable them to compile and publish their market statistics, and maintain a database capable of producing various analytical reports when required. Some African supervisory authorities barely use IT in their offices. An IT system providing a functional database for regulators is required by many countries. At present, less than 10 countries have the required database for their operations. The upgrading of information systems at African insurance supervisory authorities could be accomplished over a period of one or two years as the introduction of new requirement for financial reporting and general data gathering will have to be coordinated with the supervised entities, as they will have to produce the required information. At the same time, development of actual supervisory tools and test ratios as well as training of staff will also take some time.

Role of government as an insurance services provider

All types of insurance are not commercially viable especially in small and developing markets due to the product development, launching and operational costs. Private sector companies on a commercial basis do not normally market such insurance products. Agricultural insurance, export credit insurance, microcredit insurance, insurance of the informal sector could have substantial impact on the insurance industry in terms of turn over and market share. However, these schemes have not been promoted sufficiently both

by the private sector or the Governments of developing countries. Despite the fact that agricultural insurance in rural areas and insurance of informal sector in urban areas affect more than 50 per cent of the total population, only 5 countries provide such insurances. For example, agricultural insurance schemes are well developed for commercial farmers of key economic crops in Mauritius, South Africa and Zimbabwe; and negligible agricultural insurance operations take place in Ethiopia and Nigeria. A few other countries in Africa have entered such markets in the past and withdrawn due to bad loss experience.

Regional bodies sometimes in cooperation with UNCTAD have studied the challenges of introducing agricultural insurance schemes in developing countries. The studies clearly indicated that in view of the small size of many private insurers in Africa, these companies would not have the necessary resources, both human and financial to embark upon such types of insurance services. For example, in order to provide viable agricultural insurance schemes, a lot of information on climate patterns, farming systems, credit and inputs, agricultural extension services, loss assessment systems, etc. need to be researched and developed. This will be followed by pilot schemes over a number of sample agricultural zones with extensive education and promotion so that farmers understand and appreciate the concept and benefits of insurance. The work to be done up to this stage would require an investment of millions of dollars. Only then will the insurer be able to come up with an appropriate agricultural insurance scheme. Actual implementation of the scheme after the above stages have been completed would then require extensive infrastructure throughout the rural farming areas requiring more resources. For this reason, the initiative for implementation of agricultural insurance schemes can only come from the Government with the help of external technical assistance.

Some 10 years ago, the African Insurance Organization undertook a detailed study for the introduction of agricultural insurance schemes in African countries where agriculture is the dominant economic activity. The study indicated that there was need for up to 10 countries signing up to justify the cost of further research and product development based on their national experience. Many countries were keen to participate in the project as it would contribute to the stability of their farming communities and speed up rural agricultural development. However, none of their national insurance companies or Governments were prepared to put up the resources required, and international assistance was nor forthcoming. Understandably, the private sector insurers did not show any interest. In the end, the project was finally left in abeyance. There are similar stories of initiatives taken to promote other socially desirable insurance schemes with little return opportunities in the short run.

African countries need to promote agricultural insurance, microcredit insurance and insurance of the informal sector in urban areas, as these are significant factors for their national economic development in addition to employing in some cases up to half of the work force in the country. A number of studies that have been undertaken in the past; and international bodies such as the World Bank, UNCTAD and FAO could extend a helping hand to countries that show keen interest to introduce these insurance products and services to their communities.

Assistance required by African countries

Africa's insurance industry is very much underdeveloped, and is expected to grow at a faster rate than in developed countries. Liberalization of the economy and indeed the financial sector will have long-term benefits for the countries concerned and would be beneficial to the local insurance companies if they were given sufficient support and time to prepare themselves to cope with liberalization and international competition. What the local industry requires is not protection, but the means with which to prepare it to cope with competition. The majority of African countries have outdated insurance laws that need revision in line with current international standards. These countries also need to establish independent and transparent supervisory bodies that have legislative powers and resources to effectively manage their insurance industry in a liberalized and competitive environment. In addition, the insurance supervisory authorities in Africa need support in various areas to prepare themselves to handle the tasks of establishing functional supervisory bodies, training staff and put in place regulations and guidelines for the proper conduct of the market. For the African insurance regulators and their insurance industry that are largely SMEs, they need special assistance with the development of affordable insurance software and uplifting the capability of training institutions in the continent.

In addition to the measures mentioned above, African countries need assistance in two areas not directly related to liberalization. One is in the area of coping with natural catastrophe exposures for which the continent has realized the significance of preparing itself with ways and means of understanding catastrophe exposures and undertaking preparatory measures to cope with any eventual catastrophe that may occur. For this purpose, African countries have requested international assistance to help them set up and manage the African Catastrophe Risks Centre. The second area is in creating the appropriate environment for the mobilization of savings for national economic development through life insurance and pensions. For this Africa requires developing mortality tables based on African experience and devise appropriate insurance and pensions products.

African countries realize the importance of being part of the global marketplace in all areas of trade including insurance. Almost all African countries have signed up to the GATS/WTO with varying levels of commitment. As they enhance their commitments and try to meet their obligations under the GATS/WTO, they need urgent assistance in the following five areas to help them introduce the required changes to bring their insurance supervisory bodies and industry to international standards. The African countries voiced their request for specific assistance in the field of insurance at the tenth session of UNCTAD in São Paulo, and their ambassadors in Geneva submitted a request to UNCTAD for support in the following five key areas.

Areas of support for Africa in the field of insurance

Programme scope

Insurance is an obligatory component of any trade and development activity. With the accession of many African States to WTO and the creation of other regional free trade areas in Africa there is a pressing need for many African countries to overhaul their

insurance sector and its regulation to reflect global market "best practice" and prudential regulation to comply with IMF, OECD and IAIS inspection standards.

The latest round of financial services negotiations at WTO is due to come to a close, and time is running out for countries who have already subscribed to the fifth protocol to make the necessary internal alterations before they open their markets to international competition. There remains much ongoing work to be completed and globalization in the insurance sector continues to create additional demands on African countries for which they are not adequately resourced.

UNCTAD programme on insurance

UNCTAD is the only United Nations body in which insurance is included as part of its continuous work programme. Since its inception in 1964, UNCTAD has been assisting developing countries and those with economies in transition with building competitive insurance sectors, including local governance capacity and SME competitiveness. The ultimate goal of the programme is to help countries enhance economic growth and development, thereby reducing poverty, and achieving other economic benefits.

During the past eight years, the programme's contribution to insurance in developing countries and transition economies has been challenged due to lack of resources. On the other hand, developing countries, especially in Africa, through their supervisory authorities and regional organizations, have been calling on UNCTAD for continued assistance in view of their joining WTO and the burden of meeting international standards as well as ensuring the survival and growth of their local markets. African countries voiced their requests at various UNCTAD conferences, especially in Sao Paolo, and since then, through direct contacts made by their respective ministers of trade and finance as well as ambassadors based in Geneva. Many African countries are at present disadvantaged because they do not have an adequate regulatory infrastructure to facilitate effective prudential regulation of their insurance markets, or for their insurers to manage their companies to modern standards.

UNCTAD's current insurance mandate derives from the outcomes and conclusions of the tenth session of the Conference (UNCTAD X, held in Bangkok in February 2000), which stipulates that, "UNCTAD should carry out analytical and technical assistance work to help regulators and relevant insurance industry associations in upgrading the regulatory and institutional framework for this sector to adapt to international and best practice and to requirements under WTO/GATS". The subsequent UNCTAD XI Conference (São Paulo, June 2004), further strengthens this mandate by specifically addressing insurance problems facing LDC's and African countries, and by requiring UNCTAD to "examine the special problems that LDC's and African countries face……..through continuation of the work on the development of the insurance sector."

Following the São Paulo conference, a number of African Governments through their ministers and ambassadors in Geneva and the African Insurance Organization have requested UNCTAD to take urgent measures to assist their countries in improving the performance of domestic insurers and the capability of their Governments' insurance supervisory authorities. However, due to lack of adequate resources, very little has been done towards answering the needs of these countries.

Based on UNCTAD's insurance mandates and taking into account the outcome of consultations with the African delegations in Geneva, the African Union, and the African Insurance Organization, the following five area of support have been identified for Africa. These five areas of action consolidate the priorities of African countries in their efforts to modernize their insurance sector infrastructures so that they can better participate in global and regional markets as they have evolved today. They will also be able to comply with the regulatory standards and reporting requirements set by the international bodies, and prepare their markets to cope with the insurance and risk management demands of their countries.

Project 1: Development of affordable insurance software.

IT utilization by insurers and regulators

Many of the 650 insurers and reinsurers in 51 African countries are SMEs by international standards. Less than 100 of these companies are adequately computerized. The remaining 550 or so companies have low annual turnover, and they do not have access to adequate insurance operating software as the cost of internationally available commercial software is beyond their means. To enable the small and medium insurance companies to function competitively, produce accurate statements and reports both on insurance and reinsurance activities, as well as enabling their Governments' supervisory authorities to monitor their activities and compile national statistics in insurance, they need assistance in accessing an affordable software based on international standards, but tailored to their needs and means. As African Governments' insurance supervisory authorities and their insurance industry prepare to cope with globalization and opening up of their markets to outside competition, one of the key support areas they need would be empowerment in accessing affordable and functional insurance software. This project will enable them to access such software. At present, commercial insurance software is indeed expensive for the vast majority of insurance companies in Africa, especially in the least developed countries.

Starting in the mid-1990s, in collaboration with UNCTAD, the African Insurance Organization hosted a number of annual workshops on utilization of information technology by supervisory authorities and the insurance industry in Africa. These workshops identified a clear need for availing software tools for insurance supervisors to have the capability to capture information on a standard format and produce market statistics. At the same time, the insurance operators almost all of whom are still SMEs realized the need for computerizing their activities, but affordable and functional software that met their basic requirements were not available in the marketplace. Available software was mainly designed for big companies in the developed countries with sophisticated needs. Furthermore, the cost of such software was beyond the means of these SMEs. UNCTAD and the AIO initiated the development of affordable software that has advanced satisfactorily. The software has the twin goals of empowering supervisory authorities to have market statistics accurately and promptly compiled for a period of up to 10 years online. The other objective is providing affordable software to small and medium-sized insurance companies that would otherwise be unable to automate their

operations as the cost of available comparable software is often more than their annual income.

At present, the prototype of the software for three types of insurance covering fire, marine, and automobile risks is implemented in a test company and working well. There are suggestions to improve work done so far. In addition, there is the remaining task of applying the software to other classes of insurance. After the software development phase is completed, it will be distributed to small and medium-sized insurance companies as well as insurance supervisory authorities on a not-for-profit basis.

Development objectives

The principal objective of this project is to assist African countries, in particular LDCs, to overhaul their insurance sector and its regulation to reflect global market "best practices" and prudential regulation to comply with IMF, OECD and IAIS inspection standards to facilitate and enhance positive economic and social development of host African developing countries. Working with both the public and corporate sectors, as well as the financial services regulatory authorities, the project will aim to develop capacity via the local provision of relevant up to date tools and education, thereby contributing to the security of the Insurance sector and satisfactory performance of the African insurance supervisory authorities. The project will benefit the 43 African countries that have requested assistance as well as any other countries in Africa and beyond that would like to use the software. The structure of the software development platform will make it possible to translate the software into any of the United Nations official languages and many more. The development cost of the software should be evaluated in view of the numerous countries and companies that stand to gain from its implementation.

Without adequate insurance information processing software, African Governments and their insurance industry will not be able to meet their obligations for market opening under their WTO commitments. The completion of this software will provide them with the necessary tools to meet these obligations. The net result of this project will be the ability of African countries' governmental supervisory authorities and their insurance industries to meet the requirements of WTO and other institutions in establishing and monitoring insurance markets that meet international standards. This would result in improved good governance and better consumer protection and transparency of the insurance industry in the overall financial services sector of African countries. Furthermore, timely, accurate and valuable statistical information useful for further economic planning and international relations will be made available to those bodies requiring such information. This software will be completed to high international standards and can easily be adapted for other developing countries and those with their economies in transition.

Outputs

Produce the software for African insurance regulators and companies, to include all 33 classes of insurance including personal and commercial lines and socially useful products such as agricultural insurance, export credit insurance, catastrophe risks insurance, etc. The software will be affordable and user-friendly; and could easily be adapted for other developing regions of the world. Specifically, the project will:

1. Produce affordable insurance software for regulators and insurers on CD-ROM;

2. Produce manuals (printed and on CD-ROM) for the software for end users and technical IT professionals;

3. Translate the software and manuals into French and other official languages of the United Nations as desired;

4. Organize educational workshop for potential users, such as government supervisory authorities and insurers.

Expected impact

1. Enhanced efficiency of government insurance supervisory authorities to keep an up-to-date record of licensing, inspection, market conduct and other related market issues and ability to process industry returns and statistics to produce accurate and timely market reports for local and international use.

2. Access by SMEs to appropriate software at affordable prices, to enable them to operate competitively in a liberalized marketplace.

Project 2: African Centre for Catastrophe Risks

Just eight months before the tsunami catastrophe hit South East Asia in December 2004, the African Insurance Organization and UNCTAD organized a catastrophe conference for Africa in April 2004 under the auspices of the Government of Morocco attended by some 300 insurance experts from Africa, the middle East, Asia and Europe. Speakers and resource persons came from countries such as Switzerland, France, Germany and South Africa s that have catastrophe risk management expertise as well as African countries that have experienced the effects of natural catastrophes.

The meeting concluded by stressing the incapacity of Africa to cope with any natural catastrophes that may occur, and recommended the creation of an African Centre for Catastrophe Risks (ACCR) in Morocco. The centre would monitor events, prepare Governments in the best ways of identifying potential natural catastrophes to which countries are exposed, and preparing an adequate infrastructure to enable them to cope with such catastrophes whenever they occur.

Although some 27 African countries participated, the conference realized that many attended because of fear of the consequences of natural catastrophes on their national economy and not because they have any valuable resource or expertise. The only country in Africa that has any kind of a functional structure was South Africa. Morocco and Algeria have been hit by natural catastrophes in the past; and they briefed the conference how they tried to cope with its effects. Many countries have had a number of natural catastrophes such as flood, drought and earthquakes, with no long-term plans yet on how to deal with similar events in the future.

The conference underlined the importance of building a database of major catastrophe risks in Africa by region and country, and creating a continental catastrophe management centre that will compile information, advise countries the appropriate preparedness policy

including basic catastrophe covers for peak industrial and national risks, and promote the vital need for risk mapping key exposures in each country. A lot of these are beyond the means of African countries in terms of available expertise.

The Government of Morocco also supported the creation of the centre and agreed to provide the local physical infrastructure required for running the centre. Since then, Morocco and other African Governments have officially requested UNCTAD and the World Bank for assistance in realizing the centre.

UNCTAD believes that the African CAT centre should be implemented immediately as the budget it seeks is indeed a very small fraction of any external assistance that would be required in the event of a catastrophe. This will go a long way to prove that national preparedness is ultimately the most efficient and less costly exercise in coping with catastrophe events.

Objectives

Most countries of Africa have little expertise and information to deal with the catastrophe risks to which they are exposed. The creation of this regional centre will make it possible for African countries to access vital information that their Governments, civil society and insurers require for planning and action in the event of natural catastrophes. The centre will provide practical and technical advice on catastrophe risk management and insurance. African Governments, governmental and non-governmental bodies engaged in disaster relief work as well as their insurers will have access to the resources of the centre. The centre will provide them with a strategic plan to understand natural catastrophes to which their countries and economic institutions may be exposed to and devise the best means of protection against these events and/or means of minimizing their effects

The Centre will:

1. Explore available technical and scientific data and its applicability to Africa;

2. Review potential natural catastrophes to which African countries are exposed, monitor catastrophe events and developments and provide strategy on how best Governments and communities could prepare themselves to cope with such events;

3. Establish and manage a network of information and expertise within African countries;

4. Provide countries and subregions advice on catastrophe insurance and preparedness, and the creation of the necessary structures for post-catastrophe management;

5. Serve as the focal point and cocoordinator for experience gathering and international cooperation and identify sources of international expertise;

6. Organize workshops on catastrophes, in collaboration with OCHA, international organizations and African Governments;

7. Compile and maintain a database of risk exposures and resources of participating countries;

8. Prepare a study on natural catastrophes by country and subregion in Africa;

9. Publish detailed report for use by government planners and the financial sector;

10. Compile risk mapping of key economic zones of African countries;

11. Hold an annual international conference on strengthening national catastrophe preparedness and publish annual report on catastrophe events in Africa, and on the activities of the Centre;

12. The centre will provide training for professionals and support staff engaged in managing catastrophe centres in each country.

Project 3: Strengthening African insurance supervisory authorities

Introduction

With the assistance of UNCTAD in the past 15 years, Africa has started to develop a healthy regulatory and supervisory capacity; but this assistance has not been forthcoming in the past eight years. As a result, development of adequate regulatory capacity has not spread to all countries of the continent; and whatever capacity is available in most African countries, it is not adequate to enable the countries to manage successfully liberalization of their markets under the GATS/WTO provisions. The main tasks would include review and harmonization of insurance laws, creating healthy insurance markets, establishment of independent insurance supervisory authorities and setting good governance and supervisory standards. African Governments and their supervisory authorities need urgent assistance to review their insurance laws and put in place adequate supervisory structures equipped with trained human resources and IT capability.

Objectives

The principal objective of this project is to assist African countries in overhauling their insurance sector and its regulation to reflect global market "best practices" and prudential regulation. Working with the relevant government bodies and the financial sector supervisory authorities the project will aim at first assessing and then updating the legislative basis for the conduct and control of insurance business, the establishment of an adequate supervisory structure equipped with the required human and material resources. The establishment of a sound supervisory authority will effectively contribute to the proper functioning of the insurance sector thereby ensuring the protection of policyholders and the resultant healthy development of the national economy.

More specifically, this project will review insurance laws of African countries on a subregional basis taking into consideration international best practices and the IAIS (International Association of Insurance Supervisors) core principles and recommendations and come up with model Insurance Acts that could serve as the basis for amendments of Insurance Acts and regulatory guidelines of African countries. This initiative will avail to African countries standard, internationally acceptable insurance acts that would enable them to quickly and adequately revise their insurance acts and establish

functional supervisory authorities based on best international practice that facilitate the establishment of efficient supervisory bodies.

Outputs

1. Legislative review: To create effective and functional insurance supervisory authorities equipped with the requisite legislation and material resources that would enable them to regulate their insurance industry in line with international best practices. A compendium of insurance laws of African countries including model insurance acts and directives will be produced to provide African countries with standard reference text. The detailed activities under the project would include review of insurance laws of African countries and their commitments under WTO and other international agreements, harmonization of national insurance laws with relevant regional and international practices and drafting new legislation to adequately meet the needs and commitments of the countries.

2. Supervisory structure: For best performance and results, insurance supervisory bodies in developed countries are independent and have adequate budget with which to perform their tasks. In some developed countries, insurance regulation is integrated with supervision of other financial sectors (banking and securities) regulators in the country, with the belief that integration will allow for cross section efficiency. In others, insurance regulators are independent from the banking and securities regulators. In Africa, there are very few insurance supervisors that are part of an integrated financial services supervisory authority. There are a few insurance supervisory bodies that have been set up as independent commissions or authorities, but a number of them are under the direct control of a ministry. The majority of African insurance supervisors continue to function as departments within the ministries of finance or the central bank of the country. The trend internationally is for supervisory authorities to be independent and transparent. There is need to undertake a total review of the state of insurance supervision in African countries, consider alternative set ups either as part of the financial sector supervisory body or as stand alone supervisors, provide technical assistance and documentation adapted to the specific needs of each country that is prepared to strengthen its supervisory authorities. The technical assistance package could later include training and material assistance for selected countries.

3. Supervisory database and reports: Insurance supervisory authorities are responsible for maintaining a database on their insurance industry and produce periodic reports providing information on the state of their insurance industry and their own analysis of the significance and potentials of the insurance sector to the national social and economic development. With the completion of the software development programme in Project 1, African insurance supervisory authorities will have the tools for managing market statistics and producing periodic useful reports. Standard database and sample reports, as well as supervisory returns for the supervised entities will be developed and made available to supervisors.

4. Educational workshop: National and subregional workshops aimed at explaining the functions of insurance supervision, legal and technical (insurance and financial) aspects of supervision, development and maintenance of a supervisory database, and other related topics would help regulators to understand key issues and learn from each others experience. The workshop would also be useful in creating a network of support and information exchange that would provide long-term benefits to insurance regulators. The

national workshop could be open to executives of the insurance industry as well as their external auditors to update participants on the changes being introduced to improve the performance of supervisory authorities and introduce good governance practices for the insurance industry.

Expected impact

1. African countries will be able to assess the adequacy of their insurance laws and supervisory instruments in line with their WTO commitments and international best practice.

2. African countries will easily enact insurance legislation that meets international standards.

3. African countries will be able to set up insurance supervisory authorities that have adequate legal and administrative powers to perform satisfactorily and carry out their country's WTO and other international commitments.

4. African countries will be able to help their local insurance industry to prepare adequately and meet international standards so that it can compete on equal grounds with foreign companies licensed to operate in the country.

5. As insurance is one of the tools for international trade, the country will have insurance laws and regulations in harmony with international practices and standards.

Project 4: Promoting life insurance to mobilize national savings for development

Introduction

African countries require assistance in developing mortality tables and relevant life and pensions products as well as the accompanying investment, tax and legislative regimes. Because of the absence of a well-structured life insurance market due to lack of the above elements, the vast majority of African countries do not have a significant life insurance industry. As a result, the level of personal savings is very low, thus hampering mobilization of local resources for investment and development.

Life insurance and pensions are not very well developed in most parts of Africa also because of the low disposable income of the general population, with the exception of South Africa where the penetration of life and pensions business is around 15 per cent of GDP and life insurance constitutes more than 60 per cent of the gross premium generated for the whole country. In the rest of the continent, life insurance generates less than 20 per cent of total insurance premium.

Lack of knowledge and appropriate insurance products, lack of investment opportunities and realistic tax laws, lack of national statistics on mortality, among others, play a significant role for the continent's failure to develop life insurance and pensions. Another problem is outdated insurance and pensions acts in many countries.

Development objective

The development objective of this project is to increase the level of personal savings in order to mobilize local resources for investment and development by making available information, actuarial and other tools for the conduct of life insurance and pensions business in the countries of Africa. This project will benefit all sectors, including public, corporate and private individuals, and will assist Governments in implementing the necessary policies to promote the development of life insurance and pensions, as well as assist insurance supervisory authorities and financial services regulators to promote the necessary security for the corporate providers and consumers.

Because of this study, African countries will be able to set up performing life insurance companies whose operations are based on reliable mortality tables and studies based on their national experience in order to mobilize savings for national economic development.

Expected output

1. Comparative report on life insurance and pensions in Africa (including product types, turnover statistics, investment funds generated, etc.).

2. Review of life and pensions laws in Africa.

3. Review of taxation on life and pensions funds in Africa.

4. Mortality tables and suggested applications by subregion.

5. Educational workshop for insurance and pensions industry participants as well as their supervisory authorities.

6. Life and pensions products appropriate to the needs of African countries.

Expected impact

1. Development of mortality tables and suitable rates to conduct life insurance and pensions business in countries where mortality tables based on local experience were not previously available.

2. Development of African mortality tables for purposes of national economic planning.

3. More investments in life and pensions companies due to availability of reliable statistics.

4. Increase in national savings and investments because of the growth of life insurance and pensions in Africa.

5. Improvement in social welfare because of the uptake of life insurance and pensions products in economies where these were previously unavailable or infrequently used.

6. Creation of a conducive legal and investment environment that would encourage greater savings by individuals and institutions.

Project 5: Strengthening African insurance training centres

The state of insurance training in Africa

As African countries prepare for global competition, they need to develop adequately trained human resources. As they liberalize their economies and open up their markets to international competition, one of their main constraints would be finding adequately trained human resources, especially for their local insurance industry and supervisory authorities. This project aims at producing a sufficient number of well-trained insurance professionals as well as trained trainers and directors of training centres who are currently trying to cope with present-day challenges with their knowledge and skills from the 1980s and 1990s.

There are 18 insurance training centres in Africa providing training to employees of the insurance industry as well as supervisory authorities. Only two of these have achieved a level of excellence that compares favourably with the current demands of the insurance industry and regulatory authorities. The rest are either under resourced or inadequately managed. Many are using teaching materials and textbooks that have been prepared over 20 years ago. Their human resources leave much to be desired. Firstly, due to lack of funds, their managers and trainers have not been trained and updated on teaching skills and academic content. Insurance products and services as well as supervisory requirements and standards have undergone substantial changes in the past few years. These changes are bound to place even greater performance requirements on the staff and teaching programmes of African training institutions.

A number of LDCs in Africa do not have the resources to set up complex training centres at national level. Many of them need only provide entry-level training, to be complemented by training at subregional levels for higher-level skills, provided that the course content of the subregional training centres is in line with their needs. Furthermore, the advanced training centres in the better-developed markets could also specialize in selected high-level skills so that they could exchange programmes and trainings among training centres of similar standing. This will enhance subregional and regional cooperation and at the same time lead to specialization in selected.

Development objectives

The principal objective of this project is to assist in making available an infrastructure to provide the African insurance sector with adequately trained human resources to meet the needs of their insurance sectors in today's liberalizing and globalizing markets. This will include functional training institutes, networking and sharing of training expertise and teaching materials, and training of insurance trainers and directors of regional training centres.

Outputs

1. Establishment of training institutes with programmes meeting the needs of supervisors and the insurance industry at national and subregional levels.

2. Networking and sharing of training expertise and teaching materials on a subregional basis thereby achieving economies of scale.

3. Training of trainers and directors and upgrading their skills to international standards.

4. Upgrading the quality of existing training centres to international standards.

5. Harmonizing certification, curricula and textbook to subregional and international standards.

6. Publication of report on the Insurance Core Principles, legal aspects and business methodology as reference material for all insurance education and training centres in Africa.

7. Establish continuing education and training of insurance trainers to a common standard.

8. Compile curriculum and establish standards for international examinations.

4. Expected impact

1. Standardized education and training for supervisory authorities personnel.

2. Standardized education and training for insurance industry personnel.

3. Standardized curriculum, teaching methods and aids, textbooks, certificates and diplomas throughout the continent.

4. Specialization of training centres in selected key areas on a subregional basis, thereby attracting competent lecturers in specialized fields.

5. Enhanced cooperation among training centres resulting in better sharing of resources.

Conclusions

In order to cope with the challenges posed by their WTO membership and commitments, some African countries have started to take steps in the right direction by revising their insurance legislations, creating autonomous supervisory authorities and taking measures aimed at the establishment and operation of insurance markets based on sound principles. Mutually beneficial and successful liberalization in the insurance sector requires high standards in good governance, market conduct and strong supervision. Many countries, however, have difficulties getting together the needed expertise and resources to embark on such a task. Realizing that UNCTAD is the only United Nations body that has insurance in its programme of activities and noting the valuable work done by UNCTAD in the field of insurance since its creation, many developing countries including African countries, have requested for continued support for their insurance sector at UNCTAD X in São Paulo, Brazil, in July 2004. Through their regional bodies and diplomatic missions in Geneva as well as letters from their ministers, 43 African Governments have repeatedly expressed the need for urgent international support in the following five key areas where

they have critical problems in making insurance a relevant segment of their financial sector and an effective tool for economic development.

1. Legislative review and supervisory capacity development.

2. Provision of affordable insurance software for the SME insurers and government insurance supervisory authorities.

3. Improving the performance of insurance training institutes.

4. Preparation of mortality tables based on African experience.

5. Creation of an African centre for catastrophe risks.

In addition, introduction of viable agricultural insurance based on the needs of the rural population as well as insurance schemes adapted to the needs of microfinance institutions and the urban informal sectors could enhance the value of insurance to the socio economic development of African countries, especially LDCs. The rural agrarian population and the urban population earning its leaving from the informal sector comprise more than 50 per cent of the working population of many African countries; an introduction of appropriate insurance covers for their activities will have a positive contribution to the creation of stable societies and mobilization of resources for further socio-economic development.

Annex 1

Insurance penetration in Africa by country

(combined life and non-life)

Country	Population in millions	Premium (US$ million)	Premium ranking	Insurance penetration
Algeria	32.5	437.45	5	13.46
Angola	12.9	166.60	11	12.91
Benin	7.3	12.61	37	1.73
Burkina Faso	11.9	14.80	32	1.24
Burundi	7.7	4.75	43	0.62
Cameroon	16.9	172.70	10	10.22
Chad	8.5	13.76	35	1.62
Congo	3.57	11.09	40	3.11
Côte d'Ivoire	19.07	232.03	9	12.17
Dem. Rep. of the Congo	57.2	59.93	20	1.05
Egypt	69.9	462.34	4	6.61
Eritrea	4.1	14.39	34	3.51
Ethiopia	70.6	74.27	18	1.05
Gabon	1.4	108.78	14	77.70
Gambia	1.4	14.47	33	10.34
Ghana	20.9	78.78	17	3.77
Guinea	8	12.66	36	1.58
Kenya	33.4	374.21	6	11.20
Lesotho	2.4	11.39	38	4.75
Libya	6	132.06	12	22.01
Madagascar	17.9	33.14	26	1.85

Malawi	11.2	19.94	31	1.78
Mali	10.9	24.44	28	2.24
Mauritania	2.8	10.91	41	3.90
Mauritius	1.3	120.15	13	92.42
Morocco	29.8	617.41	2	20.72
Mozambique	19.4	38.84	23	2.00
Namibia	2	273.61	8	136.81
Niger	11.9	11.10	39	0.93
Nigeria	156.4	312.61	7	2.00
Rwanda	8.6	10.22	42	1.19
Sierra Leone	5.02	34.88	24	6.95
Senegal	10.6	105.35	15	9.94
Seychelles	0.083	20.18	30	243.13
South Africa	48.05	31,634.00	1	658.36
Sudan	35	89.47	16	2.56
Swaziland	1.1	31.93	27	29.03
Togo	5.27	20.29	29	3.85
Tunisia	10.1	482.64	3	47.79
Uganda	26.8	33.45	25	1.25
United Rep. of Tanzania	37.1	65.70	19	1.77
Zambia	11.01	49.69	21	4.51
Zimbabwe	12.1	43.11	22	3.56
	837.573	*36,054.68*		*43.05*

Annex 2

Structure of insurance supervisory authorities in Africa

Grouping	Country	Supervisory body	Reports to	Funding
North Africa	Algeria	Insurance Department	Ministry of Finance	Government
	Egypt	Egyptian Ins. Supervisory Authority	Ministry of Finance	Government
	Libyan Arab Jamahiriya	Insurance Department	Ministry of Finance	Government
	Mauritania	Insurance Department	Ministry of Finance	Government
	Morocco	Insurance Department	Ministry of Finance	Government
	Sudan	Insurance Supervisory Authority	Ministry of Finance	Government
	Tunisia	Insurance Department	Ministry of Finance	Government
CIMA Zone	Benin	CIMA	Supervisory Board	Levy/Government
	Burkina Faso	CIMA	Supervisory Board	Levy/Government
	Cameroon	CIMA	Supervisory Board	Levy/Government
	Central African Republic	CIMA	Supervisory Board	Levy/Government
	Chad	CIMA	Supervisory Board	Levy/Government
	Congo	CIMA	Supervisory Board	Levy/Government
	Côte d’Ivoire	CIMA	Supervisory Board	Levy/Government
	Gabon	CIMA	Supervisory Board	Levy/Government
	Mali	CIMA	Supervisory Board	Levy/Government
	Niger	CIMA	Supervisory Board	Levy/Government
	Senegal	CIMA	Supervisory Board	Levy/Government
	Togo	CIMA	Supervisory Board	Levy/Government

Other	Angola	Insurance Department	Ministry of Finance	Government
	Burundi	Insurance Department	Ministry of Finance	Government
	Dem. Rep. of the Congo	Insurance Department	Ministry of Finance	Government
	Eritrea	Insurance Department	Bank of Eritrea	Government
	Ethiopia	Insurance Department	National Bank	Government
	Gambia	Insurance Department	Central Bank	Government
	Ghana	Commissioner of Insurance	Board	Levy/Government
	Guinea	Insurance Department	Central Bank	Government
	Kenya	Commissioner of Insurance	Ministry of Finance	Levy/Government
	Lesotho	Insurance Department	Central Bank	Government
	Madagascar	Insurance Department	Ministry of Finance	Government
	Malawi	Insurance Department	Reserve Bank	Government
	Mauritius	Financial Services Authority	Board	Levy/Government?
	Mozambique	Insurance Department	Ministry of Finance	Government
	Namibia	Financial Services Authority	Board	Levy
	Nigeria	Commissioner of Insurance	Board/Min. of Finance	Levy/Government
	Rwanda	Insurance Commission	Ministry of Finance	Government
	Sierra Leone	Insurance Department	Ministry of Finance	Government
	Seychelles	Insurance Department	Ministry of Finance	Government
	South Africa	Financial Services Board	Board	Levy
	Swaziland	Insurance Department	Central Bank	Government
	Uganda	Commissioner of Insurance	Board/Min. of Finance	Levy/Government

	United Republic of Tanzania	Commissioner of Insurance	Board/Min. of Finance	Levy/Government
	Zambia	Pensions & Insurance Authority	Board/Min. of Finance	Government
	Zimbabwe	Insurance Department	Ministry of Finance	Government

Annex 3

Ownership of African insurance companies

Grouping	Country	Historical	Current
North Africa	Algeria	monopoly	mixed
	Egypt	mixed	mixed
	Libya	monopoly	mixed
	Mauritania	monopoly	mixed
	Morocco	private	private
	Sudan	private	mixed
	Tunisia	mixed	mixed
CIMA Zone	Benin	private	private
	Burkina Faso	mixed	mixed
	Cameroon	mixed	private
	Central African Republic	mixed	mixed
	Chad	monopoly	mixed
	Congo	monopoly	mixed
	Côte d’Ivoire	private	private
	Gabon	mixed	private
	Mali	mixed	private
	Niger	monopoly	mixed
	Senegal	private	private
	Togo	mixed	private

Other	Angola	monopoly	mixed
	Burundi	monopoly	mixed
	Dem. Rep. of the Congo	monopoly	mixed
	Eritrea	monopoly	monopoly
	Ethiopia	monopoly	mixed
	Gambia	private	private
	Ghana	mixed	mixed
	Guinea	monopoly	mixed
	Kenya	mixed	private
	Lesotho	mixed	mixed
	Madagascar	monopoly	mixed
	Malawi	mixed	private
	Mauritius	mixed	mixed
	Mozambique	monopoly	private
	Namibia	private	private
	Nigeria	mixed	mixed
	Rwanda	monopoly	mixed
	Sierra Leone	mixed	mixed
	Seychelles	monopoly	mixed
	South Africa	private	private
	Swaziland	monopoly	monopoly
	Uganda	mixed	private
	United Rep. of Tanzania	monopoly	mixed
	Zambia	monopoly	mixed
	Zimbabwe	private	private

XII. Benefits of insurance liberalization in India: a case study

Anuroop "Tony" Singh[129]

The point that India is a jumbo-sized opportunity for life insurance need hardly be belaboured. Here is a nation of a billion people, of whom merely 100 million people are insured. And, significantly, even those who do have insurance are grossly underinsured. The emerging middle class population, growing affluence and the absence of a social security system combine to make India one of the world's most attractive life insurance markets. No matter how you look at it – whether in terms of life insurance premiums as a percentage of GDP or premium per capita – the market is under penetrated and people are under-insured.

In a country where there is high unemployment and where social security systems are absent, life insurance offers the basic cover against life's uncertainties. India has traditionally been a savings-oriented country and insurance plays a critical role in the development of the Indian economy. The role of insurance in the economy is vital as it is able to mobilize premium payments into long-term investible funds. As such, it is a key sector for development.

A brief history

For 43 long years the government-owned Life Insurance Corporation of India (LIC) held a monopoly. It is only at the dawn of the twenty-first century that the sector was finally deregulated. Reforms were initiated with the passage of the Insurance Regulatory and Development Authority Bill in Parliament in December 1999. The IRDA since its incorporation as a statutory body in April 2000 has regulated the opening up of the insurance sector, which has seen 13 life and an equal number of non-life private companies launch their operations in India.

In India, the decision to liberalize was not easily implemented since there was resistance to privatization. After all, this would mean:

- Ending the government monopoly on mobilizing large-scale funds;
- LIC, a successful life insurance company, would face the heat;
- The foreign insurance companies would come marching in.

That was not all. There were other concerns too. Would new market entrants hire away all the best employees of LIC? Would the world-renowned foreign insurers that would enter the market lure current and future Indian policyholders? How would the citizens of India benefit from liberalization? What would be the impact on India's capital markets?

[129] The author is vice-chairman of Max New York Life, a new age life insurance company in India.

These and many other questions were debated for several years until 1999. The first private insurance companies began operations in 2001.

The outcome

Opening up the sector has transformed the landscape. The Indian regulator has done a commendable job in liberalizing the market and putting in place rules of the game to effectively monitor the entry and progress of the new entrants.

Domestic liberalization and introducing the monopoly providers to competition has been a part of this story. The positive change brought by deregulation is inestimable. Even so, some benefits are immediately apparent:

- ***Real life insurance:*** Historically, life insurance has been sold in India as an investment tool. Attracted by the prospect of reasonable returns and tax savings, people put away some money into life insurance. Protection against risk – which represents the true value of life insurance – did not quite enter the frame. Until the entry of private life insurance companies. For instance, Max New York Life introduced the Whole Life product in the Indian marketplace in the belief that a good life insurance product offers the right balance between protection and savings.

- ***Product range:*** The basket of products available to the customer has grown in the deregulated environment that permits the introduction of the product.

- ***Comprehensive risk coverage:*** Deregulation has enabled people in India to cover a larger variety of risks. Earlier people had no option but to buy prepackaged life insurance products, which lacked flexibility. Customization, however, has been one of the key advantages of privatization. Riders have added value to the customer's life insurance needs. Max New York Life was the first company to offer base products and riders.

- ***Customization:*** In earlier days, customers could only buy limited prepackaged products pushed by agents chasing quick sales. Today customers have access to more and better products that suit their specific needs and a new breed of insurance advisors has taken birth. These agent advisors build enduring relationships with their clients and help them better understand the value of life insurance and sell customized solutions in a needs-based manner. This higher quality of sales interaction has been among the key benefits of privatization.

- ***Market awareness:*** The money that private life insurance companies have spent on establishing their brands has helped create awareness about life insurance. Today life insurance brands compete with other financial services and manufacturing brands for marketing space.

Rapid progress

In most other markets that opened their economies, new entrants in life insurance have taken 10 to 12 years to secure a market share of 10 per cent. In India, however, the progress of private life insurers has been considerably more dynamic. In less than five years since deregulation, private life insurance companies have secured 25 per cent of the market share from LIC. Further the private sector insurers have achieved year-on-year growth of more than 60 per cent. In the number of new policies too the market shares achieved by the new players is quite impressive.

In the short period following liberalization, the new private sector insurers have together introduced more that 200 state-of-the-art products giving the customers a very wide choice indeed. It is this new dynamism that has caused insurance penetration to grow to 2.2 per cent during the years following liberalization.

Indeed, life insurance is a very large financial service, a valuable medium of long-term savings and growing at 24 per cent CAGR.

In addition to the benefits to customers of finding products to meet their needs, the insurance sector has also created sizeable job opportunities. Professionalization of insurance selling and new marketing concepts introduced by foreign players has meant that many more people are taking to insurance. There are today in India a million insurance agents and another 200,000 employees.

The introduction of competition from foreign insurers has also served to wake up the large State-owned company, the Life Insurance Company of India or LIC. LIC has shaken off slumber, upgraded its systems, embraced actuarial prudence, and introduced more modern products and withdrawn products that had inherent guarantees in them.

Foreign participation has created benefits not only for the new entrants, but also for the players already in the market. While the initial concerns were focused on how domestic insurers would lose their 100 per cent of the pie, the market has actually become more like a seven-layer cake. Even with a reduced market share, the actual number of policyholders has greatly increased.

Leveraging globalization

Recognition of the benefits of foreign participation to the Indian economy and consumers is at the heart of the Indian Finance Ministry and IRDA’s support for a proposal now before the Indian Parliament to increase the foreign investment limit in the insurance sector from 26 per cent to 49 per cent. This increase will allow insurance companies to absorb new capital, which will facilitate industry expansion, the deployment of technical competencies, and the inflow of the latest products and services.

The restrictive era in foreign investment policy was consistent with a high level of trade protection and wave of economic nationalism that perceived foreign investment to mean a loss of sovereignty and foreign acquisitions. India has put that era firmly behind it. The mindset now must change. Foreign direct investment (FDI) brings to the recipient country not only capital and foreign exchange, but also managerial ability, technical knowledge,

administrative organization, and innovations in products and production techniques, all of which are scarce commodities. These benefits are not immediately apparent in the economy because it takes time to develop. However, there is enough empirical evidence to prove that with FDI the economy is better able to provide higher productivity and bigger job pools.

Given the imperative of attracting FDI for increasing India's GDP growth rate, we need to lower barriers and, in cases where we believe the barriers must stay, have watertight arguments in favour of retaining those barriers. Any such barrier cannot be justified in the case of insurance. Insurance deregulation has also meant that the Indian customer gets access to global expertise in a specialist industry. Besides, there needs to be some harmonization in FDI laws governing financial services. Currently there is no sectoral cap on mutual funds, while there is a 74 per cent cap on FDI in private banks. Why then should there be a 26 per cent cap on insurance? Moreover, life insurance is a special industry. It can't be financed by debt; it requires shareholder capital.

Life insurance is a long gestation business and requires significant amounts of capital. A significant portion of the capital deployed is put aside for maintaining the required solvency margin. Some recent estimates reveal that to build a company the size and reach of the Life Insurance Corporation of India would require anything between Rs. 15,000 to Rs. 20,000 crore. The total capital deployed by the dozen life insurance companies is around Rs. 3,300 crore. The potential for growth is enormous and Indian capital markets are not deep enough to support this exponential growth. FDI can effectively bridge that cap.

Foreign capital will allow the people of this country to enjoy higher rates of economic growth, employment and a higher standard of living. The country will ultimately benefit immensely from removing all caps foreign investment. Limits on foreign investment or product competition in markets like insurance only inhibit the successful restructuring of these markets.

There are other issues that need to be addressed:

- ***Simplification of life insurance laws:*** Many of the existing laws are overlapping and contradictory and there are gaps that need to plugged.

- ***Traditional life insurance products need to be encouraged:*** In an underinsured country like India, where life insurance awareness is low, traditional products where life insurers manage risks should hold precedence over market-linked products. The current excessive tilt towards unit-linked insurance plans needs to be redressed.

- ***Self-regulation would be good for the industry's all-round well-being:*** The industry should show maturity and develop a robust self-regulatory framework that minimizes the need for top–down mandates. Agreement on noncompetitive, non-threatening agendas among life insurers should be possible.

- ***Fully leveraged reinsurance:*** In the initial stages of its development and growth, the Indian life insurance industry needs to fully leverage all resources possible and financial reinsurance should be allowed.

Multiple benefits

India has traditionally been a savings-oriented country and insurance plays a critical role in the development of the Indian economy. As one of the three pillars of financial systems, insurance serves a distinctive role in managing risk, providing for financial security, and mobilizing capital for investment.

The role of insurance in the economy is vital as it is able to mobilize premium payments into ready capital. As such, it is a key sector for development and a key area for attention for trade liberalization/negotiations. In the Doha round, countries have an opportunity to capture the benefits of liberalizing insurance and other financial services sectors. Perhaps the same questions, which preceded the insurance sector opening in India, are being asked in other world capitals. The questions are important and valid. The evidence for liberalization and the benefits to your citizens are tangible and positive.

Our experience in India is a significant case in point. The World Bank's 2001 report on "Global economic prospects for developing countries" indicates that liberalization of services could provide as much as $6 trillion in additional income in the developing world between 2005–2015.

Services underpin economic development efforts because more efficient provision of services in finance, telecommunications, transportation and professional business services would have broad linkage effects that make entire economies more efficient and globally competitive.

Conclusion

Market opening in India has heightened the public's awareness of the need for insurance, created new job opportunities, increased education on financial planning, brought new products and specialty lines, and advanced innovation in the sector. In India – as in other countries – the increased awareness of the benefits of insurance has created a greater demand that new foreign players have helped to fulfill. The pie does not get smaller for insurers already operating in a market – it gets bigger, it expands with new players.

That view was confirmed in a study commissioned by APEC that is available here today. In an August 2004 report on the benefits of financial market liberalization, Professor Kim Dietrich of the University of Southern California concluded that foreign direct investment had an overwhelmingly beneficial impact on domestic financial market participants.

The bottom line is that we all stand to benefit if the Doha round is successfully concluded. And any definition of success must include meaningful market liberalization in financial services.

XIII. An Indian perspective on the insurance sector

JB Boda Insurance[130]

Growth of general insurance business in India

- 1974: Rs 2 billion
- 1998: Rs 75 billion
- 2000: Rs 100 billion
- 2005: Rs 180 billion

The twin mantras for liberalization are:

- There is a potential need for insurance protection in the country which is still to be tapped.
- The changing scenario with increased private participation will enhance client level service and improve efficiency in claim settlements.

India is a signatory to the Agreement Establishing the World Trade Organization, of which the globalizatio of trade in services is an important objective.

Life insurance posted equally good results.

Management of private insurers

Under Indian law the local partner needs to invest 74 per cent or more of equity and only 26 per cent foreign equity is permitted. The Indian partner controls funds and treasury operations while the foreign partner manages the operations. The initial focus has been on volume sales and large premiums due to limitation of infrastructure, high cost of expertise and overhead costs. Social obligations to write rural insurance are complied with. Government insurers have a good network of offices throughout the country which will be difficult for private players to match in the first few years.

India`s agreement under GATS is being renegotiated.

Insurers are expected to have increased FDI of 49 per cent; law requires amendment.

[130] Indian insurance services supplier with operations in Hong Kong, China; Singapore; London; and Kuala Lumpur.

Intermediary

Prior to 2000, the only recognized intermediary was the agent. Corporate agents were allowed in 2000. Brokers have been allowed to hold a licence and operate as intermediaries only since 2002 (they are the youngest players in the market). At present, about 220 brokers are licensed in India as insurance, reinsurance or composite brokers.

> *Auxiliary services can receive up to 100 per cent FDI (this is a regulatory issue).*

Towards a free market

The market is controlled by tariff rates, regulations and policy wordings in almost 70 per cent of the volume of business being property damage, breakdown, motor and workmen compensation.

- In April 2005, Marine Hull insurance was detariffed.
- By December 2006 the remaining tariffs are likely to be removed (except possible for motor insurance).
- From 1 January 2007, insurers will be able to use their discretion for rating purposes. Policy wordings may continue to be a standard only for some time.
- The Indian Regulatory and Development Authority (IRDA) has made it necessary for insurers to “file and use” before transacting with new products. Rating guidelines are to be provided.

Mr. Harold Skipper, in a paper for the International Insurance Federation, Washington, redefines the recognition accorded to insurance by UNCTAD (1964), according to which “a sound national insurance and reinsurance market is an essential characteristic of economic growth”, to stress that it is “not merely a characteristic but is a necessity.” He lists seven parameters to assess the contribution to the economy and the same are reviewed herein. The intention is that policymakers in India would consider related issues in a larger framework of economy and law by including insurance as a serious input. Such an approach would lend weight to the IRDA as a regulator and give thrust to the emerging market. This is possible as the Government is politically stable and forward-looking.

The assumptions for the above are based on:

- Policymakers being committed to creating and supporting a competitive market;
- The Government discharging its obligation to protect ill-informed buyers;
- Insurers answering only to the host regulator.

Role of insurance in India's future

Insurance would assist businesses to operate with less volatility and risk of failure and provide for greater financial and societal stability from the growth pangs of an estimated growth rate over 6 per cent in GDP.

The Government has arranged for disaster management and provide funds for mitigating adverse consequences of calamity. Non-governmental organizations and public institutions additionally assist with fund raising and relief assistance. Besides the Government provides for social security programmes. There is considerable impact upon the Government in these respects. Insurance substantially steps in and can further step in to provide these services. The effect would be to reduce the strain on the tax payer and assist in efficient allocation of societal resources.

Facilitates trade, business and commerce by flexible adaptation to changing risk needs particularly of the burgeoning services sector .

Like any other financial institution insurance companies generate savings from the insurance sector within the economy and make available the same in well directed areas of the economy deserving investments ; a sector with potential for business as is the case with Indian insurance provides incentive to develop it all the more faster.

It enables risk to be managed more efficiently through risk pricing and risk transfers and this is an area which provides unlimited opportunities in the Indian context for consulting, broking and education in the post-privatization phase with newer employment opportunities.

The insurance industry of its own accord is interested in loss minimizat.ion. Its expertise in understanding losses assists it to share the experience across the economy thus enabling better loss control and preservation of national assets.

In its risk-pricing and investment decisions the insurance industry sets the tone for investment by others in the economy. Informed assessment by the insurance companies thus signals allocation of resources by others contributing to efficiency in allocation. In India visibility of LIC and GIC are subordinate to the Government's actions. They are two of the biggest players in the capital market in India and deserve a higher public profile in their roles as investors.

Legislative and regulatory issues

In India, legislation requires property registered in India to be insured in India and Reserve Bank of India (RBI) regulations do not permit remittance of foreign exchange for purchase of insurance overseas.

> "Persons, firms, companies etc. *resident in India* are not permitted to take insurance cover of any kind with insurance companies in foreign countries without the prior permission of Reserve Bank. Besides, permission of the Government of India under General Insurance Business (Nationalisation) Act,

> 1972, is also required to be taken in such cases" (General Insurance Memorandum, rev., 12 September 2002).

There is no compulsion in Indian law to purchase insurance (except for the few mandated covers – motor third-party liability, public liability for units handling hazardous substances, mutual fund indemnity, stockbroker's indemnity, insurance broker`s indemnity). If insurance is considered for purchase then the same is to be effected from any of the licensed insurers in India. If the intention is to purchase insurance overseas then permission is required from both the Government of India and RBI. The basis of permission is for reasons stated in GIM, other RBI regulations and, generally, non-availability of the required type of insurance in India.

The only exceptions that allow overseas purchase of insurance by residents are as follows:

1. CIF imports to India and FOB exports from India;

2. Units located in a special economic zone (SEZ).

It is of consequence to note that no insurance policy can incept unless full premium is received by an insurer. This is as per law. Installment payments are exceptionally allowed in respect of builder`s risk insurances, aviation and marine hull insurances and health insurance.

A derivative legal position is of an MNC as globally insured including their interests in India provided they do not involve their Indian operation in insurance purchase made in their country. Their Indian operation can opt not to consider purchase of insurance except for those that are mandatory.

> *Risk is proprietary and goes across borders; no Government can substitute the risk taking of an enterprise.*
>
> *Free trade and globalizing trade in services is with a view to promoting and expanding market opportunities in the long term. Detractors from this approach work on the theory of insulated and protected markets as an economic solution to social conditions.*

Mr. Bimal Jalan, a former governor of the Reserve Bank of India, has stated: "A rational view is to accept globalization as an emerging and powerful global reality. A nation should strive to maximize the advantages and minimize the risks of globalization. India is not a well globalized economy in terms of market share of global trade, foreign direct investment and foreign institutional investment. Globalization inevitably results in integration of financial markets and national economies have to follow generally accepted international norms and standards of macroeconomic management and disclosure and transparency to avoid adverse effects. India has to understand the impact of services revolution, which presently is the growth engine."

XIV. Life insurance in Africa

Basil Reekie [131]

Introduction

The purpose of this paper is to give a brief high level overview of the life insurance industry in Africa and the challenges it faces. When looking at the life insurance industry in Africa, one needs to split Africa into different regions. The reason being that the development in each region is quite different. For purposes of this paper, we have split Africa into 5 regions, namely:

- Anglophone eastern and southern Africa
- Anglophone West Africa
- Francophone Africa
- North Africa
- South Africa

Anglophone eastern and southern Africa

There are 12 countries in this region, and around 80 life insurance companies (or insurance companies writing life business). On the whole, this portion of the African market is significantly under developed. However, there are one or two companies in this region who are growing and prospering. In some countries, the majority of the business is pensions investment business coupled with group risk cover. The question is often raised, "how does one give group life cover in a high AIDS environment?"

It is interesting to note that in some of these countries, employers are prepared to pay 10 times as much for Group Life cover as they would be paying in, say, South Africa (which in turn may be twice as expensive as Europe). It is not uncommon to see 25–35 per cent of employer payrolls going towards pensions saving and group life cover.

The main problems facing life insurers in this region are:

- Low life expectancy;
- The AIDS epidemic;

[131] Basil Reekie is a fellow of the Institute of Actuaries who has spent the last 10 years working in the life insurance and pensions industry. For the past seven years he was a shareholder and director of QED Actuaries and Consultants in South Africa. QED Actuaries and Consultants focuses on providing actuarial services to Insurance Companies and Pension Funds. QED was recently sold to AON and is now a member of the Aon group of companies. Basil is also Chairman of the Life Committee of the African Insurance Organization (AIO) and sits on the executive of the AIO.

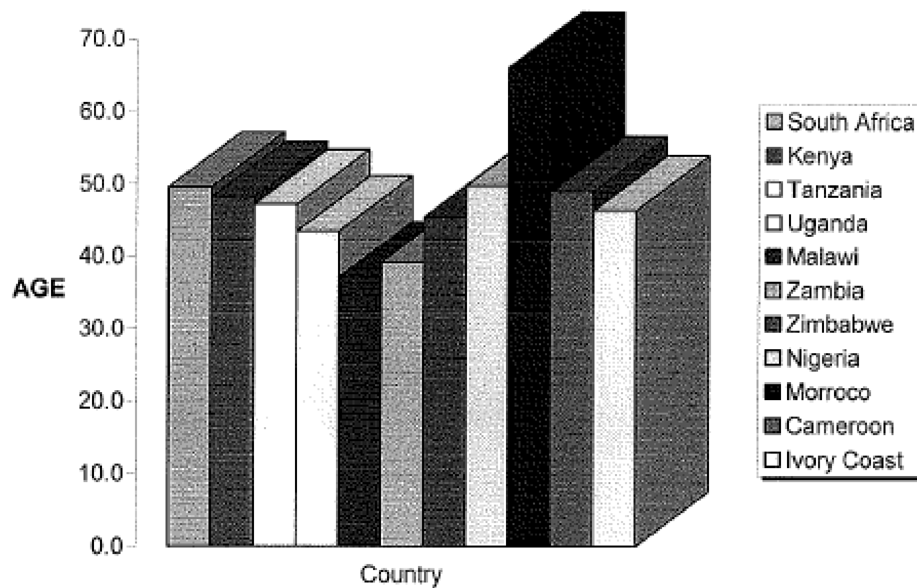
- Lack of central statistics;
- Lack of good administration systems;
- Investment markets are underdeveloped;
- Lack of management experience and insurance skills;
- Weak regulatory structure and outdated solvency measures;
- Minimum solvency basis is often meaningless.

These tend to be recurring themes with regard to problems in life insurance throughout Africa (and are not necessarily specific to the Eastern and Southern African region). We deal wth the highlights of these below:

(a) Some sample AIDS statistics for this region may clarify the picture. In Southern Africa, AIDS contributes around 10 extra deaths per 1,000 lives assured per annum and around 3 extra deaths per 1,000 lives assured in Eastern Africa (worse if one excludes Uganda) and about 4 extra lives per 1,000 in West Africa. The problem that insurers face is in pricing and reserving for products and still providing a product that gives value for money to the policyholder. Different companies have found different ways of successfully dealing with the AIDS risks, these include:

- There are companies who have insisted on periodic (say, every five years) HIV testing, otherwise premium rates for policyholders who do not undergo (or fail) the tests increase significantly;
- Many companies around Africa sell what is termed Funeral Insurance. Rates for this type of product are often much higher than normal term assurance rates and furthermore the insurer usually reviews the rates each year. Benefits are low, but cover the cost of burial;
- Companies have made innovative use of increasing term assurances and extended waiting periods in order to combat the AIDS risk (and "death bed" selling) risk to the company;
- In some countries life offices have agreed (or the Government has legislated) to ignore the HIV risk (and not test) below a certain sum assured and thus charge much higher premiums per mille for the lower sums assured;
- Universal life products have been used to allow insurance companies the ability to change mortality charges without changing the overall premium rates. This can be effective if designed correctly, however, administration and education is then vital;

(b) AIDS impacts life expectancy. The following graph, illustrates the fact that life expectancy at birth is quite different in different countries within Africa:



The differentials illustrate the need for country (or region) specific assured life statistics for meaningful product design and reserving;

(c) Another major problem is that insufficient consideration is given to the matching of assets and liabilities. This is often due to the lack of availability of appropriate investments (e.g. sufficiently long-term government bonds). Lack of expertise (and external advice on liability profiles) amongst management is also a significant factor adding to the problem;

(d) One of the significant problems encountered relates to administration. Many companies in the region (excluding South Africa and North Africa) administer their business on spreadsheets or using unreliable in-house systems. There are even some companies who do manual administration. Only a select few (usually the more profitable) companies are using reliable administration systems. This has resulted in much uncertainty regarding the solvency position of many companies. As a result, losses may only be identified too late for remedial action to be taken. Unfortunately, there are, no doubt, numerous insurance companies in Africa which are insolvent, but nobody knows! The reasons for this usually pertain to poor regulation and a lack of credible data;

(e) The regulatory framework is, in many cases, archaic (often based on the United Kingdom Insurance Act of the 1940s). In terms of solvency a risk based capital approach is almost never followed and the solvency requirements are, in some cases, pretty much meaningless. Nonetheless, there is a glimmer of hope as there are some exceptions. These include Namibia, South Africa, Mauritius, Ghana and the United Republic of Tanzania, who have new modern laws or are currently redrafting their legislation.

Anglophone West Africa

There are six or seven countries in this region; the largest by far being Nigeria. The Nigerian market (around $50 million of premium income in 2003) comprises around 100 insurers licensed to write life business; however, changes to legislation in Nigeria mean that a

significantly higher capital requirement is being introduced and thus we would expect many mergers and acquisitions and fewer life licences in the near future. If one were to combine the capital of all the existing life licences, then there would only be enough capital to establish 4 or 5 life companies under the new regime.

The issues facing life offices in this region are pretty much identical to those facing their counterparts in Southern and East Africa. However, AIDS is currently less of a problem in this region as compared to Southern Africa. Nonetheless, it is on the increase.

Francophone Africa

There are 16 countries in this region, of which 12 participate in the CIMA code. There are approximately 60 insurance companies licensed to do business in one or more of these countries. Life insurance in this region is fairly simple by European standards and is almost all term assurance or relatively simple investment business (running on an accumulation basis). The total market amounts to around $150 million of premium income with about 50 per cent of this emanating from Côte d'Ivoire.

The main challenges facing the industry here are:

- Many practitioners view the CIMA code as having restricted competitive development by being very prescriptive;
- Solvency requirements are antiquated;
- There is a lack of significant actuarial input.

Nonetheless, there are many positives in the Francophone region. These include:

- Strong local reinsurance support;
- While the CIMA code has been restrictive, it has also brought about some much-needed standardization;
- Training is better than in many Anglophone areas;
- Data is more readily available than in most Anglophone areas.

North Africa

There are five or six countries in this region, with around 50 companies writing life insurance business. The total premium income for life insurance business amounts to around $450 million annually. The regulatory environment in the French-speaking countries (Algeria, Morocco and Tunisia) is modeled on the French insurance market, whilst the regulatory environment in the Egyptian market is modeled on the United Kingdom's insurance market.

HIV/AIDS is less of a problem in these markets than in the rest of Africa. In addition, life expectancy is higher.

South Africa

The South African Life Insurance Industry is highly developed. There are currently about 70 life insurers, of which 13 write only linked investment business. Fifteen are niche players (mainly credit life or funeral insurance), with the balance offering the full range of life insurance products.

South Africa has always been on the leading edge of life insurance with some of the first linked investment products having been written in South Africa. Similarly, dread disease (commonly called critical illness insurance) was launched in South Africa ahead of much of the rest of the world and the original rating done for countries in Europe was based on the experiences of the South African market.

Hand in hand with this well developed life insurance market is a high level of penetration for life insurance. Life insurance premiums were around $24 billion in 2004 (over 90 per cent of African life insurance premium income) and this equated to about 12 per cent of GDP (compared to 3.4 per cent for Africa as a whole and 4.12 per cent for America).

However, the South African market is not immune from problems and the main problems currently facing this market are:

- AIDS;
- High withdrawals;
- The fact that small companies cannot afford good quality administration systems;
- A significant negative perception of the industry recently – particularly concerning returns on retirement and other savings product and the lack of transparency of charges on their products.

Conclusion

Despite the problems highlighted above, it is possible to run a successful Life Insurance Operation in almost any country in Africa and there are many such gems in the African insurance market which prove this point. Furthermore, there is a desperate need for life insurance on a continent which lacks investment opportunities and is plagued by AIDS and other diseases. In order to assist companies in being able to deal with these basics (and protect policyholders); the following areas need to be addressed:

- Relevant solvency regulation;
- Meaningful (and credible) assured lives statistics (particularly assured life mortality tables by region);
- New and relevant products;
- Training; and
- Updated legislation and encouragement for the industry.

Many of these changes will not be driven from within and will need to be externally motivated.

XV. Insurance as part of the financial system in Guatemala

Mauro S. Monterroso Xoy[132]

Transition from the commercial sector to the financial sector

Insurance activities in Guatemala are currently regulated by norms scattered in several laws. This has prevented them from being clearly identified within the country's financial system.

The Guatemalan Commercial Code (Decree 2-70 of Congress) regulates insurance contracts as merely a mercantile activity where the will of the parties prevails. However, regulations contain an ingredient of legal guardianship in favour of the contracting party since they are compulsory and their interpretation, as well as the interpretation of the insurance policy clauses, is to be interpreted, if there is any doubt, in favour of the insured party.

The nature of insurance has not so far diverted from Latin American countries' tradition of designating a contract as a mercantile operation in the context of private law. This precedent is important since, until two years ago, insurance entities in Guatemala were considered being more commercial sector entities than financial sector entities. Although when insurance entities were subject to surveillance by the same supervisor body of banks and other financial institutions (Superintendence of Banks), regulations and licensing granting are not ruled by the governmental body regulating the financial system (Monetary Board)[133] but by that in charge of domestic and foreign trade (Ministry of Economics and Foreign Trade).

The existing ambiguity plus a lack of recognition of the importance of insurance services development have prevented early updating of the legal framework of the insurance entities, which is scattered in several legal bodies dated in the 1960s and is anachronistic in relation with the current trends in the sector.

In 2002, financial sector laws were reformed including fundamental aspects ruling money issue, and private banks and financial consortium. Insurance entities were integrated to some extent within financial consortium, which are grouping around the strongest firm of the group – normally, a bank. Many insurance entities have emerged and developed within such consortium or groups. Thus, they have been broadly regulated and supervised by the same supervising body. This financial reform was the first step to the modernization of policy and regulation in the insurance sector. However, it is still necessary to overcome rule and regulation obsolescence.

[132] Financial services expert, Guatemala.
[133] The Monetary Board is an autonomous entity in Guatemala that sets monetary, exchange rate and credit policies, and governs the central bank.

This urgent situation has prompted a joint effort by the supervising body and private entities of the insurance sector to boost the draft of the new Insurance Activity Law, which is aimed at enhancing insurance services development in the context of the current international challenges.

With the entry into force of the new Insurance Activity Law,[134] the insurance sector will be acknowledged as part of the financial sector as both supervising authority and regulation framework will be under the sphere of the Monetary Board.

The insurance activity bill as a tool to modernize the sector

The insurance activity bill, currently in the process of being approved, updates regulating framework of the sector in conformity with the insurance supervision principles adopted in 1997 and updated in 2003 by the International Association of Insurance Supervisors (IAIS).

Although the existing regulation already complies with most of such principles, the bill incorporates or updates others like principles related to internal supervision of the insurance entities, strengthening of the supervising authority, further capital equity and reserves requirements on insurance companies, and the establishment of a regulating system on the exit of insurance companies from the market – similar to that concerning financial entities – by which insurance policy rights holders are protected.

It should be said that the bill was prepared under consensus between technical groups consisting of experts from the supervising body and the insurance private sector. Such consensus allowed adapting some IAIS principles to the Guatemalan insurance market and the sector development requirements. Therefore, while internal supervision is strengthened; other principles, like corporate management principle is adapted to the Guatemalan market. This principle is applicable in countries where stock markets developed and stock holders control the entities. In Guatemala, the insurance market consists of entities owned by small groups of investors that in many cases have direct control and participation in the decisions and activities of the entity. Well-grounded controls in developed countries with big corporations may be burdensome and ineffective in developing countries as Guatemala.

This understanding and adaptation of the supervision principles to the reality of each country was put forward at the Fifth Regional Financial Forum on "Challenges and opportunities to the development of the insurance market in Latin America and the Caribbean" held in the Inter-American Bank Center of Conferences in Washington, DC, on 7–8 November 2005. This forum recommended that "it should be secured that international supervision associations' principles work in practice as guidance and not compulsory requirements through rules".

[134] Currently, the draft of the Insurance Activity Law is reviewed by the Monetary Board to be proposed to Congress for approval.

Challenges and opportunities facing the insurance sector

The main challenges that the insurance sector faces in Guatemala, as well as in other Central American countries, concern market development and penetration.

In Guatemala, 70 per cent of the insurance activity is goods coverage and the rest corresponds to people and health coverage. The volume of net insurance premium is Q 2,200 ($289.5 million), which represents 1 per cent of GDP. The insurance industry is growing at 10–15 per cent a year, and is a source of long-term financial resources through the investment of technical reserves that amount more than Q 1,700 million ($223.7 million).

Although, insurance industry in Guatemala has assets by more than Q 2,400 million ($315.8 million), insurances exhibit relatively low penetration measured by the volume of insurance premium to GDP ratio and low density of population measured by the relation between volume of insurance premium and population.

The insurance industry is in turn properly insured by main international reinsurance companies, which were selected by the supervising entity because of their quality and qualifications. Currently, the amount of reinsurance premium reaches around Q 1,150 million ($151.3 million).

One of the main concerns of the Guatemalan insurance industry is the qualification of catastrophic risk faced in the country. In particular, the high likelihood of earthquakes, hurricanes and floods in the country puts goods and people at high risk, as well as infrastructure and productive activity, especially agriculture.

A crucial issue is the high rate of claims due to theft of and from automobiles, which has become an illegal industry that generates income by more than Q 560 million annually ($73.7 million). This problem prompts the necessity for private sector and security authorities to work together in Guatemala and in Central American countries, Panama and Mexico, due to the regional dimension of the problem. The reduction of theft and pilfering claims would result in a significant fall in insurance fees and consequently the enlargement of the automobile insurance market.

Under the Central American Free Trade Agreement (CAFTA), signed by the Dominican Republic, the United States of America and the Central American countries, which enters into force in January 2006, one of Guatemala's main commitments is to allow branches of foreign insurance companies to set up in the country within four-years of the entry into force of the agreement.[135] Although Guatemala only needs to comply with this commitment by 2009, it will actually comply with it as soon as the new Insurance Activity Law – which provides for the establishment of branches of foreign insurance companies – enters into force.

[135] Currently, business incorporation is required to foreign insurance companies wanting to establish in Guatemala.

The insurance sector's contribution to economic development

The insurance sector is one of the few sources of long-term capital accumulation in Guatemala and Central America. Thus, given the scarcity of savings in the region, one of the main contributions of the sector to economic development is precisely the promotion of saving.

Such fundamental role of insurance activity has not been well captured into economic development strategies followed by these countries. Instead of sound policies and regulations promoting the development of the insurance sector, what prevail are regulations hindering insurance market growth and, thus, long-term capital accumulation.

In Guatemala, insurance premium are subject to value added tax (VAT), which in the case of life insurance reduces coverage and constitutes a direct burden on capital accumulation since most part of premium will be turned into insurance companies' reserves for future coverage.

Another structural problem in Guatemala is the public compulsory social insurance that is run by the Guatemalan Institute of Social Security. This pension system is a distribution regime, not a capitalization one, whose structure entails the deterioration of the pension fund. The lack of policy reform in the social insurance system and the absence of transparency in regulations limit and even hinder the development of pension funds, which are crucial to enhancing saving and long-term capital accumulation.

The insurance sector also contributes to economic development through the inflow of fresh capital to relieve damages caused by catastrophes. However, due to the low penetration of insurances in the Guatemalan economy, properties insured fall short of the damages. In October 2005, Guatemala received Q 350–400 million ($46–52.6 million) to cover the damages caused by tropical storm "Stan". These funds will contribute to economic reconstruction in the zones of the country affected by the storm.

Conclusions

Some conclusions follow from the discussion above:

1. The reform of the insurance sector in Guatemala entails the incorporation of the insurance activity to the financial sector clearing the way to a development of the sector in line with current trends.

2. The insurance activity bill, currently in the process of adoption, adapts the principles of the International Association of Insurance Supervisors to the reality of the country with a view to promoting a regulation framework that strengthens insurance development in Guatemala.

3. The current supervision principles as recommended by the international supervisor associations should serve as guidance promoting the development of the sector and not become systems of burdensome compliance.

4. Problems in the automobile insurance market require joint action by national security authorities and the private sector with a view to reducing claims and, consequently, insurance fees.

5. The development of catastrophic risk coverage requires liberalization and predictability of the governmental sectors involved with infrastructure and public works.

6. The health system, as well as the social insurance and tax systems, needs to be reformed to enhance the development of pension funds.

XVI. Financial services liberalization and insurance: some key considerations[136]

Udaibir S. Das, Neil Saker and Jahanara Zaman

Executive summary

It is becoming widely accepted that a financially sound insurance industry can significantly contribute to economic growth and financial system development through efficient transfer of risks, resource allocation, and mobilization of savings. A prudent and innovative insurance sector can help reduce transaction costs, create liquidity in money and bond markets, and facilitate economic and social protection. However, surveys of the global trends in insurance indicate that the insurance sector in most emerging and developing countries has a much higher potential for development, and is often limited by low incomes, social habits and structural aspects of the real sector. Measured in terms of market penetration in developing and emerging market countries, the insurance industry is dwarfed by banks.

Given the nature of the insurance business, and in the context of a general economy-wide liberalization trend, the insurance sector can benefit from greater openness to cross-border insurance business and foreign direct investment (FDI). To be fully accrued, however, these require a set of policy and institutional preconditions. For example, regulatory issues including capital and solvency requirements, and treatment of insurance vis-à-vis the banking and securities sectors (e.g. asset and liability management), play a significant role in the successful opening up and liberalization of the insurance sector. Effective supervision of insurance companies is also important in terms of the institutional arrangements in a country for insurance supervision (e.g. in the central bank, ministry of finance or independent agency) and for monitoring and supervising foreign insurers. Other preconditions for successful liberalization in the insurance sector include macroeconomic stability, and the absence of any form of financial repression (e.g. taxation, or regulatory limitations on investment, and foreign exchange and capital account restrictions). In the absence of these types of prerequisites, there is a clear risk to the insurer's balance sheet, and its ability to manage and retail new risk products, or to manage risks associated with phenomena such as asset price bubbles.

Cross-country findings indicate that, in terms of regulatory arrangements, emerging markets and developing countries, in general, need to significantly improve several of the above-mentioned preconditions. While acknowledging country-specific factors, it is also important that country authorities further develop domestic money and capital markets, particularly the fixed-income market. Similarly, need exists for upgrading risk management practices at the firm level, and for establishing a risk-based regulatory framework. At the international level, further work is needed in terms of a harmonized

[136] This paper (written in October 2006) is based on a presentation made by Udaibir S. Das at the expert meeting on insurance services held by UNCTAD in Geneva on 24 November 2005. The authors are from the Monetary and Capital Markets Department of the International Monetary Fund and are grateful to Moses Kitonga for assistance with the data. The views expressed in this paper are those of the authors and do not represent those of the IMF.

approach with regard to disclosure requirements for insurers, solvency requirements, actuarial capacity, and training. Core supervision of primary insurers and reinsurers is also important. Attention to all these issues is critical for the benefits from liberalization to be fully accrued.

Abbreviations used in this paper

ALM/CFT	Anti-money Laundering/Combating the Financing of Terrorism
BCP	Basel Core Principles
CAEL	Capitalization, Asset Quality, Earnings and Liquidity
CPSS	The Committee on Payment and Settlement Systems
EMC	Emerging Market Countries
FR	Financial Reinsurance
FSAP	Financial Sector Assessment Programme
FSF	Financial Stability Forum
FSI	Financial Soundness Indicators
IAIS	International Association of Insurance Supervisor
IASB	International Accounting Standards Board
ICP	Insurance Core Principles
IOSCO	International Organization of Securities Commissions
ISIS	Insurance Information and Statistics
EU	European Union
FDI	Foreign Direct Investment
FSAP	Financial Sector Assessment Programme
GDP	Gross Domestic Product
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee
MNC	Multinational Corporation
NBFI	Nonbank Financial Institutions
OECD	Organization of Economic Cooperation and Development
RBC	Risk Based Capital
ROE	Return on Equity
SARS	Severe Acute Respiratory Syndrome
SPV	Special purpose vehicles
WAEMU	West Africa Economic and Monetary Union
WB	World Bank
WEO	World Economic Outlook

Introduction

The insurance sector is a significant and growing segment within the financial services sector in most developed and some emerging market and developing countries.[137] Given its growing importance and in the context of recent changes in the financial sector landscape, this paper documents some of the key trends in the global insurance sector and

[137] In line with Financial Stability Forum (2000), insurance can be classified into three major categories: (i) life insurance; (ii) non-life insurance; and (iii) reinsurance. The categorization of countries is based on IMF methodology; see the April 2006 *World Economic Outlook*.

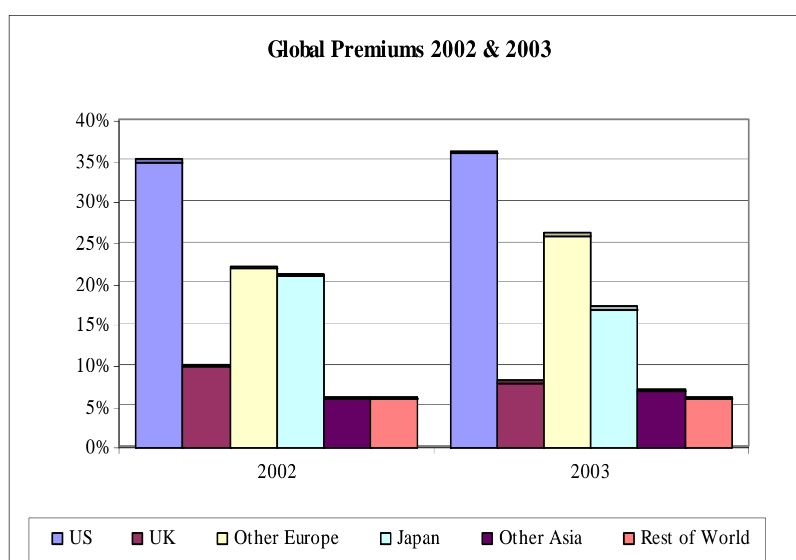
examines the prerequisites for successful liberalization of the insurance sector, especially in developing and emerging market countries.[138]

During the period 1995–2003, insurance penetration (in terms of gross premium as a percentage of GDP) among OECD members increased from 8.4 per cent of GDP to 10.1 percent. In particular, the growth was strong in the European Union, where insurance penetration jumped from 7.5 per cent of GDP in 1995 to 10.2 per cent in 2003.[139] Other factors that have contributed to the increasing importance of the insurance industry include financial consolidation, liberalization and privatization of financial institutions; the increasing use of contractual savings products; and demographic changes (see appendix I for more details on the economic benefits of the insurance sector).

Global insurance market activity is concentrated in a few major jurisdictions. Premium income for 2003 is estimated at $2,941 billion in total ($1,673 billion and $1,268 billion for life and non-life respectively). Industrialized countries dominate the market with 89 per cent and 90 per cent of the life and non-life market, respectively (fig. 1). The United States, Japan, the United Kingdom, Germany and France are the five largest markets.

The homogenization of financial services is also changing the competitive landscape for insurers in important ways. Worldwide, insurers now compete with a range of financial intermediaries and products. For example, a firm seeking to insure its plant and equipment, might instead arrange a bank line of credit as a form of contingent capital; someone thinking of buying an annuity could instead purchase a bank certificate of deposit or mutual fund. In response to this increased set of consumer choices, the frontiers of insurability have now expanded to include previously unfamiliar areas like political, financial, and operating risks.

Figure 1. Geographical breakdown of premium income in 2002 and 2003



Source: ISIS database and IMF data.

[138] Whilst there are important country-specific factors to be considered and there may be different considerations across countries, e.g. the sequencing may be different for a small economy compared to a large (albeit emerging) economy in terms of the appropriate number of market players. This paper lays out some broad themes that can be generalized across emerging market and developing economies.
[139] *OECD Insurance Statistics Yearbook, 2005* (Paris).

In addition, the manufacturing and distribution of insurance products have in cases been separated and various forms of collaboration with other financial intermediaries have evolved.[140]

Market linkages have also extended beyond the retail (product) to wholesale (market) levels. Reinsurance remains a key component of the insurance marketplace and source for credit risk placement for primary insurers in the non-life sector. Despite this, in recent years, there has been some movement away from the traditional approach of absorbing risks (including reinsurance) as insurers have been restructuring and distributing risks through capital market instruments. Insurance-related securitized operations are increasing and, although the market is still small relative to total reinsurance premium income, this market is growing.[141] For example, the growth in catastrophe bonds, one form of securitization that is used to supplement reinsurance coverage at high excess of loss levels, has been significant with approximately $1.8 billion worth of bonds being issued worldwide in 2003 through 16 issues.[142]

The insurance sector has drawn substantial attention in the context of recent liberalization trends and financial sector reform in emerging market and developing countries. Compared with the industrial countries, insurance is less significant and carries less weight in financial systems in emerging markets and developing countries (fig. 2). However, like other components of the financial system, it is also changing in response to the following key factors:

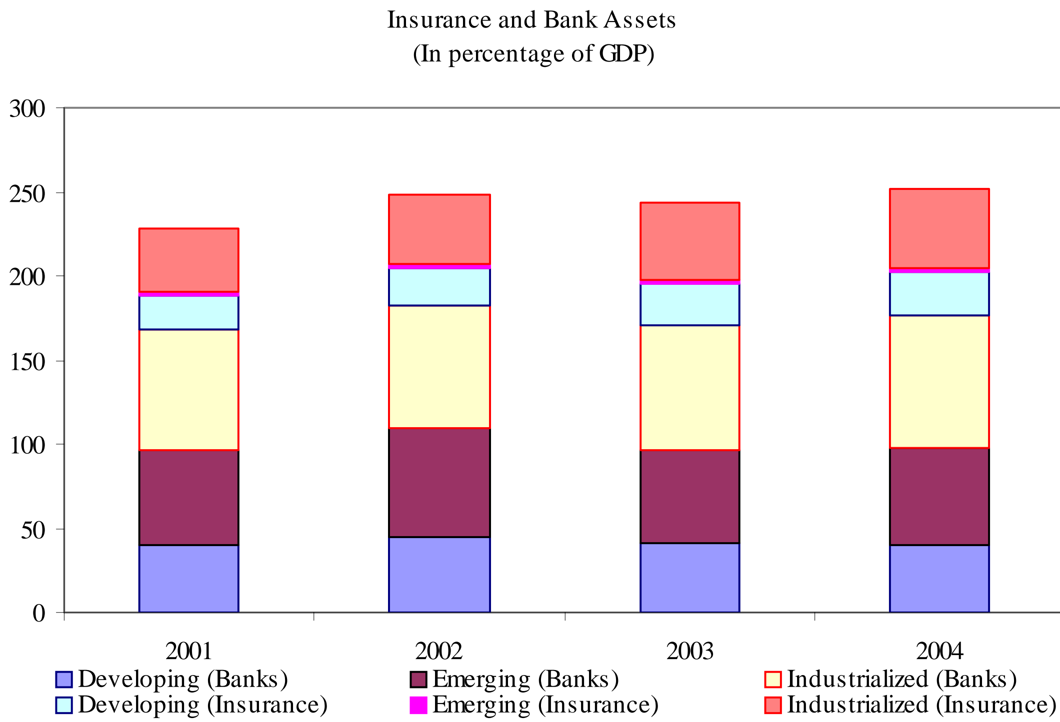
- ***Policy factors,*** including: (i) liberalization of exchange and capital controls; (ii) changes in the exchange regimes (e.g. shift toward more flexibility); and (iii) financial sector reform (e.g. privatization, market reform and deregulation, and easier access for foreign entrants);

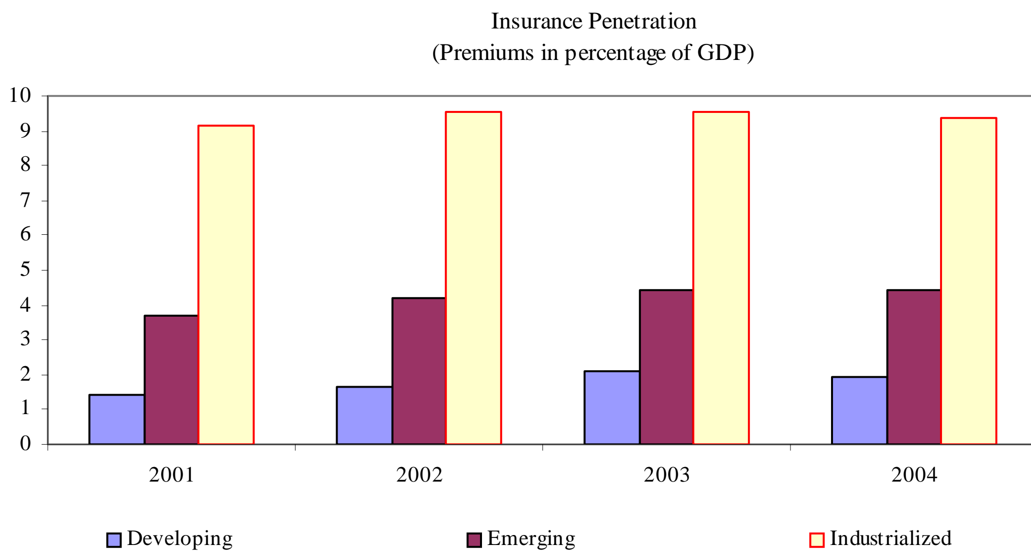
- ***Institutional factors,*** including: (i) new financial sector laws (e.g. that expand the scope of financial institutions' activities, enhance sectoral competition and permit product offerings outside traditional markets by competing more directly with banks); (ii) stronger focus on regulation and supervision; and (iii) creation of internationally diversified financial groups; and

- ***Structural factors,*** including: (i) consolidation (e.g. financial and technological innovation; (ii) increase in cross-sector competition; (iii) homogenization of financial services (e.g. differences in the products and activities of banking, insurance, and securities firms diminish); (iv) diversity with underdeveloped insurance in many emerging market and low income countries; and (v) slow pace of market development in many emerging market and low income countries, hindered by low incomes and poor policy frameworks.

[140] These arrangements range from banc assurance models, to fully integrated and merged operations including where insurers have aggressively sought to enter the wealth management industry.
[141] Total issuance of insurance related structured finance securities rated by S&P amounted to $12 billion between 1999 and June 2004, compared with net reinsurance premiums written of $163 billion in 2003. Placements of these securities are invariably through special purpose vehicles (SPVs) set up by reinsurers and often domiciled offshore. Bermuda and the Cayman Islands are among the largest registrars of such SPVs.
[142] The United States Congress Government Accountability Office has completed a study on the progress of catastrophe bond markets, with a view to determining whether their use to cover natural catastrophes could be transplanted to terrorism risks.

Figure 2. Major Trends in the Global Insurance Sector, 2001–2004





Source: IMF Insurance Database.

The following section documents the key trends in the global insurance sector, with a special focus on emerging-market and developing countries. The paper goes on to discuss the interconnectedness between the insurance and banking sectors and the general principles and framework for successful liberalization of the insurance sector. Finally, it examines some potential areas for future study, on the basis of country-specific assessments of financial stability issues, so as to ensure a sound insurance sector across countries.

Major trends and developments in the insurance sector

Global trends

A survey of the main global trends indicates:

- A high diversity associated with levels of economic development. Country experiences vary with a sharp divide between the quite positive experiences in industrial economies and a slower pace of development in many emerging market and developing countries. Although there have been some developments in certain emerging market economies, constraints still appear to limit the sector's overall growth potential.

- Cross-sectoral linkages are becoming stronger. Cross-sectoral linkages between insurers and banks have grown, either through "bancassurance" (a combination of banks and insurers) or conglomerates (broader financial groups).[143] Over the last few years, many banks and insurers have joined forces, motivated by expected synergies, economies of scale and higher revenues from cross selling each other's products, especially in Europe. While the extent of actual synergies remains to be seen, both bancassurance and financial conglomerates pose new challenges for regulators. Not only have insurers recently diversified into banking and asset management products, but also new, often complex and sophisticated, risk management products have been created.[144] Also, increased participation in complex market mechanics allows credit risk and other risk transfers.

- Recently, the occurrence of catastrophes has increased in frequency and severity leading to increased vulnerability in the insurance industry. Also demographic factors, such as an aging population, the savings gap for retirement, the pension and life sector (self-finance retirement provision), tend to impose a greater burden on the insurance sector.

[143] The conglomeration trend can be observed both in regions where conglomeration has been historically allowed (e.g. Western Europe) and in jurisdictions where restrictions on permissible activities of intermediaries have been lifted only recently (the United States and Japan). The evidence on large financial institutions worldwide indicates remarkable increases in conglomeration in some emerging market countries. See De Nicoló and others, 2003.

[144] For a more comprehensive discussion of large complex financial institutions, including insurance-led groups and groups including insurance companies, and their potential implications for financial stability, see Miles, 2002.

Regional CAEL[145] and regional developments[146]

Regional comparisons of CAEL-type financial sector indicators (FSIs) for the insurance sector indicate a range of practices and performance. North American and Oceanic life insurers have the largest capital and reserve buffers, reflecting specific prudential requirements (table 1). While Latin American companies operate with large capital levels, their reserving practice is among the lowest and only exceed the weaker systems of Africa. Latin America was also the only region with negative returns on equity (ROE) in 2002. In terms of asset quality, African insurers are significantly exposed to equities markets, a practice discouraged in other jurisdictions.

Non-life practices show similar variations. The low written premiums, high reserves and relatively high loss and claims ratios of Oceania have strained profitability (table 2). In contrast, European insurers have the highest returns of equity (ROEs). Structurally, the non-life business utilizes more reinsurance, but Middle Eastern, African, and Latin American insurers are outliers in their use of the reinsurance industry.

In the mature markets – notwithstanding differentiated outturn across countries – the primary trend for reserving has been relatively strong with strengthened balance sheets as markets benefit from improved underwriting conditions and premium increases. For example, in the non-life insurance sector, premium income increased by 13.6 per cent in Canada and 6.9 per cent in the United States. In Western Europe, life insurance companies continue to be strained by high guaranteed returns offered on policies underwritten in the 1980s and 1990s, causing reduced rates to be offered to newer and prospective policyholders. The consequent reduction in demand has been felt most acutely in the United Kingdom and Spain, which experienced 13.4 per cent and 35.2 per cent falls in volumes, respectively. The United Kingdom and Spain did, however, experience the strongest growth in the non-life sector during 2003, due largely to rate rises. Improvements in demand are anticipated with continued improvement in general economic conditions.

Table 1. Financial soundness indicators in life insurance: the core set

(base year 2002, as a percentage)

	Geographical region							
Financial soundness indicators	Western Europe	East Europe	North America	Latin America	Far East & Asia	Middle East	Africa	Oceania
Capital adequacy								
Capital/total assets	4	13	6	13	3	7	9	10

[145] Capitalization, Asset Quality, Earnings, and Liquidity.
[146] This section draws on Marston (2005).

Capital/net technical reserves	7	16	8	25	4	8	10	12
Asset quality								
(Real estate+unq. Equities+debtors) /total assets	3	11	3	6	4.0	3	0.14	5
Debtors/gross premiums written	18	34	30	26	1.0	13	7	11
Equities/total assets	5	9	2	2	1.0	2	43	14
Reinsurance and actuarial issues								
Risk retention ratio	99	99	92	99	100.0	94	100	91
Net reserves/average 3-year premiums	857	605	1784	561	734	760	462	1,242
Earnings and profitability								
Expense ratio (Expenses/NPW)	12	22	41	48	18	22	16	75
Investment income/investme nt assets	2	21	4	5	2	–1	–2	5
Return on equity (ROE)	6	26	6	–6	10	11	12	6

Source: ISIS Database and IMF data.

Table 2. Financial soundness indicators in non-life insurance: the core set

(base year 2002, as a percentage)

Financial soundness indicators	Geographical region							
	Western Europe	East Europe	North America	Latin America	Far East & Asia	Mid East	Africa	Oceania
Capital adequacy								
Net premium written/capital (surplus)	85	149	75	106	104	156	92	40
Capital/total assets	5	19	29	23	21	7	22	12
Asset quality								
(Real estate+unq. equities+debtors) /total assets	3	11	9	14	6	5	17	32
Debtors/gross premiums written	28	21	35	42	11	24	36	34
Equities/total assets	1	8	15	2	13	1	18	0.39
Reinsurance and actuarial issues								
Risk retention ratio	94	92	90	73	89	71	68	84
Net reserves/average 3-year premiums	1543	506	296	461	510	1428	575	2137
Mov’t in reserves net premium written	2	9	0	0	6	2	5	0

Earnings and profitability								
Loss ratio	77	27	84	71	66	65	69	72
Expense ratio (Expenses/NPW)	28	67	43	29	36	22	28	76
Combined ratio	105	94	127	100	102	87	96	149
Investment income/NPW	33	21	13	6	6	–5	10	64
Return on equity (ROE)	12	22	4	5	2	11	11	–2

Source: ISIS Database and IMF data.

In the emerging markets, strong economic growth and selected reforms continue to drive growth in the insurance market and this is supported by more liberal regimes with fewer entry barriers (box 1).

- Life and non-life business grew in South East Asia, especially in China driven by strong economic growth. The outbreak of SARS in Hong Kong SAR and Taiwan Province of China boosted the demand for life policies, while premium incomes in the Republic of Korea declined against a backdrop of measures to contain overheating of the economy.

- Premium income growth in Latin America has been sluggish despite strong performances in Brazil, Chile, and Argentina. Outturn in these markets was facilitated by tax reforms particularly the increase in tax-deductible life insurance policies in Brazil. In Mexico, on the other hand, changes in taxation and in the pension fund law proved detrimental to Mexico's life business.

- Strong performances in life and non-life business were recorded in the Russian Federation, the Czech Republic and the Baltic States. In the Russian Federation, the introduction of obligatory motor liability insurance and increases in premiums was a strong driver, while following the 2002 floods in the Czech Republic demand for property insurance grew markedly. In contrast to these, Hungary and the Slovak Republic recorded very slow growth in business volumes.

- Flat activity in life and a decline in non-life premiums, substantially offset steady increases in the markets in Lebanon and the United Arab Emirate. In Saudi Arabia, obligatory motor insurance and obligatory health insurance for foreign workers has resulted in the significant expansion of the largest national issuer, the NCCI.

- Life business contracted in major African markets (South Africa and Morocco) is apparently losing ground to other investment opportunities. Non-life business,

however, has been uniformly strong across South Africa, Morocco, Tunisia, and Egypt. In the case of the latter two, the growth was driven by increases in premium rates particularly in property and business interruption insurance.

Box 1. Characteristics of the insurance industry in emerging markets

The most important emerging insurance markets ordered by their total insurance premiums in 2003 were: Asia – the Republic of Korea, China and Hong Kong SAR; Latin America – Brazil, Mexico, Chile and Argentina; Eastern Europe – the Russian Federation, Poland, the Czech Republic and Hungary; Africa – South Africa, Morocco and Egypt; and the Middle East – Turkey, the United Arab Emirates, the Islamic Republic of Iran and Saudi Arabia.

Non-life business dominate the markets. In non-life, motor insurance is the dominant business line as third party liability insurance is compulsory in most countries. Property, accident and health insurance are the next biggest markets, though the size of accident and health markets varies dependent on the role of Governments in these areas. Where workers' compensation is covered by private insurers as in Latin America and Asia, these lines of business are important. Changes in liability regulations in Eastern Europe, particularly in EU accession countries has stimulated growth in the liability business. In Asia, liability insurance markets have grown also mainly due to the demand for product liability cover for exports.

State involvement in the form of State-owned insurers has lost importance in Latin America and Eastern Europe. With the exception of the reinsurance monopoly in Brazil and the State-owned insurer La Previsora in Colombia, none of the key market participants in the major Latin American markets are State-owned. In Eastern Europe, State involvement diminished as former public insurers were privatized. However, in Africa, the Middle East, and Asia, the State still plays a key role. Morocco and Egypt have State reinsurers, and in Egypt, primary insurers with approximately 70 per cent market share are State-owned. While markets in Hong Kong SAR are mainly private, public sector companies dominate the Chinese, Vietnamese, and Indian insurance sectors.

Foreign ownership is significant across most regions, especially in life business. The market share of foreign-owned insurers in Hong Kong SAR, Malaysia, Mexico, the Czech Republic, Hungary and Slovakia are all above 75 per cent. In the next quartile, (above 50 per cent market share) there are Argentina, Chile, Lebanon, Morocco, the Philippines, Poland, Singapore, and Viet Nam.

Emerging markets and developing countries

Insurance sectors in emerging and developing countries have some special features compared to those in developed countries. The following are some stylized facts:

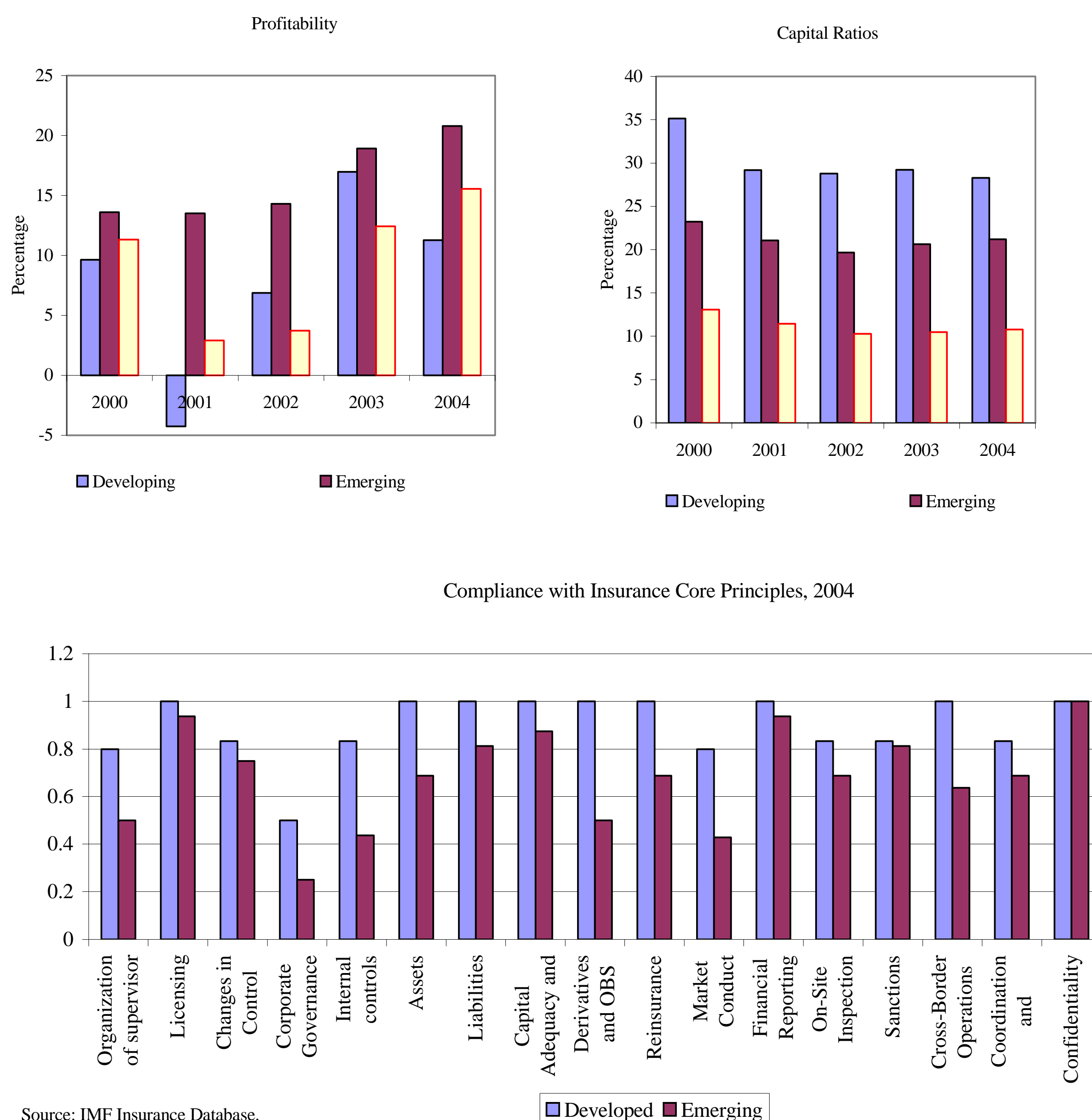
- ***Smaller size:*** The insurance sector is typically small with low penetration ratios due to low per capita incomes, and market impediments that limit the scope of the insurance sector.

- ***Underdeveloped and highly uncompetitive insurance market:*** Most insurance companies remain underdeveloped with limited actuarial capacity. The primary reason is unstable macroeconomic conditions and a high degree of financial

repression leading to negative real interest rates and capital erosion. Shallow domestic capital markets and lack of long-term instruments also cause slow progress in the insurance sector in most developing countries (fig. 3).

- ***Poor regulatory environment and inadequate supervision:*** Restrictive investment regulations hinder portfolio diversification and efficient asset allocation. There is a high degree of administrative guidance for insurance companies including price controls and priority target sectors (e.g. small and medium-sized enterprises, and agriculture).

Figure 3. Performance of the global insurance industry, 2000–2004



Source: IMF Insurance Database.

- ***Barriers to foreign entry:*** There is a high degree of protection against foreign entry, such as outright bans, limits on ownership and/or requirements for joint ventures only, and limited scope to use international reinsurance companies.

- ***Public ownership:*** Insurance companies are mostly State-owned within a limited competitive landscape or part of large domestic financial conglomerates that are opaque and whose accounts are not fully consolidated.

- ***Poor management and accounting techniques:*** Most insurance companies face problems due to poor management and investment decision making due to high moral hazard and distorted incentives. Poor accounting standards hide solvency issues which result from poor management and the high degree of financial repression. Accounting issues are particularly important as insurers are exposed to higher risks and uncertainties on the liabilities side from the estimation of technical provisions. Technical provisions are the largest liability item on insurers' balance sheets and capital plays a less significant role compared to banks. Empirical evidence would tend to suggest that more insurers fail due to inadequate technical provisions on the liability side. Interest rate is a risk for both the assets and liabilities of life insurers and foreign exchange risks could arise from asset-liability mismatches.

- ***Limited room for reinsurance:*** This means that risk remains with domestic insurers.

- ***High contingent liabilities for the Government:*** Such liabilities are due to: (i) and explicit commitment to bail out and recapitalize State-owned insurers and an implicit commitment for private insurers; and (ii) lack of product innovation such as catastrophic insurance products, which means that the State is responsible for payouts due to natural disasters.

- ***Capital markets remain underdeveloped:*** This is due to: (i) the limited duration of government bonds and the lack of well defined yield curves undermine the ability of local insurers to undertake adequate asset-liability management and heightens the risks to their balance sheets; (ii) insurers try and focus on the long end of the government bond market, and their typical "buy and hold" strategy means that secondary market liquidity is low. This further undermines market development by raising transaction costs and leading to a vicious circle of underdevelopment. Products such as investment-linked (or unit-linked) policies and insurance securitization are not developed as in developed markets.

New types of risks

There are several vulnerabilities arising from increasing conglomeration from a regulatory perspective. Besides the potential for systemic risks due to contagion, there could be conflicts of interest in the ownership structure. Large conglomerates with complex structures pose particular challenges in terms of being understood and supervised effectively.

Perhaps even more importantly, conglomeration increases the opportunities for regulatory and supervisory arbitrage, with firms channeling more risky activities to areas with

relatively less developed or less stringent regulation and supervision. Several studies (e.g. IMF, 2004, and Das, and others, 2003) explore the potential for systemic issues arising from insurance, against the backdrop of growing interlinkages between the insurance and banking sectors.

In addition to conglomeration, other forms of risk transfer within the financial sector have given rise to concern among market observers, regulators, and policymakers. For example, studies by the IMF (2002 and 2004) point out that the recent growth in credit derivatives as complex credit risk transfer instruments and the relative lack of transparency of these transactions have prompted concerns about risks migrating from the banking sector.

An IMF (2004) study finds that there has been relatively stronger growth in the credit exposure of the insurance sector compared to the banking sector. This study also argues that the broader and ongoing reallocation of credit risk could have implications for financial stability. This is despite the fact that the patterns and levels of insurer involvement in credit instruments differ widely across countries and, in gross terms, banks have conducted credit derivative transactions largely with other banks to achieve their desired exposures. Insurance companies have been found to be a net taker of credit risk through credit derivatives, but the net positions formed only a small part – generally 3 to 4 per cent – of their asset portfolios. However, this study concluded, albeit with important caveats, that the relative reallocation of credit risk between the banking and insurance sectors appears to have enhanced financial stability.

Insurance and banking: interconnectedness

Low insurance penetration vis-à-vis bank intermediation masks the systemic implications arising from ownership and financial transaction flows between banks and insurers (box 2).[147] A cursory overview suggests substantial ownership linkages to create either bank or insurance led conglomerates. For example, over 60 per cent of life insurance products in Portugal, Spain, Italy and France are sold through banc assurance arrangements; insurers are still among the largest counterparts in the credit derivatives market, and credit insurance for bank receivables is commonplace, especially in developing countries. On the liability side, of course, insurers deposit premiums in banks. These interlinkages place issues of consolidated supervision, supervisory coordination and structure, and cross-border information sharing at centre stage.

In terms of solvency issues, there are, as yet, no universally accepted standards for solvency regimes in the insurance sector. There are, however, regional pockets of commonality, for example, EU countries have very similar regimes pursuant to EU directives. Likewise, some countries have followed the United States risk-based capital (RBC) model. The diversity of regimes has led to a flexible approach to assessments of solvency based on national standards (box 3).

All regimes are based on the requirement that assets exceed liabilities by the amount of the defined regulatory margin. The valuation methodology applied to assets and liabilities is, therefore, at least as important as the calculation of the regulatory margin, or capital

[147] The Jamaican banking problems of the mid-1990s were in part triggered by solvency and liquidity problems that emerged in the insurance subsidiary of a banking-led conglomerate.

buffer, itself. Currently, there is a huge diversity in the valuation of assets, from historical cost to market value, to estimated ultimate realizable value. Likewise, there is generally the expectation that reserves for future claims will be adequate, but very little prescription or systematic monitoring of the relative strength of such reserves. Weak reserves and unrealistic asset valuations undermine capital adequacy regimes.

Box 2. Examples of ownership relations between the insurance and banking industries

Internationally active insurers

Allianz has banking subsidiaries in 21 countries, and are major shareholders in Uni Creditor (11 per cent of assets in Italy); Zagrebacka Banka (24 per cent of assets in Croatia); Bulbank (16 per cent of banking assets in Bulgaria); Dresdner Bank (7.5 per cent of assets in Germany); and Banque AGF (1 per cent of banking assets in France).

ING has banking interests in 21 countries including the United Kingdom, the United States, Canada, the Netherlands, Switzerland, Belgium, Luxembourg, and Germany, among others. For example, in Greece, through the Piraeus Bank it owns 8 per cent of banking assets. On the other hand, ABM Amro and Aegon are shareholders in ING. Global banking operations account for one third of net profit of the Group.

Largest regional insurers

Far East and Asia: *Dai-Ichi Mutual Insurance* (Japan) is involved in three of the four largest banks in Japan, i.e. Mizuho, Mitsubishi, and Sumitomo.

Africa: *Liberty Group* (South Africa) is a part of the Standard Bank Group Limited and is a major shareholder in Standard Bank Investment Corporation (Stanbic), the investment arm of Standard Bank that has banking operations in 17 African countries.

North America: *American International Group* (AIG, United States), has banking interests in seven countries, including Poland, Hong Kong SAR, India, and France. It is a major player, however, in private banking though its subsidiary AIG Private Group registered in Switzerland, which, in turn, has operations in five other countries.

Latin America and Caribbean: *Ace Limited* based in Bermuda is involved in one federally chartered Savings Bank INA Trust, in Philadelphia focused on managing trust accounts.

Middle East: *Migdal Insurance* (Israel) has as its major shareholder the Bank Leumi, which has a 37 per cent market share in the Israeli banking system.

Eastern Europe: *Ceska Pojistovna AS* a subsidiary of the financial group PPF has shareholdings in three Czech banks and one Russian bank.

Oceania: *National Australia Bank*, a subsidiary of the bank-led conglomerate National Australia Bank Group, provides insurance services in four countries.

Box 3. Generic capital buffer regimes

Capital buffer calculations are of two basic types; fixed formulae and risk-based capital formulae and are typified by the current regimes of the European Union and the United States, respectively. Both types establish a minimum by which assets must exceed liabilities. The key features of the current EU system can be summarized as setting the buffer at a specified proportion of premiums (or claims) for non-life, or a specified proportion of reserves for life business. The former is not sensitive to changes in market conditions (the buffer will decrease as premium rates decrease, not as risk profiles decrease, thus helping to create conditions for procyclicality). The latter is sensitive to reserving strength and can thus be manipulated by the insurer. This system does not adequately address asset risk. The United States system identifies certain risks, and for each risk selects a proxy from the financial statements. It applies a loading to each proxy to give a capital charge, and the combination of the capital charges gives the minimum capital buffer requirement for the company. This regime is risk sensitive though it does not fully address consistency of reserving strength.

Reinsurance practices can have a significant effect on the composition of a balance sheet and thus the ability to comply with capital adequacy requirements. The nature and usage of reinsurance is an important element for assessing the robustness of a regime. The extensive use of reinsurance means that insurers are effectively using the capital of a third party (the reinsurer), and renting that capital by means of reinsurance premiums; but this means that they are subject to credit risk posed by the reinsurers. In addition, financial reinsurance (FR) introduces a measure of opacity into such assessments. FR works by moving a block of liabilities off the insurers balance sheet for a premium, which approximates to the discounted value of the liabilities, and for which the transfer of indemnity risk is low. The immediate effect is to improve reported net asset value, but without substantially affecting the overall risk profile.

Stress tests are an effective tool in assessing the robustness of a sector, but can only be designed after due consideration of the relative strengths and vulnerabilities arising from the foregoing, namely, assets, liabilities, reinsurance, and the capital buffer calculation. A growing number of regulators apply stress tests to companies, but such tests are largely confined to the effects of asset price falls and interest rate shifts. Whereas these are useful and relatively easy to apply, they do not address the effect of under-providing for future claims.

Other important observations in the assessment of insurance sector are:

- ***Reinsurance relations:*** The reinsurance industry is a critical part of the risk management infrastructure worldwide and of particular importance in Africa, Latin America, and the Middle East. The global industry is dominated by large reinsurers.[148] In addition to the fact that many reinsurers are domiciled offshore, there are also regional reinsurers (Africa Re) – owned by a group of countries – and national State reinsurers (Brazil, IRB, and Tanzania Re), and in some cases

[148] Fitch Ratings notes that the composition of the industry's reinsurance recoverables changed in the period 1998–2002 with the portion of reinsurance recoverables due from major reinsurers decreasing and the reinsurance market in Bermuda growing.

these suffer from financial and fiscal constraints. More generally, even though reinsurance bankruptcies are rare, the fact is that record insurance losses and a slump in the stock market during 2000–03 have led to declining credit ratings.

- ***Accounting:*** The tension between prudential practice and transparency in the insurance industry has recently played out on the issue of "claims equalization reserves." Reinsurers are likely to have to access their "claims equalization reserves" to meet claims arising from the severe natural catastrophes. Equalization reserves are a contentious issue in the accounting profession. They facilitate the accumulation of reserves against large catastrophes, but are not allowed in some jurisdictions where accounting rules require that reserves be based on ex-post events. Under fair value accounting proposals, the practice would be banned as they are non-specific and forward provisions.

- ***Supervision:*** The observance of the IAIS Core principles in 42 jurisdictions indicate several weaknesses. Less than one third of the countries have satisfactory corporate governance arrangements. Asset management arrangements are also deficient in one third of the sample. Problems in managing off-balance sheet exposures occur in more than half of the countries assessed, and market conduct arrangements were generally weak. The assessments record a generally high observance with the principles on Liabilities and Capital Adequacy. However, these Principles are couched in general terms such as the need to be "adequate," and are inconsistent with data given in table 1 and figure 3. The reason for this inconsistency is the lack of objective quantitative standards against which assessments can be made.

A framework for successful liberalization

General principles

International experience has shown that successful liberalization in the financial sector significantly depends on the following factors:[149]

- ***A comprehensive and coordinated approach to liberalize the financial sector and capital-account transactions:*** The appropriate sequence of liberalization must focus on allowing longer term flows first before short-term flows; i.e. a focus on liberalization of FDI in the real and financial sector including insurance, and allowing local investors, especially pension and insurance companies to diversify overseas.

- ***Sustainable macro policies:*** It is important that inflation is low and that the exchange rate regime is consistent with macro policies.

- ***A systematic approach to safeguard financial stability,*** including: (i) a strong prudential and supervisory framework; and (ii) policies consistent with insurance and wider financial sector development.

[149] See appendix II for more details on financial sector liberalization with special focus on capital account liberalization.

However, the overall success in attaining full liberalization depends on proper sequencing and pace of capital-account liberalization. There is no general formula for success, and approaches are largely driven by overriding institutional and political concerns. Also, the speed differed widely across countries. In addition, there are complex interactions among financial sector reforms and other policy reforms (e.g. macroeconomic reforms). The following are some prerequisites for a smooth transition to liberalization in the insurance sector:

- ***An approach that is tailored for a specific country:*** As there is no general rule for success, the best approach is to adopt rules and follow policies in accordance with specific country need and circumstances. In particular, it is important to: (i) properly sequence and coordinate capital-account liberalization with other reforms, particularly financial system reforms; and (ii) adopt appropriate risk management techniques to manage risks (e.g. market risk, credit risk and liquidity risk) associated with capital flows.

- ***Effective regulatory and supervisory structures:*** Another important pillar for successful liberalization is to strengthen the prudential regulatory and supervisory framework. Templates include the total balance sheet approach under the IAIS global solvency regime and EU solvency II. The supervisory framework needs to reflect the increasing presence in the market of financial conglomerates and groups, as well as financial convergence. The major prerequisites for an effective regulatory and supervisory framework include: (i) set up clear objectives for the agencies; (ii) achieve regulatory independence, with appropriate accountability; (iii) establish arrange adequate resources (staff and funding); (iv) set up effective enforcement powers; and (v) make the framework cost efficient and reflective of industry structure.

- ***Insurance professionals:*** With liberalization comes the need for insurance professionals such as actuaries and risk managers, which are in short supply. A lot of work is still needed in developing countries in terms of capacity- and system-building.

- ***Adequate preparations for post-liberalization activities:*** Three factors assume importance in developing countries after liberalization: ability for product innovation, appropriate pricing of risk, and settlement of insurance claims.

Issues relating to foreign ownership

The insurance sector has traditionally been characterized by a general reticence to allow foreign insurers in the domestic market. Typical arguments relate to: (i) market domination and strategic considerations; (ii) higher competition that could squeeze State-owned insurers, and so impose a fiscal burden in terms of lower profits and recapitalization; (iii) “cherry picking “ by foreign insurers in the insurance market, leaving the domestic sector with more marginal and risky business and also exclusion from insurance coverage of parts of the domestic economy; (iv) capital-account considerations such as allowing foreign investors to participate in domestic capital markets; and (v) the need to delay the entry of foreign companies until supervisory and regulatory regimes have been upgraded.

However, there are a number of factors that drive further cross-border integration of the insurance sector. In particular, insurers from mature markets have incentives to diversify into emerging markets. Primary motivations include: (i) search for higher yield to gain from higher interest rates and appreciating currencies in the dynamic emerging markets; (ii) search for markets; given low penetration rates observed until this time, these markets offer large potential for market growth, to be accessed via cross-border or FDI activities. Similarly, insurers from EMs have incentives to diversify into OECD markets to gain from: (i) risk minimization through portfolio diversification and pick-up in duration; and (ii) currency matching (especially in dollarized economies where insurance contracts are written in foreign currency terms); and (iii) ability to sell insurance to expatriate communities or intermediate remittances and inbound pension or insurance flows by expatriates.

Moreover, recent studies suggest that there are many positive aspects of the insurance sector opening up. International experience has shown that the impact of the entry of foreign insurers (via foreign direct investment (FDI) in joint ventures and subsidiaries) has been largely positive. The major economic benefits associated with foreign entry are: (i) it may enhance capitalization of the overall insurance sector; (ii) higher competition leads to lower premiums; (iii) it offers new products (including longer term duration policies) and expands the market to a wider population; (iv) it allows greater domestic risk sharing through facilitating greater access to international reinsurers; and (v) foreign insurers can help promote the local bond markets and develop the yield curve. In addition, opening up the domestic insurance sector promotes the ability of local insurers to invest in global capital markets and to use international reinsurers, thereby helping in their risk diversification. However, some recent studies have indicated that the ability to leverage these benefits from foreign finance depends crucially on the absorptive capacity of the country (see, e.g., Prasad et al., 2006).

In addition, these benefits have to be carefully weighed against some disadvantages, such as the experience that foreign entry can promote dollarization where contracts are written in dollars or euros (as in many transition countries). There are issues of how to balance promoting competition with preserving a mix of large and niche players. This latter point involves addressing concentration risks of a few dominant large players and the long-term sustainability of domestic insurers that lack the economies of scale to implement sound corporate governance and effective risk management. If foreign insurers "cherry-pick" business, the domestic sector may stagnate or potentially face rapid decline. In the context of weak regulatory and supervisory structures, this may promote "gambling for redemption" type practices leading to higher risk taking.

Areas for continuing work

A number of issues arise that constitute an agenda for continuing work to enhance the process of liberalization in the insurance sector. Based on assessments of financial sector stability, the following areas assume importance: (i) implementing effective supervision of financial conglomerates; (ii) ensuring that insurance sector supervision is well organized; and (iii) enhancing the role of consistent industry standards to ensure a level playing field for international competition and internationally agreed solvency ratios.

Assessments of regulatory standards (box 4) suggest that both direct and indirect issues have important policy implications:

- ***Direct issues*** include: (i) diversity of national regulations; (ii) areas of supervisory cooperation; and (iii) comparative prudential strength of institutions.

- ***Indirect issues*** include: (i) factors affecting market development; (ii) unitary regulatory authorities; and (iii) principles-based vs. rules-based regulation.

Box 4. Evaluating good practices in insurance regulation

The IMF and the World Bank introduced the Financial Sector Assessment Programme (FSAP) in May 1999 to monitor and help strengthen financial systems in the context of IMF's bilateral surveillance and of the World Bank's financial sector development work and has since become a regular part of World Bank and IMF operations. An important component of the FSAP is to assess the effectiveness of financial supervision and regulation of banking, insurance, and securities markets. The assessments under the FSAP are based on (i) the Basel committee's Core Principles for Effective Banking Supervision (BCP); (ii) the International Association of Insurance Supervisors' Insurance Core Principles and Methodology; and (iii) the International Organization of Securities Commissions' Objectives and Principles of Securities Regulations.

Since the inception of the FSAP, 158 assessments of regulatory standards have been carried out as of the end of June 2004. These assessments have aimed at providing country authorities with: (i) a comparison of their regulatory system with the internationally accepted benchmark in this area, (ii) an identification of regulatory vulnerabilities that could feed into the overall assessment of the risks and vulnerabilities their economies are facing; and (iii) developmental needs pertaining specifically to financial regulation and to make informed policy decisions about the reforms needed. The experience so far, has however, raised the following practical issues relating to the assessment process: (i) how to assess actual implementation; (ii) the best way to account for country-specific factors; (iii) application of standards and the individual principles on the basis of their relative significance depending on stages of development and the regulatory preconditions; and (iv) cross-sectoral issues and interdependencies between standards.

The International Association of Insurance Supervisors' Insurance Core Principles (ICP) provide a globally-accepted framework for the regulation and supervision of the insurance sector.[150] These ICPs provide the basis for evaluating insurance legislation, and supervisory systems and procedures. The key principles against which actual practice is measured are: (i) the supervisor must monitor and analyse all factors that may impact on insurers and insurance markets (ICP 11); (ii) operation and information sharing must extend to all financial sector supervisors and anti-money laundering/combating the financing of terrorism (AML/CFT) enforcement authorities (ICPs 5, 28); (iii) supervision must be on both solo and group-wide bases (ICP 17); (iv) the supervisor can act to protect an insurer from financial difficulties of the group (ICP 15); (v) the group structure of the insurance sector must be sufficiently transparent to allow effective supervision (ICPs 8, 17); (vi) non-insurance activities may be restricted (ICP 6); (vii) capital cannot be inflated through group membership (ICP 23); and (viii) insurers must perform periodic stress testing (ICP 23) and risk exposures must be disclosed (ICP 26).

[150] For more details see "Insurance Core Principles and Methodology", prepared by the International Association of Insurance Supervisors (IAIS), October 2003.

Cross-country assessments reveal:

- Overall, observance differs across core principles, with several weaknesses and strengths. The area in which insurance supervision is most deficient relates to corporate governance of insurance companies. Less than one third of countries are observant or broadly observant with this core principle. This is mainly a result of unclear jurisdiction of the insurance supervisory bodies over corporate governance issues. Rules on corporate governance are to be found in general in corporate law. Also in the field of internal controls, the supervisory authorities seem to have limited jurisdiction, and the system depends on general corporate laws and regulations. The principles relevant for cross-border business appeared to be broadly non-observed in emerging market countries in 2004 (fig. 4). This is also supported by finding that emerging market countries maintain more regulatory requirements specific to the insurance sector for cross-border transactions than industrial countries do (fig. 5).

- The degree of implementation of regulatory standards in the insurance sector varies across countries (fig. 6). In general, advanced countries tend to exhibit a higher degree of compliance in all four sectors compared to those in developing countries. The higher degree of compliance in most advanced countries is associated with: (i) better confidentiality or information sharing; (ii) changes in control; (iii) better financial reporting; and (iv) high capital adequacy. On the other hand, a lower degree of compliance in most developing countries may be attributed to weakness in: (i) corporate governance or internal controls; (ii) assets or investments; (iii) organization of the supervisor; and (iv) market conduct.

- Non-observance of principles related directly to prudential rules is significantly high in developing and transitional countries compared to non-observance of all principles combined (fig. 7).

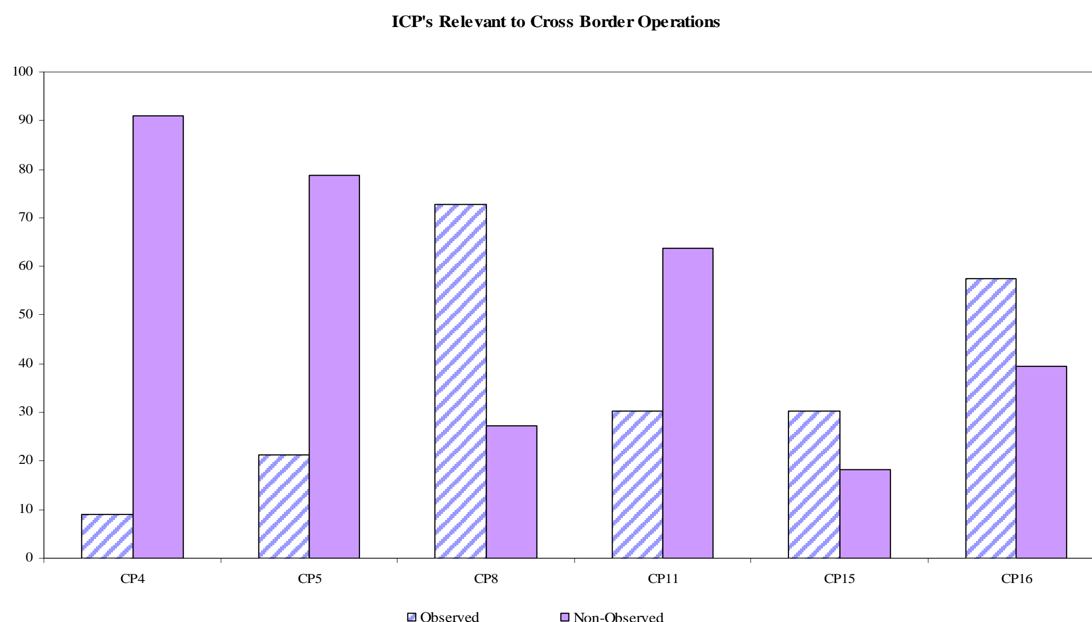
- Non-observance of principles that relate directly to regulatory governance is significantly high in developing and transitional countries compared to non-observance of all principles combined (fig. 8).

- The major areas of assessed weaknesses are related to organization of the supervisor and asset risk management. The organization of a supervisory agency needs to be improved in broadly one third of the countries assessed. In a significant number of cases, the insurance regulator was incorporated into the ministry of finance, but insufficient resources and unclear budgetary autonomy proved to be problematic in many cases. Although observance is better in this area, risk management with regard to the asset portfolio is still weakly supervised in approximately one third of countries, mostly concentrated in developing and emerging market countries. As in the banking sector, this is an area of serious concern, mainly because adverse developments in asset values would in all likelihood directly impact the financial viability of the institutions. Deficiencies also occur in supervision of off-balance sheet exposures, notably in derivatives in more than half of the countries assessed. These issues arise mainly in developing

and emerging market countries, and derive primarily from the absence of any regulations in this area.

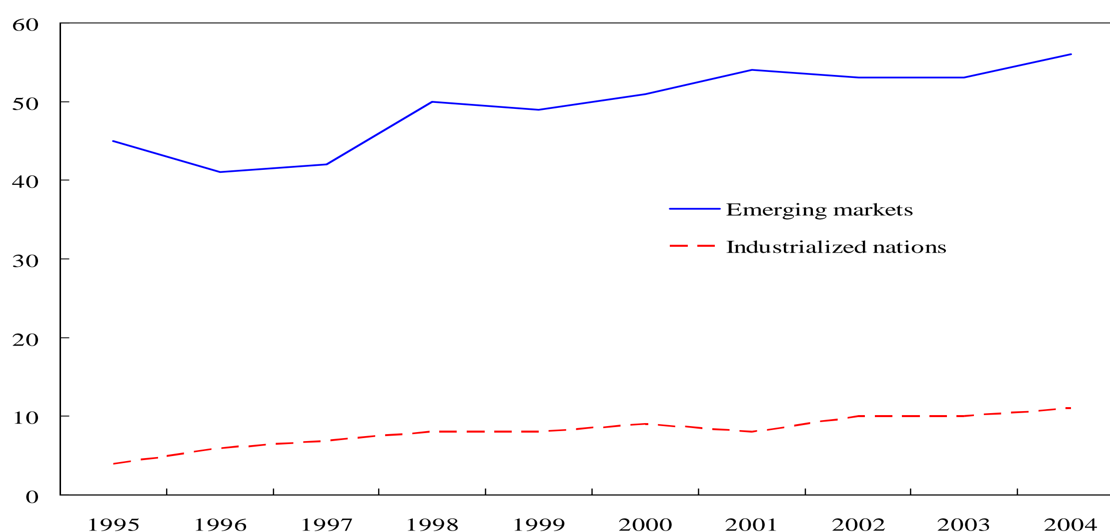
- Other areas of concern relate to market conduct. Rules were in many cases limited to rules on the registration of brokers and agents and cross-border operations. The most important issue with regard to this principle relates to deficiencies in the exchange of information with other supervisors.

Figure 4. ICPs relevant for cross-border business, selected emerging market economies, 2004



Source: IMF Insurance Database.

Figure 5. Number of countries with regulations specific to insurance companies, 1995–2004



Source: IMF, *Annual Report on Exchange Arrangements and Exchange Restrictions,* 2005.

Figure 6. Cross-sector: insurance-related stability concerns

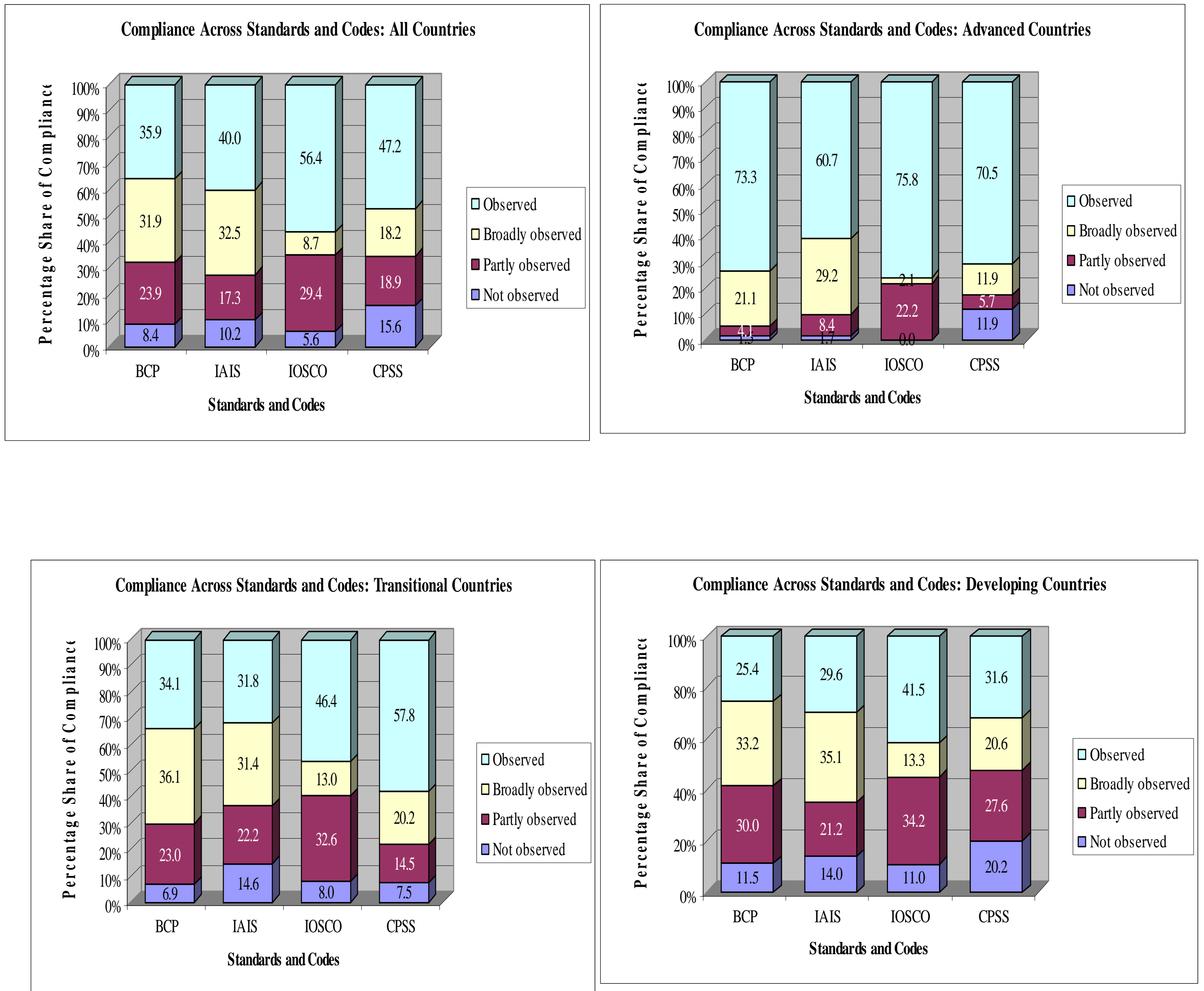
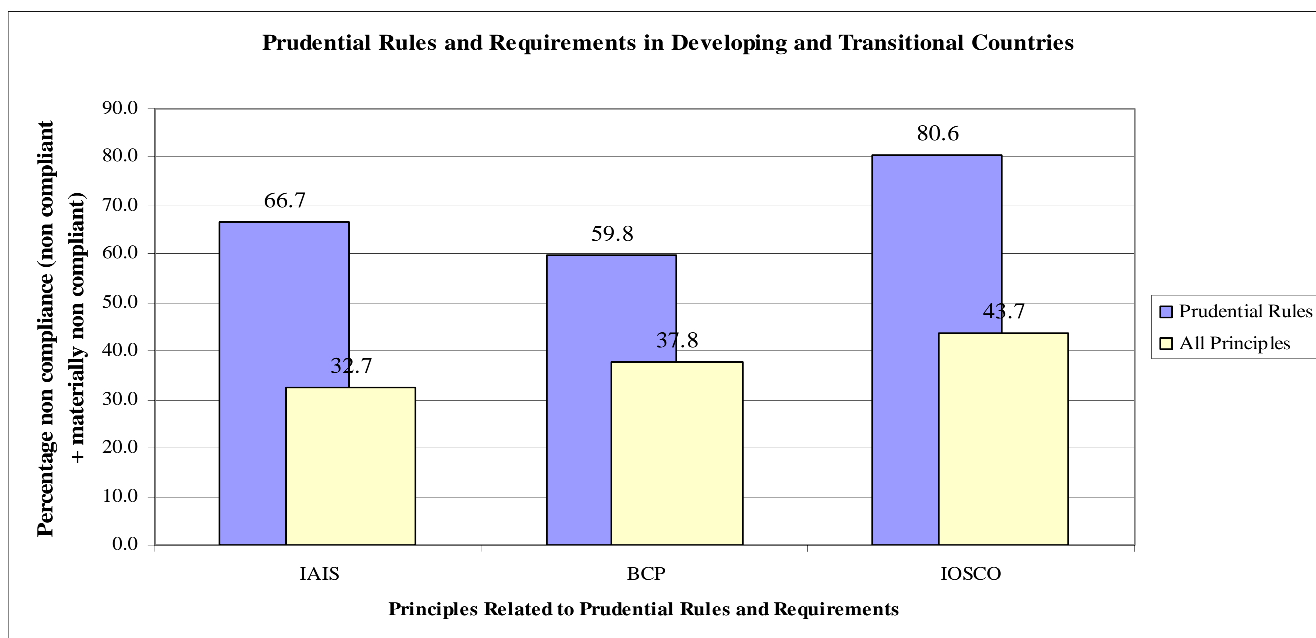
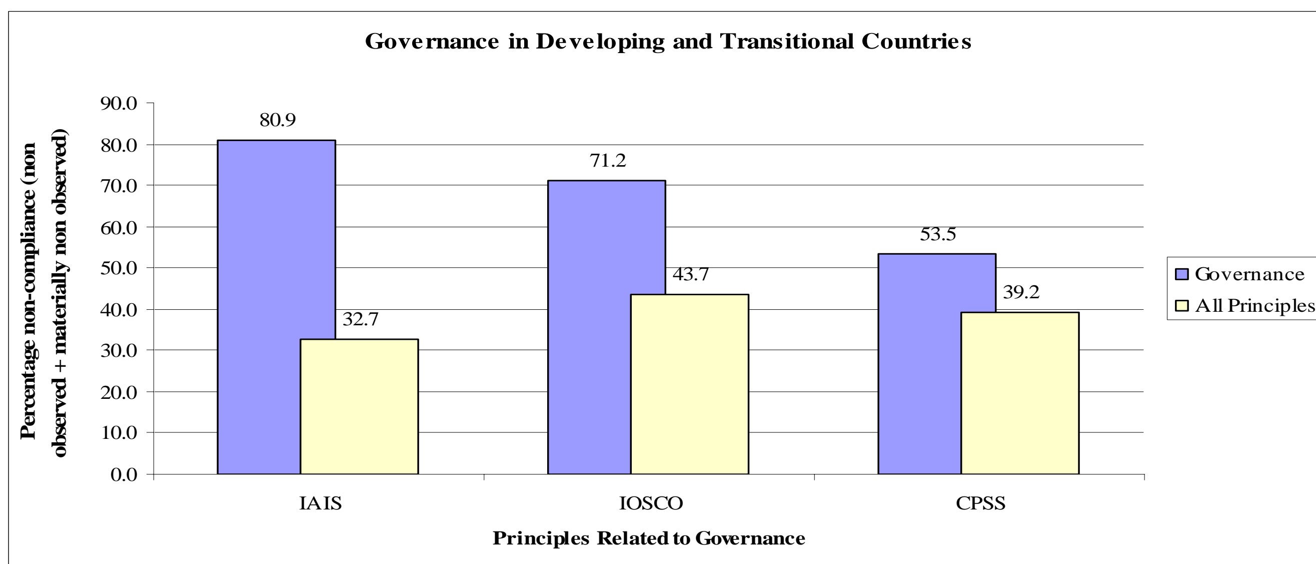


Figure 7. Prudential rules and requirements in developing and transition countries



Source: IMF Insurance Database.

Figure 8. Regulatory governance in developing and transitional countries



Source: IMF Insurance Database.

Several initiatives are ongoing by the IAIS, EU, IASB and FSF Joint Forum in areas such as capital adequacy, accounting and reporting, reinsurance, and cross-sectoral issues. A stronger and more cohesive policy and regulatory response is being developed so as to ensure best practices in capital adequacy and solvency, supervisory cooperation, cross-sectoral issues, reporting (timeliness and relevance), risk-based supervision and effective tools, and reinsurance supervision.

In addition to introducing new standards and guidance, it also important to ensure appropriate mechanisms for implementation. The following are some challenges:

- ***Practical issues in supervising financial conglomerates:*** It is important to set up special supervisory programmes for financial conglomerates, tailored to their risk profile with dedicated supervisory teams. Cooperation and strong working relationships between supervisors is key, for both cross-sector and cross-border supervision. The first line of defense against excessive risk-taking is the market itself. Robust disclosure requirements are essential for market participants to make informed decisions.

- ***Considerations regarding the institutional framework for supervision:*** It is essential to ensure that a review of existing agency structure, objectives, policies and procedures incorporates supervision of financial groups. It must include a review of laws and regulations to identify any impediments to effective consolidated supervision. Also it is important to assess staffing needs, training requirements, compensation plans, and IT resources. In addition, consideration should be given to the structure of local financial markets. Finally, it should be recognized that one size does not fit all and there is no conclusive evidence that there is a single best regulatory structure suitable for all jurisdictions. The guiding principles should be the autonomy, independence and accountability of the regulator. An appropriate structure must take into account the: (i) pros and cons of unification of the supervisory framework; (ii) role of the central bank; and (iii) alternatives to full unification.

- ***Creating a level playing field for international competition:*** A consistent approach is required for measuring solvency in the insurance industry to facilitate: (i) greater transparency; (ii) a level playing field for insurers across-borders; and (iii) enhanced communications and cooperation among supervisory authorities. In addition, further intensification of cross-border insurance business needs a common set of standards and codes and a recognized accounting framework.

- ***The role of a common standards and accounting framework:*** An important question in this context is how to assess the financial strength of insurance sectors across countries. It is a difficult task in the absence of a standard measure for solvency/capital adequacy. Two basic models exist.[151] First, under the EU-based system, only underwriting risk is included in the calculation of solvency requirements. This is also followed by many emerging market and developing countries. Second, the United States and Japanese system explicitly accounts for investment and assets and liability mismatching risks in addition to underwriting risk. The first model requires more regulations to limit investment risks while the latter model requirements are more capital based. Cross-border business and the necessary risk diversification will be hampered if countries are unable to mutually recognize each other's regulatory regimes. This increases the cost of conducting insurance business internationally.

In summary, the importance of the insurance sector for financial sector stability has been increasing, and this trend has implications for insurance supervision as it requires a

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[151] See "Solvency Assessment Models Compared", 2005, produced jointly by the Comité Européen des Assurances (CEA) and Mercer Oliver Wyman, for a comprehensive overview of solvency models.

greater focus on a broader set of risks. In this context, it is essential that supervisory authorities at a national and international level collaborate to ensure that these entities are effectively supervised so that business and individual policyholders are protected and financial markets remain stable. While regulatory and supervisory issues are important, however, it is also critical to ensure a good balance between appropriate regulation and excessive regulation that could overburden the system and raise operating and compliance costs. In addition to effective supervision, another vital precondition for successful liberalization in the insurance sector is sound macroeconomic policies due to close macrofinancial linkages.

Appendix I

The insurance sector and its role in economic development

This appendix focuses on the economic benefits of a dynamic insurance sector and discusses its impact on capital market development and financial stability and reviews some stylized facts in emerging and developing countries explaining the key reasons behind the underdeveloped insurance sectors. The economic significance of the insurance sector has been increasing recently, with insurance companies constituting a growing part of the domestic financial sector in most developed and some developing and emerging market countries.

A. Benefits of the insurance sector

Insurance has a number of important aspects:

- ***Social role:*** Insurance companies provide protection against vulnerabilities (e.g. health, accidents and disasters). Insurers and reinsurers can help promote safer safety standards which reduce output losses to society.

- ***Economic role:*** Insurance promotes economic efficiency and financial stability among households and firms by transferring risks to an entity better equipped to withstand them; it encourages individuals and firms to specialize, create wealth and undertake beneficial projects they would not be otherwise prepared to consider. For example, life insurance companies mobilize savings from the household sector and channel them to the corporate and public sectors. Insurance may actually lower the total risk the economy faces since insurers have incentives to measure and manage the risks to which they are exposed, as well as promote risk mitigation activities. Private insurance reduces call on State resources and so the size of contingent fiscal liabilities. Insurance mobilizes national savings, especially longer term savings through contractual savings schemes.

- ***Financial role:*** Long-term liabilities and stable cash flows allow the development of domestic capital markets and long-term financing of government and infrastructure. A strong insurance industry can relieve pressure on the government budget, to the extent that private insurance reduces the demands on government social security programmes and life insurance can be an important part of personal retirement planning programmes. Insurance supports trade, commerce and entrepreneurial activity in general.

B. The insurance sector and financial stability[152]

Compared to the banking sector, the insurance industry has traditionally been regarded as a relatively stable segment of the financial system with considerably lower liquidity of liabilities that help prevent contagious runs on insurance companies. However, insurance companies are not necessarily immune to financial crises, particularly when they incorporate banking type activities and/or have close business relationship with banks, including cross shareholding, placement of deposits, and credit risk transfers.

[152] Based on Das, Davies and Podpiera (2003).

Recently, a number of factors lead to a closer integration of the insurance sector with other financial institutions and so raises the risks of mutual contagion and instability. These include: (i) sale of credit protection (especially driven by Basle II, which encourages banks to reduce their own exposure through the purchase of credit protection and guarantees); (ii) emergence of insurance companies as an institutional investor in many countries underpinning government and private capital markets; and (iii) growing emergence of consolidated and fully integrated financial groups that include banks, insurance companies and pension funds.

Recent trend of financial integration and convergence between insurance companies and banks introduced an important additional risk to the insurance sector. In particular, the failure of a non-life insurance company could create a situation in which certain services are interrupted due to the loss of insurance protection for users of these services. In the case where an insurance company dominates the market, this could cause a significant and costly disruption of economic activity. However, even though costly and disruptive, the collapse of a non-life insurer is unlikely to hamper the stability of the financial system. For example, virtually all recent insurance failure episodes as discussed in Das, and others (2003) involved life insurers (or a direct link from an insurer to a bank) with (potential) systemic impact. In most of the episodes, life insurance companies actually played a role similar to banks in their investment activity (Japan and the Republic of Korea), sold deposit-like products (Jamaica and the United States), or exhibited equity or guarantee linkages to the banking sector (Jamaica and Japan).

In general, there are three main ways in which crises originating within the insurance industry can significantly disrupt financial stability:

- Some life insurers assimilate banking-type activities, on both sides of their balance sheet; their products are effectively used as deposits, which introduces the potential for the same maturity mismatch and associated problems as in the banking sector.

- Linkages between insurance companies and banks are increasingly common. Failure of an insurer may dent confidence in a related bank and lead to contagion to the banking system. The insurance industry underwrites an increasing amount of credit risk and their failure thus may directly affect the quality of bank assets.

- Reinsurers occupy a position of systemic importance to the insurance industry, for both life and non-life business. Reinsurers play a significant role in absorbing the volatility in underwriting results and peak exposures to natural catastrophes in addition to the provision of capacity to the primary market. In effect, they supply quasi-capital to insurers. The failure of a large reinsurer could result in rapid contagion to the insurers, and the failure of multiple insurers would likely have the potential to significantly disrupt the banking system and financial markets.

Although the contagion effects from failures of insurance companies may not be as virulent as in the case of banks, they have significant potential to disrupt the financial system and negatively impact the real economy.

Appendix II

A framework for financial sector liberalization

This appendix documents the experience of liberalization and financial reforms that allows the economic benefits to be accrued in most countries. However, in the context of insurance sector underdevelopment and the limited set of insurance products imply that economic benefits from insurance are often not accrued. In particular, the degree of underdevelopment is more acute in developing countries in terms of risks sharing and promoting capital market development.

The underdeveloped insurance sectors in many emerging and developing economies and the economic costs that this has entailed has prompted the move toward liberalization of the insurance sector in both domestic and external areas:

- Domestic liberalization includes privatization, allowing private sector participation in the insurance sector and the emergence of financial conglomerates that combine banks, insurance and pension providers.

- External liberalization includes cross-border insurance trade (e.g. MNCs, and reinsurance) and establishment of insurance trade (e.g. branches, subsidiaries, and agencies).

In particular, the context for liberalization of the insurance sector in the external side, has been the wider economy-wide liberalization process. The challenges of successful integration into global markets has prompted policy responses including: (i) transforming the financial system and its structure (e.g. capital account, financial institutions, and capital markets); (ii) moving towards a liberalized market-oriented system; and (iii) establishing an appropriate institutional and regulatory framework.

A. Empirical evidence: pace and sequencing

The pace of liberalization varies between mature market and emerging market countries. In mature markets the pace of liberalization remained uninterrupted compared to liberalization reversals in emerging markets following bouts of crises which reintroduced capital controls and restrictions. Evidence on sequencing of liberalization is also mixed. Industrial countries liberalized their capital account and capital markets first; Asian countries used mixed approaches; and Latin America liberalized the domestic financial sector first.

However, the key policy measures typically followed in the liberalization process are the following:

- Liberalize interest rates and credit regulations.

- Introduce market-based monetary control procedures.

- Institute internationally recognized prudential and legal framework.

- Eliminate restrictions and controls by: (i) liberalizing payments and transfers for current international transactions (e.g. accepting IMF article VIII obligations);

and (ii) liberalizing controls on capital transactions (e.g. inward and outward FDI and cross-border flows initially at the long end).

- Liberalization of foreign entry. Overall, a global trend towards liberalization of foreign entry in domestic financial sector (banks) has been observed in recent years. Foreign-controlled assets increased by 40 per cent between 1995 and 2002. However, the degree of liberalization varies across regions with substantial increase in Latin America, Eastern Europe, and only a modest change in Africa, the Middle East and Asia. Also, the IMF Annual Report on Exchange Arrangements and Exchange Restrictions, shows that in 2003, 69 countries maintain some controls on foreign ownership of domestic financial institutions: (i) limits on the ownership share in total assets and capital; (ii) limits on voting rights; (iii) requirement of approval to acquire shares exceeding specific limits; (iv) controls on opening of branches of foreign banks; and (v) limits on investments in certain types of banks.

Empirical evidence on liberalization experiences across countries suggest that in general, financial development improves along with output growth; evidence is most clear in terms of banking sector liberalization. In particular, better capitalized banks support high credit growth and higher credit/GDP ratio, and, better quality services. Evidence on foreign ownership indicates that in general more foreign entry in the domestic financial system tend to lower the likelihood of fragility (see, e.g., Detragiache and Demirguc-Kunt (1998); Detragiache and Gupta (2004)). On the other hand, State ownership tends to increase financial fragility (e.g. Barth, Caprio and Levine (1999)).

Liberalization and financial reforms may also entail some potential risks to macroeconomic and financial stability, as well as policy challenges. In particular, there are many evidences of banking crises in countries which moved rapidly towards capital-account liberalization. Primary reasons are associated with (i) lack of strong institutional environment; (ii) unsustainable macro policies – particularly exchange rate policy; and (iii) premature capital-account liberalization when the financial sector was both weak and undercapitalized, and poorly regulated and supervised. Also, recent studies indicate that the macroeconomic effects of financial globalization crucially depends on certain threshold conditions relating to financial market development, institutional quality, governance, macroeconomic and trade policies (see Kose et al., 2006).

B. Capital-account liberalization: challenges to financial stability[153]

Capital-account liberalization may involve potential risks to macroeconomic and financial stability, as well as policy challenges. Under certain circumstances, liberalization may lead to capital inflows that fuel a sharp expansion of domestic credit, raise domestic demand and inflationary pressures, increasing the risk of real exchange rate appreciation and a worsening of the external current account balance and of asset quality in the balance sheets of financial intermediaries.

If persistent, these trends may render an economy more vulnerable to sudden reversals in capital flows, particularly in situations where short-term flows are sizeable and mismatches in sectoral balance sheets are widespread. The liberalization of certain types

[153] Based on IMF (2002) study on capital-account liberalization.

of capital movements may also lead to increased risks to financial sector stability, particularly in the context of an underdeveloped financial sector with weak regulatory and supervisory frameworks. That said, the recent experience with several capital-account crises has also shown that foreign banks can help sustain economic activity, especially by lending to exporters, in situations where the domestic banks are exposed to acute adverse balance sheet pressures.

Capital inflows may finance high levels of domestic absorption, resulting in an overheating economy and a real exchange rate appreciation. In particular, capital inflows may generate excess liquidity in the domestic economy through rapid credit growth, which in turn risk being channeled into speculative investment, such as real estate, as evident from some recent financial crises. As resources are reallocated away from the traded goods sector into the (typically, less productive) nontradables sector, inflationary pressures, including on asset prices, mount, putting pressure on competitiveness and the external current account.

In extreme circumstances, an open capital account could also expose countries to sudden reversals in private capital flows, and potentially to financial crises. Experience has shown that short-term flows tend to be more volatile than longer-term investments and more prone to sudden reversals, given their high sensitivity to domestic and foreign interest rate differentials, changes in exchange rate expectations, and potentially abrupt changes in market sentiment. Hence, if an open capital account results in a rapid accumulation of short-term external debt, it could make the member more vulnerable to rollover risks and, ultimately, a liquidity crisis. The impact of a sudden stop on the economy can be amplified by a large rollover requirement of the sovereign, a credit crunch or, worse, a run on bank deposits, and result in severe spillover effects on the economy. Moreover, in cases in which a sovereign is exposed to substantial rollover risk vis-à-vis nonresident investors, sudden stops could contribute to a default by the sovereign on claims held by the domestic private sector. In such situations, crises can deepen on account of balance sheet interlinkages between the sovereign, the financial sector, and the domestic private sector. Of particular concern are those associated with sovereign debt held by the banking system, since a default by the sovereign can render an otherwise healthy banking system insolvent.

Capital-account liberalization could also pose risks to the financial sector more directly. Access to foreign financing could expose the financial sector to a number of balance sheet vulnerabilities, which may be exacerbated in the context of weak regulatory and supervisory systems. In particular, an open capital account could greatly increase the adverse consequences of excessive risk taking and imprudent lending by poorly supervised banks and other financial institutions through (i) foreign currency and maturity mismatches in balance sheets and deteriorating asset quality; and (ii) the emergence over time of speculative asset bubbles.

Financial stability is being challenged by greater integration of domestic banking systems into global financial markets. Many EMCs have liberalized their domestic financial sector, leading to greater financial intermediation, and an increase in the importance of the sector in the overall economy. This has, however, also heightened the sensitivity of the broader economy to developments in the financial sector, owing inter alia to the possible emergence of balance sheet mismatches and sudden reversals of capital flows. In particular, the interaction of capital-account liberalization and financial sector

deregulation has led to the emergence of new players in capital flows and a more complex pattern of flows between industrial and emerging market economies.

A number of challenges are involved with capital-account liberalization process. These include:

- Domestic financial sector liberalization in combination with capital-account liberalization has often led to a strong presence of foreign banks in the domestic market. On the one hand, this enhances competition, improves banking practices, contributes to the development of human capital, and mitigates the impact of a domestic credit crunch. On the other hand, however, it makes the overall economy more sensitive to capital flows to the extent that these banks intermediate foreign inflows into rapid credit growth, possibly contributing to an increase in the amplitude of business cycles.

- More non-bank financial institutions (NBFIs) in industrial countries, including insurance companies, pension funds, and leasing companies, are serving as sources of external financing and of risk transfer to emerging market countries. These forms of financing may be prone to sudden reversals and could undermine financial stability.

- In addition, nonfinancial corporations are increasingly the recipients of external debt and equity flows to emerging market countries. This financing is clearly growth enhancing for many countries. However, these nonfinancial entities are typically not supervised and often not even monitored by financial supervisors. Moreover, new products generated by their presence are often not well understood by supervisors. Some of the newer capital controls have been aimed at these flows.

- The rapid growth of financial derivative transactions poses new risks. These may include, inter alia, a transfer of risk without necessarily involving a transfer of capital, and the fact that the supervision and regulation of such off-balance sheet transactions often has not kept pace with innovations in their design.

- Finally, while capital-account liberalization can contribute to increased exposure of domestic borrowers to (short-term) foreign-currency lending – increasing the vulnerability of the country to currency mismatches and sudden shifts in investor sentiment – liberalization can help to reduce other types of risks. For example, by reducing the cost of borrowing, widening the potential number of funding sources, and enabling economic agents to choose from a wider range of assets to invest in, the dismantling of capital controls may help to decouple lending from the macroeconomic cycle and, particularly in the presence of appropriate banking regulation, reduce balance sheet vulnerabilities.

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XVII. Globalization and insurance: the challenges ahead for developing countries from the African viewpoint

Bakary Kamara[154]

Introduction

The landscape of the insurance industry in Africa has gone through profound changes in the last four decades. For instance:

- In the 1960s, a combination of liberal legislation, a favourable economic climate and the emphasis by UNCTAD on the importance of insurance in national economies led to the rapid establishment of national markets with the creation of local companies with public/private shareholding and foreign participation.

- The 1972 UNCTAD resolutions encouraged States to set up local insurance and reinsurance companies. All over Africa, local companies were registered in line with these resolutions. In a number of cases (22 States), monopolies were established.

- The economic recession that started around 1980 in many African countries, and which lasted for more than fifteen years, led to a stream of failures in most regulated economies. The downturn had its effect on free markets as well. Structural adjustment programmes were introduced to combat these economic problems, leading to market liberalization and the privatization of public enterprises, including well-managed firms. The insurance sector was not spared from the general trend leading to the establishment of new private companies. Swaziland is the only country left on the continent with a government monopoly, though this situation may not endure for much longer.

- While some national insurers and reinsurers such as Reinsurance Company of Mauritius (RCM) and Caisse Nationale de Réassurance, Cameroon, have been liquidated, a few are in the process of privatization.

The General Agreement on Trade in Services (GATS) has put pressure on national Governments to open up their insurance sectors to foreign operators and give them equal market access. In this regard, the African Insurance industry finds itself at a crossroad, with only 13 out of 41 WTO members making a commitment to comply, at least in part, with the Agreement.

This modest contribution to current studies aimed at achieving further progress in GATS negotiations on insurance services will focus on the following areas:

[154] Managing Director/Chief Executive Officer, African Reinsurance Corporation (Africa Re).

- Features of the African insurance market;
- Africa Re – corporate profile and financial highlights;
- The challenges ahead for insurance services in Africa.

Characteristics of African markets

Direct market

In 1998, there were 580 companies in the industry in Africa, including 157 in Nigeria, 120 in South Africa and 41 in Kenya. In 2004, the number of Nigerian companies fell to 110, bringing the number of companies in the continent to about 550.

It should be noted that in the past few years a number of new companies have been formed in East Africa with the liberalization of the Ethiopian, Mozambican, Tanzanian and Zambian markets.

As our objective is to analyse the behaviour of the African insurance market from the point of view of globalization as compared to other regions of the world, a comparison of their respective sizes would be instructive. The comparison is shown in tables 1 to 5 below.

Table 1. Evolution of market shares in the world (in millions of US$)

Region	1998	%	2004	%
America	817,858	37.95	1,216,899	37.51
Europe	699,474	32.45	1,198,184	36.94
Asia	571,272	26.50	736,036	22.69
South Africa	24,520	1.15	30,682	0.95
Rest of Africa	3,972	0.19	6,927	0.21
Oceania	37,872	1.76	55,178	1.70
Total	2,155,268	100.00	3,243,906	100.00

Source: Sigma.

Table 2. Details of the market share of Africa in 2004 (in millions of US$)

Region	Premium	Percentage of world market share
South Africa	30,682	82% of 1.16%
10 African countries*	5,233	14% of 1.16%
Other African countries	1,594	4% of 1.16%
Total for Africa	37,609	1.16%
World	*3,243,906*	*100.00*

* Algeria, Angola, Botswana, Egypt, Kenya, Mauritius, Morocco, Namibia, Nigeria and Tunisia.

Table 3. Breakdown of income between life and non-life in Africa, 2004 (in millions of US$)

Region	Life	Weight	Non-life	Weight
South Africa	24,381.00	1.32%	6,301.00	0.45%
10 African countries*	1,529.00	0.08%	3,802.00	0.27%
Other African countries	331.00	0.02%	1,263.00	0.09%
Total for Africa	26,241.00	1.42%	11,366.00	0.81%
World income	1,848,688.00	100.00%	1,395,218.00	100.00%

* Algeria, Angola, Botswana, Egypt, Kenya, Mauritius, Morocco, Namibia, Nigeria and Tunisia.

Africa's share of the world insurance market was 1.16 per cent with South Africa's income making up 82 per cent of the continent's premium production (tables 1 and 2). Moreover, 41 African countries represent only 4 per cent of 1.16 per cent, i.e 0.046 per cent of the world premium. From these figures, it is obvious that the insurance industry in Africa will need a special treatment within the GATS for several years.

The reinsurance market

There are two major markets in the reinsurance subsector, namely North Africa and South Africa, as may be noted in tables 4 to 6.

Table 4 (millions of US$)

Region	Insurance		Reinsurance		Cession (%)	
	2002	2003	2002	2003	2002	2003
South Africa	24,233.62	29,228.46	896.52	2,157.30	3.70	7.38
Other parts of Africa	5,139.72	6,076.32	1,427.96	1,743.82	27.78	28.70
Total Africa	*29,373.34*	*35,304.78*	*2,324.48*	*3,901.12*	*7.91*	*11.05*
World income	*2,627,000*	*2,959,359*	*142,924.70*	*163,550.40*	*5.44*	*5.53*

Table 5 (millions of US$)

Region	2002		2003		Rein/Ins Prem	
	Ins Prem	Rein Prem	Ins Prem	Rein Prem	2002	2003
North African region *	2,599.48	573.70	3,001.51	695.23	22.1%	23.2%
South Africa	24,233.63	896.52	29,228.46	2,157.30	3.7%	7.4%
Other parts of Africa	2,540.24	854.26	3,074.81	1,048.58	33.6%	34.1%
Total Africa	*29,373.34*	*2,324.48*	*35,304.78*	*3,901.12*	*7.9%*	*11.0%*

* Algeria, Egypt, Libyan Arab Jamahiriya, Mauritania, Morocco, Sudan and Tunisia

Table 6 (millions of US$)

Region	2002		2003	
	Ins Prem	Rein Prem	Ins Prem	Rein Prem
North African region *	8.8%	24.7%	8.5%	17.8%
South Africa	82.5%	38.6%	82.8%	55.3%

Other parts of Africa	8.6%	36.8%	8.7%	26.9%
Total Africa	*100.0%*	*100.0%*	*100.0%*	*100.0%*

* Algeria, Egypt, Libyan Arab Jamahiriya, Mauritania, Morocco, Sudan and Tunisia

There are currently about 30 reinsurance companies legally established in the continent including the three big international reinsurers – Swiss Re, Munich Re and Hannover Re, all based in South Africa. Three domestic reinsurers are multi nationals – Africa Re, Cica Re and Zep Re. They were established with the objective of promoting the development of the African insurance/reinsurance industry. Nine of these companies (Kenya Re, CCR-Algeria, Egypt Re, Namib Re-Namibia, National Re-Sudan, SCR-Morocco, Tunis Re, Tan Re-Tanzania, Sen Re-Senegal and Ghana Re) have the Government as the majority shareholder although the privatization of some of them is in progress. Two former national reinsurers have been fully privatized, namely Zim Re and Nigeria Re.

Furthermore, a private company Aveni Re was set up early this year at the initiative of several insurance companies of the CIMA zone, following the creation of three such private enterprises in Nigeria (Continental Re, Globe Re & Universe), one in Ghana (Mainstream), one in Kenya (East African Re), one in the Tunisian offshore zone (Best Re) and Uganda Re.

The biggest reinsurers in 2004 are shown in table 7.

Table 7. Reinsurance subsector: gross premium income ('000)

Region	**2004**	**Ppn**
Swiss Re (S/A)	492.385	12.02%
Munich Re (Mauritius+S/A)	469.935	11.48%
Hannover Re (S/A)	336.895	8.23%
Africa Reinsurance Corp. (Africa)	287.177	7.01%
SCR Morocco	263.723	6.44%
RGA Re (S/A)	65.143	1.59%
Egypt Re	64.319	1.57%
Subtotal	*1,979.577*	*48.34%*
Total for Africa	*4,095.000*	*100.00%*

Some 31.5 per cent of Egypt Re's business is non-Egyptian income. What makes up the non-Egyptian market is not readily available.

SCR income for 2004 is not readily available. We have used 2003 figures adjusted by 5 per cent to arrive at 2004 premium income. The foreign element is 4.77 per cent of the income. An estimate of $12.583 is assumed as foreign business for 2004.

Table 8. Overview of the performance of established reinsurance companies in Africa

	Financial year 2003			
	Net premium income	**Pre-tax operating inc**	**Combined ratio**	**Shareholder funds**
Munich Re (Mauritius+S/A)	203.5	38.8	93.3	114.8
SCR Morocco	177.1	33.5	116.1	79.4
Africa Reinsurance Corp. (Africa)	164.2	6.5	90.3	94.1
Swiss Re (S/A)	153.5	12.2	100.8	45.1
Hannover Re (S/A)	113.3	9.7	101.1	43.4
B.E.S.T Re	56.5	4.8	88.8	53.7
Egypt Re	38.2	15.6	152.7	123.8
Compagnie Centrale de Reassurance	25.8	10.1	49.3	56.3
Kenya Re	25	9.2	79.6	51.3
Tunis Re	21.2	N/A	N/A	N/A
PTA Re	19.4	1.4	117.5	9.3
East Africa Re	7.1	0.8	107.4	8.8

As may be observed in tables 7 and 8 above, African reinsurance companies are performing quite well when compared to foreign competitors established in the continent.

Profile of Africa Re

The African Reinsurance Corporation was set up on 24 February 1976 with the aim of assisting in fostering the development of Insurance and Reinsurance activities within the continent.

Africa Re's Gross Premium Income in 2004 was $299.07 million. Africa Re South Africa (including run-offs handled by the Nairobi office) was responsible for 49.12 per cent of the figure. The Corporation ranks (47) among the world top 50 reinsurers in term of net premium income (264 million).

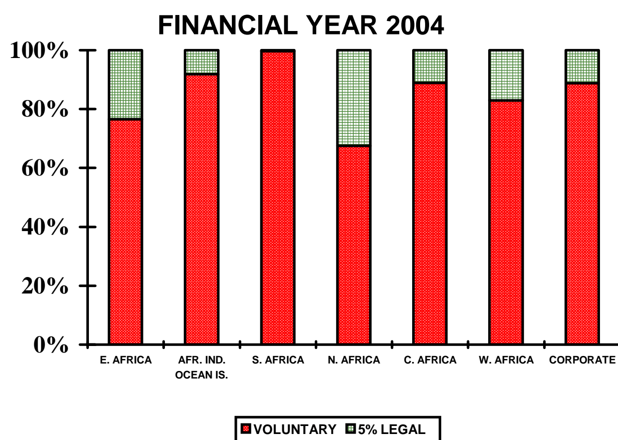
It is the desire of Africa Re to maximize incoming emanating form voluntary cessions. While in 1989, the 5 per cent legal cession on treaties from African markets yielded 67.8 per cent, in 2004 it dropped to 11.19 per cent, due to intensive marketing drive and better acceptability of the Institution security which is rated BBB+ by Standard & Poor's and A– by AM Best Europe. If not for the weak sovereign ratings of the African economies, Africa Re could have achieved better assessment, as these rating agencies link commercial ratings to the sovereign one of countries where reinsurance companies operate and/or originate from.

Table 9 (millions of US$)

	2000	2001	2002	2003	2004
Written premium	78.060	85.114	126.972	198.123	299.067
Net profit	4.281	5.540	5.709	6.502	9.650
Shareholder funds	50.049	51.617	62.840	94.077	130.023
Total assets	148.988	164.988	215.851	331.155	476.316
% of L/cession to written premium	31.08%	27.42%	20.39%	18.66%	11.19%

It is worth mentioning that the African Reinsurance Corporation has successfully completed its capital increase/opening exercise with 71 per cent of its equity held by 41 African countries, 121 local insurance/reinsurance companies and 29 per cent controlled by five AAA-rated development finance institutions, namely: the African Development Bank (founder of Africa Re) – 8 per cent; the International Finance Corporation – 8 per cent; DEG, a subsidiary of Kfw from Germany – 8 per cent; FMO, a joint venture between the Dutch Government and ABN-Amro of the Netherlands – 4 per cent; and Proparco, a subsidiary of the Agence Française de Développement – 1 per cent.

Figure 1



The challenges ahead

The issues

Competition

Premium rates are now on the low side in Africa and the situation may worsen in the years to come despite a probable respite following hurricane Katrina. Several local direct operators that are generally very small in terms of capitalization may not be able to compete effectively and could fall into bankruptcy (an indicator is the case of three companies in Mauritius). Further, the expected cross-border electronic insurance trade may be harmful to consumers and operators as well.

On the reinsurance side, we have witnessed in recent times (mid to late 1990s) an increase in the number of national/local private reinsurers as a reaction to insufficient capacity due to a relative disinterest of foreign reinsurers in African business which does not give a high volume of premium with its inherent problem of collecting balances due. However, following the spate of natural catastrophes occurring elsewhere, Africa may become very attractive to international reinsurers in the years to come, due to its limited exposure to such natural hazards, coupled with the low insurance penetration in the Continent. Local and regional reinsurers with small capital bases could then be under threat.

Legal cessions

Legal cessions on policies and treaties which have been cancelled in Nigeria and Egypt, are still in force in Morocco and Algeria, and are being progressively phased out in Kenya. Further, new reinsurance companies (Namib Re and Tan Re) are legally entitled to legal cessions but have been challenged in Court by the Cedants. For instance, in Namibia, the Government and the industry entered into a five-year deal in which NamibRe agreed to zero-rate the compulsory cession on insurance premiums. The agreement retains the provisions where insurers have to cede 20 per cent of their insurance treaties to NamibRe, which also has the right of first refusal on all other reinsurance business.

Legal cessions in respect of treaties are in force in the case of regional reinsurers: Africa Re (5 per cent), ZEP Re (10 per cent), CICA Re 15 per cent). Already with only 11 per cent of its income emanating from this type of cession, Africa Re is brassing up to the abolition of this privilege in the not to distant future. The removal of these cessions may threaten the operations of some of these reinsurers.

Localization of insurance of imported goods

This remains a legal requirement in several African countries. Its phasing out may lead to a loss of a big chunk of premium volume, thus leading to a crises in this class.

Delocalization of risks

Globalization is expected to increase the number of risk delocalizations in respect of multinationals (mega risks) and Life/Health covers. These risks shall be directly insured abroad, due the small size of many operators, the sophistication of these products and the existence of global insurance covers purchased by the Head Offices of these multinationals, thus depraving the African Insurance sector of meaningful source of business.

Possible outflow of foreign currency

It is normal for a foreign insurer established in a given country to repatriate its profit. Moreover, consumers may also settle insurance premiums to insurers based outside their country in convertible currencies

Offer of new/modern products by foreign insurers established in the country

Although this is part of the tools of competition, it is however singled out as it constitutes a major issue for developing markets as foreign insurers provide a full range of products which compete with often obsolete products in the market.

The way forward

Consolidation

In several countries, liberalization of markets is still in its infancy. In due time, however, the critical stage will be reached where consolidations would take place to ensure the overall efficiency of the system.

Markets with relatively long experience of deregulation, such as South Africa, Morocco, and the CIMA zone have already started to witness consolidation. From early 2007, the minimum capital requirement for a composite insurer and a reinsurer operating in Nigeria would be $37.5 million and $75 million respectively. This would force a number of companies into consolidation, which may further reduce the number of operators from 110 to a maximum of 30.

Consolidation among local operators as well as companies operating in the same region should be encouraged, as it will build a strong regional capacity. Regional co-insurance, which is already practiced in the CIMA zone, could also be introduced in other regions.

Regional cooperation

The level of cooperation between the developed and developing parts of Africa, as regards insurance, is still low. Increased interaction of the very developed South African insurance sector with the other markets in the continent would definitely assist sub-Saharan Africa and, to a lesser extent, North Africa in improving the skills of their various markets, especially in the following are: regulation and supervision, manpower development and product development in life assurance, terrorism and sabotage insurance, agricultural insurance etc.

Regulation and supervision

Effective and autonomous Supervisory Authorities coupled with an update of Insurance laws to reflect the modernity of our time, are necessary to check the negative effects of and adjust the inevitable globalization in Africa. The South African model has proved to be efficient in that respect. Moreover, an interactive rating at an affordable price such as that provided by the African Insurance Organization, in partnership with a reputable agency, would assist African operators in improving their reputation and acceptability of their security/credibility, as well in the competition field against well-known foreign names with subsidiaries in Africa.

Manpower development

This is a very effective means to prepare local insurers against the threat of globalization. There is an urgent need to assess the requirements of the industry (Supervisory authorities, Companies, Brokers, Actuaries, Surveyors and Adjusters). However, it must be stated that the setting up of an African College of Actuarial Sciences is imperative. The training of reinsurance underwriters and the setting up of centres for Catastrophe modelling and Risk Management must also be considered as an urgent task.

IT development

The realization of the AIO project relating to insurance software packages will greatly contribute to the efficiency of small/medium size local insurance operators vis-à-vis their foreign competitors.

Product development

Life assurance

As evidenced in table 3, the growth of Life Assurance should be given an urgent priority in Africa hence the support given by the AIO to this class of business is most welcome. Supervisory Authorities should disallow Life/Accident/Health covers given from abroad by way of the Internet or via foreign intermediaries, in order to assist in developing this class of business which is the best conduit in mobilizing long-term investment to finance economic development

Terrorism and sabotage

This type of insurance needs cross-border cooperation within Africa in view of the volume of capital needed for an adequate cover.

A pool or a fund should be established in Africa with the possible technical assistance of SASRIA of South Africa, which has been one of the first joint initiative of Government and business community (insurance industry) to address the financial/economic consequences of terrorist attacks in the world. An alternative would be the extension of the activity of the African Trade Insurance Agency (ATI) to cover terrorism and sabotage in the entire continent, as it is the case in United States (TRIA) and Europe (e.g. Pool Re in the United Kingdom, GARET in France).

Agricultural insurance

This is another area that needs regional/international cooperation, and which should be free of regulatory restrictions in Africa, on the condition that the Insurers willing to provide the guarantee to farmers are well known in the international market.

Conclusion

The challenges facing insurance services in Africa in view of the threat of globalization are enormous. Inasmuch as competition should foster a more efficient system, in Africa there is a dire need to ensure not only that consumers are adequately protected, but also that local operators are not wiped out. This is the paradox that we face today in most parts of Africa.

In this paper, we have presented a picture of an African insurance market that has both opportunities and threats as it tries to come to terms with the modern age of globalization and liberalization. We have also made some suggestions on the way forward, with specific examples that we believe will help the industry to mature and at the same time benefit from the gains of globalization. We hope to have contributed albeit modestly to develop the insurance awareness and the dissemination of the information on our continental industry.

XVIII. Insurance and developing countries: some issues for consideration

Julian Arkell[155]

Introduction

The nature of risk covered by commercial insurance policies varies across the main lines, which include:

- Life insurance
- Non-life insurance
- Accident and health
- Motor vehicle
- Property
- General liability
- Other non-life
- Reinsurance

Some of the risks covered are for the long term, such as life assurance and pension provision, and some forms of health insurance.

Insurance is a mechanism whereby “the losses of the few are borne by the many”, as it is often said. Insurance can cover personal risks related to health and accidents, ability to work and assets such as houses and vehicles, driving, travel and so on. The setting aside of funds for retirement is also important.

Organizations require insurance for their investments, and a wide range of operational risks, including loss of productive capacity, worker benefits, pensions, general liability and for many other reasons. Insurance can be looked on as a factor of production.

The State may need private sector insurance for some of its infrastructure investments, though much may be self insured. Cover might be bought in the market for a layer of higher level risk, within certain limits.

[155] The author has worked on projects in Brazil, Ghana, Jordan, Sri Lanka, Tajikistan, Thailand, the United Arab Emirates and Viet Nam and for the Commonwealth Secretariat, the European Commission, the Islamic Development Bank and other clients, which involved service sector aspects of the ACP and Caribbean countries, Chile, Egypt, the Gulf Cooperation Council States, Kenya, Malaysia, the Mercosur countries and Swaziland.

The role of insurance

The insurance sector performs various roles for the economy, in that it:

- Promotes financial stability and security at both the national and personal levels;
- Mobilizes savings and provides a channel for the efficient use of capital as a significant institutional investor;
- Facilitates credit by providing security for bank lenders in the event of borrower default;
- Encourages productive investments and innovation by mitigating the consequences of financial misfortune;
- Facilitates international trade;
- Enables the efficient management of risk, by diversifying both personal and asset risk;
- Encourages technical methods of reducing risk;
- Enables personal responsibility for certain insurance provision, thus relieving State welfare programmes of this burden – examples include life insurance, workers' compensation, medical health cover and compulsory medical malpractice cover.

The primary basis of insurance is the spread of financial loss through the pooling of risks. This is a unique role among financial services. Consumers buy policies to protect themselves against the occurrence of specific events, and insurance underwriters make provisions against the eventuality of such claims. In this manner the normal sequence of commerce is reversed, because the price – in the form of an insurance premium – is set before the service is rendered, whatever the final extent of its cost. Indeed, that total cost is possibly not known until long after the insured event has incurred.

The long-term investments made by the insurance sector to meet future claims help to stabilize financial markets. The investments made abroad – foreign direct investment – can increase the capacity and liquidity of capital markets in those countries. In this sense insurance firms act as financial intermediaries, somewhat akin to banks, some of which also sell insurance to capitalize on their distribution networks.

Insurance reduces the risk of adverse spillover effects from one sector to another as productive and trade processes become ever more interconnected, not only within countries but across regions, and indeed around the globe in a growing number of situations. General vulnerability increases as different complex systems can be impacted by such spillover from one to another in a crisis.

As economies become ever more service oriented, the risks arising from man-made systems are increasing due to value being created by performance over time, with an uncertain future. For example, the information highway based on new technologies has risks related to its stability, security and privacy. The globalization of such systems

involves an altered logic of extended supply chains and co-production, which increases market size and new product risks, and also political and cultural risks.

Insurers rely on mathematical probability techniques to estimate likely outcomes, and in the case of mass risks, the law of large numbers, provides a sound basis. However, such models are not so helpful for the less frequent occurrences, which are often also the largest ones. Insurance transfers risk not only between economic actors, but also over time, and by so doing further contributes to economic stability.

The pricing of insurance forms an important informational role in an economy, revealing the existence, frequency and extent of risks. When insurers give advice on how to improve safety and quality, they rely greatly on their databases as sources of valuable information on hard won experience.

There are limits to commercial insurability set by the capacity of insurers, by anti-selection and asymmetric information, and risks that are either too small to be worth the administrative costs of providing cover, or those where the level of uncertainty is so high that they become unmanageable. For the latter, society as a whole either explicitly or implicitly provides cover within its resource constraints.

Further there are some “killer” risks that it is difficult either for firms or the State to cover entirely by means of insurance, and require other means of solution, where this is possible. These include the loss of key personnel, goodwill and the confidence of consumers or clients consequent upon disasters.

The larger insurers offer the whole range of policies covering life and savings, and non-life, but reinsurance is usually offered by specialist firms. Insurers typically accumulate financial assets and so have to be fund managers, both as owner of the funds and on behalf of policyholders. This is one key to building up their brand reputation, and is important over the long time horizons for which they have to plan. Insurers can also provide high-skilled and well-paid jobs, with low absenteeism and accident records.

The stable supply of efficient financial services is a necessary and basic foundation of the infrastructure for a modern market economy. Insurance sales have for many decades been consistently growing faster than the increase in average income per head, and this looks set to continue. As consumer products increase in sophistication, and productive systems continually get more complex and expensive, insurance facilities are ever more crucial to economic growth and competitiveness.

Most Governments recognize the sector as an essential component of the national economy, and construct regulatory systems to ensure its long-term health and that of its customers. Due to this, the insurance system is both too sensitive and inflexible to accommodate short-term adjustments based on other national policy aims, because interference would undermine both its financial security and the very purpose of encouraging its development.

Insurance sector growth in developing countries

Where the legal system does not function reliably, and where markets remain poor and badly supervised, little foreign investment in the insurance sector is likely, because the

risks and potential returns are not commensurate with the effort and cost to establish a commercial presence, the preferred mode of supply. Many developing countries look likely to take a long time to pull out of this situation.

Thus it is probable in broad terms that estimates of future growth rate in premiums will largely be influenced by the underlying increase in GDP per head, once the single boost to motor vehicle premiums has occurred following the introduction of obligatory cover, and also where workers' compensation is made compulsory. The low current penetration levels for life cover in developing countries indicates the potential for relatively high growth rates, being further boosted by social security reforms, and tax incentives to encourage individuals to take out life contracts for ultimate pension provision.

Foreign penetration will also be conditioned by the extent to which any State monopoly incumbents remain a dominant force, as they account for a significant premium volume in many developing countries.

There is no doubt that foreign investment in this sector in emerging markets can add much needed capital strength, best practice know-how, new technology, innovative products, consumer choice, and lower prices due to economies of scale and scope.

The positive externalities of insurance: a superior public good

The stability of the financial system is a central "public good" for national economies and international trade, and for growth and development. The insurance sector is less volatile than banking and has a stabilizing effect in an economy. There is far less risk of a run on insurance firms, unlike a banking crisis when their customers withdraw their cash as a herd.

Insurance firms deploy experts who can manage risks, act as assessors and advisers on mitigation and vulnerability. They can advise on preventive measures and services, damage assessments, legal advice and assistance, claims handling services, relief and reconstruction mechanisms. This in general assists with situation of independence and self-reliance, having a positive psychological effect on policyholders in families, villages and rural areas. It can even help reduce civil unrest, due to life policy and business interruption payments made after a disaster. This enables households and firms to get more quickly back on their feet after disasters, given the sector's help with the necessary impact assessments, information sharing, public disaster information, special relief centres which can help channel humanitarian assistance. Insurers can provide information, carry knowledge, and have a training function on such subjects as buildings, geology, floods, meteorology, earthquakes and storms. The Institute of International Finance provided important coordination after the attack on the world trade centre on 11 September 2001 in New York.

Role of government

Economies are becoming increasingly dependent on insurance and accordingly the importance of regulation grows – both through specific rules for the sector and through general competition policy from which insurers cannot be excepted. Consumers must be protected, and fair market competition assured, including by foreign companies. To the extent that insurance may bring risk into the national and global financial systems

alongside those of banking and the securities markets, prudential regulations must guard against systemic risk. Thus, as the global integration of insurance markets grows, domestic regulation must take account of the international dimension. The most stringent regulation is needed to protect individual consumers, but in practice this encompasses all the key dimensions of the insurance business due to the severe impact of any major firm failing financially.

The removal of controls on capital movements, interest rates and how financial portfolio investments may be allocated, has necessitated stronger prudential regulation and transparency. The prudential mechanisms focus on capital adequacy ratios, limits to risk concentration, the nature and operation of risk in multilateral systems, liquidity requirements and on the definition of non-performing assets. There are rules to prevent insider trading, and other conflicts of interest. There are also rules for the competence and integrity of directors and managers (so called "fit and proper" requirements), on actuarial calculations and accounting standards and reporting, and disclosure of information.

Regulation for prudential reasons

Nowadays financial services are probably the most heavily regulated sectors in most economies.

The prevention of systemic financial risk is one of the highest social concerns that each Government has, and they are aware that there is risk of contagion from other nations, which can now be transmitted very rapidly. Prudential regulation and supervision is therefore an absolute necessity: neither normal daily domestic life, let alone international trade, can subsist if these interconnected services are not functioning securely and smoothly. All must acknowledge the prime importance of guarding against systemic financial failure at both the national and global levels. Prudential regulation, for the protection of the public and to maintain the integrity and confidence of the financial system, is essential to all countries.

Given the cross-border nature of so much economic activity in financial services, the importance is evident of the prudential regulations and their enforcement, being of a sufficiently high standard to enable supervisors in one jurisdiction to accept, or recognize, those of their counterparts in other jurisdictions. This may be done unilaterally, by bilateral agreement, or even in small groups.

When disaster strikes, the regulators have to decide at speed and under great political duress which of them, in which country, will take the lead and coordinate their moves to contain the systemic risk and bring the malfeasors to book, even to decide which firms should be saved (which could involve committing public funds) and which left to go under. This calls for much mutual understanding and advance preparation, and the acceptance of common guidelines for supervisory actions ahead of the need to act in concert. It also underlines how important it will be to carry these regulators along during the multilateral trade negotiations so that they "buy in" to the final results, and do not resist any fresh liberalization.

There should be full publication of the principles and rules of prudential supervision to clarify for companies what the ex ante position is. The least trade restrictive approach should be taken whenever possible, which will involve concentration by supervisors, not

on price and form control, but rather on the selling process, to ensure consumers can be made aware of their rights, of what products there are on offer, and be alerted to risks, though the former approach may be required for a while in immature markets. Disclosure of information for financial markets should be based on international accounting standards.

It is important to note that where liberalization of financial services has preceded implementation of effective prudential regulation and supervision, countries have been more prone to exchange rate volatility and capital flight during periods of macroeconomic instability. It follows that the supervision structure needs to be put in place at the outset.

However well coordinated regulation and supervision becomes internationally, the development of sound and robust insurance systems best takes place within a broader framework of macroeconomic stability, a well-developed legal system, a sound insurance infrastructure, and the accumulation of experience and expertise. In emerging markets such development will require a sequenced approach where regulatory prescription and institution-building are emphasized more in the early stages and greater reliance placed on market discipline later on when the institutional frameworks are better developed.

The regulators themselves have to avoid being “captured” by insurance interests. This may be more of an issue before any former State monopolies are fully privatized, and while the regulatory authorities themselves lack administrative and organizational skills and resources. However, at the same time the authorities need to benefit by obtaining information from firms on the increasingly complex technical issues arising from the newer, more sophisticated, products of global conglomerates offered in their jurisdiction.

Financial markets, now more closely interconnected through globalization, can suffer from broader crises arising from the bankruptcy of a large insurer in a less well regulated country, say due to collusive lending or fraudulent transactions slipping through gaps in the regulation of the financial sectors. The credit risk has been notable where there were unsound intermediation practices in emerging markets, and for example, particularly so if the regulation of insurance sales over the internet is insufficient to prevent significant fraud. There are other regulatory and political risks also, which can include pervasive corruption.

Moral hazard

The State has also to guard against the moral hazard implicit in the provision of insurance cover, one example being where the perpetrators of fraud aim to enrich themselves. This has been an important preoccupation in most countries, leading Governments to control insurance providers tightly so as to protect the interests of consumers. The need for protection particularly applies for individuals who lack the ability to assess the insurance products on offer, even where good information is made available by the insurers.

The Annex on Financial Services and prudential regulation

The GATS recognizes that financial services play a critical role in the economy related to systemic stability and monetary integrity. The Annex on Financial Services sets out key parameters for the sector.

It exempts the following from GATS rules:

- The functions of the central bank or monetary authority, whether supplied by the Government or by a private entity acting for the Government;
- Activities related to monetary and exchange rate policies, and those of any entities using government financial resources, including statutory social security and public retirement plans;
- Measures taken for prudential reasons, provided that they are not undertaken to avoid commitments or obligations under the GATS.

Other features include:

- An exemption to protect from disclosure any confidential or proprietary information in the possession of public entities;
- Rules for the recognition by a member of the prudential rules of another;
- A requirement that panels for disputes on prudential issues and other financial matters shall have the necessary and relevant expertise;
- Definitions of the covered financial services.

Observers point out that the economic and legal literature does not contain any consensus definition of prudential regulation. Indeed there are disagreements on some central issues including its aim,[156] and how to approach "conduct of business" regulation. Given this impasse, there is arguably a need for more precision for the definition of the exceptions that can be invoked in relation to prudential regulation, in the light of a decade of changes in the financial sector. Also as time passes, the likelihood increases that there could be a dispute relating to measures affecting trade in financial services.

Prudential regulation, for the protection of the public and to maintain the integrity and confidence of the financial system, is essential to all countries which have financial services sectors. Such regulation responds in the first place to national social preferences and needs. It can create difficulties and real or apparent discrimination against inward investors in the financial sector, namely those providing services under Mode 3 (commercial presence). It will be important, as part of further GATS negotiations on financial services, to develop closer international cooperation on agreed standards and methods, including methods of supervision.

In the early 1980s there was a wide gulf between the proponents for an agreement on services and the developing countries, which rejected the need for an accord. Thus at the outset of the Uruguay Round the services negotiations were placed on a separate track from other issues. Furthermore back then, the United States Treasury was advocating that financial services should form a separate agreement, and many of its OECD counterparts were in support. It took some years for their resistance to be withdrawn, and at the end of the Round it was finally agreed to make the General Agreement on Trade in Services

[156] Given the need to balance micro- and macro-regulations, such as the solvency of an individual firm and systemic stability.

(GATS) part of the World Trade Organization (WTO), with all services included in principle. This was acceptable to the developing countries because the framework enshrines the concept of progressive, or step-by-step, liberalization. The financial services supervisors were satisfied by the "carving out" from the GATS disciplines of all measures taken on "prudential grounds" by financial services authorities. The exception was purposely drawn very broadly, and furthermore the term "prudential" was left undefined, although a few examples were given of what is included.

At the Committee on Trade in Financial Services (CFTS) the "desirability of developing a definition or common understanding of the meaning of "prudential regulation" was voiced.[157] There was support from members for "discussing the matter for transparency purposes, given that the general policy regarding prudential regulation should be transparent, and to enhance their understanding of the possible issues." During subsequent discussions there was support for discussion on prudential regulation "to enhance understanding of the specific issues involved", but also on objections by those not seeing the need for clarification.[158] There is no doubt about the complexity of the issue, and there should be caution when deciding whether or not to embark upon the process of clarification. At the same time, the proponents of further discussion appear to have failed to give examples of over-regulation that could result in clear restrictions on trade in financial services.

However, in May 2001, Switzerland tabled its proposal for negotiations on financial services.[159] This stated that: "Because of its difficulty and complexity, prudential regulation can be implemented disproportionately depending on the problems involved. The measures involved can make financial markets less attractive and jeopardize their operation. We would like the CTFS to begin working on a more precise definition of the exceptions that can be invoked in relation to prudential regulation. A clearer definition would help to improve transparency of financial markets for users and operators, and this, in its turn, would have a positive impact on their attractiveness." It added that it is essential that "the CTFS should seek to cooperate closely with the international organizations that are actively involved in the supervision of financial services (the Basel Committee, the International Association of Insurance Supervisors, the International Organization of Securities Commissions, and the Joint Forum on Financial Conglomerates)."

Some observers point out that the so-called "prudential carve-out" may provide a non-transparent cover for regulators to ignore liberalization principles. They argue that the light of transparency must shine on objective standards, and on procedures, so as to reduce opacity to the necessary minimum, which can otherwise hide discretionary actions of a discriminatory nature. For example, where it is possible to set explicit and objective standards for such aspects as capital adequacy, they should be transparently set as figures, and supervisors should not thereafter move the goal posts in a discriminatory manner for individual firms.

Although the Swiss proposal has not yet been taken up in the GATS negotiations, it is important that developing countries participate in this debate should it resurface.

[157] See WTO document S/CSS/M/3 of 26 June 2000.
[158] See WTO document S/CSS/M/4 of 18 September 2000.
[159] "GATS 2000: Financial Services", Communication from Switzerland, 4 May 2001 (S/CSS/W/71).

Regulation issues for developing countries

The sequencing of reforms, and the rate at which they are introduced, constitute one of the main challenges. A basic prudential set of regulations has to be put in place, together with the resources for sound implementation, before controls on price and form can be relaxed or cross-border transactions permitted. Thereafter, the authorities can concentrate on fair competition and market efficiency. Severe problems have arisen in some developing countries where this order of play was not followed and there were a number of insurance company bankruptcies.

An independent insurance regulator

A priority for insurance is to enact solvency and prudential regulation, and enable institutions managing long-term funds to invest appropriately by minimizing Governments' discretionary scope in directing savings. An independent regulator for insurance has to be established, together with an infrastructure that includes independent share registries, reliable custodial services, credit rating agencies, and accounting and auditing services. Red tape that is unrelated to prudential and transparency standards has to be removed so as to ease entry and allow orderly exit. Other obstacles such as subsidies and protection that keep insolvent or inefficient operators afloat need to be eliminated.

Generally development is slow with contractual savings schemes (ie pensions and life insurance) still largely undeveloped, even in the more advanced emerging economies. The confidence of savers and retail investors needs to be built up in financial environments, which are still hardly settled, or only recently stabilized. However, where economic conditions are evolving faster, regulators see that appropriate solvency margins and capital requirements are more essential for the soundness of insurers, than fixing rates and conditions. The move will be towards regimes requiring risk-based solvency standards to be met. Supervision will have to change dynamically as the market develops. Failures may be inevitable in the early stages when supervisors are not experienced, data are poor and corporate governance is weak.

Any framework for the analysis of regulatory and supervisory systems for the insurance sector will need to take account of certain key elements. These will include the form, powers and activities of the supervisory authority, licensing requirements, and ongoing supervision. The extent of change toward an open market system will be greatly influenced by the rate and scale of privatization of State-owned entities.

Supervisory systems have to be built up with the following characteristics. First a supervisory body has to be set with proper powers of enforcement. Its organizational structural, and human and financial resource needs have to be approved, particularly taking into account any privatization programme, which necessarily forms a part of market structure reform.

The international dimension

Traditionally each supervisor has sought to ring-fence the activities of insurers operating within its own jurisdiction. However, they are now faced with a rapidly changing environment characterized by the formation of complex groups and conglomerates. This

increasingly demands that supervisors take a broader view of such firms, of which the supervised companies in any one jurisdiction form only a part.

The International Association of Insurance Supervisors has encouraged the exchange of information between its members and has developed a model memorandum of understanding on mutual assistance and the exchange of information. Despite this, the level of information exchange is lower than in the banking and securities sectors. Swift and effective information exchange can reduce the risk of financial contagion, though this is less of a problem for insurance than in banking.

Regulatory arbitrage has increased as financial conglomerates have grown and convergence developed, which increases the need for insurance supervisors to work with other financial regulatory bodies to coordinate and agree some harmonization of the regulatory and supervisory frameworks. The Joint Forum has established working groups to: make a comparison of the core principles of the Basel Committee on Banking Supervision, the International Organization of Securities Commissions and the International Association of Insurance Supervisors; to look at corporate governance; and capital adequacy and risk concentration principles. Coordination of risk assessment frameworks and capital requirements will present greater challenges, because the nature of risks, risk terminology and risk measurement are still in many respects different. Also, the International Association of Insurance Supervisors has yet to develop an internationally endorsed set of standards on risk assessment and capital requirements to facilitate such coordination.

Islamic principles and insurance

The degree to which the Islamic principles are applied and enforced in the services sector varies from country to country. It is clear that Islamic principles outlaw certain forms of activity, including some services (including behaviour considered illegal in other jurisdictions as well, such as fraud and abuse of monopolistic power). Under Islamic law no one may invest in entities carrying on certain prohibited activities. This prohibition constrains banks and insurance companies too. In the WTO context, the Islamic principles appear to be compatible with the liberalizing principles of the GATS.

Strictly applied, the principles impose on the banking and insurance sectors in particular the need to arrange contracts where interest is not charged, nor any predetermined fixed return computed on the size or duration of loans. Therefore, an alternative return for risk has to be obtained, as would be possible (although not the norm) in conventional financial services situations. Such contracts usually involve agreement on the party to manage the investment or project to which a loan relates, and how this duty is reimbursed, plus a profit and loss sharing arrangement, which may or may not be capped in either direction, which has characteristics more like a conventional partnership.

Competition policy

The insurance sector should be subject to the general competition laws and their enforcement, and this is a challenge for many developing countries given the resources necessary. Governments rely on encouraging each other to legislate for model competition laws, to enforce them, and to require their competition authorities to cooperate with each other in cases where restrictive business practices affect more than

one national market. OECD members have taken cooperation the furthest, concluding a number of bilateral agreements involving positive comity, which assures reciprocal action on the terms agreed.[160]

Liberalization under the GATS Doha development round of negotiations

The objective should be to channel any benefits arising from the Doha negotiations into the further development of the insurance sector in a progressive yet stable manner, so that the national firms can grow in financial strength and offer a wider and more modern range of products as demand arises. The regulatory and supervisory imperatives must take precedence over purely trade objectives, as it is unwise to liberalize before there is a strong supervisory enforcement capability in full operation. The risks of an insurance firm failing must be avoided since the costs of failure can be extensive.

Responding to requests for supply, through Modes 1 and 2, of reinsurance and major marine, aviation and transport insurance covers, would be a sensible initial step on the path of liberalization. It would permit what are elsewhere considered to be sound current commercial practices, and consequently these covers are usually the first to be liberalized. Prudential requirements would be maintained to ensure that cover is only supplied by properly constituted and funded insurers.

The liberalization in Modes 1 and 2 for insurance agency and brokerage services, and the insurance of services auxiliary to transportation, is likely to present few problems in principle, if done under due supervision. The agents and brokers should be expected to comply with the principles laid down by the World Federation of Insurance Intermediaries.

Developing countries should consider carefully whether it is necessary to set prices for reinsurance covers, and to mandate which firms accept such risks. Better terms may well be available from the major international firms based in OECD countries, with consequent benefits to the economy.

The full liberalization of market access for GATS Mode 3 commercial presence, as in certain requests put to developing countries could be contentious. The rate of increase of insurance suppliers in the market, and the relatively large size of the likely new multinational entrants need to be taken into account.

As with many sectors of the developing countries, the insurance firms owned by their nationals are not currently capable of projecting a presence into developed country markets, and so a request to trading partners calling for full opening, in conformity with prudential regulations, would mostly represent a negotiating tactic rather than substance.

Developing countries need to ask for aid for the design and implementation of capacity-building programmes aimed at training the national supervisors, and also provide courses for the management of locally owned insurers in best practices, including risk analysis, risk management, and ICT data processing to reduce fraud. This could extend to

[160] In a general sense comity involves the mutual recognition by nations of the laws and customs of others.

documentation for insurers to use when advising their client companies, and even households, on the avoidance and reduction of risk.

GATS Mode 1 supply for outsourcing

The Internet enables insurers to outsource distinct aspects of the value chain, perhaps at first the labour-intensive administrative tasks suitable to be carried out in developing countries. Some new firms operate at the other extreme and outsource all tasks to specialist partners once a policy has been sold on their web site, and so offer very competitive prices. This demonstrates how the internet has lowered market entry barriers. It is clear that the internet has the potential to reduce the costs of distribution by avoiding the commissions payable to agents and brokers, as well as reducing the costs of policy administration and claims handling, through automated processing. Better data control through electronic processing can lead to improved risk analysis and the detection of fraud.

A good example of how a small developing country can gain from the expanding trend for back office outsourcing is that of Sri Lanka. For the past year WNS, a major United Kingdom BPO (business process outsourcing) firm has been providing from its office in Colombo, finance, accounting and other professional services for the Aviva Group companies which includes Norwich Union Insurance. Aviva is the largest insurance company in the United Kingdom and among the top five in the world with more than £240 billion in assets, and a customer base that exceeds 30 million.

GATS Mode 2 supply and insurance

Patients who travel abroad to seek health care form an important aspect of trade in the health services sector. They may want to undergo surgery, specialized forms of convalescence, unusual non-emergency forms of treatment, dental treatment, to give birth and so on. Usually there are no restrictions placed by Governments on such travel, though in a few cases, there might be exit taxes and exchange controls. The principal problem for many intending patients is the non-portability of health insurance. It is seldom that mutual recognition between countries (such as within the EU for State health provision) or between insurance companies (such as between certain United States and United Kingdom health insurers) exist that extend cover to another country.

GATS Mode 3 supply for offshoring?

In the Caricom member States, as an example, there appears to be no standard and agreed approach for treating the activities of offshore financial services companies. It seems likely that offshore insurance companies will be treated as non-resident. A final decision would have to be taken by Caricom to agree on the treatment of receipts for professional services provided to those companies by residents. Payments to residents by offshore firms for miscellaneous professional services should be classified as legal, accounting, and other professional services on a prorated basis under business services. Formerly they were shown as a credit entry in financial services offshore sector.

GATS Mode 4 supply and insurance

There are cases of measures that have a disproportionate impact on foreigners compared with nationals providing the same service. They include restrictions on the mobility of family members, curtailing benefits under mandatory social insurance schemes (eg denial of pension entitlements), or on participation in government-sponsored vocational training schemes.

Liberalization of trade in insurance services: the Uruguay Round

In the Uruguay Round, WTO members made more commitments in financial services than any other sector, except tourism. About 60 members made commitments in life and non-life insurance, and only three of these had no commitments in life insurance, and only one in non-life. Nearly 70 members made commitments in "reinsurance and retrocession", but only just over 40 for "insurance intermediation" and "services auxiliary to insurance".

For market access in Mode 1, about two thirds of the developing countries and almost all least developed countries made no commitments. Just over half the developed countries made only partial commitments, and a third none. The averages for national treatment were slightly less liberal.

The figures for the modes of supply were broadly not much different. For Modes 3 and 4 about nine out of ten developed countries made partial commitments for market access, and three quarters for national treatment, whereas the figures for developing countries were about four in ten in each case, and for the LDCs, three in ten.

The commitments related to the more internationalized services such as reinsurance and services to corporate businesses, rather than to retail services or new products. However, an assessment based on counting commitments is very crude, since it does not reveal the extent of the conditions and limitations placed on market access and national treatment, nor the coverage of the four modes of supply.

Common restrictions

For market access the great majority of restrictive measures recorded for direct insurance and reinsurance were under Mode 3, with Mode 4 at about half that level, while for national treatment the number of restrictions was even higher, with those for Mode 4 being above half those for Mode 3.

The restrictions on market access focused mainly on types of legal entity, with nearly half the developed countries, and over two thirds of developing countries, imposing them. Next in frequency came restrictions on the value of transactions or assets, and on the number of suppliers. But there was a wide range of other types of restriction.

Those on national treatment were also varied but fewer in number, comprising "authorization requirements", followed by restrictions on the ownership of land and property (more frequent in developing countries), nationality and residency requirements. There were others too, the foremost being licensing standards and qualifications, registration requirements, subsidies and grants, and tax measures – four fifths of this last category being imposed by developing countries. All types of performance requirement

were imposed by countries in Asia, with the region having the highest number of nationality requirements.

Under Mode 2, the only commitment relates to insurance services that citizens might purchase when abroad. This is a clear concept for natural persons, such as tourists and students studying abroad for many months. The situation is not so clear when it comes to purchases of insurance on behalf of juridical persons, which cannot physically travel abroad, though its personnel can. It is likely that uncertainty as to the fuzzy boundary between Modes 1 and 2 for some financial services may lead to calls by trading partners to treat the two modes in exactly the same way, or to "merge" them in their schedules so as to achieve legal predictability.

As with banking and securities services, the larger developing countries are likely to be pressed hard to match the relatively high levels of bindings of the countries which have acceded to the GATS in the past few years. This might mean that they will be under pressure to make some commitments under Modes 1, 3 and 4. In the plurilateral requests, pressure is most likely to be applied by the European Union and the United States for commitments to open the market for insurance services purchased by businesses, such as reinsurance and retrocession, insurance for marine, aviation and transport risks, and for some auxiliary services, particularly risk assessment.

If this is conceded, even to some extent, trading partners will examine the investment and other relevant laws to identify the way these measures can impose limitations on normal trading activities, and interact with each other to reduce commercial freedoms or to increase transaction costs. These will then be targeted for removal by developing countries in the expectation that the subsequent more liberal regime will be bound in their schedule of specific commitments.

However, the need to set up and phase in a sound regulatory framework for the financial services sector, combined with adequate supervision, will be respected by the demandeurs.

Classification of insurance in GATS

The Annex on Financial Services of the General Agreement on Trade in Services (GATS) defines a financial services supplier as "any natural or juridical person .. wishing to supply or supplying financial services but [this] does not include a public entity."

In this Annex the following services are listed under the heading "Insurance and insurance-related services":

1. Direct insurance (including co-insurance):

    (a) life;

    (b) non-life;

2. Reinsurance and retrocession;

3. Insurance intermediation, such as brokerage and agency;

4. Services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services.

Commitments by countries that have acceded to WTO since 1995

Political pressure put on the members which have acceded to WTO since the inception of the GATS in January 1995 clearly has resulted in the bar being raised compared with their counterparts which were members at the conclusion of the Uruguay Round. Some small countries have made very liberal commitments in financial services, including, for example, Albania, Croatia, Ecuador, Georgia, Kyrgyz Republic, Moldova, Mongolia, Oman and Panama.

Proposals on negotiating issues

The major advanced economies will point to their own relatively open financial services regimes, and to the benefits of liberalization, and press other countries to reduce their restrictions on market access and national treatment, consistent with the MFN principle, and to delete any MFN exemptions based on reciprocity.

They will probably also urge that necessary prudential regulations should be transparently developed and proportionately and effectively applied, indeed as should all regulations affecting financial services. Some will urge that specific commitments should abide by the Understanding on Commitments on Financial Services as a minimum standard, in view of the fact that only 30 countries have adopted them (see annex A).

There should be more specific commitments in particular on financial intermediation (brokers), derivatives trading and financial information. Ceilings on equity participation, economic needs tests and restrictions on legal form, scope, and geographic area should be removed, along with quotas. Specific commitments on contractual services suppliers should be made – these are for services supplied on the basis of a contract, by an employee of a company that is not established in the territory.

Specific commitments in Modes 1 and 2 should be consistent, and the suggestion has been made to merge them for financial services, as the distinction between the two modes is fuzzy.

The classification of financial services products should follow the Understanding on Commitments on Financial Services which is extensive, if non-exhaustive, so as to achieve a clear, uniform, and coherent set of specific commitments.

One or two may press for a more precise definition of the exceptions that can be invoked for prudential regulations. A debate might arise on the way in which prudential imperatives can take account of, or recognize, the validity of the aims of trade liberalization so the two do not conflict to the detriment of both. Perhaps the way might lie in the recognition by the GATS of the objectives, principles, codes and guidelines of the regulators, but only if they are hammered out at the global level and attained through international consensus, to match the global nature of the GATS trade rules, and are designed to be pro-competitive and the least trade-restrictive practicable.

Annex A

Understanding on Commitments in Financial Services

The Understanding forms an optional basis for binding commitments in financial services on an alternative approach to that otherwise provided for in the GATS, and comprises a high level of liberalization. Under it, Governments undertake to do the following (the wording below being a condensed summary of the main features):

- Not to introduce any new non-conforming measures (a "standstill")
- To eliminate or reduce existing monopoly rights in financial services
- To accord MFN and national treatment to any supplier established in the market for government purchases of financial services
- To permit the cross-border supply, under conditions of national treatment, of the following services:

  (1) Insurance risks relating to maritime shipping, commercial aviation and space launching and freight, to cover any goods being transported, the vehicle transporting the goods, and any liability arising; and goods in international transit

  (2) Reinsurance and retrocession and the services auxiliary to insurance

  (3) Provision and transfer of financial information and financial data processing, and advisory and other auxiliary services (excluding intermediation) relating to banking and other financial services

- To permit its residents to purchase in the territory of any other member certain financial services
- To grant the right to establish or expand within its territory, including through M&A, a commercial presence, under the terms of any such authorization
- To permit new financial services to be offered by established firms
- To permit the transfer of information or its processing, or the transfer of equipment as necessary for the conduct of ordinary business
- To permit the temporary entry of certain specialist personnel
- To remove or limit any significant adverse effects of non-discriminatory measures that prevent suppliers offering permitted services, or expanding the supply to the entire territory, and any other measures that adversely affect the ability to operate, compete or enter the market
- To accord national treatment for access to payment and clearing systems operated by public entities, and to official funding and refinancing facilities, and access to self-regulatory bodies, exchange and futures markets, clearing agency, or other

organization or association which is required in order to compete on an equal basis with local firms

Annex B

Measures that typically act as barriers

Fiscal measures

- Subsidies and export incentives (including tied aid)
- Taxes on foreign workers (including visa fees)
- Entry and exit taxes
- Company taxes on foreign firms
- Withholding taxes
- Sectors selected for favourable or adverse treatment
- Customs duties on equipment for use by service firms

Investment measures

- Prohibition of foreigners from carrying on specific activities
- "Alien business" laws that restrict the scope of activities
- Authorizations required separately at national and local levels
- Multiplicity of government agencies with overlapping powers
- Branches not allowed
- Fees, charges, prices, margins, etc. controlled by the State
- National economic plan reserves or directs a sector towards particular suppliers, either government-owned, or private (under "buy national" policies)
- Licensed monopolists, or oligopolists
- Sector reserved for supply by government-owned supplier
- State control over advertising media, space and time
- Domination of sector through ownership by major bank, etc
- Untransparent criteria for new licences in restricted services
- Restrictions on importation of sales leaflets, literature and other material and handbooks to use with the supply of a service

- Restrictions on participation by a foreign Government or State-controlled enterprise
- Government procurement of services not open to foreign suppliers

Measures related to the presence of natural persons

- Nationality requirement
- Residency requirement
- Economic needs test – hidden criteria
- Ban on entry for the self-employed
- Requirement to train nationals
- Work permits specific to occupation, employer and location
- Work permits restricted in number for some sectors
- Fees for work permits set too high
- "Alien employment" laws that restrict employment scope
- Periods for work permits and visas that do not coincide

Land and immovable property laws

- Prohibition from owning or leasing land, or immovable property
- Restrictions on method of ownership
- Foreigners banned from ownership in certain areas
- Artificial restrictions on availability of land for certain activities
- Restrictions on the location of particular services outlets

Legal form measures

- Restrictions on operational format for foreign suppliers
- Ban on sole practitioners, and/or partnerships
- Ban on joining local partnerships
- Ban on signing professional opinions and official applications
- Requirement for joint venture with local firm
- Equity cap below 50 per cent

- Restriction on use of foreign firm's name
- Ban on use foreign person's name in a firm's name
- Requirement to use a local citizen's name in a partnership name
- Lack of transparency on any legal procedures, especially discretionary areas

Standards applied

- Requirement to use local standards that do not conform with international standards
- Complex environmental and safety regulations

Annex C

Statistics on trade in insurance services

The *Manual on Statistics of International Trade in Services* (the *Manual*) recommends a measurement of insurance that nets claims against premiums and designates a portion of the premium as services. Measurement on a gross basis for both insurance and reinsurance would show:

Credits – being premiums earned by resident insurers from their customers abroad, plus claims by residents incurred on policies issued by non-resident insurers

Debits – being claims by non-residents incurred on policies issued by resident insurers, plus premiums earned by non-resident insurers from resident customers

This follows the procedure recommended in the IMF *Balance of Payments Manual* (fifth ed., 1993, para. 257, BPM5): "For some purposes – eg for use in trade negotiations – total premiums and claims are relevant and are shown as memorandum items under *insurance services.*"

Although the *Manual* recommends that gross premiums and gross claims be listed as memorandum items, the data may not be comparable if different treatments are followed. For example if gross premiums are added separately, some come from credits and some from debits, and the same goes for gross claims. The result would be different from adding up the credits first and then adding up the debits. The latter would be of greater relevance.

Work on revising BPM5 will produce changes in balance of payments methodology affecting insurance, involving a move from measurement based on premiums less claims, as described above, to premiums less "adjusted" claims, aimed at smoothing out the effects of major disasters. All types of insurance cover will use the formula:

premiums earned

plus adjusted premium supplements

less adjusted claims

The *Manual* includes an EBOPS memorandum item to cover, on a gross basis, life insurance, freight insurance, other property and casualty insurance, reinsurance, and auxiliary services including outsourced administrative functions. This will enable analytical comparison with other service sectors, whether or not in the context of trade negotiations. Instead of reflecting the administration of insurance policies, much of which is now being outsourced, the values would rather reflect risk that is assumed by the underwriters, on behalf of their customers.

For greater detail on the measurement and compilation of insurance services for the balance of payments, see box 3.2 of the *Manual* and the IMF *Balance of Payments Compilation Guide* (paras. 551–561). A priority should be to record the origin of receipts and destination of payments by major trading partner, even if only at the aggregated level of insurance services.

XIX. Towards more inclusive insurance markets[161]

Craig Churchill[162]

Low-income households in developing countries live in risky environments, vulnerable to numerous perils, including illnesses, accidental death and disability, loss of property due to theft or fire, agricultural losses, and disasters of both the natural and man-made varieties. Poor households are more vulnerable to many of these risks than the rest of the population, and yet they are the least able to cope when a crisis does occur.

Poverty and vulnerability reinforce each other in an escalating downward spiral. Not only does exposure to these risks result in substantial financial losses, but vulnerable households also suffer from the ongoing uncertainty about whether and when a loss might occur. Because of this perpetual apprehension, the poor are less likely to take advantage of income-generating opportunities that might reduce poverty.

Although poor households often have informal means to manage these risks, informal coping strategies generally provide insufficient protection. Many risk management strategies, such as spreading financial and human resources across several income-generating activities, result in low returns. Informal risk management strategies also do not stand up well against a series of perils, which unfortunately is often the case with the poor. Before the household has a chance to fully recover from one crisis, they are struck by another.

Access to appropriate insurance products is one way to assist low-income households to manage their risks better. Yet the concern for the poor is not the only reason to explore insurance as a possible solution to their predicament. Indeed, in many countries, low-income households constitute the vast majority of the population and therefore represent a significant untapped market, particularly for insurance which is guided by the law of large numbers.

This article begins by defining microinsurance and then it uses Prahalad's (2005) framework to illustrate how low-income households represent a potential fortune at the bottom of the pyramid for insurance companies. To achieve that objective, however, Governments can and must play a greater role, as discussed in section 3, to minimize the regulatory obstacles that inhibit the expansion of microinsurance and to facilitate market development.

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[161] This paper is adapted from a forthcoming book to be published by the ILO entitled, *Making insurance work for the poor: Current practices and lessons learned*. The contents of the book are derived largely from a series of case studies – *Good and Bad Practices in Microinsurance* – published by the ILO for the CGAP Working Group on Microinsurance. The case studies were funded by GTZ, DFID, SIDA and the ILO. The book is being funded by the ILO and the Munich Re Foundation. The views expressed in this paper are those of the author and do not reflect official policy of the International Labour Organization or any of the agencies that have supported the research.
[162] ILO Social Finance Programmeme.

Microinsurance defined

Microinsurance is the protection of low-income people against specific perils in exchange for regular premium payments proportionate to the likelihood and cost of the risk involved. This definition is essentially the same as one might use for regular insurance except for the clearly prescribed target market: *low-income people*. However, those three words make a big difference, especially with product design and delivery methods.

How poor do people have to be for their insurance protection to be considered micro? The answer varies by country, but a more global answer is that microinsurance is for persons currently ignored by mainstream insurance providers, men and women who do not have access to appropriate products. Of particular interest is the extension of insurance to persons working in the informal economy who do not have access to social protection and benefits often provided by employers directly, or by the Government through employers. Since formal workers are easier to reach (via employers) than workers in the informal economy; since it is easier to offer insurance to persons with a predictable income, even if it is a small sum, than to cover informal economy workers with irregular cash flows; informal workers represent the microinsurance frontier.

Microinsurance does not refer to the size of the risk carrier, although some microinsurance providers are small and even informal. There are, however, examples of very large companies that offer microinsurance – such as AIG Uganda (McCord et al., 2005), Delta Life in Bangladesh (McCord and Churchill, 2005) and all insurance companies in India (Garand, 2005; Roth et al., 2005).[163] These large insurance providers have a product or product line that is appropriate for low-income persons. An important aspect of microinsurance is that it can be delivered through a variety of different channels, including small community-based schemes, credit unions and other types of microfinance institutions (MFIs), or enormous multinational insurance companies. In fact, Allianz, the largest insurance company in the world, has recently launched an initiative with UNDP and GTZ to provide insurance to the poor in India and Indonesia.

Microinsurance also does not refer to the scope of the risk as perceived by the clients. The risks themselves are by no means "micro." Microinsurance could cover a variety of different risks, including illness, death, property loss – basically any risk that is insurable. Demand research in many countries has identified illness and death as the primary concern of most low-income households, although in rural areas concerns about weather (e.g. drought, floods) and infestation are also high priorities (Sebstad et al., 2005). The general experience with microinsurance to date has focused on idiosyncratic risks, although there is an increasing interest in applying microinsurance lessons to the provision of cover for covariant risks.

Since microinsurance is just one of several risk-management tools available to low-income households, organizations truly concerned about helping the poor to manage risks should assess whether the provision of microinsurance is the most appropriate response. For risks that result in small losses, for risks with high predictability of occurring or high frequency of occurrence, savings and emergency loans would be more appropriate risk-

[163] Indian insurance companies are required to allocate a percentage of their insurance portfolio to persons in the "rural and social sectors," which in practice generally means low-income households. Consequently, all Indian insurers are involved in microinsurance in one way or another, so many of the interesting microinsurance innovations are coming from India.

managing financial services. Savings and credit are also more flexible than insurance, as they can be used for a variety of different risks (and opportunities). Insurance, on the other hand, provides more complete coverage for large losses than poor households could provide on their own. For these larger risks, participating in a risk pool is a more efficient means of accessing protection than if households try to protect themselves independently.

One must be careful not to overstate the potential impact of insurance; it certainly cannot eliminate poverty on its own. By reducing the likelihood that households will be pushed further into poverty in the event of a crisis or catastrophe, however, insurance can contribute to several of the Millennium Development Goals (MDGs). Specifically, it can help address the health-related objectives of reducing child mortality, improving maternal health, and combating HIV/AIDS, malaria and other diseases. Health microinsurance schemes typically provide immunizations, train birth attendants, make it possible for women to afford transportation and hospitalization for difficult births, and provide valuable information and resources for risk prevention. While policymakers often focus on efforts to boost economic development to achieve the MDG targets, gains can quickly be lost when vulnerable households experience a loss or crisis. It is necessary to complement efforts to enhance productivity with corresponding attempts to provide protection.

A fortune at the bottom of the pyramid

One might argue that there are two varieties of microinsurance: one focused on extending social protection to the poor in the absence of appropriate government schemes; the other that sees low-income households as a potentially profitable market segment for the insurance industry. Indeed, the protection against risks is a citizen's right, so the State must use all possible means to deliver this public good (ILO, 2002). Yet fiscal limitations are a reality. In many developing nations, no more than 20 per cent of the active population is usually included in regular social security systems (ILO, 2000). Many Governments are currently unable to provide these fundamental services to the vast majority of their citizens. One strategy to partially address this objective is for Governments to encourage the private sector to reach out to this market.

The guru behind the articulation of new market perspective is C.K. Prahalad, who illustrates in his book *Fortune at the Bottom of the Pyramid* that the "private sector, in its desire to … gain market coverage, will invent new systems depending on the nature of the market". Prahalad identifies the more than four billion persons living on less than $2 per day as a market opportunity if the providers of products and services, including multinational corporations, innovate new business models and create low-income consumers.

This thinking is certainly not new to those involved in microfinance, where commercialization has been under way since 1992 with the creation of BancoSol in Bolivia. Besides microfinance, Prahalad also draws examples from other industries, including construction, consumer goods and health care. Based on case studies of successful innovations, Prahalad identifies common principles to be considered when innovating for the bottom of the pyramid (BOP). Even though he does not analyse insurance case studies, most of Prahalad's principles are remarkably applicable to the provision of microinsurance:

1. ***New understanding of price-performance relationship:*** Obviously, the poor cannot afford to pay high prices, but that does not mean that they deserve poor quality products. For microinsurance, it could even be argued that the low-income market requires a better quality product (e.g. expeditious claims settlements, few claims rejections) to overcome their apprehension about paying upfront for some undetermined future benefit. Prahalad also contends that the BOP market is surprisingly brand-conscious, something that microinsurers must keep in mind as they strive to secure the market's confidence.

2. ***Combine advanced technologies with existing infrastructure:*** Although this has not yet emerged in microinsurance, some MFIs are experimenting with technologies – including ATMs with biometrics, smartcards, palm pilots and point of sale devices – to enhance efficiency and productivity. It would not be surprising if microinsurers also move in that direction since they also need to find ways to enhance efficiencies.

3. ***Scale of operation:*** In a BOP business model, the basis for returns on investment is volume. Even if the per unit profit is minuscule, when it is multiplied across a huge number of sales, the return can become attractive to shareholders. This attribute is a perfect fit for insurance and the law of large numbers, whereby actual claims experience will run much closer to the projected claims when the risk pool is larger. When projections can be estimated with a high degree of confidence, then the product pricing does not have to include a large margin for error, making it more affordable to the poor.

4. ***Requires different functionality:*** Products and services for the BOP market cannot just be scaled down or less expensive versions of traditional products. With microinsurance, for example, insights into how low-income households might use an insurance payout would help clarify if it is more appropriate in cash or in kind, as a lump sum or spread over a time.

5. ***Process innovation:*** When designing a microinsurance product, it is necessary to adapt the process as well as the product. One must recognize that the premium is not the only expense – the indirect costs of accessing and using that product, including transportation and the opportunity costs of lost wages, may be much higher than the actual cost. To make the product truly affordable, one must streamline the customers' costs associated with application, premium payment and claims submission, while tailoring the premium payment schedules to the households' variable cash flows.

6. ***Deskilling work:*** Service industries are naturally labour-intensive; those focusing on the BOP market are even more so, given the scale of operations. Since labour costs can represent over half of the total expenses, one strategy to contain costs is to simplify the operations so that the products can be sold and serviced by less expensive workers. Such an approach is quite appropriate for microinsurance because the customers also want simple, easy-to-understand products. For instance, in India, Tata-AIG contracts poor housewives to sell its endowment policies to their friends and neighbours, similar to the direct marketing approach of Tupperware and Avon (Roth and Athreye, 2005).

7. ***Significant investments in educating customers:*** Prahalad is explicit about the importance of creating BOP consumers through education and awareness-raising, using innovative mechanisms to reach persons in "media dark zones". This has also been

the experience of microinsurers who need to explain to their clients how insurance works and how they will benefit from it.

8. ***User-friendly interfaces:*** The heterogeneous BOP market speaks a myriad of languages with a variety of literacy levels. Serving this market requires careful consideration to make it as easy as possible for poor households to use the service. For microinsurance, the application form should be short and easy to complete. More challenging is the simplification of claims documentation without exposing the insurer to fraud.

9. ***Distribution:*** One of the great challenges in serving the BOP markets, for insurance and other industries, is to get the product to the market. Insurance companies generally have good expertise in underwriting, and decent administrative capacities for processing applications, producing contracts, but they are particularly weak at distribution. The main solution to this problem is to partner with another organization that already has financial transactions with low-income households so the insurer can leverage existing infrastructure to reach the poor.

10. ***Challenge the conventional wisdom:*** In sum, to serve the low-income market, insurers have to think differently – about customers' needs, product design, delivery systems and even business models. There is a viable market out there if insurers are willing to learn about that market and develop new paradigms for serving it.

These characteristics suggest operational approaches to extend insurance to low-income households that are quite distinct from conventional insurance. For example, while insurers tend to exclude high-risk persons, microinsurance schemes generally strive to be inclusive. Such an approach makes sense when microinsurance is seen as an extension of a Government's social protection scheme. Indeed, to achieve the social mission of microinsurance, it is necessary to provide protection when vulnerable households need it the most. However, is inclusion feasible for market-based microinsurance? Following Prahalad's lead in rethinking business models for the poor, it is important to consider that the costs of identifying high-risk persons may be higher than the benefits of excluding them in the first place. Plus, if microinsurance schemes can reach tremendous volumes of customers, many exclusions can be just administrative nuisances rather than an important controls for insurance risks.

At the end of the day, microinsurance schemes have to be affordable to the poor, otherwise they will not become policyholders and will not benefit from the coverage. Various strategies could make microinsurance affordable, including having small benefit packages and spreading premiums payments over time to correspond with the household's cash flow.

To be appropriate for the low-income market, microinsurance must have clearly defined and simple rules and restrictions. The chief executive officer of a major United States insurance company once admitted that even he did not understand his homeowner's insurance policy. Insurance contracts are generally full of complex conditions, conditional benefits, written in legalese that even lawyers struggle to discern. Although the rationale for the fine print may be consumer protection, if the consumers do not understand what is written, its very purpose is defeated. Moreover, its contents can give the insurance

company an excuse not pay a claim. Microinsurance has to be kept straightforward so that everyone has a common understanding of what is and is not covered.

The process for accessing benefits from insurers tends to be so arduous that it discourages all but the most persistent claimants. Such obstacles are inappropriate for low-income households that cannot afford to spend days away from work, paying "unofficial fees" to access official documents. While controls have to be in place to avoid fraudulent claims, for microinsurance to be effective, it has to be easy for low-income households to submit legitimate claims.

Lastly, microinsurers must have effective strategies to overcome the apprehension of low-income households toward insurance. One of the primary ways to achieve that objective is through client education, to raise awareness among perspective policyholders about how insurance works and how it can benefit them. Equally important, however, is upholding promises and fulfilling obligations. For microinsurers to earn the market's confidence, they has to avoid many of the common criticisms of insurance providers, who are seen as quick to take one's money, but slow to pay it out. Indeed, microinsurance needs systems to pay benefits expeditiously, to minimize or avoid claims rejections, and provide a quality of service that earns the trust of a wary market.

Role of government in enhancing access to insurance

In many countries, the regulatory and policy environment is either not conducive to microinsurance or, worse, actually inhibits insurers from serving the poor. Yet, if the Government cannot provide an appropriate degree of social protection itself, it should at least create an environment in which insurers can extend coverage to underserved market segments. This can take the form of adjustments to the insurance regulations to deepen the outreach of commercial insurers, or the creation of alternative institutional options for insurers that want to serve the poor.

Yet, even in a conducive regulatory environment, market forces alone are unlikely solve the problem of insufficient coverage. On a purely commercial basis, the small transactions, low premium income and relatively high administrative costs of microinsurance is not particularly attractive to insurance companies. Consequently, Governments also need to play the role of facilitators, honest brokers and even cheerleaders to overcome market imperfections.

Regulatory obstacles and solutions[164]

Since microinsurance involves huge volumes of very small policies, there are a number of regulatory issues that are inappropriate or obstruct the provision of insurance to the poor. Consequently, many microinsurance providers operate outside the insurance laws, which generally does not work to the advantage of poor consumers. The primary objective of insurance regulators is to protect consumers, but that should not be accomplished by excluding low-income consumers from accessing insurance. To develop a market for microinsurance, regulators need to consider ways of overcoming numerous obstacles, three of which are discussed below: minimum capital requirements, stipulations for agents and the institutional options.

[164] This section is adapted from IAIS, 2006.

Capital requirements

A major obstacle for microinsurance is the high capital requirements for licensing of insurance companies compared to small size of microinsurance sums assured. This requirement can impede the establishment of formal insurance institutions dedicated to the micro market since the volumes of small policies required to generate a return on such an investment could take years, if ever. Furthermore, for the protection of the financial system, high capital requirements are inappropriate for such small polices – an elephant's worth of capital to back an anthill of policies.

High entry barriers prevent small organizations – often locally based and oriented toward the low-income market – from accessing an insurance licence. As a result, they operate outside the insurance laws and escape prudential oversight. To avoid attracting the attention of regulators, they give their products different names other than insurance. In many countries, for example, health care facilities operate such parallel schemes offering free or discounted access to healthcare in exchange for regular payments (premiums). Yet policyholders have no recourse if the informal insurer chooses not to fulfil its obligations.

Stipulations for agents

Microfinance institutions are a key distribution channel for microinsurance because they already have financial transactions with the low-income market. By linking insurance with their existing savings and credit operations, delivery costs are minimized, thus making microinsurance viable. However, often MFIs – and other institutions that work closely with the low-income population – cannot always be used as distribution channels due to licensing requirements for insurance agents. For example, the requirement that an agent has to be a private person may not to allow an MFI to sell insurance. The requirement of having specialized staff to sell insurance undermines the efficiencies that are possible by selling insurance through loan officers and tellers.

Box 1. Requirements for agents and brokers

In the Philippines, the Insurance Commissioner licenses agents after having fulfilled certain criteria (e.g. registration fee, exam, and no criminal record). An agent has to be a private person. However, several MFIs in the Philippines have a partnership with Cocolife that covers more 300,000 poor households, although these MFIs are not registered as agents. They sell Cocolife's products, but do not receive a commission. Instead they load the net premium charged with an administration fee that is paid by the client to the MFI at the start of each loan. AIG Uganda has a partnership with 26 MFIs to cover over 1.6 million lives. Technically, any individual selling insurance as an employee of an MFI would need to be licensed; however, none are. In Bangladesh, insurance agents also need to be licensed. This may help to ensure a minimum level of agent quality; however, it also may make it difficult to serve the rural poor. Delta Life, for example, certifies the agents for its mainstream products that target middle and upper income persons in urban areas. However, it calls its microinsurance agents "organizers" to avoid licensing requirements. Another complication is that agents are eligible to continue to earn commission on renewal premiums even after they have left the insurance business, which creates additional administrative complications when dealing with hundreds of thousands of very small policies, and thousands of organizers. In India, agent requirements have been relaxed of late by defining a microinsurance agent separately. Training norms have been reduced and there is no requirement of passing of an examination provided agents sell only microinsurance products.

Furthermore, the training requirements to become licensed agents may be excessive given the simplicity of microinsurance products – should a poor housewife who wants to sell $500 endowment policies to her friends and neighbours have to go through 100 hours worth of training? In some jurisdictions, the agent requirements are not strictly enforced, allowing microfinance institutions and microinsurers to sell insurance, albeit in a potentially vulnerable legal situation (see box 1).

Institutional options

To significantly expand the availability of insurance for the poor, a variety of institutional options are likely to be required to enhance the inclusiveness of the insurance industry. In particular, mutual insurance, where the policyholders are the owners and any profits generated by the insurer are shared among the members, is an important institutional option for providing microinsurance. Yet in some countries, this is not option.

There are many advantages to the mutual form of ownership. Stock insurers must balance the contradictory interests of policyholders, who want cost-effective and enriched insurance products; and shareholders, who want profits. Mutual insurers serve only the needs of their policyholders. With no stockholders to pay profits to, mutual insurers often use excess earnings to lower premiums, enhance products, or issue special dividends in the form of capital distributions – all of which are appropriate for the low-income market. However, the governance structures of mutuals can be weak, and they may have difficulty raising capital from their members, which may limit their ability expand.

Promotion and facilitation role of Governments[165]

Besides creating a conducive regulatory framework, there are also other roles for Governments to create an enabling environment for microinsurance. By identifying possible environmental or infrastructure obstacles that impede the development and expansion of microinsurance, Governments can make minor adjustments requiring limited investments that could significantly increase the availability of insurance to the poor.

Preventive roles and promotion campaigns

To help microinsurance schemes to minimize claims, Governments can play a key role in loss prevention. Risk reduction activities, such as improved sanitation, preventive health care and effective controlling for communicable diseases, can lower claims expenses and therefore make it possible for insurance products to be more affordable to the poor. Naturally, Governments would want to initiate such programmes for its citizens in general, not just to bolster microinsurance schemes, but they do have a positive spin-off effect.

Besides taking direct action to create a healthier living environment for the poor, the Government can also build greater awareness and understanding among citizens on the significance of risk prevention and avoidance, like anti-smoking campaigns or providing assistance for households to dig tube wells. Several microinsurance schemes, including BRAC and Grameen Kalyan in Bangladesh, participate in the Government's immunization programme campaign directed towards children. Vaccines are provided free of charge by the health authorities and small contributions are made to cover the cost

[165] This section is adapted from Trommershauser, Lindenthal and Krech (forthcoming).

of promoting the campaign. Such participation strengthens the schemes' own prevention programmes and enhances their public image (Ahmed et al., 2005).

Social marketing can also extend to promoting risk management strategies and trying to create an insurance culture. Indeed, the lack of an insurance culture is regularly identified as a major obstacle to the expansion of microinsurance, one that the Government could address with limited resources. These efforts could either be undertaken by the Government itself or, as in South Africa, the Government could encourage the insurance industry to assume responsibility.

Insurance infrastructure

Another aspect of the enabling environment is the infrastructure that needs to be in place for the insurance industry to function properly. While such infrastructure could be quite diverse, it is useful to highlight two key issues: statistical services and health care providers.

The more information microinsurers have to determine appropriate prices and product features, the lower the premiums should be for poor policyholders. A statistical service for the insurance industry, which could be supported by the State, would provide information that helps insurers in setting premiums and benefit packages. In health insurance, for example, this might include information on disease prevalence and the quality of facilities. It can also facilitate the sharing of lessons learned among institutions involved in microinsurance.

The second infrastructure element is the health care facilities. In fact, the accessibility of existing health facilities and the quality of care they provide represent key determining factors of any insurance scheme's prospects of success. Therefore, Governments can support and promote the development of microinsurance by improving the availability, accessibility and quality of health services for all citizens in its primary health care centres and public hospitals.

Apex structures

For microinsurance to be successful, local and occupation-based units need to be linked to larger network structures to enhance the insurance function through a wider pooling of risks. This critical linkage also provides a support structure for more professional operations, through internal control and performance monitoring, training, research facilities, and liaisoning with external stakeholders such as the policymakers and health care providers. Networks also play a key role in starting up new schemes, and therefore expanding the availability of microinsurance and increasing the economies of scale of the network. Accordingly, Governments should, whenever appropriate, encourage the creation and/or support of networks or alliances of local microinsurance schemes, and facilitate linkages to appropriate support organizations.

Besides promoting the federation of informal schemes, the Government can also engage in discussions with the formal insurance industry association to explore the activities that it might undertake to encourage or assist its members to serve the low-income market. If the Government can convince the industry association that microinsurance is a priority, the association can use its influence to set voluntary targets and reporting requirements

about their efforts to deepen outreach. In addition, as mentioned above, social marketing campaigns are a logical activity for the association since they should increase the market for the industry as a whole. The association can also provide training for their members. For example, in India, the insurance association has developed streamlined courses to train and license microinsurance agents.

Facilitating linkages with commercial insurers

In some countries, important microinsurance providers might include employers and workers organizations, service providers, professional associations, civil society groups (e.g. religious bodies or non-governmental organizations), microfinance institutions and cooperatives. All of these organizations might extend insurance to the poor, either on their own or in partnership with formal insurance companies. The partner-agent model is a viable way to expand microinsurance. It links a commercial insurance company with an appropriate distribution channel to reach the poor, to the advantage of the insurer, agent and client. Given the mutually beneficial results of such a model, Governments could help facilitate linkages between insurers and potential delivery agents.

Besides facilitating linkages, Governments need to develop a conducive legal framework for this type of collaboration. For example, in India, the IRDA has developed more relaxed standards to be licensed as a microinsurance agent. In addition, it is important to recognize that such relationships are not always mutually beneficial, especially when the delivery agents do not have a strong grasp of insurance concepts and therefore do not negotiate good deals for their clients. Consequently, Governments also must ensure that consumers' rights are respected and quality standards are met.

Financial assistance

Where microinsurance can be delivered purely on a market basis, financial support from the Government is not needed. However, there are numerous situations in which purely market-driven microinsurance is not possible. For example, it is very difficult for new operations to be sustainable, except for the partner-agent model, which utilizes existing infrastructure. Market-based microinsurance is unlikely to ever reach the poorest and most destitute members of society, and therefore financial assistance might be required to deepen the outreach of microinsurance schemes. Subsidies may also be required for research and development, such as creating new products, enhancing benefits, or experimenting with technology. Given the potential need for financial assistance, Governments have to decide if they are going to make investments, and if so, how they can be most effectively leveraged.

In providing subsidies towards microinsurance, or facilitating access to resources from international donors, Governments need to understand the effects on non-members as well as members, and analyse whether overall governmental objectives are optimally met given the chosen combinations. In general, subsidies do not guarantee social fairness or improved access for the poor.

Reinsurance

Reinsurance is another way in which public intervention could contribute to the viability of microinsurance schemes. Social reinsurance techniques could be used to improve the

viability of small risk-pools typical of informal microinsurance schemes (Dror and Prekker, 2002).

However, just as the poor have no access to insurance, microinsurance providers typically have no access to reinsurance. If market-based reinsurance options for microinsurance are insufficient, the Government may encourage and support the development of reinsurance mechanisms by either: (a) reinsuring microinsurance schemes directly against certain covariate risks (the Government may both establish a fund and make financial contributions to the pooled resources, i.e. a combination of reinsurance and subsidy); or (b) subsidizing the premium microinsurers would have to pay for reinsurance.

Conclusion

Microinsurance must be designed to help poor people manage risks. With that overarching objective forging a unique mindset, microinsurance clearly emerges as quite distinct from mainstream insurance and social protection schemes, however, ideally complementing both the instruments. Perhaps when insurance first emerged a couple of centuries ago, it was based on such ideals. Many of today's large insurance companies began in 1800s as mutual protection schemes among factory workers. Yet over the years, efforts to prevent fraud and misuse have created a maze of bureaucratic rules and requirements that undermine their effectiveness and their appropriateness for the poor. In addition, for commercial insurers, efforts to maximize shareholder returns have led them away from their original clientele in search for a more profitable market.

Indeed, microinsurance can be described as a "back to basics" campaign, to focus on the risk-management needs of vulnerable people, and to help them manage those risks through the solidarity of risk pooling. Although not all microinsurance schemes are true to these values, the closer they can come, the more likely they will benefit the people who need it the most.

Compared to insuring businesses, personal insurance for individuals and groups in the informal economy is expensive because of the higher unit cost of acquiring new business (e.g. marketing and advertisement expenses or sales commissions). This market is considered by insurers to be high-risk. The misperception that low-income segments lack adequate capacity to pay premiums and ensure the viability of insurance operations further deters many insurance providers. This has resulted in a vicious cycle. Because of the limited interest shown by most commercial insurance companies, many low-income households are unaware of available insurance services, which has led to limited demand for these services, and further contributed to the lack of interest by most insurers to see this segment as a market opportunity.

Cost-effective means of delivering affordable insurance services to low-income markets exist, for example by linking insurance services to microfinance operations. Therefore, in many developing economies, microinsurance initiatives are steadily on the rise. Many operate outside of the realm of prevailing insurance laws. In the absence of supervision, there is growing concern for customer protection; the long-term viability of these schemes is circumspect since their contributions (premiums) may not have any actuarial basis. However, what is increasingly clear is that there is a demand for insurance among low-income households and they are insurable.

Today, microinsurance is at the frontier between financial services and social protection, incorporating elements of both. Systematic efforts to establish and disseminate cost-efficient delivery and product models will enable insurance providers to serve the low-income market better. With some notable exceptions, most countries have yet to develop specific policies on microinsurance. At the same time, insurance providers that intend to target low-income groups often consider the requirements of the existing insurance laws inadequate. Consequently, there is a need for an in-depth policy review based on successful international experiences and amendments to insurance laws, rules and regulations to create an enabling regulatory framework for microinsurance without threatening the stability of the insurance sector.

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XX. The role of insurance intermediaries

World Federation of Insurance Intermediaries

Introduction

The importance of insurance in modern economies is unquestioned and has been recognized for centuries. Insurance "is practically a necessity to business activity and enterprise."[166] But insurance also serves a broad public interest far beyond its role in business affairs and its protection of a large part of the country's wealth. It is the essential means by which the "disaster to an individual is shared by many, the disaster to a community shared by other communities; great catastrophes are thereby lessened, and, it may be, repaired."[167]

Insurance is an essential element in the operation of sophisticated national economies throughout the world today. Without insurance coverage, the private commercial sector would be unable to function.

Insurance enables businesses to operate in a cost-effective manner by providing risk transfer mechanisms whereby risks associated with business activities are assumed by third parties. It allows businesses to take on credit that otherwise would be unavailable from banks and other credit-providers fearful of losing their capital without such protection, and it provides protection against the business risks of expanding into unfamiliar territory – new locations, products or services – which is critical for encouraging risk taking and creating and ensuring economic growth.

Beyond the commercial world, insurance is vital to individuals. Lack of insurance coverage would leave individuals and families without protection from the uncertainties of everyday life. Life, health, property and other insurance coverages are essential to the financial stability, well-being and peace of mind of the average person.

Insurance is a financial product that legally binds the insurance company to pay losses of the policyholder when a specific event occurs. The insurer accepts the risk that the event will occur in exchange for a fee, the premium. The insurer, in turn, may pass on some of that risk to other insurers or reinsurers. Insurance makes possible ventures that would otherwise be prohibitively expensive if one party had to absorb all the risk.

Advances in medicine, product development, space exploration and technology have all become a reality because of insurance.

Consumers buy automobile insurance to cover both their cars and people who may be injured in accidents. Homeowners and renters buy insurance policies to protect their property and protect themselves from liability. People buy life and health insurance to protect themselves and their families from financial disaster in case of illness or death.

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[166] *German Alliance Ins. Co. v. Lewis*, 233 U.S. 389, 415 (1914).
[167] Ibid., p. 413.

In some instances, Governments require businesses to purchase insurance. Known as financial responsibility requirements, government-mandated purchases of insurance is intended to ensure that injured parties will be compensated. Businesses also require other businesses to buy insurance. For instance, a retailer may require its suppliers to carry product liability insurance. Similarly, hospitals may require doctors to carry medical malpractice insurance, and mortgage firms often require their clients to insurance the properties used as collateral.

Distribution of insurance is handled in a number of ways. The most common is through the use of insurance intermediaries. Insurance intermediaries serve as the critical link between insurance companies seeking to place insurance policies and consumers seeking to procure insurance coverage. Intermediaries, traditionally called "brokers" or "agents" or "producers", offer advice, information and other services in connection with the solicitation, negotiation and sale of insurance. Over the last two decades, many professional intermediaries have developed services that go beyond the services related to the transferring of risk from insureds to insurers. Intermediaries now offer services such as the evaluation and implementation of alternative means of funding for potential losses, risk management strategies and claims management.

This paper will explain what an insurance intermediary is, the role of intermediaries in the insurance marketplace and the wider economy, and the services provided by intermediaries to insurance providers and consumers. It will also briefly describe the legal and regulatory regimes governing the business of insurance around the world.

Insurance intermediaries

Insurance intermediaries facilitate the placement and purchase of insurance, and provide services to insurance companies and consumers that complement the insurance placement process. Traditionally, insurance intermediaries have been categorized as either insurance agents or insurance brokers. The distinction between the two relates to the manner in which they function in the marketplace.

Insurance agents

Insurance agents are, in general, licensed to conduct business on behalf of insurance companies. Agents represent the insurer in the insurance process and usually operate under the terms of an agency agreement with the insurer. The insurer-agent relationship can take a number of different forms.

In some markets, agents are "independent" and work with more than one insurance company (usually a small number of companies); in others, agents operate exclusively – either representing a single insurance company in one geographic area or selling a single line of business for each of several companies. Agents can operate in many different forms – independent, exclusive, insurer-employed and self-employed.

Insurance brokers

Insurance brokers typically work for the policyholder in the insurance process and act independently in relation to insurers. Brokers assist clients in the choice of their insurance

by presenting them with alternatives in terms of insurers and products. Acting as "agent" for the buyer, brokers usually work with multiple companies to place coverage for their clients. Brokers obtain quotes from various insurers and guide clients in determining the adequate policy from a range of products.

In some markets, there are distinctions among brokers depending upon the types of insurance they are authorized (licensed) to intermediate – all lines of insurance, property and casualty or life/health coverage. While most, if not all, brokers are active in commercial lines, some also intermediate personal lines policies. There are also distinctions between "retail brokers" who negotiate insurance contracts directly with consumers, and "wholesale brokers", who negotiate insurance contracts with retail brokers and agents, but not directly with consumers.

Reinsurance brokers solicit, negotiate and sell reinsurance cessions and retrocessions on behalf of ceding insurers seeking coverage with reinsurers. Reinsurance brokers can also be involved in a reinsurer's retrocession of parts of its risk.

As a technical matter, a broker's role may change during an insurance transaction and over the course of an ongoing relationship with a client. Many brokers sometimes act as an "agent" of the insurer and other times as a "broker" of the client when assisting a client with insuring its risk exposures through an insurance contract with a traditional carrier.

For example, the broker acts on behalf of the client when negotiating the contract of insurance and placing the policy. When the broker provides services that would otherwise be handled directly by the insurance company, such as premium payments and claims handling, the broker is essentially acting as agent for the company. This unique concept makes the insurance process more efficient for both the policyholder and the insurer.

As a practical matter, regardless of the legal role in which a broker is acting, the manner in which the broker approaches all such placements for their clients is as an intermediary – working on behalf of their clients to facilitate the consummation of insurance contracts with carriers that have the ability and capacity to properly insure their risks.

Having said that, determining whether an intermediary is legally an agent or broker is not always clear-cut. An intermediary's status is determined by the totality of the facts regarding the specific transaction at issue. An intermediary might be called a "broker," but actually represent the insurance company in a particular transaction. In such situations, the broker is actually – and legally – considered the company's agent, not that of the customer. Although, such an activity-based approach is increasingly used around the world, the legal status of insurance intermediaries varies throughout the international insurance market. For purposes of this memorandum, included within the term "intermediary" are insurance agents, brokers, producers, advisors and consultants.

The role of insurance intermediaries

As players with both broad knowledge of the insurance marketplace, including products, prices and providers, and an acute sense of the needs of insurance purchasers, intermediaries have a unique role – indeed many roles – to play in the insurance markets in particular and, more generally, in the functioning of national and international economies. Intermediary activity benefits the overall economy at both the national and

international levels. The role of insurance in the overall health of the economy is well understood.

Without the protection from risk that insurance provides, commercial activities would slow, perhaps grinding to a halt, thus stunting or eliminating economic growth and the financial benefits to businesses and individuals that such growth provides.

The role of insurance intermediaries in the overall economy is, essentially, one of making insurance – and other risk management products – widely available, thereby increasing the positive effects of insurance generally – risk-taking, investment, provision of basic societal needs and economic growth.

There are several factors that intermediaries bring to the insurance marketplace that help to increase the availability of insurance generally:

Innovative marketing

Insurance intermediaries bring innovative marketing practices to the insurance marketplace. This deepens and broadens insurance markets by increasing consumers' awareness of the protections offered by insurance, their awareness of the multitude of insurance options, and their understanding as to how to purchase the insurance they need.

Dissemination of information to consumers

Intermediaries provide customers with the necessary information required to make educated purchases/ informed decisions. Intermediaries can explain what a consumer needs, and what the options are in terms of insurers, policies and prices. Faced with a knowledgeable client base that has multiple choices, insurers will offer policies that fit their customers' needs at competitive prices.

Dissemination of information to the marketplace

Intermediaries gather and evaluate information regarding placements, premiums and claims experience. When such knowledge is combined with an intermediary's understanding of the needs of its clients, the intermediary is well positioned to encourage and assist in the development of new and innovative insurance products and to create markets where none have existed. In addition, dissemination of knowledge and expansion of markets within a country and internationally can help to attract more direct investment for the insurance sector and related industries.

Sound competition

Increased consumer knowledge ultimately helps increase the demand for insurance and improve insurance take-up rates. Increased utilization of insurance allows producers of goods and services to make the most of their risk management budgets and take advantage of a more competitive financial climate, boosting economic growth.

Spread insurers' risks

Quality of business is important to all insurers for a number of reasons including profitability, regulatory compliance, and, ultimately, financial survival. Insurance companies need to make sure the risks they cover are insurable – and spread these risks appropriately – so they are not susceptible to catastrophic losses.

Intermediaries help insurers in the difficult task of spreading the risks in their portfolio. Intermediaries work with multiple insurers, a variety of clients, and, in many cases, in a broad geographical spread. They help carriers spread the risks in their portfolios according to industry, geography, volume, line of insurance and other factors. This helps insurers from becoming overexposed in a particular region or a particular type of risk, thus freeing precious resources for use elsewhere.

Reducing costs

By helping to reduce costs for insurers, broker services also reduce the insurance costs of all undertakings in a country or economy. Because insurance is an essential expense for all businesses, a reduction in prices can have a large impact on the general economy, improving the overall competitive position of the particular market.

Of course, the insurance cycle of "hard" and "soft" markets can have a significant impact on the benefits – both good and bad – of increased availability. Generally, however, increased availability benefits the consumer by leading to product competition, price competition and improved services. By reducing insurance costs across markets, intermediaries make an important contribution to improving the economic conditions in a country.

Insurance intermediation in practice

The intermediary's role within this enterprise stems from two essential functions performed by the intermediary: reducing search costs and uncertainty.[168]

Search costs

Intermediaries reduce the search costs to insurance buyers looking for the right coverage and the right insurer for their risks, and they reduce sales and marketing costs to insurance companies in search of insurance buyers. Intermediaries know the insurance marketplace. They know their clients' risks; they know the insurers willing to cover those risks; and they know the best way to secure that coverage.

Uncertainty

Insurance purchasers and companies do not have all the information relevant to the placement of a policy, which makes it difficult to negotiate a fair price and the proper terms and conditions of a policy. Purchasers know the risks in need of coverage, but may not know the financial health of the insurer or the prevailing conditions of the insurance market. Insurers, on the other hand, may have all the company and market financial

[168] Partly from Swiss Re, Sigma No. 2/2004.

information necessary to make a decision, but are not in a position to know enough about the risk and the prospective client.

Intermediaries know the insurance marketplace, they solicit and provide information on insurance purchasers and companies, and they make the information more easily understood to both parties to a transaction.

In the interest of long-term client and insurer relations, brokers have a strong incentive to ensure that all parties have the information they need so as they are able to enter into a mutually beneficial arrangement.

Insurance purchasers and companies may come to a transaction with unequal bargaining power. A small or medium-sized insured may come to a transaction with significantly less clout than the large insurer with whom they need to do business. An intermediary is often able to balance the equation by leveraging its business volume with carriers, and thereby obtain better terms and conditions for the client.

Every carrier essentially offers the same promise – to compensate the insured for a loss. To make that promise meaningful, however, the carrier must have the ability to properly understand and evaluate the risk presented and the capacity and financial solvency required to pay any claims that may result from that risk, as well as a reputation that suggests a willingness to make good on that promise.

There are literally thousands of insurance carriers, from large national carriers that offer a broad range of coverages to small regional carriers that may specialize in a single product line. For most clients, coverage terms must be solicited from and negotiated with the carriers on a case-by-case basis. Clearly, numbers dictate that this cannot be done with every carrier in the marketplace that has the capacity to insure a given exposure. Clients rely on intermediaries to know a universe of carriers that are well situated to address their needs and negotiate with selected companies to obtain the relatively best overall insurance value for them.

To do this, the development of a relationship between intermediary and carrier is essential. In order to provide products and services to their clients, intermediaries must have expertise with the risk profiles presented by their clients and the savvy to go to the right place for the right coverage for each risk profile.

The best way for an intermediary to evaluate a carrier's ability to insure a risk and its capacity to pay claims is by working with that carrier over time. Similarly, a carrier will be in a much better position to understand and evaluate the risk presented if it understands and trusts the intermediary presenting the risk to be insured.

Intermediaries are valued by insureds and insurers as an essential element of the insurance marketplace. They search the insurance marketplace to find and place coverage for their clients' risks. They also assist clients in the development of alternative risk transfer mechanisms for risks that otherwise would be impossible – or prohibitively expensive – to insure, and they provide services to both insureds and insurers.

In today's complex insurance marketplace, however, intermediaries have become more than middlemen between insurance companies and insurance buyers. They bring experience and expertise to the insurance marketplace, using their knowledge of the

insurance markets, their familiarity with their clients and clients' risk, and their access to insurers forged through long-term relationships, to sell and service insurance coverage for costly, and in many cases unique, risks.

Commercial insurance clients are generally professional risk managers. As sophisticated insurance purchasers, they realize that commercial insurance products are not commodities; rather, they are customized risk transfer tools, the price and terms of which are generally negotiated on a case-by-case basis. Placement of such risks can be a long and difficult process. Sophisticated commercial purchasers rely on their intermediary to fully understand and appreciate their insurance coverage needs and to find the coverages suited to address those needs.

Intermediaries and risk management

Risk managers increasingly use enterprise risk management tools to allow them to understand their risk profile, identify cost drivers and analyse enterprise-wide risk. Some intermediaries are active in providing such tools.

One of the functions of some insurance intermediaries is to help clients manage their risks, improving their risk profiles and reducing the likelihood that an insured event will occur.

Not all risks must be accepted as they are. When properly managed, risks can be controlled and minimized. Some can be avoided; others can be modified to limit their frequency or financial consequences.

Risk management is the process of analysing possible exposure to loss, reducing loss potential, and protecting financial assets. Businesses often look to their intermediary to act as consultants on risk management and advise them on the best ways to mitigate risk.

Some intermediaries therefore represent their clients in all phases of the risk management process: helping clients evaluate risk exposures; implementing measures to minimize such exposures; identifying and facilitating the purchase of insurance products or risks management systems best suited to a client's insurance needs; and managing the claims process.

There are many ways to protect financial assets. Purchase of insurance is the traditional way to transfer risk, but there are other methods that intermediaries and their clients use to ameliorate risks. Use of alternative risk transfer mechanisms – such as forming a captive insurance company, accepting higher insurance deductibles, or setting up reserves to pay losses – is an example.

Self-insurance

Self-insurance can take many forms. Policyholders can assume higher deductibles or accept lower amounts of insurance coverage. Self-insurance programmes, however, must be carefully balanced with a well-managed loss control programme to minimize the exposure a business faces and to protect third parties that are injured. That is where skilled intermediaries come in – to act as consultants in designing programmes.

Captives

Creating a captive insurance company is a popular risk-financing alternative, especially when insurance costs are high. Captives are also popular options for commercial enterprises that want to finance and control their risks.

A captive insurer is an insurance company that is wholly owned by a non-insurance organization, typically a large company or group of companies in the same business. An intermediary may help a client to establish a captive or manage the captive once it is up and running.

A captive's primary purpose is to insure or reinsure the risks of the parent organization, but they can also cover risks of non-related parties. A well-run captive can provide insurance coverage at lower rates than are generally available in the traditional insurance marketplace. Captives rely on reinsurance to spread the risk, just as traditional underwriters do.

Risk management involves far more complexity than the simple purchase of insurance. A large part of the task is preventing risk in the first place. Some Insurance Intermediaries are skilled in the art of working with their corporate clients in analysing and controlling risk, setting up safety programmes and other risk control techniques, and arranging alternative risk transfer mechanisms, as necessary.

These activities and services are beyond those typically associated with the placement and servicing of a policy contract, and have contributed to the evolution of intermediaries from their role as providers of basic brokerage services into full-service intermediaries, providing not only strict intermediation services, but a wide variety of fee-based risk management and consulting services, as well.

XXI. Insurance liberalization and the Model Schedule

Association of British Insurers[169]

Introduction

The “Model Schedule of Insurance Commitments” is a reference text for worldwide insurance liberalization. The purpose of this article is to place it in the wider context of the importance of financial services to economic development and to show how multilateral liberalization of insurance markets, based on the Model Schedule, can complement domestic market reforms and contribute to the rapid development of the insurance sector.

Insurance plays a crucial role in economic development: a well-functioning insurance sector is a vital piece of national infrastructure. Insurance liberalization, successfully managed, will help to attract foreign direct investment and drive development in financial services, in turn spurring overall economic development, financial security and levels of prosperity.

The General Agreement on Trade in Services (GATS) should, over the years, make a major contribution not only to the liberalization of financial services markets worldwide and to the expansion of international trade in financial services, but also to the development of financial services sectors which are so crucial to overall economic development. It does so by providing a framework within which countries can liberalize by offering multilateral commitments to do so, on the basis of an international agreement. But translating the practicalities of a liberalized insurance market into the terminology of

[169] The Association of British Insurers is the trade association for the United Kingdom’s insurance industry. It represents around 400 companies, accounting for over 95 per cent of the business of United Kingdom insurance companies. They provide all kinds of insurance in Britain and worldwide, including savings, pensions and life insurance, as well as motor, household and health insurance. The United Kingdom has the largest insurance market in the European Union, and the third largest in the world (after the United States and Japan). Nearly a quarter of United Kingdom insurance companies’ net premiums is derived from outside the United Kingdom. The total premium income of ABI member companies from overseas business is £37 billion. The United Kingdom insurance industry contributes around £8 billion to United Kingdom overseas earnings, employs around 360,000 people directly or indirectly and pays out over £140m in pension benefits every day (compared to £127m paid out daily by the United Kingdom Government in state pension provision). Insurance companies are also the largest domestic owners of United Kingdom shares – owning about 21 per cent of United Kingdom ordinary shares. ABI is one of the insurance organizations represented in the Financial Leaders Working Group (FLWG) that subscribe to the Model Schedule. The other subscribing associations include those from all the Quad members (the European Union, the United States, Canada and Japan).

The full list of associations that have subscribed is as follows: American Council of Life Insurers, Reinsurance Association of America, American Insurance Association, International Insurance Council, Council of Insurance Agents and Brokers, Bureau International des Producteurs d’Assurances et de Réassurances, World Federation of Insurance Intermediaries, Marine & Fire Insurance Association of Japan, Canadian Life and Health Insurance Association, Comité Européen des Assurances (CEA) and its national member associations from EU member states (Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the United Kingdom). The constituent United Kingdom member of the CEA includes the Association of British Insurers, the International Underwriting Association of London and Lloyd’s.

a multilateral agreement can be a complex task. The Model Schedule is therefore designed to act as a practical reference tool for understanding the shape to be taken by a liberalized insurance market in terms of the language of commitments under the GATS rules-based system. It is hoped that it will foster negotiations in the Doha round of trade talks by helping to frame discussions on insurance liberalization.

Scope for growth in insurance markets

In many markets there is great potential for further growth in insurance. There are two broad yardsticks to support this proposition. First, a measure of the degree of maturity of various insurance markets can be gained by analysis of insurance densities (total premium income per person in a country's population) in different markets, in comparison to those of the most intensely developed markets. The world's largest three insurance markets (United States of America, Japan and the United Kingdom) have insurance densities of $3,266, $3,508 and $3,394 respectively. Insurance density over the OECD countries as a whole is $1,969, and in ASEAN countries is $32. This huge difference in densities gives some idea of the potential which different markets have for growth.

Such figures point towards the other approach to appreciating the scope for growth in the insurance sector in emerging markets. It has long been a well recognized global trend that insurance markets grow faster than national income; and this in turn has helped facilitate structural change in insurance markets. For emerging insurance markets, there has often been a multiple of three or four times faster growth in insurance markets than in the economy as a whole. For more mature insurance markets, the multiple comes down, but even so growth has generally been faster than the expansion of national income.

The role of insurance in economic development

Such trends are important. They underline the message that a vibrant insurance industry is one of the keys to wider economic advance. This is scarcely surprising. Insurance aids economic development through its financial intermediation function in at least five ways:

- Insurance facilitates business. Modern economies rely on specialization and improvements in productivity, including productivity in financial services. Trade and commercial specialization demand, in turn, financial specialization and flexibility. Unless there is a wide choice of financial products – and this includes insurance products – with corresponding levels of innovation, developments in trade and commerce can be held back.

- Insurers provide risk management services. In their widest sense, these services cover risk pricing, risk transformation, and risk reduction. They are all essential services for a competitive market. Businesses and individuals need to transform their risk exposures in property, liability, loss of income and many other fields to achieve an optimum "fit" to their own needs. Again, life insurers enable individuals to manage their savings to match the liquidity, security and other risk profiles desired.

- Insurers offer risk management through risk pooling. This is the essence of insurance, taking underwriting and investment together. Pooling reduces volatility.

If volatility is reduced, there is a smaller “risk premium” to be faced by insureds and borrowers. And, through risk management, insurers can bring to bear economic incentives for reducing business risk exposures.

- Insurance mobilizes personal savings. In general, countries with high savings rates are those showing fastest growth. An IMF study in 1995 indicated that of the world’s twenty fastest growing economies over the previous 10 years, fourteen had savings rates greater than 25 per cent of GDP, and none had a saving rate of less than 18 per cent. But fourteen of the twenty slowest growing countries had savings rates below 15 per cent. Insurers have a key role in enhancing savings rates and in channelling domestic savings into domestic investment; and, through long-term investments, matched to risks and generally located in the host economy in which they operate, insurers are key holders of equity and bond portfolios.

- Insurers play a key role in fostering efficient allocation of capital and economic resources. In assessing risks, they engage in an information function which requires them to evaluate firms, projects and managers. And they do so both in deciding whether to offer insurance and in their role as lenders and investors.

In these ways, a vibrant insurance sector can act as a catalyst to economic growth.

The need for liberalization

All these trends and indicators should be pointers to the value of liberalization and foreign direct investment in insurance markets. Historically however, Governments have often leant towards the view that a critical sector such as insurance, with its key role in wider economic development, should be reserved, wholly or partly, to national economic operators, enjoying a degree of protection. And Governments are sometimes swayed towards protection, for a number of reasons. First, strategic reasons are implied: they may feel that there needs to be a strong domestic insurance industry, with strong local regulatory systems. Second, other development-related reasons: given insurance companies’ key role in mobilizing savings for financial investments, Governments may wish to ensure that the insurance industry’s investments closely match their own investment priorities. Third, social reasons: given the role of insurance in maintaining financial security and quality of life, it is argued that there needs to be a strong State-controlled or State-dominated domestic insurance industry. Finally, there is the “infant industry” argument, often closely associated with the suggestion that liberalizing the insurance market would have adverse effects on a country’s balance of payments.

All these arguments can be, and are, put forward. In different countries they have been used to justify measures taking a variety of forms, for example:

- Restrictions are placed on entry to the market for foreign insurers.

- Where access is allowed, foreign insurers are required to operate only through joint ventures with local companies or subjected to other restrictions on corporate form.

- Foreign companies and their agents are subject to discriminatory levels of taxation.
- Reinsurance has to be ceded to a specified national reinsurer.
- Restrictions are placed on the nature of assets in which an insurer can hold funds.
- Limitations are imposed on the amount of insurance and reinsurance business which can be placed abroad.
- Restrictions are placed on the level of remittances to overseas parent companies.

These arguments for restricted markets, and the measures that go with them, are historically familiar. Yet the commercial case for liberalization, and for opening markets to direct investment from abroad, is far stronger. First, economic analysis points strongly to liberalization being the right route. A report by the British Trade Policy Research Centre showed that infant industry protection of the insurance industry in emerging markets raised the price of insurance and lowered the quality of cover, while at the same time failing to achieve the principal policy goal of improving the balance of payments. And, at a more pragmatic level, economic growth gives rise to strong pressures for liberalization. With rising levels of economic development, the number of large risks being faced has risen dramatically. These risks tend to be capital intensive investments, with each project worth hundreds of millions of dollars. In addition, many countries have been investing in advanced telecommunications systems and improving infrastructure. Much of this technology is directly transferred from the United States, Japan and Europe,but without the corresponding transfer of methods of risk control protection available in technology-exporting countries. In many cases, domestic insurance industries have faced difficulties in keeping pace with the changing and increasingly complex risks to be covered. There is a real requirement for broader-based, external expertise and capital to help develop a deeper and more innovative insurance market to cover these risks.

There are similar pressures on the personal insurance side. Increased levels of individual wealth in many countries have led to fast-growing personal lines insurance markets, with growing demand for both protection and investment products. But product ranges offered by domestic insurance industries can remain limited in scope, and sold through traditional distribution networks, with little attention paid to innovation in insurance product marketing. In some countries this lack of innovation may hold back development of personal insurance markets.

And the requirements of personal insurance markets raise the whole question of the reform of welfare provision, as an important global trend. No country is free from this trend, which is acting all over the world as a catalyst for new developments in the insurance and pensions sector, and as a pressure for enhanced insurance capacity and product innovation. As people live longer, insurance and pensions expectations have risen, and are rising still further. But the economic cost of insurance cover and pensions is high. Many countries are already actively involved in changing the balance of provision from the State to the private sector, often on the basis of one or more “pillars”. This is hardly surprising, taking just one statistic: the percentage of the population over 60 years old today and what this is projected to be by the year 2050. On average, for OECD countries,

18.4 per cent of the population were 60 years old or over in 2000; but by the year 2050 the percentage is expected to be about 34 per cent (almost doubling the proportion of the population aged 60 or over). Clearly, this presents the challenge of a major funding requirement. For Asian countries, the challenge is even greater: in 2000 on average 6.8 per cent of the population were aged 60 or over, but by the year 2050 this percentage is expected to rise to about 21.9 per cent – more than trebling the proportion aged 60 or over. These challenges are recognized in every country of the world, and are international in scope.

The solutions – whatever form they take – will require huge reserves of funding, which unless met by the State (through taxation) will need to be borne by private individuals. In an increasing number of countries, solutions involving an element of private funding are under discussion; and in these countries it is an insurance-based solution that is most frequently considered. In turn, the liberalization of insurance offers a path towards facilitating that solution, bringing with it international standards, technical, managerial and technological expertise, and high standards of regulatory compliance as well as extra capital for local investment, a transfer of experience, and an enhanced level of know-how throughout the industry as long-standing providers (including wholly domestically-owned insurers) alter their business practices to compete effectively with the new entrants.

Services liberalization under the GATS

It is of course entirely possible to liberalize an insurance market without reference to the GATS: indeed most OECD countries had advanced far along the path of liberalization well before the advent of the GATS in 1994. But the GATS offers a number of practical advantages, both to the country concerned and to participants in the sector in question. In particular it offers:

- Reference principles and rules, concerning market access for foreign market-entrants and non-discriminatory equality of treatment ("national treatment") once the market has been entered;
- A system of binding commitments which allows a Government to augment domestic reforms (designed to encourage growth and development) with international undertakings to maintain its level of liberalization;
- A standard of comparison by which the degree of liberalization in different markets can be compared;
- A negotiating process, allowing Governments the reassurance that negotiated liberalization will maintain a degree of parity between trading partners;
- A clear system of liberalization undertakings in a framework that is understood by commercial enterprises, providing business with a guarantee that commitments, once scheduled under GATS, will not be rescinded.

All these advantages were evident in the negotiations leading to the WTO Agreement on Financial Services 1997 and are equally important in the current WTO Doha development round.

The GATS approach has been formulated to take account of the nature of services, and the fact that services supply takes various forms. Four "modes" of service supply are defined in the GATS on the basis of the origin of the service-supplier and consumer, and the degree and type of territorial presence that they have at the moment the service is delivered. These four modes are:

1. ***Cross-border:*** where the service supply takes place from the territory of one member into that of another. Only the service itself crosses the border, without the movement of persons.

2. ***Consumption abroad:*** this relates to services consumed by nationals of a member, in the territory of another member where the service is supplied. Essentially, the service is supplied to the consumer outside the territory of the member where the consumer resides.

3. ***Commercial presence:*** where the service-supplier crosses the border to have a "commercial presence" abroad through which the service is provided. This presence can take the form of any type of business or professional establishment, including incorporation, branch, representative office, joint venture, and so on.

4. ***Presence of natural persons:*** this mode applies to natural persons only, when they stay temporarily in the market, for the purpose of supplying services, for example, as employees of service-suppliers.

In the insurance sector, different types of insurance currently tend to be supplied under different modes. Large commercial risks, including marine, aviation and transport (MAT) risks for example, are often insured from highly developed insurance centres such as London, on a Mode 1 or Mode 2 (cross-border or consumption abroad) basis. On the other hand, retail life and general insurance, for example, are commonly sold to consumers through insurers established in the local market under Mode 3 (commercial presence).

However, meaningful market access for insurers can often only be achieved through liberalization of a combinationof the relevant modes. This is because cross-border supply, commercial presence, and the presence of natural persons can all have a part to play. For instance, although Mode 3 (commercial presence, or "establishment") is essential for retail insurance companies setting up businesses on a branch, subsidiary or joint-venture basis, it needs to be supported by liberalization in Modes 1 and 2 (crossborder and consumption abroad) in areas such as reinsurance, to allow insurers established in a market to tap into additional capital provided by the worldwide reinsurance market, to cover their levels of risk exposure flexibly.

GATS commitments: certainty for business for the future

Under the GATS, when a Government undertakes to liberalize a certain sector under a particular mode of supply, it enters a "commitment" outlining the areas to which the liberalization applies in its "Schedule of Commitments" – a statement of its various liberalization measures in all service sectors. A commitment such as this is considered

"bound": that is to say, the Government binds itself to maintain that level of liberalization in that area, and undertakes not to reduce it. If no liberalization is undertaken, then the word "unbound" is entered in the schedule, and the Government is free in future to alter the current level of market access in that area.

This system of commitments is peculiarly well suited to the insurance sector: insurers, perhaps more than any other service sector, attach great importance to binding commitments under the GATS. Uniquely among services sectors, the insurance sector provides products that may continue as long as forty years or more, particularly in the case of life and pension products. Insurers therefore need the guarantees of a stable environment that bindings in the GATS are designed to provide. That stable environment is an important feature of insurance companies' individual decisions as to the markets in which they will make investments (which entail high levels of initial capital outlay in order to cover new business strain and meet solvency requirements set by regulators). To reach a decision to make a foreign investment, an insurer is greatly helped if there are in place GATS commitments from the host country demonstrating that the regulatory environment has reached a particular level of liberalization and will remain stable at that level. It is better still if there are prospects of further liberalization and greater freedom to operate, and this too is provided by the GATS, under which Governments commit themselves to further negotiating rounds aimed at "progressive liberalization".

Domestic regulation and the "prudential carve-out"

Service sector liberalization under the GATS inevitably depends critically on regulation in the host country. For liberalization to be effective, it is essential to ensure that wherever possible regulation follows a "pro-competitive" approach facilitating competition within a market, rather than having the effect of creating unnecessary barriers to market access. In the area of insurance regulation (as in financial services regulation as a whole) regulators enjoy a degree of freedom under the GATS Annex on Financial Services, containing the "prudential carve-out". This provides that "notwithstanding any other provision of the Agreement [GATS] a member shall not be prevented from taking measures for prudential reasons, including for the protection of investors [and] policyholders… or to ensure the integrity and stability of the financial system". It cannot however be used as a means of avoiding a member's commitments or obligations under GATS.

The wide ambit of the "carve-out" makes it all the more important that, for highly regulated services such as insurance, regulation and regulatory decisions should follow general principles of transparency, necessity, proportionality, availability to those regulated and – in the case of regulatory decisions – justiciability, appealability and the provision of reasons for decisions taken. All these are areas in which high standards of practice have been developed by some of the most advanced and successful financial services regulators. As liberalization progresses worldwide, it is important for such "best practices" to be widely followed.

The model schedule: a vision for liberalization in the Doha development round

The agreement on a new WTO negotiating round that was reached at the WTO Doha ministerial conference in November 2001 set a brisk timetable for the negotiations on services, with a deadline of 1 January 2005 for the completion of negotiations. For financial services, this gives WTO members the opportunity to build on the 1997 Financial Services Agreement, and go further in encouraging foreign direct investment by providing their trading partners and the global insurance industry with bound commitments of the level of liberalization in their countries.

It is against this background that the international insurance community, through the Financial Leaders Working Group (FLWG), representing the main insurance trade associations of the "Quad" (the European Union, the United States, Canada and Japan), as well as a number of individual companies, has developed an insurance model schedule and the best practices that accompany it. This is designed to offer a structured approach to translating the practicalities of a liberalized insurance market into insurance commitments to be scheduled under the GATS on market access and national treatment and on best regulatory practices. The Model Schedule covers market access and national treatment. On market access, Sections A to D of the Model Schedule correspond to GATS Modes 1 to 4. Section E covers principles of national treatment. The accompanying Best Practices in effect cover the additional commitments (on, for instance, regulatory practices) that WTO members can make under the GATS, and commitments that are not directly addressed under market access and national treatment.

In the case of both market access and national treatment, it is recognized that not all countries can or will act at once on all of these, and the Model Schedule recognizes the need for liberalization to proceed at different paces in different markets. Nonetheless, the hope behind the text is that all countries can make the full set of commitments within a finite number of years, say two years, after the entry into operation of the agreement to emerge from the Doha development round. As for the Best Practices, it is hoped that they will be adopted uniformly by a critical mass of all the WTO members participating in the GATS negotiations. In these ways, the Model Schedule and Best Practices should offer a road map for a multilateral approach towards insurance liberalization through a consistent pattern of clear and uniform commitments specifically formed to secure the needs of the insurance industry and the economic benefits that liberalized insurance markets can bring.

Proposed model schedule for future insurance commitments by WTO members

Introduction

This proposed model schedule is a proposed text for the use of WTO members in scheduling commitments under the framework of the GATS. It does not require a new framework of GATS, nor does it require a new annex or a new method of scheduling commitments under the GATS.

It is suggested as a desirable text to be used not only when members schedule new commitments, but also for members who have already made commitments as described in each item of the text.

The attached document represents two separate contributions which WTO members would add to their commitments in insurance. The first represents commitments to market access and national treatment. It builds on existing commitments already in the schedules of many countries, but incorporates certain specific obligations so as to remove any ambiguity as to whether they are built into the more general obligations assumed in the schedule. For instance, some countries already have inserted "none" in their insurance commitments for certain modes of supply, such as that of commercial presence. The purpose of the attached text is to give greater specificity and predictability to those commitments that are important to the industry. In addition, it sets forth obligations clearly not addressed in current schedules, such as the obligation to fully stage a commitment within a specified timeframe, as well as a standstill to protect acquired rights.

The second part of the contribution could be entitled "Best Practices in Insurance", which take the form of "additional commitments" under GATS article XVIII. It addresses those aspects of domestic regulation that are not addressed by the market access or national treatment provisions. They reflect regulatory obligations that exist for both foreign[170] and indigenous suppliers of services. Unlike the first part of the text, however, the best practices would be uniformly adopted by a critical mass of countries. Conceptually, the two parts serve the same objective, in that they are addressing effective market access for insurance providers. However, they are separated because of the way in which the GATS is structured. In order to make clear the intended effect of this text, the following comments are felt necessary to ensure completeness in the obligations to be assumed in the area of insurance.

I. Proposed model schedule for insurance services

The following would be an integral part of the specific commitments in the insurance sector pursuant to articles XVI and XVII of the GATS, entered into in accordance with the wider obligations in parts I and II of the GATS relating to sub-federal entities. The obligations to be assumed by a member must be read with commitments expressed in the columns of market access and national treatment in its schedule, in order to reflect the full extent of the member's undertakings. In some instances, the obligations assumed in the market access and national treatment columns in a member's schedule may capture some of the undertakings listed in this text. It nonetheless is suggested that those obligations should be described or supplemented by the wordings used in this proposed model schedule with the objective of providing greater clarity and specificity to certain aspects of the member's insurance obligations. It is recognized that some obligations can not be assumed at the conclusion of the current negotiation. However, some appropriate time frame for the staging of obligations is to be established, in general leading to full obligations in a maximum two years time from entry into force of the results of this negotiation.

[170] "Foreign" means "from another WTO member" throughout the Model Schedule and the "Best Practices" annex.

The proposed text does not suggest a different method of scheduling commitments. It recognizes the right of members to schedule commitments according to the Financial Services Understanding, which is annexed to the GATS; or according to standard scheduling techniques as provided for in article XX of GATS.

Unless otherwise indicated, the terms "insurance services" and "insurance supplier" incorporate all forms of insurance and reinsurance underwriting; insurance intermediation (brokerage and agency services, including reinsurance brokerage); surety; consultancy, actuarial, risk management, risk assessment, and claims settlement services.

Market access and national treatment

A. Acquired rights

With respect to all insurance services, future measures and schedules of commitments adopted by members will, at a minimum, not reduce or impair the current level of market access and national treatment available to foreign insurance services and services suppliers.

B. Market access – cross-border delivery in respect of reinsurance, marine/aviation/ transport insurance

1. Reinsurance, marine/aviation/transport insurance and insurance services related to these types of insurance are to be bound under the cross-border mode of supply without restrictions to market access. Members will assume identical undertakings with respect to access to marine/aviation/transport and insurance intermediation (brokerage and agency) services related to these types of insurance by clients located abroad, without regard to whether the foreign insurance supplier is registered in the consumer country.

2. For life and non-life reinsurance[171] the following additional specific commitments are to be included in the schedule:

(a) Elimination of mandatory cessions imposed on insurance suppliers to cede all or a portion of their risks to specified insurance or reinsurance suppliers;

(b) Elimination of any requirements that impose greater restrictions on the percentage of cessions to foreign reinsurance suppliers than to domestic reinsurance suppliers;

(c) Elimination of right-of-first-refusal privileges for domestic reinsurance suppliers;

(d) Elimination of discriminatory requirements imposed on foreign reinsurance suppliers as they relate to collateralization and localization of assets;

[171] The commitment should allow for differentiation on a least trade restrictive basis for life and non-life reinsurance market segments, consistent with the nature of risks assumed.

(e) The abolition of reinsurance monopolies; and

(f) The guarantee of freedom of form of reinsurance and freedom of reinsurance contract terms.

C. Market access – commercial presence

1. Form of establishment

(a) A foreign insurance supplier may establish a commercial presence by setting up a subsidiary (either wholly or partly (majority) owned), or by forming a new company, or through acquisition of an insurance supplier already established in the host country or as a branch;

(b) In their regulatory approach to a foreign insurance supplier, Members shall have full regard for the relationship between such a supplier and its parent company when the supplier enters into the market;

(c) Consistent with international intellectual property, business name registration and trademark law, a licensed foreign insurance supplier may provide its services using its home company name in the host country market, provided it does not infringe an already established trademark in that country;

(d)Foreign insurance suppliers should not be denied a commercial presence in the form of a branch or a subsidiary on the basis of their form of legal organization in the home market.

2. Equity shares

(a) Where commercial presence is in the form of a joint venture with a partner located in the host country, the decision to operate through a joint venture, and the percentage of equity shares assumed by the foreign partner, should be determined solely by the joint venture partners themselves;

(b) Foreign equity share restrictions will be eliminated. Where necessary, this will be achieved over a transition period terminating by a fixed date, not to exceed two years from the entry into force of this schedule of commitments;

(c) During the above transition period, any such limitations should permit the foreign partner to hold at least 51 per cent of the equity in the company, with staged increases.

3. Compulsory lines

Members will assume full commitments to market access and national treatment that cover compulsory risks, to ensure that foreign insurance

suppliers can compete for insurance lines and insurance services that are required of persons and businesses that reside in member countries.

4. Monopolies

Members should endeavour to eliminate the provision of insurance services by designated monopolies or exclusive services suppliers.

5. Private participation in pensions and funds management[172]

Upon the adoption of measures that allow for private participation in the pension systems of WTO members whose current regime prohibits this, or for members whose current system authorized private participation in such pension systems, such members will commit in their schedules to give other WTO members the benefits of market access and national treatment. Foreign suppliers providing pensions and funds management services[173] will have access, on a non-discriminatory basis, to offer their services to private and/or public pension systems provided by host country members. Where pension fund services are provided through the commercial presence mode, foreign suppliers will be afforded the choice of opportunities as provided in C.1 (a) and C.2 above. Foreign suppliers providing public and private pension funds and services may offer the range of product and investment options they find necessary to meet benefit needs consistent with national treatment requirements.

D. Market access – temporary entry of natural persons

1. In general, nationality and residency requirements on personnel should be avoided.

2. Where a foreign insurance supplier operates through a commercial presence, it may select, as its representative in the host country, any person who physically resides in the host country, irrespective of nationality; provided that the representative meets regulatory standards that identify competency to perform services in such a role, and any other provisions relating to the fitness of that individual to perform the obligations of a company representative.

3. In addition to the commitments undertaken in the general headnote to the GATS schedule pertaining to the temporary entry of natural persons, the following additional obligation is assumed with respect to insurance: host country members shall provide temporary visa and associated work permits, where required, to professional level personnel employed by the foreign insurance services supplier's home and third country offices in a timely

[172] Reservation by the Italian market.
[173] Pension fund services would include the design of public and private pensions systems; the marketing of such pensions to individuals, employers, and governmental entities; the investment of pension funds on behalf of pension plan participants and retirees; and the administration of public and private pension plans including, but not limited to, administrative services and record keeping, compliance and enrollment services.

manner for the purpose of entering the country and providing short and mid-term assistance to its host country insurance services operations.[174]

E. National treatment

1. In addition to the right to compete for all lines of insurance in a host country, foreign insurance suppliers, who are licensed or established in the host country, shall have the same opportunities to compete for domestic insurance business as indigenous insurance services suppliers with respect to insurance for State-owned or State-affiliated enterprises, or any enterprise where the State holds an equity share.

2. Foreign insurance suppliers will be treated no less favourably than domestic services suppliers with respect to capital, solvency, reserve, tax and other financial requirements, subject to the provisions of Paragraph 2 (a) of the Annex on Financial Services. Where less favourable treatment is imposed on the basis of Paragraph 2 (a) of the Annex, members will explain the basis for the different treatment accorded and, in particular, why such treatment is necessary for the protection of policyholders.

3. In the case of insurance intermediation, members will limit any conditions or limitations with respect to monetary transfers by insurance intermediaries to what is necessary to assume their legal responsibilities in the country where the service is delivered.

II. Best practices in insurance

The following obligations are assumed under article XVIII of the General Agreement on Trade in Services, which allows for additional commitments to be entered into schedules other than those covered by market access and national treatment, as defined in articles XVI and XVII, respectively.

A. Transparency

1. New and existing regulations, as well as revisions to existing regulations, will be made publicly available at all times, preferably in a public journal or register, in order to ensure their availability to all interested parties.[175]

2. New or revised regulations will be submitted for public comment prior to their enactment. A reasonable period of time, ordinarily no less than one month, will be provided to interested parties to submit comments on all proposed regulations.

3. New or revised regulations will not be made effective until market participants have had a reasonable period of time to become familiar with their contents and take necessary steps to implement them. Except for

[174] These obligations under the fourth mode of supply must be read with undertakings in the headnotes to services schedules addressing this category. For members who have scheduled according to the Understanding on Financial Services, any specific obligations assumed under the Understanding must be read with these obligations.

[175] This obligation forms part of a general obligation assumed by all members under GATS article III.

regulations which must be implemented immediately, due to emergency or other exigency, they will, at a minimum, enter into legal force two weeks following their publication.

4. As part of the procedures for implementing new or revised regulations, members will provide, in writing, their explanation as to the reasons for rejecting or accepting proposals made by interested parties.

5. An insurance supplier applying for a licence will be provided with a written statement, setting out fully and precisely the documents and other information necessary for obtaining authorization. This statement should aim to simplify and accelerate, as appropriate, the specific procedures to be followed.

6. Members will ensure that there are established procedures that enable consumers to assess the creditworthiness of insurance companies. In addition, they will ensure that insurance suppliers are free to provide information on their creditworthiness to the public, including information from independent rating organizations that provide such assessments[176].

7. Subject to the exception under article XIV (c) (ii), members will ensure that there will be no restrictions on the availability of financial services information from domestic or foreign sources to registered insurance suppliers.

8. Members will ensure that there are publicly available, non-discriminatory rules and procedures established that govern the identification and handling (including disclosure) of financially troubled institutions.

9. Measures adopted with respect to taxation (national and sub-national) that affect all insurance products will not enter into force until they have been notified to WTO through a semi-annual notification process established under the Services Council.

B. Solvency and prudential focus

1. Members will provide for insurance market stability and consumer protection through solvency and prudential regulations, allowing the market to determine which products and services are offered and rates applied.

2. Members will adopt and implement procedures that encourage and expedite the offering of insurance products and services.

(a) With the exception of products sold and rates applied to individual persons and compulsory lines, insurance regulation will not require new products, rates, and services to be filed or approved;

(b) Where filing and approval of an insurance product or service is required, the member regulatory authority will make publicly available

[176] This obligation is subject to article 2 (b) of the Annex on Financial Services.

the policy reasons for such requirements and explain how the requirements are the least burdensome means of accomplishing those objectives;

(c) Where filing and approval is required, insurance suppliers will be permitted to introduce a new product, which will be deemed to be approved after sixty days time if the insurance supervisor has not taken action to disapprove it;

(d) No limits will be placed on the number and frequency of new product and service introductions by an insurance supplier.

3. Members will not restrict the payment of dividends by foreign insurance suppliers provided solvency margins are met.

4. Standardized Reporting, Actuarial, Training Practices/Requirements.

Members should encourage adoption of accounting and auditing standards based on recognized international "best practices" standards. International Actuarial Association standards should be adopted to harmonize standards, and to facilitate the evaluation and comparison of insurance suppliers' financial strength, and their incorporation of new skills.

C. Insurance monopolies

For remaining insurance monopolies, the following obligations are to be assumed:

1. As a general rule, designated insurance monopolies are to be prohibited from offering insurance products outside the area of their monopoly designation. Where monopolies are permitted to engage in the sale or underwriting of insurance products outside the area of their monopoly rights, appropriate supervisory and oversight steps will be taken to ensure that monopolies do not abuse their monopoly position when competing in product areas that are open to competition[177].

2. Insurance suppliers with designated monopoly rights will maintain separate accounts for monopoly and non monopoly activities, to ensure that revenues from the monopoly do not subsidize competitive insurance activities.

D. Independent regulatory authority

The insurance regulatory body will be an independent government entity, to ensure that decisions regarding procedures adopted by the regulator are impartial with respect to all participants, and will encourage a competitive insurance market.

[177] This obligation is addressed in article VIII (2) of GATS.

XXII. Approaches to GATS liberalization, and the challenges for emerging markets

John Cooke[178]

This paper draws on presentations and background contributions from the UNCTAD ad hoc expert meeting on insurance services on 24 November 2005. Much has happened since the expert meeting, including the WTO Hong Kong ministerial meeting and (in the insurance field) the subsequent negotiations on financial services in a plurilateral framework. The author is therefore grateful for the opportunity to revise his earlier presentations and contributions in a composite, updated form.

Executive summary

This paper is in four parts. The first part considers approaches to liberalization under the GATS, taking account of the GATS framework, GATS commitments (including their contribution to certainty for business for the future) and domestic regulation & the "prudential carve-out". The second part turns to insurance industry approaches to GATS, taking in turn (1) the insurance industry's "Pro-Competitive Regulatory Principles", and (2) the "Insurance Model Schedule". The third part offers a detailed examination of sector-specific disciplines for insurance and a topic already broached in other forums,[179] namely the possibility of a GATS insurance reference paper, taking account of recent approaches to Domestic Regulation in the WTO Working Party on Domestic Regulation, the case for reference papers generally, the case for an insurance reference paper and the telecommunications analogy, finishing with some related issues and the way ahead for sector-specific disciplines. After this rather technical discussion, the final part returns to the present, with comments on the mid-2006 agenda after the WTO ministerial meeting in Hong Kong, with particular reference to the current plurilateral negotiations among the "Friends of Financial Services", and a look at the way ahead.

Introduction

It is of course entirely possible to liberalize an insurance market without reference to the GATS: indeed most OECD countries had advanced far along the path of liberalization well before the advent of the GATS in 1994. But the GATS offers a number of practical advantages, both to the country concerned and to participants in the sector in question. In particular it offers:

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[178] Chairman, Liberalization of Trade in Services (LOTIS) Committee, International Financial Services, London (IFSL).

[179] "The Regulation of Financial Services in Relation to Risk" 19th PROGRES International Seminar, 18–19 September 2003: Geneva Association "Etudes et Dossiers" No. 275, pp. 169–175. See also "Domestic Regulation and Insurance: The Case for a GATS "Reference Paper" for Insurance" *Geneva Papers on Risk and Insurance* Vol. 29, No. 2, April 2004, pp. 284–299.

- Reference principles and rules, concerning market access for foreign market-entrants and non-discriminatory equality of treatment ("national treatment") once the market has been entered;

- A system of binding commitments which allows a Government to augment domestic reforms (designed to encourage growth and development) with international undertakings to maintain its level of liberalization;

- A standard of comparison by which the degree of liberalization in different markets can be compared;

- A negotiating process, allowing Governments the reassurance that negotiated liberalization will maintain a degree of parity between trading partners;

- A clear system of liberalization undertakings in a framework that is understood by commercial enterprises, providing business with a guarantee that commitments, once scheduled under GATS, will not be rescinded.

All these advantages were evident in the negotiations leading to the WTO Agreement on Financial Services 1997 and are equally important in the current WTO Doha development round.

The GATS framework

The GATS approach has been formulated to take account of the nature of services, and the fact that services supply takes various forms. Four "Modes" of service supply are defined in the GATS on the basis of the origin of the service-supplier and consumer, and the degree and type of territorial presence that they have at the moment the service is delivered. These four modes are:

1. ***Cross-border:*** where the service supply takes place from the territory of one member into that of another. Only the service itself crosses the border, without the movement of persons.

2. ***Consumption abroad:*** this relates to services consumed by nationals of a member, in the territory of another member where the service is supplied. Essentially, the service is supplied to the consumer outside the territory of the member where the consumer resides.

3. ***Commercial presence:*** where the service-supplier crosses the border to have a commercial presence" abroad through which the service is provided. This presence can take the form of any type of business or professional establishment, including incorporation, branch, representative office, joint venture, and so on.

4. ***Presence of natural persons:*** this mode applies to natural persons only, when they stay temporarily in the market, for the purpose of supplying services, for example, as employees of service-suppliers.

In the insurance sector, different types of insurance currently tend to be supplied under different modes. Large commercial risks, including marine, aviation and transport (MAT) risks for example, are often insured from highly developed insurance centres such as

London, on a Mode 1 or Mode 2 (cross-border or consumption abroad) basis. On the other hand, retail life and general insurance, for example, are commonly sold to consumers through insurers established in the local market under Mode 3 (commercial presence).

However, meaningful market access for insurers can often only be achieved through liberalization of a combination of the relevant modes. This is because cross-border supply, commercial presence, and the presence of natural persons can all have a part to play. For instance, although Mode 3 (commercial presence, or "establishment") is essential for retail insurance companies setting up businesses on a branch, subsidiary or joint venture basis, it needs to be supported by liberalization in Modes 1 and 2 (cross-border and consumption abroad) in areas such as reinsurance, to allow insurers established in a market to tap into additional capital provided by the worldwide reinsurance market, to cover their levels of risk exposure flexibly.

GATS commitments: certainty for business for the future

Under the GATS, when a Government undertakes to liberalize a certain sector under a particular mode of supply, it enters a "commitment" outlining the areas to which the liberalization applies in its "Schedule of Commitments" – a statement of its various liberalization measures in all service sectors. A commitment such as this is considered "bound": that is to say, the Government binds itself to maintain that level of liberalization in that area, and undertakes not to reduce it. If no liberalization is undertaken, then the word "unbound" is entered in the schedule, and the Government is free in future to alter the current level of market access in that area.

This system of commitments is peculiarly well suited to the insurance sector: insurers, perhaps more than any other service sector, attach great importance to binding commitments under the GATS. Uniquely among services sectors, the insurance sector provides products that may continue as long as forty years or more, particularly in the case of life and pension products. Insurers therefore need the guarantees of a stable environment that bindings in the GATS are designed to provide.

That stable environment is an important feature of insurance companies' individual decisions as to the markets in which they will make investments (which entail high levels of initial capital outlay in order to cover new business strain and meet solvency requirements set by regulators). To reach a decision to make a foreign investment, an insurer is greatly helped if there are in place GATS commitments from the host country demonstrating that the regulatory environment has reached a particular level of liberalization and will remain stable at that level. It is better still if there are prospects of further liberalization and greater freedom to operate, and this too is provided by the GATS, under which Governments commit themselves to further negotiating rounds aimed at "progressive liberalization".

Approaches to liberalization under the GATS

Service sector liberalization under the GATS inevitably depends critically on regulation in the host country. For liberalization to be effective, it is essential to ensure that wherever possible regulation follows a "pro-competitive" approach facilitating competition within a

market, rather than having the effect of creating unnecessary barriers to market access. In the area of insurance regulation (as in financial services regulation as a whole) regulators enjoy a degree of freedom under the GATS Annex on Financial Services, containing the "prudential carve-out". This provides that "notwithstanding any other provision of the Agreement [GATS] a member shall not be prevented from taking measures for prudential reasons, including for the protection of investors [and] policyholders…or to ensure the integrity and stability of the financial system". It cannot however be used as a means of avoiding a member's commitments or obligations under GATS.

The wide ambit of the "carve-out" makes it all the more important that, for highly regulated services such as insurance, regulation and regulatory decisions should follow general principles of transparency, necessity, proportionality, availability to those regulated and – in the case of regulatory decisions – justiciability, appealability and the provision of reasons for decisions taken. All these are areas in which high standards of practice have been developed by some of the most advanced and successful financial services regulators. As liberalization progresses worldwide, it is important for such "best practices" to be widely followed.

Insurance industry approaches to GATS

Essentially, the insurance industry approach to GATS draws on the experience of the negotiations leading to the WTO Financial Services Agreement 1997.[180] The insurance private sector, represented in the Financial Leaders Working Group (FLWG), took a close interest in the conclusion of the Agreement which was a major step, the more so for being concluded against the uncertain background of the Asian financial crisis. For insurers, it represented a considerable success. But the insurance sector also learned lessons from the 1997 Agreement. The Agreement contained a strong element of entrenching ("binding") existing degrees of liberalization rather than making forward commitments to new liberalization. While insurers attach enormous importance to the bindings that were given, they would now welcome more commitments to future liberalization.

As has been said, there are particular reasons why the insurance industry attaches such importance to binding commitments under the GATS. Perhaps uniquely among financial services, the insurance sector provides products that may last as much as forty years or more, particularly in the case of life and pension products. Insurers therefore need the guarantees of a durable environment that bindings in the GATS are designed to provide. That stable environment is an important feature of insurance companies' individual decisions as to the markets in which they will establish themselves (and may be equally important for those customers investing in the products, such as pensions, offered by insurers).

Against that background the 1997 Agreement was very important. But it also demonstrated that certain features could be refined further. First, the Agreement showed that the language of commitments could be rather vague, or in some cases contradictory: different WTO member countries might have broadly the same intention as to a commitment to be offered, but commitments might be expressed in different ways, they might diverge from GATS, and the language of commitments might be imprecise.

[180] Fifth Protocol to the GATS, 1997.

Secondly, except in rare cases, the 1997 Agreement contained rather little on best practice in regulation. A clear implication of the Agreement was that insurance supervisors needed to be more fully involved in any further negotiations touching on this essential area. It is a regrettable fact that the regulatory communities and the trade negotiating communities tend to live in different worlds and to speak different languages (just as the trade policy community and the competition policy community speak different languages, one referring to "market access" and the other to "market entry"). These different communities have not so far been drawn sufficiently together.

The insurance industry's pro-competitive regulatory principles

The various lessons of the 1997 Agreement prompted the work undertaken by the insurance industry in the Financial Leaders Working Group Insurance Evaluating Team (representing a group of national insurance associations, and the Comité Europeén des Assurances (CEA) in the "Quad" countries[181]). The first step, in 1999, was the publication by the FLWG of Pro-Competitive Regulatory Principles for Insurance.[182] These attempted to set out structured principles of market access, national treatment, and regulatory best practice that the insurance industry considered important if liberalized insurance markets were to combine strong prudential regulation with competition, innovation and diversity.

The thinking behind the Pro-Competitive Regulatory Principles was straightforward. It sprang from the observation that regulators of financial services in the prudential regulatory area had every reason to operate all kinds of safeguards for the integrity of the financial system and the protection of consumers; but they did not necessarily have any reason, when doing so, to facilitate a pro-competitive environment making it at least reasonably practical for new market entrants to enter the market. Ease of market entry is not necessarily seen by regulators as part of their remit. There was therefore concern among providers of financial services in general, and insurers in particular, that, even if a valuable degree of market access were secured in the course of the GATS negotiations, the benefits of that market access might be negated by the failure of regulators in different countries to admit the real validity of a philosophy of encouraging a competitive market. There was apprehension that constant tension could be the result.

But it became clear that simply to express principles was probably unlikely to be enough to encourage the clarity that was necessary for framing more standardized schedules of commitments. The FLWG therefore decided on the further step of translating the Pro-Competitive Regulatory Principles into the actual language of commitments on insurance under the GATS. No easy task, this process resulted in the Insurance Model Schedule and the Best Practices that accompany it.

The Insurance Model Schedule

The Insurance Model Schedule is designed to offer a structured approach to translating the practicalities of a liberalized insurance market into insurance commitments to be scheduled under the GATS on market access and national treatment and on best regulatory practices. The Model Schedule is therefore intended as a practical reference

[181] Canada, the European Community, Japan and the United States.

[182] Published as an annex to "Developments in services" (chap. 4 of "Due Process in WTO Dispute Settlement", *Third Yearbook of the World Trade Law Association,* London 2000.

tool for understanding the shape to be taken by a liberalized insurance market in terms of the language of commitments under the GATS rules-based system. It is hoped that it will foster negotiations in the Doha round by helping to frame discussions on insurance liberalization.

The Model Schedule annexed to this paper covers market access and national treatment. On market access, Sections A to D of the Model Schedule correspond to GATS Modes 1 to 4. Section E covers principles of national treatment. The accompanying Best Practices in effect cover the additional commitments (on, for instance, regulatory practices) that WTO members can make under the GATS, and commitments that are not directly addressed under market access and national treatment. In the case of both market access and national treatment, it is recognized that not all countries can or will act at once on all of these, and the Model Schedule recognizes the need for liberalization to proceed at different paces in different markets. Nonetheless, the hope behind the text is that all countries can make the full set of commitments within a finite number of years, say two years, after the entry into operation of the agreement to emerge from the Doha development round. As for the Best Practices, it is hoped that they will be adopted uniformly by a critical mass of all the WTO members participating in the GATS negotiations. In these ways, the Model Schedule and Best Practices should offer a road map for a multilateral approach towards insurance liberalization through a consistent pattern of clear and uniform commitments specifically formed to secure the needs of the insurance industry and the economic benefits that liberalized insurance markets can bring.

It is too soon to judge the overall success of the Model Schedule. It has certainly been a success in the sense that a wide range of negotiators now have a model or a template for both the aims of the insurance industry in seeking market access and the language in which market access commitments could be expressed. After all, trade negotiators cannot be expected to have specialist knowledge of insurance (any more than of any other service sector): to ensure that they can negotiate in ways that will be useful to the industry it is valuable to provide the right linguistic structure. That has been successfully achieved.

Less successful has been the aim of securing the adoption of the model schedule as a package in requests and offers in the current round. Perhaps it was naïve to hope for such an outcome: after all, when a GATS request to another country is being drafted, there is a tendency – and this is evident in those requests that have become public – for the request to be structured in fairly telegraphic terms under the heading “Nature of barrier” (for instance, “barriers on cross-border delivery of commercial lines insurance”), followed by an equally telegraphic proposal under the heading “Request” (for instance, “remove the barriers”). A fairly simple and crude request of this kind is a recognized tactic: it opens the way for a possible offer hinting at the measures that another WTO member may be ready to take, as a basis for further detailed discussion to clarify the offer. Given these technical realities of the request/offer process it may therefore have been naïve to hope that the language of the model schedule would be imported wholesale into its working.

All in all, discussion in the trade policy and regulatory communities in developed countries suggests a good degree of support for the Model Schedule as a useful negotiating tool. Its market access and national treatment provisions formed a basis for the insurance Requests put forward by the European Union and the United States in the Doha development round request/offer process. There are mixed views as to whether the Model Schedule goes far enough, or should go further, in its proposals for liberalization,

and as to whether OECD countries should move beyond the Understanding on Financial Services. Many OECD members agree that the Best Practices in insurance regulation are broadly consistent with current OECD national practice, and think that it would be good to enhance the quality of underlying regulatory conditions bound in GATS commitments, but with few specific suggestions on how to achieve this outcome.

Sector-specific disciplines for insurance: a GATS insurance reference paper?

The current GATS negotiations in the Doha development round have gradually moved forward, even if frustratingly slowly. But a potentially important regulatory issue remains to be resolved in concurrent discussions in Geneva. It concerns the work by WTO on domestic regulation. Here the WTO Working Party on Domestic Regulation (WPDR) has been considering possible approaches, under the GATS, to the problem of ensuring that domestic regulation does not impede advances in liberalization achieved in WTO negotiations. The likely tenor of those conclusions is (2006) gradually becoming clearer. It may be that they will be limited to the provisions under GATS article VI on disciplines covering qualification requirements and procedures, technical standards and licensing, aiming to ensure that these are based on objective and transparent criteria, not more burdensome than necessary, and, in the case of licensing procedures, not in themselves a restriction on the supply of the service (the current drift of discussion in the Working Party suggests this). On the other hand, a wider menu of other domestic regulation possibilities could still be discussed in Geneva: it is too soon to be certain.

Domestic Regulation clearly lies at the core of the interplay between regulation and liberalization. The GATS offers two broad approaches which, while not mutually exclusive, probably need to be seen as alternatives if practicable, workable ways forward are to be developed:

- ***GATS article VI:*** This offers the possibility of disciplines, agreed by a consensus of all 148 WTO members, covering either a regulatory principle (e.g. transparency or necessity) or regulatory features that will underlie all members' regulation of a particular sector (e.g. the GATS Accountancy Disciplines approved by the WTO Council for Trade in Services in December 1998). The merit of the article VI approach is that disciplines, once agreed, would have some quality of universalism and would command the adherence of all WTO members. But this is potentially outweighed by corresponding problems and restrictions. One is the difficulty – if not impossibility – of securing consensus among all 148 WTO members to such disciplines, whether at the level of general principles or, still more, at the detailed sectoral level. Another is that disciplines, even if agreed, might only apply in areas where a member had made a liberalization commitment and might be subject to a member giving an additional commitment, under GATS article XVIII, confirming the member's intention to apply them. Early on, the WPDR was given a remit to establish consensus on disciplines under GATS article VI:4 that would cover all services sectors. But this task is widely regarded as either unrealistic in its magnitude or potentially vulnerable to pressures to reach "lowest common denominator" disciplines of little practical value. The WPDR's discussions have therefore moved very slowly.

- ***GATS article XVIII:*** This offers an alternative, more flexible, approach, under which obligations can be assumed by one or more WTO members under GATS article XVIII, which allows WTO members to opt to enter additional commitments in their GATS schedules, going beyond those covered by market access (defined in GATS article XVI) and national treatment (GATS article XVII). In financial services, GATS article XVIII was used by Japan in the financial Services Agreement 1997, to give multilateral effect to the US/Japan bilateral insurance agreements 1994 and 1996, negotiated with the Japanese Ministry of finance by USTR Barshefsky. But the main example of its use remains that of telecommunications, where the Telecommunications reference paper was a reference text setting out in short form[183] the specific regulatory and other features essential for the liberalization of telecommunications. WTO members wishing to liberalize telecommunications then scheduled additional commitments under GATS article XVIII in the WTO Basic Agreement on Telecommunications (1997), [184] indicating whether they subscribed to the reference paper as a whole, or whether they maintained specified exceptions to it. The telecommunications reference paper is widely regarded as a considerable success. True, it may lack the theoretically multilateral and universalist character of GATS article VI commitments based on a consensus of all WTO members. But the WTO Basic Telecommunications Agreement commands widespread adherence from a "critical mass"[185] of those members who wish to subscribe to it.

The two options are not mutually exclusive. It might be possible, for instance, to have article VI:4 disciplines on transparency in domestic regulation as a whole across all WTO members and all sectors (although even in this narrow field consensus might prove hard to attain) together with an insurance (or financial services) reference paper covering specific regulatory issues affecting insurance or the financial services sector as a whole.

Recent approaches in the Working Party on Domestic Regulation

Certain possible lines of discussion have been canvassed in the Working Party. As might be expected, these aim principally at fulfilling the mandate enshrined in GATS article VI:4 and 5[186] for the development of any necessary disciplines relating to qualification requirements and procedures, technical standards and licensing requirements. An early

[183] The Telecommunications Reference Papers is three pages long.

[184] Fourth Protocol to the GATS 1997.

[185] There were 55 schedules of specific commitments when the Basic Agreement on Telecommunications came into force (1998), representing 69 WTO members.

[186] Apart from GATS article III (on transparency), GATS article VI (on domestic regulation) is the principal GATS article prescribing such general features of domestic regulation as clarity and proportionality. Article VI:4 says:

> "4. With a view to ensuring that measures relating to qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade in services, the Council for Trade in Services shall, through appropriate bodies it may establish, develop any necessary disciplines. Such disciplines shall aim to ensure that such requirements are, *inter alia*:
> a) based on objective and transparent criteria, such as competence and ability to supply the service;
> b) not more burdensome than necessary to secure the quality of the service;
> c) in the case of licensing procedures, not in themselves a restriction on the supply of the service."

Article VI:5 amplifies article VI:4 by specifying, inter alia, that, in determining whether a WTO member is meeting the obligations in article VI:4, account shall be taken of the international standards of relevant international organizations applied by that member (a footnote makes clear that "relevant international organizations" refers to international bodies whose membership is open to the relevant bodies of at least all members of the WTO).

example was the GATS Accountancy Disciplines (1998). These are divided into eight sections.[187] On similar lines, there have been proposals for a draft GATS annex on domestic regulation intended to be applicable to all services sectors. Such proposals are organized on lines similar to the Accountancy Disciplines, redividing the Accountancy Disciplines' eight sections into many more detailed sections.[188] All in all, the Accountancy Disciplines and the idea of a draft GATS annex represent, respectively, a "sectoral" and a "horizontal" approach to regulatory disciplines within the GATS article VI framework. Despite, or perhaps because of, their breadth of scope, it has to be doubted whether the GATS annex approach can easily be made to command the consensus that it would require.

Alternative approaches have considered Regulatory Disciplines with particular reference to Licensing Procedures. These might allow GATS disciplines under article VI.4 to be based on a horizontal approach or developed on a sectoral basis. The two approaches might not be mutually exclusive, although there is a point of view that there should be no overlap between GATS articles XVI and XVII (market access and national treatment), which belong to Part III of the GATS, and GATS article VI which belongs to Part II (general obligations and disciplines); and, on that basis, measures subject to scheduling under GATS articles XVI and XVII might not be addressed by disciplines under GATS article VI.4. This, however, would not necessarily preclude work on the development of other regulatory principles outside the scope of article VI (e.g. issues such as the independence of regulators, universal service obligations, and access to networks or essential facilities), and some of these regulatory issues could be addressed through other approaches (including horizontal disciplines, sectoral disciplines, or disciplines "tailored" to specific sectors, such as a reference paper). An outstanding issue is whether there are limits to what may be achievable by disciplines under GATS article VI; and whatever decision is taken on this would affect the case for a reference paper setting out issues calling for additional commitments under GATS article XVIII.

The case for reference papers

To some extent GATS articles VI and XVIII both cover the same subject matter: both refer to qualifications, standards or licensing matters. But the distinction between them appears to be that disciplines under article VI are *confined* to ensuring that measures relating to qualifications, standards and licensing do not constitute unnecessary barriers to trade in services.[189] To go further, and to combine such disciplines with other measures (i.e. whatever other measures may be thought necessary as preconditions for liberalization in the domestic market), seems to require recourse to GATS article XVIII. In the case of telecommunications the key preconditions were competition and competitive safeguards,

[187] The eight sections are: I. Objectives, II General Provisions, III Transparency, IV Licensing Requirements, V Licensing Procedures, VI Qualification Requirements, VII Qualification Procedures, VIII Technical Standards.

[188] The fourteen sections are: I Objectives, II Scope and Definition, III Preparation, Adoption and Application of Measures, IV Transparency and Public Comment Procedures, V Licensing Requirements VI Licensing Procedures, VII Qualification Requirements, VIII Qualification Procedures, IX Technical Standards, X Adverse Administrative Dispositions relating to Licences and Qualifications, XI Administrative Guidance relating to Licences and Qualifications, XII Procedure of Judicial Tribunals, XIII Administration, XIV Miscellaneous Provisions.

[189] It is recognized that the language of article VI:4 does not limit the realm of disciplines to those within the ambit of (a)–(c) and conceivably might also be a basis for other disciplines. Nonetheless, what has clearly emerged in discussions about the use of article VI:4 is a *de facto* mandate not to go beyond those provisions specifically itemized in article VI:4 (a)–(c).

given the widespread previous history of single national service providers in the sector. And so it is that the reference paper at the heart of the GATS Basic Telecommunications Agreement contains core provisions on Competitive Safeguards, Interconnection, Universal Service and Allocation and Use of Scarce Resources (all essential preconditions for competition in a country's domestic telecommunications market) as well as provisions on Public Availability for Licensing Criteria and Independent Regulation. It seems, therefore, that if there is a need for *special, sector-specific provisions*, *going beyond limited disciplines relating to qualifications, standards and licensing,* that points the way towards additional commitments under article XVIII, rather than simply disciplines under article VI, as the necessary route. In turn, standardization of such additional commitments under article XVIII is likely to require a reference text (or reference paper) enshrining the preferred wordings.

The above is a reasoned and impartial approach to deducing the point, in terms of GATS provisions, at which a reference paper becomes necessary. But there are also practical reasons for recommending a reference paper as the preferred approach when dealing with detailed issues that are specific to services sectors or subsectors:

- ***Sectoral "fit":*** The article VI "horizontal" approach may simply not suit all sectors and subsectors of a field of services under negotiation: in financial services, for instance, the range of subsectors is wide (covering insurance, banking and securities dealing) and the same disciplines may not be appropriate to all subsectors. A suitable vehicle for disciplines fitted to the specific sector in question may be needed;

- ***Article VI and national treatment:*** The article VI approach can give rise to ambiguities over national treatment, as seen in 1998 in the debate over the Accountancy Disciplines. For many WTO members involved in that debate, it was unclear whether or not they were assuming expanded national treatment obligations, given the inevitable grey area, in a number of cases, between national treatment and article VI disciplines. Difficulties of this kind, which could easily arise again, have a bearing on the strategic choice between article VI disciplines and a reference paper: certain countries may hesitate to join a consensus in favour of article VI disciplines, if these are seen as placing them in a de facto position of having made, albeit unintentionally, national treatment commitments. Such members may prefer disciplines under GATS article XVIII: they can then decide, quite specifically, whether or not to offer an additional commitment under GATS article XVIII, and they are bound only by the precise terms of the commitment that they have made.

These are practical reasons, based on negotiating experience, as to why the reference paper approach should recommend itself to WTO members hesitant about subscribing to article VI disciplines, as well as to sectors which seek a sector-specific approach suited to their sectoral requirements. It is interesting that the legal services sector and the postal sector are reported to have considered reference papers for these reasons.

An insurance reference paper

If the above theoretical and practical arguments are right, the case for an insurance reference paper turns on the extent to which sector-specific provisions are required for

insurance, going beyond general disciplines on qualifications, standards and licensing. The Best Practices text forming Part II of the Model Schedule proposal itemizes the areas in which the insurance sector needs such sector-specific provisions. True, some of Parts A and D of the Best Practices (concerned with transparency and an independent regulatory authority) might be covered in disciplines under article VI; but these parts also include insurance-specific issues, as regards creditworthiness, the role of rating organizations, and the role of supervisors in encouraging competitive insurance markets. Turning to Parts B (solvency and prudential focus) and C (insurance monopolies) of the best practices, the issues are evidently insurance-specific; and it would be difficult to imagine how they could be covered under article VI, as they go beyond its ambit. Against that background, there is a cogent case for a reference paper for insurance services, bringing together all the provisions necessary for the true realization of liberalization of an insurance market, in a coherent whole, as further obligations to be assumed by WTO members in the form of additional commitments.

The telecommunications analogy

In considering the case for an insurance reference paper, it is worth examining the history of the GATS Basic Telecommunications Agreement, the reasons for the success of the telecommunications reference paper, and analogies with insurance. Taking these in turn:

- ***History:*** At the start of the telecoms negotiations there was resistance to the idea of a reference paper. It had been contended that the GATS disciplines, as brought together in all the relevant GATS texts, together with the GATS Annex on Telecommunications, were clear, and that they explicitly or implicitly met the all the concerns inherent in market-opening for telecommunications. As the negotiations developed, however, it became increasingly accepted that the GATS provisions were not explicit enough to cater for all the telecoms-related issues that arose. For one thing, the negotiators found themselves facing the fact that in virtually all countries the telecoms sector was, or had very recently been, a monopoly (usually a State monopoly), so that there was a need to counteract the anti-competitive attitudes (among both sectoral entities and regulators) that still persisted. A Group of Experts was therefore formed, to explore how this might best be done. In addition, discussion was broadened out among a wider group of "Friends of Telecommunications" which was open to any delegations that expressed interest. The Group and the Friends both recognized that, given the existence of regulatory attitudes that were not pro-competitive, a wider concept needed to be developed. This concept was framed round the general notion that "liberalization on its own is not enough", which became the basis for the development of the telecommunicationss reference paper.

- ***Developing the reference paper:*** As the negotiators identified all the issues requiring settlement in any Telecommunications Agreement, the original opposition to a reference paper tended to melt away, at least among a critical mass of WTO members. The Group of Experts continued to develop the provisions of a reference paper, in parallel with wider discussions on liberalization and the specific commitments that would need to be scheduled to attain it. Shortly before the time for formal scheduling of commitments the Group of Experts came forward to the main negotiating group and proposed a more or less final version of the reference paper, which the negotiating group adopted to

facilitate the negotiating and scheduling process: negotiating parties were told that there was no obligation to accept or use the reference paper, but were asked to consider doing so and to consider scheduling additional commitments (which were set out in the reference paper). In the event, the telecommunications reference paper gained wide currency. Many countries were content to schedule in line with it; others slightly adapted it in their scheduling. It was the key text of the WTO Basic Telecommunications Agreement.

- ***Reasons for success:*** There appear to have been two reasons why the telecommunications reference paper gained such wide support. First, national telecommunications regulators saw that it contained measures or actions that they would in any case expect to take. Secondly, Governments grew keen to schedule according to the reference paper, as a way of demonstrating that they wished to secure inward investment in telecommunications, on competitive and internationally recognized terms, as an essential part of the commercial infrastructure required for economic development.

- ***Analogies with insurance:*** In the telecommunications sector, the case for a reference paper was strengthened by the history of monopoly and the perception that "liberalization on its own is not enough", coupled with regulators being won over and Governments wishing to attract investment in an essential piece of economic infrastructure. Circumstances in the insurance field, if not identical, are certainly analogous in some respects (the need for regulatory good practice as a complement to liberalization, the strong influence of the State over a highly regulated service, and the need for a well-functioning insurance sector as part of economic infrastructure).

Related issues

This paper does not seek to tackle all the issues potentially relevant to sector-specific disciplines for in insurance and the question of a reference paper. But some important additional issues need to be recognized, however briefly, not least because they raise the question whether a reference paper could be confined to insurance (as described in the GATS Annex on Financial Services) or whether, given the blurred boundaries between all kinds of financial services, it would be better for any reference paper to cover financial services as a whole. The following matters would need further consideration:

- ***WTO Understanding on Financial Services:*** in many ways, this is confined to market access and national treatment, and so may not be relevant to a reference paper. But certain provisions of the understanding (e.g. art. 7, on new financial services) may raise questions about the relationship between the understanding and a reference paper.

- ***GATS Annex on Financial Services:*** this annex, and particularly its provisions on definitions and on the prudential carve-out, raises questions requiring further study in relation to a reference paper.

The second issue above is of particular importance. In his article "Should the GATS prudential carve-out for financial services measures be revisited now – rather than left to

store up a crisis for the WTO dispute settlement system?",[190] Julian Arkell has raised cogent questions about the scope and interpretation of the prudential carve-out in its implications for dispute settlement, its relationship with GATS article VI:4 and 5, and overarching political sensitivities in this area. This paper will not examine these. Suffice it to say that, the more complex the GATS architecture governing financial services, the clearer the articulation of all GATS provisions needs to be, and the greater the scope for misunderstanding over the proper and acceptable scope of the prudential carve-out.

Sector-specific disciplines: the way ahead

It is clear that a stage has been reached when individual services sectors, insurance among them, have an opportunity to review the progress that has been made in discussions so far on regulation and liberalization and to promote policy options of their choice and ensure that these are pursued and developed.

How individual services sectors will use this opportunity will depend on the economic and infrastructural importance of the sector concerned, its significance for economic development and wealth creation, the extent to which the service in question is internationally traded, the role and scale of regulation as a factor in the sector's commercial operations, and many other features. For some services sectors, the final outturn – not yet foreseeable – of the current complex discussions on domestic regulation in the WPDR may prove adequate or tolerable. But others may wish to take a more proactive approach, now or in future negotiations, towards influencing discussion in WTO.

The immediate agenda

This paper has ranged across a wide spectrum of issues affecting insurance liberalization, including a long excursus into the question of an insurance reference paper. It is now time to return to the present (mid-2006). Drawing the threads together, a number of themes stand out. At the strategic level, developments in global economy point have some key implications for the insurance sector in emerging markets. Priorities include capacity-building, training insurance professionals, developing regulatory frameworks and enhancing public awareness of the sector's importance and developmental role. These priorities are probably best achieved through appropriate, sequenced liberalization measures.

Building on the 1997 Agreement

At the tactical level, the Doha development round offers a significant opportunity to build on what was achieved in the WTO Financial Services Agreement 1997. The Agreement certainly leaves room for further steps to be taken. Although significant at the time it was concluded, nearly a decade ago, it contained serious limitations. True, it tackled the achievable sector-specific goals. But it was restricted by the terms of GATS and GATS definitions; coming at a time when the separate subdivisions of the financial services sector as a whole only beginning to lose their previous traditional descriptions, it did little to redefine sectoral frontiers; it engaged the attention of regulators only to a limited extent;

[190] *Progres*, No. 37, June 2003.

it suffered significantly from defective scheduling; and it left relatively little legacy in terms of approaches to future liberalization strategy.

There are therefore a number of issues that remain to be tackled. There is the problem – probably a growing problem – of definitions for GATS scheduling purposes; there is the issue of "prudential" regulation and the ambit of the "prudential carve-out"; there is also the question domestic regulation, extending to transparency, on the one hand, and the interaction of sectoral regulation and wider regulatory policies in individual countries, on the other. It seems unlikely that all of these issues will be tackled in the Doha round: some at least will remain matters for the future.

Plurilateral negotiations

In the meanwhile, at the time of writing (mid-2006), negotiations on financial services in general and insurance in particular are on the cusp of a qualified success. The GATS "plurilateral" approach, agreed at the WTO Hong Kong Ministerial, offers a possible tactical opportunity. In principle, it is an approach with attractions for emerging markets and their WTO negotiators. On the one hand, it goes a good way towards adhering to the familiar "bottom-up", schedule-based approach, in line with precedent: it therefore offers a degree of flexibility to developing countries: they can commit to the terms of a type of model schedule to the extent that they wish. On the other, it is essentially voluntary: by attracting a group of "Friends" of financial services it facilitates a focus on the common aim of a plurilateral negotiating outcome in which offering countries can track and understand each others' commitments. Finally, it brings together, in an aggregated way, the key commitments under negotiation, in a text in which they are grouped simply and plainly, in a less technical, more "headline" manner than before.

The plurilateral negotiations on financial services are based on a Collective Request text that brings together the key elements of individual requests. It opens with a chapeau on the role of WTO negotiations in liberalization and economic growth. It then states that the objective of the Collective Request, as with bilateral requests, is to help towards the identification and negotiation of meaningful GATS commitments in financial services within the request-offer process. It adds that, when scheduling commitments, countries should use the definitions in the GATS Annex on Financial Services (i.e. all the definitions covering the principal financial services subsectors, plus intermediation services and ancillary services relating to them).

The remainder of the text is taken up with specification of market access commitments under Modal headings across all financial services subsectors (omitting Mode 4, because at least one party to the Collective Request could not, at the time the Collective Request was made, offer any commitments under Mode 4); some national treatment and regulatory commitments are also itemized. The requested commitments are summarized below:

- Mode 1: Insurance (i.e. marine, aviation and transport (MAT) insurance); reinsurance; insurance broking and auxiliary services. Financial advice. Financial information and information-processing. (There are no requests for Mode 1 commitments in banking and securities);

- Mode 2: Insurance (as for Mode 1) and reportedly all other non-insurance financial services, i.e. including banking, securities and asset management;

- Modes 1 and 2: An entry covering both Modes 1 and 2 reportedly adds that there can be advantages to additional liberalization especially where the consuming agent is sophisticated, for example, institutional consumers of securities services;

- Modes 1–3: Commitments to dismantle domestic monopolies. Commitments to eliminate quantitative restrictions and economic needs tests;

- Mode 3: Commitments under Mode 3 are widely drawn to cover rights to establish or acquire businesses as subsidiaries, branches or joint ventures;

- National treatment: Commitments under Modes 1–3 to remove legal and regulatory discrimination between foreign and domestic service suppliers;

- Regulation: Commitments to transparency in developing and applying laws and regulations. Commitments on expeditiousness of licensing procedures.

The text is arguably weakest on commitments on banking, securities and asset management under Mode 1, apparently reflecting some fundamental difference of outlook between regulators among certain of the key requesting countries. At the time of writing it remains under discussion, alongside bilateral request/offer negotiations.

Taken at its best, the plurilateral approach offers the hope of a degree of consistency, with the prospect of broadly similar commitments to a similar degree of market-opening across a range of countries, worded in a similar way, with a degree of uniformity. All in all, it would have the advantages of being a voluntary vehicle demonstrating commitment of those countries ready to opt in (some may see here a possible analogy with the merits of the basic telecommunications reference paper). And it is an approach to negotiations that cannot be stopped by countries that are uninterested or opposed: they can opt out.

The way ahead

The plurilateral approach has given a boost to the negotiations. But this is not to say that negotiations on insurance, or on any other aspect of financial services, are likely to be concluded via the plurilateral process alone in the remaining stages of the Doha development round. The bilateral request/offer process will continue to have a key role to play, and its success will depend on the scheduling of revised services offers by, or around, the deadline of the end of July 2006. In turn, those revised offers will no doubt be predicated upon a satisfactory settlement of negotiating modalities in other fields, notably agriculture and non-agricultural market access. However the plurilateral process for services has provided an important incentive for re-engaging in services negotiations, and will, it is to be hoped, contribute to their successful conclusion.

Annex

Proposed model schedule for future insurance commitments by WTO members[191]

Introduction

This proposed model schedule is a proposed text for the use of WTO members in scheduling commitments under the framework of the GATS.

It does not require a new framework of GATS, nor does it require a new annex or a new method of scheduling commitments under the GATS.

It is suggested as a desirable text to be used not only when members schedule new commitments, but also for members who have already made commitments as described in each item of the text.

The attached document represents two separate contributions which WTO members would add to their commitments in insurance. The first represents commitments to market access and national treatment. It builds on existing commitments already in the schedules of many countries, but incorporates certain specific obligations so as to remove any ambiguity as to whether they are built into the more general obligations assumed in the schedule. For instance, some countries already have inserted “none” in their insurance commitments for certain modes of supply, such as that of commercial presence. The purpose of the attached text is to give greater specificity and predictability to those commitments that are important to the industry. In addition, it sets forth obligations clearly not addressed in current schedules, such as the obligation to fully stage a commitment within a specified timeframe, as well as a standstill to protect acquired rights.

The second part of the contribution could be entitled “Best Practices in Insurance”, which take the form of “additional commitments” under GATS article XVIII. It addresses those aspects of domestic regulation that are not addressed by the market access or national treatment provisions. They reflect regulatory obligations that exist for both foreign[192] and indigenous suppliers of services. Unlike the first part of the text, however, the best practices would be uniformly adopted by a critical mass of countries. Conceptually, the two parts serve the same objective, in that they are addressing effective market access for insurance providers. However, they are separated because of the way in which the GATS is structured.

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[191] The insurance associations subscribing to the Model Schedule include associations from all the Quad countries (Canada, the European Union, Japan and the United States). The full list of subscribing associations is as follows: American Council of Life Insurers, Reinsurance Association of America, American Insurance Association, International Insurance Council, Council of Insurance Agents and Brokers, Bureau International des Producteurs d’Assurances et de Réassurances (BIPAR), the World Federation of Insurance Intermediaries (WFII), the Marine & Fire Insurance Association of Japan, the Canadian Life and Health Insurance Association, the Comité Européen des Assurances (CEA) and its 15 national member associations from EU member States (Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the United Kingdom). The constituent United Kingdom member of the CEA includes the Association of British Insurers, the International Underwriting Association of London and Lloyd’s.

[192] Foreign” means “from another WTO member” throughout the Model Schedule and the “Best Practices” annex.

In order to make clear the intended effect of this text, the following comments are felt necessary to ensure completeness in the obligations to be assumed in the area of insurance.

Proposed model schedule for insurance services

The following would be an integral part of the specific commitments in the insurance sector pursuant to Article XVI and XVII of the GATS, entered into in accordance with the wider obligations in Parts I and II of the GATS relating to sub-federal entities. The obligations to be assumed by a member must be read with commitments expressed in the columns of market access and national treatment in its schedule, in order to reflect the full extent of the member's undertakings. In some instances, the obligations assumed in the market access and national treatment columns in a member's schedule may capture some of the undertakings listed in this text. It nonetheless is suggested that those obligations should be described or supplemented by the wordings used in this proposed model schedule with the objective of providing greater clarity and specificity to certain aspects of the member's insurance obligations.

It is recognized that some obligations can not be assumed at the conclusion of the current negotiation. However, some appropriate time frame for the staging of obligations is to be established, in general leading to full obligations in a maximum two years time from entry into force of the results of this negotiation.

The proposed text does not suggest a different method of scheduling commitments. It recognizes the right of members to schedule commitments according to the Financial Services Understanding, which is annexed to the GATS; or according to standard scheduling techniques as provided for in article XX of GATS.

Unless otherwise indicated, the terms "insurance services" and "insurance supplier" incorporate all forms of insurance and reinsurance underwriting; insurance intermediation (brokerage and agency services, including reinsurance brokerage); surety; consultancy, actuarial, risk management, risk assessment, and claims settlement services.

Market access and national treatment

A. Acquired rights

With respect to all insurance services, future measures and schedules of commitments adopted by members will, at a minimum, not reduce or impair the current level of market access and national treatment available to foreign insurance services and services suppliers.

B. Market access – cross-border delivery in respect of reinsurance, marine/aviation/ transport insurance

1. Reinsurance, marine/aviation/transport insurance and insurance services related to these types of insurance are to be bound under the cross-border mode of supply without restrictions to market access. Members will assume identical undertakings with respect to access to marine/aviation/transport and insurance intermediation (brokerage and agency) services related to these types of insurance by clients located

abroad, without regard to whether the foreign insurance supplier is registered in the consumer country.

2. For life and non-life reinsurance[193] the following additional specific commitments are to be included in the schedule:

(a) Elimination of mandatory cessions imposed on insurance suppliers to cede all or a portion of their risks to specified insurance or reinsurance suppliers;

(b) Elimination of any requirements that impose greater restrictions on the percentage of cessions to foreign reinsurance suppliers than to domestic reinsurance suppliers;

(c) Elimination of right-of-first-refusal privileges for domestic reinsurance suppliers;

(d) Elimination of discriminatory requirements imposed on foreign reinsurance suppliers as they relate to collateralization and localization of assets;

(e) The abolition of reinsurance monopolies; and

(f) The guarantee of freedom of form of reinsurance and freedom of reinsurance contract terms.

C. Market access – commercial presence

1. Form of establishment

(a) A foreign insurance supplier may establish a commercial presence by setting up a subsidiary (either wholly or partly (majority) owned), or by forming a new company, or through acquisition of an insurance supplier already established in the host country or as a branch;

(b) In their regulatory approach to a foreign insurance supplier, members shall have full regard for the relationship between such a supplier and its parent company when the supplier enters into the market;

(c) Consistent with international intellectual property, business name registration and trademark law, a licensed foreign insurance supplier may provide its services using its home company name in the host country market, provided it does not infringe an already established trademark in that country;

(d) Foreign insurance suppliers should not be denied a commercial presence in the form of a branch or a subsidiary on the basis of their form of legal organization in the home market.

2. Equity shares

(a) Where commercial presence is in the form of a joint venture with a partner located in the host country, the decision to operate through a joint venture, and the

[193] The commitment should allow for differentiation on a least trade restrictive basis for life and non-life reinsurance market segments, consistent with the nature of risks assumed.

percentage of equity shares assumed by the foreign partner, should be determined solely by the joint venture partners themselves;

(b) Foreign equity share restrictions will be eliminated. Where necessary, this will be achieved over a transition period terminating by a fixed date, not to exceed two years from the entry into force of this schedule of commitments;

(c) During the above transition period, any such limitations should permit the foreign partner to hold at least 51 per cent of the equity in the company, with staged increases.

3. Compulsory lines

Members will assume full commitments to market access and national treatment that cover compulsory risks, to ensure that foreign insurance suppliers can compete for insurance lines and insurance services that are required of persons and businesses that reside in member countries.

4. Monopolies

Members should endeavour to eliminate the provision of insurance services by designated monopolies or exclusive services suppliers.

5. Private participation in pensions and funds management[194]

Upon the adoption of measures that allow for private participation in the pension systems of WTO members whose current regime prohibits this, or for members whose current system authorized private participation in such pension systems, such members will commit in their schedules to give other WTO members the benefits of market access and national treatment. Foreign suppliers providing pensions and funds management services[195] will have access, on a non-discriminatory basis, to offer their services to private and/or public pension systems provided by host country members. Where pension fund services are provided through the commercial presence mode, foreign suppliers will be afforded the choice of opportunities as provided in C.1 (a) and C.2 above. Foreign suppliers providing public and private pension funds and services may offer the range of product and investment options they find necessary to meet benefit needs consistent with national treatment requirements.

D. Market access - temporary entry of natural persons

1. In general, nationality and residency requirements on personnel should be avoided.

2. Where a foreign insurance supplier operates through a commercial presence, it may select, as its representative in the host country, any person who physically resides in the host country, irrespective of nationality; provided that the representative meets regulatory standards that identify competency to perform services in such a role,

[194] Reservation by the Italian market.
[195] Pension fund services would include the design of public and private pensions systems; the marketing of such pensions to individuals, employers, and governmental entities; the investment of pension funds on behalf of pension plan participants and retirees; and the administration of public and private pension plans including, but not limited to, administrative services and record keeping, compliance and enrolment services.

and any other provisions relating to the fitness of that individual to perform the obligations of a company representative.

3. In addition to the commitments undertaken in the general headnote to the GATS schedule pertaining to the temporary entry of natural persons, the following additional obligation is assumed with respect to insurance: host country members shall provide temporary visa and associated work permits**,** where required**,** to professional level personnel employed by the foreign insurance services supplier's home and third country offices in a timely manner for the purpose of entering the country and providing short and mid-term assistance to its host country insurance services operations.[196]

E. National treatment

1. In addition to the right to compete for all lines of insurance in a host country, foreign insurance suppliers, who are licensed or established in the host country, shall have the same opportunities to compete for domestic insurance business as indigenous insurance services suppliers with respect to insurance for State-owned or State-affiliated enterprises, or any enterprise where the State holds an equity share.

2. Foreign insurance suppliers will be treated no less favourably than domestic services suppliers with respect to capital, solvency, reserve, tax and other financial requirements, subject to the provisions of paragraph 2 (a) of the Annex on Financial Services. Where less favourable treatment is imposed on the basis of Paragraph 2 (a) of the Annex, members will explain the basis for the different treatment accorded and, in particular, why such treatment is necessary for the protection of policyholders.

3. In the case of insurance intermediation, members will limit any conditions or limitations with respect to monetary transfers by insurance intermediaries to what is necessary to assume their legal responsibilities in the country where the service is delivered.

Best practices in insurance

The following obligations are assumed under article XVIII of the General Agreement on Trade in Services, which allows for additional commitments to be entered into schedules other than those covered by market access and national treatment, as defined in articles XVI and XVII, respectively.

A. Transparency

1. New and existing regulations, as well as revisions to existing regulations, will be made publicly available at all times, preferably in a public journal or register, in order to insure their availability to all interested parties.[197]

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[196] These obligations under the fourth mode of supply must be read with undertakings in the headnotes to services schedules addressing this category. For members who have scheduled according to the Understanding on Financial Services, any specific obligations assumed under the Understanding must be read with these obligations.

[197] This obligation forms part of a general obligation assumed by all members under GATS article III.

2. New or revised regulations will be submitted for public comment prior to their enactment. A reasonable period of time, ordinarily no less than one month, will be provided to interested parties to submit comments on all proposed regulations.

3. New or revised regulations will not be made effective until market participants have had a reasonable period of time to become familiar with their contents and take necessary steps to implement them. Except for regulations which must be implemented immediately, due to emergency or other exigency, they will, at a minimum, enter into legal force two weeks following their publication.

4. As part of the procedures for implementing new or revised regulations, members will provide, in writing, their explanation as to the reasons for rejecting or accepting proposals made by interested parties.

5. An insurance supplier applying for a licence will be provided with a written statement, setting out fully and precisely the documents and other information necessary for obtaining authorization. This statement should aim to simplify and accelerate, as appropriate, the specific procedures to be followed.

6. Members will ensure that there are established procedures that enable consumers to assess the creditworthiness of insurance companies. In addition, they will insure that insurance suppliers are free to provide information on their creditworthiness to the public, including information from independent rating organizations that provide such assessments.[198]

7. Subject to the exception under article XIV(c) (ii), Members will ensure that there will be no restrictions on the availability of financial services information from domestic or foreign sources to registered insurance suppliers.

8. Members will ensure that there are publicly available, non-discriminatory rules and procedures established that govern the identification and handling (including disclosure) of financially troubled institutions.

9. Measures adopted with respect to taxation (national and sub-national) that affect all insurance products will not enter into force until they have been notified to WTO through a semi-annual notification process established under the Services Council.

B. Solvency and prudential focus

1. Members will provide for insurance market stability and consumer protection through solvency and prudential regulations, allowing the market to determine which products and services are offered and rates applied.

2. Members will adopt and implement procedures that encourage and expedite the offering of insurance products and services.

(a) With the exception of products sold and rates applied to individual persons and compulsory lines, insurance regulation will not require new products, rates, and services to be filed or approved;

[198] This obligation is subject to article 2 (b) of the Annex on Financial Services.

(b) Where filing and approval of an insurance product or service is required, the member regulatory authority will make publicly available the policy reasons for such requirements and explain how the requirements are the least burdensome means of accomplishing those objectives;

(c) Where filing and approval is required, insurance suppliers will be permitted to introduce a new product, which will be deemed to be approved after sixty days time if the insurance supervisor has not taken action to disapprove it;

(d) No limits will be placed on the number and frequency of new product and service introductions by an insurance supplier.

3. Members will not restrict the payment of dividends by foreign insurance suppliers provided solvency margins are met.

4. Standardized Reporting, Actuarial, Training Practices/Requirements.

Members should encourage adoption of accounting and auditing standards based on recognized international "best practices" standards**.** International Actuarial Association standards should be adopted to harmonize standards, and to facilitate the evaluation and comparison of insurance suppliers' financial strength, and their incorporation of new skills.

C. Insurance monopolies

For remaining insurance monopolies, the following obligations are to be assumed:

1. As a general rule, designated insurance monopolies are to be prohibited from offering insurance products outside the area of their monopoly designation. Where monopolies are permitted to engage in the sale or underwriting of insurance products outside the area of their monopoly rights, appropriate supervisory and oversight steps will be taken to ensure that monopolies do not abuse their monopoly position when competing in product areas that are open to competition.[199]

2. Insurance suppliers with designated monopoly rights will maintain separate accounts for monopoly and non-monopoly activities, to insure that revenues from the monopoly do not subsidize competitive insurance activities.

D. Independent regulatory authority

The insurance regulatory body will be an independent government entity, to ensure that decisions regarding procedures adopted by the regulator are impartial with respect to all participants, and will encourage a competitive insurance market.

[199] This obligation is addressed in article VIII (2) of GATS.

XXIII. The way forward: policy conclusions and recommendations[200]

Insurance services and development

The multifaceted role of the insurance services sector

Insurance services form part of the integrated world of global finance. They play a crucial infrastructural and commercial role in a country's economy. From an infrastructural perspective the provision of insurance services is closely linked to macroeconomic factors such as inflation, national economic policies and the achievement of national development objectives. This is particularly important in the light of the fact that a well-functioning insurance sector promotes financial stability. As an infrastructural service, insurance services not only have the capacity to mobilize and channel savings (for example, life insurance companies effectively mobilize savings from the household sector and channel them to the corporate and public sectors) but can also support trade, commerce and entrepreneurial activities in other sectors. They do so, inter alia, by reducing the total risk faced by the economy. At an individual level the insurance sector can improve the quality of life of individuals and increase social stability. Insurance services can thus relieve the pressure on Governments' budgets. Strengthening the insurance sector can lead to the development of domestic capital markets, particularly in terms of long-term financing of government bonds. Also, corporate sector financing may be facilitated, for example through the reinvestment of insurance funds.

Global market trends in insurance services

The world insurance premium for 2004 stood at $3.244 trillion. Although nearly 85 per cent of the world's population is to be found in developing countries (also referred to as emerging markets), the global insurance market is dominated by industrialized countries, which account for 88 per cent of the global life insurance market and 90 per cent of the global non-life insurance market. However, emerging markets are experiencing a rapid overall growth rate (7.5 per cent for emerging markets as opposed to 1.7 per cent for industrialized countries), which indicates the significant potential for future expansion. Current growth rates are particularly high in Asia (e.g. China, which has a growth rate of 27 per cent adjusted for inflation). Also, insurance markets differ between developing countries, including in their growth rates and in their size. This is due to, among other things, variations in culture, insurance regulation and GDP.

The following market drivers have been highlighted in respect of insurance services: (i) *Demand for insurance services:* Demand is determined by changes in demographics and wealth profiles, as well as cultural consumption and spending patterns. It will also be affected by the largely untapped emerging market in the East and the unutilized – or underutilized – saving capacities of people in the developed countries. (ii) *Regulation:* The past decade has seen increasing globalization and the opening up of financial services

[200] This text is based on the chairperson's summary of the UNCTAD ad hoc expert meeting on insurance services. It is also reflected in document UNCTAD/DITC/TNCD/2006/1.

markets. It has also seen several failures, including the failures of insurance companies, both in developed and in developing countries. This has generated a need for corporate governance requirements and transparency, as well as careful regulation of the insurance sector. This is particularly important since failures in the financial sector can be very costly, potentially shattering the underpinnings of a country's economy and resulting in financial instability. With Governments striving to put comprehensive regulatory systems in place, some fear that this will result in a regulatory avalanche, which in turn would entail additional costs in implementation and compliance. (iii) *Increased liberalization and privatization of insurance services:* Increasing liberalization and privatization have occurred either independently or as a result of bilateral/multilateral arrangements. The bigger players in the global insurance markets have a crucial interest in continued liberalization, particularly in the context of the larger insurance markets, including China, South Africa, Brazil and India.

The insurance sector is also subject to operational drivers, and participants discussed, among others, the following: distribution; risk management and liability management; offshoring, outsourcing and operational capacity; and consolidation and economies of scale. (i) *Distribution:* It was noted, that except in Europe, distribution networks for insurance services are not as well developed as distribution networks for banking services. This is particularly true with regard to developing countries. Since the distribution of insurance services is less developed and more difficult to manage than the distribution of banking services, insurance services providers are forging alliances with banks to distribute their insurance products. This is part of a broader trend in terms of closer ties between insurers and banks, and has given rise to questions about the nature of regulation not only within the insurance services sector but also across the financial services sector as such. (ii) *Risk management and liability management:* The management of risk and liabilities is also undergoing changes, including trends towards pooling data and using modern, high-tech IT services. (iii) *Offshoring, outsourcing and operational capacity:* As in other sectors, there is a growing trend in the insurance services sector towards outsourcing certain services, inter alia for the purpose of improving cost-effectiveness. (iv) *Consolidation and economies of scale:* There will continue to be a convergence of trends (in terms of size of markets and operations), building on an existing trend, towards the concept of "big will increasingly be beautiful". This applies to both the developing and the developed world.

Other trends include the increasing use of technology and the Internet, and the increasing disaggregation of insurance services that are provided. Attention was drawn to the fact that the latter would allow developing countries to capture specific, disaggregated processes as areas with export potential. Other key factors which can facilitate the integration of developing countries into the global insurance marketplace include development by domestic insurance suppliers of the expertise necessary for successfully engaging in the international market (essentially by building human capital and know-how), and development of micro insurance.

Insurances services in developing countries: some characteristics and challenges

Insurance markets in developing countries have a number of particular features. These include their small size, undercapitalization, and institutions that are underdeveloped or do not exist, as well as insufficient experience and know-how. In many developing

countries, insurance services are not yet considered a key component of the financial services sector. This results in a low profile, a lack of interest and the Government's allocation of insufficient resources to the development of the insurance sector. Divergences remain, both between developing countries and within the insurance market itself (for example, the life insurance sector, which could have the most widespread positive welfare impact, remains less developed, particularly in comparison with the non-life sector). However, more recently the size of developing countries' insurance markets has been growing substantially (despite a temporary fall in profitability in 2001–2002).

Nevertheless, developing countries face a series of specific challenges. These derive from, among others, the important infrastructural role of insurance services, the rapid evolution of the global financial and insurance markets, and the trend towards liberalization in the insurance services sector, as well as from the lack of human capital and skilled personnel.

The first of these challenges relates to the importance of developing national strategies and policies, with due account being taken of national development objectives. This applies to both the financial services sector in general and the insurance services sector in particular. The discussion emphasized the importance of developing a coherent strategy, particularly since in many developing countries the insurance sector is not yet considered a key component of the financial architecture. This has led to a lack of public awareness of the benefits and uses of insurance products, a lack of demand for such products, and ultimately an inadequately and scarcely diversified insurance sector. It was suggested that a broader, pro-development strategy for the insurance sector could start with a comprehensive and sound cost-benefit analysis of the insurance sector in individual countries (looking at, among things, existing financial service suppliers, demand for insurance products, institutional mechanisms, and so forth). This stocktaking could form a solid basis for setting out recommendations and future directions, and policies in line with national objectives. Such an exercise should focus on, inter alia, issues related to risk and how to avoid crises.

The second of these challenges relates to the importance of setting up effective regulatory, supervisory and legislative structures as a prerequisite for liberalization. Developing countries face the challenge of preserving the integrity and viability of the financial infrastructure through effective supervisory and regulatory frameworks. These frameworks are even more important in the light of technological developments, new and hybrid insurance products (e.g. banc-assurance) and the liberalization and privatization of insurance services. However, frameworks in developing countries tend to be inadequate or, in some cases, are non-existent. Even when new legislation and structures are put in place, they may not be effectively implemented and old practices may continue to exist. It was pointed out that often this may lead to the continuing existence of weak insurers within the insurance market. Also, there are differences between the regulatory frameworks of developing countries and huge gaps between the frameworks of developing and developed countries. These differences make efforts to standardize regulation at the international level a difficult task.

A third area of concern for developing countries relates to challenges with regard to liberalizing insurance services and admitting foreign players into the domestic market. While, traditionally, the State has played a key role in the provision of insurance services, increasing diversification and differentiation of insurance-related consumer products have provided an increasing role for the private sector (especially institutions with diversified

investment strategies). This has been intensified by the growing inadequacy of tax revenues to match the pension needs of an ageing population, particularly in developed countries.

Some participants believed that opening up might lead to increased competition, which could be favourable since it forces insurers to become more efficient and cost-effective. Other stressed that it was equally important that such competition take place on a level playing field. In sum, opening up brings benefits and challenges. On the one hand, the admission of foreign insurance companies can be beneficial in that it contributes substantial financial strength; transfer of technical, managerial and technological knowledge; global market credibility; and risk and asset liability management. On the other hand, the operation of foreign insurance companies can lead to anti-competitive practices; selective marketing to high-value clients; potential employment losses; and the need to carefully manage any balance-of-payments difficulties that arise.

One of the key issues as regards FDI in the insurance sector relates to the nature of the FDI regime. Some suggested approaches relate to the following: regulatory transparency (and the equal application of regulations); adherence to IAIS (International Association of Insurance Supervisors) standards; protection of FDI; freedom to invest (within prudential limits), including by allowing realistic foreign capital levels and not requiring uneconomic cross-subsidization; and freedom to reinsure if necessary in global reinsurance.

A fourth area which was considered to pose a challenge for developing countries related to the need to overcome supply-side constraints and promote the operations of domestic insurance suppliers and nascent industries. It was stressed that this is an area where the Government can and should play an important role.

In essence, the specific supply-side constraints which developing countries face are a lack of diversified insurance products within their insurance markets. This weakness derives from, inter alia, a weak supervisory and regulatory environment, a lack of sufficiently well developed distribution networks, and, more broadly, a lack of public awareness about insurance products and their usefulness (often linked to social and cultural aspects in terms of attitudes towards risk, which has resulted in constraints on the demand side). Also, infrastructure constraints play a major role; in fact, there is, inter alia, a lack of technical skills, particularly human skills; a lack of well-developed institutional mechanisms (e.g. for information and data collection); and insufficient use of information technology (e.g. as a tool to facilitate insurance operations and risk assessment). There is, therefore, a need to strengthen the regulatory environment so as to include appropriate legislation, taxation policies and effective enforcement mechanisms, as well as to effectively build human capital. Using auxiliaries and intermediaries (e.g. agents and brokers) could also help raising public awareness and facilitate distribution.

A closer look at Africa: the example of the life insurance sector

The meeting dealt in depth with the functioning of, and the difficulties faced by, African insurance markets, with a particular focus on the life insurance industry. Overall, the African continent has varying levels of development. The African insurance market is dominated by South Africa, which generates 79 per cent of the continent's premiums.

While Africa has taken the lead in several areas (e.g. in catastrophe insurance and by setting up the African Insurance Organization), much remains to be done.

Discussants drew attention to what could be among the most things to do in that context: training the trainers (including training at the level of government officials) and creating facilities for insurance professionals and regulators to network and specialize in core areas of insurance education. Also, studying what is needed to build both regulatory and market capacity would prove useful. Another important challenge is the setting up of stringent regulatory and supervisory standards (on a par with international standards and meeting WTO obligations); the provision of insurance services to the rural and agricultural sector and the urban informal sector; and the development of a strategy for catastrophe risks as well as an enabling environment for life and pensions. Since any move towards addressing these challenges would involve substantial outlays (in financial, human and technical terms), African countries would benefit from external assistance.

The meeting also focused on the African life insurance sector. Life insurance is important (particularly for developing countries) because of its ability to mobilize and channel savings. In Africa, the life insurance industry is characterized by regional peculiarities. The South African life insurance industry is highly developed and has always been in the forefront of life insurance. In fact, some of the first linked investment products (e.g. insurance products where a specified part of the premium is invested in securities and funds) originated in South Africa. In comparison, the life insurance sector in anglophone East and Southern Africa is significantly underdeveloped. In some of these countries, the majority of the business relates to pension investment, coupled with group life risk cover. The anglophone/West Africa market consists of six to seven countries, with Nigeria being the largest insurance market. The Nigerian market (over $50 million) comprises around 100 insurers licensed to write life business. Changes in Nigeria's legislation will give rise to significantly higher capital requirements in the near future. This is expected to result in mergers and acquisitions and the issuance of fewer life licences. It is estimated that if the capital of all existing life licences in Nigeria were combined, there would be enough capital to set up about three companies under the new regime.

Francophone Africa comprises 16 countries, of which 12 participate in the CIMA insurance code (Conférence interafricaine des marchés d'assurance, Inter-African Conference on Insurance Markets). There are approximately 60 insurance companies licensed to do business in one or more of those countries. Life insurance in this region is fairly simple by European standards and is almost all term insurance or very simple investment business (running on an accumulation basis). In comparison with other regions, the life insurance sector in the francophone region has a number of positive features, including strong local reinsurance support, adherence to the CIMA code (which has brought much-needed standardization) and, compared with anglophone areas, better training facilities and more readily available data.

Despite regional differences, it is possible to identify certain common areas of challenge for the African life insurance industry. Experts pointed out that one of the more serious challenges relates to the AIDS epidemic and its negative impacts on average life expectancy. They explained that some insurance companies have successfully modified their strategies in response to the AIDS risk factor. For example, companies sell what is termed funeral insurance (an approach being described in relation to AIDS coverage in South Africa), with higher, annually reviewed rates (when compared with normal term

assurance rates); the use of universal life products allows insurance companies to change mortality charges without changing overall premium rates; and there is periodic (every five years) HIV testing (in the South African case, premium rates for policyholders who do not undergo (or fail) the tests increase significantly), and innovative use of an increasing term insurance in order to combat the AIDS risk (as undertaken by a Malawi life insurance company).

Experts also identified another common challenge, namely the lack of good administrative systems and central statistics. Only a few (usually the more profitable) companies use reliable systems, while others conduct their business on spreadsheets, use unreliable in-house systems or use manual administration. As a result, losses may be identified when it is too late to take remedial action. A third common challenge relates to the existence of insufficient and often archaic regulatory framework and solvency margins. A good example is the use of the United Kingdom's Insurance Act dating from the 1940s in many parts of anglophone East and Southern Africa. However, countries such as Namibia, South Africa, Mauritius, Ghana and the United Republic of Tanzania have taken the initiative and are currently redrafting their insurance legislation.

Other challenges in the life insurance industry relate to a high number of withdrawals; low life expectancy; negative perceptions regarding the industry; lack of management experience and insurance skills; and the lack of transparency of charges on savings-type products. In terms of solvency margins, a risk-based capital approach is rarely followed and the solvency requirements are, in some cases, meaningless. Experts also referred to the problem of giving insufficient consideration to the investment matching of liabilities, a problem which often stems from the absence of appropriate investment avenues (e.g. in the case of life insurance, where sufficiently long-term government bonds would be a valuable investment avenue).

It was pointed out that despite all the problems Africa is facing, it is still possible to run a successful life insurance operation in almost any country in Africa. This could be achieved by ensuring that adequate solvency regulation is put in place; by making available meaningful (and credible) assured life statistics (particularly assured life mortality tables by region); by creating new and relevant products; and by training insurance staff, updating legislation and providing incentives to the industry.

The multiple roles of government: regulator, facilitator and provider of insurance services with a view to enhancing development

The role of the Government is not confined to that of regulator and supervisor of insurance services. Rather, as experts pointed out, the Government plays a very important role as a facilitator, including by ensuring access to insurance services as well as overcoming obstacles in the development of the insurance services sector. This is done by coordinating and setting out a financial services policy with national development objectives in mind, creating an enabling environment through appropriate legislation, ensuring cooperation among all stakeholders and policymakers (industry, insurers, consumers, tax authorities, judicial authorities) and, more broadly, ensuring effective engagement at the multilateral level both at WTO and in international standard-setting processes. Other examples of government engagement include the establishment of

public-private partnerships, for example in the area of data exchange, management and reporting systems.

Two particular questions arose as regards the Government's role as a provider of insurance services. The first related to the importance and nature of the role that Governments play; and the second related to how the Government would finance its provision of insurance services. As regards the first question, there are types of insurances which would benefit lower-income and rural sections of the population. These include agricultural insurance, catastrophe insurance and micro insurance, as well as social security schemes. In that context, it is important to remember that very often the supply of such insurance services to lower-income segments of the population is considered non-profitable by private insurance suppliers. Thus, in developing countries, the Government should play an important role in ensuring that insurance services are accessible to large lower-income segments and the rural sections of the population.

Thus, as suggested, in the interest of providing a public good, the Government may choose to act as a provider of insurance services to these sections or to create an enabling environment for other insurance service suppliers to operate in. This could be done by putting in place support mechanisms (e.g. assistance with risk assessment, data collection); acting as a reinsurer; creating public awareness; setting up favourable regulatory and enforcement mechanisms; and allowing the use of existing distribution networks such as banks and post offices for the distribution of insurance products or exploring alternative insurance schemes (e.g. community-based schemes for rural populations or bank account holders receiving insurance instead of interest, mechanisms for strengthening rural insurance or micro insurance). One expert pointed out that the Government should not act as a primary insurance supplier but rather as a facilitator. Catastrophe insurance is another area of concern for developing countries, given the extent and widespread nature of damage. The Government can act as a reinsurer in this sector since insurance companies may be willing to cover only a part of the risk arising. In 2004, the African Insurance Organization set up the Catastrophe Insurance Centre in Morocco, the objective of which is to collect information, map risks, and provide comprehensive services, contacts and information in relation to catastrophes (including an annual report) for all Governments in Africa and for the relevant agencies.

While the Government can and should play a role as an insurance service supplier or facilitator in the provision of insurance services, it is important that this role be played with due account being taken of the financial bottom line in the provision of such services.

Insurance services and the emergence of new regulatory frameworks: challenges for developing countries

Insurance services and international regulatory standards

By setting out clear rules of the game, international standards and harmonization can help improve the functioning of the markets, and perform an important guiding function for domestic reform processes. Regulators in both developed and developing countries are faced with newer regulatory challenges arising from the increasingly heterogeneous and complex nature of the insurance sector, challenges from technological developments and those from the new and hybrid insurance products, as well as the shifting focus of

regulation. For developing countries whose regulatory frameworks are minimal or in the process of being developed, these problems create particular challenges.

In this context, the IAIS (International Association of Insurance Supervisors) is mandated not only to set international standards, but also to help member States to implement those standards. By focusing on core principles, IAIS standards tend to be simple and clear. Some noted that this would avoid overregulation or the creation of a "regulatory avalanche". Frequently, these standards serve as mere "guiding principles", allowing regulators to fit any implementation to their country's particular developmental needs. Specific other country experiences can help shed light on how to manage such regulatory transition processes.

Guatemala, for example, is in the process of revising current insurance laws, many of which date back to the 1950s and 1960s. While a reasonable amount of Guatemala's law reform process is based on IAIS standards, the country is also conscious of the limits of international standards, notably the need to adapt regulatory standards which suit its particular developmental needs. In this regard, the IAIS principles are considered to be guiding principles, which, as they have a degree of flexibility, can be adapted as necessary. Also, it was pointed out that regulation can be extremely burdensome for companies. Finally, regulatory challenges for developing countries are not always a North/South issue: they can frequently arise from the need to properly differentiate between small and medium-sized enterprises and transnational companies.

Despite such positive experience, overall, developing countries still face difficulties in terms of complying with IAIS standards, one of the reasons being that regulators receive only limited support from Governments. This is compounded by the problem of keeping up with the rapid developments in the markets. There is therefore a need for assistance, cooperation and expertise, including for the purpose of improving data and monitoring market developments.

International standards can also play a key role in relation to the liberalization of insurance services, including in the WTO framework. There is the challenge of realizing (and responding appropriately to) the differences between liberalizing trade in goods and trade in services. It was pointed out that adopting common standards can be an important first step to overcoming difficulties related to liberalization. An example of that is the case of Europe, where common standards helped to achieve liberalization.

While compliance with international standards can help countries improve their reputation and facilitate synergies with the global insurance market (thereby helping developing countries, particularly those in Africa, to benefit from globalization), experts also pointed to the need for an examination of domestic regulatory frameworks and structures, and for identification of how developing countries may benefit from international standard setting, as well as to the implications of international standard setting and to developments in insurance liberalization at the multilateral level. UNCTAD was commended for having provided valuable inputs and was asked to step up its efforts in this context. This would include capacity-building (e.g. as part of the agenda in economic recovery programmes under the World Bank and the International Monetary Fund) and improving Governments' support for regulators in the insurance sector. In that connection, it was suggested that Africa develop a common strategy as regards liberalization of insurance services in WTO.

Africa's emerging regulatory frameworks and international standards

Africa provides an interesting example of the challenges that developing countries face in the context of liberalizing insurance services. As regards international standards, there is a wide gap in terms of knowledge between regulators in developed markets and those in Africa. Nevertheless, it is estimated that nearly 80 per cent of supervisors have adopted some sort of international regulatory standards. Within Africa, most of the insurance regulatory bodies (except those in South Africa) are experiencing problems. Most of these difficulties relate to the shortage of techniques for risk analyses and measurements, the need for regulators to be autonomous, and the lack of clear goals and strategies, as well as an overall low level of insurance awareness, which results in a low level of insurance penetration. Other challenges stem from the fact that Africa is mainly a non-life insurance market, and that the insurance industry has not been perceived as being innovative enough to offer services of interest to the everyday consumer.

Thus, except in South Africa, insurance practice in Africa has yet to catch up with the global developments in regulatory infrastructure. Despite obvious challenges, harmonization and international standards can help in this process. According to some participants, experiences suggest that Africa can indeed achieve a certain degree of harmonization (despite important cultural and political divisions). The successful experience of the East African Community with motor, fire and property risk insurance is a case in point.

The African Insurance Organization (AIO) is another example of a regional initiative. The AIO constitutes a joint effort to improve risk management in African countries. Its objectives are to gather information and data and make them available to African countries, to create a network for that purpose, and in that context to tap the potential and expertise of companies, insurance brokers and relevant entities from abroad. Participants commended the AIO for taking the initiative in facing challenges and limitations, and highlighted the need for further funding to continue that endeavour, including through support by UNCTAD.

China's emerging regulatory framework and its WTO accession

China provides an interesting and positive example of the liberalization and regulation of insurance services. In fact, a closer look at China reveals the linkages between its domestic reform process and its accession to WTO. In 1998 the Chinese Insurance Regulatory Commission (CIRC) took over from the People's Bank of China as the main regulator of the insurance sector. The CIRC works according to the "1 plus 3 principle", whereby the central bank collaborates with three government agencies, which focus respectively on banking, securities and insurance. The establishment of the CIRC has greatly strengthened the supervision of the insurance industry.

China's accession to WTO prompted the establishment of a series of new legal frameworks, including as regards so-called foreign-funded insurance companies, insurance agents, brokers and reinsurance. In pursuing its regulatory objectives, the CIRC covers a broad array of issues and uses a series of regulatory tools. The latter include the following: the *regulation of market entry,* where the CIRC has loosened formerly strict limitations on market access and areas of operation (this has led to an increase in the

number of foreign insurance companies); the *regulation of clauses and premium rates*, where despite a loosening of formerly strict limitations on clauses and premium rates, insurers are still required to obtain prior approval for certain insurance products (e.g. mandatory insurance products, products recognized as being in the public interest and life insurance carrying death protection); the *regulation of insurance investment*, where a 1995 law placed strict requirements on insurance investments (with the goal of ensuring the solvency of the insurance companies); the *regulation of market behaviour* (regarding sales, marketing, insurance agents, advertisement, policy dividends, investment returns, misrepresentation, biased comparison between products etc.); and the *regulation of insurance solvency*, which requires companies to ensure a certain, calculated solvency margin or the regulation of foreign-funded insurance companies.

More specifically, China's entry to WTO prompted the promulgation of the Regulation on the Administration of Foreign-funded Insurance Companies, with a more detailed regulation following in 2004. The latter establishes the so-called 523 requirements, under which the applicant's total assets should be more than $5 billion at the end of the year before application; the applicant should have established its representative office(s) two years before applying; and the applicant should have had over 30 years of experience in the insurance business. While at first glance, these appear to be stringent requirements, it was noted that almost every foreign applicant meets the criteria. Another focus of the CIRC is risk prevention, which is approached on the basis of five lines of defence: (i) enforcing the internal control of insurance companies; (ii) enforcing the regulation of solvency; (iii) reinforcing on-site inspections; (iv) enforcing the regulation of insurance investments; and (v) establishing and completing the system of insurance protection.

Insurance services in the GATS and the interests of developing countries

Insurance services commitments and offers submitted to date

Financial services – and insurance services as part of them – are the second most committed sector after tourism. Overall, the insurance services commitments that WTO members have entered into are skewed in favour of Mode 3 as opposed to Modes 1 and 2. There are only a few instances of full commitments. Thus many members maintain limitations on the entry of insurance providers, with the most commonly found limitations being foreign equity limitations, followed by limitations related to restrictions on foreign branching. Other limitations relate to the type of legal entity and quotas on the number of suppliers, especially in reinsurance services.

In the current round of negotiations, the offers submitted so far indicate that there has not been a substantial change in the overall picture/pattern of commitments. Out of 69 offers, 30 contain some sort of improvements in relation to insurance services, either by including new subsectors or by making improvements to existing commitments. One expert pointed out that, in general, offers are minimal and fall short of what could be achieved (i.e. considering what the current national-level practice already allows). It was also pointed out that during the Uruguay Round, developed countries made relatively deeper commitments (especially on Mode 3). Also accession countries have made deep commitments. In the current round of negotiations further and deeper commitments have been sought specifically in cross-border trade in insurance services.

Proposals submitted during the current negotiations relate to the elimination of barriers to establishment, the right to establish any type of legal form and the elimination of discriminatory limitations. Some of the most extensive proposals even address regulatory issues, most importantly the need to interpret the scope of the prudential carve-out contained in the Annex on Financial Services. Several proposals also address transparency issues, including transparency specific to licensing and qualification requirements. It was pointed out that the importance of regulatory reform was widely recognized and accepted as a prerequisite to liberalization within the insurance services sector; this suggests that there is a need to ensure proper sequencing between liberalization and regulation.

As regards Modes 1 and 2, some proposals suggest liberalizing these modes and clarifying classification issues in that respect. In fact, technological and market developments have resulted in the blurring of distinctions between Modes 1 and 2. Clarity has also been sought about whether the Annex on Financial Services or the United Nations Central Product Classification (CPC) is the preferred method for the classification of insurance services and subsectors. Another area that has given rise to discussion is the scope of article I, paragraph 3 (b), of the GATS, which relates to "services supplied in the exercise of governmental authority". Regarding this provision and the Annex on Financial Services, participants raised questions about their definition and scope.

Complementary/alternative approaches to liberalization

More recently, some members have indicated their disappointment about the progress made so far in the services negotiations. In that context, they suggested complementary approaches (including measuring and targeting) as a tool to meet quantitative and other qualitative objectives. Suggestions for qualitative thresholds focused on the elimination of limitations, while suggestions for quantitative targeting focused on liberalizing a fixed percentage of subsectors within specified sectors. Developing countries would be permitted to have a lower percentage target to be met, while LDCs would not be required to make any changes. Another alternative suggestion was using the plurilateral approach to negotiations, whereby a group of countries interested in opening up specific sectors may come together and formulate liberalization proposals, with the outcome of the negotiations applying on an MFN basis. Many developing countries have not been supportive of the newer approaches to the liberalization of services, as they could imply a loss of flexibility, have a negative impact on the architecture of the GATS, and raise questions as to the costs of autonomous liberalization and binding (where the issue of reciprocity comes in), as well as the extent and depth of the commitments that would be required.

Attention was drawn to another tool that would merit attention in this context, namely the model schedule for future commitments in insurance services, as proposed by the Financial Leader's Working Group. The objective of this schedule is to provide for equal treatment for insurers and to address issues relating to effective market access for insurance providers through the prescription of guidelines for scheduling liberalization commitments within the GATS framework. The model schedule consists of two parts, the first one relating to market access and national treatment commitments, and the second one taking the form of additional commitments, including on regulatory measures (the idea behind this part being that it would be uniformly adopted by a critical mass of

members). It was pointed out that the use of the model schedule has to factor in differences in the regulatory capacities of countries. Thus, while the model schedule affords greater predictability and comparability of commitments, the need for individual flexibility also has to be recognized. The need to further examine the template's development implication was pointed out.

Insurance services, GATS and the interests of developing countries

It is important for developing countries to ensure that current negotiations on the liberalization of services, including insurances services, deliver development benefits to them. A comprehensive assessment can help developing countries to identify their interests in insurance trade negotiations, at both the multilateral and the bilateral levels. Such an assessment would include a comprehensive examination of those areas where developing countries either have or can develop a comparative advantage, which can be developed into areas of export interest. Developing countries must also identify those areas which could benefit from some level of foreign private sector participation (e.g. areas where there is a need, but insufficient domestic capacity to meet this need). In any event, liberalization within the insurance services sector specifically needs to take place gradually, with careful sequencing and pacing based on each country's development objectives.

It was pointed out, in the Indian context, that the objective of trade policymaking in the insurance sector is closely linked to the achievement of sustainable development within the sector. The spin-off effects of this approach are to ensure that insurance services have a wider reach (particularly to the rural population) and that equity and regulatory capabilities are strengthened. In this regard, liberalization and reform should be concomitant, especially for insurance where the regulatory capabilities of countries are very different.

Despite the fact that the provision of insurance services is a capital-intensive activity, there are areas in which developing countries can develop an export interest, which in turn could be facilitated through GATS market opening. It was stressed that more broadly, developing countries can avail themselves of opportunities provided by the global trading system and the newer trends in the global insurance market. Experts and participants provided different ideas for areas where developing countries could develop an export interest, including outsourcing and offshoring (e.g. Modes 2 and 3 trade); the provision of insurance services through Modes 3 and 4; the distribution of insurance services and insurance intermediation (particularly as targeted to the local level); leveraging advantages based on knowledge of local markets; developing software services related to the insurance sector; enhancing the portability of insurances (e.g. health insurance); and looking at possibilities for South-South cooperation and trade.

Policy conclusions and recommendations

As discussed in the ad hoc expert meeting, the insurance sector presents a series of challenges and opportunities for development. There is, therefore, a need to properly understand these challenges and to identify what could be done to assist developing countries in facing them.

To begin with, there is a need to recognize that globalization may have different implications for developed and developing countries. It was pointed out that shocks or developments that are marginal or gradual for industrialized countries may have far-reaching implications for developing countries. Examples include development challenges arising from the reversal of FDI, from weaknesses of particular insurers or from the increasing cross-sectoral linkages (e.g. between banks and insurers), it being noted, however, that the latter can also present challenges for developed countries. Broadly, globalization highlights challenges related to financial stability and the need to focus on macroeconomic aspects. However, there is not yet a clear recipe for the appropriate pacing and sequencing of reforms while liberalization (autonomously and at the national level) is proceeding. The recognition that liberalization alone is not enough may be one of the reasons for the hesitation of some countries in the context of the liberalization of insurance services.

Besides macroeconomic issues, long-term strategic challenges related to the liberalization of insurance services also exist in the need to build supply capacities, train insurance professionals, develop regulatory frameworks and raise public awareness. More broadly, many of these questions also come down to the nature of reforms, which can be either gradual or radical. So far, however, there is no clear evidence as to which of the two it is better to pursue. Some suggest that a gradual approach may avoid the most painful of the transition experiences and failures and generate more sequenced and carefully paced reforms of laws, regulations and insurance enterprises. At the same time, it was pointed out that gradual reforms run the risk of being captured by vested interest groups, a challenge which the WTO framework can help to address.

According to some experts, the WTO framework can also offer some more tactical opportunities, particularly arising from the current GATS negotiations. This is despite the legacy of GATS in terms of relatively limited liberalization effects flowing from past negotiations and the broad array of issues that need to be addressed (e.g. definitional issues or prudential regulation). Some, in fact, perceive current discussions on the plurilateral approach as offering advantages, both for negotiators (as this approach would be based on precedents, offer a certain degree of flexibility, enhance confidence and avoid blocking by those reluctant to engage etc.) and particularly for foreign investors (as plurilateral negotiations offer the prospect of resulting in similar liberalization commitments across countries, which in turn enhances transparency and predictability for investment).

While developing countries (e.g. those in Africa) may realize opportunities from the liberalization of insurance services (including WTO liberalization), many benefits may arise only in the long term. In the short term, however, there are challenges arising from significant adjustment costs, as well as other problems arising from the inability to capture benefits. Sub-Saharan Africa, for example, is not a major player in insurances services, including because of lack of technical capacities, knowledge and training.

There is, therefore, a need to strengthen domestic and regional capacities so as to allow developing countries, their regulators and their insurance providers to play an effective role. In this regard, it was pointed out that assistance from and cooperation with international organizations, including UNCTAD, can facilitate management of the regulatory and liberalization process, thereby enabling companies and regulators to perform better, and, ultimately, to better serve the interests of consumers. However,

further funding and support are needed, including from donors and multilateral institutions, in order to continue developing these efforts, as well as supporting regional processes. There is an intention to work collectively to improve data, and there is a need for donor contributions in this context. UNCTAD has in the past collaborated with AIO, but there is a need for it to be further involved.

One key step for developing countries is to have a strategic and clearly defined national policy on the financial services sector in general and on the insurance sector more specifically (taking into account each country's specific national development objectives). This should be accompanied by the development of efficient and effective regulatory and supervisory frameworks, in line with international initiatives. In addition, there is a need to raise public awareness about the benefits of the insurance services sector and to invest substantially in building human capacity through the training of insurance professionals (for both the regulatory and the private sector, and as regards general insurance issues as well as specific sets of skills concerning risk management, accountancy and actuarial issues). Similarly, developing countries could strive to harness technological developments with a view to improving infrastructure (e.g. for information collection, regulation and data collection) for developing specific areas of export interest.

Also, the use of regional/South-South cooperation should be explored, for example in terms of pooling technical and financial resources and expanding insurance services trade. This was suggested in the Arab but also in the African (e.g. COMESA) context. Sub-Saharan Africa does not play a meaningful role in the world insurance market, and building regional capacity is therefore essential.

In all these aspects, the Government has multiple roles to play, ranging from regulator and facilitator to provider of insurance services. The challenge is to reconcile efficiency and social considerations, particularly for lower-income and marginal sections of the population.

UNCTAD's contribution and future work

With a view to achieving the Millennium Development Goals, and building on UNCTAD's longstanding work on insurance, UNCTAD could:

(a) Analyse the contribution of the insurance sector to economic and human development;

(b) Provide data and information on, for example, weaknesses/strengths, challenges or the presence of developing country enterprises in developed and developing countries:

(c) Facilitate the assessment of insurance services at the subsectoral level. This would assist developing countries, particularly LDCs, in formulating domestic policy options and in defining negotiating positions and strategies in multilateral, regional and bilateral trade negotiations;

(d) Analyse trade opportunities arising from the global trading system and evolving trends in the global insurance market as well as ways and means of facilitating such trade with a view to enhancing developing countries' exports. This could include an

analysis of measures that Governments/regulators may put in place to maximize benefits and minimize challenges arising from international trade (and investment) in insurance services;

(e) Identify the regulatory challenges arising from the global/international nature of trade in insurance services, including in terms of cooperation, monitoring and enforcement, as well as possible responses at the national and international levels;

(f) Identify the impacts of liberalization, privatization and increasing investment in the insurance sector, as well as whether these impacts differ across countries and the trends and similarities arising from liberalization;

(g) Identify measures that Governments/regulators can take to improve domestic efficiency and to address supply capacity constraints in developing countries' insurance markets. Related to this would be an identification of the exact nature of the role of Governments, both as regulators and as providers of insurance services;

(h) Analyse the effects which economic and financial crises have on the growth of the insurance services sector (e.g. in terms of employment and economic development);

(i) Provide an understanding of the possible impacts that the consolidation and restructuring of financial sectors have on financial services trade (in terms of the extent to which reforms enhance competition and consumer welfare);

(j) Provide an understanding of the implications of technological innovations for the structure of financial services industries and markets:

(k) Look into the effects which the general trend towards the privatization of State-owned financial institutions has on the structures of financial industries and markets, as well as the regulatory challenges arising therefrom;

(l) Analyse the impact of the GATS and the ongoing negotiations to liberalize services trade (including negotiations on domestic regulation) and how they reflect current realities. Such an analysis could discuss the impact that current negotiations could have on the insurance sector, as well as the development challenges arising from recent suggestions about complementary and other approaches;

(m) Provide an understanding of the technical challenges that WTO members face and the problems that may be encountered when interpreting the scope of the prudential carve-out as defined in the GATS Annex on Financial Services;

(n) Provide for key technical assistance and capacity-building, satisfying the needs of developing countries in terms of assistance with international trade in insurance services;

(o) Conduct an analysis of the potential for and existence of South-South and regional cooperation (for example, as suggested in the Arab and African context);

(p) Assist in revising national legislation in line with international commitments, including through a model law on insurance legislation to provide guidelines for

developing countries (for example, as suggested in the context of the United Republic of Tanzania).

Annex I: Programme of the ad hoc expert meeting on insurance services, and list of participants

24 November 2005, Palais des Nations, Geneva

10.00–10.30 **Opening session**

- Ms. Lakshmi Puri, Director, Division on International Trade and Commodities
- Ms. Mina Mashayekhi, Head, Trade Negotiations and Commercial Diplomacy Branch

10.30–11.30 **First session: global market trends in insurance services**

This session will provide a snapshot of the global insurance services sector in terms of volume, rate and sectors of growth, regional configuration and emerging trends within the market (including liberalization of insurance services and investment in emerging markets). The session will also touch upon the impact of liberalization and investment on insurance markets in Asia, Africa and Latin America, as well as private sector interests and what determines the private insurer's decision to invest in the insurance service sector in emerging markets.

Panellists followed by interactive debate

11.30–12.15 **Second session: the role of insurance services in economic development**

This session will look at how to harness the insurance sector for development benefits. It will address measures that can be taken to improve domestic efficiency and address supply capacity constraints. It will look at urgent challenges and actions, both at the national and the international level, to safeguard a functional insurance market at the service of the national economy and encourage international trade. It will examine the impacts which the emergence and growth of the global insurance services sector can have on developing countries in terms of: the costs and benefits of insurance services liberalization; access to insurance products; risk management; enabling enterprises to cover risks efficiently; and mobilizing personal savings. Finally, the session will further address the question as to the role the Government can play as a provider of insurance services as a public good.

Panellists followed by interactive debate

12.15–13.00 **Third session: insurance services, regulatory frameworks and international regulatory standards**

This session will consider whether the regulatory frameworks in developing countries are prepared for integration into the global insurance markets. In this context it will specifically address: (i) the importance of a strong national regulatory framework and its essential elements; (ii) harmonization of regulations regionally and internationally, and the implications thereof on developing countries; and (iii) whether there is a need for

more active involvement, including because of the potential nexus between GATS and international standards.

Panellists followed by interactive debate

15.00–16.00 **Fourth Session: Liberalization of insurance services in the GATS and developing countries: The way forward**

This session will examine the state of play of GATS negotiations in the run-up to the WTO Hong Kong Ministerial, focusing on their relevance for the insurance sector. More specifically, the session will discuss:

(i) The assessment of the initial and revised offers and proposals for insurance services;

(ii) The impact that proposals for complementary approaches or model schedules can have on developing countries;

(iii) Ways and means of implementing articles IV and XIX (2) in the context of insurance services;

(iv) Whether developing countries have the regulatory and financial service infrastructure needed;

(v) Potential areas of export interest to developing countries.

Panellists followed by interactive debate

16.00–17.30 **Fifth Session: Globalization and insurance: The challenges ahead for developing countries**

This session will aim to sum up the challenges and opportunities for developing countries from a regulatory and trade negotiations perspective. It will give pointers for building supply side capacity, as well as identifying areas of export potential for developing countries. What actions need to be taken, and by whom, to assist developing countries to harness the developmental benefits of the insurance sector?

Panellists followed by interactive debate

17.30–18.00 **Closing: Summary of discussions; the way forward**

1. Experts from the following member States of UNCTAD attended the meeting:

Algeria
Azerbaijan
Belarus
Benin
Burundi
Cambodia
Mozambique
Nigeria
Pakistan
Poland
Republic of Korea
Russian Federation

China
Egypt
Ethiopia
Eritrea
Ghana
Guatemala
India
Indonesia
Japan
Jordan
Morocco
South Africa
Syrian Arab Republic
Sweden
Switzerland
Tunisia
Turkey
Ukraine
United Kingdom of Great Britain and Northern Ireland
United Republic of Tanzania
Zimbabwe

2. The following intergovernmental organizations were represented at the meeting:

European Commission

International Monetary Fund

World Trade Organization

International Association of Insurance Supervisors

United Nations, New York, Department of Economic and Social Affairs

Common Market for Eastern and Southern Africa

3. The following non-governmental organization was represented at the meeting:

International Confederation of Free Trade Unions

4. Representatives from the following organizations also attended the meeting:

German Insurance Association

Financial Sector Reform and Strengthening (FIRST) Initiative

5. The following panellists addressed the meeting:

Global market trends in insurance services

Mr. Chris Gentle, Director, Global Financial Services Industry Research, Deloitte Touche Tohmatsu

Mr. John Cooke, Chairman, Financial Leaders Working Group, Insurance Team

Mr. Basil Reekie, Chief Executive Officer, QED and Chairman, African Life Committee

Ms. Patrizia Baur, Senior Economist, Swiss Reinsurance Company

The role of insurance services in economic development

Mr. Yoseph Aseffa, former Secretary-General, African Insurance Organization

Mr. Nigel Easton, Head, UNCTAD Insurance Industries Programme

Mr. Udaibir S. Das, Division Chief, Exchange Regime and Debt and Reserve, Management Division, Monetary and Financial Systems Department, IMF

Insurance services, regulatory frameworks and international regulatory standards

Mr. Yoshihiro Kawai, Secretary General, International Association of Insurance Supervisors

Mr. Wei Zheng, Secretary General, China Center for Insurance and Social Security Research

Mr. Israel Kamuzora, Commissioner of Insurance, United Republic of Tanzania, member of the Executive Committee, Association of African Insurance Supervisory Authorities

Liberalization of insurance services in the GATS and developing countries: the way forward

Mr. Juan Marchetti, Counsellor, WTO Trade in Services Division, Secretary of the WTO Committee on Trade in Financial Services

Mr. Jürgen Huppenbauer, European Committee of Insurance

Mr. Sumantha Chaudhuri, India

Globalization and insurance: the challenges ahead for developing countries

Mr. Yoseph Aseffa, former Secretary-General, African Insurance Organization

Mr. John Cooke, Chairman, Financial Leaders Working Group

Mr. Wei Zheng, Secretary General, China Center for Insurance and Social Security Research

Mr. Ahmed Zinoun, Executive Manager, Société Centrale de Réassurance (SCR), Casablanca, Morocco

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Annex II: Presentations made at the UNCTAD ad hoc expert meeting on insurance services

Insurance Services

Highlights of the UNCTAD Background Note

UNCTAD Ad Hoc Expert Meeting
24 November 2005
Mina Mashayekhi
Head, Trade Negotiations and Commercial Diplomacy Branch
UNCTAD

Outline: Insurance Services

Introduction & Background:
- scope & coverage, market features & trends;

Development Benefits:
- what are they & what are the challenges in realizing them;

Regulation:
- types, importance & interface between national & international levels;

Insurance Services in the WTO:
- background, state of play of current negotiations & issues arising from liberalization;

Fostering export opportunities of DCs
- & the "Way Forward".

Insurance Services: Scope and Coverage

The insurance industry is heterogeneous & complex,
- with the structure of the sector varying according to the level of development;

Broadly, the insurance sector covers:
- Life insurance;
- Non-life insurance;
- Reinsurance.

The GATS, Annex on Financial Services defines the insurance sector to contain:
- Direct insurance, both life and non-life;
- Reinsurance and retrocession;
- Insurance intermediation, such as brokerage and agency services;
- Services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services.

Insurance Services: Development Implications

Insurance Services:
- have close linkages with macroeconomic factors;
- are both, key infrastructure & commercial services;

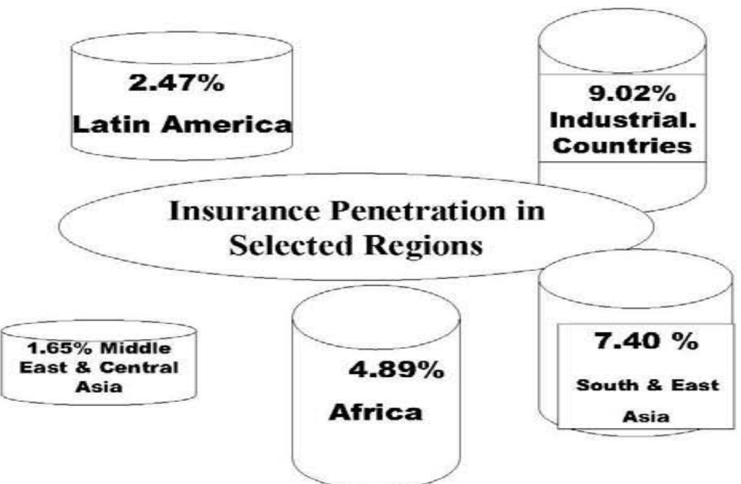
Within an effective regulatory & policy framework, they:
- can contribute to economic development
  - including by significantly affecting an economy's productivity
- can provide benefits of a public good; &
- constitute a key element in the trade and development matrix.

Insurance Services: Market Features

Market share, dominated by industrialized countries:
- Life insurance: 88%
- Non-Life Insurance: 90%

Overall growth rate: 2.3 %
- Emerging markets: 7.5%
- Industrialized countries: 1.7%

Among emerging markets:
- Differences in growth rate, arising from
- Differences in size, culture, insurance regulation & GDP;
- Developing countries' markets are characterized by: small size, undercapitalisation and insufficient experience and know-how.



The World's 10 Largest Insurance TNCs, (USD millions, 2003)

Firm	Country	Foreign Insurance Income	Nr. of host countries
Allianz	Germany	75,230	62
AXA	France	65,120	46
ING	Netherlands	47,990	58
Zurich Financial Services	Switzerland	44,520	46
Ass. Generali	Italy	38,155	42
AIG	United States	32,718	92
Munich Re	Germany	27,900	36
Aviva	United Kingdom	26,180	32
Swiss Re	Switzerland	25,540	28
Winterthur	Switzerland	19,680	16

Insurance Services: Market Trends

Two main trends:
- Move towards privatization & liberalization;
- Consolidation of insurance operations;
- Developing countries' market potential:
  - Insurance premiums are growing (large populations & rising living standards)
  - Attractive market for investment (India, China, Brazil).

Other trends include:
- Technology and the Internet;
- Break-up of the service being supplied;
- Closer ties between insurers and banks (*bancassurance*)
- Emergence of new insurance "products" & the need to identify their precise impact & decide on the most appropriate regulatory approach;
- Offshore centers;
- Shift in the focus of regulation (from "what" is being sold to "how" it is being sold).

Development Benefits of the Insurance Sector

There is a positive correlation between a country's level of development & insurance coverage;

Insurance services can contribute to economic development, including by:

- playing an infrastructural & commercial role;
- promoting financial stability;
- fostering the efficient allocation of a country's savings;
- mobilizing and channeling savings (life insurance);
- relieving pressure on the government budget;
- supporting trade, commerce & entrepreneurial activity;
- lowering the total risk faced by the economy;
- improving individuals' quality of life and increasing social stability;
- granting export opportunities for DCs;

Benefits from the Presence of Foreign Insurers

The benefits of global insurers include, amongst others:

- substantial financial strength;
- transfer of technical, managerial & technological knowledge;
- global market credibility &
- risk and asset liability management.

Development Benefits: What are some of the Challenges?

Developing country concerns regarding the liberalization of the insurance sector relate to:

- The need to preserve the integrity & viability of the financial infrastructure;
- Weak supervisory and regulatory frameworks;
- The potential for anti-competitive practices;
- Selective marketing to high-value clients;
- The need to promote domestic insurance suppliers & nascent industries;
- The potential loss of employment;
- The need to avoid BoP difficulties.

Development Benefits: How to Capture Them?

Effective policy-making to capture development benefits from the insurance sector relates to:

- the role of the government as an insurance service provider (incl. to allow for the benefits of a public good);
- the role of the government as a regulator of insurance services; including through:
  - building domestic capacity & overcoming supply-side constraints;
  - appropriate pacing & sequencing of privatization and liberalization of insurance services;
  - fostering the development of human capital;
  - ensuring consumer protection & other prudential regulation.

Development Benefits: The Role of the Government as a Service Provider

Public provision is key in sectors:

- which are non-profitable but benefit large populations (both rural & low income); &
- where private interest in operating these areas is lacking.

Examples include:

- agricultural insurance;
- micro-insurance;
- catastrophe insurance;
- social security schemes.

Development Benefits: The Role of the Government as a Service Provider

There is a need for additional supporting mechanisms, including:

- Creating public awareness;
- Setting up favorable regulatory & enforcement mechanisms;
- Providing incentives (e.g., subsidies for risk assessment, data collection);
- Exploring alternative insurance schemes (e.g. community based schemes for rural populations, bank account holders receiving insurance instead of interests, channeling compulsory contributions from public/private operators towards rural insurance or micro-credit);
- Acting as a re-insurer.

Regulation: Its Importance for Capturing Development Benefits

Amongst others, regulation aims at:

- Ensuring the viability, integrity & stability of the financial system;
- Ensuring confidence in financial infrastructure (& the economy as whole);
- Avoiding possibility of failures (& effect on the economy);
- Preventing anti-competitive practices.

Regulation: Challenges for Regulators

Regulators face challenges, arising from:

- The heterogenic and increasingly complex nature of the insurance sector;
- Technological innovations and newer financial products (blurring the lines between sub-sectors);
- The stage of developing countries' regulatory infrastructure (which often is minimal, inadequate, or still at an emerging stage).

Even developed countries face challenges & failures

- Australia non-life insurance, Japan life insurance, Korea.

Regulation: Types of Regulations

Regulation of market conduct, including:

- Entry requirements to avoid admission of financially weak or non-credible insurance companies, e.g.
  - licensing requirements, specified organizational requirements, ownership restrictions, operating restrictions;
- Corporate governance requirements,
  - presupposing an efficient internal control;

Prudential regulation, including:

- Capital adequacy & solvency margins;
- Monitoring, information gathering & independent supervision;
- Technical provisions, e.g.
  - to avoid inaccurate estimations, possibly leading to financial difficulties;
- Investment regulation, e.g.
  - relating to investment of premium money, or need to ensure reasonable rates of return;
- Consumer protection, e.g.
  - public complaints processing or policy holder protection & consumer redressal forum, guarantee funds.

Regulation: Interface Between National & International Levels

International standards & approaches:

- Can respond to linkages between economies;
- Can create favorable conditions for investors;
- Are being undertaken in: IAIS, OECD, GAAP, IFRS, IOSCO.

But also give rise to questions about the limits of harmonization, in light of:

- Differences in regulatory developments;
- Differences in resources for effective participation in international standard setting;
- The need to design regulatory measures according to individual economic & developmental situations;
- The potential of standard-setting bodies to be used to assess countries' prudential regimes;
- References to international standards in the GATS (Art. VI:5 (b),
  - "In determining whether a Member… is in conformity with the obligations … account shall be taken of international standards … applied by that Member."

Insurance Services in the WTO

Financial services:

- one of the most committed sectors (after tourism);

Insurance Services

- governed by provisions of the:
  - the GATS;
  - the Annex on Financial Services;
  - the Understanding on Financial Services
    - alternative mechanism for scheduling deeper commitments;
  - Members' individual schedules of commitments.

Insurance Services in the WTO

Some areas lack full clarity, such as:

- Classification of sub-sectors:
  - Using the Annex on Financial Services or the UN CPC;
- The Modes:
  - Blurring of lines between Modes 1 and 2;
- The Scope of services covered;
  - i.e. what amounts to "services supplied in the exercise of governmental authority";
- The Scope of the prudential carve-out:
  - i.e. a narrow or broad interpretation.

WTO: State of Play in Current Negotiations

- Negotiations as part of the Doha Work Program,
  - which places the needs & interests of developing countries at its heart;
- Offers: 32 out of 68 Members made offers
  - in relation to insurance and insurance-related services.
- Issues for discussion relate to:
  - Market access and national treatment proposals
    - eliminating limitations relating to: establishment, types of transactions, nationality requirements, type of legal entity, on provision of insurance activities (e.g. only through incorporation under provincial statues etc), ENTs;
  - Liberalization of Modes 1 & 2;
  - The importance of regulation;
  - Proposals relating to transparency;
  - Alternative approaches to liberalization.

Fostering Export Opportunities for Developing Countries Through:

- Outsourcing and off-shoring;
- Provision of insurance services (Modes 3 & 4);
- Distribution of insurance services and insurance intermediation;
- Leveraging advantages from knowledge about local markets;
- Developing software services related to the insurance sector;
- Enhancing the portability of insurances (e.g. health).

The Way Forward

- Reconcile efficiency & social considerations;
- Allow for appropriate pacing & sequencing of liberalization;
- Agree upon commercially meaningful commitments
  - in areas of export interest for DCs;
- Foster & benefit from South-South cooperation & trade;
- In addition, there is a need to:
  - build supply capacity;
  - invest in training insurance professionals;
  - set up strong and efficient regulatory frameworks;
  - enhance public awareness;
  - make optimal use of technology;
  - exchange of information & views between all stakeholders.

Thank You

Financial services liberalization and insurance: some observations

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International Monetary Fund

UNCTAD
24 November 2005
Geneva

Outline

- Changes in the financial sector landscape
- Key trends in the global insurance sector
  - High diversity associated with levels of economic development
  - Slow process of industry development
- Insurance sector and its role in economic development
  - Economic benefits of a dynamic insurance sector and the impact on capital market development and financial stability
  - Stylized facts in emerging and developing countries: explaining the underdeveloped insurance sectors
- Insurance sector: liberalization trends
  - Allowing the economic benefits to be accrued
  - Financial sector and capital-account liberalization
  - Insurance sector specific liberalization issues
- Factors for successful liberalization
  - Sequencing issues
  - Prerequisites for an effective regulatory and supervisory structure
- Areas for continuing work?
  - Refining the financial stability analysis framework
  - Policy implications from fsap findings
  - Supervision of financial conglomerates
  - How should insurance sector supervision be best organized?

- The role of consistent industry standards: ensuing a level playing field for international competition

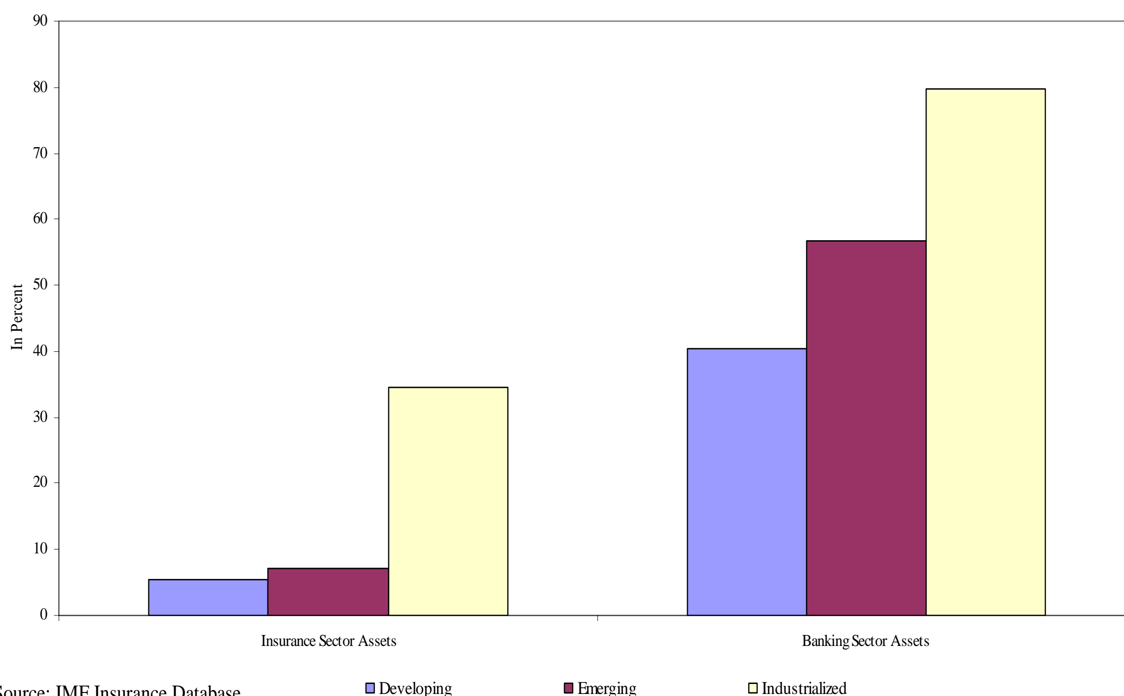
Financial sector: a changing landscape

- Policy factors
  - Liberalization: exchange and capital controls
  - Exchange regimes: shift toward more flexibility
  - Financial sector reform: privatization; market reform and deregulation; easier access for foreign entry
- Institutional factors
  - New financial sector laws
  - Expand scope of financial institutions' activities; enhance competition
  - Permit product offerings outside traditional markets,e.g. banks sell
  - Stronger focus on regulation and supervision
  - Creation of internationally diversified financial groups

Financial sector: a changing landscape

- Structural factors
  - Consolidation: financial and technological innovation
  - Increase in cross-sector competition
  - Homogenization of financial services: differences in the products and activities of banking, insurance, and securities firms diminish
  - Diversity remains; with underdeveloped insurance in many emerging market and low income countries
  - Slow pace of market development in many emerging market and low income countries, hindered by low incomes and poor policy frameworks

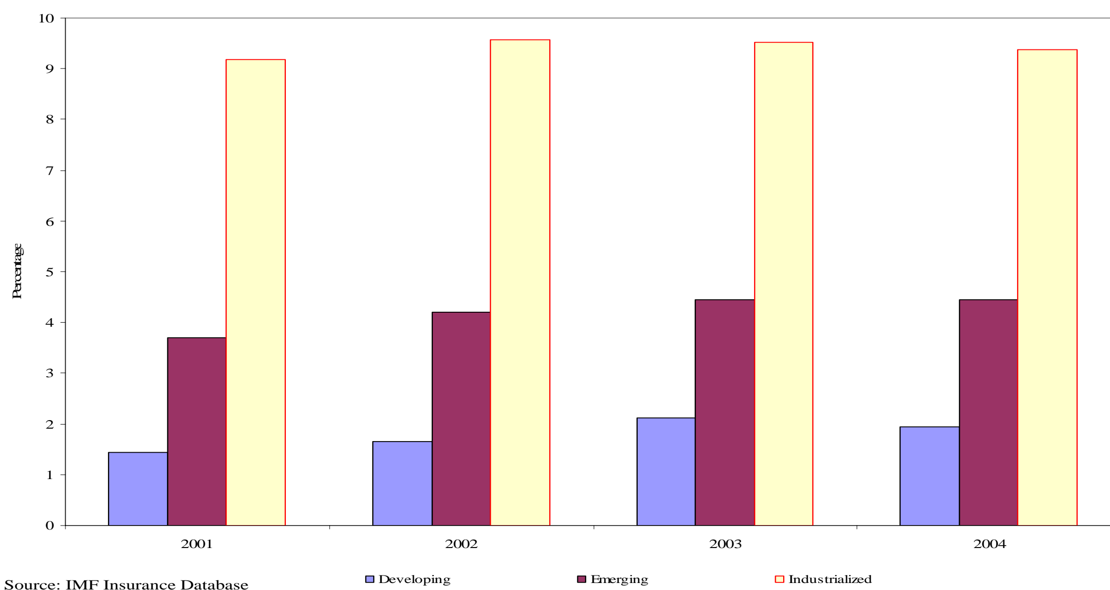
Assets held by the banking and insurance sectors (assets/GDP)



Source: IMF Insurance Database

Insurance industry: trends

Global insurance industry is dominated by industrial countries (premiums/GDP)



Source: IMF Insurance Database

Trend #1: insurers' financial positions and market linkages

- Risks assumed on the asset side: accounting and valuation issues
  - Greater exposed to exchange rate and interest rate movements

Trend #2: cross-sectoral linkages becoming stronger

- Bancassurance growing: bank-led
- Increased participation in complex market mechanics: credit risk and other risk transfers
- Large and small complex financial institutions: often ignored
- Regionally active financial conglomerates: insurance-led groups

Trend #3: exogenous factors

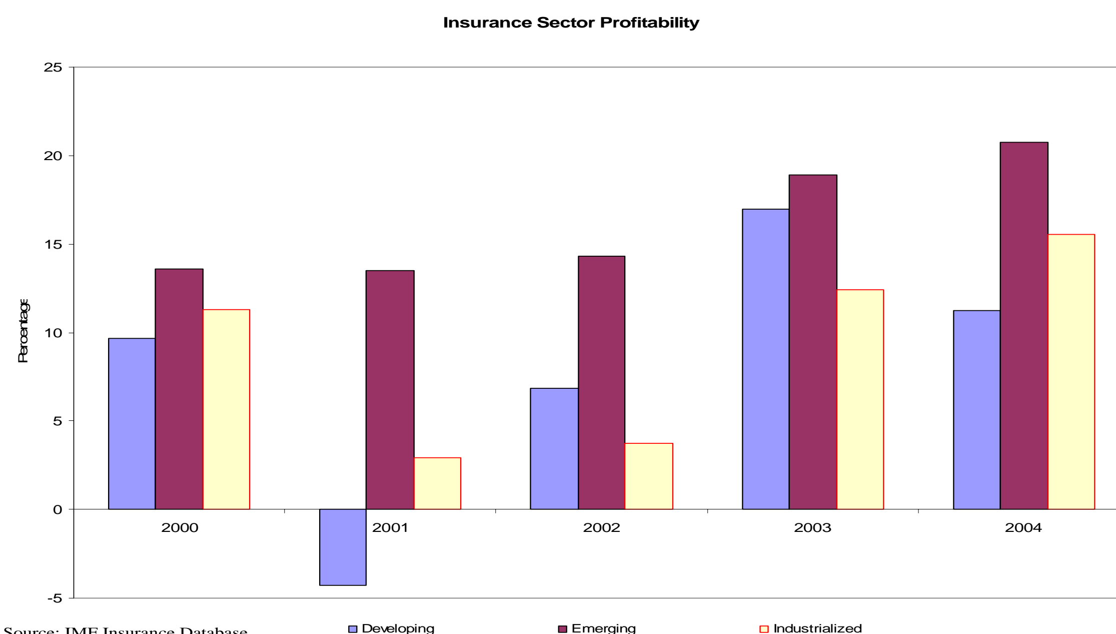
Catastrophes: increased frequency and severity

- Demographic: aging population, savings gap for retirement, pension and life sector (self-finance retirement provision)

Trend #4: weak, or problem insurers

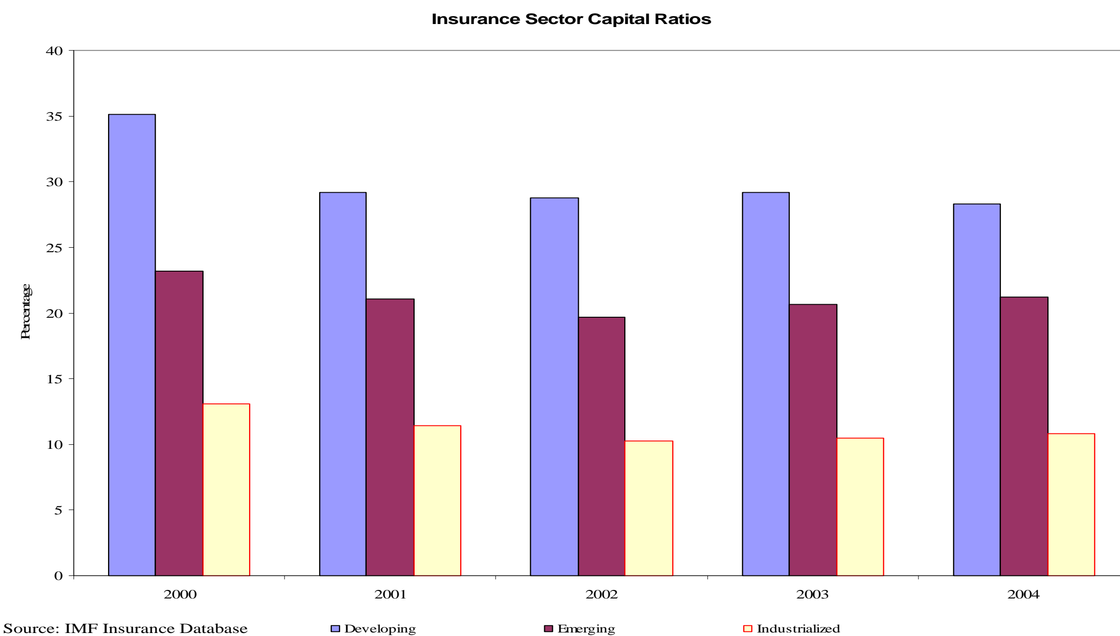
- Strained position of small insurers
- Weakness in prudential rules for holding and valuing assets
- Insolvencies and failures

Insurance sector profitability (profit before tax/capital)



Source: IMF Insurance Database

Capitalization ratios have been falling (capital/total assets)



Insurance sector: role in economic development

- Insurance has a number of important aspects:
- Social role
    - Protection against vulnerabilities (e.g. health, accidents and disasters)
    - Insurers and reinsurers can help promote safer safety standards which reduce output losses to society
- Economic role
    - Insurance promotes economic efficiency by allowing risk to be better shared by those who can better bear it: risk pricing, risk transformation, risk pooling and risk reduction
    - Private insurance reduces call on State resources and so the size of contingent fiscal liabilities
    - Insurance mobilizes national savings, especially longer term savings through contractual savings schemes
- Financial role

Long-term liabilities and stable cash flows allow the development of domestic capital markets and long-term financing of government and infrastructure

- Growing importance to rest of financial sector in both industrial and emerging market economies

    - Sale of credit protection (especially driven by Basel II, which encourages banks to reduce their own exposure through the purchase of credit protection and guarantees)
    - As an institutional investor in many countries underpinning government and private capital markets
    - Growing emergence of consolidated and fully integrated financial groups that include banks, insurance companies and pension funds

- These factors lead to a closer integration of the insurance sector with other financial institutions and so raises the risks of mutual contagion and instability

    - Insurance sector is small
    - Low penetration ratios due to both low per capita incomes but also market impediments that limit the scope of the insurance sector
    - Unstable macroeconomic conditions and high degree of financial repression lead to negative real interest rates and capital erosion
    - Shallow domestic capital markets and lack of long-term instruments
    - Poor regulatory environment and inadequate supervision
    - High degree of administrative guidance on insurance companies including price controls and priority target sectors e.g. SMEs, agriculture
    - Restrictive investment regulations hinder portfolio diversification and efficient asset allocation
    - High degree of protection against foreign entry
    - Outright bans
    - Limits on ownership and/or requirements for joint ventures only
    - Limited scope to use international reinsurance companies
    - Often State-owned within a limited competitive landscape
    - OR part of large domestic financial and nonfinancial conglomerates that are opaque and whose accounts are not fully consolidated
    - Limited actuarial capacity
    - Poor accounting techniques hide solvency issues which result from poor management and the high degree of financial repression
    - Underdeveloped and highly uncompetitive insurance market

    - Poor management and investment decision making due to high moral hazard and distorted incentives
    - Misallocation of resources from mispricing of risk
    - Limited room for reinsurance means that risk remains with domestic insurers
    - High contingent liabilities for the Government
    - Explicit commitment to bail out and recapitalize State-owned insurers and implicit commitment for private insurers
    - Lack of product innovation such as catastrophic insurance products means that the State is responsible for payouts due to natural disasters

- Capital markets remain underdeveloped:
- Limited-duration government bonds and no well defined yield curves further undermine the ability of local insurers to undertake adequate Asset-Liability Management and heightens the risks to their balance sheets
- For instance in the Republic of Korea, typical life insurer's liability is long term, at over 10 years, while the duration of assets is much shorter, at 3.5 years
- Insurers try and focus on long end of the government bond market; their typical "buy and hold" strategy means that secondary market liquidity is low.
- This further undermines market development by raising transaction costs

  Vicious circle of underdevelopment

Insurance sector: liberalization trends

Liberalization process allows the economic benefits to be accrued

- Insurance sector underdevelopment and the limited set of insurance products mean that economic benefits from insurance are often not accrued
- Especially in terms of risks sharing and promoting capital market development
- The underdeveloped insurance sectors in many economies and the economic costs that this has entailed has prompted the move toward liberalization of the insurance sector:
- Domestic
    - Privatization
    - Allow private sector participation in the insurance sector
    - Allow the emergence of financial conglomerates that combine banks, insurance and pension providers

- External
  - Cross-border insurance trade
  - MNCs
  - Reinsurance
  - Establishment insurance trade
  - Branches
  - Subsidiaries
  - Agencies

Insurance liberalization and the wider context

- The context for liberalization of the insurance sector, especially on the external side, has been the wider economy-wide liberalization process
- The challenges of successful integration into global markets has prompted policy responses including:
- Transforming the financial system and its structure
- Capital account
- Financial institutions
- Capital markets
- Moving towards a liberalized market-oriented system
- Establishing an appropriate institutional and regulatory framework

Empirical evidence: pace and sequencing

- Gradual increase in the degree of financial liberalization (especially of the banking system)
- Reform completed within few years after partial liberalization
- Pace of liberalization
  - In mature markets: uninterrupted compared to....
  - ...liberalization reversals in emerging markets following bouts of crises: capital controls and restrictions reintroduced
- Sequencing of liberalization
  - Industrial countries liberalized their capital account and capital markets first

- Asian countries used mixed approaches
- Latin America liberalized the domestic financial sector first

Empirical evidence: key policy measures typically followed

- Liberalize interest rates and credit regulations
- Introduce market-based monetary control procedures
- Institute internationally recognized prudential and legal framework
- Eliminate restrictions and controls
  - Liberalize payments and transfers for current international transactions

▪Accepting IMF article VIII obligations

- Liberalize controls on capital transactions

▪ Inward and outward FDI

▪ Cross-border flows initially at the long end

Liberalization of foreign entry in domestic financial sector (banks)

- **Trends**
- Foreign-controlled assets increased by 40 per cent between 1995 and 2002
- Regional variations – increase in Latin America, Eastern Europe; modest change in Africa, the Middle East and Asia
- Factors promoting the trend
- Financial sector liberalization and market access discussions, overall economic reform

- However, IMF's *Annual Report on Exchange Arrangements and Exchange Restrictions,* shows
- In 2003, 69 countries maintain some controls on foreign ownership of domestic financial institutions:

▪ Limits on the ownership share in total assets and capital

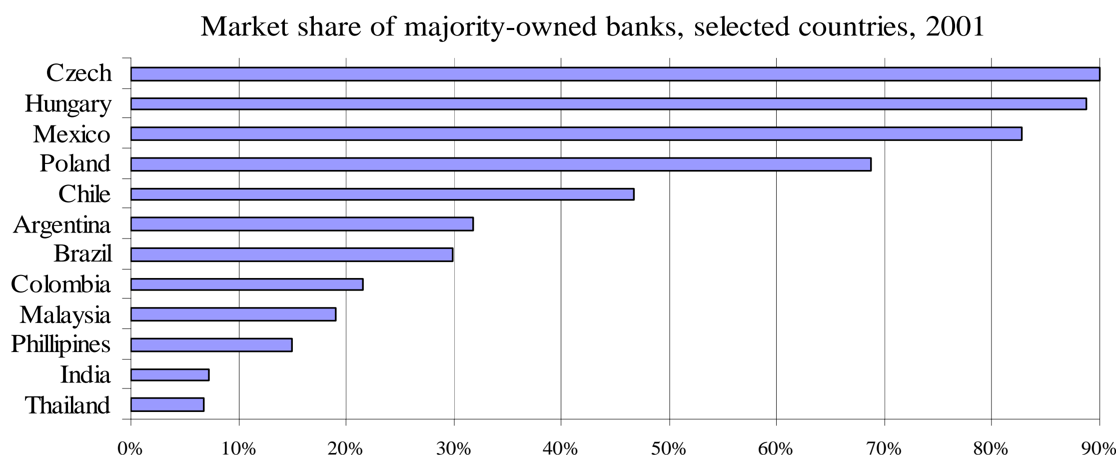
▪ Limits on voting rights

▪ Requirement of approval to acquire shares exceeding specific limits

▪ Controls on opening of branches of foreign banks

▪ Limits on investments in certain types of banks

Market share of foreign majority-owned banks



Empirical evidence: the international experience

- In general, financial development improves (along with output growth); evidence is most clear in terms of banking sector liberalization
- Better capitalized banks support high credit growth and higher credit/GDP, better quality services
    - Foreign ownership – lowers fragility
        - Demirguc-Kunt, Levine and Min (1998); Detragiache and Gupta (2004)
    - State ownership – increases fragility
        - Caprio and Martinez-Peria (2000); Barth, Caprio and Levine (2001)
- However, incidence of banking crises in liberalized systems where:
    - Strong institutional environment was missing
    - Unsustainable macro policies—particularly exchange rate policy
    - Capital-account liberalization undertaken when financial sector was:
        - Weak and undercapitalized
        - Poorly regulated and supervised

Capital-account liberalization: challenges to financial stability

- Capital-account liberalization not without risk:
    - Large capital inflows

  - Overheating of economy (rising inflation, real exchange rate appreciation, widening current account balance)
  - Not channeled to productive investment opportunities, resulting in a deterioration in the balance sheets of the domestic financial sector (asymmetric information between foreign investors and domestic borrowers)
  - Less autonomy of monetary policy under inflexible exchange rate regimes=>Asset price bubbles
- Sudden reversal of capital flows
  - Loss of investor confidence and herding
  - Bubble burst and economic downturn
  - Volatile exchange rates and interest rate defense
  - Deterioration in banks' asset quality, liquid

Managing the liberalization process in the insurance sector

- What should be the correct pace and sequencing of insurance sector liberalization?
- Problems
- Macroeconomic stability and an end to financial repression are musts for successful liberalization; without these there is a clear risk to insurers balance sheet especially on the asset side
- Can insurance company management handle the new products and freedom to invest (due to human capital capacity constraints)?
- Risks of asset bubbles and subsequent deflation that can undermine the balance sheet
- Regulatory issues
- Capital and solvency requirements
- Links with other financial institutions
- Supervision
- Location of the supervisor e.g. in the central bank, ministry of finance or independent agency
- How to supervise foreign insurers

Overcoming the traditional reluctance to allow entry of foreign insurers

- Typical arguments used to reduce the entry of foreign insurers include:

- Fear of market domination / strategic considerations
- Higher competition could squeeze State-owned insurers, imposing fiscal burden in terms of lower profits and recapitalization
- Foreign insurers could "cherry pick" the insurance market, leaving the domestic sector with more marginal and risky business. Fears of exclusion from insurance coverage of parts of the domestic economy
- Capital-account considerations; fears over allowing foreign investors participate in domestic capital markets
- Delayed entry until supervisory and regulatory regimes gave been upgraded
- ▪ Of these the last point has the most validity

Positive aspects of the opening up of the insurance sector

- ▪ But international experience has shown that entry of foreign insurers (via FDI in joint ventures and subsidiaries) has been largely positive:
- Enhance capitalization of the overall insurance sector
- Higher competition leads to lower premiums
- Offer new products (including longer term duration policies) and expand the market to a wider population
- Allow greater domestic risk sharing through facilitating greater access to international reinsurers
- Foreign insurers can help promote the local bond markets and develop the yield curve
- But they can promote dollarization where contracts are written in dollars or euro
- ▪ Ability of local insurers to invest in global capital markets and to use international reinsurers helps in their risk diversification

Factors that drive further cross-border integration of the insurance sector

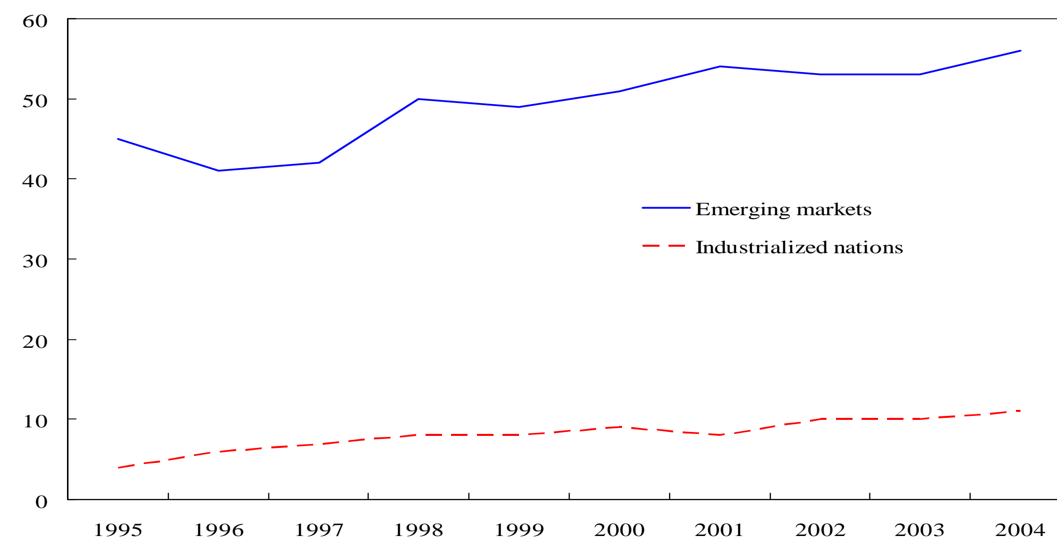
- ▪ Insurers from mature markets have incentives to diversify into emerging markets
- Search for higher yield: to gain from higher interest rates and appreciating currencies in the dynamic EMs
- Search for markets: given hitherto low penetration rates, these markets offer large potential for market growth, to be accessed via cross-border or FDI activities
- ▪ Insurers from EMs have incentives to diversify into OECD markets
- Risk minimization through portfolio diversification and pick up in duration

- Currency matching (especially in dollarized economies where insurance contracts are written in foreign currency terms)

- Ability to sell insurance to expatriate communities or intermediate remittances and inbound pension or insurance flows by expatriates

ICPs relevant for cross-border business, selected emerging-market economies, 2004

Number of countries with regulations specific to insurance companies, 1995–2004 (as at end of year)



Factors for successful liberalization

- International experience has shown that successful liberalization depends on:

- Comprehensive and coordinated approach to liberalizing the financial sector and capital account

- Focusing on allowing longer term flows first before short-term flows; i.e. a focus on liberalization of FDI in the real and financial sector including insurance, and allowing local investors, especially pension and insurance companies to diversify overseas

- Sustainable macro policies

- Exchange rate regimes consistent with macro policies

- Systematic approach to safeguard financial stability

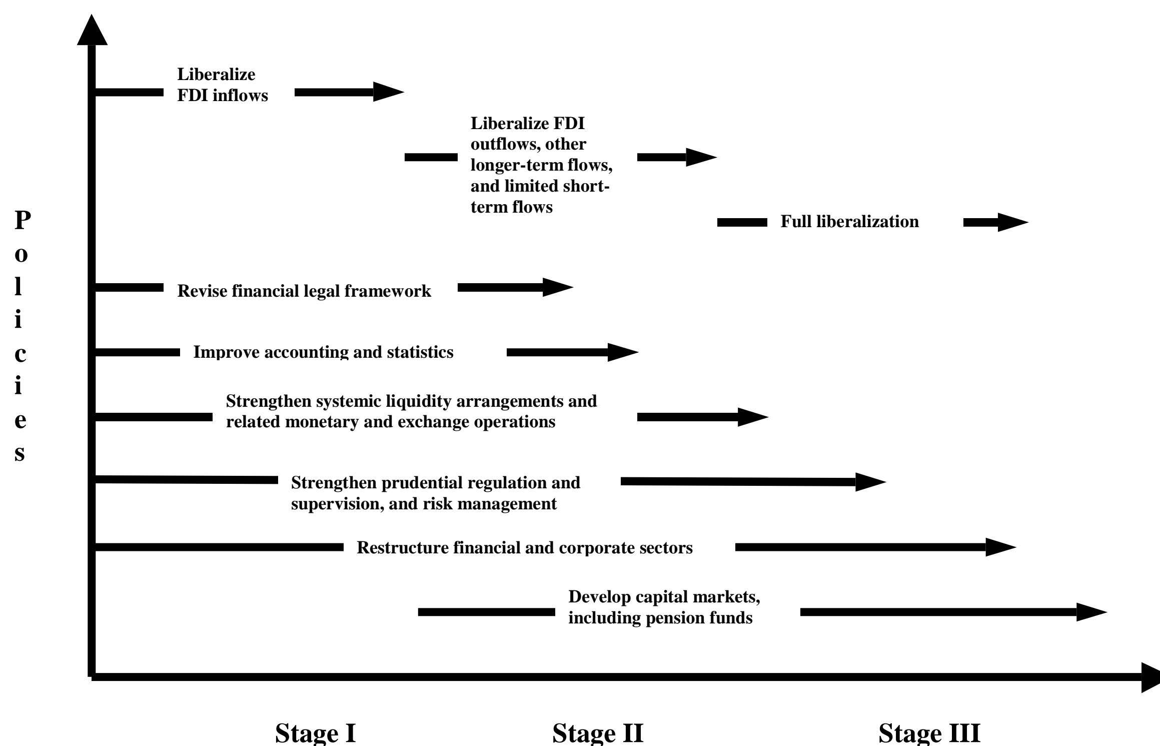
- Strong prudential and supervisory framework

- Evolves with insurance and wider financial sector development

Need for proper sequencing and pace of capital-account liberalization

- No general formula for success
- Choice of approach largely driven by overriding institutional and political concerns
- Speed differed widely
- Complex interactions among financial sector reforms and other policy reforms
- Approach needs to be tailored for specific country
- Manage risks associated with capital flows (market risk, credit risk, liquidity risk)
- Properly sequence and coordinate capital-account liberalization with other reforms, particularly financial system reforms

Stylized representation of capital-account liberalization sequencing



Prerequisites for an effective regulatory and supervisory structure

- Clear objectives for the agencies
- Regulatory independence, with appropriate accountability
- Adequate resources (staff and funding)
- Effective enforcement powers
- Cost efficiency
- Reflective of industry structure
- Recognition of cross-sector risks

- Moral hazard from bailouts or overly generous lender of last resort or deposit insurance can undermine incentives for oversight by the market

Recognition of cross-sector risks

- Preconditions relate to entire financial sector – ICP 1
- Supervisor must monitor and analyse all factors that may impact on insurers and insurance markets – ICP 11

Supervisory cooperation and action

- Cooperation and information sharing must extend to all financial sector supervisors and AML/CFT enforcement authorities – ICPs 5, 28
- Supervision must be on both solo and group-wide bases – ICP 17
- Supervisor can act to protect an insurer from financial difficulties of the group – ICP 15

Requirements for insurers

- Group structure must be sufficiently transparent to allow effective supervision – ICPs 8, 17
- Non-insurance activities may be restricted – ICP 6
- Capital cannot be inflated through group membership – ICP 23
- Insurers must perform periodic stress testing – ICP 23
- Risk exposures must be disclosed – ICP 26

Areas for continuing work? Issues that drive the policy agenda ahead

- Refining the Financial Stability Analysis Framework

- ■ Policy implications from FSAP findings
- ■ Supervision of financial conglomerates
- ■ How should insurance sector supervision be best organized?
- ■ The role of consistent industry standards

- Internationally agreed solvency ratios
- Ensuing a level playing field for international competition

I. Financial stability analysis framework

Surveillance of financial market conditions and risks of shocks **+**	**Macro-prudential surveillance** **=>**	**Macro financial Linkages** **+**	**Macro economic conditions**
▪ Macroeconomic and Asset Price Shocks ▪ Market Liquidity	▪ Condition of non-financial sector ▪ Financial system vulnerability (insurance-credit/market/liquidity risks) ▪ Capital solvency (capacity to absorb losses)	▪ Access to finance ▪ Financial firms and monetary stability	▪ Impact on debt sustainability ▪ Economic Output ▪ Growth ▪ Macro policies
▪ **Financial Soundness** ▪ **Supervisory Efficacy** ▪ **Regulatory Resilience**			

II. Policy implications of FSAP findings

Direct issues

- ▪ Diversity of national regulations
- ▪ Areas of supervisory cooperation
- ▪ Comparative prudential strength of institutions

Indirect issues

- ▪ Factors affecting market development
- ▪ Unitary regulatory authorities
- ▪ Principles-based vs. rules-based regulation

Have supervisory frameworks improved?

Higher degree of compliance

- Confidentiality / info. sharing
- Changes in control
- Financial reporting
- Capital adequacy
- Liabilities

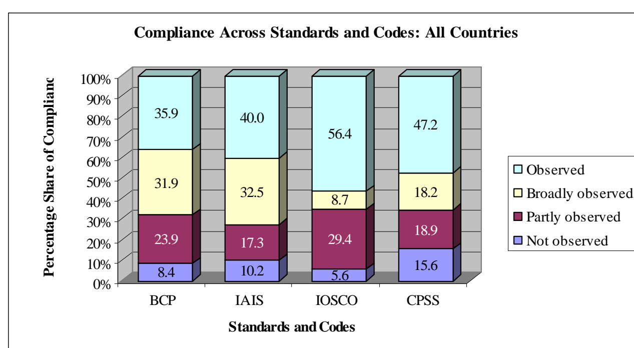
Lower degree of compliance

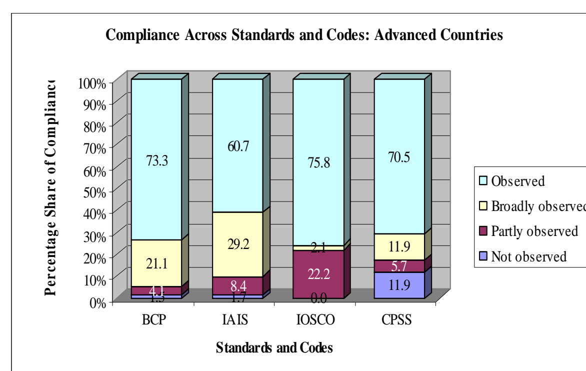
- Corporate governance

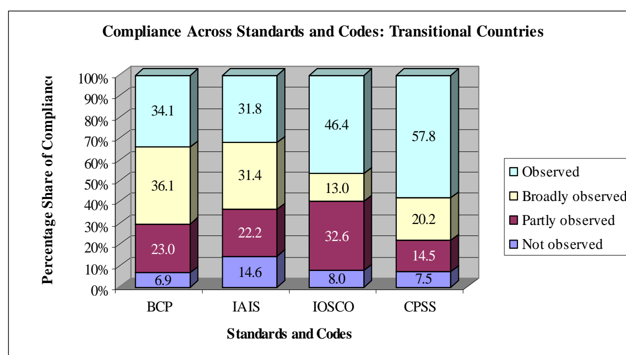
Internal controls

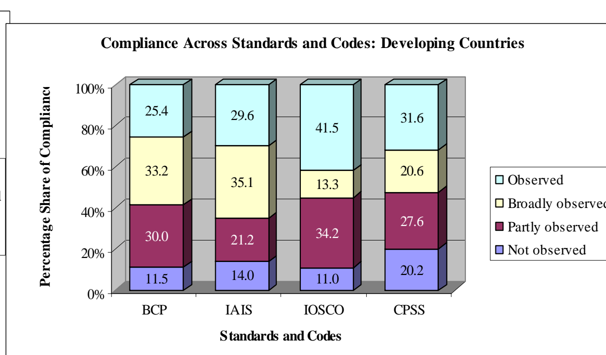
- Assets / investments
- Organization of supervisor
- Market conduct

Cross-sector: insurance-related stability concerns

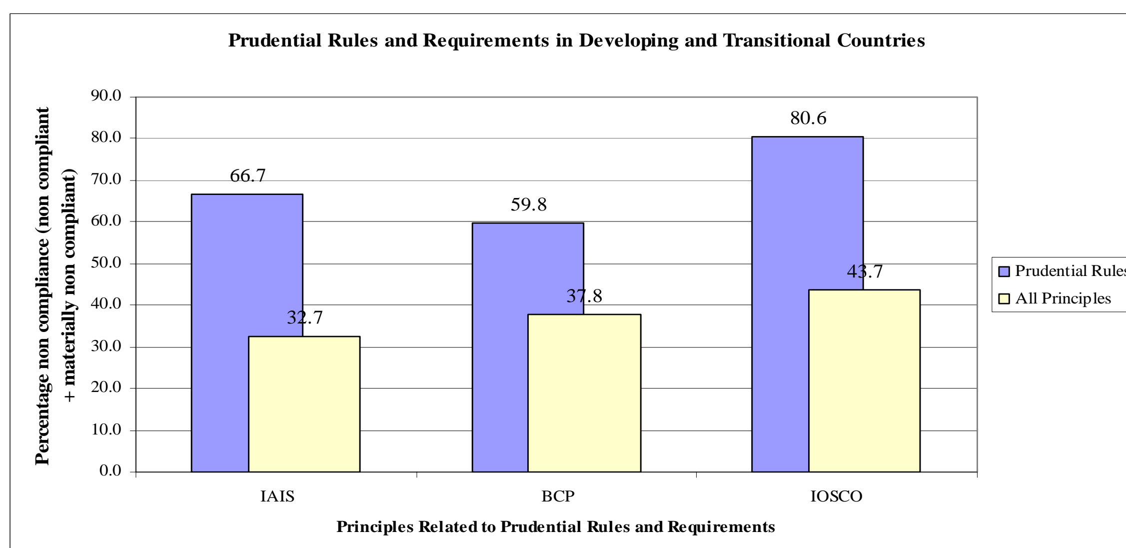




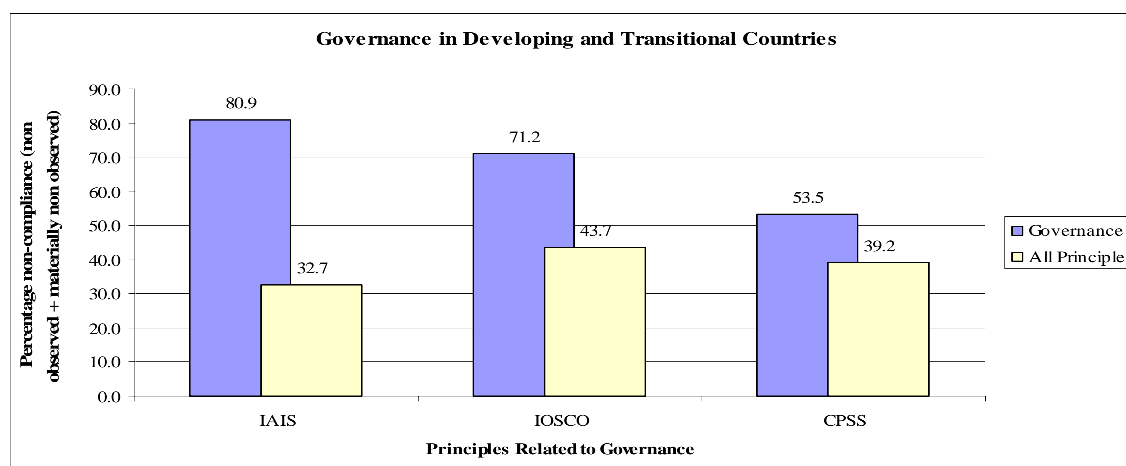




Prudential rules



Regulatory governance



Non-observance of principles that relate directly to regulatory governance is significantly high in developing and transitional countries compared to non-observance of all principles combined.

Some progress in addressing gaps

Several initiatives are ongoing (IAIS, EU, IASB and FSF Joint Forum)

Developments in:

- Capital adequacy
- Accounting and reporting
- Reinsurance

- Cross-sectoral issues

Policy implications

- A stronger and more cohesive policy and regulatory response is required
- Capital adequacy and solvency
- Supervisory cooperation
- Cross-sectoral issues
- Reporting – timeliness and relevance
- Risk-based supervision and effective tools
- Reinsurance supervision
- Not just new standards and guidance, but mechanisms for ensuring implementation

III. Practical issues in supervising financial conglomerates

- Special supervisory programmes for financial conglomerates, tailored to risk profile with dedicated supervisory teams
- Cooperation and strong working relationships between supervisors is key, both cross-sector and cross-border
- First line of defense against excessive risk-taking is the market itself
- Robust disclosure requirements essential for market participants to make informed decisions

IV. Considerations regarding the institutional framework for supervision

- Review existing agency structure, objectives, policies and procedures to incorporate supervision of financial groups
- Review laws and regulations to identify any impediments to effective consolidated supervision
- Assess staffing needs, training requirements, compensation plans, and IT resources
- Consider structure of local financial market
- One size does NOT fit all
    - Pro and cons of unification
    - Role of the central bank

- Alternatives to full unification

V. Creating a level playing field for international competition

- ■ A consistent approach to measuring solvency in the insurance industry would facilitate:

- Greater transparency
- A level playing field for insurers across-borders
- Enhanced communications and cooperation among supervisory authorities

■ Further intensification of cross-border insurance business needs a common set of standards and codes; and a recognized accounting framework

- ■ How to assess the assessing the financial strength of insurance sectors across countries?
- Absence of a standard measure for *solvency/capital adequacy*
- Two basic models exist

■EU-based system; only underwriting risk is included in the calculation of solvency requirements. This is also followed by many emerging market and developing countries

■The United States and Japanese system explicitly accounts for investment and assets and liability mismatching risks in addition to underwriting risk

■The first model requires more regulations to limit investment risks while the latter model requirements more capital

- Cross-border business and the necessary risk diversification is hampered if countries are unable to mutually recognize each others' regulatory regimes. The cost of conducting insurance business internationally increases

Concluding remarks

- ■ A dynamic insurance sector offers wider benefits to economic development and financial stability
- ■ The development of capital markets is a major positive aspect of the development of the insurance sector
- ■ Hitherto typically the insurance sector in emerging countries and developing countries has been limited by both low incomes and inappropriate regulations and inadequate supervision
- ■ As part of the wider economy wide liberalization trends, the insurance sectors can leverage from greater cross-border insurance business and FDI
- ■ National authorities need to:

- Further develop the domestic capital markets and particularly promote the issuance of long dated bonds and extend the yield curves

- Upgrade risk management capabilities and ensure adequate regulatory framework

- At the multilateral level, work still needs to be done:

- To standardize international regulations and standards so that the benefits from liberalization are fully accrued